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PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17105-3265

Public Meeting held May 21, 1998

Commissioners Present:

John M. Quain, Chairman, Dissenting in part (on Phase-In)
Robert K. Bloom, Vice Chairman, Dissenting in part (on Phase-In)
John Hanger, Statement attached
David W. Rolka
Nora Mead Brownell

Application of Duquesne Light Company for Approval of Its Restructuring Plan Under Section 2806 of the Public Utility Code	R-00974104; R-00974104C0001-C0004

OPINION AND ORDER

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I. INTRODUCTION

Before the Commission for consideration and disposition is the Recommended Decision of Administrative Law Judge (ALJ) John H. Corbett, Jr., which was issued on March 25, 1998, relative to the above-captioned proceeding. Also before us for disposition are the Exceptions, identified below, to the Recommended Decision. Reply Exceptions were filed by the Parties as noted infra.

A. History of the Proceedings

On August 1, 1997, Duquesne Light Company (Duquesne or Company) filed with the Pennsylvania Public Utility Commission (Commission) a restructuring plan to implement direct access to a competitive market for the generation of electricity pursuant to Section 2806(d) of the Electricity Generation, Customer Choice and Competition Act (Act). 66 Pa. C.S. §§2801, et seq. With the appearance of the Commission's Office of Trial Staff (OTS), the following Parties petitioned to intervene in this proceeding: the Office of Consumer Advocate (OCA); the Office of Small Business Advocate (OSBA); Allegheny County; the City of Pittsburgh (City); the School District of Pittsburgh; Jim Ferlo, pro se; David Hughes, pro se; Allegheny Electric Cooperative, Inc.; System Council U-10 of the International Brotherhood of Electrical Workers (IBEW); PECO Energy Company (PECO); Pennsylvania Power Company; Armco, Inc.; NorAm Energy Management, Inc.; Duke Energy Trading & Marketing, LLC; the Pennsylvania Retailers' Association (PRA); Electric Clearinghouse, Inc.; Enron Power

Marketing, Inc. (Enron); QST Energy, Inc.; The Environmentalists (Env.);[1] Low Income Advocate Parties (LIAP); MidCon Gas Services Corporation; mc², Inc.; Allegheny Teledyne, Inc.; The Peoples Natural Gas Company; Hospital Shared Services and Administrative Resources, Inc. (HSS/ARI);[2] CNG Energy Services Corporation; New Energy Ventures East, LLC (NEV); Duquesne Industrial Intervenors (DII);[3] Metropolitan Edison Company and Pennsylvania Electric Company, individually and collectively trading as GPU Energy (GPU); Mid-Atlantic Power Supply Association (MAPSA); the Skipping Stone;[4] Pennsylvania Power & Light Company; Wheeled Electric Power Company; Dollar Energy Fund; The Eastern Group; the Pittsburgh Chapter of the NAACP; and the IBEW, Local 2357. No objection was raised to any of these requests to intervene. Motions for admission, pro hac vice, of counsel for various parties were granted without objection as well.

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[1] The Environmentalists' coalition consists of the following organizations: Citizen Power, Inc.; Citizens' Organization on Utility Policies; Clean Water Action; The Group Against Smog and Pollution; The Pennsylvania Public Interest Research Group; and The Sierra Club.

[2] HSS/ARI, together, represent the following entities: Allegheny General Hospital, Children's Home of Pittsburgh, Forbes Metropolitan Hospital, Forbes Nursing Center, Forbes Regional Hospital, Gateway Rehabilitation Center, Healthsouth Harmarville, LGAR Health & Rehabilitation Center, Ohio Valley General Hospital, Presby Senior Care/Allegheny, Riverview Center for Jewish Seniors, St. Clair Hospital, Vincentian Home, South Hills Health System, and the University of Pittsburgh Medical Center. HSS/ARI M.B. at 1-2, fn. 1.

[3] DII is an ad hoc association of Duquesne's large industrial and institutional customers including: BOC Gases; General Motors Corporation; J&L Specialty Steel Company, Inc.; LTV Steel Company, Inc.; Nabisco, Inc.; Nova Chemicals, Inc.; and U.S. Steel Group, a unit of USX Corporation.

[4] The Skipping Stone describes itself as an energy consulting firm specializing in the deregulation of the electric industry. It represents a number of power marketers and aggregators who plan to do business in Pennsylvania.

The OCA (at Docket No. R-00974104C0001), City (at Docket No. R-00974104C0002), the Community Action Association of Pennsylvania (CAAP)[5] (at Docket No. R-00974104C0003), DII (at Docket No. R-00974104C0004), LIAP, Environmentalists, and the Pittsburgh Chapter of the NAACP filed Complaints against the restructuring plan. Answers thereto were waived by the presiding ALJ with the consent of the Parties.

A Prehearing Conference was held on September 4, 1997.[6] Duquesne, the OTS and the OCA submitted Prehearing Memoranda. When agreement could not be reached at the Prehearing Conference, the Parties held an informal telephonic conference on September 10, 1997, to discuss a litigation schedule.[7] On this latter date, the ALJ issued a Prehearing Order which, among other things, established a litigation schedule for this proceeding. All Parties agreed they would not object to the Commission issuing its final Opinion and Order on this Application by May 29, 1998, which was more than nine

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[5] CAAP is a statewide association of local community action agencies in Pennsylvania whose primary mission is to serve the needs and represent the interests of low income citizens.

[6] This conference was held jointly with the restructuring application of West Penn Power Company (West Penn) at Docket No. R-00973981 with ALJ Larry Gesoff co-presiding.

[7] These conferences were held jointly with the West Penn restructuring proceeding at Docket No. R-00973981, because Duquesne and West Penn filed their restructuring plans on the same date and, as a result, both proceedings were on the same statutory timetable. Also, the parent companies of Duquesne and West Penn filed a merger application at Docket No. A-110150F0015. The two restructuring proceedings are not consolidated nor is either restructuring proceeding consolidated with the merger application.

months after the Application was filed, as directed in the Act.[8] Altogether, a total of ten Prehearing and Interim Orders were issued in this case concerning various matters. In addition, a Protective Order for proprietary material applying to all Parties in this proceeding was issued on October 1, 1997. Further Prehearing Conferences scheduled for October 21, 1997 and December 9, 1997, were canceled.

In addition to Duquesne, the following Parties filed Statements of Prepared Testimony, together with numerous supporting exhibits: the OTS, the OCA, the OSBA, City, DII, Enron, Environmentalists, HSS/ARI, IBEW, MAPSA, NEV, PRA, CAAP,[9] and David Hughes. Evidentiary hearings to cross-examine witnesses supporting prefiled prepared written testimony for Duquesne were held in the Commission's offices in Pittsburgh on December 15-18, 1997. These hearings generated an additional 1,075 pages of notes of testimony. Further evidentiary hearings scheduled for January 5-9, 1998, to cross-examine witnesses supporting prefiled prepared written testimony for the aforementioned intervenors were canceled when Duquesne, together with all of the active intervenors, agreed to allow this testimony to be moved into the record without objection while waiving cross-examination. All active Parties filed first and second Stipulations evidencing their agreement with this procedure.

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[8] 66 Pa. C.S. §2806(f). Without the waiver, the run date for a Commission Opinion and Order on this Application expired April 30, 1998.

[9] The CAAP, a corporation, was not represented by counsel. Corporations must be represented by an attorney-at-law in adversary proceedings before the Commission. See, 52 Pa. Code §1.22. However, all active Parties stipulated to the introduction of CAAP's and other intervening Parties' prepared written testimony because no Party wished to cross-examine the witnesses sponsoring the testimony. Therefore, the presiding ALJ admitted their statements into the record.

The record in this proceeding closed on January 23, 1998. The following Parties filed both Main and Reply Briefs: Duquesne, the OTS, the OCA, the OSBA, DII, HSS/ARI, PRA, IBEW, Enron, and MAPSA. The following Parties filed Main Briefs only: City, Environmentalists and LIAP (jointly), CAAP, Mr. Hughes, NEV, GPU, and PECO.

The Recommended Decision of ALJ Corbett was issued on March 25, 1998. The following Parties filed Exceptions to the Recommended Decision: on April 10, 1998, CAAP, and IBEW; on April 13, 1998, HHS/ARI, Duquesne, and David Hughes; on April 14, 1998, PECO, Enron, Env., MAPSA, DII, the OSBA, PRA, the OCA, and the OTS. The City filed a Letter on April 14, 1998, advising that it would not be filing Exceptions. Reply Exceptions were filed on April 20, 1998, by IBEW; on April 22, 1998, by the OTS; on April 23, 1998, by Duquesne and HSS/ARI; on April 24, 1998, by the OCA, MAPSA, PRA, the OSBA, DII, and Enron.

B. Overview of the Act

On December 3, 1996, Governor Thomas J. Ridge signed into law the Electricity Generation Customer Choice and Competition Act, P.L. 802, No. 138, effective January 1, 1997, 66 Pa. C.S. §§ 2801-2812 (the "Act"). The Act fundamentally restructures the provision of retail electric service in Pennsylvania by mandating the direct access to a competitive electric generation market by retail customers. 66 Pa. C.S. § 2802(12). Direct access to the competitive electric generation market is accomplished by the retail customer's choice of electric generation supplier (EGS). Thus, direct access to competitive electric generation will begin with phased implementation, beginning in January 1, 1999, following a period of Pilot Programs. 66 Pa. C.S. § 2806(b).

The Act further requires all jurisdictional electric utilities (EDCs) to file restructuring plans for review and approval by the Commission. 66 Pa. C.S. § 2806(d). The Act requires the restructuring plan address the following matters: (1) establishment of reasonable terms and conditions for open access retail competition; (2) the calculation and recovery of reasonable stranded costs through a proposed competitive transition charge (CTC); (3) the establishment of unbundled rates for the generation, transmission and distribution of electricity; and (4) the provision of continued customer protections, particularly the continuation of safe and reliable service and programs for the assistance of low-income customers.

On January 24, 1997, at Docket No. M-00960890, F0005, this Commission established a schedule for filing of the restructuring plans. On April 1, 1997, Duquesne filed an Application for Approval of its Restructuring Plan at the above-captioned docket. Notice of the proposed Restructuring Plan was provided to Duquesne's customers through billing inserts and in newspapers of general circulation in Duquesne's service territory.

C. Public Input Testimony

Pursuant to public notice, three hearings were held at two locations in southwestern Pennsylvania to receive public comment upon the proposed restructuring plan. Public Input Hearings were held as follows: on November 12, 1997, in Beaver Falls, Pa.; and on November 13, 1998, two hearings in Pittsburgh, Pa. These hearings were also held to receive public comment upon the proposed merger of Duquesne Light Company and West Penn Power Company in the Joint Application of DQE, Inc., Allegheny Power System, Inc., et al., at Docket No. A-110150F0015. The majority of the

people appearing at these hearings testified about their concerns relating to the proposed merger plan.

D. Summary of Key Determinations in the Proceeding

Duquesne has a current bundled system average rate of 8.93 cents/kwh, a rate that is more than 10% lower than the Pennsylvania electric utility with the next lowest rate. Duquesne's rates are about 21% above the national average. Pennsylvania's statewide average electric rate is about 15% higher than the national average. Duquesne's customers will still be able to achieve savings by shopping and will be protected against rate increases pursuant to the rate caps in the Act whether they shop or not.

For Shopping Customer:

a. Existing Bundled Rate	8.93
b. Unbundled T&D	2.35
c. Unbundled G	6.58
d. CTC	2.58
e. "Shopping Credit" (e=a-b-d)	4.00

The CTC was developed to permit Duquesne to recover 1.332 billion in stranded and transition costs until January 1, 2005. The amount includes $951 million for utility generation, $339 million in regulatory assets, that includes $10 million for consumer education. Duquesne is permitted to recover 100% of its documented jurisdictional stranded costs.

The following Table summarizes the unbundling of existing rates, the Competitive Transition Charge ("CTC") and the Shopping Credit that will be available on

a system-wide average basis in 1999 as a result of today's decision. Each customer class will experience somewhat different results that will be finalized upon acceptance of Duquesne's filing in compliance with today's decision. In the following Table, "Unbundled T&D" is the rate for transmission and distribution services that customers now pay and will continue to pay. "Unbundled G" is the rate that all customers now pay Duquesne for generation and only non-shopping customers will continue to pay Duquesne for generation. The CTC is a transition period charge that all shopping customers will pay Duquesne to compensate for stranded costs. The Shopping Credit is the amount leftover to a shopping customer to purchase generation from a competitive Electric Generation Supplier ("EGS").

For Customer Not Shopping:	System Average
a. Existing Bundled Rate	8.93
b. Unbundled T&D	2.35
c. Unbundled G	6.58
d. Total Price Paid to Duquesne (d = a = b+c)	8.93

II. PHASE-IN OF CUSTOMER CHOICE

A. Method of Customer Selection

1. *Positions of the Parties*

Section 2806(b) of the Act, 66 Pa. C.S. §2806(b) provides that:

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

Duquesne proposes to phase-in direct retail access in three equal increments of one-third of the peak load of each customer class annually starting January

1, 1999, so that all customers will be eligible for direct retail access by January 1, 2001. Residential and small commercial customers will be selected for phase-in to customer choice by zip code-based geographic areas of choice (GACs) based on interest in its pilot program. Within those areas, customers will have first-come, first-served rights when their area is phased-in. Other commercial and all industrial customers will be selected based on SIC code-based "market segments," with the order based on the percentage response of customers within the segments to the Company's pilot solicitation. (R.D., p. 9).

Duquesne argued that its plan for residential and small commercial customers promotes an orderly, rather than a random, transition to customer choice for small customers, while also using the first-come, first-served method. As to its plan for industrial and larger commercial customers, Duquesne claims two key benefits. First, it uses the results of the first-come, first-served pilot enrollment, so the market segments that demonstrated the most interest in choice will have the first opportunity for it during the transition period. Second, it eliminates potential disadvantages within market segments that an open enrollment will create, with certain competitors having choice and others not (because of oversubscription). (R.D., pp. 9-10).

The OCA urged the rejection of Duquesne's proposal for selection of residential customers; instead, the OCA recommended adoption of a first-come, first-served approach. The OCA found no compelling reason to phase-in customer choice for residential customers by geographic area. First, the OCA argued that suppliers will typically market throughout an entire service territory, as opposed to the smaller zip code-based areas that Duquesne proposed. Second, the OCA claimed Duquesne has not shown that its proposal is fairer to lower socio-economic classes, as the Company asserted. Adoption of a first-come, first-served approach, where motivated residentials can choose

to participate in the competitive market, will, according to the OCA, create the robust market that the General Assembly intended. (R.D., pp. 11-12).

The OSBA conditionally accepted Duquesne's phase-in proposal because the Company indicated that it will favorably treat a complainant within the dispute resolution process if a customer shows: "a) their business has been misclassified or b) other businesses with the same product or service have received a competitive advantage." (R.D., p. 13).

However, the OSBA claimed a first-come, first-served approach will likely result in an under-representation of small business customers in the first two steps of the phase-in. Duquesne's small business customers receive service via Rate GS/GM, which is available to all non-residential customers whose billing demands do not exceed 300 kW. The OSBA argued that the high end, large account customer within the GS/GM class will be over-represented in the first two steps of the phase-in under the first-come, first-served system, while the small account customers will be under-represented. (R.D., pp. 14-15).

The OSBA recommended, if the Commission adopts a first-come, first served procedure, that the Rate GS/GM class group be segmented into "Small Rate GS/GM" and "Large Rate GS/GM," with segment limitation for the Small Rate GS/GM at a 40-kilowatt load. The OSBA recommended that the Company designate progressively one-third of the peak load of the Small Rate GS/GM segment over the phase-in period and the same for the Large Rate GS/GM segment, with the total of the segmented load levels eligible for a given year equal to that allowed for Rate GS/GM as a whole. (R.D., p. 15).

DII found Duquesne's customer selection proposal inappropriate under the Act. DII noted that the Act directs that the percentage of participation be determined based on "the peak load of each customer class." (66 Pa. C.S. §2802(b)(1) and (2)). DII argued that Duquesne's proposal merges the commercial and industrial customer classes, and does not treat each customer class separately as required by the Act. DII claimed that the Act's clear language mandates consideration of each class separately. Additionally, the Company admitted that phasing an entire segment, as a group, may cause it to exceed the maximum participation levels in the Act (N.T. 1027, R.D., p.16).

The PRA urged rejection of Duquesne's proposal and, instead, recommended adoption of the phase-in methodology that the DII favors. (R.D., p. 20). The PRA noted that Duquesne rejected this approach. The PRA claimed that Duquesne's proposal lacks specificity as to the standard industrial codes (SIC) that will be utilized, and some market segments may compete with each other. Consequently, the PRA argued that competitive disadvantages will be administratively created under Duquesne's proposal. (R.D., pp. 20-21).

The Environmentalists preferred a first-come, first-served approach, which allows customers to volunteer to shop. The Environmentalists suggested that if too many residential and small commercial customers sign up for one phase a lottery be held to determine who is able to join. The Environmentalists argued that for large commercial and industrial customers, if the number of customers signing up exceeds the allowance, then each volunteering customer should be allowed to participate with a pro-rata share of its load. The Environmentalists noted that the Commission adopted this approach in PECO Energy, which they support. They further noted the Commission adopted the

principle of customer self-selection in the Retail Access Pilots proceeding[10] and recommend it as sound policy for this proceeding as well. (R.D., pp. 23-24).

Enron submitted that Duquesne's process will result in far less than 33% of its customers (or 66% if the first two phase-in steps are conducted more or less simultaneously, as discussed below) having access to customer choice. Enron contended that the GAC and SIC method Duquesne advances will indiscriminately prevent customers who desire to participate in the competitive market place from attempting to take advantage of competition. Enron argued that small commercial customers will also be disadvantaged from one neighborhood to another. (R.D., p. 24). Enron argued that the Commission rejected the "GAC/SIC process" as Duquesne proposed in the Pilot proceeding[11] and urged the adoption of the procedure established by the Commission in PECO Energy as the most reasonable method of customer selection. (R.D., p. 25).

Likewise, MAPSA urged rejection of Duquesne's proposal as the Commission did with a substantially similar approach in the Opinion and Order entered in Duquesne's pilot program. MAPSA claimed that Duquesne's artificial imposition of constraints upon the process will restrict the amount of load purchased from alternative suppliers and unnecessarily complicate the enrollment process. MAPSA contended that Duquesne's arguments regarding building on experience gained from the Pilot Program are irrelevant. During the Pilot Program, MAPSA noted that Duquesne did not employ

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[10] 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).

[11] Re: Petition for Approval of Retail Access Pilot Program Pursuant to 66 Pa. C.S. §2806(g) (Duquesne Pilot Order) P-00971175 (Opinion and Order entered Aug. 29, 1997) at 25-28.

the process it proposed to employ following restructuring. Therefore, MAPSA contended that no party has experience with the methodology Duquesne proposed. (R.D., pp. 26-27).

2. ALJ's Recommendation

The ALJ recommended that we reject Duquesne's proposed method to select customers for phase-in to direct retail access because the Commission has already determined a pure first-come, first-served selection process is the fairest and most orderly process for customer selection. PECO Energy, Slip Op. at 47-49. In accordance with this determination, the ALJ recommended that beginning July 1, 1998, Duquesne should conduct an open enrollment period for residential customers on a "first-come, first-served" basis. The ALJ asserted that if less than 33% of the residential customer load enrolls as of September 30, 1998, the ALJ recommended that Duquesne should notify all customers who have volunteered as of that date that they can participate in the phase-in beginning January 1, 1999. Id. at 48. If more than 33% of the customer load enrolls as of September 30, 1998, Duquesne should have an independent party conduct a lottery to determine which customers may participate in the phase-in beginning January 2, 1999. Id.; See, also, PECO Energy Restructuring Order, Slip Op. at 22.

With respect to large industrial customers, the ALJ also found that no apparent reason exists for departure from a uniform statewide approach on this issue. The ALJ noted that in the PECO Energy Order, Slip Op. at 22, the Commission departed from the pure "first-come, first-served" selection process for large industrial customers. The ALJ observed instead that, subscription for large industrial customers for each stage of phase-in will occur on a first-come, first-served basis, unless a class load is oversubscribed. The ALJ concluded that in such event, each customer nominating a

portion of load in the oversubscribed class will experience a pro-rata reduction in their nominated load, so the total load available for direct access in that class meets the Act's 33% requirements for that phase. (66 Pa. C.S. §2806(b)).

For small business customers, the ALJ recommended adoption of the proposal of the OSBA for customers receiving service from Duquesne via Rate GS/GM, which is available to all non-residential customers whose billing demands do not exceed 300 kW. Thus, the ALJ recommended that Duquesne segment the Rate GS/GM class group into "Small Rate GS/GM" and "Large Rate GS/GM." The OSBA suggested a segment limitation for the Small Rate GS/GM at a 40-kilowatt load; however, the OSBA noted that the Company may determine a more appropriate breakpoint after a detailed billing frequency analysis of all Rate GS/GM accounts. The OSBA noted that thereafter, customers within each class may designate their loads in the same manner described above for large industrial customers until one-third of the peak load of each class for that phase-in period is reached. (R.D. pp. 28-30).

For all other customers, the ALJ recommended that the pure "first-come, first-served" approach described above for residential customers should apply. The ALJ further recommended that the Commission consider the Environmentalists' "Better Choice Plan" when it promulgates its regulations required by Sections 2807(e)(2) and (3) of the Act, consistent with the Commission's action in PECO Energy, Slip Op. at 135. (R.D., p. 30).

3. Parties' Exceptions

Two parties except to the ALJ's recommendations concerning the method of customer selection. The Environmentalists argue, in their Exceptions, that the ALJ

erred in rejecting the "Better Choice Plan." The Environmentalists submit that under the "Better Choice Plan," a more diverse market is created because alternative suppliers can volunteer to become part of the default supplier which serves customers who fail to choose. (Environmentalists Exc., p. 2).

The PRA argues, in its Exceptions, that 100% of large commercial customers should be permitted minimally to nominate 33% of their load in each year of the three year phase-in period, assuming no acceleration of the phase-in period. The PRA contends that all commercial customers should be permitted to shop for part of their load on January 1, 1999. (PRA Exc., pp. 8-10).

It its Reply Exceptions, the OCA argues that the "Better Choice Plan" should be considered at a later date. (OCA R. Exc., p. 24).

4. Resolution

We shall adopt the position of the ALJ, which supports (1) system-wide, "first-come, first-served," selection for residential customers as modified below; (2) the OSBA proposal to split small commercials on a "first-come, first-served," basis, and (3) DII and PRA's pro-rata subscription for industrial and large commercial customers.

In making this determination, we reject Duquesne's proposed method to select customers for phase-in to direct retail access to the competitive generation market. In moving toward this market the Legislature, in the Act, directed that " . . . the Commonwealth must resolve certain transitional issues in a manner that is fair to customers, electric utilities, investors, the employees of electric utilities, local communities, . . . and other affected parties." 66 Pa. C.S. §2802(8). Further, "[t]he

procedures under this chapter provide for a fair and orderly transition from the current regulated structure to a structure under which retail customers will have direct access to a competitive market for the generation and sale or purchase of electricity." 66 Pa. C.S. §2802(13). Therefore, consistent with the Act, whichever method is determined to be appropriate for customer selection must assure a fair and orderly transition.

Because, as argued by the OCA, the competitive electric market is larger than a zip code area and because Duquesne has not shown its plan to fairer to lower socio-economic classes, we determine a first-come, first-served selection process as the fairest and most orderly process for customer selection as was done in PECO Energy Order, Slip Op. at 47-49. Based on our review of the record as developed, we conclude that it is reasonable, appropriate, and in the public interest to direct Duquesne to implement this approach for residential customers. Beginning July 1, 1998, Duquesne will conduct an open enrollment period for residential customers on a first-come, first-served, basis. If less than 33% of the customer load for that tariff class enrolls as of August 14, 1998, Duquesne shall notify all customers who have volunteered as of that date that they can participate in the phase-in beginning January 1, 1999. (Id. at 48). If more than 33% of the customer load for that tariff class enrolls as of August 14, 1998, they shall be included in the second phase of enrollment for January 2, 1999. (Enrollment Procedures re: EDCs and EGS during Phase-in, Docket No. M-00960890F0014, Adopted May 21, 1998).

We note that in PECO Energy, Slip Op. at 22, we departed from a strict, "first-come, first-served," selection process for large industrial customers. Instead, subscription for large industrial customers for each stage of the phase-in will occur on a first-come, first-served basis, unless a class load is oversubscribed. In such event, each customer nominating a portion of load in the oversubscribed class will experience a pro-

rata reduction in their nominated load, so the total load available for direct access in that class meets the 33% load for that phase. (66 Pa. C.S. §2806(b)). This adjustment reflects the concern for competitive disadvantages this class may otherwise face, as the intervenors in this Application so eloquently argue. PRA has requested similar treatment for customers above 300 kW. Since no persuasive argument exists in the record to support a less than uniform approach to this issue, we will adopt the same method here for the large customers above 300 kW, as recommended by the ALJ.

We did not address the same competitive concerns of smaller commercial customers in the PECO Energy case. We will adopt the proposal of the OSBA, as herein modified, as it relates to small business customers receiving service from Duquesne via Rate GS/GM, which is available to all non-residential customers whose billing demands do not exceed 300 kW. We do this to address OSBA's concerns that Rate GS/GM contains customers with inherently diverse billing demands, usage patterns and physical size. (OSBA St. 1R at 12-13). Thus, we find that Duquesne should segment the Rate GS/GM class group into "Small Rate GS/GM" and "Large Rate GS/GM." (Id. at 14).

The OSBA suggests a segment limitation for the Small Rate GS/GM at a 40-kilowatt load; however, we recognize that the Company may determine a more appropriate breakpoint after a detailed bill frequency analysis of all Rate GS/GM accounts. (Id). Therefore, we determine that for all industrial customers with usage over 300 kW and large commercial customers with usage in the over 40 kW range, subscription for each stage of phase-in will occur on a first-come, first-served basis, unless a class load is oversubscribed. We hasten to add that in such event, each customer nominating a portion of load in the oversubscribed class will experience a pro-rata reduction in their nominated load, so the total load available for direct access in that class meets the Act's 33% requirements for that phase. (66 Pa. C.S. §2806(b)).

The small rate GS/GM and large rate GS/GM commercial customers shall be treated as separate classes for first-come, first served purposes. The same lottery procedure, as discussed above, shall be used for these classes, as well as for all other customer classes, as described above for residential customers. With regard to the Environmentalists' proposed "Better Choice Plan," as we decided in PECO Energy, Slip Op. at 135, we shall defer consideration of the plan until we promulgate regulations required by Sections 2807(e)(2) and (3) of the Act. 66 Pa. C.S. §2807(e)(2) and (3).

B. Timetable for Phase-In

1. Positions of the Parties

Duquesne proposed to phase-in direct retail access in three equal increments of one-third of the peak load of each customer class annually starting January 1, 1999, so that all customers will be eligible for direct retail access by January 1, 2001.

In recognition of the precedent established in PECO Energy, OSBA claimed that the phase-in established in PECO effectively makes the potential for competitive disadvantages to small business customers a one-year, rather than a two-year, problem. OSBA agreed that a phase-in consistent with PECO Energy addresses the statutory mandates of Section 2806(b) of the Act and minimizes potential competitive problems of small business customers. (R.D., p. 31).

DII proposed that Duquesne offer one-third of its load to direct access on January 1, 1999, the second one-third on January 2, 1999, and the final third on January 2, 2000. DII contented the Act established annual maximum participation targets as of

January 1, 1999, January 1, 2000, and January 1, 2001. DII asserted that the day after each target date, the next participation limit becomes effective. DII argued that the Act does not establish a one-year period in which only the minimum amount of load can have direct access; rather, the Act simply establishes the next target and a maximum level that cannot be exceeded on that date. DII also argued that customers in the Duquesne territory deserve the same accelerated access as the Commission provided to customers in PECO's service territory. See, PECO Energy, Slip Op. at 48-49. (R.D., pp. 30-31).

The PRA, the Environmentalists, and Enron contended that the Commission should establish a phase-in timetable for direct access in this case in the same manner as PECO Energy. Enron submitted that an accelerated phase-in, compared to Duquesne's proposal, is in the public interest, permitted by the clear language in the Act, and will bring the benefits of competition to more customers sooner. Enron argued that Section 2806(b) established the maximum "peak load of each customer class," which can be provided the opportunity for direct access "as of" or, in other words, not later than each date. Enron asserted that the plain language of that section states that "as of" a date certain, the maximum penetration of direct access shall not exceed a certain level. Enron submitted that by any reasonable reading, at any time after that date certain, the Commission has discretion to increase the penetration, as long as it does not exceed the next cap. (R.D., pp. 34-36).

MAPSA joined the foregoing intervenors in objecting to Duquesne's proposal. MAPSA also pointed to the phase-in approved in PECO Energy as the most appropriate method for eliminating the potential for discrimination and competitive disadvantages between similarly-situated customers. (R.D. p. 37).

GPU contended that the phase-in schedule that the Commission adopted in PECO Energy, and advocated here by others, cuts one full year (minus one day) out of the

phase-in schedule established in Section 2806(b). GPU noted that the Commission did not provide the rationale for its accelerated phase-in in PECO Energy. To GPU, it appears that the Commission may have adopted this schedule based on an interpretation of the words "as of," which appear at the beginning of subparagraphs (b)(1), (2), and (3) to mean "at the latest," rather than "beginning on." GPU argued that under this interpretation, the Commission could order an EDC to phase-in direct access to the second one-third of the peak load of each customer class on January 2, 1999, and the final one-third on January 2, 2000. (R.D., pp. 37-38).

GPU argued that this interpretation of Section 2806(b) of the Act is erroneous. Section 2806(b) establishes a three-step phase-in, beginning in January 1999 and ending January 1, 2001. GPU asserted that while an EDC and its customers may settle upon an expedited phase-in of direct access, thereby waiving the EDCs right under the Act to a more gradual phase-in, GPU claimed that the Commission may not unilaterally cut a year out of the process. (GPU M.B. at 5). GPU claimed that the language of Section 2806(c) supports its argument for two reasons. First, Section 2806(c) establishes January 1, 1999, as the "implementation date." In other words, January 1, 1999, is the date upon which the phase-in to direct access begins. Thus, the words "as of" at the beginning of Section 2806(b)(1) can only mean "beginning on." Second, GPU argued that the Legislature did not delegate discretion to the Commission in Section 2806 to adopt an accelerated phase-in schedule. (R.D., pp. 38-39).

PECO concurred with the position of GPU that the Legislature adopted a series of provisions in the Act which contemplate that customer choice will be phased in gradually over a three-year period. (66 Pa. C.S. §2806(b)). PECO strongly disagreed with the Commission's phase-in decision in PECO Energy; however, PECO claimed that fairness dictates that uniform phase-in schemes be imposed on all jurisdictional electric

utilities in Pennsylvania. Otherwise, PECO submitted that the spirit, and arguably the letter of the Act's reciprocity feature, will be violated. (R.D., p. 42). (We note a settlement concerning this issue has been reached with PECO, pursuant to which the phase-in schedule adopted in the Commission's Order will remain and all appeals of the case are expected to be withdrawn. This Settlement was unanimously approved by the Commission on May 14, 1998.)

2. ALJ's Recommendation

For the reasons GPU and PECO advanced concerning proper statutory construction, the ALJ recommends the Commission to reconsider the phase-in schedule for customer choice that it adopted in PECO Energy, Slip Op. at 47-49. The ALJ commented that (R.D., pp. 42-43) "As of" may mean "at the latest," which the Commission apparently attributed to the phase-in schedule in PECO Energy. The ALJ reasoned that on the other hand, "as of" may mean "beginning on," which GPU contended is the only reasonable construction, if one accepts the premise that Section 2806(c) establishes January 1, 1999, as the "implementation date" for the commencement of phase-in to direct access. The ALJ asserted that, given that premise, all of the remaining portions of the statute must be read "in pari materia," pursuant to Section 1932 of the Statutory Construction Act, 1 Pa. C.S. §1932, for the reasons GPU advances. Accordingly, the ALJ concluded that each of the subsections of Section 2806(b) must be interpreted to mean "beginning on" January 1, 1999, etc. For these reasons, the ALJ recommended that the Commission adopt the phase-in schedule favored by GPU and PECO.

3. Parties' Exceptions

The OSBA, Environmentalists, MAPSA, DII, PRA and Enron except to the ALJ's recommendation for (1) a phase-in over three years with a mandatory schedule in which one-third of the peak load of each customer class is given the opportunity for direct access in January of three successive years - 1999, 2000, and 2001, and (2) reconsideration of the accelerated phase-in schedule favored in PECO Energy. (R.D., pp. 42-43). Generally, the parties argue that neither the statutory construction argument, relied upon by the ALJ, nor the record provide sufficient justification for the Commission to reconsider its established precedent on the phase-in. (OSBA Exc., pp. 4-8; Env. Exc., p. 2; MAPSA Exc., pp. 1-2; DII Exc., pp. 2-3, R.Exc., p. 18; PRA Exc., pp. 10-11).

In its Exceptions, PECO concurred with the ALJ's determination that the Commission, in PECO Energy, misconstrued the Act's phase-in requirements. However, as previously noted, on May 14, 1998, the Commission approved a Settlement with PECO which maintains the phase-in plan contained in the Commission's December 23, 1997 Order. PECO has agreed to withdraw its appeal before the Commonwealth Court of Pennsylvania.

In its Reply Exceptions, Duquesne concurs with the ALJ's determination, arguing that an accelerated timetable represents a "distorted interpretation of the [Act]." (DLC Statement 6R at 10; R. Exc., p. 20).

4. Resolution

Section 2806(b) provides that:

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

We note that GPU and other parties argue that the Act requires one specific phase-in schedule of exactly 33% of load eligible for direct access exactly on each of the three dates specified above. These parties interpret Section 2806(b) of the Act to provide the Commission with no discretion concerning the phase-in schedule, except to extend the phase-in schedule pursuant to Section 2806(c).

The parties interpretation is not consistent with the plain language of Section 2806(b) of the Act. Any argument that the Commission has no discretion to

adopt a phase-in schedule within the parameters of Section 2806(b) ignores the phrases "a maximum of" and "as of" that give the Commission discretion. Furthermore, rules of statutory construction do not permit an interpretation of the Act in a manner that would render specific language superfluous. The Legislature intended "a maximum of" to mean "exactly," the phrase "a maximum of" would not have been used. If the legislature intended "as of" to only mean "commencing on," the legislature would have said "commencing on."

Moreover, the general rule in subsection (a), "consistent with the commission's discretion under this section," grants the Commission discretion to fashion a phase-in within the guidelines of 2806(b). If the Commission's discretion were limited to extending the schedule pursuant to subsection (c), the grant of discretion that appears in section (a) would have been written only into subsection (c), and the language in subsection (b) would have provided a precise load for phase-in on a precise date instead of using the phrases "a maximum of" and "as of."

We do agree that the phrase "as of" has several meanings in the English language, including "on," "no later than", and "by". However, consideration of the entire statutory language does not support the argument that the language may only be interpreted to mean "commencing on." Even if the phrase "as of" is interpreted to mean "on," the schedule adopted in PECO Energy is fully consistent with the language of the Act. We note that on January 1, 1999, there will be a maximum of 33% eligible for direct access; on January 1, 2000, there will be a maximum of 66% eligible for direct access; and on January 1, 2001, all customers will be eligible for direct access.

Similarly, if the phrase "as of" is interpreted to mean "by," our schedule is fully consistent with the language of the Act. By January 1, 1999, there will be a

maximum of 33% eligible for direct access; by January 1, 2000, there will be a maximum of 66% eligible for direct access; and by January 1, 2001, all customers will be eligible for direct access. If the phrase "as of" is interpreted to mean "no later than," the schedule that we support is fully consistent with the language of the Act. No later than January 1, 1999, there will be a maximum of 33% eligible for direct access; no later than January 1, 2000, there will be a maximum of 66% eligible for direct access; and no later than January 1, 2001, all customers will be eligible for direct access.

In contrast, the interpretation that "as of" may only mean "commencing on" requires a conflict with the very provision being interpreted. Section 2806(a) defines a "transition and phase-in period beginning on the effective date of this chapter (January 1, 1997) and ending, consistent with the Commission's discretion under this section, January 1, 2001. " Section 2806(b) begins with the statement, "Recognizing that approximately 5% of the peak load will have direct access through pilot programs..." Clearly the transition began on January 1, 1997, the effective date of the Act, and the phase-in to direct access began with the phase-in of 5% of customer load during the pilots. Interpreting "as of" to mean "commencing on" would require ignoring the cited provisions.

It has been argued that "as of" must mean "commencing on" because otherwise the Commission could have phased-in competition prior to January 1, 1999. This argument must also fail. The statute may have permitted increasing beyond 5% to 33% prior to January 1, 1999. The fact that we did not so exercise our discretion does not mean that "as of" must mean "commencing on."

Lastly, we note the statutory directive in Section 2806(b)(4) grants the Commission both the discretion and the responsibility to adopt a phase-in plan that

"prevents competitive disadvantages among similarly situated customers within a customer class." The above phase-in schedule is the simplest, most effective means to minimize competitive disadvantages.

We have carefully reviewed the record developed and we find that different phase-in schedules for competition in different parts of the Commonwealth would advantage or disadvantage customers depending upon where they live and through which utility they are served.

In PECO Energy, this Commission ordered that a maximum of 33% of the non-coincident peak load of each tariff class shall have the opportunity for direct access on January 1, 1999, a maximum of 66% shall be eligible for direct access on January 2, 1999, and that all customers shall be eligible for direct access on January 2, 2000. To deny customers outside the PECO service territory the same schedule that PECO customers will have would be to disadvantage the rest of Pennsylvania.[12] Avoiding such a result is one of the reasons why Section 2806 gives the Commission discretion and why we must exercise such discretion accordingly.

This schedule is in the public interest in order to provide the benefits of direct access expeditiously. Moreover, we find that the schedule is appropriate both to minimize competitive disadvantages among customers and among EDCs. We conclude that this schedule will facilitate an orderly transition without confusion due to different phase-in schedules for different EDCs in overlapping media markets.

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[12] As previously noted, on May 14, 1998, the Commission approved the Joint Petition submitted by the parties in PECO Energy which maintains this phase-in plan as contained in the Commission's December 23, 1997 Order. Accordingly, we have an element of certainty that the phase-in will be implemented as prescribed, and we foresee no legal impediments to this process.

C. Summary and Conclusion

In summary, the ALJ recommended that we reject the method proposed by Duquesne to phase-in direct retail access. Specifically, Duquesne proposed to phase-in direct retail access in three equal increments of one third of the peak load of each customer class annually starting January 1, 1999, so that all customers will be eligible for direct retail access by January 1, 2001. The ALJ recommended that Duquesne be directed to conduct an open enrollment period beginning July 1, 1998, for all customer classes except small business customers on a "first come, first served" basis.

For the business customers, the ALJ recommended adoption of the OSBA's proposal that to create two classes for customers receiving service through the creation of Small Rate GS/GM and "Large Rate GS/GM". This, the ALJ reasoned, would prevent small account customers from being under represented. The ALJ recommended that the Commission consider the Environmentalists' "Better Choice Plan" when promulgating regulations required by Sections 2807(e)(2) and (3) of the Act.

For the timetable for Phase-in, the ALJ recommended that we reconsider the phase-in schedule for customer choice that we adopted in PECO Energy, and adopt the phase-in schedule proposed by GPU and PECO which begins on January 1, 1999.

For the reasons specified herein, we shall adopt the position of the ALJ to implement; 1) system-wide "first-come, first -served" selection for residential customers as modified below; 2) the OSBA's proposal to split small commercials on a "first-come, first -served" basis; and 3) PECO's pro-rata subscription for industrial and large commercial customers.

We reject the ALJ's recommendation to adopt the positions of Duquesne, GPU and PECO to reconsider the phase-in schedule for customer choice that we adopted in PECO Energy. We shall adopt the same phase-in schedule as adopted in PECO Energy. We find that different phase-in schedules for competition in different parts of the Commonwealth would advantage or disadvantage customers depending upon where they live and through which utility they are served.

III. TRANSMISSION AND DISTRIBUTION RATES - UNBUNDLING ISSUES

A. Introduction

Several interdependent standards of the Act and the Code apply to transmission and distribution (T&D) rates. The Act requires electric utilities to unbundle their "rates and services . . . to allow competitive suppliers to generate and sell electricity directly to consumers in this Commonwealth." (66 Pa. C.S. §2802(14)). Since the T&D components of a utility's rates will continue to be regulated under Chapter 13 of the Code, the rates for these components must be just and reasonable. (PECO Energy, Slip Op., p. 61; See, also, 66 Pa. C.S. §1301).

The process by which the Commission is obligated to unbundle the company's rates into generation, transmission and distribution components is fundamentally a ratemaking process. The Commission must determine the company's cost of service, properly allocate those costs among the generation, transmission and distribution portions of the company's operations, and translate those total costs into individual rates. The Commission is also called upon to set a new rate, known as CTC, based upon expert witness testimony, to recover a just and reasonable portion of the company's uneconomic (or stranded) assets. The CTC is designed to permit the company to recover those stranded costs over a reasonable period of time. These are traditional ratemaking functions as exercised by the Commission since its inception in 1913.

B. 1996 Test Year Cost of Service

1. Positions of the Parties

Duquesne used its 1996 cost of service study as the basis for allocating all of its costs between generation, transmission, and distribution. Duquesne submitted that the only disputes to its proposal related to the functionalization of these costs among generation, transmission, and distribution. It claimed the proposals of others move costs out of T&D and into the generation function, thereby reducing the regulated rates paid by the constituents of the intervenors. Duquesne stated that Enron's proposed adjustments were rejected in PECO Energy and further insisted that Enron's alternative cost of service study (Enron Exh. PDR-3) contains circular references and other errors, such as over-allocation of costs to Duquesne's only wholesale customer and omitting revenue from rate class GL. (R.D., p. 46).

Regarding HSS/ARI's request that 50% of Duquesne's past (since 1987) and projected T&D capital expenditures be disallowed, Duquesne asserted that HSS/ARI did not identify a single expenditure that was imprudent. Furthermore, Duquesne argued that HSS/ARI failed to meet their own test: that an intervenor must raise "credible issues" regarding an expenditure to overcome its "presumption of reasonableness." Because Duquesne has not filed a rate case since 1986, HSS/ARI insisted that Duquesne must establish that its T&D capital expenditures since 1986 were just and reasonable to the extent that those costs are subsumed within its current distribution rate structure. (R.D., p. 48).

DII provisionally accepted the Company's 1996 test year Cost of Service, with certain adjustments as discussed below, as the rate unbundling starting point. (R.D., p. 48).

Like HSS/ARI, the PRA found it difficult to accept Duquesne's 1996 cost of services levels since this Commission last approved base rates in 1986; however, the PRA offers no specific criticisms of the test year proposal. (PRA M.B. p. 19; PRA R.B. p. 5). Duquesne used the percentage of labor expenses charged to generation, transmission, and distribution as a proxy method to allocate administrative and general expenses and general plant to these three categories. Enron recommended that the Commission direct Duquesne to conduct a detailed functional cost study and submit it at a later date so distribution rates may be revised accordingly. (Enron M.B. at 12).

Enron further contended that Duquesne's cost of service study inappropriately assigns sales expense, customer information and assistance expense, and uncollectible accounts expense entirely to the distribution function, even though these costs are associated with all aspects of service. Enron claimed Duquesne's attempt to charge 100% of these costs to distribution rates unfairly charges distribution customers for costs for which they are not responsible and also provides an unfair advantage to Duquesne's generation supply activities. Enron asserted that such a cross-subsidy cannot be condoned. (R.D., pp. 52-53).

Enron recommended allocating 100% of sales expense and customer information and assistance expense to the generation function. Under Enron's proposal, uncollectible accounts expense should be allocated to the three functional categories, or, to the extent energy suppliers or third parties other than Duquesne provide billing services and take credit risks, uncollectible accounts expense should be unbundled and removed

from distribution rates. Further, Enron claimed it is entirely inappropriate, once these costs are allocated to the generation portion of Duquesne's functional unbundled rates, to simultaneously add them to the Company's stranded cost recovery allowance. (R.D., pp. 54-55).

2. ALJ's Recommendation

Because this Commission denied the same objections of Enron in PECO Energy, Slip Op., p. 59-61, to that utility's proposed allocations for uncollectibles, customer accounts, customer service, and sales, the ALJ reasoned the same treatment should be accorded Duquesne in this proceeding. Furthermore, the ALJ agreed with Duquesne that this Commission should also reject the position of HSS/ARI on this issue. For these reasons, the ALJ recommended that this Commission accept Duquesne's 1996 cost of service study, subject to the adjustments denoted in the Recommended Decision. (R.D., p. 57).

3. Parties' Exceptions

Two parties except to the ALJ's recommendation concerning the 1996 Test Year for Cost of Service. First, HSS/ARI argues the ALJ erred in stating that "HSS/ARI failed to identify even a single expenditure as unreasonable." (R.D., p. 176). HSS/ARI contends Pennsylvania courts have made clear that the burden on an intervenor is merely to establish the existence of a credible issue. The Pennsylvania Commonwealth Court has found that an intervenor challenging a utility's claim which is supported only by the utility's bare assertion "was under no obligation to adduce either evidence or analysis." (University of Pennsylvania v. Pa. PUC, 485 A.2d 1228 (Pa. Cmwlth 1984)). HSS/ARI

argues that it did not bear the burden of showing that Duquesne's expenditures were unreasonable. (HSS/ARI Exc., pp. 6-7).

Second, while recognizing that this Commission rejected a similar proposal by Enron in PECO Energy, Enron requests that we reconsider our decision in PECO Energy and accept Enron's proposal here. Enron contends that by including 100% of sales-related costs in T&D rates, Duquesne will have a competitive advantage and customers of generation suppliers will pay twice -- once in Duquesne's distribution rate and a second time in the rate charged by the supplier. Enron argues this violates Section 2804(6) of the Act, 66 Pa. C.S. §2804(6), which requires that T&D services be provided to all retail customers and generation suppliers on terms comparable to the utility's own use of its system. (Enron Exc., pp. 9-12).

In its Reply Exceptions, Duquesne submits that Enron's argument that certain costs (uncollectibles, customer accounts, customer service, and sales) should be "allocated" to the generation function should be rejected because Enron ignored the functions of how an EDC operates. (Duquesne R.Exc., pp. 18-19).

4. Resolution

Based upon the record before us, we will adopt the ALJ's recommendation to accept the Company's cost of service calculation and reject the HSS/ARI adjustment to remove 1986-1996 distribution plant additions. In addition, we will accept the Company's functionalization and reject the Enron sales expense adjustment, Account 908 adjustment, and uncollectible accounts adjustment.

We note that we denied the same objections of Enron in PECO Energy, Slip Op., p. 59-61, to that utility's proposed allocations for uncollectibles, customer accounts, customer service, and sales. As in PECO Energy, we conclude herein that Enron has not documented sufficiently that a specific portion of the expenses are in fact generation related. The same treatment should be accorded Duquesne in this proceeding. In reaching this result, in PECO Energy, we noted that PECO's T&D rates continued to be subject to Chapter 13 of the Public Utility Code and subject to the Act's rate caps. Parties may challenge existing rates in future proceedings. Further, we noted in the PECO Energy case that as functions continue to be unbundled, a utility's rates may be reexamined to determine if the utility provides for charges which encompass generation or other unbundled services. (Id., p. 61).

We agree with Duquesne that the Commission should reject the position of HSS/ARI on this issue. An intervenor must raise "credible issues" regarding an expenditure in order to overcome the "presumption of reasonableness." (Equitable Gas., supra.). The HSS/ARI have failed to do so. Therefore, the Commission accepts Duquesne's 1996 cost of service study, subject to the adjustments denoted below.

C. Required v. Realized Rate of Return

1. Positions of the Parties

Duquesne proposed establishing T&D rates on a traditional cost-of-service basis, using the traditional three steps. First, Duquesne computed a functionalized revenue requirement for the T&D functions using its authorized rate of return. Second, it allocated the functionalized revenue requirements to customer classes. For distribution, it allocated demand costs to classes on the basis of non-coincident peak demands, and it

allocated customer costs on the basis of the number of customers. For transmission, it allocated costs to classes on the basis of coincident peak demands, which is consistent with the Federal Energy Regulatory Commission (FERC) policy. Third, using these allocated revenue requirements, Duquesne then designed T&D rates for each class. (R.D., p. 58).

Duquesne noted that the several parties objecting to this approach would have T&D rates set on the basis of "realized" (or "earned") rather than "required" rate of return. Duquesne argued that this position must fail because regulated rates are set to recover the required rate of return. Duquesne further contended that no party suggested, much less demonstrated, that the T&D revenue requirements Duquesne proposes are higher than the T&D revenue requirements which this Commission approved in 1987 in Duquesne's last rate case; hence, no basis existed for the claim that the Act is violated. Finally, Duquesne contended that the intervenors' proposals have nothing to do with a concern over shifts between classes; their key objective is to shift costs between functions. (R.D., pp. 58-60).

The OCA posited that Duquesne's use of the full "required" rate of return in developing T&D rates improperly assumes T&D services have been earning a higher rate of return than generating services. The OCA declared that such an approach is inconsistent with establishing the rate cap for "non-generation charges" at the same level which this Commission previously approved for such services. For purposes of unbundling rates, return by function should be determined by applying the same rate of return to all plant. Consequently, the OCA adjusted the Company's T&D rates to reflect the achieved return, rather than the claimed return. The OCA argued that the fact that Duquesne filed rates on this basis in other proceedings does not justify the unbundling of rates on that basis in this proceeding. (R.D., pp. 60-62).

DII argued that use of a "required" rate of return constitutes an inappropriate cost-shift and a violation of the Act's rate cap. (66 Pa. C.S. §§2808(a), 2804(7) & 2804(4)(i)). DII noted that Duquesne requested a rate of return of 9.61%; however, Duquesne's current bundled rates reflect the earned rate of return produced by each rate class as established in Duquesne's last base rate proceeding. DII asserted that the use of required rate of return, rather than earned rate of return, shifts costs between the distribution function and the generation function of the unbundled rates. Although moving class rates of return closer to system average may be appropriate in other contexts, Duquesne asserted that the Act requires that, in order to prevent cost shifting, individual components of distribution rates must be capped at the January 1, 1997 levels until July 2001, or the time when the utility is no longer collecting a CTC, whichever is shorter. (66 Pa. C.S. §2804(4)(i); R.D., pp. 62-63).

DII contended that the Company's use of required rate of return shifts the costs from distribution to generation (or vice versa), either raising or deflating the generation component of the class's rate. DII claimed that this shift violates the Act's mandate that stranded costs be recovered in a manner that does not affect an inter- or intra-class cost shift. (DII M.B., pp. 11-12; 66 Pa. C.S. §2808(a)). DII argued that the purpose of this proceeding is not to set new T&D rates for Duquesne; the purpose is to unbundle existing rates in a manner that does not shift costs or violate the rate caps. (66 Pa. C.S. §§2802(14), 2804(3), 2804(7) & 2808(a); R.D., pp. 63-66).

Enron claimed that Duquesne's proposal amounts to a de facto attempt to secure a rate increase for this portion of its operations. Enron contended that the cost of T&D at Duquesne's "pro forma" or claimed "required" rate of return increases those costs above the level actually incurred in the 1996 test year because the return level

included in Duquesne's study is the level the Company claims it should be earning, not the amount it actually earned. Enron argued that this result contravenes the Act. Enron concurred with DII that Duquesne's proposal shifts costs between customer classes and functions, arguably violating the Act's prohibition against inter-class costs shifts. (66 Pa. C.S. §2808(a)). Enron also urged this Commission to reject Duquesne's proposal. (R.D., pp. 66-68).

2. ALJ's Recommendation

The ALJ agreed with the OCA, DII, and Enron that the Company's use of a "required" rate of return to develop T&D rates constitutes an inappropriate cost-shift and a violation of the Act's rate cap. (66 Pa. C.S. §§2808(a), 2804(7), & 2804(4)(I)). The ALJ also agreed that the purpose of this proceeding is not to set new T&D rates for Duquesne; the purpose is to unbundle existing rates in a manner that does not shift costs or violate the rate caps. (See, 66 Pa. C.S. §§2802(14), 2804(3), 2804(7), & 2808(a)). The ALJ thus recommended that we direct Duquesne to use the "realized" rate of return for each class, as established in its last base rate case, to develop rates. (R.D., pp. 68-69).

3. Parties' Exceptions

In its Exceptions, Duquesne contends that the ALJ's recommendation is in error because there is no possibility of cost-shifting under its proposal. Duquesne maintains that the ALJ's finding that the rate caps prohibit recovery of just and reasonable T&D rates renders the Act confiscatory. Duquesne also contends that its rates for transmission and ancillary services cannot be "set" by this Commission; they are set by the FERC. Duquesne argues that any contrary finding is preempted by federal law. Mississippi Power & Light Co. v Mississippi ex rel. Moore, 487 U.S. 354 (1988). (Duquesne Exc., pp. 33-34).

In their Reply Exceptions, the OCA, the OSBA, the PRA, DII, and Enron argue that Duquesne's Exceptions concerning "required" rate of return are without merit because Duquesne's proposal is inconsistent with the Act's requirements and Duquesne's jurisdictional argument is without merit. The parties submit that Duquesne's proposal to unbundle its rates based on its claimed rate of return for T&D service is inconsistent with the Act's requirement. They note that this Commission established the cap for the non-generation portion of rates at the level that had been approved as of the effective date of the Act. (66 Pa. C.S.§2804(4)(i)(B). Because, the non-generation charges were not specifically separated from generation charges at that date, the parties argue that the only appropriate way to unbundle these services is to assume they were realizing the same actual rate of return at that date and unbundle them accordingly. (OCA R.Exc, pp. 18-19; Enron R.Exc., p.10; PRA R.Exc., p. 7; OSBA R.Exc., pp. 9-10; DII R.Exc., p. 14).

Generally, the parties argue that, as evidenced by PECO Energy, this Commission is fully aware of the jurisdictional lines between T&D rates and that, while it has full authority to establish unbundled distribution rates, transmission rates are exclusively within the FERC's jurisdiction. The parties submit that if FERC awards Duquesne a higher rate of return for transmission rates than the realized rate of return recognized by this Commission, Duquesne's unbundled T&D rate (and unbundled generation rates) will have to be adjusted. Enron submits that such an approach was endorsed by this Commission in PECO Energy and is a necessary approach to fulfilling the Act's mandate. (Enron R.Exc., pp. 10-11; OCA R.Exc., pp. 18-19).

4. Resolution

Based upon our review of the record herein, we adopt the ALJ's disposition which uses realized rather than required returns for setting of the distribution rates. To redesign rates to the required return would disaggregate earnings such that distribution would earn at a different level than generation. Such earnings separations increase stranded cost potential by depressing earnings from generation in order to fund full earnings on T&D from the cap rate levels. In addition, it would require a review of all costs/revenue requirements in T&D.

As stated in the Recommended Decision, the OCA, DII, and Enron argue that the Company's use of "required" rate of return to develop T&D rates constitutes an inappropriate cost-shift and a violation of the Act's rate cap. (66 Pa. C.S. §§2808(a), 2804(7), & 2804(4)(i)). Duquesne is correct that development of "required" rate of return follows traditional rate-making principles; however, the unbundling methodology that we adopt still permits Duquesne the opportunity to earn its authorized rate of return based on the revenue requirements in existing rates. While this is a rate proceeding in which both existing rates are being unbundled and a new rate, the CTC, is being established, neither Duquesne nor any other party introduced evidence or advocated setting new T&D rates from the ground up. Under such circumstances, it would be inappropriate to change rates on a single issue, such as the authorized rate of return. Our approach retains the existing authorized rate of return.

In contrast, Duquesne's approach would establish an increased opportunity to achieve the authorized rate of return on T&D while essentially reducing the authorized rate of return of generation. The Recommended Decision correctly holds that, on day one after implementation of new rates as approved by this Commission, a utility begins earning

"realized" or "earned" rate of return and not "required" rate of return. We are reminded that ratemaking provides an opportunity to earn a fair rate of return, not a guarantee of its realization. If Duquesne is not now achieving its required rate of return, Duquesne will continue to have the opportunity to achieve it, given unbundling of the rates.

D. Distribution Losses

1. Positions of the Parties

Compensation is embedded in current bundled rates for electricity losses (distribution losses) experienced as electricity moves along distribution lines. This additional compensation represents the cost of extra generation required to replace the distribution losses. Duquesne asserted that no dispute any longer exists regarding this issue. Duquesne initially included the costs associated with distribution losses in its T&D rates. Duquesne agreed to "unbundle" losses so customers can procure them from alternate suppliers. According to Duquesne, a portion of the embedded costs allocated to losses will consequently become potentially stranded and, hence, must be included in the CTC. The OCA agreed that stranded costs associated with distribution losses should be included in the CTC. (R.D., pp. 69-70).

Only the PRA and Enron seemed to disagree that the issue of distribution losses appears to be settled. Both, however, urged this Commission to require distribution losses to be removed from Duquesne's distribution rates, so alternative suppliers may bid competitively for such losses. (R.D., p. 70).

2. ALJ's Recommendation

The ALJ found that, since Duquesne has already agreed to remove distribution losses from its distribution rates (so that alternative suppliers may bid competitively for such losses), a perceptible issue no longer exists. For this reason, he recommended that this Commission accept Duquesne's proposal to allow customers to procure distribution losses from alternate suppliers. To the extent that a portion of the embedded costs allocated to distribution losses will become potentially stranded, he also recommended that they be included in the CTC. (R.D., p. 70).

3. Parties' Exceptions

In its Exceptions, the OCA wishes to make clear that its calculation of stranded cost already has been increased to include line losses. The OCA asserts that its proposed CTC calculation requires no additional modification to reflect treatment of distribution line losses as costs functionalized to generation costs. Regarding Duquesne's assertion that a portion of distribution line losses will be potentially stranded as a result of shifting costs in order to unbundle distribution line losses, the OCA emphasizes that Duquesne included the capacity costs associated with providing line losses in T&D rates based upon estimated market prices for providing line loss service. The OCA asserts that there is, thus, no basis to assume that there will be additional stranded costs as a result of moving line losses back to the generation function. (OCA Exc., pp. 19-20).

Enron argues that the ALJ erred because these costs do not meet the definition of stranded costs, which include only those costs recoverable in a regulated environment but which may not be recoverable in a competitive environment. (66 Pa. C.S. §2803). Enron contends that since all companies in the competitive market will be

required to procure energy, including distribution line losses, the cost of those losses is a cost that can be and will be recovered in the competitive market -- the opposite of the standard required by the statute. (Enron Exc., pp. 13-14).

In its Reply to Enron's Exceptions, Duquesne argues that distribution losses are one of the very functions that will be subject to competition, thereby giving rise to stranded costs. The resulting stranded costs should be recoverable in the same manner as all other generation-related stranded costs. (Duquesne R.Exc., p. 19).

4. Resolution

Duquesne has already agreed to remove distribution losses from its distribution rates. Therefore, we will accept the ALJ's recommendation that customers be allowed to procure distribution losses from alternate suppliers. With regard to the OCA's exception that its calculation of stranded costs already has been increased to reflect line losses, we would note that, to the extent that a portion of embedded costs allocated to distribution losses will become potentially stranded, such costs may be recoverable through the CTC, if appropriate, based on the determination of stranded utility generation.

E. Ancillary Services

1. Positions of the Parties

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. While generating units provide a number of these services, Duquesne 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, for a total of $18,121,980. (R.D., pp. 70-71).

With the exception of scheduling services, Duquesne explained that all ancillary services are provided by generating units and each is "necessary to maintain the integrity of the transmission system" in an open access regime. In its Order No. 888, the FERC ruled that all public utilities must offer these services to direct access customers at regulated rates. The FERC also distinguished between services that can only be offered by the host public utility and others that can be competitively procured, assuming that prevailing regional reliability rules permit it. (FERC Order No. 888, p. 31, 715-716; Duquesne St. 7, p. 13-14). Duquesne contended that it has complied with FERC Order No. 888 by filing cost-based ancillary services rates with the FERC. (Duquesne M.B. at 15; Duquesne Light, FERC Docket No. OA96-56-000). (R.D., p. 71).

The first question is whether Duquesne should allow its customers to procure all these services from alternative suppliers. Duquesne submitted the FERC has determined which services Duquesne must provide and which services can, consistent with regional rules, be supplied by others. (FERC Order No. 888, p. 31,715-716; Duquesne St. 7, p. 13-14). The second question is whether, for ratemaking purposes, these services should be treated like T&D, and thereby purchased from Duquesne at regulated rates, or treated like generation, and thereby competitively procured in the market, with the stranded portion being recovered through the CTC. (R.D., p. 72).

The OCA disagreed with Duquesne's proposed adjustment to shift the cost of ancillary services from generation to transmission. Since these costs are associated with generating units, the OCA removed the Company's adjustment which transferred

these costs from the generation function to the T&D functions. The OCA showed T&D costs of $285,417,000 before Duquesne's adjustments for ancillary services. (R.D., pp. 73-74).

DII argued that inclusion of generation-related ancillary services in the Company's unbundled transmission rates is inappropriate because it shifted costs between functional categories. Generation-related ancillary services costs are not included in Duquesne's current transmission rates. Consequently, DII claimed these costs cannot properly be assigned to the transmission function in unbundling Duquesne's rates. To prevent inappropriate double payment, DII recommended moving $18 million of ancillary services costs from the transmission rates into the market price component of unbundled generation rates. (R.D., pp. 74-75).

The Company agreed that generation-related ancillary services which can be competitively supplied should be removed from the transmission rate. (Tr., pp. 720-721). Because all generation-related ancillary services are not currently subject to competition, the Company's adjustment resulted in only a partial removal of ancillary services costs from the transmission rate. DII contended that all generation-related ancillary services be removed from the transmission rate and that the Company may charge customers for any generation-related ancillary service not competitively procured. If its adjustments are not accepted, DII argued that either ratepayers must receive a credit toward stranded costs for those services or Duquesne's market price forecast and stranded cost calculation should be adjusted to reflect the Company's ability to receive greater compensation for these services (at embedded costs as opposed to market price). (R.D., pp. 76-77).

The PRA agreed with the assessment of the OCA and DII concerning Duquesne's proposal for the costs of ancillary services but concurred with the treatment DII proffers on this issue. (R.D., p. 78).

Enron disagreed that the appropriate mechanism is through an end-of-the-year "market based" credit. Rather, Enron suggested the transmission-related portion of the rate should be unbundled to recognize the delivery of those services by an alternative supplier. Enron would base the credit upon the embedded cost of the ancillary service as established by Duquesne's cost of service study. Enron urged the Commission to direct Duquesne to calculate the embedded generation cost of ancillary services; this value should then be deducted from the Company's generation revenue requirement. In addition, Enron agreed with MAPSA's arguments on imbalance charges and scheduling charges. (R.D., pp. 78-79).

MAPSA asserted that Duquesne's proposal includes the partial unbundling of ancillary services and allows for competitive provision of only one of them. Duquesne initially proposed to unbundle the ancillary service of supplemental reserves and subsequently modified its proposal to provide for a "market-based" credit for those services that can be purchased from an entity other than Duquesne (currently only supplemental reserves) and to add that credit to its customer generation credit (CGC). (Duquesne St. 5R, p. 2.) MAPSA submitted that Duquesne should be required to unbundle all ancillary services and provide a separate, fully-allocated credit for each of those services, which should be added to the CGC to compensate customers if they choose to have these services competitively provided. (R.D., pp. 79-80).

Regarding charges for imbalances, Duquesne proposed to charge each supplier for imbalances that fall outside of a 1.5% "dead-band" during off-peak periods at

the higher of 110% of Duquesne's out of pocket costs, or $50/mWh, and during on-peak periods, the higher of 110% of Duquesne's out of pocket costs or $100/mWh. Duquesne will provide class-average load data for customers with specific meter types to suppliers, who will then have to match the load shape. Suppliers are penalized if the supply does not match the usage but not if the supply does not match the load data. In actually scheduling the load, suppliers will be forced to rely on load data which Duquesne provides and which MAPSA alleged is likely to be highly inaccurate for any particular supplier. When the data on which a supplier must rely is not accurate, MAPSA argued the penalties should be adjusted or eliminated because of the potential for abuse. (R.D., pp. 80-81).

MAPSA proffered that a reasonable charge should be 100% of Duquesne's out-of-pocket expenses and that this Commission should allow imbalances to be traded among competitive suppliers. MAPSA also suggested that this Commission allow imbalances to be resolved in-kind, at a time, and in a manner agreed upon by Duquesne and the suppliers. (R.D., p. 81).

Duquesne proposed to charge suppliers $100 for each schedule and each change in schedule which is submitted to Duquesne. MAPSA noted that the Company derives the fee by dividing the adjusted labor expense by the number of hours in a year, which MAPSA contended merely yields a result establishing the hourly cost of scheduling and not the actual transaction cost. MAPSA argued the fee is so high it is likely to hinder the development of a robust competitive market. When utilities impose charges which are anti-competitive, MAPSA argued that those charges must be proved to be necessary and not speculative and must be specifically quantified. Where a utility fails to meet its burden of providing substantial evidence, its proposed rate must be denied in its entirety. (Lower Frederick Township Water Company v. Pa. PUC, 409 A.2d 505, 507

Pa Commonwealth Ct.(1980) (affirming this Commission's denial of all elements of a proposed rate increase where the utility did not meet its burden of proof)). (R.D., pp. 82-83).

2. ALJ's Recommendation

The ALJ initially found that Duquesne admitted that generating units provide the ancillary services and the costs associated with the challenged adjustments to transmission were estimated as portions of the revenue requirement associated with generating units estimated to be required to provide these services. Therefore, the ALJ reasoned, it follows that the costs of ancillary services should be attributed to the generation function if the particular service can be competitively procured, and any stranded costs associated therewith should be recovered in the CTC. The ALJ also noted that FERC Order No. 888 will require the unbundling of ancillary services consistent with applicable reliability council requirements. In the absence of such unbundling and the competitive availability of ancillary services, FERC Order No. 888 requires that all public utilities must offer these services to direct access customers at regulated rates.

Finding that it is not at all clear that the East Central Reliability Coordination Agreement (ECAR) imposes significant restrictions on the competitive procurement of these services, the ALJ recommended that the following amounts be removed from T&D rates and moved into generation costs: $4,021,675 for reactive power, $5,187,040 for regulation and frequency control, and $8,913,265 for operating spinning reserve, for a total of $18,121,980. Further, the ALJ recommended that this Commission disallow Duquesne's proposed imbalance charges and the $100 scheduling charge, since the Company did not provide sufficient evidence to justify them and for the reasons MAPSA espoused. (R.D., pp. 83-84).

3. Parties' Exceptions

Duquesne takes exception to the ALJ's recommendations on the basis that the Commission is preempted by federal law. (R.D., p. 84). Regarding the ALJ's finding that Duquesne had not proven that ECAR rules require that certain ancillary services be provided by the control area, Duquesne argues that any question of how it applies these rules must be addressed through the complaint procedures available under its open access tariff or Section 206 of the Federal Power Act. Duquesne contends that the finding was in error because of confusion regarding whether ECAR rules prohibit unbundling of rates; Duquesne alleges they do not and that unbundling is actually required by FERC Order No. 888. Duquesne alleges further confusion over whether ECAR rules prohibit the provision of services by generators located outside the control area; Duquesne alleges they do and that such services are also within FERC's authority. Duquesne also argues that its proposed energy imbalance charge is under FERC jurisdiction. (Duquesne Exc., pp. 34-35).

The OCA's exceptions regarding ancillary services are combined with its exceptions regarding distribution line losses and have been discussed supra.

Two parties replied to Duquesne's exception disputing the Company's assertion that the only forum before which parties may question the rates charged to retail consumers for these services is the FERC. The DII and MAPSA note that the issue concerning ancillary services is that generation costs should properly be included in generation rates. They argue that the Company's exception should be denied. (DII R.Exc., 14-15; MAPSA R.Exc., pp. -5).

4. Resolution

As the Recommended Decision correctly states, a traditional rate making principle is that assignment of costs follows function. Since Duquesne admits that its generating units can provide the ancillary services, (Duquesne M.B., p. 15), and the costs associated with the challenged adjustments to transmission services were estimated as portions of the revenue requirement associated with generating units estimated to be required to provide these services, (OCA St. 4, p. 4), then it naturally follows that the costs of ancillary services should be attributed to the generation function if the particular service can be competitively procured, and any stranded costs associated therewith should be recovered in the CTC. Duquesne and the intervenors apparently agree on this general principle.

With respect to ancillary services, the question is which ancillary services can be competitively procured. FERC Order No. 888 holds that all public utilities must offer ancillary services to direct access customers at regulated rates. Yet, the FERC also distinguishes between services that can only be offered by the host public utility and others that can be competitively procured, assuming that regional reliability rules permit it. Duquesne contends that its regional reliability council, ECAR, imposes significant restrictions on when many of these ancillary services can be competitively procured. (Duquesne St. 7, pp. 13-14; Duquesne St. 5R, p. 19). Duquesne's witness admitted this may not be the case, thereby undermining Duquesne's point. (Tr., p. 772).

We agree with most of the parties that ancillary services should be available for competitive procurement, but the fact remains that they are FERC-jurisdictional and all are now included in the FERC-approved open access tariff. Transmission services are FERC jurisdictional and, as such, the terms and conditions under which unbundled

transmission services are to be provided to customers will be controlled by the FERC-approved Open Access Tariff for the transmission services procured by either Duquesne or a competitive supplier, as the case may be, on behalf of end-use customers, or procured directly by qualifying large customers. It would be both difficult and inappropriate to unbundle such rates and services at this time without FERC participation. Unbundling these services must await a future date. Accordingly, Duquesne's Compliance filing need not contain any unbundled retail end-use transmission rates. The terms and conditions for transmission services for each separate rate classification are those established by FERC.

Additionally, consistent with the ALJ's recommendation, we will disallow Duquesne's proposed imbalance charges and the imbalance trading standard (see additional discussion concerning imbalance charges, infra) and the $100 charged to suppliers for scheduling changes, since the Company has not provided sufficient evidence to justify them. In addition, as noted by MAPSA, Duquesne's proposal includes the partial unbundling of ancillary services by providing a "market-based" credit. Based upon the record before us, we find, however, Enron's proposal that the "market based" credit should be based on the embedded cost of the ancillary services established in Duquesne's cost of service study to be reasonable and in the public interest.

We find that in the unbundling of an existing rate, use of a "market-based" credit is inappropriate. Only embedded rates are considered in the unbundling process. As such time as FERC and/or ECAR permits the unbundling of any ancillary service, a credit for the embedded cost of that service, as determined by the FERC open-access tariff, will be provided to a customer obtaining that ancillary service competitively.

We direct Duquesne to include a specific Supplier Tariff as part of its compliance filing. The Supplier Tariff must reflect all applicable FERC and ECAR rules while supplementing those rules to reflect all aspects of the interaction between Duquesne and an EGS necessary and appropriate for the efficient implementation of retail direct access. The Supplier Tariff is not a services agreement; it is a set of rules and procedures. It should include no fees or other charges except as have been approved by FERC or this Commission upon documentation of net incremental cost. The Supplier Tariff must address customer sign-up and switching, balancing, billing, and data exchange. The compliance filing Supplier Tariff shall be consistent with this Opinion and Order and all other relevant Commission regulations and Orders that have been adopted to date concerning relevant issues, procedures, and protocols.

F. Voltage-Differentiated Rates

1. Positions of the Parties

Enron proposed a Distribution Services Tariff (DST) which, it claimed, will apply to suppliers who will be acting as agent for individual or aggregated end-user customers. In conjunction with the DST, Enron proposed that applicable rates be designed so as to reflect the characteristics of a customer's service, including voltage level, rather than historical identification by traditional "class" of service. Enron suggests the important pricing distinctions between customers will be the timing of electricity consumption, the voltage level at which customers take service, and whether that service entails single-phase or poly-phase facilities. (R.D., pp. 85-87).

Both Duquesne and DII argued that Enron's proposal should be rejected because Enron did not sufficiently demonstrate that implementation of its voltage differentiated rates will not shift costs between classes. (R.D., pp. 85-87).

2. ALJ's Recommendation

The ALJ agreed with Duquesne and DII on this issue and recommended that this Commission reject Enron's proposal. The ALJ reasoned that the Act prohibits cost shifting in the unbundling process and mandates a rate cap on non-generation rates through mid-2001. (See, 66 Pa. C.S. §§2804(4)(i) & 2804(7)). The ALJ concluded that the fact that the cost shifting may affect the supplier, who is the "agent" for the end-user customer, is irrelevant. (R.D., pp. 87-88).

3. Parties' Exceptions

Enron argues the ALJ erred in determining that Enron's proposed DST could cause cost-shifting or rates that exceed the rate cap. Provisions in the Act concerning cost-shifting and rate caps apply only to the EDC. Since, under the proposed delivery tariff, the supplier would be paying the EDC's rates, Enron contends there can be no cost shifting or rate-cap excess, in the aggregate, because competitive forces mandate that rates charged by an EGS to end-users are not going to be in excess of the EDC's rate cap. Duquesne's position, Enron argues, obscures the real dispute, which is how far and how fast the Commission should go in unbundling distribution services and rates. (Enron Exc., pp. 15-16). As an alternative to its DST, Enron argues that this Commission should advance the development of such a tariff by ordering Duquesne to work with interested suppliers and customer groups to develop a voltage differential DST for future application. (Id., p. 16).

In their replies to Enron's exception, DII and Duquesne argue that Enron has not sufficiently addressed the potential for cost shifting under its proposal. (DII R.Exc., p. 19; Duquesne R.Exc., p. 19).

4. Resolution

We accept the ALJ's recommendation to reject the Enron voltage-differentiated rates proposal. We agree with the ALJ that insufficient evidence has been presented by Enron to demonstrate that Enron's voltage-differentiated rates will not violate the Act's prohibition against cost-shifting or exceed the rate cap on non-generation rates.

G. Other Issues

1. Distribution - Related Capital Expenditures

(a) Positions of the Parties

HSS/ARI claimed that, with respect to distribution-related capital expenditures, the Duquesne Exhibit DJC-3, pp. 22 & 28, reveals that, between the years 1997 and 2005, Duquesne will have to make capital additions of $532 million to provide a cost basis that will allow it to back-in to its proposed 11.5% return on equity. HSS/ARI argued that Duquesne's projections of distribution-related capital expenditures appear to be designed to help Duquesne maintain its substantial financial achievements for its shareholders, with no commensurate benefit for its ratepayers.

HSS/ARI pointed out that Duquesne has a history, dating back to 1987, of forecasting distribution-related capital additions of approximately 10% more than actual

expenditures. HSS/ARI cited the holding in PECO Energy for the proposition that the Commission should disallow 10% of Duquesne's projected distribution-related capital additions because the Company has a history of over-budgeting future capital improvements.

(b) ALJ's Recommendation

The ALJ found that Section 2808(c)(4) of the Act, 66 Pa. C.S. §2808(c)(4), imposes a duty upon every electric utility, during the transition period, to mitigate generation-related transition or stranded costs to the extent practicable. These efforts may include minimization of new capital spending for existing rate base generation assets. (66 Pa. C.S. §2808(c)(4)(ii)). Giving affect to these provisions, the Commission in PECO Energy, Slip Op., pp. 81-82, disallowed 5% of the budgeted capital additions to generating plant because PECO had a ten-year history of over-budgeting future capital improvements and the Commission determined permitting full recovery would constitute an anti-competitive subsidy of PECO's future competitiveness in the generation market. The ALJ recommended that this Commission deny this proposal of HSS/ARI. (R.D., p. 91).

(c) Parties' Exceptions

No party excepted to the ALJ's recommendation

(d) Resolution

The Act does not compel the result advocated by HSS/ARI. HSS/ARI has not documented that existing rates are unreasonable. HSS/ARI overlook the fact that T&D

rates will still remain regulated after implementation of this restructuring plan. If HSS/ARI believe T&D rates are still unreasonable at that time, HSS/ARI can challenge those rates in a future proceeding before this Commission. We shall adopt the ALJ's recommendation to reject the HSS/ARI proposal.

2. Targeted Area Planning

(a) Positions of the Parties

The Environmentalists propose that this Commission require Duquesne to use "Targeted Area Planning" for T&D system improvements. (Env. M.B., pp. 11-12). As load grows, the Environmentalists posited that EDCs will come under increasing pressure to upgrade transmission and distribution lines. The Environmentalists recommend 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 distribution system needs or problems. (Env. St. 1, pp. 16-18). The Environmentalists suggest targeting demand-side management approaches or citing generation in local areas to reduce or avoid the need for distribution system upgrades.

(b) ALJ's Recommendation

The ALJ noted that the Commission already requires jurisdictional electric utilities to file annual integrated resource plans. Presumably, this practice will continue for that portion of the electric utility industry still regulated by this Commission after implementation of direct access to the electric generation market, i.e., T&D. For

purposes of this proceeding, the ALJ recommended that this Commission need undertake no further action on the Environmentalists' proposal. (R.D., p. 93).

(c) Parties' Exceptions

The Environmentalists renew their arguments in their Exceptions. In its reply to the Environmentalists exceptions, DII argues that the ALJ's recommendation should be adopted because these issues are better addressed through specific legislation or a generic proceeding before the Commission. DII submits that uniform environmental requirements may hinder the development of a robust competitive environment. (DII R.Exc., p. 20).

(d) Resolution

The Environmentalists proposed that Duquesne be directed to collect data now to facilitate "Target Area Planning," incorporating integrated resource planning principles for planning transmission and distribution system upgrades. The Environmentalists argue that regulated distribution service should be provided at the lowest cost to provide reasonable service. If the least-cost strategy to provide reasonable distribution service is to reduce load through conservation or through strategic location of distributed power, then such approaches are preferable to new construction.

The Environmentalists have made several good suggestions, however, it is not appropriate to adopt any specific requirements in this proceeding, The Environmentalists state in Exceptions that all they sought 'in raising this issue is a clear statement by the Commission putting the EDC on notice that a least cost-planning approach is expected." To that extent, the Environmentalists Exception is granted: distribution

service is to be planned with such principles in mind. The Environmentalists and other parties are encouraged to pursue such issues in other Commission proceedings such as those concerning resource planning, reliability, and maintaining the transmission and distribution system.

H. Summary and Conclusion

The ALJ recommended that Duquesne's proposal to use its 1996 cost of service study as the basis for allocating all of its costs between generation, transmission, and distribution subject to the adjustments denoted in the Recommended Decision. The ALJ recommended rejection of Duquesne's proposal to use a "required' rate of return to develop T&D rates, and recommended that we direct Duquesne to use the "realized" rate of return for each class, as established in its last base rate proceeding to develop T&D rates.

The ALJ recommended that we accept Duquesne's proposal to allow customers to procure distribution losses from alternate suppliers, and that embedded costs allocated to distribution losses be included in the CTC, to the extent that they will potentially become stranded. The ALJ found that the costs of ancillary services should be attributed to the generation function if the particular service can be procured, and any stranded costs associated therewith should be recovered in the CTC. With regard to voltage-differentiated rates, the ALJ recommended that we reject Enron's proposed Distribution Services tariff which it claimed would apply to suppliers who will be acting as an agent for individual or aggregated end user customers.

The ALJ recommended that we reject the proposal of HSS/ARI to disallow 10% of Duquesne's projected distribution related capital additions, based upon the

argument of HSS/ARI that Duquesne has a history of over-budgeting future capital improvements. Reasoning that the Commission already requires jurisdictional electric companies to file annual integrated resource plans, the ALJ concluded that for purposes of this proceeding, there was no need act upon the Environmentalists' proposal to use Targeted Area Planning for T&D system improvements.

For the reasons specified herein, we shall adopt the ALJ's recommendation to adopt Duquesne's proposal to use its 1996 cost of service study as the basis for allocating all of its costs between generation, transmission, and distribution subject to the adjustments denoted in the Recommended Decision.

We shall also reject the Enron-proposed sales expense adjustment. We will adopt the ALJ's proposal to use "realized" rather than "required" rates of return for setting of distribution rates.

Noting, as did the ALJ, that Duquesne has already agreed to remove its distribution losses from its distribution rates, we will adopt the ALJ's recommendation to procure distribution losses from alternate suppliers. Additionally, we find that to the extent that a portion of embedded costs allocated to distribution losses will become potentially stranded may become recoverable through the CTC, if appropriate, based on the determination of stranded utility generation.

We will adopt the ALJ's recommendation to attribute the costs of ancillary services to the generation function if the particular service can be competitively procured, and that any stranded costs therewith should be recovered in the CTC. We also direct Duquesne to include a specific Supplier Tariff, which reflects all applicable FERC and ECAR rules, as part of its compliance filing.

We agree with the ALJ's recommendation to reject Enron's proposed voltage-differentiated rates proposal, because Enron failed to demonstrate that the proposed voltage-differentiated rates would not violate the Act's prohibition against cost shifting.

We will adopt the ALJ's recommendation to reject HSS/ARI's proposal to disallow 10% of Duquesne's projected distribution-related capital additions. We find that the proposal overlooks the fact that T&D rates will remain regulated, and any party can challenge those rates in a future proceeding before us.

We adopt the ALJ's recommendation to take no further action on the Environmentalists' proposal regarding Target Area Planning since there is already a requirement for jurisdictional electric utilities to file annual integrated resource plans.

IV. TRANSITION OR STRANDED COSTS

A. Overview of Stranded Cost Valuation Approaches

1. Statutory Directives Concerning the Identification and Recoverability of Stranded Costs

Pursuant to Sections 2808(a) and 2804(13) of the Act, 66 Pa. C.S. §§2808(a) & 2804(13), electric companies are provided the opportunity to recover transition or stranded costs, as defined in the Act, through a CTC assessed upon every customer accessing the electric company's T&D network. The Act defines "transition or stranded costs" as:

> 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 [C]ommission determines will remain following mitigation by the electric utility.

In accordance with the Act, the term "transition or stranded costs" includes: (i) regulatory assets and other deferred charges typically recoverable under current regulatory practice, the unfunded portion of the utility's projected nuclear generating plant decommissioning costs and cost obligations under contracts with non-utility generating ("NUG") projects which have received a Commission Order, the recoverability of which is to be determined pursuant to 66 Pa. C.S. §2808(c)(1); (ii) prudently incurred costs related to cancellation, buyout, buydown or renegotiation of NUG projects, subject to statutory conditions, the recoverability of which is to be determined pursuant to 66 Pa. C.S. §2808(c)(2); and (iii) net plant investments and costs attributable to the utility's existing generation plants and facilities, and certain other

enumerated costs, the recoverability of which is to be determined pursuant to 66 Pa. C.S. §2808(c)(3).

2. Positions of the Parties

Duquesne proposed, in the event no merger with APS is consummated, to offer an immediate divestiture of its generating assets to determine the value of its stranded assets. (R.D., p. 159).

Duquesne noted that the pivotal issue in this proceeding is whether this Commission should accept its offer to auction its generating assets today. Duquesne stated, that if its offer is accepted, it should resolve most disputes regarding the quantification of stranded costs and the methodology for recovering them. If that offer is not accepted, Duquesne argued that the Commission must choose between sharply different market valuation and stranded cost recovery proposals.

In its direct case, Duquesne claimed regulatory assets and decommissioning expenses under Section 2808(c)(1) of the Act. Duquesne noted that it has no NUG project exposure. As a result, stranded costs under Section 2808(c)(2) are not an issue. With respect to its generation plant-related stranded costs under Section 2808(c)(3), Duquesne proposed, in its direct case, a market-based valuation approach which will defer until 2003 a final valuation of its generation plant-related stranded costs as of December 31, 2005. The Company contended that, by that time, a competitive generation market will likely have developed so as to permit a stranded cost determination based upon actual market data. According to Duquesne, only a market-based determination of stranded costs can reasonably satisfy the "known and measurable" criteria set forth in the Act. (R.D., p. 95).

Duquesne proposed this final market valuation in 2003 to be calculated by a three-member arbitration panel using objective market data such as forward contracts, future contracts, and/or comparable generating unit asset sales. Until the final valuation occurs, Duquesne proposed to set annual CTCs on the basis of an annual Request For Proposal (RFP) to sell a substantial block of power for a one-year term. Duquesne asserted that customer-specific CTCs will be set using the market prices established by the RFP, information about each customer's consumption and information on class load shapes.

Duquesne asserted that the CTC, based on these annual RFPs, will collect a pool of money that will be compared to the book value of generation-related assets (net of amortization) as of December 31, 2005, in the final valuation process. In the final valuation, the panel will recommend a CTC that will recover any remaining level of stranded costs. If no stranded costs associated with generating plants exist at that time, there will be no CTC. If stranded costs are projected to extend beyond 2005, given Duquesne's rate cap under Section 2804(4) of the Act , Duquesne will propose to extend the rate cap beyond 2005. (R.D., p. 96).

Since it posited that a final stranded cost valuation should be deferred until 2003, the Company did not propose a one-time administrative valuation of generation plant-related stranded costs in its direct case. However, in rebuttal, in response to the OCA's and DII's contentions that its market valuation proposal is deficient because it does not include a one-time quantification of stranded costs as of January 1, 1999, Duquesne presented evidence intended to support a total stranded cost determination of $1,916 million, including regulatory assets of $374.45 million.. The stranded generation plant component of the $1,916 million is $1,542 million, including a first-time claim of

approximately $208 million, relating purportedly to unavoidable sunk costs incurred regardless of whether plants are operating (PV of Costs Independent of Operation), and approximately $41 million claimed as M&S and Fuel-Related Sunk Costs. (R.D., p. 99).

Duquesne rejoined that it is willing to advance the date for the optional asset auction. Instead of the 2003 date for the auction referenced in rebuttal, the Company will, in its stand-alone restructuring case, agree to an immediate auction, if this Commission determines that it cannot accept Duquesne's auction offer due to the delay. Duquesne, however, reserved the right to submit a proposal for addressing its continuing obligation to serve under the rate cap if and when the Commission orders an immediate auction. Duquesne posited that the fundamental premise of its approach to stranded cost recovery is that the market, not career forecasters, should set the value of its generating assets. The Company claimed that no party presented a compelling argument to rebut this premise, and indeed, most parties agreed with it. (R.D., p. 100).

Duquesne suggested that the principal dispute is not over the premise that administrative "forecasts" are inherently unreliable. Duquesne asserted that, the disputes center on the market valuation method and the timing of that valuation. In contrast, the essential criticism of Duquesne's initial plan was that an auction of generation is the best and whatever valuation method is used, it must be employed today, not in 2001-2003 (as proposed by Duquesne). Duquesne urged the Commission to "resolve" the matter by finding that an auction provides the best valuation method. Duquesne submitted that any necessary findings regarding competing valuation methods presented in the merger case should be made in that case, not here. (R.D., p. 105).

If its auction offer is accepted, Duquesne claimed that three main implementation issues must be addressed:

1. The process and rules by which the auction is conducted. Duquesne commits to file proposed procedures and rules within 90 days of the date of entry of a Commission Order accepting its auction proposal.

2. The establishment of an "interim" CTC to take effect January 1, 1999 applying the same rates (and credits) approved in the pilot program for customers electing direct access during this interim period.

3. The method for calculating a "permanent" CTC using market values produced by the auction[13].

The OTS did not oppose Duquesne's divestiture option, which Duquesne agreed in rebuttal and rejoinder testimony to submit to this Commission. Likewise, the OTS did not oppose the Company's claim for regulatory assets, with the exception of deferred caretaker costs and decommissioning, infra. The OTS supported, with two modifications, the Company's direct case proposal to defer a final valuation of generation plant-related stranded costs until 2003, and to base the valuation on objective market data in 2003 rather than today's projections. The OTS opined that the market value approach is superior to a "regulator-administered approach," which would be involved in the one-time administrative quantification of stranded costs as of January 1, 1999, sought by DII and the OCA.

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[13] If an immediate divestiture occurs, Duquesne proposed to "waive" application of Section 2804(4)v and adopt the general approach used in PECO Energy, provided the following two conditions are met. First, Duquesne be permitted to fully recover (e.g. with no "sharing" and a compensatory return on equity) its stranded costs, as established by the market values produced by the auction. Second, Duquesne's continuing obligation to serve at capped rates be addressed. Duquesne commits to submit a proposal to address its continuing obligation to serve at the same time it files a final CTC calculation, using market values produced by the auction. (R.D., p. 104).

The OTS proposed two modifications to Duquesne's deferred valuation proposal. First, the OTS proposed that the rate cap under Section 2804(4) and the CTC collection period be extended if the final valuation in 2003 results in a stranded cost level which will produce CTC "rate shock." The OTS' second modification concerned the Company's ROE spill-over proposal. Duquesne posited that 11.5% is a reasonable rate of return on equity and linked its "ROE spill-over" trigger to 11.5% in earnings. its earnings exceeded 12%. The OTS asserted that a reasonable rate of return on equity for Duquesne is 10.50%. Consequently, the OTS recommended that 10.50% be used for the "ROE spill-over" trigger.

The OCA opposed Duquesne's final valuation and rate cap/ROE spill-over proposals and submitted that this Commission should reject them in favor of a one-time determination of stranded costs in this proceeding. The OCA asserted that 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 should be approved by the Commission. The OCA argued that Duquesne's proposals should be rejected because they are inconsistent with the Act, provide no near-term rate relief to consumers, are administratively burdensome, will interfere with the competitive market, will interfere with the Company's incentive to mitigate stranded costs, and will require customers to bear the entire stranded cost burden of the significant amount of uneconomic excess capacity currently held by the Company. The OCA emphasized that the 11.5% ROE is far too high and that it will be practically impossible to determine earnings as part of its ROE spill-over proposal when the Company has "one foot in the competitive market."

The OCA claimed that the Company's argument that the Act requires this 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 the Commission's PECO Energy decision contravenes the law. The OCA 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. The OCA noted that, in PECO Energy, this Commission found PECO's stranded cost determination was known and measurable. (R.D., p.112).

The OCA also averred that Duquesne misinterpreted Section 2804(4)(v) of the Act, by allowing the Company to maintain its rates at the level in effect at the effective date of the Act. The OCA submitted that the Legislative Intent of this Section, which is included in the rate cap provisions of the Act, was to preempt complaints against current rates after a company's restructuring had been completed, not to prevent rates from being lowered in a company's restructuring case.

The OCA further argued that it is inappropriate to assume the uncertainty in estimating stranded costs will be dispelled over the next several years or that an "unbiased" arbitration panel will be able to reach a better valuation of stranded costs. The OCA suggested that 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. The OCA further argued that Duquesne's proposal eliminates the possibility of any rate savings for customers during the CTC recovery period. The OCA contended that this 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. The OCA interjected that a final valuation in 2003 will weaken Duquesne's incentives to mitigate stranded costs and maximize asset value of stranded costs.

The OCA contended that Duquesne's entire approach to valuation and recovery of stranded costs is fraught with problems. First, Duquesne's proposal would require annual reexamination of the Company's returns on capital. Second, Duquesne's proposal contemplates review of its earnings on a total company basis, including a review of its generation earnings, which will be subject to the competitive market. Third, the Company can effectively evade an over-earnings finding by using such "excess earnings" to fund marketing efforts or offer rate discounts associated with unregulated market transactions.

The OCA proposed a current valuation of stranded costs and recovery of these costs over the seven-year CTC recovery period, except the Company should not be permitted to recover a return on the unamortized balance of its owned-generation assets. With that adjustment, the OCA claimed its proposal will reduce rates to a just and reasonable level. (R.D., p. 121).

The City maintained that the Company manipulates its stranded cost claim in an attempt to thwart the goals of the Act. Rather than promoting competition and making its service area more attractive for business development, the City asserted that Duquesne's stranded cost claim virtually assures that there will not be any competition with Duquesne in the generation market place for many years to come and Duquesne's ratepayers will continue to pay some of the highest rates in the United States for at least the next eight years. The City asserted that Duquesne's proposal does not promote competition or make its service area more attractive for business development.

The City asserted that Duquesne's stranded cost valuation approach is rife with errors that seriously inflate Duquesne's claim and provide an incentive to maximize,

rather than minimize, stranded costs. The City contended that Duquesne's stranded cost calculation methodology impairs formation of a competitive market and minimizes traditional risk faced by utility investors. The City argued that Duquesne's stranded cost claim must be denied in its entirety, unless Duquesne commits to divest itself of its generating assets. The city reasoned that divestiture will not only result in an immediate transition to a competitive market, but is a more credible method of valuing assets than merely ascertaining stranded costs. The City continued that divestiture will also have the benefit of creating generation competition in Pittsburgh. The City further noted that the market is fully capable of valuing assets now as is evidenced by the numerous asset sales that have occurred and are expected in the near future. (R.D., p.123)

DII argued that the Duquesne proposals delay asset valuation past the start of the direct access phase-in must be rejected. DII reasoned that acceptance of either of the Company's delayed approaches would prevent this Commission from quantifying Duquesne's net transition and stranded costs in this proceeding, which is inconsistent with the provisions of the Act, precedent established in PECO Energy, and the public interest. DII agreed that divestiture of all of Duquesne's generating assets (as Duquesne has offered) would satisfy the need for a definitive level of stranded costs as of the beginning of the transition period. DII cautioned that many additional issues must be addressed affecting the immediate divestiture that may undercut the viability of this option.

DII proposed to establish the market value of Duquesne's generating assets based on a market price forecast and an asset value methodology of computing stranded costs. The DII methodology offered prediction of revenues that a generating unit will be able to earn in the competitive environment. DII suggested that this methodology is a reasonable compromise of the competing interests and the only method that the Act contemplates. DII noted that this Commission used a determination of stranded

generation costs based on application of a market price forecast to the asset value methodology to find the known and measurable level of PECO's total stranded generation costs in PECO Energy, Slip Op., pp. 80-91. DII averred that this precedent, as well as other portions of the Act, required a similar calculation based on an asset value methodology to establish Duquesne's stranded cost entitlement. (R.D., p.127).

HSS/ARI asserted that Duquesne has not proven, even on a preliminary basis, that it has any stranded costs. HSS/ARI criticized Duquesne's proposals extensively and asserted that Duquesne has failed to carry its evidentiary burden to support its request to accelerate amortization and depreciation. HSS/ARI noted that Duquesne derives its estimated range of claimed post-2005 remaining stranded costs by relying upon computer-generated market price projections, notwithstanding its own criticisms of such projections. (R.D., pp. 128-129). HSS/ARI noted that Duquesne admits it overstates its projected costs and that as a result, as of January 1, 2006, Duquesne may not have any stranded costs at all. As a result of its examination, HSS/ARI concluded that Duquesne failed to meet its burden of proof and should be denied any stranded cost recovery.

HSS/ARI concluded that Duquesne had substantial evidence of the market value of Duquesne's generation assets that the Company did not put in the record in this case. HSS/ARI argued that actual valuations of Duquesne's assets performed by the Company and its consultants mere months before the filing of the application show that Duquesne's assets have positive market value. Those studies, as well as evidence of market value demonstrated by actual market transactions, including, but not limited to, Duquesne's sale of its interest in the Ft. Martin plant, show that Duquesne has no stranded costs at all, according to HSS/ARI.

HSS/ARI concluded that studies performed by and for Duquesne present a far different picture concerning the value of Duquesne's generation facilities than the dismal picture Duquesne presents to the Commission in support of Duquesne's exorbitant and unjustified stranded cost claim. The market value estimate derived by Duquesne, its consultants and financial investors also is substantially higher than the market valuations derived from OCA's and DII's computer-generated price forecasts as well, according to HSS/ARI.

Finally, HSS/ARI argued that Duquesne has failed to undertake actions that could have or would have mitigated any stranded costs Duquesne claims to have. (R.D., p.132). HSS/ARI contended that Duquesne's generation assets have positive market value. HSS/ARI requested that this Commission: (i) deny Duquesne's request to accelerate depreciation and amortization; (ii) deny Duquesne recovery of any amount claimed to be a stranded cost; (iii) deny Duquesne the right to charge its customers a CTC; and (iv) deny Duquesne's request to have its potential stranded costs reexamined through a final valuation conducted at some future date. (R.D., p. 133).

The IBEW did not specifically address the valuation method used by Duquesne, except to contend that it is unlawful to the extent that it gives this Commission the authority to order Duquesne to close or sell a power plant. Likewise, the IBEW did not specifically address the valuation method used by various other parties, except to note they also are unlawful to the extent they give the Commission the authority to order Duquesne to close or sell a power plant. The IBEW suggested that the lack of information concerning the proposed sale of Duquesne's power plants is striking. The IBEW challenged that neither Duquesne nor any other party attempted to evaluate the effect of plant sales or closures on Duquesne's employees. (R.D., p.134).

The PRA urged the Commission to reject any deferral of a determination of the Company's stranded costs. It found several problems with deferral from both a practical standpoint, as well as a legal one. The PRA argued that deferral of the determination of the level of stranded costs recoverable from ratepayers is contrary to the dictates of the Act. The PRA proffered that the Act requires a rapid deployment of a competitive retail generation market in Pennsylvania. The PRA suggested that an important component of the development of that market is the recovery of stranded investment by electric utilities to ensure that utilities have a fair opportunity to permit their investors to recover their investment in a Pennsylvania plant and that ratepayers have complete understanding of the cost of paying for stranded investment in their electric utility. (R.D., pp. 140-141).

In addition, the PRA claimed that Duquesne's proposal to defer calculation of a definitive stranded cost level is primarily one which shifts risk associated with stranded costs from stockholders to customers. The PRA urged that the Legislature never intended customers to face exposure to uncertainty regarding the CTC. The PRA asserted that the Legislature required the CTC to be established during the restructuring period and not at a future date. According to the PRA's argument, 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. The PRA contended that 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 PRA concluded that this Commission must reject Duquesne's proposal (R.D., p. 146).

The Environmentalists took no position on Duquesne's valuation proposal for stranded costs nor the positions of any other intervenor, which will entail divestiture of assets. Instead, the Environmentalists noted a higher stranded cost award means a

higher CTC in the unbundled rates. The Environmentalists suggested that, because of the rate cap, a higher CTC means a lower generation or shopping credit, which means less of the bill is subject to competition and customers will have less opportunity to obtain savings from alternate suppliers. The Environmentalists argued that this result means alternate suppliers will have a tougher time entering and staying in the market, robust competition will fail to develop, and the promise of the Act will remain unfulfilled.

These issues are important according 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, the Environmentalists argued that 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 in the view of the Environmentalists. They also suggested that this result in turn may impose restrictions on economic development, constraining the citing of manufacturing operations or competitive power producers. The Environmentalists contended that treatment of 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. (R.D., p.147).

MAPSA maintained that the CTC, by its very definition, is a device that allows utilities to recover costs which are not recoverable in the ordinary competitive market. MAPSA suggested that the CTC, by its very nature of imposing above-market costs on ratepayers, is an anti-competitive device which serves to allow utilities to recover some of their prior investments which now have turned out to be "above-market." (R.D., p.149).

MAPSA further argued that the collection of utility stranded costs through the CTC can and will be used by electric utilities as a "cleverly designed" device to allow the utilities to charge under-market, and possibly even under-cost, prices for generation, and still recover the previously allowed stranded costs and profit. It is possible for a utility in the new competitive world to charge an under-market (or even under-cost) generation rate and still recover its full pre-1997 revenue requirement by using the CTC to recover the difference. All that is required to accomplish this result is to convince this Commission, in these restructuring proceedings, that the market price will be lower than it actually turns out to be. MAPSA suggested that the utilities clearly have a tremendous incentive to use the lowest possible number for "market price," where market price is used to calculate stranded costs. (R.D., p.150).

MAPSA asserted that, without competition, there are no "stranded costs" by definition, under the provisions of Section 2803 of the Act. MAPSA argued that Duquesne's proposal for calculation of stranded costs fails to meet the known and measurable standard and is based upon faulty market price assumptions. MAPSA urged the conclusion that Duquesne's proposal is seriously flawed and contrary to the statute and that it should be rejected.

Enron adopted the position of MAPSA with respect to these issues. (R.D. pp. 149-158). Further, Enron strongly endorsed Duquesne's proposal that its level of stranded costs be determined by divestiture of its generating assets and that such divestiture take place "today." Enron found Duquesne's "immediate auction" alternative consistent with the Act because it allows the market to provide evidence of the value of Duquesne's generating assets in a competitive retail marketplace. Enron's main concern, however, was that the proposal for an immediate divestiture was not superseded by other proposals that may be advanced in an extraneous proceeding involving the

APS/Duquesne merger. Enron posited that Duquesne's offer to be subjected to an immediate auction should be accepted unconditionally and that this offer should be final and not subject to any modification as a result of the merger proceeding. Enron suggested that a careful reading of the Act mandates an unconditional acceptance under the required procedures set forth in the Act,[14] which appears to require a "once and done" determination.

3. ALJ's Recommendation

The ALJ recommended that this Commission accept Duquesne's proposal to offer an immediate divestiture of its generating assets to determine the value of its stranded utility generation cost. The ALJ recommended that, within 90 days of entry of a final Order in this case, Duquesne should file with this Commission a plan of divestiture, together with a proposal for addressing its continuing obligation to serve under the rate cap. All interested parties should have an opportunity to respond to either or both proposals. The ALJ calculated that this divestiture should occur within 18 months of entry of a final Order disposing of the application in the event the proposed merger is not consummated for any reason whatsoever. Concerning the issue of an interim CTC and shopping credit to take effect January 1, 1999, the ALJ proposed that Duquesne should apply the same rates and credits approved in the pilot program for customers electing direct access during this interim period.

Finally, relating to the issue of what method to use for calculating a "permanent" CTC, using market values produced by the divestiture, the ALJ urged this Commission to direct the Company to adopt the general approach used in PECO Energy.

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[14] See, 66 Pa. C.S. §2806(f) ("The [C]ommission shall . . . issue an order accepting, modifying or rejecting [a restructuring] plan."). (Enron R.B., p. 13, fn. 32).

The ALJ would permit Duquesne to fully recover (e.g., with no "sharing" and a compensatory return on equity) its stranded costs as established by the market values produced by the auction. The ALJ would require Duquesne to submit a proposal to address its continuing obligation to serve at the same time that it files a final CTC calculation, using market values produced by the auction. (R.D., p. 160).

4. Parties' Exceptions

Duquesne excepts that a longer time frame may be necessary.

The IBEW excepts to the ALJ's recommendation that the Commission order Duquesne to sell its power plants if Duquesne does not merge with Allegheny Power. (IBEW Exc., p.2). The IBEW states that, in response to proposals made by several other parties, Duquesne has proposed to sell its power plants if the Commission permits it to do so. The IBEW notes that Duquesne made it clear, however, that selling its plants was not its preferred method of valuing its stranded costs and that it does not believe that such a sale is the best course of action. However, Duquesne has offered to "waive our right" and sell its plants if the Commission so orders. (IBEW Exc., p.2).

The IBEW suggests that the ALJ apparently accepted Duquesne's offer, without considering any of the legal or factual reasons why the Commission cannot and should not order Duquesne to sell its power plants. The IBEW contends that this Commission lacks the legal authority to order, or otherwise compel, Duquesne to sell any of its power plants. Section 2804 of the Public Utility Code, Section 2804(5), specifically prohibits the Commission from ordering a utility to sell any of its facilities, stating: "The commission may permit, but shall not require, an electric utility to divest itself of facilities or to reorganize its corporate structure."

The IBEW supports its arguments by noting that one of the fundamental principles of utility regulation in this Commonwealth is that this Commission does not sit as the "super board of directors" over a utility and neither owns nor controls a utility's property. (Northern Pennsylvania Power Co. v. Pa. PUC, 333 Pa. 265, 267-68, 5 A.2d 133, 134-35 (1939)).

The IBEW further contends that unless Duquesne makes a voluntary commitment, free of any coercion by the Commission, to sell its power plants, then the Commission cannot order or expect those plants to be sold. The IBEW points out that Duquesne's President made it clear that the Company did not make a voluntary commitment to sell its power plants. Rather, it was willing to waive its protection under the law from having the Commission order it to sell its power plants. However, the Company cannot waive the protection that the law gives to others, including the utility's employees and the communities where those plants are located. (See Section 2802(18)). The IBEW further suggests that, more importantly, the Company cannot give this Commission authority that this Commission does not have under the law.

The IBEW argues that it is not in the public interest for Duquesne to sell or close any of its power plants. Even if it were a good idea to have Duquesne sell or close its power plants and that any stranded cost proposals based on this Commission ordering the sale or closure of a power plant must be rejected. (IBEW Exc., pp. 2-7)

5. Resolution

(a) Divestiture

The record in this case includes substantially different overall approaches to determining recoverable stranded costs and significant differences in many details. The extremely varied proposals in this proceeding make it appropriate at the outset to clarify the concept of recoverable stranded costs under the Act. The definition of stranded costs in Section 2803 provides the framework that we must adopt. Even if the Commission agreed with the alternative proposals of several of the parties, many of those proposals are inconsistent wit the Act and may not be adopted.

In particular, the definition of stranded costs requires that the costs are: 1) in fact stranded, meaning not recoverable in a competitive market; 2) stranded as a result of the transition to competitive markets; 3) generation related, not transmission or distribution costs; 4) known and measurable; 5) determined over the life of the asset; 6) only a "net" amount; 7) unmitigated; and 8) determined on a net present value as of January 1, 1999.

As discussed below, we accept Duquesne's proposal to divest its generation assets as a proper method to value Duquesne's utility generation in compliance with the Act. We reject Duquesne's other approaches, both as applied to stranded utility generation and to other stranded assets, because Duquesne's proposals ignore the assumptions, definitions, and directives of the Act that stranded costs are to be determined in this proceeding at a net present value as of December 31, 1998. Section 2808(a) authorizes the collection of stranded costs through a CTC only following the

determination of just and reasonable recoverable stranded costs by the Commission pursuant to 2808(c).

We cannot accept Duquesne's basic proposal that it should continue to collect the total level of existing rates until stranded cost recovery is complete. Such a proposal would preclude the development of a competitive market or any consumer savings for many years and is not consistent with the Act. As discussed below, we do not accept Duquesne's suggestion that a determination of the value of stranded generation assets in a few years or through projections at that time will render a more accurate determination of stranded costs. Other than its immediate divestitire proposal, we cannot agree that Duquesne's proposals are preferable because they rely on actual market evidence. We are not convinced that Duquesne's proposals other than divestiture reflect all actual market evidence.

As described in the following sections of this Order, we determine the net present value of Duquesne's stranded costs, recoverable under the definition of stranded costs in the Act, as of January 1, 1999.

We agree with the ALJ that it is an economic tenet that the marketplace determines the true value of an asset. Specifically, an actual "arms length" market transaction between a willing seller and a willing buyer to determine the value of an asset is superior to the expert predictions of what the future value of that asset may be.

We find that a present divestiture of utility generation can reasonably satisfy the "known and measurable" criteria set forth in the Act. Therefore, as recommended by the ALJ, we accept the rejoinder offer of Duquesne to divest itself of generation if the proposed DQE-APS merger is not consummated. We also accept

Duquesne's proposal to offer that divestiture of its generating assets in order to determine the value of its stranded utility generation. In the event the proposed merger with APS is not consummated for any reason whatsoever, divestiture should occur, preferably within 18 months of entry of our final Order disposing of the application. As noted in Duquesne's exceptions, we recognize that a longer time frame may be necessary. A more specific time frame will be determined in the divestiture proceeding involving Duquesne.

Within 90 days of entry of this Order in this case, and in conformity with the guidelines established below, Duquesne should file a plan of divestiture of its generating assets, together with a proposal for addressing its continuing obligation to serve under the rate cap. All interested parties should have an opportunity to respond to the divestiture and/or obligation to serve proposals.

Duquesne is directed to provide the following items in its divestiture plan:

1. Company shall file the proposed plan for divestiture within 90 days.

2. The plan shall be served on all parties to this proceeding.

3. Parties shall file comments to the filed plan within 60 days.

4. Duquesne shall file a response to comments and accepted revisions within 30 days, thereafter.

5. The plan shall detail a schedule for pre-bid conferencing and the exchange of relevant information.

6. The plan shall disclose those assets and/or operational criteria of an asset essential for the continued reliability of service in the Duquesne territory.

7. The plan shall include a discussion of the treatment of shares of nuclear and fossil units for whom Duquesne is a minority owner. Specifically, the plan shall delineate Duquesne's proposed treatment of nuclear ownership shares should no bids materialize for those

shares, as well as Duquesne's ability to sell its stake in Beaver Valley 2 and Perry 1 to the other owners of those units or to swap Duquesne's stake in these units with the owners for the output of other fossil units.

8. Divestiture shall include both fossil and nuclear assets.

9. Proposals may be accepted for an individual asset or portion thereof.

10. The plan shall detail the approvals necessary for the acquisition of an individual asset or portion thereof.

11. The plan shall disclose environmental obligations of a particular asset and enforcement agreements entered into by Duquesne associated with an asset. The plan should detail the handling of current trust funds and reserves associated with environmental liabilities.

12. The plan shall describe the transmission access available to a particular asset and any general transmission agreements associated with a particular asset.

13. The plan shall include tracking and accounting for the transaction costs associated with the divestiture activities, both internal and external.

14. The plan shall describe the ratemaking accounting for use of proceeds of the plan as it relates to offsetting the generation and regulatory stranded costs and the computations of the CTC and shopping credit.

15. The plan shall include opportunity provisions for the continued sale of output to permit Duquesne to satisfy its obligation as provider of last resort.

16. The plan shall set forth transitional issues and the resolution of those issues in a manner that is fair to customers, investors, the employees of the Company, local communities, and other affected parties.

We would also note that as divestiture may not be accomplished by January 1, 1999, for the interim period the shopping credit in use shall continue to be the Pilot Customer Participation Credit ("CPC") and energy credits. Upon determination of the

value of Duquesne's utility generation assets, following implementation of the divestiture plan, a CTC shall be adopted that reconciles the actual stranded utility generation value with the interim amount collected, as described below.

With regard to the exceptions of the IBEW, we note that its reliance upon Section 2804(5) of the Public Utility Code (66 Pa. C.S. § 2804(5)) is misplaced. This section states that:

> The Commission may permit, but shall not require, an electric utility to divest itself of facilities or to reorganize its corporate structure.

It is clear that this section of the Act expressly gives us the authority to approve a divestiture of facilities or other reorganization by an EDC. In the present case, we are accepting an offer made by the Company. Moreover, we have not ordered Duquesne to sell its generating units. The IBEW's claim that we are some how sitting as a "super board of directors" over Duquesne's operations is also in error. We are accepting a proposal made by Duquesne and are in no way dictating that it divest itself of the generating units in question.

The IBEW statement that Duquesne is not voluntarily offering to sell its generating plants, but actually waiving its right to be protected from an order directing it to sell the generation facilities is not supported by the preponderance of the record which shows that the Company constructed a detailed plan and presented it of its own volition.

The IBEW claims that allowing Duquesne to sell these assets violates the rights of its employees and the communities given them in Section 2802(18) of the Act (66 Pa. C.S. § 2802(18)) is also baseless. The divestiture plan must consider environmental, employee, and community impact, as described above. IBEW and all

other parties may raise issues in response, and the approved divestiture plan will consider all issues as appropriate.

(b) Non Divestiture

In the event that Duquesne does not file a Divestiture Plan within 90 days from the date of entry of the final Order in this case, in conformity with the foregoing guidelines, the value of Duquesne's stranded utility generation shall be determined based on the record of this proceeding as described below. The first task in making such a determination is to ascertain the net book value of Duquesne's utility generation as of January 1, 1999. Second, we must ascertain the market value of those assets as of January 1, 1999. The difference between the net book value and the market value of the assets as of January 1, 1999 is the stranded utility generation amount. We note that the determination is the exact same in the event of divestiture, except that the proceeds of the sale shall be used instead of the market valuation adopted herein.

6. Summary and Conclusion

We find that only a market-based determination of stranded costs can reasonably satisfy the "known and measurable" criteria set forth in the Act. Expert predictions based upon market price projections are subject to errors of estimation and are inherently inferior to valuations based upon market data.

Therefore, as recommended by the ALJ, we accept the rejoinder offer of Duquesne to divest itself of generation if the proposed DQE-APS merger is not consummated. We also accept Duquesne's proposal to offer that divestiture of its generating assets in order to determine the value of its stranded assets. In the event the

proposed merger with APS is not consummated for any reason whatsoever, divestiture should occur, preferable within 18 months of entry of our final Order disposing of the application. As noted in Duquesne's exceptions, we recognize that a longer time frame may be necessary. A more specific time frame will be determined in the divestiture proceeding involving Duquesne.

Within 90 days of entry of final Order in this case, and in conformity with the guidelines established below, Duquesne should file a plan of divestiture of its generating assets, together with a proposal for addressing its continuing obligation to serve under the rate case. All interested parties should have an opportunity to respond to the divestiture and/or obligation to serve proposals.

B. Generation Related Stranded Costs (Recovery Pursuant to Section 2803(3))

1. Net Book Value

(a) Total Net Book Value

(i) Positions of the Parties

The Company claimed a net book value for its generating plant of $917.61 million. The Company asserted that this value is net of claims for M&S and fuel related sunk costs of $41.11 million, the present value of the lease expense for Beaver Valley 2 of $475.57 million, and deferred income taxes of $197.33 million. (R.D., p.160).

The OTS found that the total net book value of Duquesne's fossil generating plants should be reduced by $65.58 million to reflect a disallowance of the

stranded cost claim made by Duquesne with respect to Phillips Power Station (Units 1, 2, 3, and 4) and Brunot Island Power Station (Units 3 and 4). Furthermore, the OTS asserted that if a one-time administrative valuation of stranded costs is required as of January 1, 1999, then the Company's claim for $1,236.95 million in net book value should also be reduced by $41.11 million ($33.40 million nuclear and $7.70 million fossil) for the category "M & S and Fuel-Related Sunk Costs." The OTS' resulting net book value is $1,139.22 million ($764.14 million nuclear and $375.08 million fossil. (R.D., p.161).

The OCA estimated the total net book Value of the Company's owned generation assets to be $913.02 million, excluding Beaver Valley 2 lease costs and $1,274.91 including those costs (net of tax). (R.D., p.161).

DII used Duquesne's quantification of net generating plant and CWIP balance of $979.130 million at December 31, 1998. (R.D., p.162).

HSS/ARI claimed that Duquesne failed to satisfy the "known and measurable" standard imposed by the Act as a predicate to recovery of any stranded costs. HSS/ARI did not dispute Duquesne's calculation of a net book investment in generation-related assets is $1.236 billion. However, HSS/ARI did object to the use of that net book value for purposes of establishing the generation component of Duquesne's rates or Duquesne's potential stranded costs. (R.D., pp. 162-163).

The PRA urged adoption of the OCA's calculation of total net book value to be utilized for calculating the Company's stranded investment in owned-generating plant. (R.D., p.164).

(b) Beaver Valley 2 Lease Costs

(i) Positions of the Parties

Duquesne claimed that the present value ("PV") of its Beaver Valley Unit No. 2 lease expense is $278.24 million. The OTS, the OCA and DII all agreed that Duquesne should be permitted to recover the costs of the lease payments for Beaver Valley Unit No. 2.[15] (R.D., p.164).

The OTS included a nuclear stranded cost allowance of $287.19 million for the present value of the Beaver Valley 2 lease expense. (R.D., p. 165).

The OCA argued that the level of recovery under Section 2808(c)(3) of the Act is a discretionary determination and recovery under Section 2808(c)(1) and (c)(2) is not discretionary. Duquesne proposed to treat only $32.48 million associated with Beaver Valley 2 as an "owned-generation" asset and proposed to treat the lease payments as regulatory assets subject to recovery under Section 2808(c)(1). The OCA submitted that the entire amount of the Beaver Valley 2 lease should be classified as owned-generation and subject to Section 2808(c)(3). (R.D., pp. 165-166).

DII agreed that Duquesne should be permitted to recover the Beaver Valley 2 lease costs, but sought to ensure that the Company does not recover the costs in two portions of its stranded cost calculation. The DII maintained that its treatment of these

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[15] Duquesne entered into a sale-leaseback transaction that removed the Beaver Valley 2 asset from its books. Duquesne M.B. at 24, fn. 10; Duquesne St. 2 at 9; Duquesne St. 2-R at 57.

costs ensures no double recovery. (R.D., p.167). The PRA concurred with the approach of the OCA on this issue. (R.D., p.168).

3. Phillips and Brunot Island Costs

(a) Positions of the Parties

Duquesne claimed $65.58 million net book value[16] for Units 1, 2, 3, and 4 at Phillips Power Station and Units 3 and 4 at Brunot Island Power Station. (R.D., p.168).

The OTS opposed inclusion of the Phillips and Brunot Island cold reserved units in the Company's stranded cost claim as being contrary to the Act and stated that costs for generating plants that are not "used and useful" are not traditionally recoverable under a regulated environment. The OTS further argued that Duquesne has not met its burden of proving the costs relating to its cold reserved units that are traditionally recoverable under a regulated environment or those costs are attributable to plants no longer used and useful because of the transition to retail competition. (R.D., pp. 170-171).

The OCA noted that the Company's and the OCA's net book value differ by only $5 million. The OCA further noted that this difference reflects the OCA's adjustment with respect to treatment of Brunot Island Units 2B and 3, which are currently in cold reserve. (R.D., p.171).

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[16] The OTS noted that the $106.8 million claim for the cold reserve units mentioned in OTS' witness Mr. Metro's testimony is the $65.58 million rate base amount plus approximately $40 million in deferred taxes. OTS M.B. at 22, fn. 4; OTS Cross Exh. 3.

HSS/ARI also opposed the Company's claim relating to stranded costs for Phillips and Brunot Island. For purposes of considering Duquesne's stranded cost claim, HSS/ARI argued that its net book investment of $1.236 billion in generation-related assets also should be reduced to eliminate the net book investment associated with the Phillips and Brunot Island cold reserve capacity. (R.D., p.173).

The PRA agreed with the OCA that the cost of the cold storage units of Phillips and Brunot Island should be included in the net book value. (R.D., p.175).

(b) ALJ's Recommendation

If a one-time administrative valuation of stranded costs is required as of January 1, 1999, the ALJ recommended that the Commission adopt the Company's calculation of net book value for its generation-related stranded costs, with the following adjustments. The ALJ concluded that the Commission should allow Duquesne its claim of $41.11 million ($33.40 million nuclear and $7.70 million fossil) for the category "M & S and Fuel-Related Sunk Costs," since this claim appears reasonable and no substantial reason exists to deny it. Furthermore, the ALJ recommended that the Commission should also allow the Company to include $475.57 million representing the lease expense for Beaver Valley 2. However, for the reasons the OCA advanced, the ALJ concluded that we should treat the lease payments as part of the net book value of "owned-generation" rather than as a regulatory asset subject to recovery under Section 2808(c)(1) of the Act.

Additionally, the ALJ recommended that we not include $65.58 million net book value for Units 1, 2, 3, and 4 at Phillips Power Station and Units 3 and 4 at Brunot Island Power Station. (R.D. pp. 175-176).

(c) Parties' Exceptions

HSS/ARI excepts to the ALJ's Recommended Decision by asserting that the ALJ erred in his recommendation that Duquesne be permitted to include in net book value, for purposes of calculating stranded costs, expenditures that Duquesne has not shown to be just and reasonable. HSS/ARI further contends that the ALJ erred by failing to order an immediate rate reduction to reflect a disallowance of such expenditures.

HSS/ARI also excepts to the ALJ's conclusion that HSS/ARI failed to introduce a credible issue with respect to the expenditures included in Duquesne's 1996 Test Year cost of service. The ALJ concluded that HSS/ARI failed to "identify even a single expenditure as unreasonable," thus improperly shifting the burden of proof to HSS/ARI. HSS/ARI contends that the Commission has stated emphatically that "[a]n intervenor challenging a company claim supported only by the utility's bare assertion 'was under no obligation to adduce either evidence or analysis.' Accordingly, HSS/ARI argues that the ALJ misread the law with respect to the burden on HSS/ARI in challenging the Company's expenditures. (HSS/ARI Exc., p14.).

HSS/ARI further assert that the ALJ erred by including in Duquesne's net book value a portion of Duquesne's remaining net book investment in the cold-reserved Phillips and Brunot Island facilities. HSS/ARI states that in the Recommended Decision, the ALJ correctly ruled that the net book value of Units 1, 2, 3, and 4 of the Phillips Power Station and Units 3 and 4 at the Brunot Island Power Station should be disallowed. (R.D. pp. 175-76). However, the ALJ erroneously disallowed only $65.58 million associated with those plants. (HSS/ARI, Exc. p 16).

HSS/ARI and the OTS assert that it is undisputed that Duquesne's net book investment in the cold-reserved units is $106.8 million. The OTS notes that the $65.58 million disallowed by the ALJ, is net book value, net of taxes. (OTS Exc. p. 18 f. 5). Accordingly, HSS/ARI and the OTS contend that the Recommended Decision should be modified to provide for the disallowance of the full $106.8 million in Duquesne's net book investment in the cold-reserved units. (HSS/ARI Exc. p. 16, OTS Exc. p. 19).

Duquesne excepts to the ALJ's finding that the costs of the cold-reserved Brunot Island and Phillips units cannot be recovered because these costs were not stranded by the Act. Duquesne stated at page 12 of its exceptions that the notion that these cold-reserved units are not stranded by the Act, while perhaps superficially appealing, is incorrect as a matter of fact. Duquesne argues that the Company's decision to place a unit in "cold reserve" – rather than to retire it – is based on the very expectation that the unit will have value in a future year. Therefore, Duquesne asserts that the past treatment of these units supports recovery of their costs. (Duquesne Exc. p. 12).

(d) Resolution

In determining the Total Net Book Value under the merger scenario, we find that the principal starting point shall be the OCA valuation as expressed by Duquesne in Appendix B of its Reply Brief in this proceeding. A one-time administrative valuation of stranded costs is required as of January 1, 1999, and we will adopt the Company's calculation of net book value for its generation-related stranded costs, with the following adjustments. We will adopt the OCA's level of working capital of $61.53 million as this claim appears reasonable and supported by the evidence of record. We note that Duquesne identified this claim but did not include it within its claim of stranded costs. Ostensibly, Duquesne's working capital is comprised of items traditionally recoverable through base

rates. The items in this claim include fuel inventory and materials and supplies (M&S) as maintained at each plant site.

We find that it is reasonable and appropriate to allow the Company its stated claim of $475.95 million representing the lease expense for Beaver Valley 2. As the OCA explained, the sale leaseback transition of Beaver Valley 2, is a "financing vehicle" and that the facility is "owned" by Duquesne. (R.D., p. 166). Therefore, we shall treat the lease payments as "owned-generation", rather than as a regulatory asset subject to recovery under Section 2808(c)(1) of the Act.

We find that the OTS' adjustment to exclude the Company's claim of fossil plant stranded costs of $65.58 million net book value for Units 1, 2, 3, 4 at Phillips Power Station and Units 3 and 4 at Brunot Island Power Station to be reasonable and in accord with the evidence. We note that Section 2803 of the Act defines "stranded costs" as costs that are traditionally recoverable under a regulated environment. Costs for generating plants that are not "used and useful" are not traditionally recoverable under a regulated environment.

While the Act provides an exception for costs attributable to physical plants no longer used and useful because of the transition to retail competition, Duquesne acknowledges that these units were placed in cold reserve and removed from rate base more than ten years ago, when no competitive electric generation market for Duquesne's end use customers existed. (Tr. 195-196). It is evident that the Act and the transition to a competitive generation market played no role in the decision to "cold reserve" these units. Accordingly, consistent with the provisions of the Act we find that the Company's claim, for inclusion of the net book value of Phillips and Brunot Island in our stranded cost determination, is not meritorious and, therefore, it is denied.

Premised on our review of the record as developed in this proceeding, we find that it is reasonable and appropriate to allow the Company its stated claim of $475.95 million representing the lease expense for Beaver Valley 2. As the OCA explained, the sale leaseback transaction of Beaver Valley 2, is a "financing vehicle" and that the facility is "owned" by Duquesne. (R.D., p. 166). Therefore, we shall treat the lease payments as "owned-generation", rather than as a regulatory asset subject to recovery under Section 2808(c)(1) of the Act.

e. Summary

In determining the Total Net Book Value under the merger scenario, we find that the principal starting point shall be the OCA valuation as expressed by Duquesne in Appendix B of its Reply Brief in this proceeding. We shall adopt the OCA's level of working capital of $61.53 million as this claim appears reasonable and supported by record evidence.

Based on our review of the record as developed in this proceeding, we find that the OTS' adjustment to disallow Duquesne's claim of fossil plant stranded costs of $65.58 million net book value for Units 1, 2, 3, and 4 at Phillips Power Station and Units 3 and 4 at Brunot Island Power Station to be reasonable and in accord with the evidence.

We conclude that the Duquesne RFP process was seriously flawed and its use would result in an administratively determined market price that bears no relation to whether the price that consumers are likely to pay in a competitive market or the price which suppliers can be expected to provide generation.

We shall treat the lease payments as "owned generation", rather than as a regulatory asset and we find that it is reasonable and appropriate to allow Duquesne its stated claim of $475.95 million representing the lease expense of Beaver Valley 2.

2. Market Value

a. Future Market Value of Duquesne's Generation

Three witnesses in this case submitted market price and market revenue projections for Duquesne's portfolio of generation: Michael Schnitzer (Duquesne), Douglas Smith (OCA) and Randall Falkenberg (DII). In addition, Dr. Robert Weisenmiller (HSS/ARI) provided testimony on various issues affecting the market value of Duquesne's generation assets. We find the testimony of OCA witness Smith to be the most reasonable and credible for utilization in this proceeding and the testimony of HSS/ARI witness Weisenmiller most credible in criticizing the Duquesne proposals and providing other evidence of market value.

i. Duquesne's Proposal

Duquesne argues that it proposes to determine market prices for the purposes of calculating its utility generation stranded costs by using "actual market evidence" wherever possible. To do so, Duquesne presented witness Schnitzer, who divided the task into two segments. First, witness Schnitzer estimates future market prices for the period 1998 through 2005 using as a starting point for his analysis the results of Duquesne's summer 1997 Request for Proposals ("RFP"). Second, Duquesne witness Schnitzer inputs computer assumptions to derive price projections for the period 2006 until the book retirement date of each of Duquesne's generation facilities. Duquesne witness Schnitzer

based his forecast (for those years) primarily on the cost of new capacity, arguing that the cost of new capacity serves as a "cap" on market prices.

Duquesne's witness Schnitzer assumes "the technology of choice for new entrants in 2006 will be a gas-fired combined cycle unit" and develops a range of prices reflecting alternate assumptions concerning capital cost, heat rate and the capital structure and payback requirements of the project. In order to determine market prices for new gas-fired combined cycle entrants, Duquesne witness Schnitzer estimates gas prices delivered into ECAR. OCA M.B. at 30-31; Duquesne St. 3 at 26-27. Using this approach, Duquesne witness Schnitzer estimates market prices in 2006 ranging from $34/MWh to $44/MWh in 2006 dollars, and escalates these prices with an annual estimate of general inflation of 2.5%. Id. at 27. He presents his results as "a real levelized price," reflecting an 84% capacity factor, which reflects the average capacity factor of Duquesne's generation portfolio. Id. Duquesne witness Schnitzer concludes that actual prices are likely to be lower than his results indicate due to improvements in technology, customer willingness to interrupt, less costly supply options than included in his projections, and entry of excess capacity into the competitive market.

Duquesne witness Schnitzer's market 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.

ii. Duquesne's Market Prices through 2005

Duquesne's witness Schnitzer bases his market price projections for the period 1998-2005 on the results of the Duquesne RFP in June of 1997. Pursuant to the RFP, Duquesne offered to sell a minimum of 50 MWs of firm power for a one-year period

and a minimum of 100 MWs (with a maximum of 500 MW) of firm power for an eight-year period commencing on January 1, 1998. Duquesne St. 7 at 6. Duquesne sent out 300 notices to marketers around the country to solicit participation in the RFP. N.T. 156. Duquesne received five bids for the one-year sale and 11 bids on the eight-year sale. Duquesne St. 7 at 9; N.T. 823. As a result of the RFP, contracts were executed with two entities for a total sale of 50 MW for one year, and with one entity for a sale of 100 MW for the eight year period. Duquesne St. 7 at 10. The weighted average price for the one-year sale was $18.16/MWh and the winning bid for the eight-year sale was $20.19/MWh on a "nominal" levelized basis. Id.

Duquesne witness Schnitzer used the winning bids in the RFP as the basis for his projected market prices through 2005. He adjusted the RFP results to reflect a 1998 spot market price of 1.78¢/kwh, and assumed inflation at 2.5% annually through 2005. Duquesne Exh. MMS-4.

iii. Responses of Other Parties

OCA, DII, HSS and MAPSA extensively criticized the RFP conceptual approach and the implementation of the approach as inadequate to provide a credible market valuation for the period ending in 2005. HSS/ARI provided the most detailed criticism, although OCA, DII, and MAPSA raise several of the same concerns.

Conceptually, the parties argued that the RFP provides little, if any useful information for determining the value of Duquesne's generating assets. For example HSS/ARI argues that the Duquesne RFP reflects only a wholesale price for the incremental energy produced by an existing unit. HSS/ARI argues the RFP at best measures only the incremental generating costs of incremental output from existing generation that has already

been committed. These incremental costs do not include any "start-up" or "no load" variable O&M costs, much less any of the "to go" or "going forward" costs, such as fixed O&M costs, capital additions, or fixed fuel costs. HSS/ARI cites Duquesne's testimony that its "to go" or "going forward" costs for its generating units are between $23.3/MWh and $35.9/MWh on a five-year levelized basis. HSS/ARI M.B. at 32; HSS/ARI Exh. RBW-12.

HSS/ARI argues that in a competitive market, a firm only will commit to sales at prices at least covering its "to go" costs, and that most firms typically would not sell unlimited quantities for $18/MWh, as suggested by the results of the RFP, because it will cost them significantly more to produce such power on a "going forward" basis. Rather, plants with higher operating costs will not operate. As supply decreases, the market price will increase to higher levels sufficient to attract expanded operation of existing units or new capacity. Id. at 29.

HSS/ARI argues that the prices resulting from the RFP for minimal quantities of power cannot be reflective of the value of the whole market for Duquesne's energy in 1998 or in the years through 2005. HSS/ARI St. 1 at 27. HSS/ARI argues that the proposition that a solicitation for 50 MWs of electricity (or even 500 MWs) is a meaningful surrogate for all the power needs of Duquesne, let alone the Western Pennsylvania region, is not reasonable.

HSS/ARI concludes that the RFP concept suffers fatal design flaws that disqualify its use to establish the market price of energy through 2005.

Besides conceptual flaws, several parties criticize the specific requirements of the RFP process imposed by Duquesne. HSS/ARI and City assert that Duquesne's RFP has

such restrictive rules that it must have been intended to provide the result Duquesne wanted: a low estimate of the market value of electricity that would serve to maximize Duquesne's stranded cost claim. They argue that the terms and conditions of the RFP reduced the number of potential buyers and reduced the price bid by the limited number of bidders that actually participated in the process.

First, the RFP did not contain any flexibility to accommodate differing power purchaser's needs with respect to the length of the purchase terms. HSS/ARI Exh. RBW-14. The universe of potential bidders was reduced to those needing power for exactly one year or eight years, with no flexibility in bidding. For example, the bid process could not accommodate a bid for five years combined with another entity's bid for the remaining three years of the eight-year term. Accordingly, potential bidders not interested in power for a one- or eight-year term would not have contributed any competitive effect on the price. HSS/ARI M.B. at 33.

Second, the RFP explicitly excluded any firm transmission rights or any ancillary services. HSS/ARI argues that the RFP prices reflect solely the value of Duquesne's firm power at the generating station, and that power with transmission services and ancillary services available is inherently more valuable to a larger number of potential bidders, since the transmission and ancillary services are necessary to use the purchased power. Thus, the net effect of this limitation was to reduce the amount bid for the electricity. HSS/ARI M.B. at 34-35.

Third, the RFP included a "take-or-pay" provision requiring payment of 75% of the winning bid price, regardless of how much power could be delivered to its market. HSS/ARI Exh. RBW-14 at 7-8. For example, if a bidder agreed to pay $19/MWh with a 75% take or pay clause, but only expected to be able to take the power 50% of the time, the

resulting effective price of the power would be $28.5/MWh (before transmission and ancillary service charges). HSS/ARI St. 1 at 36. HSS/ARI argues that the combination of the "take-or-pay" provision with the failure to assure firm transmission rights increases the real price of power to the bidder, therefore lowering the bid and limiting the number of potential bidders.

In addition, HSS/ARI identifies several actions by Duquesne related to the bids themselves. HSS/ARI suggested that Duquesne was not interested in maximizing the number of bidders or obtaining the highest bids. For instance, HSS/ARI points out that Duquesne rejected a facsimile, even though it was hand-delivered to Duquesne on a timely basis, because the RFP rules prohibited the submission of bids by facsimile. HSS/ARI Exh. RBW-15. That bid for the one-year term was $20.00/MWh or $1.84/MWh higher than the weighted average of the two accepted bids. Id.

HSS/ARI assert that the minimum number of bids alone should have suggested to Duquesne witness Schnitzer that there were factors at play that disqualified the RFP results from being a meaningful measure of market value. HSS/ARI M.B. at 30. For the foregoing reasons, HSS/ARI contend that the projections based upon the results of the RFP cannot provide a reasonable measure of future retail market values. HSS/ARI M.B. at 30-31.

iv. Resolution

We conclude that HSS/ARI in particular, as well as OCA, DII and MAPSA, substantially discredit the usefulness of the RFP results for establishing a market price of energy through 2005. We find that the RFP is conceptually flawed and was not implemented in a manner permitting it to provide an evidentiary basis for the valuation of

Duquesne generation assets. In particular, we reject the Duquesne RFP as a basis for projecting market prices for the following reasons:

- it reflects the incremental energy price, not the total cost for energy and capacity;

- it does not reflect any ancillary services, line losses, start-up costs, variable O&M costs, or "to go" costs such as fixed O&M costs, capital additions, or fixed fuel costs;

- it reflects the price only within the Duquesne control area, not a market clearing price that will exist in the region;

- it denied prospective bidders any assurance that they would be able to purchase firm transmission rights on Duquesne's system or from Duquesne's system to their loads;

- it required a proposed contract with a take-or pay provision at a high capacity factor, imposing a higher delivered cost in the absence of firm transmission rights.

- it was only for a one-time sale of a small amount of power that does not reflect a regional market price for competitive power;

- it proposed required terms that were not negotiable as would be the case in a competitive market; and

- Duquesne rejected a timely, hand-delivered facsimile bid at a higher price than the winning bid because the rules prohibited facsimiles.

We conclude that the Duquesne RFP process was seriously flawed and its use would result in an administratively determined market price that bears no relation to either the price that consumers are likely to pay in a competitive market or the price at which suppliers can be expected to provide generation.

b. Duquesne's Post-2005 Market Prices

Duquesne witness Schnitzer used a computer-based projection to determine the market prices and market revenues that determine the value of Duquesne's generation assets considering the period that begins in 2005 through the end of their useful lives. OCA witness Smith and DII witness used a similar method to determine the market prices and market revenues for the entire period beginning in 1999, although their modelling was substantially different.

Duquesne witness Schnitzer's projection for the post-2005 period is primarily based on the assumption that new capacity will be needed, that natural-gas fired combined cycle (cc) units will be constructed to meet the additional capacity requirements, and that the cost of such new capacity will set the ceiling on the market price of electricity. Thus, Duquesne witness Schnitzer's projections concerning the capital and operating costs of the combined cycle units, including the price of natural gas, are central to his forecast. The following discussion focuses on these key issues that strongly support our conclusion that Duquesne witness Schnitzer's forecast for the post-2005 period is not credible.

DII argues that Duquesne witness Schnitzer does not address a number of relevant factors that must be considered in a market price forecast, including the following: The relevant market for the forecast, an accurate assessment of fuel prices, consideration of information about the regional fleet of generation resources, such as generator capacities, heat rates, availability statistics, and maintenance requirements, customer demands (average energy and usage patterns), sufficient future capacity additions, and a realistic assessment of the cost and efficiency of new capacity. DII finds Duquesne's analysis simply lacks the level of detail necessary for it to provide an adequate basis for the Commission determination of Duquesne's stranded utility generation.

c. Price of capacity

Duquesne witness Schnitzer assumes capital costs for CC units in 2005 from a low of $395/kW to a high of $500/kW. In 1996 dollars, Duquesne witness Schnitzer's capital cost estimates would be $316/kW and $400/kW. N.T. 438-439. Duquesne witness Schnitzer indicated that he based his high and low capital cost estimates upon his review of industry data, including "a review of Gas Turbine World . . . indicates that . . . installed costs are now quoted as low as $318 to $380 per kW." Duquesne St. 3R at 22. The Gas Turbine World edition that Duquesne witness Schnitzer refers to was for 1997. N.T. 440.

DII and HSS/ARI assert that Duquesne capital cost assumptions are unreasonably low, thereby understating the market price of power. New units must sell electricity at prices sufficient to recover their average variable cost, which includes a contribution to the fixed cost associated with operating the unit. DII St. 2 at 16. DII assumes a capital cost of new combined cycle capacity of $595/kW and, $300/kW for an oil-fired combustion turbine. Id. at 25. These figures are consistent with assumptions used by other utilities in restructuring proceedings.

HSS/ARI presented evidence asserting that Duquesne witness Schnitzer's capital cost assumptions for the capital costs of combustion turbines are understated. HSS/ARI presented the 1996 edition of Gas Turbine World indicating prices for 28 units ranging in price from a high of $1200/kW to a low of $403/kW. HSS/ARI indicated that many of the less expensive units have prices per kW that range from $500/kW to $800/kW, substantially higher than Duquesne witness Schnitzer's high case estimate of only $400/kW. Id.

In rebuttal, Duquesne witness Schnitzer indicated that his estimates were based on 1997 Gas Turbine World data, and not 1996 data, and that prices dropped significantly from 1996 to 1997. Duquesne St. 3R at 22; N.T. 440. HSS/ARI responded that the 1997 report provides prices for 28 units excluding the smallest units, with prices ranging from a high of $1000/kW to a low of $612/kW in 1997 dollars, compared to Duquesne witness Schnitzer's high case assumption of $410/kW. Only 11 of the 28 units list prices lower than Duquesne witness Schnitzer's high case estimate of $410/kW, and only one unit has a price lower than his low case estimate of $324/kW. In general, the 11 units with prices lower than Duquesne witness Schnitzer's high case estimate carry the highest absolute prices ranging from approximately $100 million to $260 million. Further, the net plant output on those units range from approximately 260 MW to 760 MW, as compared to the lower absolute cost units listed in the report as a whole that, in general, have net plant output ranging from just 7.9 MW to approximately 180 MW. Moreover, according to Duquesne witness Schnitzer, the lowest cost per kW unit listed in the report, the only one that has a lower price per kW than Duquesne witness Schnitzer's low case estimate, is the state of the art design. N.T. 440-441. Its net plant output is rated at 757.5 MW. HSS/ARI M.B. at 39-40.

Thus, HSS/ARI argues that Duquesne witness Schnitzer's capital cost high case estimate requires an assumption of one particular unit and the exclusion from consideration of the 45 other units listed in the report, regardless of the plant output needed to serve incremental load at any given time. HSS/ARI argues that Duquesne witness Schnitzer's low case estimate requires the assumption that only a state of the art unit with capacity of approximately 760 MW and an absolute cost of $240 million will serve the market and the exclusion from consideration of the 55 other units listed in the report, regardless of the plant output needed to serve incremental load at any given time. HSS/ARI asserts that such assumptions are not reasonable because many factors affect the selection of

a particular unit for installation, requiring a market projection that reflects a variety of requirements.

Duquesne witness Schnitzer testifies that his cost estimates are "installed costs" that include items such as "interconnection with the electric grid, an initial stocking of spares and materials and supplies and a fuel supply interconnection . . . (and) a cost of land." N.T. 431-433. As HSS/ARI notes, however: The 1997 Gas Turbine World report states:

> These turnkey price levels, as noted, are for 'plain vanilla' plant equipment and services. Extended site work such as co-generation process steam or utility plant tie-ins are not covered, nor are extensive buildings, nor are a large inventory of operational spares such as combustor baskets, blades and vanes, etc.
>
> Also not included are the indirect, or so-called 'soft costs' that can significantly increase the overall project budget costs.[17] These would include interest during construction, financing and legal fees, licensing and permitting, insurance and bonding, workman's compensation, sales tax, extensive inland freight, owner's cost and overhead, and finally, project contingency funds.

HSS/ARI M.B. at 41; HSS/ARI Cross Exh. 10 at 22 .

As a consequence, HSS/ARI concludes that Duquesne witness Schnitzer's presents an unreasonably low capital cost assumption that is the major input driving his post-2005 price projections, precluding its usefulness in this proceeding.

[17] Schnitzer was not familiar with the term "soft costs." N.T. 431.

i. Inflation Assumptions

Duquesne witness Schnitzer's forecast assumes a future annual inflation rate of 2.5% until 2026, the end of the analysis period.

HSS/ARI argues that an a assumption of 2.5% annual inflation through the end of the useful lives of Duquesne's generation units is unreasonably low. All of the cost components of a new generation facility are exposed to the effects of inflation. In contrast, existing plants' costs include amounts which already were expended, are kept on the books at historical costs, and, thus, are not affected to the same degree by a change in future rates of inflation as are new facilities. Thus, HSS/ARI argues that Duquesne witness Schnitzer's assumption of an unrealistically low 2.5% inflation rate depresses market-clearing price projections, in turn inflating stranded costs.. HSS/ARI M.B. at 45-46.

HSS witness Weisenmiller independently reviewed the U.S. Department of Commerce's inflation data . He compares Duquesne's 2.5% inflation assumption to the gross domestic product price deflator ("GDPPD") and concludes that the average GDPPD has been 4.64% per year over the last 25 years and 4.2% over the last 50 years. Those historical measures of inflation exceed Duquesne's projection by more than 60%. HSS/ARI Exh. RBW-53. Moreover, Dr. Weisenmiller finds that during the last 50 years, the GDPPD never has increased on average at a rate of 2.5% or less annually for a 25-year period. Id. at 130-131. Dr. Weisenmiller also finds that outbreaks of significant inflation occur periodically.

ii. Gas Price Forecasts

Since Duquesne witness Schnitzer assumes the technology of choice in 2006 will be natural gas-fired combined cycle units, his forecast of natural gas prices is a critical factor in his post-2005 price projections of electricity. Duquesne witness Schnitzer's forecasts a basically flat nominal price ranging from $2.20 to $2.60 per MMBtu.

HSS/ARI criticizes the forecast as unreasonably low, without any substantial supporting evidence, and that it produces an unreasonably low forecast of electric prices, resulting in a higher stranded cost determination. Since the Duquesne gas price forecast is stated in nominal terms, it implies that the real price of gas, after accounting for inflation, is projected to decrease in each year at approximately the rate of inflation through 2026. HSS/ARI St. 1 at 126

HSS/ARI asserts that there are two primary flaws in Duquesne witness Schnitzer's analysis that discredit his forecast of natural gas prices. First, Duquesne witness Schnitzer assumes a wellhead gas price forecast that is low by comparison to other existing forecasts. Second, Duquesne witness Schnitzer uses a gas transportation rate that is unrealistically low. HSS/ARI M.B. at 42; HSS/ARI St. 1 at 125.

For the price of the gas itself, Duquesne witness Schnitzer bases his forecast on "quotes for forward prices through 2005 for gas delivered to Henry Hub in Louisiana." Duquesne St. 3, at 26. HSS/ARI Exhibit RBW-49 and HSS/ARI Cross-Examination Exhibit 5 identify the "quotes" as a letter from an over-the-counter securities brokerage firm concerning futures prices at Henry Hub.

HSS/ARI argues that Duquesne witness Schnitzer uses underlying source "data" for his price forecast that is remarkably shallow. HSS/ARI M.B. at 42-43. HSS/ARI witness Weisenmiller presented data from his review of publicly available natural gas wellhead forecasts released by EIA, WEFA, DRI and GRI. HSS/ARI Exh. RBW-50. Over the period 1995 to 2015, all of those forecasts predict real increases in the price of natural gas, ranging from 0.1% to 2.5% per year. HSS/ARI St. 1 at 126. In Duquesne's latest Integrated Resource Plan ("IRP"), filed September 1996 and updated May 1997, Duquesne used a natural gas price escalation rate of 4.9% per year. HSS/ARI St. 1 at 128. Thus, HSS/ARI concludes that Duquesne witness Schnitzer's natural gas forecast not only is unreasonably low vis-a-vis the forecasts of industry forecasting experts, it is even far below Duquesne's own forecast officially on file with the Commission. HSS/ARI M.B. at 43.

To determine a transportation rate to get natural gas to delivery points in ECAR, Duquesne witness Schnitzer relies upon a handwritten note he received from Columbia Energy Services, an affiliate of Columbia Gas Transmission. N.T. 457-458. Based upon the handwritten document, Duquesne witness Schnitzer assumes a 24¢ transportation rate to transport natural gas from Henry Hub to the market area. N.T. 457. That differential is set forth in Duquesne Exhibit MMS-3. HSS/ARI M.B. at 43-44.

HSS/ARI presented evidence that Duquesne witness Schnitzer's transportation rate does not capture a reasonable price for the transportation of natural gas. First, the document on its face notes that CNG, another interstate pipeline that supplies transportation to the Duquesne market, "trades .06-.09 higher than Columbia Transmission. HSS/ARI Cross Exh. 7. Further, although Duquesne's witness Schnitzer believes the handwritten note he relies upon is intended to account for transportation from the Gulf Coast to ECAR, he could not confirm that quoted rate includes use of all pipelines necessary to reach Duquesne, did not review the actual tariffed rates of Columbia, and did

not consider the transportation rates of other pipelines serving the region. N.T. 462-464; HSS/ARI Cross Exh. 8.

HSS/ARI witness Weisenmiller examined historical differentials between wellhead and Midwest citygate prices to compare those data to Duquesne witness Schnitzer's transportation charge estimate of 24¢/MMBtu. He finds those differentials average in the $0.50 to $1.00/MMBtu range, or 2.5 to five times Duquesne witness Schnitzer's assumed transportation rate. HSS/ARI M.B. at 45; HSS/ARI St. 1 at 128.

iii. Resolution

The Commission accepts much of the HSS/ARI criticism of Duquesne witness Schnitzer's analysis and concludes that his testimony does not provide a credible, substantiated foundation for Duquesne's request for recovery of its stranded utility generation. We find that the evidence presented concerning the capital costs for new combined cycle units, inflation and gas prices do not reflect a reasonable review of available evidence and are not reasonable once available market evidence is considered. We find that witness Schnitzer did not conduct an adequate review of readily available market data, adopted assumptions that are inconsistent with available evidence, and produced a recommendation that is not credible, reasonable, nor substantiated by the record in this case.

d. OCA's Market Valuation of Duquesne's Generation

(i) OCA Witness Smith's Market Valuation

The OCA's witness D. Smith indicates that while Duquesne witness Schnitzer's analysis focused on the cost of entry of a new combined cycle plant as the upper bound of a range of market value, OCA witness D. Smith presents a dispatch simulation model of the APS/DLC system as a single market area using the ENPRO dispatch simulation model to estimate market revenues in each hour. OCA St. 2 at 5. OCA characterizes ENPRO as a detailed, chronological model used by utilities and others for a range of operational and planning analysis, that is well suited for the purpose of estimating market prices based on the dispatch of marginal units for a large electric system. OCA notes that the Commission specifically approved the ENPRO model as quite suitable to the task of estimating generating market revenues in PECO Energy. OCA M.B. at 31-32.

The OCA's witness D. Smith indicates that he modeled the APS/DLC region as the relevant market, while incorporating trading with other markets through the use of import proxies that reflect existing transmission limitations in the region. DII witness Falkenberg also concluded that it was preferable to model the existing region rather than make assumptions that are unsupportable at this time concerning what the relevant future regional market will be. DII witness Falkenberg concluded that using a larger region as the market would have no discernible impact on the results of the market valuation analysis.

The OCA's witness D. Smith represents 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. He testified that actual market prices can turn out to be higher because upward pressure may be exerted on prices in the Northeast and Mid-Atlantic due to an 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; he conservatively assumes existing units will continue to operate. OCA M.B. at 33-34.

The OCA's witness D. Smith used the DRI fuel forecasts adopted by the Commission in PECO Energy. OCA characterized the DRI forecast as an independent, nationally respected forecast. It's accuracy and objectivity is such that PECO Energy used the DRI fuel price forecast in formulating its market valuation.

The OCA's witness D. Smith assumes that newly constructed combustion turbine units will be used for peaking duty and that combined cycle units will be used for baseload/intermediate duty. Id. He assumes all-in capital costs of $560/kW in 1997 dollars for combined cycle units and $296/kW in 1997 dollars for combustion turbines. His assumptions are based on his review of industry data and estimates provided by other Pennsylvania utilities. OCA witness Smith indicated that several factors could raise future generation costs above his projections:

- Greater interest costs during construction;
- Increase in CC/CT equipment costs from current market conditions, which represent a historical low point;
- Greater land costs;
- Greater project development costs, representing the "soft costs" needed for the legal, financing, and permitting efforts needed to develop a successful project;

- Non-standardized plant features, reflecting tradeoffs between plant design and capital cost. For example, combined cycle units with the most complex and efficient steam cycles will tend to cost more, as will units with reliability features such as a bypass stack or multiple shaft design;

- Selective catalytic reduction ("SCR") equipment for control of NOx emissions on CC units. The turnkey equipment costs underlying his estimate include dry low-NOx burners, but not equipment for catalytic reduction of NOx or CO_2 emissions. To the extent that SCR or other control measures are actually required for some or all of the new CC generating units built in PJM, additional capital and operating costs would be required;

- General Plant. His cost estimates treat the CC and CT options as stand-alone facilities, and do not include an allocation of general plant which would presumably be incurred by generating companies in the ECAR market.

The OCA's witness D. Smith's analysis assumes all generators selling into the spot market at any given time will receive the same price for their output and price will reflect the highest bid accepted by the system operator, and bidders will bid hourly output based only on its variable cost. Thus, generating units with high variable costs that run infrequently will receive little or no contribution toward their fixed costs in most hours. However, such units will need to recover such costs and the market will provide mechanisms to enable the recovery of such costs.

The OCA's witness D. Smith identifies four ways in which the market will compensate for these costs: (i) bids above variable costs; (ii) interruptible demand payments; (iii) bilateral transactions; and (iv) ancillary service revenues. OCA M.B. at 33; OCA St. 2 at 12-13. OCA witness 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. Thus, OCA witness Smith concludes that "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 terms "reliability-related" revenues. OCA witness 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." He further assumes these revenues will be concentrated in "only the highest-demand hours, so that all generating units will receive the same reliability-related revenues on a per-kW basis" and that sufficient generating capacity will be constructed to maintain an 8% reserve margin of installed capacity above the annual peak demand. OCA M.B. at 33; OCA St. 2 at 13.

(ii) Postitions of the Parties

Duquesne witness Karl criticizes some of the assumptions OCA witness Smith uses in his analysis. First, Mr. Karl criticizes Mr. Smith's use of an 8% capacity reserve margin, suggesting that Mr. Smith inappropriately uses this value as an administratively determined capacity requirement for ECAR. Duquesne St. 9R at 2. However, OCA explains that witness Smith's analysis is not based on the assumption of an administratively determined capacity requirement. OCA witness Smith assumes that customers will seek a level of system reliability comparable to historical minimum targets, which require approximately an 8% regional installed capacity reserve margin. OCA St. 2S at 2-3. The OCA submits it is reasonable to use this approach in the context of forecasting generation market prices. OCA M.B. at 36

Duquesne witness Karl also criticizes OCA witness Smith's assumption that annual peak demands and energy requirements in the APS/DLC area will increase as projected for ECAR in the 1996 NERC Electricity Supply and Demand Database. Based on this database, OCA witness Smith develops an hourly load shape based on an average of the 1995 and 1996 actual hourly shapes. OCA St. 2S at 4. Duquesne witness Karl contends

that the development of a combined load shape requires an assessment of the individual customer classes for APS and Duquesne. Duquesne St. 9R at 7. OCA witness Smith explains this is not the case for the base year, which simply represent the sum of the hourly loads of the two systems. OCA St. 2S at 4. He indicates that installed loads and usage patterns are relatively stable, making the historical curve the best basis from which to forecast. Id. In addition, OCA witness Smith explains that short term trends in load shape will have a limited impact on market prices and that other factors, such as the overall magnitude of demand growth, fossil fuel prices and the cost of new market entry are substantially 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. OCA M.B. at 37.

(iii) Resolution

The Commission finds the testimony of the OCA's witness D. Smith to be objective, thorough, well supported in the record of the case and credible. We conclude that his testimony provides the best evidence in the record of this case for a determination of the market value of Duquesne's utility generation and adopt the testimony of OCA witness Smith as the basis for our determination of Duquesne's recoverable stranded utility generation. The OCA's witness Smith's evaluation will not be used to determine Duquesne's stranded utility generation in the event of divestiture, as previously discussed.

Besides being the most credible and least criticized of any of the other market valuation witnesses, we note that it produces a reasonable result that is within the range of market values produced by the other credible evidence in the record of this case. We find that witness Smith's model fairly represents several key matters necessary for a reasonable

determination of market value, such as fuel prices, imports and exports, and heat rates. In addition, we find that OCA witness Smith's market prices are sufficient to support the construction of new generation capacity. The Act requires the Commission to ensure that reliability is maintained during the transition and upon the establishment of a competitive generation market.

e. Other Evidence of Market Value

In its proposal, Duquesne indicated that it was preferable to use actual evidence of market value wherever possible instead of analytic projections. HHS witness Weisenmiller presented several examples of actual market valuation as well as other Duquesne projections of market value.

(i) Ft. Martin Sale

First, in 1996, Duquesne sold its 276 MW share of Ft. Martin to a subsidiary of APS for $169 million, a price that is four and a half times the $37 million net book value of Duquesne's share of the plant. Duquesne St. 1 at 26; Duquesne St. 2 at 10-11. Duquesne's President and CEO acknowledges that the sale established the fair market value of the plant at the time of the sale. N.T. 71:15-20. OCA and HSS in particular argue this sale is the single most useful market evidence to establish the current valuation of Duquesne's utility generation, and it suggests that real market prices will capture much plant value in excess of book value.

(ii) Other Duquesne Studies

In addition, a 1995 Duquesne study concluded that sale of the Cheswick and Elrama units would yield purchase premiums above book value of between $160 million and $460 million. (HSS/ARI M.B., p. 5) The $160 million premium is based on the base case of existing operation of the plants. If power sales were increased, the purchase premium would rise to $335 million and to $460 million if sales increased and O&M costs were reduced by one-third. The same study concluded that Duquesne could capture a purchase premium of $733 million above net book value upon sale of all of its generating assets.

(iii) Metzler & Associates Study

Duquesne contracted with Metzler & Associates ("Metzler") to perform an asset valuation for Duquesne using three assumptions concerning the price of power. An assumption of $18-20/MWh was the "worst case" considered, a "most likely case" of $27/MWh was considered and a "best case" scenario of $35/MWh was considered. Exh. RBW-5 at 2. Using those assumptions, Metzler projected market values as high as $225 million for the Cheswick unit and $150 million for Elrama. Exh. RBW-6 (study dated July 15, 1996).

In an update of the initial study, Metzler increased its market value projections to $264 million for Cheswick (compared to net book value of $120 million); $224 million for Elrama (net book value $100 million); $112 million for Brunot Island (net book value $26 million); and $140 million for Phillips (net book value $78 million). Exh. RBW-7 at 3; Duquesne Statement 2, Exh. DJC-3 at 32-38 and Exh. MKO-1C at 1

(iv) CS First Boston Study

In addition to the Metzler study, Duquesne received a study of the value of Duquesne's generating assets from the investment banking firm CS First Boston in late November 1996. Duquesne later hired CS First Boston as its advisor in connection with its proposed merger with APS. Exh. RBW-10; N.T. 275. CS First Boston advised Duquesne that it could sell five of its generation plants with a total net book value of $450 million for between $827 million and $1.184 billion. Such sales would produce a premium above book value ranging from $377 to $734 million. Exh. RBW-10; HSS/ARI St. 1 at 21, Table III-1; HSS/ARI M.B. at 54. The assumed power price in the CS First Boston study is 2.6¢/kwh or $26/MWh. Exh. RBW-10.

(v) Other Market Transactions

HSS witness Weisenmiller presented other actual market evidence suggesting that some of Duquesne's generation assets could be sold at substantial premiums above book value. New England Electric System ("NEES") recently sold to U.S. Generating Company generation facilities with a book value of $1.1 billion for $1.59 billion, approximately $500 million or 40% above net book value. HSS/ARI St. 1 at 146. Similarly, Pacific Gas & Electric Company ("PG&E") and Southern California Edison Company ("SoCal Edison") recently sold generation facilities for approximately $500 million and $1.1 billion, respectively. HSS/ARI St. 1S at 7. PG&E's sale was consummated at approximately 32% above net book value, and SoCal Edison's facilities sold at 2.65 times net book value.

(vi) Resolution

The record includes substantial evidence of actual market transactions, including an asset sale by Duquesne, that suggest market values higher than those produced by the OCA's witness Smith. We find that these transactions provide a useful parameter permitting us to conclude that the adoption of the OCA's valuation in this proceeding is exceedingly moderate. Acceptance of these studies supports the finding that Duquesne's divestiture proposal is in the public interest. We do not, however, find that the actual market transaction evidence provides an adequate basis for adopting a valuation of all of Duquesne's utility generation based on the actual sales of other units, because individual transactions are based on many specific considerations that may not be applicable to other transactions.

In addition, we conclude that the CS/First Boston and Metzler studies performed by Duquesne, for purposes other than this proceeding, provide the Commission with substantial evidence corroborating OCA witness Smith's projections of both electric prices and asset market values as exceedingly moderate. As HSS/ARI noted, if market price embedded in the CS First Boston price projection is used, Duquesne's generation assets would have a positive market value in 1998 of $481 million. Exh. RBW-57.

f. Summary of Market Valuation

We have reviewed the record concerning this issue in extraordinary detail in order to determine the most credible and reasonable market valuation of Duquesne's utility generation assets supported by the evidence in this proceeding. Our conclusion requires the exercise of judgment based on the evidentiary record. The Duquesne proposal is not credible nor reasonable. Moreover, rather than using actual market evidence wherever possible, as Duquesne claims, we conclude that it completely ignores and is contradicted by the actual market evidence that does exist. Although there is no single proposal that we find completely convincing on every component of its analysis, we adopt the testimony of the OCA's witness Smith as the most reasonable determination of future market value in the record of this proceeding. We conclude that Duquesne's utility generation has a market value of $110.95 million as of December 31, 1998 reflecting the results of the OCA's witness Smith's analysis, but not considering other considerations discussed elsewhere in this Order.

3. Proposed Adjustments to Market Value

(a) Life Extension

(i) Position of the Parties

Duquesne noted that the OCA made projections assuming that Duquesne's coal plants are "life extended" an additional 15 years. Using this adjustment, Duquesne asserts that the OCA's witness L. Smith created nearly $200 million in additional market value. Duquesne states that the OCA's projection is not based on a life extension study of Duquesne's units. Rather, it is based on studies by other utilities (PECO Energy and

APS) in other cases involving the plants of those other utilities. Therefore, Duquesne objects that these estimates cannot possibly support a "known and measurable" calculation for its units. Duquesne also cited this Commission's determination in PECO Energy (as to fossil decommissioning), to argue that such a forecast of "[p]rospective...expenses [and revenues]...without a specific plan to [life extend] a particular plant at a particular time and in particular manner" cannot satisfy the known and measurable standard. (R.D., p. 274).

The OCA noted that the Company calculated market revenues realized over the book lives of its generating units. As the OCA notes, for the Company's major coal-fired generating plants, this assumes a "useful life of approximately 40 years." (R.D., p. 274). In part, stated the OCA, this is because Duquesne believes that addressing life extension at this time would be premature. Duquesne would reserve judgment on this issue until its proposed "final valuation" in the year 2003. For this reason, the OCA argued that Duquesne was unable to provide any studies regarding life extending its generating units, but has indicated that such a study would be prepared and made available for the year 2003 valuation.

The OCA maintained 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," the Company's position is not reasonable in the context of a stranded cost study intended to provide the basis for competitive transition charges. The OCA contended that, even were the Commission to accept Duquesne's final valuation approach, 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. Ignoring the likelihood of life extension means that this test is biased and distorted. The OCA stated these life extensions were incorporated in the OCA analysis in PECO, which

was adopted by the Commission. (R.D., pp. 275-276). In the PECO case, the OCA explains, PECO Energy projected, and the Commission adopted, life extensions for three coal plants. It was the study in that case which formed the basis for the OCA's $172.72 million unit life extension adjustment here. Because the Company failed to provide any substantive response to OCA's position on this issue on the record of this proceeding, OCA submitted that its economic life extension of units adjustment should be adopted. (R.D., p. 277).

Based on the foregoing, the OCA submitted that its adjustment to reflect economic life extension of units in the amount of $170.72 million is appropriate and should be adopted. In conclusion, the OCA noted that the Company has not performed such an analysis, even though it would have been appropriate to do one for purposes of determining stranded costs. Consequently, the OCA performed its own analysis using reasonable assumptions such as the escalation of market prices. (R.D., p. 277). The Company did not present specific rebuttal to the OCA's testimony with respect to life extension. The City agreed with the OCA on this issue. (R.D., p. 278).

HSS/ARI argued that one factor which caused Duquesne to overstate its stranded cost exposure was that the Company failed to consider the potential benefits that could result from extending the life of certain plants to create a positive cash flow. It follows as a matter of logic that when low cost plants are operated over longer periods, their below-market costs can offset greater amounts of above-market prices. Thus, argued HSS/ARI, sales of electricity from competitive plants (i.e., capable of producing electricity at below market clearing prices) can offset sales from noncompetitive plants (those capable of producing electricity only at above market clearing prices). Accordingly, the longer competitive plants operate, the greater the offset against stranded costs. Notwithstanding that fact, however, in performing its stranded cost calculation,

Duquesne assumed that when a facility's costs are fully recovered for ratemaking purposes, the facility will cease operation regardless of the value of its power. Because, states HSS/ARI, many plants continue to operate after the date of full recovery of depreciation, it is not reasonable for Duquesne to calculate its stranded costs based on a scenario that contravenes operating its facilities in a prudent, economically rational fashion.

HSS/ARI additionally point out that with respect to operation of a plant after it has been fully depreciated, the portion of the plant's revenue dedicated to return of invested capital could be devoted to other purposes. As a result, argued HSS/ARI, plants, both competitive and non-competitive, could be operated at lower operating costs such that noncompetitive plants may, in fact, become competitive and competitive plants would become more competitive, i.e., more effective at offsetting stranded costs. Nonetheless, HSS/ARI, criticizes Duquesne's stranded cost claim as it fails to take into account such offsets.

HSS/ARI suggested that the proper indication of whether a power plant should be retired should be based on the unit's going forward costs. If the unit can recover its variable and fixed costs, including fuel O&M expenses, administrative and general costs, capital additions and taxes from the market value of its power, the plant should continue to operate. Otherwise, it should not.

Based on the foregoing analysis, HSS/ARI argued that Duquesne is prematurely retiring numerous units. As a consequence, its stranded cost claim is overstated and must be adjusted to reflect the offset associated with continued operation of its generating facilities.

The PRA explained that extension of the operating lives of generating plants beyond their "book or financial life" is common in the electric industry. The fact that Duquesne has failed to consider this factor in its stranded investment analysis is not a basis for rejecting the validity of life extension assumptions argued PRA. The Act requires that the Commission consider all possible mitigation strategies in determining stranded investment. Consequently, states the PRA, life extensions of existing plants is a form of mitigation of the level of stranded investment. Even under the Duquesne scenario of "testing," at some time in the year 2005, a review of the possibility of extending the lives of generating plants would be required. (R.D., p. 280).

The PRA urged this Commission to adopt, as a reasonable estimate of the cost of extending the life of a coal plant that was provided by the OCA. The PRA asserted that the OCA analysis revealed that all generating units analyzed can be economically life extended at $200/kW capital costs although effective for only two units at $300/kW. Thus, according to the PRA position, the range of NPV of life extension is $200 to $171 million as of January 1, 1999. (R.D., p. 28). The OCA conservatively selected the $171 million amount. And, states the PRA, this position should be adopted by the Commission. (Id.).

(ii) ALJ's Recommendation

The presiding ALJ noted that Duquesne calculated market revenues realized over the book lives of its generating plants. Therefore, he observed that it is unreasonable to assume the physical life of a stranded asset equates exactly with its book life. Thus, some "life extension" must be attributed to that asset. (R.D., p. 281). Further, ALJ Corbett disagreed with Duquesne that addressing this issue in this proceeding is premature and should be reserved until its proposed "final valuation" in Section 2003. He

concluded that the issue of mitigation of stranded costs must be addressed now, unless there is a divestiture of generating assets as discussed. Sections 2804(4)(v) & 2808(c)(4).

Since the OCA provided the only credible evidence on this subject in this proceeding, the ALJ recommend that we adopt the OCA's adjustment of $170.72 million to reflect an appropriate economic life extension for these assets.

(iii) Parties' Exceptions

Duquesne excepted to the ALJ's acceptance of the OCA's life extension projections. Duquesne submits that the ALJ was wrong to conclude that the "physical life" of a generating asset cannot "equate exactly with its book life." It states that the "book life" of an asset is the best estimate of its projected physical life. These book lives are developed using detailed engineering and economic analysis for the purpose of establishing appropriate depreciation schedules, states Duquesne. Duquesne observes that the OCA did not undertake any study of the cost required to life-extend Duquesne's units. Rather, Duquesne repeats its criticism that the OCA used studies by other utilities which studies, it argues, cannot possibly provide a "known and measurable" calculation for Duquesne. (Duquesne Exc., p.15).

Duquesne further critiques the OCA's life extension forecast as the epitome of "speculative" projections by expert witnesses. It asserts that the OCA projections assume that current technology will continue to set market prices nearly 40 years from now, an assumption that is "somewhere between silly and reckless." (Duquesne Exc., citing St. 3-R at 22). Indeed, Duquesne states the OCA concedes that: "[i]n reality, the Company would defer life extension investment decisions until the years shortly before book retirement date[s] due to the inherent uncertainty of making such decisions this far

in advance." (Duquesne Exc. citing OCA St. 1 at 35-36). Duquesne concludes that there is no basis in fact for adopting these projections. (Duquesne Exc., p.16).

(iv) Resolution

On consideration of the Exceptions of the Company, we agree with Duquesne that in light of probable significant changes in technology over the remaining years of life of its plants, it would defer life extension investment decisions until the years shortly before book retirement dates due. This is due to the inherent uncertainty of making these decisions at the present time. Even though it is possible that some of Duquesne's plants may be life extended, this eventuality is uncertain, unknown, and unmeasurable at this time. We, therefore, reject the OCA's adjustment adopted by the ALJ. We decline to adopt the proposal for a $170.72 million adjustment to reflect an economic life extension for Duquesne's generating plants.

We further reject the OCA proposal as it is unclear from the record, given the age of the Duquesne units, that life extension is feasible. Finally, we find the OCA forecast additionally infirm as the costs associated with extending the life of the units for 15 years have not been included in its analysis.

(b) Plant Shutdowns

(i) Position of the Parties

The Company noted that several witnesses suggested that Duquesne should permanently shut down certain of its generating stations. The issue arises because, under Mr. Schnitzer's market price forecast, some of Duquesne's units were determined to have

"negative" operating margins, i.e., they receive less revenue than it costs to operate them. Duquesne pointed out that while this fact intuitively supports a shut down decision, it is not a complete analysis.

Duquesne witnesses argued that there may be unavoidable costs (e.g., property taxes and labor costs), that Duquesne will incur even if the plants are shut down. In any event, Duquesne committed to file a detailed study regarding potential plant closures in 1998 and allow "the Commission [to] make the determination of whether any units should be shut down." (R.D., p. 283).

The OCA noted in its direct case that Duquesne 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. Consistent with this approach, the OCA's witness's stranded cost analysis produced a $0 market value for all of the Company's nuclear plants and several of the coal plants. For purposes of determining costs that would be "stranded" as of January 1, 1999, the OCA stated that 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. (R.D., p. 284).

The OCA did not recommend the retirement of any generating units, especially in the absence of an analysis of the economics of doing so. However, it noted Duquesne's failure to address these operating losses prior to its Rebuttal case and Duquesne's 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. The OCA stated that Duquesne did not contest the accuracy of this evidence, but rather asserted that "there is not adequate time to investigate" it. (R.D., p. 283).

On the basis of the foregoing, the OCA submitted its approach of setting the plant margins of these units to $0 (excluding decommissioning) is reasonable and should be adopted.

The City noted Duquesne's plan does not call for shutting down uneconomic power plants in an effort to mitigate stranded costs, even in instances where to do so would save its customers hundreds of millions of dollars. The City argued that Duquesne's proposal to provide a 1998 shutdown study indicates Duquesne's acceptance of the criticism that it has ignored its duty to mitigate stranded costs by previously conducting such a study. It observes that shutdown issues should have been addressed in Duquesne's plan and not been put off to be the subject of a later study proposed in rebuttal testimony. This observation again speaks volumes about Duquesne's motives and the anti-competitive mind set of its management, states the City. (R.D., p. 286).

HSS/ARI argued that several of Duquesne's facilities, i.e., the Elrama, Brunot Island and Perry Units, should be retired immediately. The effect of those retirements would be a further reduction to Duquesne's stranded cost claim. (R.D., p. 286).

(ii) ALJ's Recommendation

The ALJ agreed with the Company and the OCA that there is inadequate time in this proceeding to investigate the feasibility of shutting down any of Duquesne's power plants. Therefore, the ALJ urged the Commission to adopt Duquesne's commitment to file a detailed study regarding potential plant closures by December 31, 1998, and, thereafter, allow the Commission to determine whether any units should be shut down.

(iii) Resolution

The Commission is not convinced that the submission of a plant shutdown study at this time would be a valuable work product. It would be immaterial if Duquesne is to proceed with divestiture. In the event of the merger, we are constrained to this case record for a determination of stranded costs. Such information provided at the end of 1998, could not be used to raise or lower a determination of stranded costs. Therefore, we find no useful purpose would be served by requiring the Company to undertake such a study.

(c) Productivity Gains

(i) Position of the Parties

The OCA proposed to increase the market value of Duquesne's plants by $13 million to reflect estimated "productivity gains." (R.D., p. 287). HSS proposed that, in setting any CTC, the Commission should assume cuts in operating and capital expenditures of between 10% and 20%. (R.D., p. 287).

Duquesne urged the rejection of each proposal arguing that they were not based on any study of the efficiencies that could be achieved given Duquesne's particular assets and work force. Also, Duquesne stated each proposal avoided addressing the significant cost savings and operating improvements already made by the Company and the further savings ($25 million annually) projected for the future. Additionally, each failed to consider the additional savings ($500 million on a nominal basis) that Duquesne expects to achieve through the merger. (R.D., pp. 287-288).

The OCA pointed out that Duquesne, in developing the market value of generating units, developed budget figures for non-fuel O&M expense for the transition period and escalated those at the Company's assumed rate of inflation of 2.5%. (R.D., p. 288-citing OCA St. 1, p. 33). Duquesne also escalated its A&G costs assigned to generating units and escalated them at its general inflation rate of 2.5%.

Based on the escalation of the above-referenced costs, the OCA maintained 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. (R.D., p. 288).

OCA witness Kahal explained "...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." (R.D., p. 288 citing OCA St. 1, p. 29).

OCA proposed that there should be additional efficiency gains after the first few years of retail competition. Specifically, the OCA's witness Mr. Kahal estimated a 1.0% per year gain in productivity, beginning in the year 2003 and extending for ten years, with the savings capped at 10% and held constant over the remainder of the study period. Mr. Kahal supported his estimates with detailed citation to the analysis of the Staff of the FERC, which conducted an analysis of utility industry efficiency gains resulting from the introduction of wholesale competition from transmission access and also relied on a recent study conducted by the U.S. DOE which provided projections of the rate impacts associated with the introduction of retail access nationwide. (R.D., p. 289, n. 89).

The OCA's witness Kahal applied the productivity adjustment to Duquesne's non-fuel O&M and A&G expense for those plants with positive plant margins. Thus, the analysis resulted in savings capped at approximately 10% in 2012, which are held constant over the remainder of the study period. See OCA Schedule MIK-6. As noted by the ALJ, the result of the 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. On the basis of the Kahal schedule, plant margins increased as of January 1, 1999, by approximately $13.04 million. (R.D., p. 290, citing OCA St. 1-S, p. 14; OCA M.B. at 43-44).

The OCA defended its efficiency adjustment as a conservative adjustment of 10% savings achieved over a ten-year period. This is in contrast to the observation of the FERC Staff and the Department of Energy of 15-25%, and 25-40% respectively. (R.D., p. 291).

In response to Duquesne's position that the OCA failed to consider the savings already achieved by the Company and savings expected to be achieved through the proposed merger, the OCA noted that the savings are those to be achieved in a competitive market. The OCA disagreed that the efficiencies created by the proposed merger are the same efficiencies that will be realized through competition. They are, stated the OCA, different and should be separately taken into consideration. OCA submits that its estimation of productivity savings, which simply reduces the annual rate of inflation in generation-related non-fuel O&M and A&G expenses by 1.0% for a ten-year period, is reasonable and should be adopted. (R.D., p. 291).

The City argued Duquesne's projections assume "fixed technology" and even Duquesne admits that a "fixed technology" estimate is inaccurate. The City states that Duquesne erroneously assumed that competitive pressures will not result in technological innovation, efficiency and productivity gains. Competition, observes the City, will motivate new efficiencies and could provide millions of dollars in cost savings. Finally, notes the City, Duquesne has more room than its competitors to reduce costs since Duquesne had the lowest relative efficiency of utilities studied in Pennsylvania, in the ECAR region, and the third lowest of utilities studied in the nation. (R.D., p. 292).

The PRA held the view that productivity is the central tenet of a competitive environment. It notes that this was a major rationale for injection of competition into the retail electric generation market. The PRA notes that a productivity gain has not been reflected by Duquesne in its stranded cost analysis. The PRA agrees with the OCA that utility operating costs should be reduced as competition is introduced in the retail generation market. 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. Therefore, the PRA agrees that the OCA has assumed reasonably a productivity gain beginning in 2003 and extending for ten years thereafter. (R.D., p. 293).

(ii) ALJ's Recommendation

The ALJ was of the opinion that insufficient evidence exists in this record to support a productivity gain adjustment to Duquesne's generation related stranded costs. Therefore, he urged the Commission to reject it. (R.D., p. 294).

(iii) Parties' Exceptions

The OCA excepted to the ALJ's rejection of its productivity adjustment. The OCA submits that the industry experts and analysts expect that generating plant productivity will increase as a result of the introduction of competition into the generation marketplace. The OCA further submits that this is one of the primary reasons for moving from a system of regulated monopoly to a competitive market. Estimates have been made that fixed O&M costs of generating plants will be reduced from between 15% to 40% on an industry-wide basis, based on estimates made by the FERC and the U.S. Department of Energy (DOE). (R.D. p. 291).

(iv) Resolution

On consideration of the positions of the parties, we agree with the OCA that the transition to a competitive environment will result in productivity gains, reducing both Duquesne's non-fuel O&M and its A&G costs. Consistent with the observations of the OCA's witness Kahal, 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, but will be continual. Once deregulated, the owners of generation assets will, as a result of market pressures, seek ways of controlling costs and improving productivity on a ongoing basis. Therefore, we find the OCA's efficiency adjustment to be conservative, and based on demonstrated efficiencies and productivity gains resulting from the introduction of competition in the wholesale market. The studies of the FERC Staff and DOE show productivity levels in excess of the modest 1% per year gain in productivity

beginning in 2003 and extending for ten years, (capped at 10% and held constant over the remainder of the study period) proposed by the OCA.

Also, we reject the Company's reliance on post-restructuring mitigation as the sole indicator of the efficiencies and productivity gains that inure to the new, competitive regime.

Accordingly, we conclude that the OCA has demonstrated that it is reasonable to expect Duquesne's generating units to improve their productivity. Hence, we shall accept the OCA productivity gain as part of the market value calculation and reverse the ALJ's recommendation. The Exceptions of the OCA are granted consistent herewith.

(d) Costs Independent of Operation

(i) Position of the Parties

Duquesne explained that its claim for "Costs Independent of Operation" represent costs that are unavoidable if a generating unit is shut down. Duquesne stated that these costs, such as nuclear decommissioning, cannot be avoided by shutting down a nuclear plant. In some instances, Duquesne noted, the costs increase (on a net present value basis) the sooner a plant is shut down. (R.D. p. 294). For illustrative purposes, ALJ Corbett references two additional categories of costs, property taxes and administrative and general costs..

The OTS opposed Duquesne's claim. It referenced the OCA's witness Mr. Kahal's testimony that the claim assumed the Company should incorporate negative

market values for generating units - a change from the Company's direct case where negative market values (except decommissioning) were set to zero. (R.D., p. 295).

The OCA further contested the claim. The OCA objected that the Company's failure to identify these cost in its direct case given the Company's final valuation proposal prevented other parties from assessing their validity.[18]

The OCA also noted the Company initially assumed that plants with a net negative plant margin at January 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 January 1, 1999, has included a claim of $208.23 million for "Costs Independent of Operation" which are essentially the net[19] "unavoidable costs" associated with the operation of plants that produce net negative margins in the Company's analysis.

DII took no position on the propriety of allowing the Company to recover these alleged costs independent of operation; yet, DII expresses the concern that such costs were not identified in the Duquesne direct case.

(ii) ALJ's Recommendation

ALJ Corbett concluded that sufficient evidence existed in this record to support the Company's claim for Costs Independent of Operation. Therefore, he

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[18] The OCA further observed that no other utility in Pennsylvania has presented a stranded cost claim for "Costs Independent of Operation." (R.D., p. 297 citing OCA R.B., p. 12).

[19] 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.

recommended its approval. However, the ALJ did not offer any reasoning or justification for his conclusion. (R.D. p. 298).

(iii) Parties' Exceptions

The OCA excepted to the ALJ's recommendation. (OCA Exc. p.11). The OCA finds objectionable, the fact that this claim was presented for the first time in Rebuttal Testimony.

The OCA submits that the assumption that there are substantial continuing costs associated with plants that provide no economic benefit is an irrational and inappropriate assumption to make in determining stranded costs. The OCA contends that the stranded costs associated with generating plants that have no economic value should be limited to the book value of the plant and should not extend to the general operating costs of the utility.

Finally, the OCA submits that a large claim such as the Duquesne's claim for costs independent of operation should have been accompanied by a detailed study of the ability to mitigate such costs and, in the absence of such an analysis, such a novel claim should be rejected.

The OTS also filed Exceptions. Again, it concurred with the OCA, that the aforementioned $208 million claim should be rejected.. At a minimum, argued the OTS, Duquesne should not be permitted to recover this claim if the merger is not consummated but a market based valuation option provided by the Company is exercised. (OTS Exc., p.7).

DII, in its Exceptions, submits that the Company's failure to fully state its claim for the $208 million for these costs in its case-in-chief prevents the proper recovery of these costs in this proceeding. DII respectfully requests that the R.D. be modified to deny recovery for "Costs of Independent Operation." (DII Exc., p.7).

(iv) Resolution

We shall reverse the ALJ's recommendation on this claim. We conclude that compensation to the Company for costs stranded, independent of operations, has not been adequately supported in this record. Duquesne does not propose any plant shutdowns. Therefore, no costs independent of operation exist. We agree with the comments of the OCA in its Exceptions that:

> "The assumption that there are substantial continuing costs associated with plants that provide no economic benefit is an irrational and inappropriate assumption to make in determining stranded costs. The stranded costs associated with generating plants that have no economic value should be limited to the book value of the plant and should not extend to the general operating costs of the utility".

(OCA Exc., p. 12).

We concur with the OCA that it is not rational to assume that absent a shutdown there are continuing costs associated with plants which have already been included in our determination of the permitted level of stranded costs.

Moreover, it is apparent that this claim only becomes operable if a unit is shut down, as these are continuing costs for the property absent energy production. These costs, in that event, would offset the removal of the plant values from the analysis. This

adjustment to stranded costs is unnecessary for our purposes since no shutdown is ordered, and would only be accounted for should a future shutdown be authorized.

Based on the foregoing, we shall grant the Exceptions of the OCA and reverse the ALJ.

(e) Projected Capital Additions and O&M Expense

(i) Positions of the Parties

HSS/ARI submitted a proposal regarding an "assumed" level of O&M or capital expenditure reductions. (R.D., p. 299).

HSS/ARI asserted in considering Duquesne's stranded cost claim that, it must be remembered that there are two sides to the equation, i.e., Duquesne's projected revenues have to be measured against Duquesne's projected costs. Thus, an overstatement of stranded costs can as readily occur from an overstatement of cost projections as from an understatement of projected revenues. As a result, as previously indicated, HSS/ARI examined Duquesne's costs, as well as its price, projections. In doing so, it identified two significant instances in which Duquesne overstated its projected costs, thus unreasonably inflating its stranded cost claim.

The first of those two instances concerned Duquesne's projections of generation-related capital additions. As HSS/ARI pointed out, Duquesne forecast those capital additions for some of its generation plants as far out as 2026, or nearly 30 years into the future. Moreover, Duquesne's rate proposal implicitly relies upon the capital additions through 2005. In addition, to calculate its stranded cost claim, Duquesne

accounted for generation-related projected capital additions by determining what they would be as of December 31, 2005 on a net present value basis. Thus, Duquesne's claim that it might have stranded costs as of that date expressly is based upon Duquesne's inclusion of the projected costs of those generation-related capital additions. Duquesne estimated that it would construct capital additions at a cost of $352 million from 1997 to 2005. Duquesne's evidence does not demonstrate any reason why those cost projections should be deemed to be reasonable. On the other hand, the evidence clearly establishes that Duquesne's projections are excessive. (R.D., p. 300).

Duquesne's projected O&M expenses also should be reduced. That reduction is warranted for several reasons. HSS/ARI compared Duquesne's historic production costs to those of other utilities in ECAR, as well as in Pennsylvania, using data from benchmarking studies performed by Standard & Poor's Rating Information Services. HSS/ARI also reviewed similar benchmarking studies commissioned by Duquesne and statements by Duquesne in recent annual reports. Those sources of data showed that Duquesne's production and operation costs fall short of industry standards in numerous categories. (R.D., p. 301). HSS/ARI contends that there are no grounds that support ratepayers' continued subsidization of Duquesne's inefficiencies. Accordingly, HSS/ARI proposed that the Commission should reduce Duquesne's O&M expenses by 15%.

(ii) Recommendation of the ALJ

The ALJ concluded that insufficient evidence existed in this record to substantiate the proposals of the HSS/ARI relating to projected capital additions and O&M expense. Therefore, he urged the Commission to reject them.

(iii) Parties' Exceptions

HSS/ARI excepted to the ALJ's recommendation.

First, HSS/ARI states that with respect to Duquesne's projections of capital additions, it produced the Company's own "Corporate Budget Variance Reports" which indicate that on average, from 1987 through 1996, Duquesne's actual generation-related capital expenditures were 17% lower than its projected expenditures for the next twelve months. (HSS/ARI St. No. 1 at 60; Exh. RBW-21). Thus, the data submitted by HSS/ARI with respect to Duquesne's projected capital expenditures, i.e., data showing a history of over-budgeting, are exactly the type of data the Commission relied upon in PECO Energy to order a disallowance.

Given that the Corporate Budget Variance Reports submitted here are Duquesne's own records, and Duquesne never challenged HSS/ARI's statements concerning those data, they argue it is implausible that the Commission could determine, in view of its ruling in PECO Energy, that the evidence here is insufficient. Accordingly, consistent with the ruling in PECO Energy, HSS/ARI submit that Duquesne's forecasted capital additions should be reduced by 20% to reflect its past, documented history of overbudgeting.

They further argue that the Commission also should reduce Duquesne's forecast of O&M expenses. With respect to those expenses, HSS/ARI take the position that they showed that Duquesne's production and operation expenses fall short of industry standards in numerous categories and that Duquesne's forecast of O&M expenses is inconsistent with its corporate strategy to reduce costs. (HSS/ARI, Exc., p.11).

HSS/ARI submit that Duquesne should be taken at its word, *i.e.*, that it is attempting to streamline its operations to compete in the new competitive environment. Accordingly, HSS/ARI recommended that Duquesne's O&M expense projections be reduced by 15%. (HSS/ARI, Exc., p.13).

(iv) Resolution

On consideration of the position of HSS/ARI, we concur with the ALJ in this area. We, therefore, accept his recommendation rejecting the HSS/ARI adjustment as unsupported by sufficient evidence.

Specifically, although HSS/ARI contend that Duquesne significantly over budgeted its capital addition and O&M expenses, HSS/ARI fail to identify a single expenditure since the last base rate proceeding as unreasonable. Additionally, HSS argued that all transmission and generation related capital additions that were made since the last rate case should be disallowed, or should be approved only in part, because Duquesne did not meet its "burden of proof" on these issues. (HSS Exc. pp. 6-10, 13,16, 26-27). We find these claims are without merit because they confuse the issue of a utility's "burden of proof" with the issue of an intervenor's burden of going forward with "credible evidence" to contest the reasonableness of particular cost items.

Based on the foregoing, we deny the Exceptions of HSS/ARI.

(f) Environmental Regulations

(I) Positions of Parties

Duquesne stated that all the market price forecasts in this case ignore two recent proposals that, if implemented, would add significant costs to operating Duquesne's generation. The first Duquesne claim is the EPA State Implementation Plan ("SIP call"), which would add more than $100 million in capital and O&M expense to Duquesne's fossil units. The second Duquesne claims is the recent Kyoto conference, where the participating nations agreed to significantly reduce CO_2 emissions. While it is not possible to quantify precisely the impact of such proposals on Duquesne's generation costs, it argues the Commission should recognize that all of the market value estimates are conservative in not taking into account the cost impact of these potential regulations. (R.D., p. 302). However, the OCA noted the impact of environmental regulations is included in the context of its market valuation forecasts, discussed supra. (R.D., p. 302).

DII alleged that the Company failed to challenge DII's market price projection on this point. Because of this alleged failure, DII said it is misleading to assume the DII projection does not address environmental regulations. Second, the Kyoto Accords on CO_2 emissions must be adopted by the U.S. Senate to become effective. Duquesne's witness expresses doubt that the treaty will be passed. Even if it were passed, Duquesne suggests that "at this point, it is impossible to say what those impacts will be." (R.D., p. 303).

(ii) ALJ's Recommendation

Since the ALJ recommended that the OCA's market value study be adopted, which adjusts for the impact of the known environmental regulations, he concluded no further adjustment should be allowed. He also determined that no substantial evidence exists in this record to substantiate any adjustment for the impact of the recent Kyoto conference. Accordingly, the ALJ urged the Commission to reject Duquesne's proposal to further adjust its stranded costs to reflect the impact of environmental regulations. (R.D., p. 303).

(iii) Parties' Exceptions

Duquesne excepted to the ALJ's failure to make an adjustment for the impacts of two environmental proposals that, if implemented, would add significantly to Duquesne's operating costs. (R.D., p.302).

(iv) Resolution

We agree with the ALJ's recommendation that the OCA's market value study resolves the environmental issue. The OCA's study adjusts for the impact of known environmental regulations. Thus, no further adjustment is offered and no adjustment should be allowed. At the same time, we reject Duquesne's proposal to further adjust stranded costs.

4. Summary

On consideration of the Exceptions of the Company, we agree with Duquesne that in light of probable significant changes in technology over the remaining

years of life of its plants, it would defer life extension investment decisions until the years shortly before book retirement dates due. This is due to the inherent uncertainty of making these decisions at present time. Even though it is possible that some of Duquesne's plants may be life extended, this eventuality is uncertain, unknown, and unmeasurable at this time.

We, therefore, reject the OCA's adjustment, as recommended by the ALJ. We decline to adopt the proposal for a $170.72 million adjustment to reflect an economic life extension for Duquesne's generation plants. We further reject the OCA proposal as it is unclear from the record, given the age of the Duquesne units, that life extension is feasible. Finally, we find the OCA's forecast additionally infirm as the costs associated with extending the life of the units for 15 years have not been included in its analysis.

In regard to plant shutdown studies, we are not convinced that the submission of a plant shutdown study at this time would be a valuable work product. It would be immaterial if Duquesne is to proceed with divestiture. In the event of the merger, we are constrained to this case record for a determination of stranded costs. Such information provided at the end of 1998 could not be used to raise or lower a determination of stranded costs. Therefore, we find no useful purpose would be served requiring the Company to undertake such a study.

We conclude that the OCA has demonstrated that it is reasonable to expect Duquesne's generating units to improve their productivity. Hence, we shall accept the OCA's productivity gain as part of the market value calculation and reverse the ALJ's recommendation. The Exceptions of the OCA are granted consistent herewith.

We conclude that compensation to the Company for costs stranded, independent of operations, has not been adequately supported in this record. Duquesne does not propose any plant shutdowns. Therefore, no costs independent of operations exist. We, therefore, shall reverse the ALJ's recommendation on this claim.

Although HSS/ARI contend that Duquesne significantly over budgeted its capital addition and O&M expenses, HSS/ARI fail to identify a single expenditure since the last base rate proceeding as unreasonable. We, therefore, accept his recommendation rejecting the HSS/ARI adjustment as unsupported by sufficient evidence.

We agree with the ALJ's recommendation that the OCA market value study resolves the environmental issue. The OCA study adjusts for the impact of known environmental regulations. Thus, no further adjustment is offered and no adjustment should be allowed. At this time, we reject Duquesne's proposal to further adjust stranded costs.

C. Merger Savings

1. Positions of the Parties

Duquesne proposed that any issues regarding merger-related synergies are appropriately addressed in the merger docket, not this proceeding. (R.D., p. 305). The OCA and MAPSA disagreed and indicated that merger savings from the stranded cost study should not be totally omitted from this proceeding (R.D., pp. 305, 308). The OCA suggested that we should consider stranded costs with and without merger savings. (R.D., p. 306). MAPSA added that since the restructuring proceeding and merger proceeding

are inextricably intertwined, we should render a decision in this proceeding based on an assumption that the merger is likely to occur. (R.D., p. 308).

The OCA recommended approval of $152.28 million of estimated generation-related merger savings at January 1, 1999, on an after tax basis and net of costs to achieve the savings. DII supported the OCA's position with respect to Duquesne's claimed savings that will result upon approval of the proposed merger (R.D., p. 306). Duquesne has not reflected merger savings in its computation of stranded costs, but stated instead, that the issue be addressed in the context of the merger proceeding (R.D., pp. 305-306). HSS/ARI indicated that, in the event of merger consummation, we should recognize the resulting cost savings and use the projected $550 million costs savings to offset any allowed stranded costs. PRA stated that stranded investment analysis must quantify savings if we approve or reject the proposed merger (R.D., pp. 307-308).

2. ALJ's Recommendation

ALJ Corbett agreed with MAPSA that this restructuring proceeding and the merger proceeding are inextricably intertwined. Under the ALJ's decision, an adjustment must be made in this case to account for the savings due to synergies that the Company admits will be achieved if the merger is successfully consummated. ALJ Corbett also recommended that we adopt the OCA's position (R.D., pp. 310-311).

3. Parties' Exceptions

Duquesne disagrees with the ALJ's recommendation and argues that any issues regarding merger related synergies are appropriately addressed in the merger docket, not in this proceeding (Duquesne Exc., p.17). The OCA argues that Duquesne's

stranded costs should be adjusted downward by $152.8 million if the merger is approved. (OCA R.Exc., p. 10). The DII submits that Duquesne's Exception to the ALJ's adjustment should be rejected. (DII R. Exc., p. 11). The HSS/ARI argue that Duquesne's attempt to shield merger savings from its ratepayers should be rejected. (HSS/ARI R. Exc., pp. 13-14).

4. Resolution

We note that this portion of the Recommended Decision provides guidance to conditions applicable if the merger goes forward and is successfully consummated. Consequently, we adopt Duquesne's presentation of the merger savings of $152.28 million as an offset to the recoverable stranded costs. We conclude that the OCA's recommendation in this regard is persuasive and supports our adoption of the merger savings adjustments.

Because the outcome of the proposed merger will not be known until after the record in this proceeding is closed, we find that it is improper to totally omit merger savings from the stranded cost study. Fairness and equity require that any merger savings should be credited against any stranded cost recovery authorized in this proceeding. In addition, we note the OCA's estimate of merger-related savings adopted Duquesne's own projections. Duquesne did not rebut the estimate other than to argue that such savings could be addressed in the final valuation.

The OCA also proposed an immediate rate reduction of $15 million to begin January 1, 1999, to reflect Duquesne's statement of merger savings associated with distribution operations. Duquesne had proposed that the rate reduction occur in the year 2001, to reflect distribution expense reductions. We agree with Duquesne that some time

must pass before such savings can be generated by the restructuring attendant to the merger. The record reflects, however, that both companies have been working to create these savings since the merger was announced last year. Merger savings from distribution revenues is one item that benefits all customers whether they shop for generation or not. This is a strong indicator of the benefits gained from a merger.

As a result, we conclude that the customer rate reductions should begin January 1, 2000, rather than in 2001, as the Company proposed. The reduction of $15 million in distribution revenues as proposed by the OCA is reasonable and is in the public interest because such savings from distribution revenues will benefit all customers even if they do not shop for generation.

D. Decommissioning

1. Nuclear Decommissioning

a. Positions of the Parties

The OTS noted that Duquesne claimed a share of the decommissioning responsibility for the Beaver Valley 1 and 2 and the Perry nuclear sites in its stranded cost claim. Duquesne's estimate for the decommissioning of Beaver Valley 1 and 2 is $727.7 million and its estimate for Perry is $650 million, for a total of approximately $1,378 million (1997$). The OTS disagreed with Duquesne's $1,378 million estimate. The OTS specifically opposed the use of contingency factors because the Act claimed that stranded costs must be "known and measurable." The effect of removal of the contingency factors from Duquesne's total nuclear decommissioning estimate is a reduction of $222.9 million. (R.D., pp. 313-315).

The OCA recommended modifications to Duquesne's nuclear decommissioning claim by calculating the annual funding contributions which are required over the years 1999 to 2005 to fully fund nuclear decommissioning costs prior to December 31, 2005. The OCA identified 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. (R.D., pp. 319-320).

The DII argued that Duquesne's claim of $281.0 million for nuclear decommissioning costs is inflated because it is not valued on a NPV basis. The DII recommended that we accept $42.959 million as the NPV of stranded nuclear decommissioning costs at December 31, 1998. The DII opposed Duquesne's proposal to calculate nuclear decommissioning costs as of December 31, 2005. (R.D., pp. 321-322).

The HSS/ARI contended that we should not reach a determination today concerning nuclear decommissioning costs that are not known and measurable and which Duquesne has not shown as stranded. HSS/ARI recommended that we reject Duquesne's request for $57.4 million in alleged nuclear decommissioning costs. As an alternative, The HSS/ARI suggested that we retain an independent expert in the field to perform an audit on Duquesne's nuclear decommissioning costs. (R.D., pp. 325-326).

The PRA asserted that we should permit a nuclear decommissioning cost recovery level of $42.959 million on a net present value basis for Duquesne's nuclear plants. The PRA argued that nuclear decommissioning costs must be valued at January 1, 1998, and not the final valuation date requested by Duquesne. (R.D., p. 328).

The Environmentalists urged us to address the complicated and technical policy issues of nuclear decommissioning in a generic case. (R.D., p.333).

b. ALJ's Recommendation

ALJ Corbett recommended that we adopt the OCA's proposed adjustment to Duquesne's claim for nuclear decommissioning costs. (R.D., p. 335).

c. Parties' Exceptions

The Environmentalists argue that the ALJ erred in rejecting its nuclear decommissioning proposals which included an incentive to control costs, the need for mitigation of decommissioning costs, the need for a generic proceeding on nuclear decommissioning, the need for an external fund, the need for cost-benefit analysis, and the proper treatment of spent nuclear fuel and radioactive waste. (Environmentalists Exc., p. 3).

Duquesne claims that the ALJ erred in adopting the OCA's proposal for nuclear decommissioning which used a contingency factor of 10%. (Duquesne Exc., p. 18). The OTS agrees that the ALJ erred in allowing a 10 % contingency factor add-on to Duquesne's nuclear decommissioning estimates. (OTS Exc., p. 7). The OTS also claims that the ALJ erred in recommending that Duquesne be permitted to recover the OCA's total projected level of nuclear decommissioning expenses over the seven year transition period. (OTS Exc., p. 11).

d. Resolution

We adopt the DII calculations which are supported by substantial evidence and, are consistent with our decision in, Pa P.U.C. v. Pennsylvania Power & Light Company, 85 Pa. P.U.C. 306 (1995). In order to protect against over-valuation, we specifically find that nuclear decommissioning expenses must be valued at net present value as of December 31, 1998, as calculated by the DII. We find that the Company's proposal, which includes a 4% annual inflation factor up to the year of each plant's decommissioning, is improperly inflated due to the inclusion of contingency factors. Since the Act provides that claimed stranded costs must be "known and measurable, we therefore reject Duquesne's proposal to defer stranded cost valuation as of December 31, 2005.

The proposed use of the December 31, 2005 date for the net present value calculation of the Company is intrinsically linked to Duquesne's residual CTC method. The annual recalculation of stranded costs and the "final look" valuation in 2003 does not comply with the statute directive for a stranded cost determination as a result of this restructuring proceeding. Therefore, the net present value shall be determined as of December 31, 1998.

2. Fossil Decommissioning

a. Positions of the Parties

Duquesne estimated a future fossil decommissioning expense of $274.4 million and argues that the expense is recoverable as a stranded cost because it is based on the actual decommissioning study presented by Duquesne witness LaGuardia.

The OCA argued that Duquesne's estimated future fossil decommissioning costs are not properly included in the stranded cost calculation and are not recoverable in this proceeding. The OCA further noted that we rejected PECO's claim for prospective fossil decommissioning in its entirety. See PECO Energy at 91. (R.D., pp. 341-343).

The DII concurred with the OCA's position and indicated that future fossil decommissioning expenses are not recoverable as stranded costs under the Act. The DII also cited our rejection of PECO's recovery for prospective fossil decommissioning as a stranded cost pursuant to the Act. See PECO Energy at 91. (R.D., pp. 343-345). The HSS/ARI agreed with the OCA and the DII, and concluded that future or prospective fossil plant decommissioning expenses are not traditionally recognized in rates in this Commonwealth, nor do they satisfy the known and measurable standard test for recovery as stranded costs. (R.D., p. 346).

The PRA noted that we should reject Duquesne's proposal to recover prospective fossil fuel decommissioning costs as a stranded cost due to the speculative nature of such projections. (R.D., p. 347).

The OTS disagreed with Duquesne's $274 million estimate because it was improperly inflated due to the inclusion of a 15% contingency factor. The OTS claimed that the inclusion of contingency factors is inconsistent with the Competition Act which provided that stranded costs must be known and measurable. The OTS recommended a $41.6 million reduction for a total remaining decommissioning expense estimate of $232.8 million. (R.D., pp. 337-338).

b. ALJ's Recommendation

ALJ Corbett recommended that we reject Duquesne's claim for fossil fuel decommissioning costs in its entirety because PECO Energy controls the issue. (R.D., p. 347).

c. Parties' Exceptions

Duquesne argues that the ALJ erred by disallowing recovery of future fossil decommissioning expenses. (Duquesne Exc., p. 18). PECO claims that the ALJ erred in denying Duquesne's request regarding the recovery of future fossil decommissioning costs. (PECO Exc., p. 3).

d. Resolution

The definition of stranded costs in Section 2802 clearly includes non-nuclear plan decommissioning as a potentially recoverable stranded cost within the Commission's discretion pursuant to Section 2808(c)(3). However, Duquesne does not claim any present actual fossil decommissioning costs. Instead, Duquesne claims its current estimate of future fossil decommissioning costs.

Even if this Commission could assume that Duquesne witness Laguardia's current estimate of future fossil decommissioning expense was accurate and that fossil decommissioning would in fact occur at the time and expense scenarios assumed by Duquesne witness Laguardia, the record of the case would remain devoid of any evidence suggesting that Duquesne's claimed fossil decommissioning costs will be stranded. The sale of Ft. Martin at a price substantially above book value and the market valuation

evidence in this proceeding provides no basis for a finding that future fossil decommissioning costs will ever be stranded for any particular plant, let alone every one of Duquesne's fossil units. Without a demonstration that a cost will be stranded, surely there is no recoverable costs. Fossil plant decommissioning, if it occurs at all, will occur after the transition period has ended, and it is possible that Duquesne will no longer own the plant. Indeed, Duquesne has proposed, to divest all of its generating units, and the Commission herein accepts that proposal.

Similarly, nothing in the Act requires recovery of future fossil decommissioning costs that do not yet exist as plant operating expenses. Crucially, future decommissioning costs are completely different from other operating costs that are now in rates and are not quantified. There are also unlike the book value of a plant that is now in rates and form the basis for a stranded cost claim. Future fossil decommissioning costs by definition are not now in rates and are not known and measurable, unlike the other expenses or assets at issue in this case.

We agree with Duquesne that prospective fossil decommissioning assumptions are somewhat like life assumptions. Like life extensions, it is possible that fossil decommissioning may occur at some future date. However, we cannot agree with Duquesne's assertion that fossil decommissioning is certain to occur within any meaningful time horizon. It is no more certain that the life extension assumption that Duquesne strongly rejects as inherently unknown and unmeasurable. Future fossil decommissioning expense is not a known and measurable amount at this time, because decommissioning is not certain to occur at all, the amount and the timing of any expense is speculative, and the level of decommissioning required and residual use of the site are entirely unknown. Thus, like life extensions and future environmental compliance costs, we conclude that there is not substantial evidence to support a finding that Duquesne will

incur any known and measurable fossil decommissioning costs that would have been recoverable under traditional ratemaking but are not stranded.

Duquesne's argument that the LaGuardia study is adequate to support stranded cost recovery for future fossil decommissioning ignores the fact that future fossil decommissioning costs are not recoverable under traditional ratemaking. Future fossil decommissioning expenses are not like recoverable stranded future operating expenses such as depreciation or fuel expense that are included in current rates at a precise expense level or a normalized level pursuant to traditional ratemaking.

Under traditional ratemaking, fossil decommissioning expense may be recoverable when the cost is incurred for the actual retirement of a plant. Present fossil decommissioning expense could be included in rates pursuant to Penn Sheraton, and within the Commission's discretion to permit recovery under the Act. Both Penn Sheraton and long-standing Commission precedent, however, preclude a present determination of recovery of prospective, speculative decommissioning expense. In order to be recoverable under traditional regulation, the cost must be known and measurable and actually incurred. For example, the Commission explicitly rejected a PPL claim for future fossil decommissioning expense in its last rate case.

Fossil decommissioning expenses are also unlike nuclear decommissioning expenses. Nuclear decommissioning expenses are already included in rates, are required by federal law, are specifically required for stranded cost recovery under the Act, and are required for urgent public health and safety reasons. Future fossil plant decommissioning is neither federally mandated nor urgent for public health reasons, and is not required under the Act.

We conclude that Duquesne has not documented any known and measurable future fossil decommissioning expense that meets normal ratemaking standards, demonstrated that the costs would be recoverable under traditional regulation, demonstrated that the cost will in fact be stranded, or demonstrated that the costs will be non-mitigated. Duquesne's claim therefore does not meet the basic requirements for stranded cost recovery and must be rejected. For these reasons, as well as those articulated by the OCA, DII, PRA and HSS/ARI, we deny Duquesne's claim.

E. Regulatory Assets and Liabilities

1. SFAS 109 Deferred Taxes

(a) Positions of the Parties

Duquesne claimed $179 million, net of taxes, for SFAS deferred taxes. The Company, 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 a regulatory asset. (R.D., p. 348). The OCA argued that this framework must be adjusted to a net present value of $62.94 million. (R.D., p. 350).

The DII argued that the SFAS 109 is not properly claimable by Duquesne as a stranded regulatory asset. DII, however, submitted that SFAS 109 net plant should remain part of the net book value of the Perry and Beaver Valley 1 generating units and that Duquesne's claimed regulatory asset of $62.94 million be denied. (R.D., p. 352)

HSS/ARI opposed Duquesne's recovery of $179 million on a net present value basis. HSS/ARI noted that Duquesne's request conflicts with our ruling in PECO. PECO Order at 66. (R.D., p. 353).

PRA recommended that the amount of the SFAS 109 asset related to plant should be included in the Duquesne qualification of generation related costs only. (R.D., p. 354).

(b) ALJ's Recommendation

ALJ Corbett recommended that we approve the OCA's approach to avoid the "double recovery" problem. Accordingly, Duquesne's SFAS 109 obligation should be treated as a tax liability from the balance of plant in service and not as a regulatory asset. ALJ Corbett's recommendation reduces Duquesne's regulatory asset claim by $ 62.94 million. (R.D., p. 354).

(c) Parties' Exceptions

The HSS/ARI claims that the ALJ erred in approving Duquesne's claim for recovery of any SFAS 109 deferred taxes as a regulatory asset. HSS/ARI argues that since Duquesne did not file a rate case since 1986, it retained any tax benefits for its shareholders. (HSS/ARI Exc., pp. 20-21, R. Exc., p. 21).

(d) Resolution

We conclude that in order to be claimable as stranded costs, regulatory assets must be "known and measurable" and traditionally recoverable under current

regulatory practice but not recoverable in the competitive market. The Commission must quantify the amount of any properly claimed stranded regulatory asset on a net present value basis. Under its methodology proposed in the case, Duquesne removed SFAS No. 109 plant tax liability from the balance of plant in service and included it as a regulatory asset. While we do not dispute that this was necessary under the Company's approach to properly recover the SFAS 109 plant obligation, we conclude that the Companies adjustment must be reversed. We note the Company's final regulatory asset claim reflects the OCA adjustment of $62.94 million for SFAS 109 plant obligation, so no further adjustment is required.

We find that this SFAS 109 net plant regulatory asset is not properly claimable by Duquesne as a stranded regulatory asset. This particular asset contrasts to nuclear decommissioning expenses which are fully recoverable. The claimed SFAS 109 regulatory asset is not a "net generation-related" cost pursuant to the Act. Prior to claiming the regulatory asset, SFAS 109 net plant was included as "plant in service" for the Perry and Beaver Valley 1 units. In order to avoid the problem of double recovery, and allow for consistency in the application of the analysis of the recovery of stranded costs, we conclude that Duquesne's SFAS 109 obligation should be treated as a tax liability from the balance of plant in service and not as a regulatory asset. We, therefore, reduce the Company's regulatory asset claim by $62.94 million.

2. Unamortized Debt Costs

(a) Positions of the Parties

Duquesne claimed pre-2006 unamortized debt costs of $9.8 million and post-2005 debt costs of $19.04 million. (R.D., p. 354). The OCA, however,

recommended a different approach to the determination of stranded costs-specifically that a determination of stranded costs be made as of December 31, 1998. The OCA concluded 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. (R.D., p. 355-356).

The DII opposed Duquesne's recovery of unamortized debt costs because these costs are not "net electric generation-related costs" pursuant to the definition of stranded costs in the Act. The DII also noted that Duquesne admitted that the inclusion of these costs as regulatory assets and in its cost of debt conceptually represents double recovery. (R.D., p. 358-359).

The HSS/ARI and the PRA are opposed to Duquesne's request to recover unamortized debt costs and unamortized premium on reacquired debt as regulatory assets. HSS/ARI noted that it would be inequitable to allow Duquesne to realize a benefit while at the same time it recovered a CTC associated with its unamortized debt costs. (R.D., pp. 360-361).

(b) ALJ's Recommendation

ALJ Corbett agreed with the OCA's claim for unamortized debt costs should be valued as of December 31, 1998. (R.D., p. 361).

(c) Parties' Exceptions

The DII contends that the ALJ inappropriately permitted Duquesne to recover its claimed regulatory asset for unamortized debt costs (DII Exc., p. 9). The

HSS/ARI adds that the ALJ erred in granting Duquesne's request for recovery of $47.77 million in unamortized debt costs as a regulatory asset (HSS/ARI Exc., p. 21).

(d) Resolution

We support the ALJ's recommendation which adopts the position of the OCA. The OCA concluded 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. As a result of this approach, we find that the full generation-related balance of unamortized debt costs as of December 31, 1998 should be recognized as a regulatory asset. We reject the arguments of the HSS/ARI and DII relative to improper Company claims of unamortized debt costs as a regulatory asset. The HSS/ARI and DII also claimed that Duquesne's request results in a double recovery. We concur with the OCA witness Catlin who considered unamortized debt as of December 31, 1998 as a regulatory asset (exclusive of unamortized debt costs associated with the Beaver Valley 2 sale/leaseback).

3. Unamortized Sale/Leaseback Premiums

(a) Positions of the Parties

The OCA noted that Duquesne claimed as a regulatory asset full recovery for the "premium of reacquired debt associated with Beaver Valley No. 2." The Company valued the regulatory asset at $30.06 million. The claimed regulatory asset is divided in two parts-pre 2005 and post 2005. OCA utilized a 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 Agreement, resulting in a net present value amount of $55.13 million. (R.D., p. 362).

The DII recommended that we deny Duquesne's treatment of the Beaver Valley 2 sale/leaseback premium of $30.06 million. DII noted that because recovery for the refinancing premium will be provided from elsewhere both pre-2005 and post-2005, Duquesne's claimed regulatory asset for the Beaver Valley 2 sale/leaseback premium is not a "net" stranded regulatory asset pursuant to the Act. As a result, the DII contended that recovery should be denied. (R.D., p. 365). PRA noted that the effect of improper inclusion in both generation stranded cost quantification and as a regulatory asset is an excessive quantification of stranded costs. (R.D., p. 365).

(b) ALJ's Recommendation

ALJ Corbett recommended that we adopt the claim of Duquesne for unamortized sale and leaseback premiums, as modified by the OCA. (R.D., p. 366).

(c) Parties' Exceptions

There are no arguments on exception for this issue.

(d) Resolution

Consistent with the ALJ's recommendation, we adopt Duquesne's claim for unamortized sale and leaseback premiums as modified by the OCA treatment. We agree that the OCA's approach in determining a net present value of $55.13 million is reasonable and appropriate. We also agree with the OCA that Duquesne, for all practical purposes, is the owner of the Beaver Valley 2 nuclear generating station and treat all of the costs of the sale/leaseback as an owned-generation asset. We likewise concur with the

OCA's removal of $63.66 million to reflect the benefits of the Ft. Martin agreement. We note that Duquesne has no particular quarrel with the OCA's treatment.

4. Deferred Rate Synchronization Costs

(a) Positions of the Parties

Duquesne claimed deferred rate synchronization costs of $23.5 million. (R.D., p. 366). The OCA argued that the correct quantification, as agreed to by the Company, is $24.87 million (at December 31, 1998). (R.D., p. 367). HSS/ARI contended that Duquesne should not be permitted to recover its deferred rate synchronization costs as a regulatory asset in this proceeding (R.D., p. 368). PRA noted that under its proposal, Duquesne would amortize the unamortized balance by the end of the year 2005. PRA contended that 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. (R.D., p. 370).

(b) ALJ's Recommendation

ALJ Corbett recommended that we permit recovery of $23.5 million, on a net present value basis for Duquesne's claim of $23.5 million for deferred rate synchronization costs. (R.D., p. 370).

(c) Parties' Exceptions

HSS/ARI argues that the ALJ erred in granting Duquesne's requested recovery of $23.5 million in deferred rate synchronization costs as a regulatory asset.

HSS/ARI contends that the ALJ's recommendation is inconsistent with PECO Energy. (HSS/ARI Exc., p. 22).

(d) Resolution

We adopt the ALJ recommendation which accepts the revised Duquesne claim. The ALJ specifically finds that the record supports the Duquesne claim, and we permit recovery of $23.5 million, on a net present value basis. Deferred rate synchronization costs are early window costs associated with Perry and Beaver Valley 2 that the Company is permitted to amortize through 2006, as part of the Ft. Martin settlement. Since a return on these costs in a regulated environment would not be recoverable, the deferred rate synchronization regulatory asset in this proceeding must be quantified on a net present value basis.

5. Deferred Employee Costs

(a) Positions of the Parties

Duquesne claimed deferred employee costs of $13.830 million, on a net present value basis. (R.D., p. 370). DII claimed the Company's stranded regulatory asset for deferred employee costs is inappropriate and must be rejected. DII submitted that Duquesne's claim that all regulatory assets simply represent timing differences between accrual and cash recognition of expenses is incorrect. PRA concurred with DII. (R.D., pp. 371-374).

(b) ALJ's Recommendation

ALJ Corbett recommended that Duquesne's claim for deferred employee costs of $13.830 million, on a net present value basis appears justified and should be approved. (R.D. p. 374).

(c) Parties' Exceptions

DII argues that the ALJ erred in permitting Duquesne to recover a stranded regulatory asset for deferred employee costs. (DII Exc., p. 11). DII claimed that this is inappropriate under the Act since the costs are not rendered unrecoverable by the transition to a competitive market. (DII Exc., p. 12).

(d) Resolution

We adopt Duquesne's claim for compensated absences, injuries and damages of $14.24 million, as computed by the OCA, on a net present value basis, as supported by the ALJ. We believe that these costs are justified and should be approved. Since all regulatory assets represent the timing difference between accrual and cash recognition of expenses, the asset should be allowed. We note that similar regulatory assets were approved in PECO Energy.

6. Deferred Coal Costs

(a) Positions of the Parties

Duquesne claimed deferred coal costs in the amount of $13.5 million, on a net present value basis. (R.D., p. 374). The OCA recommended that Duquesne's entire deferred cost claim be denied because the Commission settlement at Docket Nos. P-00890386 and P-00890387 Slip Op. (June 15, 1990) did not provide assured recovery of any costs which the Company was required to defer because the price paid for coal exceeded the price cap. (R.D., p. 375). DII added that Duquesne's claim for a regulatory asset representing deferred coal costs is inappropriate under the Act because the amounts would not be typically recoverable in the regulated environment. (R.D., p. 377). HSS/ARI contended that since Duquesne cannot determine its future deferred coal costs on a net known and measurable basis, the Company's attempt to recover such costs must, therefore, be rejected. (R.D., p. 378). PRA also favored denial of Duquesne's claim because this amount represents costs which historically have been above market costs that limited the amounts that could be included in an annual ECR. (R.D., pp. 378-379).

(b) ALJ's Recommendation

ALJ Corbett recommended that Duquesne's claim for deferred coal costs of $13.5 million be denied in its entirety. (R.D., p. 379).

(c) Parties' Exceptions

Duquesne claims coal costs that exceeded "caps" in the Company's ECR and were deferred for recovery until fuel costs fell below those caps in the amount of

$13.5 million, on a net present value. The Company argues that the ALJ's finding is based on the argument that the caps were "market" based and that Duquesne's fuel cost will never fall below market levels, when, in fact, the caps at issue are cost-based, and Duquesne's fuel costs will decline in 2000 to below these. (Duquesne Exc., p. 19-20).

(d) Resolution

Duquesne claims deferred coal costs in the amount of $13.5 million, on a net present value basis. The balance represents the amount that Duquesne paid for coal from the Warwick mine or at the Mansfield plant 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 in Petition of Duquesne Light Company for Order Establishing a New Coal Standard at Docket Nos. P-00880386 and P-00890387. Duquesne's witness O'Brien argued that the settlement provided for recovery of these deferred coal costs at some future time. The OCA's witness Catlin disagreed and recommended that Duquesne's entire deferred cost claim be denied. He argued that 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.

We adopt the ALJ's recommendation which disallows the Duquesne claim for deferred costs of $13.5 million in its entirety, finding that the Company has failed to show that these costs would be recoverable in a regulated environment. We likewise concur with the OCA's witness Catlin that the settlement at Docket Nos. P-00880386 and P-00890387 did not provide assured recovery of any costs which Duquesne was required to defer because the price paid for coal exceeded the price cap.

7. Deferred Caretaker Costs

(a) Positions of the Parties

Duquesne claimed deferred caretaker costs of $3.92 million, on a net present value basis, that are incurred in maintaining Brunot Island and Phillips plants in cold storage in the expectation that, in the future, they would become economic. (R.D., p. 379).

The OTS indicated that since Duquesne has clearly failed to meet its burden of proof that these costs are recoverable under the Act, the Company's claim should be denied. (R.D., p. 380). The OCA added that there is no basis that the recovery of deferred caretaker costs and the $6,770,000 on a pre-tax basis should be removed from Duquesne's regulatory asset claim. (R.D., p. 382). DII further contended that these costs do not meet the standards for recovery of stranded costs pursuant to the Act and should, therefore, be denied. (R.D., p. 383). HSS/ARI agreed with the DII and added that these caretaker costs are not related to industry restructuring and should be removed from Duquesne's stranded cost claims (R.D., p. 384). PRA also contended that Duquesne's claim should be disallowed because recovery would have been permitted only if the plants had been returned to service (R.D., p. 385).

(b) ALJ'S Recommendation

ALJ Corbett recommended that we deny Duquesne's claim for deferred caretaker costs of $3.92 million on a net present value basis in its entirety. ALJ Corbett noted that nothing in the record appears to support a determination that the assets

associated with these caretaker costs will be returned to service within the foreseeable future. (R.D., p. 385).

(c) Parties' Exceptions

Duquesne claims that the ALJ erred in disallowing deferred caretaker costs associated with Brunot Island and Phillips. (Duquesne Exc., p. 20).

(d) Resolution

The deferred caretaker cost regulatory asset reflects the accounting treatment authorized by the Commission at Docket No. P-00900485 for preservation costs associated with maintaining the Philips and Brunot Island Generating plants. Since Duquesne has stated that it has no intention to return these units to commercial operations, we conclude that recovery of the regulatory asset is inappropriate under the standards set forth in the Act. Regulatory assets are recoverable under the Act for specific reasons, including that they would be typically recoverable in a regulated environment and stranded as a result of the transition to a competitive market. Several commentators, including the OCA, OTS, DII, HSS/ARI, and PRA concur that Duquesne's claim should be rejected.

We adopt the ALJ recommendation which holds that the assets to which these costs relate, the Phillips and Brunot Island plants, are not "used and useful". We deny those costs of $3.92 million on a net present value basis in their entirety. We find that nothing in the record appears to support a determination that the assets associated with these caretaker costs will be returned to service within the foreseeable future.

8. Pre-Accrual of Nuclear Outages

(a) Positions of the Parties

Duquesne claimed a charge of $10.29 million, on a net present value basis, for pre-accrual of nuclear outages. (R.D., p. 385). The OCA opposed the charge because it feared that this will result in a double accounting of costs. (R.D., p. 387). DII added that the Company inappropriately requested recovery for a regulatory asset related to its change in the accounting treatment of costs associated with nuclear outages. DII claimed that these costs are not "stranded" pursuant to the Act because the accounting deferral will reverse in the final year of the nuclear unit's life. PRA supported DII on this issue. (R.D., pp. 387-388).

(b) ALJ's Recommendation

ALJ Corbett recommended that we allow Duquesne to claim as a regulatory asset pre-accrual of nuclear outages in the amount of $10.29 million on a net present value basis. ALJ Corbett noted that the transition to a competitive market justified a change in accounting methods for this asset. (R.D., pp. 388-389).

(c) Parties' Exceptions

DII claims that the ALJ erred in permitting Duquesne to recover a stranded regulatory asset for pre-accrued nuclear outage costs. (DII Exc., p. 12). DII notes that these costs will be recoverable in the competitive market and do not qualify under the Act's definition of stranded cost. (R.D., p. 13).

The OCA argues that the ALJ's decision to allow recovery of pre-accrued nuclear outage costs as a separate claim was in error (R.D., pp. 388-389). The OCA objects to including these costs as a regulatory asset because the costs were recovered elsewhere. (OCA Exc., pp. 21-22).

(d) Resolution

Duquesne claims a charge of $10.29 million, on a net present value basis, for pre-accrual of nuclear outages. This regulatory asset arises from a change in accounting that was specifically approved by Duquesne's outside auditors and FERC staff. The OCA opposes this change because it will result in double counting of costs. The OCA's witness Catlin stated that these outage costs are already included in the OCA's stranded cost analysis and, thus, would not deny Duquesne any recovery. DII added that the claimed regulatory asset is not stranded because Duquesne will recover the deferral amount regardless of the transition to the competitive market. Consequently, DII's claim that pre-accrued nuclear outage costs are not properly recoverable as a stranded cost pursuant to the Act.

For these reasons, we reject the ALJ's recommendation to allow Duquesne to claim as a regulatory asset pre-accrual of nuclear outages in the amount of $10.29 million, on a net present value basis. We concur with the OCA that this adjustment is included in plant operations and allowance as a regulatory asset would double count the expenses of a nuclear outage.

9. Transition Costs

(a) Positions of the Parties

Duquesne claimed transition costs of $10.59 million, on a net present value basis. (R.D., p. 389). The OTS and the OCA do not oppose this recovery because PECO Energy permitted recovery of similar costs. (R.D., p. 389). DII and HSS/ARI opposed part and all, respectively, of these costs, but they do not contest any expenditures as unjust or unreasonable. DII specifically requested that $8.3 million in Customer Advanced Reliability System (CARS) related expense be removed from the Company's proposed transition cost claim (R.D., pp. 390-391).

(b) ALJ's Recommendation

ALJ Corbett recommended that we allow the Company to claim the full amount of its transition expenses in the amount of $10.59 million, on a net present value basis. (R.D., p. 392).

(c) Resolution

We adopt the ALJ's recommendation to allow Duquesne the full claimed amount of transition expenses in the amount of $10.59 million on a net present value basis. We note that there is no support for DII's contention that Duquesne's claim included $8.3 million in Customer Advanced Reliability System (CARS) related expenses. We find that these transition costs, which relate to the expense of this restructuring proceeding and pilot program deferrals, should be approved because they

were required to be expended to implement the Act. We note that recovery of similar costs was permitted in PECO.

10. SFAS 106 Deferred Costs

(a) Positions of the Parties

Duquesne claimed $1.92 million, on a net present value basis, for SFAS 106 deferred costs. (R.D., p. 392). The OTS and the OCA do not oppose their recovery since PECO Energy approved recovery of a similar regulatory asset. (R.D., p. 392). The DII and HSS/ARI, however, opposed recovery. the DII argued that the Company's claimed regulatory asset for SFAS 106 costs lacked a factual and statutory basis. PRA concurred with DII. HSS/ARI added that Duquesne has not offered any support for our approval of these costs as a regulatory asset. (R.D., pp. 393-395).

(b) ALJ's Recommendation

ALJ Corbett recommended that we deny Duquesne's claim for $1.92 million, on a net present value basis. ALJ Corbett noted that SFAS 106 is not a regulatory asset and all suppliers in a competitive environment will be subject to SFAS 106. (R.D., p. 395).

(c) Parties' Exceptions

Duquesne excepts to the ALJ's disallowance of SFAS 106 health care benefits and life insurance for retired employees. (R.D., p. 395) (Duquesne Exc., p. 20). HSS/ARI argued that Duquesne's exception should be denied because the Company has

not been able to demonstrate that it is entitled to recover any SFAS 106 deferred costs. (HSS/ARI R. Exc., p. 19). The DII adds that Duquesne's exception is without merit and should be denied because the concept of stranded cost recovery is only available for the portion of future operating costs not compensated for by future market prices. (DII R. Exc., p. 13). PRA concurs that SFAS 106 costs are not transition costs. (PRA R. Exc., p. 6).

(d) Resolution

Duquesne claims $1.92 million, on a net present value basis, for SFAS 106 deferred costs related to post-retirement benefits such as health care and life insurance. Duquesne's witness Clayton stresses that these expenses are required under Generally Accepted Accounting Procedures (GAAP). The OCA and OTS support the recovery of these costs.

Since these costs are required under GAAP, are known and measurable, and incurred under traditional regulation, and otherwise meet the definition of stranded costs, we find that Duquesne's claim is justified. We, therefore, reject the ALJ's recommendation and adopt the Duquesne/OCA/OTS allowance of $1.92 million. We note that recovery of a similar asset was approved in PECO.

11. Warwick Mine Costs

(a) Positions of the Parties

Duquesne submitted a claim for over $15 million in stranded costs associated with the Warwick Mine. Duquesne explained that Warwick mine costs are

included in plant, not regulatory assets. (R.D., p. 396). No party other than HSS opposed its recovery. HSS/ARI argued that Duquesne is inappropriately seeking direct recovery of its capital investment in the mine from its ratepayers. (R.D., pp. 396-397).

(b) ALJ's Recommendation

ALJ Corbett recommended that we deny Duquesne's claim in its entirety since Warwick Mine costs are not currently in rate base and the costs are not stranded by the transition to a competitive generation market. (R.D., p. 397).

(c) Parties' Exceptions

Duquesne claims that the ALJ decision disallowing Warwick Mine costs is in error. The Company argues that the finding ignores the agreement reached with the Commission since the last rate case, under which Duquesne can recover the cost of the Warwick Mine through the ECR. (Petition of Duquesne Light Company for Order Establishing A New Coal Cost Standard, P-890386, Order 3) (Duquesne Exc., p. 21).

(d) Resolution

Duquesne seeks to recover over $15 million in claimed stranded costs associated with the Warwick Mine. The claimed $15 million represents the net book value of Duquesne's investment in the mine. In 1981, the Commission required Duquesne to remove Warwick Mine from the Company's rate base. After 1981, Duquesne was permitted to recover its investment in the Warwick Mine through the cost of coal subject to the coal cost cap in the ECR. In 1996, the operator of the mine ceased operations. HSS/ARI argues that for the same reason applicable to deferred coal costs as previously

discussed, Warwick Mine capital does not qualify as a regulatory asset. Also, because there has been no production from the mine well, before this restructuring proceeding, Duquesne is not entitled to collect any cost of, much less its capital investment with, the mine under the coal cost cap.

We agree with the exceptions of Duquesne and reject the ALJ's adoption of the HSS position. The inclusion of the remaining plant balance in net plant in service is the proper treatment to be accorded this stranded property. We have disallowed the regulatory asset claim for deferred fuel costs associated with the past operation of the mine. The net plant is the cost that would have had rate recovery through the ECR absent the Act. Duquesne never sought treatment of the property as a regulatory asset as claimed by HSS.

F. Recovery of Stranded Costs

1. Proposals to Adjust the Level of Stranded Cost Recovery

(a) Mitigation

(i) Positions of the Parties

Duquesne noted that by the year 2005 its mitigation efforts will have achieved $1 billion in savings and $700 million in avoided rate increases. (R.D., p. 400). The OCA determined the reasonable level of the Company's owned-generation stranded costs at January 1, 1999, to be $1.020 billion.

The DII contended that we should strongly urge Duquesne to pursue securitization of stranded costs as a final mitigation strategy to arrive at a just and reasonable recovery from ratepayers. (R.D., p. 405). The HSS/ARI contended that the evidence fails to demonstrate that Duquesne in fact has any stranded costs. (R.D., p. 405). The PRA suggested that once stranded costs are quantified, we must determine the allowed level permitted for recovery from ratepayers. (R.D., p. 407).

(ii) ALJ's Recommendation

ALJ Corbett concluded that no substantial evidence exists in the record to justify any adjustment to the mitigation efforts already committed to be undertaken by the Company. (R.D., p. 409).

(iii) Parties' Exceptions

The Environmentalists argue that the ALJ erred in concluding that Duquesne's mitigation efforts were adequate. (Environmentalists Exc., p. 3). Mr. Hughes concurs with the Environmentalists. (Hughes Exc., p. 9). The PRA argues that certain of the stranded cost component disallowances in this proceeding are based upon a need to mitigate and those should be adopted by the Commission. (PRA Exc., p. 14).

(iv) Resolution

We adopt the ALJ's determination that Duquesne's past actions have been adequate, but the Company must also continue a commitment to mitigation. We are aware that Duquesne's mitigation efforts will have achieved $1 billion in savings and $700 million in avoided rate increases by 2005. Duquesne St. 1 at 20; Duquesne St. at

24-26. Additionally, Duquesne auctioned a generating plant prior to the Act and used the proceeds to increase the depreciation of nuclear assets. Duquesne St. 2 at 10-12; Duquesne St. 1-R at 21.

(b) Sharing of Stranded Costs

(i) Positions of the Parties

The OCA, DII and Environmentalists each recommend a "sharing" of stranded costs. The OCA argued that sharing is appropriate, consistent with the Act, and will not significantly impair the Company's financial integrity. (R.D., p. 413). The DII added that we should employ the equity return disallowance as a reasonable method to share stranded costs between shareholders and ratepayers. (R.D., p. 425). The PRA noted that the Act does not require 100% recovery of stranded costs. (R.D., p. 426). Environmentalists believe that 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 reasonable return on that investment. (R.D., pp. 431-432).

Duquesne opposed a recommended "sharing" of stranded costs because, in their view (1) there is no support in the Act; (2) the proposals are not consistent with historic regulation in Pennsylvania; (3) the proposals are arbitrary in that they bear no relation to the facts of this case; and (4) the proposals violate state and federal law. (R.D., pp. 409-412).

(ii) ALJ's Recommendation

ALJ Corbett recommended that we deny any proposal for stranded cost sharing. ALJ Corbett concluded that any "sharing" proposal conceptually can be viewed as a "taking" of assets, subject to constitutional due process constraints. (R.D., p. 432).

(iii) Parties' Exceptions

The DII contends that the ALJ erred in rejecting its proposal for sharing stranded costs between ratepayers and shareholders. (DII Exc., p. 13). The DII requests that we modify the ALJ's Recommended Decision on this issue and use the DII recommended equity return disallowance to equitably share stranded costs between ratepayers and shareholders. (DII Exc., p. 17).

The HSS/ARI argues that the ALJ erred in recommending that Duquesne be permitted to include in stranded costs expenditures that the Company has not shown are just and reasonable. (HSS/ARI Exc., p. 13). The Environmentalists also argue that the ALJ erred in denying a sharing of the stranded generating assets. (Environmentalists Exc., p. 3). The OCA adds that the ALJ erred in placing on ratepayers the full burden, including a full return on capital, of the company's uneconomic investments, especially its uneconomic investment in nuclear generating facilities. (OCA Exc., p. 13).

(iv) Resolution

We reject the ALJ's conclusion that the Act prohibits sharing of stranded costs and that any sharing amounts to a taking. To the contrary, we find that the Act contemplates the Commission's deliberation as to just and reasonable rates for recovery of stranded

costs. It is quite apparent that the Act does not restrict the Commission's deliberation. The fact that sharing is not explicitly detailed, was to provide the Commission with the full opportunity to customize the stranded cost result and recovery to the circumstances of the individual utility. We exercise our discretion to allow Duquesne to recover 100% of its stranded costs documented to exist in fact. We find that under the circumstances of this case, the authorized recoverable smount results in a just and reasonable balancing of complex, competing interests. See PECO Energy, pp. 100-101.

To require Duquesne to share the stranded generating assets would amount to denying it recovery of a portion of its proven, stranded costs which cannot be mitigated. In our December 23, 1997 Order, in PECO Energy, we held that full recovery of these costs was just and reasonable because it balances the interest of shareholders and ratepayers. PECO Energy at 100-01. This gives the utility a fair transition to full competition when stranded cost recovery expires and provides customers with adequate shopping credits, even while they are paying the CTC. At that time we stated:

> We are confident that allowing PECO full recovery of its actual stranded costs as determined in this proceeding will enable PECO to make an effective transition to competitive markets as required under the Act, while also establishing a vibrant competitive market with real economic opportunities for competitive suppliers and consumers.

Id. At 101. We continue to hold that belief and see no reason why, absent compelling evidence, one utility should be treated any differently than another utility within the Commonwealth.

(c) Securitization

(i) Positions of the Parties

Duquesne argued that the Act does not permit forced securitization and claims such requirements would be inappropriate. (R.D., pp. 432-433). DII argued that we should require Duquesne to securitize its authorized level of stranded cost recovery in this proceeding. They claim that the Act specifically recognizes the issuance of securitized debt as a proper mitigation effort by the Company in determining the level of stranded costs that an electric utility may recover through the CTC (R.D., p. 433).

(ii) ALJ's Recommendation

ALJ Corbett recommended that DII's securitization proposal be rejected because the unrebutted evidence disclosed that Duquesne has the highest degree of debt leverage in the state, thereby lowering the its cost of capital. (R.D., p. 436).

(iii) Parties' Exceptions

The Environmentalists contend that the ALJ erred in rejecting securitization as a strategy for mitigation of stranded cost. The Environmentalists contend that Duquesne should not be able to foreclose securitization as a mitigation strategy by giving preference to its other debt. (Environmentalists Exc., p. 4). DII also contends that the ALJ erred in rejecting its securitization proposal. DII believes that Duquesne should be directed to securitize its authorized level of stranded costs as a final step of mitigation to reduce the amount of stranded costs that must be recovered from taxpayers. (DII Exc., pp. 17-19).

(iv) Resolution

We conditionally adopt the ALJ's recommendation on this issue. We find that the Act provides that securitization may be proposed only by the Company. While Duquesne, as a stand alone company, does not believe that it can securitize within its sale/leaseback and financial covenants, the post merger company should examine the option for both operating territories and determine, after a fresh look, whether securitization can provide benefits for both companies and customers. We also note that after divestiture, securitization may then be possible.

2. Methods of Stranded Cost Recovery

(a) Accelerated Amortization and Regulated Rate Cuts

(i) Positions of the Parties

Duquesne's major proposal was to have its offer of an immediate divestiture of its generation assets accepted. (Duquesne M.B., p. 18). It contended that if this offer were accepted, most disputes regarding the quantification of stranded costs and the methodology for recovering them would be resolved.

In the event the offer to divestiture were not accepted, Duquesne proposed to set CTCs pursuant to Section 2804(4)(v) of the Act. This Section provides:

> If an electric distribution utility rolls its energy cost rate into base rates at a combined level that does not exceed its combined level of such rate which have been approved by the [C]ommission as of the effective date of this chapter, the utility shall not be required to reduce its capped rates below

> the capped level upon the complaint of any party if the [C]ommission determines that any excess earnings achieved under the cap are being utilized to mitigate transition or stranded costs for the benefit of ratepayers or to offset other known and measurable cost increases that would be recoverable under traditional ratemaking but are not included within the capped rates.

The OCA objected to this method because it does not produce immediate rate reductions. (OCA St. 1 at 13).

The OCA and others argued that this is a misreading of the Act. The OCA proposed the establishment of a specific CTC, specific T&D rates, and a specific market price of generation (avoidable generation component). The OCA states that ratepayers who remain with Duquesne should only be required to pay the sum of these components. The OCA submitted that if the sum of these components produces a rate below the current rate, customers should realize a rate reduction. (R.D., p. 443). The OCA noted there is one difference between the Commission's approach in its Order in the PECO case and that recommended by the OCA in this proceeding. The OCA submitted that the approach taken in the PECO case should, thus, be modified in this case. (R.D., pp. 443-444).

Duquesne contended that the OCA's argument cannot be accepted because Section 2804(4)(v) is written in proscriptive terms. Consequently, Duquesne submitted that the only real issue is whether Duquesne's proposal for implementing Section 2804(4)(v) requires modification. On that issue, the only real dispute relates to the "ROE spillover" proposal.[20]

[20] Duquesne states that notably, no party took serious issue with Duquesne's commitment to amortize a minimum of $1.7 billion over the transition period, Duquesne

The OTS did not oppose the Company's ROE spillover proposal, with one exception, that being the 10.50% ROE should be substituted for Duquesne's 11.5% ROE in the Company's ROE spill over proposal. (R.D., p. 438).

The OCA further argued 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: (i) unnecessarily postpone the determination of the CTC resulting in uncertainty to ratepayers; (ii) likely require the establishment of a false proxy for the market price; (iii) deny ratepayers the benefits of any near-term rate savings; (iv) remove incentives to mitigate stranded costs; and (v) would require substantial regulatory oversight that is inconsistent with the objectives of the Act. (R.D., p. 438).

The City argued Duquesne's ROE spillover mechanism fails to provide Duquesne with an incentive to reduce costs or mitigate stranded costs. The City continues that the spillover fund can be manipulated so that earnings can be used to fund items associated with unregulated market transactions. For instance, according to the City, Duquesne could increase its capital expenditures before the end of the transition period so that reduced expenditures would be needed after the transition period is over when Duquesne is forced to compete. The City also states that Duquesne could also use earnings to build market share by selling power below market prices. (R.D., p. 440).

HSS/ARI noted Duquesne claims an entitlement to the rate floor protection of Section 2804(4)(v) of the Act based upon its proposal to accelerate depreciation and

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St. 2 at 39-40, Duquesne Exh. DJC-6; this proposal provides ratepayers a guarantee that Duquesne will achieve the aggressive cost reduction and containment projections contained in its case-in-chief. (Duquesne St. 1 at 5).

amortization of its generation assets by $1.7 billion through 2005, ostensibly for the purpose of mitigating stranded costs. However, HSS/ARI claimed that Duquesne has no stranded costs to mitigate. As a consequence, Duquesne has no right to accelerate amortization and depreciation (R.D., p. 441).

(ii) ALJ's Recommendation

The ALJ concluded that the OCA positions, which entailed immediate rate reductions but also an extension of the transition period, should be rejected. (R.D., p. 447).

The ALJ observed that the Company's proposal appears to track the exact language of the statute. The ALJ recommended that, to ensure "excess earnings" will be used to accelerate the amortization of stranded costs, Duquesne should be directed to file annual earnings reports in sufficient detail to permit the Commission to monitor the amortization process. For these reasons, the ALJ recommended acceptance of the Company's proposal for accelerated amortization under Section 2804(4)(v) with the ROE spill-over mechanism set at the level of 11.5% (R.D., pp. 436-437).

The ALJ also noted that if a merger is achieved, the methodology the OCA proposed for determining the Company's stranded costs should be used, since that approach appears the most reasonable, and substantial evidence supports it. Moreover, the ALJ found that the OCA's approach will allow the Commission to establish Duquesne's stranded costs in this proceeding at this time so the clock can begin ticking to bring the transition period quickly to an end without further delay. For these reasons the ALJ rejected any proposal to extend the transition period is rejected. (R.D., pp. 447-448).

(iii) Parties' Exceptions

The OCA claims that the ALJ erred in suggesting that Duquesne's ROE spillover mechanism is an appropriate mechanism to address the Company's excess earnings (OCA Exc., p. 7, 9). The Environmentalists added that the ALJ erred in accepting the Company's proposal for accelerated amortization of the CTC (Environmentalists Exc., p.4). HSS/ARI likewise indicated that the ALJ erred in approving Duquesne's proposal to accelerate amortization and deny an immediate rate reduction (DII Exc., p. 24-25).

PRA supports Duquesne's ROE spill-over mechanism (PRA Exc., p. 14). PRA argues against the ALJ recommendation that Duquesne not be required to "share" in the appropriate recovery of stranded costs as proposed by OCA and DII (PRA Exc., p.16). PRA also objects to the ALJ's rejection of the PECO Energy methodology (R.D., p.554) (PRA Exc., p. 18). PRA further contends that the ALJ's methodology incorrectly calculated the CTC and shopping credit (PRA Exc., p.18).

The OCA argues that the ALJ's recommendations with respect to the development of the CTC, shopping credit, and rate reductions should be adopted (R.D., pp. 555-557). Further the OCA requests that we clarify that, in the absence of divestiture, there should be a one-time determination of stranded costs rather than postponing that determination until the year 2003 (OCA Exc., pp. 3-4, 9).

The OCA argues that the ALJ's recommendation to reject an immediate rate decrease is inconsistent with the adoption of the proposed levelized rate reduction at p. 556 of the ALJ's Recommended Decision. The OCA urges the Commission to clarify, or modify, the statements on p. 447 of the Recommended Decision to make them

consistent with the result on page 556 of the Recommended Decision. (OCA Exc., pp. 1-8). The Environmentalists argue that the ALJ erred in rejecting a guaranteed rate reduction for the Company's customers. The Environmentalists contend that the Company should not be allowed to defer this benefit (Environmentalists Exc., p. 5).

(iv) Resolution

Duquesne argues that present rates should remain in effect without consumer savings during the transition period, permitting quicker recovery of stranded costs. On the other hand, the OCA argues that a direct regulated rate cut should be approved for all customers whether or not they shop. Neither proposal is consistent with the Act or the record of this proceeding, and both are rejected.

The CTC must be calculated as the amount necessary to fully amortize the authorized recoverable stranded and transition costs over the recovery period, including a return on the unamortized principal balance. All customers will pay the unbundled transmission and distribution rate. Non-shopping customers will pay the unbundled rate for generation such that the total rate will precisely reflect current existing rates. A proportionate amount of the unbundled generation rate collected from non-shopping customers will be allocated to CTC recovery.

Customers choosing to shop will pay their chosen supplier instead of Duquesne for generation. These customers will continue to pay a temporary charge for Duquesne's stranded generation related costs to Duquesne through the CTC. The residual amount left over from the unbundled generation rate and the CTC amount is the Shopping Credit.

We find that Section 2808(4)(v) of the Act has no relevance to a determination of the proper CTC. It states:

> If an electric distribution utility rolls its energy cost rate into base rates at a combined level that does not exceed its combined level of such rates which have been approved by the commission as of the effective date of this chapter, the utility shall not be required to reduce its capped rates below the capped level upon the complaint of any party if the commission determines that any excess earnings achieved under the cap are being utilized to mitigate transition or stranded costs for the benefit of ratepayers or to offset other known and measurable cost increases that would be recoverable under traditional ratemaking but are not included within the capped rates.

This section provides a utility with a defense against a complaint seeking a reduction in capped rates because of overearnings, something that is not being done in this case. Even if we were to accept Duquesne's argument that it is not presently earning its authorized rate of return, the section would be inapplicable on its face because the section only applies when the utility is, in fact, overearning. If it were read to do that, no customer would have any possible economic benefit from shopping. If it were read to require a shopping customer to pay its full existing rate to its present supplier, competition would be impossible and nearly the rest of the Act could not be implemented.

This section is a modification of the rate cap requirements of Section 2804(4) of the Act. Section 2804(4) does not raise any issues related to the calculation of the CTC. Section 2804(4) does not require that Duquesne be entitled to collect its full capped rate from a shopping customer.

We conclude that the CTC must be calculated as the amount necessary to fully amortize the authorized recoverable stranded and transition costs over the recovery period, including a return on the unamortized principal balance as described above. All customers will pay the unbundled rate for generation such that the total rate will precisely reflect the existing rates. Finally, we cannot agree with the OCA's proposal that the existing rate should be cut in the absence of a cost-of-service analysis.

Customers choosing to shop will pay their chosen supplier instead of Duquesne for generation; however, these customers will pay the CTC to Duquesne. The residential amount compared to the unbundled generation rate is the CGC. As we enter the era of competitive deregulated generation, this Commission is not establishing an administratively determined market price for generation that directly imposes the parameters for savings from selecting a competitive supplier. The CTC shall be designed to reflect a declining CTC over the transition period ending December 31, 2005. We conclude that it is appropriate to use a declining CTC in order to properly balance Duquesne's earnings in the early years of the transition and reasonable customer savings during the entire transition period.

We also reject the OCA's Immediate Rate Reduction Proposal consistent with the ALJ's recommendation. Rate reductions are a function of shopping. The Act provides an opportunity to achieve lower rates for Duquesne's customers through the transition to a full competitive market.

We conclude that the CTC must be calculated as the amount necessary to fully amortize the authorized recoverable stranded and transition costs over the recovery period, including a return on the unamortized principal balance. All customers will pay the unbundled transmission and distribution rate. Non-shopping customers will pay the

unbundled rate for generation such that the total rate will precisely reflect currently the existing rates. We cannot agree with OCA's proposal that the existing rate should be cut in the absence of a cost of service analysis.

(b) Rate Cap/CTC Extension

(i) Positions of Parties

The Company takes no position on this issue. (R.D., p. 448).

The OTS proposed that the rate cap under Section 2804(4) of the Act and CTC collection period be extended if the final valuation in 2003 determines a stranded cost level which would produce "rate shock." Apparently it is the Company's intention to begin collecting stranded costs determined by the panel, pursuant to the 2003 valuation, on January 1, 2004, and to collect these costs over the two remaining transition years (R.D., p. 448).

DII posited that Duquesne acknowledged that under its delayed valuation method for determining stranded costs, the Company may need an extension of the CTC recovery period in order to fully recover stranded cost revenues that the Commission authorizes. (Duquesne St. 2 at 41). Duquesne proposed to make this determination based on a CTC revenue analysis after the final delayed market valuation. (Id). Duquesne sought to extend or shorten the CTC collection period accordingly. (Id). Although DII generally assented to the concept that the collection period be extended, its agreement is subject to certain conditions. (DII M.B. at 72).

As a preliminary matter, DII noted that the Company's perceived need for an extension of the recovery period is created, in large part, by the Company's proposals to delay the market valuation of its assets and to have a variable CTC. DII's analysis, on the other hand, established a definitive level of stranded costs to be recovered and a fixed schedule of CTCs. DII submitted, with a high degree of certainty, that if the DII recommendations are adopted (and Duquesne's sales remain comparable), Duquesne will fully recover its allowed stranded cost by 2002. (DII St. 1 at 35, Exh. SJB-5). (R.D., p. 449).

The PRA posited the mere possibility of an undercollection of stranded costs is not a sufficient basis to now order an extension of the CTC. The PRA further noted that the statute provides for an annual reconciliation designed to insulate Duquesne from sales variations. Thus, the Act solely contemplates a catastrophic loss of load such that the CTC must be increased enormously to permit Duquesne 100% recovery of its Commission determined level of stranded costs. (R.D., p. 451).

The Environmentalists argued that the Act provides for the CTC collection period to end on December 31, 2005.

(ii) ALJ's Recommendation

The ALJ noted that Duquesne proposed CTC collection will end on December 31, 2005, and Duquesne 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. (R.D., p.451).

(iii) Parties' Exceptions

Duquesne takes no position on this issue. The OTS argues that the ALJ erred in concluding that it is unnecessary to grant the OTS Rate Cap/CTC Extension proposal. The OTS contends that its proposal is essential to avoid possible CTC "rate shock" if a deferred final evaluation is implemented (OTS Exc., pp. 16-17).

(iv) Resolution

Since we have rejected Duquesne's basic proposal and adopt a CTC collection period that coincides with the rate cap, the rate cap extension issue is not applicable at this time. We note that our establis hment of the CTC recovery period may be modified upon receipt of the divestiture results.

According to the ALJ, the foregoing recommendations render this proposal for rate cap/CTC extension unnecessary. Therefore, the Commission need take no action on this subject. We find the ALJ's recommendation relative to rate cap/CTC to be reasonable and in accord with the evidence if there is no divestiture; otherwise the recovery period may be extended. Therefore, we shall adopt the ALJ's recommendation.

3. Other Arguments Regarding Recovery of Stranded Costs

(a) Positions of the Parties

The Company noted the only other position that requires attention here is that of Mr. Hughes. Mr. Hughes, a Duquesne ratepayer, believes the Commission should

make a determination as to whether Duquesne's current rates are just and reasonable before it makes decisions with regard to prospective issues such as stranded cost recovery. Mr. Hughes contends Duquesne's current rates are unjust and unreasonable as a result of the failure of the Perry 1 and Beaver Valley 2 generating units to provide an economic benefit to ratepayers. He continues that the high cost of these units has precluded Duquesne from giving its customers rate reductions. Mr. Hughes contends that Perry 1 and Beaver Valley 2 failed to meet the useful side of the used and useful test. He notes that Duquesne's rates were set by the Commission in March 1988. Mr. Hughes continues that, in that rate base case, the Commission found that Duquesne had failed to meet its burden of proof that Perry 1 and Beaver Valley 2 did not represent economic excess capacity on the Company's system; and the Commission made a relatively small excess capacity adjustment for this at the time.

Duquesne argued that the result sought by Mr. Hughes, however, suffers from the same flaws as the "sharing" proposals, in that it bears no relation to Duquesne's mitigation efforts or opportunities and does not meet the standards set forth in Duquesne. Duquesne submitted that Mr. Hughes' factual claims are either in error or are attempts to rehash matters previously raised, and decided, in Duquesne's last rate case. (R.D., p. 452).

The City argued that Duquesne's methodology impairs the formation of a competitive market, the very goal of the Act. According to the City, under Duquesne's plan, it will be very difficult for new suppliers to meaningfully compete for market share. (R.D., p. 453).

The City contended that, in a properly functioning competitive market, decisions on whether to supply power are based on avoidable costs. Under Duquesne's

plan, supply decisions have nothing to do with avoidable costs and everything to do with overrecovery of stranded costs. For instance, according to the City, using Duquesne's own forecasts, Duquesne should shutdown its Elrama plant since Elrama's avoidable costs will exceed revenues from sales by $215 million. The City continues that, instead, Duquesne's plan is to operate this plant to the detriment of ratepayers. (Id. at 20).

Mr. Hughes supported the OTS and HSS/ARI in requesting that the Commission not include the Brunot and Phillips cold reserved units in its stranded cost calculation. (R.D., pp. 460-461).

(b) ALJ's Recommendation

The ALJ observed that in various sections of his Recommended Decision, he addressed the concerns of the City and certain issues Mr. Hughes raised. The ALJ was not persuaded by the arguments presented to change his recommendations as previously delineated in this Section. As a result, the ALJ recommended that the relief sought by Mr. Hughes should be denied.

(c) Parties' Exceptions

Mr. Hughes argues that the ALJ erred in rejecting the following four arguments: 1) Duquesne's current rates are unjust and unreasonable; 2) Duquesne's nuclear units should not be included in the Commission's calculation of stranded costs; 3) Duquesne's Cold reserve units should not be included in the Commission's calculation of Duquesne's stranded costs; and 4) Duquesne has a poor stranded cost mitigation track record (Hughes Exc., pp. 1-9)

(d) Resolution

We reject Mr. Hughes claims because, as is apparent from a review of the record of this proceeding, such claims are either in error or are attempts to rehash matters previously raised, and decided, in Duquesne's last rate case.

G. Discount Rate For Stranded Costs

Regarding the proper discount rate for stranded costs, we note that Duquesne incorporates an equity rate of 11.5 percent. (R.D., pp. 558-560). The OTS recommended 10.5 percent (R.D., pp. 563-577) and the OCA 10.0 percent. (R.D., pp. 558, fn. 185).

The ALJ recommended a discount rate of 10.5 percent as proposed by the OTS. (R.D., pp. 586-587). In its Exceptions, Duquesne argues that the ALJ erred in not determining that Duquesne had established that its proposed discount rate of 11.5 percent is justified. (Duquesne Exc., p. 31).

In its Exceptions, PECO notes that it makes no specific recommendation regarding Duquesne's cost of capital, its appropriate after-tax discount rate or the return it should be allowed to earn on the unamortized balance of its stranded costs. However, PECO argues that PECO was granted a pre-tax return equivalent to its embedded cost of long-term debt (7.47 percent) on the grounds that the recovery of CTC revenues is essentially risk free. While rejecting this reasoning, PECO contends that this same rationale should apply to all other incumbent utilities. PECO submits that there can be no justification for granting Duquesne a 10.5 percent return on its stranded costs while

providing PECO with an approximate 4.73 percent equity return (7.4 percent less applicable federal and state income taxes).

In considering this matter, we note that the ALJ recommended granting Duquesne a 10.5 discount rate , based upon the recommendations of the OTS. However, we observe that, based on its DCF analysis, the OTS stated that the range of 9.5 percent to 10.5 percent represents a reasonable cost range of common equity for publicly traded electric companies. (OTS St. 1, pp. 31-32, R.D., p. 570). The record in this proceeding demonstrates that Duquesne will experience a reduced risk profile because of the CTC recovery mechanism. Based upon the OTS' DCF range, we adopt the recommendation of the OCA to use a 10 percent return for the equity portion of the discount rate for Duquesne as reasonable and compensatory. This results in an after tax discount rate of 7.29 percent for the net present value calculations of Duquesne's stranded costs.

V. THE COMPETITIVE TRANSITION CHARGE

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

1. *Positions of the Parties*

The Company noted the method for calculating the CTC is one of the most complex and misunderstood aspects of this case. While there are a multiplicity of proposals in this regard, they generally fall into two categories. The first, proposed by Duquesne, is a "top down" approach that sets rates according to Section 2804(4)(v) of the Act. The second general approach, proposed by the OCA (and applied in modified form in PECO Energy), is a "bottoms up" methodology.

Duquesne argued the competitive generation credit, ("CGC") also referred to as the "avoidable generation charge" or "shopping credit," 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. Duquesne continues that 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. According, to Duquesne, the CTC could be designed in several different ways. Duquesne opined that the residual establishment of a shopping credit does not purport to track a market price for generation but is the Commissions' determination of what is necessary to create incentives for customers to want to shop and for sellers to be able to offer savings, therefore building the foundation for a competitive market. According to Duquesne, nothing in the Act explicitly or implicitly links the unbundling of rates and the design of

the shopping credit to market price. Duquesne posits that under the Act, the CTC is the charge necessary to recover authorized transition and stranded costs over the recovery period. For example, it could be designed to provide levelized collection of stranded costs, declining CTC, levelized rate reduction, or a levelized charge. Some parties proposed to define the CGC as an administrative determination of the market price of generation, although parties using this approach proposed substantially differing methods and results. The OCA proposed a levelized rate reduction which utilizes a declining CTC.

The OCA contended that while the pre-determined shopping credit, under its proposal, may not precisely track market prices, it will provide a reasonable initial proxy of such prices and sufficient certainty to enable an infant marketplace to grow. The OCA continued that after the phase-in period, the Company will be permitted to charge "prevailing market prices" for generation and such prevailing market prices will, in effect, be the CGC. The OCA also noted that Enron proposed to treat the CGC as the residual rather than providing for rate reductions, relying on the Commission's Order in PECO Energy. The OCA posits that Enron's approach would require the Company to charge more than this amount and would effectively cause remaining utility customers to subsidize shopping customers. (R.D., pp. 468-472).

DII suggested the Commission's determination of a CTC design methodology for the recovery of Duquesne's stranded costs encompasses many sub-issues. The fundamental issue, according to DII, is the "overall approach" of the CTC design. DII defined "overall approach" to mean whether the methodology uses a CTC residual approach or a CGC residual approach. DII contended that the choice of methodology is an overarching issue, because use of one methodology or the other may

dictate whether customers are economically able to participate in the competitive market during the transition period. DII submitted that adoption of the CTC residual methodology by the Commission is clearly appropriate under the Act.

HSS/ARI submitted that there are no grounds for Duquesne to recover a CTC because Duquesne has no stranded costs and thus has no entitlement to charge a CTC. If the Commission grants any portion of Duquesne's stranded cost claim, HSS/ARI submitted that Duquesne's proposal for calculating CGCs and CTCs be rejected. (R.D., p. 476).

The Environmentalists posited 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 Environmentalists proposed to treat the CGC as a residual. According to the Environmentalists, the generation or shopping credit is the most critical number in the unbundled rates to both the ratepayers and for the alternate suppliers. The Environmentalists argued that 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. (R.D., p. 478).

Enron explained that Duquesne's methodology for unbundling of rates subtracts its proposed T&D rate from the present total and then sets the CGC at a wholesale market price, calculated through an annual RFP conducted by Duquesne. The residual is then declared the CTC. Enron argued that Duquesne's approach, while in the furtherance of Duquesne's objective to impede competitive development until at least it recovers all of its stranded costs, is not consistent with the Act's objectives. Enron submitted that, by unbundling rates in a manner that treats the CTC rather than the CGC

as the residual, Duquesne "pegs", the generation or shopping credit at Duquesne's RFP estimate of prevailing market prices for each year of the CTC recovery period, thereby turning the Act, and the PECO Energy approach on their heads. Therefore, Enron concluded that the record does not support the OCA/DII position.

PECO contended that the generation credit will apply to all customers and be the generation charge for all customers who: cannot choose, do not choose or who choose and then return to Duquesne unless and until (a) Duquesne voluntarily changes those rates pursuant to Chapter 13 of the Code; or (b) the rate for such "Provider of Last Resort" customers is changed pursuant to a formula established by the Commission pursuant to regulations. (R.D., pp. 479-492).

MAPSA argued that Duquesne's proposed CGC is too low to allow for the development of meaningful competition for retail sales of electric energy and should be rejected. MAPSA advocated a stranded cost approach, which focuses on administratively setting the CGC. Under MAPSA's approach, the CTC would be a residual. As MAPSA pointed out, in PECO, the Commission did not follow MAPSA's approach as advocated in this case. MAPSA vigorously disputed Duquesne's methodology and stated that it could endorse the PECO methodology, should the Commission feel bound to follow the PECO approach. (R.D., pp. 492-501).

(a) Resolution

In PECO, we stated previously that:

> The shopping credit is not a selected number. It is a number that results from the difference between a particular

customers' total rate as of January 1, 1997 and the sum of T&D and CTC rates established pursuant to this order.

(PECO, p. 42).

Based upon the preceding discussion, we find that the CGC is a residual number which is not calculated but produced after determinations of the portions of Duquesne's rates which were associated with transmission and distribution and CTC. When these elements are determined and removed from Duquesne's current rates, the remainder-whatever that may be is the customer generation credit.

(b) Summary

We adopt the merger savings of $152.28 million, as an offset to stranded costs.

We support an immediate rate reduction of $15 million. We accelerate the customer rate reductions to begin January 1, 2000, rather that in 2001, as Duquesne proposed

We adopt the DII's calculation of nuclear decommissioning costs as of December 31, 1998, on a net present value basis.

We conclude that Duquesne has not documented any known and measurable future fossil decommissioning expense that meets normal ratemaking standards, demonstrated that the costs would be recoverable under traditional regulation, demonstrated that the cost will in fact be stranded, or demonstrated that the costs will be

non-mitigated. Duquesne's claim, therefore, does not meet the basic requirements for stranded cost recovery and is rejected.

We conclude that Duquesne's SFAS 109 obligation should be treated as a tax liability form the balance of plant in service and not as a regulatory asset. We, therefore, reduce the Company's regulatory asset claim by $62.94 million.

We conclude 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.

We adopt Duquesne's claim for unamortized sale and lease back premiums as modified by the OCA.

We permit recovery of $23.5 million, on a net present value basis of deferred rate synchronization costs associated with Perry and Beaver Valley 2.

We adopt Duquesne's claim for compensated absences, injuries and damages of $14.24 million, as computed by the OCA, on a net present value basis.

We disallow Duquesne's claim for deferred coal costs of $13.5 million, finding that Duquesne has failed to show that these costs would be recoverable in a regulated environment.

We disallow Duquesne's $3.92 million net present value claim for recovery of deferred care taker cost as a regulatory asset as the record does not appear to support a

determination that the assets associated with these caretaker costs will be returned to service within the foreseeable future.

We disallow Duquesne's claim for pre-accural of nuclear outages of $10.29 million on a net present value basis. We find that this adjustment is included in plant operations and allowance as a regulatory asset would double count these expenses.

We allow Duquesne's claim for transition costs of $10.59 million, representing expenses of this proceeding and pilot program deferrals, as they were required to be expended to implement the Act.

We accept Duquesne's claim for $1.92 million, on a net present value basis, of SFAS 106 deferred costs. These costs are required under GAAP, are known and measureable, and incurred under traditional regulation, and otherwise meet the definition of stranded costs.

We agree with the exceptions of Duquesne and reject the ALJ adoption of the HSS position regarding the Warwick Mine. The inclusion of the remaining plant balance in net plant in service is the proper treatment to be accorded this stranded property. We have disallowed the regulatory asset claim for deferred fuel costs associated with the past operation of the mine. The net plant is the to go cost that would have had rate recovery through the ECR absent the Act. Duquesne never sought treatment of the property as a regulatory asset as claimed by HSS.

We adopt the ALJ's determination that Duquesne's past action regarding stranded cost mitigates have been adequate, but the Company must also continue a

commitment to mitigation. We are aware that Duquesne's mitigation efforts will have achieved $1 billion in savings and $700 million in avoided rate increases by 2005. Duquesne St. 1 at 20; Duquesne St. at 24-26. Additionally, Duquesne auctioned a generating prior to the Act and used the proceeds to increase the depreciation of nuclear assets. Duquesne St. 2 at 10-12; Duquesne St. 1-R at 21.

We reject the ALJ's conclusion that the Act prohibits sharing of stranded costs and that any sharing amounts to a taking. To the contrary, we find that the Act contemplates the Commission's 's deliberation as to just and reasonable rates for recovery of stranded costs. It is quite apparent that the Act does not restrict the Commission's deliberation. The fact that sharing is not explicitly detailed, was to provide the Commission's the full opportunity to customize the stranded cost result and recovery to the circumstances of the individual utility. To require Duquesne to share the stranded generating assets would amount to denying it recovery of a portion of its proven, stranded costs which cannot be mitigated.

We conditionally adopt the ALJ's recommendation on the issue of securitization. We find that the Act provides that securitization may be proposed by the Company. While Duquesne, as a stand alone company, does not believe that it can securitize within its sale/leaseback and financial covenants, the post merger company should examine the option for both operating territories and determine, after a fresh look, whether securitization can provide benefits for both companies and customers. We also note that after divestiture, securitization may then be possible.

On consideration of the positions of the parties, we adopted the levelized CTC method for CTC calculation. Duquesne proposed a flexible valuation and recovery

mechanism which would reset the CTC every year. Because we are determining stranded costs and the need for their recovery, we removed the need for flexible amortization as proposed by the Company.

We conclude that the CTC must be calculated as the amount necessary to fully amortize the authorized stranded and transition costs over the recovery period, including a return on the amortized principal balance. All customers will pay the unbundled transmission and distribution rate. Non-shopping customers will pay the unbundled rate for generation such that the total rate will precisely reflect currently the existing rates. We cannot agree with OCA's proposal that the existing rate should be cut in the absence of a cost of service analysis. The CTC is designed to promote competition, not to serve as a single rate reduction.

We concur with the ALJ's recommendation which indicates that rate cap/CTC extension is unnecessary in order to recover the allowable stranded costs under the rate cap, unless there is an auction, we tentatively adopt seven years.

We adopt the recommendation of the OCA to use a 10% return for the equity portion of the discount rate for Duquesne as reasonable and compensatory. This results in an after tax discount rate of 7.29% for the net present value calculations of Duquesne's stranded costs.

We agree with PRA that the Act requires us to establish the CTC. It is this foundation that guides our resolution to reject both the Company proposal and the OCA proposal, which both result in the CTC being a residual of a calculation, rather than a finding of the Commission.

Pursuant to Section 2808(a) of the Act we concluded that the transition cost responsibility be assigned to each customer class on the basis of the production capacity allocator utilized in Duquesne's last rate case.

We agree with the ALJ that the Company's optional CTC design should not be implemented.

We agree with OCA and find that rate class specific annual reconciliation is appropriate to avoid inter-class shifting of stranded cost recovery.

We do not accept the recommendation of the ALJ to adopt the OCA fixed schedule of market prices and residual CTC calculation. We find that the CTC should be determined on a levelized basis, based upon our stranded cost finding being amortized with an appropriate return on the Unamortized balance. The CTC should remain in place until 12/31/05. It should be reconciled annually by rate class for actual sales versus the forecasted sales.

The CTC shall be calculated on a, "per kwh" basis, allocated to each class. Section 2808(a) requires that the CTC be calculated in a manner that does not shift interclass or intraclass costs and is consistent with the allocation methodology for utility production plant accepted by the commission in the most recent base rate proceeding. We conclude that Duquesne properly used the cost of service study in its most recent base rate proceeding for this purpose as required. The revenue requirement of the CTC shall be allocated on a class basis to assure no interclass cost shifting, and cost responsibility to each customer class on the basis of the production capacity allocator utilized in Duquesne's last rate case.

The CTC distorts market prices and directly impacts the competitive market because it limits the opportunities for consumers and competitive suppliers to achieve savings and earn profits, respectively. The parties have presented various proposals for adjusting CTC recovery levels in each year to address their concerns. We conclude that the facts of this case and the stranded recovery authorized herein support the use of a levelized CTC over the transition period.

The CTC shall be calculated based on annual 1999 sales of 13,177,788 MWH, escalating annually per the Attachment to this Opinion and Order.

2. Design of CTC Issues

(a) One Time Determinations v. Fixed Schedule

The Company observed that Duquesne and the OCA's methods differ in that Duquesne's shopping credit will adjust each year (per the RFP results for that year), while the OCA sets a fixed shopping credit in advance for each year of the transition period. (R.D., p. 503).

The OCA related that part of the Company's final valuation proposal is to adjust the CGC annually to reflect market prices. The OCA believed that 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. The OCA recommended that the Commission reject this approach in favor of setting the CGC in this proceeding.

DII suggested another conceptual difference among the CTC proposals in this proceeding is whether the schedule of CTC and CGC charges for each year of the transition period should be established definitively as part of this proceeding or whether the CGC and CTC should be redetermined each year. DII recommended that Duquesne's proposal be rejected and that the Commission establish a fixed schedule of CTCs for each year of the transition period as part of this proceeding using the methodology they recommend. (R.D., pp. 507-508).

PRA noted that Duquesne desires to calculate actual market rates on an annual basis. PRA argued that there are inherent problems and that this annual true up method may be illegal in enacting the Competition Legislation. PRA continues that the Act requires the establishment of the CTC (and by definition the CGC) in this proceeding. According to the PRA, there is no provision for an annual true-up of the market price. PRA opined that 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. (R.D., p. 508).

(i) Resolution

Without engaging in a lengthy analysis of the conceptual disputes regarding calculation of the CTC/CGC in the record, we adopt the levelized CTC, adjusted annually

for actual sales, as the primary method for calculating the CTC. Consistent with the ALJ's recommendation, we reject the optional rate design for customers to choose for their CTC payments.

(b) Determination of Class Responsibility for Stranded Costs

The OCA and the OSBA 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 (R.D., p. 509). The OSBA added that maximum CTC revenues should be collected, as available, from all rate classes to effectively amortize Duquesne's stranded cost balance as quickly as possible (R.D., p. 511). DII argued that this methodology is inappropriate because it results in cost-shifting and possible rate cap violations. DII claimed that stranded costs must be unbundled as they are contained in current rates (R.D., p. 515). HSS/ARI noted that Duquesne's rate proposal should be modified by reducing revenue for certain classes (R.D., p. 522). PRA suggested that stranded costs should be allocated in the manner required by the Commission in the PECO proceeding (R.D., p. 522).

(i) Resolution

Section 2808(a) of the Act specifies that transition cost responsibility to each customer class in the following manner:

> ...[E]very customer accessing the transmission or distribution network shall pay a competitive transition charge to the electric distribution company in whose certificated territory that customer is located. The costs to be recovered shall be allocated to customer classes in a manner that does not shift

> interclass or intraclass costs and maintains consistency with the allocation methodology for utility production plant accepted by the commission in the utility's most recent base rate proceeding.

Pursuant to Section 2808(a) of the Act we direct that the transition cost responsibility be assigned to each customer class on the basis of the production capacity allocator utilized in Duquesne's last rate case.

(c) Levelized CTC v. Other Methods

Duquesne proposes to put some CTC in fixed and declining variable. The OCA recommended the establishment of a levelized rate reduction to allow full recovery of stranded costs and a declining CTC because of the estimated increase in market prices (R.D., pp. 522-523). PRA agreed with OCA and indicated that a levelized recovery period is consistent with the Act (R.D., p. 524).

The OSBA related through the Company's rate redesign plan, Duquesne proposes to reduce current rate levels over 25% on average for consumption above 1996 levels. Duquesne St. 5 at 31. This proposed rate reduction on incremental usage has a dual purpose: (i) to provide more efficient price signals, and (ii) to encourage economic load growth. The OSBA advocated an amendment to the Company's original plan whereby a customer could select an all-variable CTC or a fixed/variable CTC dependent upon which plan would best suits the customer's needs and anticipated consumption.

The Company adopted the amendment proposed by OSBA, noting that this change causes its rate redesign plan to be more reasonable with respect to the customer's interests. The OSBA agrees. (*R.D., pp.* 529-531).

DII argued that use of a levelized CTC for recovery of Duquesne's stranded costs may be inappropriate because it may prevent some customers for participating in the competitive market (R.D., p. 523). Environmentalists contended that the Act implied a straight amortization of stranded costs (R.D., p. 525). DII noted that Duquesne proposes a mandatory rate redesign that collects 50% of the customer's monthly CTC charge on a fixed dollar per month basis and 50% on a consumption basis. DII submitted that the Commission must reject this proposal because, it violates the rate cap and anti-cost shifting provisions of the Act.

PRA argued that 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.

The Environmentalists opposed 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. The Environmentalists oppose this change for several reasons.

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 per kWh basis. The Company can ensure against the risk of under-collection by implementing a true-up at the end of each year. (R.D., pp. 535-536).

MAPSA contended that Duquesne has proposed to calculate and collect a customer-specific competitive transition charge. In essence, Duquesne's proposal is to use a previous years' usage to determine a customer's future year total CTC allocated share and then to charge a customer a fixed CTC based upon the previous years' usage. MAPSA M.B. at 27. According to MAPSA, Duquesne's proposal is contrary to law because it violates the Commission's mandate that CTCs be charged on a per-kWh basis. (R.D., pp. 536-537).

(i) Resolution

We reject Duquesne's proposal to collect half of the CTC through a fixed charge and half through a declining variable charge, because it shifts costs to low users,

We also conclude that a levelized CTC is appropriate.

We agree with the ALJ that the Company's optional CTC design should not be implemented. In particular, as this proposal was closely linked to the overall proposal of Duquesne, it was based upon a residual CTC design which we have rejected as not in conformance with the Act. While a customized CTC sounds attractive, we believe it will lead to annual reconciliation problems. Finally, we find that to have multiple CTC designs in place at this time will add confusion for the customers as they enter into customer choice.

(d) Reconciliation of CTCs

(i) Class Reconciliation of Annual Sales

OCA argued that consistent with the statutory requirement for annual reconciliation and with the 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. (R.D., p. 539).

(ii) Position of the Parties

The Environmentalists explained that true reconciliation of the CTC requires reconciliation of the difference between the projected market price and the actual market price. The Environmentalists have already addressed the weaknesses of Duquesne's proposal to fix a market price by selling a block of power each year on the open market. (R.D., p. 541).

To avoid an over-recovery of stranded costs, the Environmentalists argue that the CTC should be reconciled to reflect changes in sales. Because the CTC are charges added to each kilowatt-hour, the total CTC recovery is directly dependent on the number of kilowatt-hours sold throughout the collection period. According to the Environmentalists, even a very small discrepancy between projected sales and actual sales will result in a large difference in collections. The Environmentalists posit that the Act directs 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[21] and it should do so.(R.D., p. 541).

In designing the reconciliation mechanism, the Environmentalists asserted 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.[22] 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.[23] 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). (R.D., p. 542).

Duquesne proposed an annual readjustment of the shopping credit to reflect the results of an annual RFP for the sale of firm power, thereby annually readjusting the CTC and recoverable stranded costs as well.

In PECO Energy, Duquesne observed that the Commission accepted evidence that, with respect to the CTC proposed by PECO, a long-term debt rate represented the appropriate cost of capital. PECO Energy, Slip Op. at 107. While

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[21] 66 Pa. C.S. §2808(f).

[22] This position is shared by others. See, OCA St. 4 at 11-12.

[23] 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.

Duquesne does not agree with that finding, it contended that is not pertinent here. Duquesne has not proposed a "fixed" CTC that is "trued up" each year for changes in sales levels, as was proposed in PECO Energy. Rather, Duquesne has proposed an ROE spillover and a commitment to amortize a minimum of $1.7 billion in stranded costs over the transition period. Duquesne urged approval of its CTC design proposal. If the immediate divestiture is accepted, Duquesne is willing to accept a CTC design that generally is consistent with the method used in PECO Energy, as discussed, supra. (R.D., pp. 549-550).

In order to ensure that the Company does not over-recover stranded costs, a CTC revenue tracking mechanism must be established. DII suggests that the Company should track CTC revenues on a monthly basis. The Company will begin the stranded cost recovery period with the unamortized total stranded cost balance authorized in this proceeding to be recovered from ratepayers. This balance will accrue interest monthly at the revenue requirement level (i.e., fully grossed-up cost of capital). Each month, the Company will accumulate the CTC revenues produced that month by each rate schedule. The unamortized stranded cost balance will be reduced each month by the accumulated monthly CTC revenues until the balance is fully amortized at a $0 level.

(iii) ALJ's Recommendation

On the subject of CTC, this Commission explained in the only restructuring application to date to receive final review, PECO Energy, Slip Op. at 103-104; PECO Energy, Slip Op. at 109-110.

The ALJ agreed with the OCA that its proposed market prices will serve as an appropriate proxy for actual market prices during the transition period with sufficient certainty to enable a nascent marketplace to grow. Under the OCA's approach, the CTC is a residual, which declines each year as the forecasted market prices for the CGC increase each year during the transition. The OCA's methodology for calculating the CTC will mean that the CGC will be sent annually according to the fixed schedule of market prices appearing in OCA Exhibits LS-7 & LS-7R. Of course, the Company's collection of the CTC will be subject to annual review by the Commission.

The ALJ recommended that the Commission adopt the OCA's recommendation to establish a levelized rate reduction. The ALJ further recommended that Duquesne's proposal be denied to redesign its rates pursuant to a two-part Customer Transition Charge, which would include a fixed (customer-specific) charge and a usage-based (class-specific) charge. The ALJ noted that 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. The ALJ concluded that this approach is necessary to avoid inter-class stranded cost shifting and was specifically adopted in PECO Energy, Slip Op. at 113.

(iv) Resolution

We agree with the OCA and find that rate class specific annual reconciliation is appropriate to avoid inter-class shifting of stranded cost recovery.

We do not accept the recommendation of the ALJ to adopt the OCA's fixed schedule of market prices and residual CTC calculation. We find that the CTC should be

determined on a levelized basis, based upon our stranded cost finding being amortized with an appropriate return on the unamortized balance. The CTC should remain in place until 12/31/05. It should be reconciled annually by rate class for actual sales versus the forecasted sales. Our Attachment A to this Order provides the expected CTC based upon the current forecast.

B. Return on Unamortized Balance

Regarding the return on the unamortized balance of the stranded costs as it relates to the CTC/CGC calculation, we conclude that Duquesne should be permitted to collect an annual return of 11.0 percent including the gross-up for taxes. We determine this to be appropriate because the risk of not collecting the CTC is low. Furthermore, we find that this return is comparable to the Company's long-term debt costs. (R.D., p. 577). It is within the range of the proposals of the parties. Furthermore, this return is on the unamortized principal balance. It, therefore, represents a "floor" for Duquesne's earnings. Duquesne has no limit on the return it may achieve in the competitive market.

VI. TARIFF ISSUES

A. Rule 4 Contracts

1. Positions of the Parties

In its argument before the ALJ, Duquesne stated that Rule 4 Contracts are executed "as a mitigation strategy to attract or retain incremental load that Duquesne would have otherwise lost to a competitive alternative." Duquesne St. 6-R at 4; See, also, Tr. 1029-30. Two issues have arisen regarding these contracts. First, DII contended that Rule 4 contracts should be unbundled so that customers can gain access to the competitive market. The second contention was OCA's argument that the revenue effect of Rule 4 "discounts" class should be imputed, for CTC calculation purposes, to the class receiving the discounts. (OCA St. 4 at 8-10). (R.D., pp. 588-589).

DII claimed that Duquesne inappropriately denies customers currently taking service under Rule 4 contracts the right of choice of electricity supplier guaranteed to them by the Act because Duquesne refuses to unbundle these contracts. (Duquesne St. 6-R, p. 4). According to DII, this refusal is anti-competitive, contrary to the Act and must be rejected by the Commission. Rule 4 customers must be granted their statutory right to direct access unless the particular contract clearly prohibits the customer from accessing competitive supply in the deregulated environment for the duration of the transition period. (DII St. 1, p. 54; DII M.B., p. 89).

HSS/ARI supported Duquesne's continued ability to offer Rule 4 contracts. HSS/ARI also believed, consistent with Duquesne's proposal, that existing Rule 4 contracts should remain in effect during their term. However, parties with Rule 4

contracts should not be deprived of benefits that result from this proceeding. (R.D., p. 592).

The PRA asserted that Duquesne's proposal to deny Rule 4 customers' access to a competitive retail generation market is in violation of the law and PECO Energy's underlying decision. Therefore, it must be rejected. (R.D., p. 593).

Enron argued that, in PECO Energy, supra, at page 117, the Commission established standards governing the application and continuance of certain tariffs and riders available to special customer classes. As a general rule, the Commission required that "[a]ll existing tariffs shall remain available throughout the transition period and all special contracts shall remain in force, except as modified pursuant to this Opinion and Order or other tariff modifications approved by the Commission." Enron submitted that all of the standards established at PECO, supra, at pages 117-118, reflect Commission policy decisions, which should not vary from case to case or from EDC to EDC. Accordingly, they should be adopted by the Commission in this proceeding. (R.D., pp. 593-598).

2. ALJ's Recommendation

The ALJ noted that, on the subject of special customer classes, the Commission, in PECO Energy, Slip Op. at 116, stated that Section 2804(7) requires that the Commission implement the Act "in a manner that does not unreasonably discriminate against one customer class to the benefit of another." The Commission acknowledged its obligation to consider the special circumstances of several customer classes to ensure that all customer classes receive a fair opportunity to benefit as intended by the Act.

The ALJ further noted that Section 2804(3) provides that "the Commission shall require the unbundling of electric utility services, tariffs, and customer bills to separate the charges for generation, transmission and distribution." However, several tariffs serving special customer classes were designed without granting the customers an opportunity to choose an alternative generation supplier. In such instances, the Commission found in PECO Energy, supra, at page 117, that it will, as a general rule, attempt to treat all of these customer classes the same as all other customers with respect to transmission, distribution and generation services provided by PECO Energy. The Commission determined that all existing tariffs, including special contracts, shall remain available throughout the transition period, except as modified in that Opinion and Order so that each customer could continue to receive the economic benefits of these tariffs.

The ALJ further noted that existing contracts containing language covering the future availability of competitive generation services will be governed by the terms of the contracts. Existing customers under contracts that are silent concerning future opportunities to choose competitive suppliers will be permitted to enter into separate generation contracts.

Regarding CTC payments by special customer classes, the ALJ observed that, pursuant to Section 2808(a) of the Act and PECO Energy, supra, no contract or tariff may permit a customer to bypass payment of the full CTC. To achieve that end, the ALJ determined that it may be necessary to provide a "comparable dollar value offset" on regulated transmission, distribution and generation rates. (R.D., p. 598).

The ALJ determined that Duquesne's contracts and tariffs for special customer classes should be modified to comply with the requirements of PECO, supra, and Section 2808(a) of the Act, 66 Pa. C.S. §2808(a).

3. Parties' Exceptions

In its Exceptions, Duquesne contends that the "offset" which the ALJ determined may be necessary to ensure that no customer bypasses payment of the full CTC as it applies to regulated transmission and distribution rates would be contrary to the Act, confiscatory, and preempted by the Federal Power Act as it applies to transmission or ancillary service rates. Duquesne submits that the only lawful result is to extend the transition period for customer classes that cannot complete payment of their allocated share of stranded costs before the year 2005. (Duquesne Exc., pp. 35-36).

In its Exceptions, the OCA contends that the ALJ's recommendation that stranded costs are to be allocated based on the utility's production plant allocator used in the Company's last base rate case does not specifically address the situation where such an allocation results in a CTC that violates the generation cap for discounted rate customers. The OCA argues that this determination should be clarified regarding Rule 4 Contracts. (OCA Exc., pp. 20-21, R.Exc., p. 20-21).

4. Resolution

In considering this issue, we concur with the ALJ's recommendation to specifically direct Duquesne to unbundle its contracts for distribution, transmission and generation CTC charges. This is required by Section 2804(3) of the Act, which states:

> The commission shall require the unbundling of electric utility services, tariffs and customer bills to separate the charges for generation, transmission and distribution. The commission may require the unbundling of other services.

(66 Pa. C.S. §2804(3)).

In PECO Energy, supra, we stated, at pages 117-119, that, as a general rule, we intended to treat these special rate classes in the same manner as all other customer classes with respect to all regulated rates and services, including CTC obligations. We further stated that our goal was to permit customers to continue to receive the economic benefits of the existing contracts until the CTC expires. We acknowledged that Section 2804(2) of the Act requires that interruptible options must be available. We determined that an EDC must file tariffs for distribution and transmission service applicable to customers in all classes who choose to shop. This applies in the proceeding now before us, as well.

We further determine, consistent with PECO Energy, supra, at page 119, that existing contracts containing language covering the future availability of competitive generation services will be governed by the terms of the contracts. Where those contracts are silent regarding future opportunities to chose competitive suppliers, the customers will be permitted to enter into separate generation contracts. Realized CTC charges should be computed and reconciled by tariff class.

B. Riders 8, 9 and 20

1. Positions of the Parties

Duquesne noted that it offers the following three economic development tariff riders: (i) Rider 8, which offers discounts for incremental consumption by existing industrial customers; (ii) Rider 9, which offers discounts for new load from large new customers; and (iii) Rider 20, which offers discounts for both incremental consumption by existing commercial customers and new load from new commercial customers.

(Duquesne St. 6, p.16). Duquesne has proposed to eliminate the discounts for incremental load from existing customers (Rider 8 and part of Rider 20), but not discounts for new load from new customers. (R.D., p. 599).

DII asserted that Duquesne proposes to eliminate the economic development incentive rates currently available to existing customers in Tariff Rider 8 "Industrial Economic Development Rider for Customers at Existing Service Locations" and Tariff Rider 20 "Small Business Development Rider." Duquesne Light Company Supplement to No. 4 to Tariff Electric Pa. P.U.C. No. 17, issued May 28, 1997, pp. 71-76 & 100-103 (hereinafter "Duquesne Tariff"). According to DII, these rates are proposed to be phased-out as customer contracts expire over the next five years. (Duquesne St. 6 at 18). DII submitted that this phase out is clearly inappropriate under the Act and must be rejected, since Chapter 28 guarantees that the generation component of rates is capped at the January 1, 1997, level for the entirety of the transition period. 66 Pa. C.S. §2804(4)(ii). (R.D., pp. 600-601).

The PRA also argued that Duquesne's elimination of these economic development incentive rates currently available to customers is in violation of the Act in that it increases the customer's rate above the rate cap imposed on January 1, 1997. Moreover, PRA contended that Duquesne's action is inappropriate when considered in light of its discriminatory treatment of providing special treatment to new customers at new service locations by authorizing access to the competitive retail generation market far earlier than existing customers. (R.D., p. 604).

2. ALJ's Recommendation

The ALJ noted that, in PECO Energy, supra, page 119, the Commission observed that these contracts provide rate discounts in order to retain or expand customers or load as competitive pressures limited the EDC's ability to continue to charge fully regulated rates. In recognition of the increasing competitive pressures that led to adoption of the Act, the Commission approved such tariffs or individual contracts provided the EDC received at least the marginal cost of service and no foregone revenues were shifted to other customers.

The ALJ determined that, since all existing customers under a special discount contract will have the opportunity to fully shop for generation no later than the final phase-in on January 1, 2001, the Commission should approve Duquesne's proposal to phase out these special customer discount contracts as they expire over the next five years, provided the affected customers are fully phased in to direct access to the generation market at the time of contract expiration. The ALJ further determined that the Company's offering of special discount contracts to new customers or existing customers with new load constitutes discriminatory treatment proscribed by the Act. 66 Pa. C.S. §2804(7). The ALJ concluded that Duquesne can acquire new customers or new load in the competitive generation marketplace. For these reasons, the ALJ recommended approval of the Company's proposal for Rider 8, as herein modified, and denial of the Company's proposal for Riders 9 & 20. (R.D., pp. 604-605).

3. Parties' Exceptions

In its Exceptions, Duquesne contends that the ALJ erred in recommending not to permit Duquesne to offer special discount rates to new customers or existing

customers with new load. Duquesne argues that the ALJ's characterization of these contracts as providing discounts is erroneous because these contracts apply to load that would not otherwise by served by Duquesne. (Duquesne Exc., p. 36).

In its Exceptions, DII contends that the ALJ's recommendation to phase out economic development incentive rates available to existing customers is contrary to the Act. DII submits that the Act requires that these rates remain available during the entire transition period. DII further argues that, contrary to the ALJ's determination, in PECO Energy the Commission required that PECO continue to offer existing economic development rates throughout the transition period. (DII Exc., pp. 8-9).

4. Resolution

In considering this matter, we note that, with respect to special customer classes, all tariff classes should be unbundled, permitting all customer classes to procure generation competitively. All existing contracts shall remain in effect on their terms. A contract that explicitly prohibits shopping in contemplation of the passage of the Act shall remain unchanged. However, any customer with a contract that does not explicitly prohibit shopping must be permitted to shop. Upon expiration, contracts need not be extended, but the rate caps remain applicable as provided in Section 2804(4).

No contract may permit bypass of the CTC. Any existing contract purporting to do so must assign customer payments to full recovery of the allocated CTC and provide the associated discount as a credit to the customer against other portions of the bill. As rates are unbundled, customers with existing discounts must receive an allocated discount to the T&D portion of the bill unless the nature of the discount is exclusively on the generation component.

Accordingly, we will approve Duquesne's proposal for Rider 8, as modified, but will deny Duquesne's proposal with respect to Riders 9 and 20.

C. Self-Generation

1. Net Metering

(a) Positions of the Parties

Duquesne's Restructuring Plan did not include net metering. The Environmentalists argued that Duquesne should be required to implement a net metering tariff for renewable energy and fuel cell projects. (R.D., pp. 605-607).

(b) ALJ's Recommendation

The ALJ recommended that the Environmentalists' proposal for using a "net metering" arrangement should be rejected as violating the Act's mandate for a non-bypassable CTC. 66 Pa. C.S. §2808(a); PECO Energy, Slip Op. at 124. The ALJ further recommended that the remaining issues raised by the Environmentalists should be more appropriately considered in generic proceedings. (R.D., p. 607).

(c) Parties' Exceptions

In their Exceptions, the Environmentalists contend that the ALJ erred in recommending the rejection of the Environmentalists' proposal. The Environmentalists argue that Duquesne does not currently have a net metering tariff and should be directed

to implement one for renewable energy and fuel cell projects by any customer class which is 10 kw or less. (Environmentalists' Exc., p. 6).

(d) Resolution

In considering this matter, we note that the ALJ rejected the Environmentalists' proposal to require Duquesne to implement a net metering based tariff for renewable energy and fuel cell installations which have a capacity of 10 kw or less. The ALJ determined that this proposal conflicted with Section 2808(a) of the Act regarding a non-bypassable CTC. We observe, however, that Section 2808(a) is conditioned upon significant reductions in the purchases of electricity. Section 2808(a) states, in relevant part;

> ...If a customer installs on-site generation which operates in parallel with other generation on the public utility's system and which significantly reduces the customer's purchases of electricity through the transmission and distribution network, the customer's fully allocated share of the transition or stranded costs shall be recovered from the customer through a competitive transition charge.

In our opinion, it is unlikely that the size of these installations will materially affect the recovery of stranded costs by the Company. Therefore, in order to remove a barrier to the development of these small installations, we direct Duquesne to include a net metering based tariff schedule consistent with the Environmentalists' proposal.

2. Interconnections

(a) Positions of the Parties

The Environmentalists argued before the ALJ that several changes to the interconnection provisions of Duquesne's proposed tariff should be made. The Environmentalists contended, among other things, that the technical standards should be simplified and the cost of engineering review for small projects should be capped at $35, and for other installations, at $250. (R.D., pp. 606-607).

(b) ALJ's Recommendation

The ALJ recommended that this interconnection issue should be addressed in a generic proceeding. (R.D., p. 607).

(c) Parties' Exceptions

In its Exceptions, the Environmentalists argue that the ALJ erred by not requiring Duquesne to change its interconnection tariff as proposed by the Environmentalists. The Environmentalists contend that these changes are designed to remove unnecessary barriers to interconnection. (Environmentalists' Exc., pp. 6-7).

(d) Resolution

In considering this matter, we note that Section 2804(2) provides that restructuring shall permit "reasonable and fair opportunities to self-generate and interconnect" to the transmission and distribution system. Duquesne made no proposals

to address this statutory directive in its restructuring plan. Consistent with PECO Energy, supra, we conclude that Duquesne must provide reasonable opportunities for both large and small customers to interconnect self-generation. We adopt the proposals of the Environmentalists in this regard, except that we do not require Duquesne to purchase the generation of any customer. With customer choice and direct access, a self-generating customer may contract to buy and sell electricity with any willing EGS. Duquesne must, however, as an EDC, provide the opportunity for self-generation through reasonable net metering and interconnection provisions.

D. Other Tariff-Related Issues

1. Positions of the Parties

As noted by the ALJ, DII contended that three other tariff-related issues must be addressed in this proceeding. DII observed that Duquesne proposes changes to its current tariff for Interruptible Service (Rider 7), Time-of-Day Service (Rider 5) and High Voltage Power Service (HVPS). DII submitted that these proposed changes are inappropriate and must be rejected. DII asserted that all of Duquesne's tariff offerings must remain intact throughout the transition period in order to provide customers with the rate cap protection mandated by the Act. 66 Pa. C.S. §2804(4). (R.D., p. 608).

(a) Interruptible Service (Rider 7)

DII asserted that Duquesne submitted a tariff for Interruptible Service that makes two significant changes to the rate. (Duquesne St. 5, Exh. JAL-12, pp. 95-97; compare, Duquesne Tariff at 68-70). According to DII, both changes are unreasonable

and not necessary to introduce the competitive generation supply option to Duquesne's service territory. (DII M.B., p. 93).

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

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

(Duquesne St. 5, Exh. JAL-12 at 95). DII contended that this provision places two restrictions on the availability of Interruptible Service, neither of which is in the current tariff. Duquesne Tariff at 68-70. Namely, those restrictions are the requirements that customers must contract under this rider prior to December 31, 1998, and must take full service as defined in the appropriate rate schedules. Therefore, DII asserted that these restrictions are inappropriate and must be rejected. (R.D., p. 608).

(b) Time-of-Day Rates (Rider 5)

DII noted that Duquesne proposes to restrict the availability of Time-of-Day service (Rider 5) to customers that contract prior to December 31, 1998. (Duquesne St. 5, Exh. JAL-12 at 92). DII observed that this restriction is not present in the current tariff and contended that this change is unreasonable and must be rejected for the reasons stated in the previous section. (R.D., pp. 610-611).

(c) HVPS Tariff

DII contended that the Company's proposed tariff omits the provision in the HVPS tariff with regard to "Generation Avoidance" energy. DII asserted that this generation avoidance is designed to permit an HVPS customer that produces a portion of its energy requirement for its own use with internal generating equipment to purchase electricity from Duquesne and avoid the use of alternative energy sources when its equipment fails. (DII St. 1, p. 57). DII contended that the Company acknowledges that generation avoidance was inadvertently omitted and agrees to reinsert the provision in the final tariff to be submitted as part of the compliance filing in this proceeding. (Duquesne St. 5-R, Exh. JAL-14 at 19). This reinsertion of the provision alleviates DII's concerns with respect to Generation Avoidance in this part of the proceeding. (DII St. 1-S at 14). DII recommended that the Commission require the Generation Avoidance section to be reinserted in the compliance filing by Duquesne in this proceeding. (R.D., p. 611).

2. Recommendation

The ALJ recommended that, for the reasons advocated by the DII, the Commission should deny the Company's proposed changes to its current tariffs for Interruptible Service (Rider 7), Time-of-Day Service (Rider 5) and High Voltage Power Service (HVPS).

3. Parties' Exceptions

In its Exceptions, Duquesne does not object to the ALJ's recommendations regarding Rider 7, but requests clarification, so that it is understood that the interruptible credit applies only to the load that Duquesne can interrupt.

4. Resolution

In considering this issue, we note that Section 2804(4) of the Act requires that all tariff offerings must remain intact throughout the transition period in order to provide customers with the rate cap protection mandated by the Act. Only tariff changes necessary to unbundle rates and introduce competition for generation supply are appropriate during the transition period while customers are captive to the payment of a CTC. We are not persuaded by the record in this proceeding that Duquesne's proposed changes to its current tariffs for Interruptible Service (Rider 7), Time-of-Day Service (Rider 5) and High Voltage Power Service (HVPS) are consistent with Section 2804(4) of the Act. Accordingly, we shall adopt the ALJ's recommendation to deny Duquesne's proposed changes to these current tariffs.

E. Summary

In this Section, with respect to Rule 4 Contracts, we specifically directed Duquesne to unbundle its contracts for distribution, transmission and generation CTC charges. With respect to Riders 8, 9, and 20, we determined that all special customer tariffs should be unbundled so that all customers can procure competitive generation. Regarding self-generation, we directed Duquesne to include in its compliance filing a net metering tariff. Regarding interconnections, we determined that Duquesne must provide reasonable opportunities for both large and small customers to interconnect. Finally, with respect to Interuptible Service (Rider 7), Time of Day Service (Rider 5), and High Voltage Power Service (HVPS), we denied Duquesne's proposed changes to these tariffs.

VII. COMPETITIVE SAFEGUARDS

A. Code of Conduct

1. Positions of the Parties

Duquesne proposed a Code of Conduct which it maintained provided an adequate separation of the regulated and unregulated portions of its business. After reviewing the Company's filing, the OCA presented several specific proposals that the OCA's witness Alexander made to Duquesne's proposed Code of Conduct to supplement or clarify the Company's proposal.

OCA maintained that it is necessary that an appropriate Code of Conduct to address interaction between Duquesne's regulated and unregulated functions be put in place at this time, since it is anticipated that these rulemakings will not be concluded prior to the implementation of customer choice. The OCA contended that the Commission reached a similar decision in PECO Energy. Slip Op. at 129. As such, the OCA submitted that the Duquesne's proposed Code of Conduct should be modified as set forth in the OCA's Main Brief, as well as the OCA's witness Alexander's testimony.

The PRA asserted that an appropriate Code of Conduct is absolutely necessary for the development of a competitive retail generation market. According to the PRA, the use of a Code of Conduct places all market participants on notice as to inappropriate conduct thus providing a level of comfort to Duquesne's employees.

Enron maintained that, although complete divestiture or structural separation is the preferred safeguard, at a minimum, complete functional separation enforced by a strong Code of Conduct is critical to meaningful competitive development. Enron contended that it is critical that the Commission establish a Code of Conduct to govern the activities of Duquesne and its affiliates/divisions while a binding regulation is pending and that Duquesne's proposed code is not adequate, even on an interim basis. Enron stated that the PECO interim Code of Conduct is fully supported by the record in this proceeding and should be adopted pending codification of final regulations.

Enron reproduced the PECO interim Code in its brief as follows:[24]

1. The Company, in its role as the Electric Distribution Company ("PECO EDC"), shall not give a PECO Supplier preference over a non-affiliate in the provision of goods and services, such as processing requests for information, complaint processing and responses to service interruptions. PECO EDC shall provide comparable treatment without regard to the customer's chosen supplier.

2. PECO EDC shall supply services and apply the rules and other provisions of its Tariffs to non-affiliates in the same manner it applies them to a PECO Supplier.

3. PECO EDC shall not sell non-power goods or services to a PECO supplier at a price below the cost or market price, whichever is higher, for said goods or services. PECO EDC will not purchase non-power goods or services from a PECO Supplier at a price above the market price for said goods or services. No transaction between PECO EDC and a PECO Supplier shall

[24] An addition to Section 7 made by Enron is not reproduced here.

involve an anti-competitive cross-subsidy, and all such transactions shall apply with applicable law.

4. PECO EDC shall simultaneously make available to all EGSs any market information, not in the public domain, that it provides to a PECO Supplier.

5. Employees of PECO EDC who have responsibility for operating the distribution system, such as receiving requests for power, purchasing power, scheduling delivery, or billing and metering, shall not be shared with a PECO Supplier, and their offices shall be physically separated from the office(s) used by those working for the PECO Supplier. Such employees of PECO EDC may transfer to a PECO Supplier provided such transfer is not used as a means to circumvent this Interim Code of Conduct. Any PECO Supplier shall have its own direct line management. Any shared facilities shall be fully and transparently allocated between the PECO EDC function and the PECO Supplier function. PECO EDC accounts and records shall be maintained such that the costs a PECO Supplier incurs may be clearly identified.

6. PECO EDC shall not condition the provision of any PaPUC jurisdictional regulated services on the purchase of power from a PECO Supplier.

7. Neither PECO EDC nor a PECO Supplier may directly or by implication falsely and unfairly represent:

   - that the PaPUC jurisdictional regulated services provided by PECO EDC are of a superior quality when power is purchased from a PECO Supplier; or

- that the merchant services (for power) are being provided by PECO EDC rather than a PECO Supplier;

- that the power purchased from an EGS that is not a PECO Supplier may not be reliably delivered;

that power must be purchased from a PECO Supplier to receive PECO EDC PaPUC jurisdictional regulated services.

8. PECO EDC shall establish and file with the Commission a dispute resolution procedure to address complaints alleging violations of these rules.

(Enron M.B. at 37-39).

Enron asserted that the most efficient course for the Commission would be to order the implementation of the Code it ordered be implemented in the PECO proceeding with some modification. Additionally, Enron noted, that the Commission barred EDCs from promoting their competitive affiliate any differently than non-affiliated suppliers. Enron argues Duquesne's code does not address this, and must be modified accordingly.

MAPSA stated that Duquesne has proposed a Code of Conduct in this proceeding, which would apply only if Duquesne offers unregulated services to customers within its own service territory. Duquesne's proposal ignores the reality that much of the expense of doing business is the start-up, and that it is at the start-up that the opportunity for improper exchange of resources is greatest. Duquesne also proposes to limit the applicability of its Code of Conduct to affiliate

transactions within its own service territory, although Duquesne presumably would not be required, under its proposal, to engage its Code of Conduct and protect ratepayers and competitors if it competes in the service territories of other utilities. MAPSA proposes an interim Code of Conduct that would apply until the Commission's final rules are implemented.

2. ALJ's Recommendation

The ALJ noted that in PECO Energy, Slip Op. at 128-129, the Commission recognized, that consistent with the dictates of the Act, the Commission must establish procedures so as to provide for a "fair and orderly transition." Therefore, it is incumbent upon this Commission to ensure that as a result of this decision a competitive market will be permitted to operate fairly in a manner that fulfills the statutory directives. Accordingly, the ALJ concluded that it is appropriate to adopt certain competitive safeguards.

The ALJ further noted that the Commission is in the process of adopting regulations concerning competitive safeguards in Docket L-0097 and Customer Supplier Interaction at Docket No. M-00960890F0011. The ALJ observed that, until those regulations are formulated, an interim Code of Conduct must be established in this proceeding. The ALJ stated that, in PECO Energy, the Commission accepted the EDC's proposed Code of Conduct with certain modifications. In order to bring Duquesne's proposed Code of Conduct within the parameters established in PECO Energy, the ALJ recommended that the Company modify it's proposed Code of Conduct in a number of respects including but not limited to: prohibitions against giving preferential treatment between affiliated and non-affiliated suppliers, anti-competitive pricing, and the tying of regulated and

unregulated services. (R.D. at 627-28). Additionally, the interim Code of Conduct should require all tariffed services to be offered in the same manner to affiliates and non-affiliates alike and require physical separation of employees, and must require segregated accounts and records or allocation of shared facilities. Id.

3. Arguments on Exception

Enron and MAPSA contend that, although the ALJ stated he was adopting the interim code of conduct which we approved in PECO Energy, the Recommended Decision actually fell short of matching the final code approved in that case. Enron and MAPSA agree that the interim code should mirror that approved for PECO, but that additional modifications are necessary to bring the Duquesne interim code, as already altered by the ALJ, into accord with the code adopted in PECO Energy.

4. Resolution

We believe that it is important to underscore our desire to establish state-wide consistency in this area. The Code of Conduct will be in effect until such time as we adopt regulations establishing a permanent Code of Conduct. Until those regulations are finalized in Docket L-980132, an interim Code of Conduct must be established in this proceeding. We also agree with the ALJ that in order to bring Duquesne's proposed Code of Conduct within the parameters established in PECO Energy, we must direct the Company to modify it in the following respects:

1. Duquesne's interim Code of Conduct must prohibit preferential treatment between affiliated and non-affiliated suppliers.

2. Duquesne's interim Code of Conduct must require all tariffed services to be offered in the same manner to affiliates and non-affiliates alike.

3. Duquesne's interim Code of Conduct must include a prohibition on anti-competitive pricing.

4. Duquesne's interim Code of Conduct must require it to make confidential market information available simultaneously to all suppliers, affiliated and non-affiliated alike.

5. Duquesne's interim Code of Conduct must require physical separation of employees, and must require segregated accounts and records or allocation of shared facilities.

6. Duquesne's interim Code of Conduct must prohibit the tying of regulated and unregulated services.

7. Duquesne's interim Code of Conduct must preclude the EDC from promoting "its competitive affiliate any differently than non-affiliated suppliers."

(R.D. at 627-28).

With respect to the exceptions of Enron and MAPSA, we are in agreement that the Recommended Decision is not completely consistent with the interim Code of Conduct we approved in PECO Energy. The Recommended Decision sets forth the following additional modifications and clarifications which Enron claimed, in its brief below and in brief on exceptions, will help to bring Duquesne's Code of Conduct into conformity with the code approved for PECO:

> In addressing the further modifications and clarifications required by the Commission, first the Commission further mandated that affiliate or divisional transactions "for all goods and services, including power, must not involve any anti-

competitive cross-subsidy." Second, the Commission barred an EDC from making available any goods and services to its supplier affiliate unless those goods and services are also made available to other suppliers on comparable terms and conditions. Such provisions appropriately preclude EDC promotion of its competitive business affiliate's efforts. Duquesne's proposed Code does not include such a prohibition on cross-subsidization.

Third, all EDC functions were required to be separately staffed from all competitive supplier functions, including management responsibility, and all employee transfers are made subject to functional separation requirements. While Duquesne has included rules on "Separation of Functions" and "Officers and Directors" in its proposed Code, the provisions are not broad enough to comply with the Commission's standard in that they do not contain appropriate restrictions on employee transfers, and do not apply at all to the individuals having management responsibility over such employees.

Fourth, the Commission additionally required that comparable treatment be provided to both affiliated and non-affiliated suppliers and supplier customers for all customer goods and services. The nondiscrimination provision in Duquesne's proposed Code of Conduct only prohibits "preferential treatment" of affiliated suppliers and "undue discrimination" against customers. This provision should be modified to clarify that, if necessary, positive efforts must be made in order to provide comparable treatment. Overall, the Commission established the general standard that the EDC must "treat all competitive suppliers in a comparable non-discriminatory manner with similar terms, conditions and access to information, goods and services." This Commission mandate provides for equal access, both in terms of timing and method of disseminating

> information, for all information, not just certain types of information as Duquesne has proposed.
>
> Fifth, the Commission went beyond the PECO proposal and prohibited the tying of the EDC service with any other goods or services both as a condition of the provision of service and as a condition on the availability of certain terms and conditions. Duquesne's Code of Conduct is silent on this subject, and should be modified appropriately.
>
> Sixth, the Commission required a provision which bars the EDC from using its name or any other method to imply, directly or indirectly, that EDC service will be superior if an affiliate is subscribed to, that the reliability of service is inferior if a non-affiliate is subscribed to or that generation services are in fact being provided by the EDC. Duquesne has no comparable provision in its proposed code, which must be modified to achieve compliance.
>
> Finally, the Commission barred EDCs from promoting their competitive affiliate any differently than non-affiliated suppliers. Again, Duquesne's code does not address this, and must be modified accordingly.

(R.D. at 622-24; footnotes and citations omitted). The interim Code of Conduct shall be based upon the Code we approved in our Order of February 5, 1998 at Docket Nos. R-00973953 and P-00971265 in PECO Energy.

We recognize that, at this point, EDCs are implementing codes of conduct that are interim to the implementation of a state-wide code. Nonetheless, the fundamental principles of open competition should not vary from one place to another or from one market to another. Therefore, in order to enhance competition wherever possible, it is necessary to keep the interim codes of conduct as consistent as possible. We are of the opinion that the modifications and

clarifications advocated by Enron will improve the proposed Duquesne Code of Conduct by making the standards of behavior more conducive to the creation of a free market for electricity where the distribution company will not be able to use its market power to enhance its own position or that of its affiliates. Therefore, the exceptions of Enron and MAPSA are granted as set forth above.

MAPSA also urges us to adopt the language we approved in the PECO Energy, Order on Revised Compliance Filing (Entered February 26, 1998) at page 21. (MAPSA Exc., p. 6). MAPSA provides us with no detailed discussion of how the issues discussed at page 21 of that Order would apply here. The matters discussed there appear to be subsumed within the additional modifications we have adopted above. Therefore, the exception of MAPSA will be denied as moot.

B. Pro Forma Tariffs

1. Positions of the Parties

The Company suggested that this section relates to another proposal by Enron that should be addressed by the Commission on a generic basis, not in this case. The proposal is for a new "Pro Forma Electric Generation Supplier Tariff." Duquesne says many of Enron witness Cole's assertions regarding the "inadequacies" of Duquesne's direct access proposal ignore the specifics of that proposal.

Enron has presented a Pro Forma Electric Generation Supplier Tariff, which it intends to define suppliers' jurisdiction and responsibilities in

relation to meeting customers' loads and all necessary involvement with the EDC. Enron asserted that this tariff should be adopted by the Commission for all Pennsylvania utilities. Enron argues the pro forma supplier tariff will establish a clear and enforceable set of rules and procedures to govern the multifaceted relationship between Duquesne and suppliers seeking to deliver power to customers using Duquesne's distribution system. The Commission endorsed the need for a supplier tariff in its Compliance Order in the PECO restructuring proceeding. (PECO Compliance Filing Order at 38).

Duquesne's response to the Enron call for the filing of a Supplier Services Tariff – now a PUC requirement – was to claim that such a tariff was "unnecessary," because many of the provisions are covered and controlled by Duquesne's FERC approved Open Access Tariff. While general topics suggested in the Enron Supplier Tariff may be contained in FERC-filed tariffs, many others, having to do specifically with retail distribution service, are not. In any event, suppliers would benefit by a comprehensive listing of functions, services, and procedures, to the extent that Duquesne's FERC tariff does not provide such rules and services.

In this regard, Enron's witness Coles detailed several, specific issues and services which, if they are not covered by FERC-jurisdictional tariffs, must be included in a reasonable manner in Duquesne's PUC-approved Supplier Tariff. These issues include:

Supplier obligation, energy balancing and load reconciliation.

To ensure reliable electric service to ultimate end-users there must be a clear, detailed understanding among all suppliers as to their obligations and balancing and reconciliation methods.

Energy Imbalance Service

Enron's Pro Forma Supplier Tariff provides a mechanism to handle energy imbalance service. Suppliers need a system to be in place which will determine a load aggregator's hourly responsibility for supply delivery to meet the needs of customers and a means of balancing supplies and actual loads.

Supply Planning and Planning Reserves

Enron's witness Coles sets forth a series of important factors that should be considered by the Company and the Commission in the process of conducting supply planning and accounting for planning reserves.

2. ALJ's Recommendation

For the reasons cited by the Company, the ALJ concluded that the issue of a Pro Forma Electric Generation Supplier Tariff is better suited for a generic proceeding.

3. Parties' Exceptions

Enron argues that the ALJ misconstrued the purpose of Enron's Pro Forma Supplier Tariff when he concluded that it was best addressed in a generic proceeding. Enron states that the tariff was intended as a starting point and that it could be amended to reflect the PECO Energy experience and circumstances unique to Duquesne.

4. Resolution

We agree with the Exceptions of Enron that implementation of retail direct access pursuant to the Act requires a comprehensive Supplier Tariff that includes all rules, procedures and protocols appropriate and necessary for the seamless and efficient implementation of retail access. Therefore, we direct Duquesne to include a specific Supplier Tariff as part of its compliance filing. Duquesne should use as a guide the Commission February 5 decision regarding PECO Energy at Docket R-984298, and prepare an EGS tariff consistent with the requirements of its service territory.

The Supplier Tariff is not a services agreement; it is a set of rules and procedures. It should include no fees or other charges except as have been approved by the Commission upon documentation of incremental cost. Thus, items rejected in our discussion of Ancillary Services, supra, should not be included in the tariff. The Supplier Tariff must address customer sign-up and switching, balancing, billing, and data exchange consistent with all applicable rules and regulations..

Additionally, we agree with Enron's exceptions concerning imbalances which are discussed earlier in the ALJ's Recommended Decision. (R.D. at 70-84). Inclusion of energy imbalances in the F.E.R.C. open access tariff does not preclude the development of supplemental rules, consistent with those of the F.E.R.C., but related to retail access. We agree with the ALJ's Decision and the exceptions of Enron and MAPSA that the Supplier Tariff must include procedures to permit trading such imbalances among suppliers to permit the efficient service of retail load.

C. Summary

We are in agreement that, to the greatest degree possible, an interim Code of Conduct should establish state-wide consistency. This makes it easier for consumers, suppliers and utilities to do business in Pennsylvania. We are granting the exceptions of Enron and MAPSA and directing the Company to conform its proposed Code of Conduct to that approved by the Commission in its February 5, 1998 Order concerning PECO Energy at Docket Nos. R-00973953 and P-00971265. We are also using our Order in that proceeding as a guide for a comprehensive Supplier Tariff which we direct Duquesne to include as part of its compliance filing.

VIII. DUTY TO SERVE

A. Service to Returning Customers

1. Positions of the Parties

The Company proposed that customers returning to "rate cap" service must remain with Duquesne for 12 months thereafter to address certain "gaming" opportunities. Duquesne argued that the proposal is necessary to protect it against customers leaving the system during low cost periods and returning to rate cap service during high cost periods (*e.g.*, the summer peak period).

The OCA submitted that the Company's arguments should be rejected. In short, the OCA contended that the Company's requirement that a customer returning to rate cap service remain with Duquesne for 12 months is unduly restrictive. The OCA asserted that there are many reasons why Duquesne customers may need to return to generation service that have nothing to do with an attempt to game the system. For example, the customer may be merely in between suppliers, a supplier may have refused the customer service or the supplier contract may have been canceled. (OCA St. 5, p. 52). The OCA also suggested that the 12 month minimum service requirement may hinder the development of the competitive market.

DII posited that this Commission must not eliminate the statutory right of all customers to return to service from Duquesne at the capped rate levels specified in the Act during the transition period. DII asserted that the rate cap is a necessary consumer protection that must not be impinged.

Enron asserted that service to returning customers must be offered by an EDC under regulated, tariffed rates, consistent with PECO Energy. While this Commission has stated it will consider and implement 66 Pa. C.S. §2807(e)(3) (which governs the rules under which service to returning customers must be provided after transition), by regulations at a later date, Enron asserted that it is important to consider that issue now as this Commission plans for the future. Consistent with the effect of the holding in PECO Energy with respect to the transition period, Enron argued that it is imperative that this Commission apply Section 2807(e)(3) in a manner that will not thwart electric competition after the phase-in period is over. According to Enron, although the Act does not define the phrases "prevailing market prices" and rates that "recover fully all reasonable costs" under §2807(e)(3), that rate should be interpreted to be the same as the generation credit determined by this Commission.

2. ALJ's Recommendation

The ALJ concluded that no evidence exists in this record to suggest that a problem will arise with returning customers engaging in "gaming" to the detriment of Duquesne. A 12-month "stay-in" provision appears, on its face, to be a serious impediment to competition. The ALJ concluded that this Commission should deny the Company's proposal until it can satisfactorily demonstrate that a serious problem exists.

3. Parties' Exceptions

Duquesne argues that the ALJ erred in that its customers will have an obvious incentive to leave Duquesne as a supplier during low-cost periods and return during high-cost periods because of the rate cap. (Duquesne Exc., p. 36-37). The Company states further that its customers will be able to "game" the system.

4. Resolution

We shall adopt the ALJ's recommendation that we deny the 12-month "stay in" provision offered by Duquesne. As OCA points out, there are real and legitimate concerns which could force a customer to return to Duquesne such as being refused service by a supplier, the cancellation of a supply contract or the simple situation of being in between suppliers. On the other hand, we believe that Duquesne's claim that its customers will attempt to game the system is speculative, particularly at this early stage of the unbundling process. As the ALJ correctly states, the record does not support the suggestion that a problem will arise with respect to returning customers engaging in "gaming" to the detriment of Duquesne. It is within our province to determine the weight and credibility of evidence presented. (Peoples Natural Gas v. Pa. PUC, 552 A.2d 1135, 1142 (Pa. Cmwlth 1989). Duquesne has not demonstrated that a serious problem exists, and, therefore, its exception is denied.

B. Provider of Last Resort

1. Positions of the Parties

Duquesne observed that the Environmentalists proposed the same "Better Choice Plan" that was rejected in PECO Energy, Slip Op., p. 135. Duquesne urges this Commission to reject it here.

Even as the market develops, the OCA suggested that 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. The OCA

noted that 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 this Commission to provide this service. (66 Pa. C.S. §2807(e)(1)). The OCA argued that by the end of the phase-in period, the Act requires this Commission to develop regulations to govern the POLR service. (66 Pa. C.S. §2807(e)(2)).

In its restructuring filing, Duquesne proposed to provide POLR service by pricing the power supply portion of its unbundled bill based on prices obtained from a competitive RFP process. Although Duquesne proposes to explore competitive solicitation, the OCA submitted that more detail is required before this proposal is adopted. The OCA recommended that this Commission refrain from adopting Duquesne's proposal at this time.

The Environmentalists posited that 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 Environmentalists argue that this 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. 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. They called this the Better Choice Plan.

Under the Environmentalists' Better Choice Plan, suppliers can volunteer to participate in the default supplier group if they agree to seven conditions. These conditions are designed to protect the customers and to advance some important public

interest goals. This *quid pro quo* is fair and appropriate, the Environmentalists argue, because participation in the group is entirely voluntary and the participating suppliers receive from this Commission the private benefit of an allocation of default customers without incurring the costs and effort to recruit these customers.

The Environmentalists acknowledged that implementation of the Better Choice Plan is possible only after additional work to address some of the unresolved issues. However, the Environmentalists say this Commission should 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.

Enron suggested that the OCA presents somewhat conflicting views of the approach that should be used to establish the rates applicable to POLR customers. As OCA noted, these include customers who: (i) choose not to shop; (ii) cannot find a supplier (presumably including those who legally are not yet permitted to shop); and (iii) those who may return to Duquesne for service for various reasons. As the OCA stated in its POLR discussion, the rates for such customers -- which include all but pilot customers prior to January 1, 1999, -- should be established in accordance with procedures that this Commission establishes in a POLR rulemaking. Enron agreed with this approach but noted that the rulemaking-derived generation rates that would have to be established pursuant to the Act would not reflect simply some derived market price for generation as the OCA implies.

2. ALJ's Recommendation

The ALJ found no reason to deviate from this Commission's position in PECO Energy.

(3) Resolution

We agree with the ALJ that there is no basis in this record to warrant reconsideration of PECO Energy and await consideration of the Environmentalist's proposal to make mandatory assignments of customers to suppliers. In PECO Energy, Slip Op., p. 135, we expressed doubt whether the Environmentalists' Better Choice Plan assignment of customers to suppliers is permissible under the Act. We stated our preference to consider this option when we promulgate regulations required by Sections 2808(e)(2) & (3). Nothing in this record convinces us to reconsider that decision.

As to the second issue raised here concerning the POLR providing electric service at "prevailing market prices," all parties apparently now agree that this matter should await the proposed POLR rulemaking. We agree that the decision as to whether such service should be provided at, "prevailing market prices," should await the proposed Provider of Last Resort Rulemaking. Moreover, we note that the statutory rate caps will continue to protect non-shopping customers pending the conclusion of the rulemaking.

C. ELECTRIC TRANSMISSION AND DISTRIBUTION SERVICE

1. Unbundling Other Customer Services

(a) Positions of the Parties

Duquesne suggested that the issues addressed in this section (the unbundling of "revenue cycle services") are principally matters of generic policy that this

Commission should decide on a fair and consistent basis for all EDCs and suppliers in the Commonwealth in a generic proceeding.

The OTS maintained that the Act requires Duquesne, in this case, to submit unbundled prices for generation, jurisdictional transmission, distribution, and other services.

The OCA has made recommendations regarding metering, billing and other customer services to assure that options for competitive provision of these services are not foreclosed. These recommendations are discussed below.

The IBEW posited that numerous provisions of the Public Utility Code and this Commission's regulations require that billing and metering for public utility services must be provided by a public utility and not by marketers. The IBEW did not dispute the ability of non-utilities to provide their own bills solely for the supply of electricity or for other non-utility services. The IBEW asserted that it is necessary to determine whether billing and metering services are part of the "distribution services" that are provided by a public utility. The IBEW contended that under the Public Utility Code, the metering and billing for the distribution of electricity are part of the provision of service by a public utility. As of this point in time, Duquesne is the only public utility that is authorized to provide electric distribution service within its service territory. The IBEW argued that it is unlawful for any entity other than Duquesne to provide a meter or render a bill for the electric distribution services that Duquesne provides.

As early as January 1997, the IBEW asked this Commission to establish a generic proceeding to resolve the important legal, policy, and factual issues concerning the provision of billing, metering, and meter reading services by Marketers and other non-

utilities. The IBEW believed that these issues were best decided before any of the utilities' specific restructuring plans were filed. The IBEW noted that this Commission preferred to decide these issues on a case-by-case basis in each restructuring plan, rather than in a generic proceeding.

Enron explained that the provision of non-wire services has nothing to do with the actual distribution of power and energy and is not part of a natural monopoly. Enron submitted that each of the non-wire services in Duquesne's service territory should be provided competitively in accordance with appropriate standards and protections to assure safety, reliability and consumer protection. In addition, Enron asserted that Duquesne's costs and prices for these services must be unbundled from Duquesne's charges for distribution-related services.

Duquesne opposed unbundling, claiming that it does not believe there are much savings to be offered to the customer through unbundling. Enron contended that there is good reason to unbundle non-wire services from distribution services at this time even if they are not immediately made competitive – so that the customer will know what the charges are for such services.

Enron noted that Duquesne suggests that resolution of these issues should be handled generically, relying principally on this Commission's rulemaking orders, such as the Customer Services Order and Advanced Meter Order (Advanced Meter Deployment for Electricity, Docket No. L-00970120, 28 Pa. Bull. 493 (Jan. 31, 1998)). Duquesne also relies on the PECO Restructuring Order, wherein this Commission determined not to require PECO to unbundle those services at this time based on the record before it. Enron addressed, in detail, this Commission's treatment of revenue cycle services in the PECO Restructuring Order and demonstrated why revenue cycle

services should now be unbundled in Duquesne's service territory based on the record of this proceeding.

Enron characterized the IBEW's position as a frontal attack on this Commission's legal authority to require the unbundling and competitive provisioning of non-wire services. Enron submitted that the IBEW improperly relies upon and misreads Section 2807(d) of the Act to assert that only an EDC may legally provide these services. But, Enron argued, this provision does not prohibit the unbundling or the competitive provision of these services (any more than it precludes the competitive provision of electric generation, or other services "traditionally provided by EDCs") by those same suppliers.

MAPSA explained that Duquesne's proposal does not allow for the competitive provision of the metering or billing functions. MAPSA's witness Russell testified that in order to have a truly competitive market, in which suppliers are permitted to provide all of the services that the utility can provide, it is necessary to allow suppliers the single bill option and to allow supplier provision of the metering function.

As an alternative to Duquesne's proposal, which allegedly allows Duquesne to further entrench its monopoly position, MAPSA urged that this Commission should consider adopting the Metering and Billing Principles which were proposed in this proceeding by MAPSA witness Russell.

The OCA recognized that there are several generic proceedings at this Commission that could potentially resolve some of the issues presented here. The OCA asserted that 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.

The IBEW argued that even if the law did not prohibit the Marketers from metering and billing for electric distribution services, the evidence of record in this case demonstrates that it is not in the public interest for metering and billing services to be provided by the Marketers. The IBEW submitted that the Marketers' proposal cannot be adopted. The IBEW argued this proposal violates the provisions of the Act, citing Section 2807(c) which specifically states that the customer has "the right . . . to choose to receive separate bills" from the marketer and Duquesne. (66 Pa. C.S. §2807(c)). The IBEW claimed that customers will be reluctant to change suppliers if it means having to obtain a different electric meter. The IBEW further claimed that safety can be compromised if the meter is changed frequently or if several different meter suppliers must be contacted before a building can be serviced.

Enron postulated that billing and collection are competitive functions that an EGS should have the option of providing. To this end, Enron argued that Duquesne should be required to separate and unbundle its billing and collection functions as part of its restructuring, as this Commission has held it has legal authority to require. Otherwise, customers will be required to pay for the EDC's billing and collection activities even though they choose to receive billing services from their supplier as the Act permits.

NEV raised the matter of conjunctive billing within the context of customer billing. Under the current regulatory system, NEV claimed that many customers, who receive service on multiple meters throughout an EDC's service territory, are discriminated against when compared to customers with similar loads served through a single meter. In particular, a customer with multiple meters, who is on the same rate

schedule and who places the same type of non-distribution-related load on the system as a single-meter customer, is being charged more than that single-meter customer.

Although the Act is silent on this specific issue, NEV argued that the Act does give this Commission authority "to approve flexible pricing and flexible rates, including negotiated, contract-based tariffs designed to meet the specific needs of a utility customer and address competitive alternatives." Moreover, leveling the playing field for multiple-meter customers is in keeping with the Act's undisputed purposes, among others, of creating a competitive market and promoting economic development in the Commonwealth, according to NEV.

NEV further argued that this Commission's decision in PECO Energy is entirely consistent with NEV's testimony in this proceeding regarding the need to eliminate the current discriminatory effect on customers with multiple meters by permitting alternative generation providers to treat these customers as a single service for purposes of billing for transmission and CTC-related charges. In particular, when a customer has multiple metering locations, NEV argues that the customer should be permitted to elect to consolidate the bills for any or all of its meters served under the same rate. As a result, given NEV's proposal, transmission and CTC-related charges would not change with the number of installations or meters, as they currently do, but with the amount of load placed on the system.

(b) ALJ's Recommendation

On the subject of customer billing, the ALJ recounted that this Commission stated in PECO Energy, Slip Op., p. 139, as follows:

> Section 2807(c) of the Act provides that the EDC may be responsible for billing customers for all electric services while granting the customer the right to choose to receive a separate bill from its generation supplier. The manner and details of the interaction between customers, suppliers, and EDCs are governed by the rulemaking at Docket No. M-00960890, F0011. The Act explicitly specifies a presumption that the EDC shall have the duty to provide a single bill, including competitive generation services, to all customers unless the customer chooses to receive a separate bill directly from its EGS.
>
> Several parties have argued for a "third" billing option that would permit customers to choose to receive a single bill from their EGS that includes billing of the EDC charges. PECO and others conversely maintained that the EDC should be the entity responsible for billing except when a customer elects to receive one bill from the EDC and a separate bill for generation from the EGS.
>
> We recognize there may be potential benefits of such proposals but cannot conclude that it is appropriate to unbundle billing based on this record. Therefore, PECO shall provide all billing services, including billing for generation services, unless a customer indicates a preference to receive a separate bill directly from the supplier for generation services.

The ALJ recommended that Duquesne must provide all billing services, including billing for generation services, unless a customer indicates a preference to receive a separate bill directly from the supplier for generation services. The ALJ also recommended that the "third" billing option, permitting customers to opt to receive a single bill from their EGS that includes billing for the EDC charges, cannot be determined on the basis of this record and should await the results of this Commission's generic rulemaking on this subject. Finally, according to the ALJ, this Commission should permit billing consolidation for customers with multiple sites to aggregate their

load with a single EGS. (PECO Energy, Slip Op.. p. 140). This is consistent with the arguments put forward by NEV.

(c) *Arguments on Exceptions*

Enron has taken exception to the Recommended Decision, arguing that there are "substantial consumer benefits" to be gained by unbundling billing functions. (Enron Exc., pp. 27-29). It states that no party has offered persuasive reasons why customers should not receive those benefits now. At a minimum, Enron contends, this Commission should immediately open a rulemaking on this issue. The Environmentalists similarly take exception, arguing that costs to customers would be lower if customer billing were unbundled. (Environmentalists Exc., p. 7).

Additionally, Enron excepts to the ALJ's refusal to require Duquesne to permit customers to receive a single bill, including EDC charges, from their generation supplier. (Enron Exc., pp. 29-31). It is joined on this issue by MAPSA. (MAPSA Exc., pp. 6-7). Enron maintains that the ALJ erred by relying on the PECO Energy decision to reject supplier-only billing option. It states that there is no reason to deny customers the benefits of this option as competition commences. MAPSA makes the identical arguments, stating that adoption of this option will allow for "further development of competitive alternatives and bring additional value to customers who seek those alternatives."

(d) Resolution

We adopt the ALJ's recommendation that Duquesne must provide all billing services, including billing for generation services, unless a customer elects to receive a separate bill directly from the supplier for generation services. With respect to the

arguments made by Enron and MAPSA, we note that the mere fact that we can unbundle billing services does not mean that we should unbundle those services. As we noted in the PECO Energy, quoted by the ALJ at page 718 of the R.D. and reproduced earlier in this Order, "the manner and details of interaction between customers, suppliers and EDCs are governed by the rulemaking at Docket No. M-00960890, F0011." As in PECO Energy, we do not have a record before us which is adequate to support adoption of this proposal. We note that the proponent of a rule or order has the burden of proof in the matter pursuant to 66 Pa. C.S. §332(a). The advocates of unbundling all billing services have not met that burden in this proceeding.

Likewise, the "third" billing option which permits customers to receive a single bill from their EGS that includes billing for the EDC charges cannot be determined on the basis of this record and should await the results of this Commission's generic rulemaking. The fact, as Enron argues, that no party has presented evidence why we should not permit this option immediately is not a persuasive reason as to why we should approve Enron's proposal. We believe those arguments for these billing options, as well as those against the proposals, are best considered in a generic proceeding.

Finally, we shall also adopt the ALJ's recommendation that we allow billing consolidation for customers with multiple sites to aggregate their load to a single EGS as we did in PECO Energy. At page 140 of the slip opinion in that proceeding, we stated that:

> PECO has defined "customer" to include a single point of delivery. In challenging PECO's position, it was asserted that EGSs should be permitted to treat customers with multiple locations as a single service for purposes of billing for transmission and CTC-related charges. In other words, transmission and CTC-related charges would not change with

the number of installations or meters, as they currently do, but with the amount of load placed on the system.

PECO's restriction is inappropriate in a competitive generation market because it makes it more difficult for customers with multiple sites to aggregate their load with a single EGS. Accordingly, we shall permit billing consolidation. For administrative ease, billing consolidation should only apply to customers who have multiple meters on the same rate tariff. This change shall not apply to distribution charges because customers with multiple meters may impose a cost on the system that is different than a similar load from a single location associated with the distribution of the service.

We see no reason to deviate from that rationale and shall follow it here.

(2) Metering

(a) Positions of the Parties

The Company argued that the main issue here is whether to unbundle metering services, which several intervenors urge this Commission to do. Duquesne argues these proposals must fail under PECO Energy, Slip Op., p. 140 ("As indicated in our rulemaking at Docket No. L-00970120, we do not believe it is necessary to unbundle metering as a competitive service at this time").

The OTS posited that billing and metering costs should also be specifically delineated on the customers bills. These costs are borne by the ratepayers. The OTS submits that, if the generation supplier can offer billing and metering at a lower cost than the distribution company, the ratepayer should have the option of choosing the least

expensive alternative. According to the OTS, this can only be known and measured by the ratepayer if these costs are unbundled.

The OCA's witness Alexander made the following recommendations: (i) Duquesne's short term policies should be compatible with the possibility of increased competition in metering and metering services; (ii) Open architecture standards should be developed by the stakeholders and approved by this Commission; (iii) 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; (iv) Duquesne should be prepared for installation and billing for alternate meters by suppliers; (v) Standard load profiles used for low use residential and small commercial customers should be updated frequently and approved by this Commission; and (vi) Duquesne has not proposed any charges to provide usage or billing information to suppliers for access to customer-specific usage information, and, therefore, none should be imposed. The OCA requested that this Commission adopt these recommendations.

Enron argued that meters and billing should be provided competitively. Enron further argued that meter installation and repair must be conducted by properly trained personnel in accordance with appropriate standards. But, Enron continued, there is no merit to Duquesne's contention that only employees who work for an EDC are capable of being so trained. Enron noted that Duquesne's present metering system for residential customers has been "outsourced" to a non-utility company. Enron asserted that EDC concerns can and should be addressed by having this Commission establish minimum qualifications and training for installation personnel and to require EGS services to meet the same service standards as the EDC.

Enron urged this Commission, based on the record in this case, to allow EGSs not only to select the type of advanced meter, but to own it and provide it competitively. Enron concluded by saying that, following this Commission's ruling on the legality of unbundling billing and customer service functions, there is no rational or legal reason that would preclude the unbundling and competitive entry into metering and metering functions.

(b) ALJ's Recommendation

On the subject of metering, the ALJ observed that this Commission stated in PECO Energy, Slip Op., p. 140-141, as follows:

> As indicated in our rulemaking at Docket No. L-00970120, we do not believe that it is necessary to unbundle metering as a competitive service at this time. However, we do believe that advanced metering offers substantial opportunities for the development of competitive generation products and that this Commission must facilitate development of those products and services. The right to choose a competitive EGS is inherently related to the ability to choose alternative generation services and products made possible by advanced metering. Customers must have a reasonable choice of advanced meters in conjunction with the services offered by their chosen EGS. In our rulemaking, we have outlined the standards and procedures to ensure that customers have real options for competitive metering while retaining all physical work related to metering as a regulated EDC function.
>
> Therefore, all customers may, in conjunction with their EGS, request use of a "qualified meter" that has been approved by this Commission based on the recommendations of a working committee composed of interested parties. This Commission will ensure that the list of qualified meters includes all meters necessary to support market services such

> as two-way communication, remote readings, time-of-use capability, and net metering. While PECO, as a regulated EDC, shall be responsible for all physical work related to the meter, the customer and/or the EGS may select the qualified meter to be used and shall pay as a regulated rate any net incremental cost incurred by PECO as a result of the metering choice.

Accordingly, the ALJ recommended that Duquesne must allow customers the option, in conjunction with their EGS, to request the use of a "qualified meter" that has been approved by this Commission as stated in PECO Energy. Further, the ALJ recommended that, as the regulated EDC, Duquesne should be responsible for all physical work related to the meter and the customer should pay as a regulated rate any net incremental cost incurred by Duquesne as a result of the metering choice.

(c) Arguments on Exceptions

Enron takes exception to the ALJ's recommendation, arguing that Duquesne's situation among electric utilities is unique and that this Commission should permit unbundling of metering services. It states that Duquesne has planned to phase out its metering services and place a contract with a third party provider. (Enron Exc., pp. 31-34). Enron posits that the ALJ failed to recognize that metering services could be unbundled on an interim basis pending the outcome of the Advanced Metering rulemaking at Docket No. L-00979120. MAPSA also takes exception on this issue, arguing that an EGS should be able to own, supply and read a customer's meter at the customer's delivery point.

(d) Resolution

We will adopt the ALJ's recommendation that Duquesne must allow customers the option, in conjunction with their EGS, to request the use of a "qualified meter" that has been approved by this Commission. As the regulated EDC, Duquesne shall be responsible for all physical work related to the meter, and the customer shall pay as a regulated rate any net incremental cost incurred by Duquesne as a result of the customer's metering choice.

With regard to the exceptions of Enron and MAPSA, we note that these issues are governed by the Advanced Meter rulemaking at Docket No. L-00970120 in which we did not find it necessary to unbundle metering at this time in order to facilitate the deployment of advanced metering. Nothing in the record of this proceeding suggests that metering should be unbundled in Duquesne's service territory at this time. The fact that Duquesne planned to contract its metering services to a third party is in no way dispositive of this issue. As Enron points out, even Duquesne agreed that its plans for contracting out metering services were not in compliance with the Advanced Meter rulemaking. (Enron Exc., p. 32). Moreover, Duquesne has not asked, or received, a waiver of our regulations with regard to this matter.

3. Agency

(a) Positions of the Parties

Duquesne defined the issue as whether a supplier can act as an agent for the customer and provide a "total electric package," including billing and collection. Duquesne argued that Enron's proposal should be rejected because: (i) the Act does not

authorize this type of agency arrangement and this Commission's Customer Services Guidelines would appear to prohibit it; (ii) if the supplier were to act as agent, it would have to provide metering and disconnection services, but under the guidelines only the EDC, Duquesne, can provide metering services for customers; and (iii) agency is inextricably linked with the single supplier bill option, but this Commission has not yet endorsed the supplier bill option. (Customer Services Guidelines, 1997 Pa. PUC LEXIS 42 at *1, *26, & *51; PECO Energy, Slip Op., p. 139).

The OCA observed that 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. For these reasons, the OCA submited that Enron's proposal raises significant concerns that must be thoroughly explored before approval and should not be adopted here.

Enron observed that it is undisputed in marketing circles, regardless of the commodity, that the vast majority of consumers, if given the choice, will seek and subscribe to a provider that can offer a comprehensive service package to the customer. Enron argued that, in a competitive market, market pressures will require market participants to provide products and services which meet customers' needs. Given that fact, Enron argued that in a competitive electric generation market, most customers will want their preferred provider to serve not only as their supplier of electricity, but also as their "single point of contact" with the utility. Since transmission and distribution services will remain a monopoly under the Act, in order to ensure that consumers have complete freedom of choice, suppliers should be able to act as agent for the customer to procure distribution, transmission, generation, and revenue cycle services on behalf of

their principal-customers, and send them a single bill for these services as well as to bill and collect the CTC/ITC and transfer such payments to the utility or its agent.

Enron argued that, under any agency arrangement, suppliers would be able to accept orders for service from customers and, through contact with the EDC, initiate or continue service at the customer's location. Essentially, through the agency agreement, the supplier would become the customer of record and would be directly responsible for payment to Duquesne of the EDC's charges associated with distribution and transmission. Such an agency relationship is not new to this Commission or to Pennsylvania utilities. Enron suggested that, in the natural gas industry, consumers have this option available to them in those markets which have been subject to competition. Enron noted that industrial natural gas customers have been able to enter into an agency relationship with their utility to procure gas service for more than ten years.

Enron posited that there is no legal impediment which would prevent this Commission from approving the agency relationship between supplier and customer as proposed by Enron. Enron predicated that, if allowed to occur, agency holds the possibility of many benefits for both consumers and for the competitive market. Enron noted that Duquesne contends first that the Act does not authorize agency and that the Customer Services Order would appear to prohibit it. (Duquesne M.B., p. 84). Enron countered that Duquesne provided no citation for either of these propositions, because there are none. Enron suggested to the contrary, that this Commission explicitly acknowledged the right of an EGS to act as agent for an end use customer in the PECO Energy case.

(b) ALJ's Recommendation

The ALJ concluded that a number of unanswered consumer protection issues abound in Enron's agency proposal. One of these unanswered issues concerns the proper interface between the agency proposal and the protections accorded residential customers in Chapter 56 of this Commission's regulations. For these reasons, the ALJ concluded that any action on Enron's agency proposal should be delayed until a future proceeding can consider this subject in greater detail.

(c) Arguments on Exceptions

Enron excepts to the rejection of its proposal to permit an EGS to act as an agent for customers. It argues that agency is a necessary tool to compete in a competitive market. Enron states that the ALJ's concerns about consumer protection matters are "largely irrelevant at present" and could be based upon a misunderstanding of the agency proposal.

(d) Resolution

We agree with the ALJ that there are too many unanswered questions concerning Enron's proposal. For example, it appears that under this proposal the EGS would have to provide metering and disconnection services. Therefore, the exception of Enron must be denied.

4. Customer Advanced Reliability System

(a) Positions of the Parties

Duquesne explained that, prior to the Act, it entered into a 15-year contract requiring Itron, Inc., to install, operate and maintain an automated metering service, known as Customer Advanced Reliability System (CARS). At present, Itron has installed a substantial portion of the system, and it should be fully operational by December 31, 1998, according to Duquesne.

The Intervenors have three main objections to CARS: (i) CARS will not satisfy this Commission's Advanced Metering Guidelines; (ii) CARS may be "anti-competitive" and hinder retail competition; and (iii) this Commission should stop Duquesne from installing a "gold-plated" system, or alternatively, make Duquesne shareholders at risk for this investment.

Duquesne argued that this Commission has not yet finalized advanced metering standards. Once those standards are set, "Duquesne and Itron will work with the Metering Committee to qualify CARS, ensuring that distribution system benefits, etc. are accessible to competitive suppliers." Next, the Company stated, CARS is pro customer choice and will promote, not hinder, competition. Duquesne noted that CARS will support a more reliable and accurate supplier settlement process than programs based on estimated load profiles. Duquesne added that CARS will enable retail suppliers in Duquesne's service area to offer new value-added services to their customers, such as time-of-use pricing. Moreover, Duquesne asserted, CARS does not preclude the unbundling of billing or other services in the future. Finally, the Company argued that CARS is not a "gold plated" system. CARS streamlines the use of distribution system

assets, lowering overall service costs. These benefits will accrue to customers that choose alternative suppliers as well as customers that do not, according to Duquesne.

Enron argued that Duquesne claimed that it will provide retail suppliers equal access to the service offerings of the CARS system, but it is significant that in describing these services, Duquesne witness Allison speaks of Duquesne offering these services. Enron asserted that, to the extent that Duquesne provides these services to suppliers, they should be at cost and should be fully available to resell by the supplier.

Enron also stated that Duquesne must assure that its CARS system is fully open and capable of accommodating both this Commission's very limited metering proposed rule, as well as full competitive provision that this Commission has indicated it intends to implement in the future. The fact that Duquesne has signed a 15-year lease should not change the result. Enron argued that once this Commission mandates competition in non-wire services, this Commission should order a revision in the lease, if necessary, that would guarantee that ratepayers did not lose the advantages of competitive metering. Finally, Enron would have this Commission direct Duquesne to work with suppliers and others to implement modifications in CARS to allow supplier-provided meters, automatic meter reading and billing through an Independent Operator Agreement (IOA).

(b) ALJ's Recommendation

On the subject of metering, the ALJ concluded that Duquesne must allow customers the option, in conjunction with their EGS, to request the use of a "qualified meter" that has been approved by this Commission as stated in PECO Energy. As the regulated EDC, Duquesne would be responsible for all physical work related to the meter

and the customer would pay as a regulated rate any net incremental cost incurred by Duquesne as a result of the metering choice. The ALJ concluded that any further move to develop competition in this area should await further Commission rulemaking on this subject.

(c) Resolution

We are in agreement with the ALJ, as discussed in the previous section, that Duquesne must allow customers the option, in conjunction with the EGS, to request use of a qualified meter which has been approved by this Commission. Duquesne shall remain responsible for all physical work related to the meter whether it does the work itself or contracts out the work to another company. We have not in the past and are not now endorsing or approving the CARS program. The CARS program must not stand in the way of any future move to competition regarding these services. There being no exceptions to this determination, we adopt the ALJ's recommendation.

D. Consumer Protection and Service Issues

1. Termination

(a) Positions of the Parties

Duquesne affirmed it will not terminate a customer for failure to pay an alternative supplier's charges consistent with this Commission's Order in Licensing Requirements for Electric Generation Suppliers, Docket No. M-00960890, F0004, (February 13, 1997). (R.D., pp. 735-736).

The OCA observed that Duquesne's procedures regarding termination of a customer from the electricity grid for nonpayment of charges were unclear. (R.D., p. 735). The OCA, however, submitted that the Duquesne affirmation noted above is consistent with this Commission's Order and recommended that Duquesne's compliance filing should clearly set forth its procedures. (R.D., p. 736). The OCA also recommended that 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. (R.D., p. 736).

Enron claimed that enabling suppliers to act as agents for customers will allow the supplier to act on behalf of the customer to request the cancellation of electric supply from one source and to replace it by ordering electric service from another supplier. (R.D., p. 736). Enron responded to concerns that suppliers could act in their capacity as agents to have the EDC physically disconnect customers by clarifying Enron neither claims that it can physically disconnect customers, nor desires to make this a prerogative as part of the supplier's agency responsibility. (R.D., p 736). Enron further

clarified its position that suppliers can "cancel service" in that they can stop providing service to a non-paying customer by terminating the contract with that customer, after complying with all applicable Chapter 56 requirements, including the sending of appropriate written notices to the customer and to the EDC. (R.D., pp. 736-737). At that point, the customer will either attempt to repair the relationship with the supplier or will default to the supplier of last resort. (R.D., p. 737). Enron contended that is the extent of the power of suppliers to stop service to a customer. (R.D., p. 737).

(b) ALJ's Recommendation

ALJ Corbett recommended that, given the apparent agreement of all parties and for the reasons cited by the OCA, Duquesne should be directed that, as an EDC, it cannot terminate service to a customer for failure of that customer to pay an alternative supplier's charges. (R.D., p. 737). For the same reasons, ALJ Corbett recommended that 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. (R.D., p. 737). ALJ Corbett recommended Enron's agency proposal should be denied. (R.D., p. 737).

(c) Parties' Exceptions

Enron excepts to the ALJ's conclusions about reducing "consumer protections" as largely irrelevant at present because they involve concerns that arise only if the supplier is providing a single bill-or based upon a misunderstanding of the agency proposal. (Enron Exc., p. 36). Enron clarifies that the supplier-agent is agent for the customer. Accordingly, the supplier cannot reduce or eliminate consumer protections

mandated by Chapter 56 and which Duquesne, as the Delivery Service Company, is obligated to provide. (Enron Exc., p. 36).

(d) Resolution

We adopt the ALJ's recommendation. As agreed to by the parties, Duquesne, as an EDC, may not terminate service to a customer for that customer's failure to pay an alternate supplier's charges. Likewise, based upon the record before us, we adopt the ALJ's recommendation that, as an EDC, Duquesne may not condition restoration or reconnection on the payment of past-due supplier charges unless those charges are owed to the territory's provider of last resort. Finally, we adopt the ALJ's recommendation to reject Enron's agency proposal. These clarifications are consistent with the Act's Universal Service requirements and POLR directives. As noted, in PECO Energy, Slip. Op., p. 136, we will adopt regulations clarifying that POLR duties upon the conclusion of the transition period.

2. Switching Fees

(a) Positions of the Parties

Duquesne, in rebuttal testimony, 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. (R.D., p. 738).

The OCA noted that Duquesne made no quantification during this proceeding of what these charges will be, or what their amount will be. (R.D., p. 738). The OCA argued that, since this proceeding was the proper forum to evaluate the need for such additional fees, Duquesne should not be permitted to implement such charges, without proper review and justification. (R.D., pp. 738-739).

Enron contended that, to the extent Duquesne is proposing any fee for switching suppliers, such fees should be prohibited in accordance with the policy articulated in PECO Energy and Duquesne's failure to support the fee.[25] (R.D., p. 740).

Regarding a customer's change of supplier, Duquesne 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. (R.D., p. 739). The OCA distinguished between customer-initiated changes and marketer-initiated changes and recommended 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

[25] PECO Reconsideration Order, p. 17.

customer communicate directly with the distribution company is not reasonable.

(R.D., p. 739).

The OCA also submitted that the Company's proposed five 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. (R.D., p. 739). The OCA requested that these proposals be adopted. (R.D., p. 739).

(b) ALJ's Recommendation

ALJ Corbett recommended that, since no substantial evidence exists in this record to support the Company's claim for a fee for switching suppliers, this Commission should deny this claim until such time as Duquesne can substantiate the cost-basis for this charge. On the other hand, the Company's proposed Tariff Rule 27, which allows for a change of supplier based upon either an 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, appears to be a reasonable attempt to prevent "slamming" and should be approved until such time as this Commission approves a rulemaking on this subject. Further, the ALJ recommended that the Company's five day notice requirement to switch suppliers and obtain a meter reading should be approved as presented by Duquesne without further modification. (R.D., p. 740).

(c) Parties' Arguments on Exception

Duquesne does not except to the ALJ finding that Duquesne not be entitled to charge certain fees "until such time as Duquesne can substantiate the cost-basis" for them, provided that it is interpreted to permit a subsequent filing that specifies the fees and provides the cost basis for them. (Duquesne Exc., p. 37).

(d) Resolution

We adopt the ALJ's recommendation to deny Duquesne's claim for a fee for switching suppliers. Duquesne has not met its burden to establish such a fee in this record. In regard to Duquesne's proposed Tariff Rule 27, we adopt the ALJ's recommendation to approve this rule subject to modification to conform with the final IRRC-approved Commission rulemaking at Order Establishing Standards for Changing a Customer's Electric Supplier, Docket No. L-00970121. We also adopt the ALJ's recommendation regarding Duquesne's five day notice requirement to switch suppliers and obtain a meter reading.

E. Partial Payments

1. Positions of the Parties

Duquesne committed to apply customer payments "in the consolidated bill scenario consistent with the Guidelines for Maintaining Customer Services," thus implementing the partial payment procedures. (R.D., pp. 740-741).

The OCA stated that this commitment by Duquesne resolves this issue. (R.D., p. 741).

Enron requested that this Commission, in its determination of the distribution of partial payments received by the EDC, assure that payment application be fair and nondiscriminatory. (R.D., p. 741). Enron argued that the only reasonable way to assure equitable application of partial payments is to apply payments on a *pro rata* basis. (R.D., p. 741). Enron contended that, if payments are not applied on a *pro rata* basis, a disproportionate amount of delinquencies will be allocated to suppliers likely, leading to early discontinuance of service by the supplier and, through return to the POLR, elimination of competitive benefits to those customers – customers who may most need the price reductions offered by the competitive environment. (R.D., pp. 741-742). Enron further argued that since EDCs, including Duquesne, are already recovering all uncollectibles, including those uncollectibles associated with the generation portion of the bill, in current rates, assigning a disproportionate amount of potential uncollectibles to suppliers will result in double recovery of uncollectible expense by Duquesne.[26] (R.D., p. 742).

2. ALJ's Recommendation

ALJ Corbett recommended that, since the Company has committed to apply customer payments in the consolidated bill scenario consistent with this Commission's Guidelines for Maintaining Customer Services, no further action appears warranted to modify Duquesne's proposal for handling partial payments. (R.D., p. 742).

[26] Enron St. 4.0, pp. 18-19.

3. Parties' Exceptions

Enron excepts to the ALJ's refusal to recommend that partial payments be applied on a *pro rata* basis. (Enron Exc., p. 37). Enron argues that, notwithstanding the Customer Services Order, the ALJ erred by failing to recognize *pro rata* application of partial payments as the only reasonable way to assure that a disproportionate amount of delinquencies are not allocated to suppliers, and to prevent double recovery of uncollectible expenses by Duquesne. (Enron Exc., p. 37).

4. Resolution

We agree with and adopt the ALJ's recommendation regarding application of partial payments. The concern that the "priority" method will result in a disproportionate amount of delinquencies allocated to suppliers is mitigated by the policy that, unlike the EDC, suppliers can address and control delinquencies more quickly through cancellation of contract. Additionally, the adoption of this order of priority for partial payments is consistent with the applicable guideline in the Customer Services Order, and, therefore, reflects our general desire that regulations and Orders pertaining to customer service issues shall control these issues. This will ensure that utilities, competitive suppliers, and consumers receive fair treatment across Pennsylvania.

F. Summary

We are rejecting the Company's proposal to require customers who return to its sales service to "stay in" that service for 12 months. We agree with OCA that there may be good reasons for consumers to need to switch back to Duquesne and we believe that the Company's claim that customers may game the system is speculative. We also reject the "Better Choice Plan" put forward by the Environmentalists with respect to the

Provider of Last Resort. That option will be examined when we promulgate regulations required by Section 2808(e)(2) and (3). As to the provision of electric service by the POLR at prevailing market rates, we believe the matter is best considered in a generic rulemaking.

We are also directing that Duquesne provide all billing services, including billing for generation services, unless a customer elects to receive a separate bill directly from the supplier for generation services. Additionally, we shall allow billing consolidation for customers with multiple sites to aggregate their load to a single EGS as we did in PECO Energy.

With respect to metering, we are declining to require Duquesne to unbundle metering services at this time. However, we have decided that the Company shall allow consumers, in conjunction with their EGS, to request the use of a, "qualified meter," that has been approved by this Commission. Duquesne shall be responsible for all physical work related to the meter, and the customer shall pay as a regulated rate any net incremental cost incurred by Duquesne as a result of the customer's metering choice.

We are also rejecting Enron's proposal to allow an EGS to act as an agent for its customers. As OCA points out, there are still too many unanswered questions concerning this proposal. Enron has not met is burden of proof with respect to convincing us that this plan will work.

With regard to termination of service, Duquesne, as an EDC, may not terminate service to a customer for that customer's failure to pay an alternate supplier's charges. Likewise, based upon the record before us, we adopt the ALJ's recommendation that, as an EDC, Duquesne may not condition restoration or reconnection on the payment

of past-due supplier charges unless those charges are owed to the territory's provider of last resort. Finally, we adopt the ALJ's recommendation to reject Enron's agency proposal.

We reject Duquesne's claim for a fee for switching suppliers on the basis that Duquesne has not met its burden to establish such a fee in this record. In regard to Tariff Rule 27, we adopt the ALJ's recommendation to approve this rule subject to modification to conform with the final IRRC-approved Commission rulemaking at Order Establishing Standards for Changing a Customer's Electric Supplier, Docket No. L-00970121. We also adopt the ALJ's recommendation regarding Duquesne's five day requirement to switch suppliers and obtain a meter reading.

Concerning application of partial payments, we adopt the recommended requirement that Duquesne's procedures comply with the guideline relating to partial payments found in the Final Order Re: Guidelines for Maintaining Customer Services at the Same Level of Quality Pursuant to 66 Pa. C.S. §2807(d), and Assuring Conformance with 52 Pa. Code Chapter 56 Pursuant to 66 Pa. C.S. §2809(e) and (f), Docket No. M-00960890F0011 (July 10, 1997) (Appendix B, Guideline H).

IX. UNIVERSAL SERVICE AND ENERGY CONSERVATION

Duquesne's application for approval of its restructuring plan included, pursuant to §2806(e), a proposed universal service and energy conservation cost-recovery mechanism. Duquesne also addressed how it intends to satisfy the universal service and energy conservation obligations under the Act. Duquesne Witness Flynn presented testimony regarding the Company's proposed universal service program. Duquesne's two principal low-income assistance programs are the Customer Assistance Program (CAP) and Smart Comfort or Low-Income Usage Reduction Program (LIURP). The CAP provides payment assistance and Smart Comfort provides funding for energy conservation measures. (R.D., pp. 556-760).

A. Specific Programs

Duquesne requested the Commission to accept the design of its CAP plan. Duquesne submitted that in its rebuttal testimony the Company addressed in detail the numerous design recommendations of OCA witness Brockway and City witness Mr. Colton. Duquesne stated that it had either incorporated these recommendations or addressed their concerns by the plan's design. Duquesne asserted the primary differences between the intervenors and the Company center on program eligibility criteria and levels of funding. (R.D., p.796).

Duquesne proposed to maintain the following annual funding and enrollment levels for each universal service program: CAP funding at $550,000 for 1,600 participants; Smart Comfort (LIURP) funding at $700,000 for 700 participants; CARES funding at $60,000 for approximately 4,500 participants; Consumer Credit Counseling Service funding at $6,000 for approximately 710 participants. The Company disagreed

with the intervenors who advocated a broader definition of need than Duquesne, thus expanding the pool of persons eligible for assistance. Duquesne argued its use of additional eligibility criteria is consistent with PECO, which approved PECO's use of additional eligibility criteria. (R.D., pp.756-760).

Duquesne explained that Smart Comfort is its LIURP program and has evolved from strictly a weatherization program into an "end use" strategy. Usage reduction measures include cost-effective appliance and lighting replacements. The primary disputes between the Company and intervenors regarding this program centered on eligibility and funding levels. Duquesne agreed with Environmentalists' witness Colton about the need to further link its Smart Comfort and CAP programs and is taking steps to do that. (R.D., pp. 800).

Duquesne disagreed with the intervenors who advocated a broader definition of need than Duquesne, thus expanding the pool of persons eligible for Smart Comfort. Duquesne argued its use of additional eligibility criteria is consistent with PECO, which approved PECO's use of additional eligibility criteria. (R.D., pp.756-760).

Duquesne does not have, and did not propose, a specific renewable program. Duquesne indicated that it continuously evaluates new technologies for its Smart Comfort program and will incorporate promising technologies into its programs. Duquesne pointed out that the OCA witness Brockway's suggestion for a photovoltaic program is not cost-effective. (R.D., pp. 801-802).

The OCA submitted the following design changes to CAP: reduce payments, expand the size of the program, expand eligibility, reduce arrearage payments, implement a more detailed evaluation plan, and provide portable universal service

benefits. The OCA noted that Duquesne stated that their plan incorporated a number of OCA witness Brockway's recommendations, or the plan is already sufficient. The OCA disputed Duquesne's claim and requested the Commission to direct Duquesne to incorporate the OCA's recommendations in a detailed compliance filing. (R.D., pp. 796-799).

The OCA argued that Duquesne's proposed CAP budget of $550,000 does not meet the need of Duquesne's service territory. The OCA recommended that the Commission approve a CAP budget of 0.5% of gross revenues or $5,725,000 to serve 24,000 participants. (R.D., pp. 757-759). The OCA supported a full-scale CAP program that makes reasonable efforts to serve 50% of the eligible households. The OCA estimated the number of eligible CAP households as high as 117,000. Because of budget constraints, the OCA recommended that the Commission require Duquesne to set a goal for its CAP program of providing bill assistance to 24,000 eligible customers by the end of three years.

The OCA's witness Brockway stated that Duquesne's LIURP program primarily addresses baseload uses and is delivered free to eligible customers. (R.D., pp. 800-801). OCA witness Brockway recommended 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. Witness Brockway explained that ramping up beyond the capacity to maintain the hands-on involvement of current managers would jeopardize the intangible qualities that make Smart Comfort successful. (R.D., p.760).

The OCA contended that 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. The OCA's witness Brockway recommended that Duquesne broaden its eligibility

requirements 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. (R.D., pp. 757, 761).

The OCA recommended that Duquesne issue an RFP to solicit proposals to install ten units of photovoltaic ("PV") electricity panels at 1 kW in 1999, and 20 units of PV in 2000. Additionally, OCA noted that in PECO, the Commission directed that a renewable pilot be included, consistent with OCA witness Brockway's recommendation. (R.D., pp. 802).

The Environmentalists stated that Duquesne's CAP is generally well designed, except for the funding and eligibility levels. The Environmentalists recommended that the Company modify the program to ensure that CAP operates closely with the other universal service programs and suggested that Duquesne refer all CAP recipients to LIURP. The Environmentalists also opposed the use of prepaid meters. (R.D., pp. 799-780).

The Environmentalists recommended a universal service budget of $17.49 million that includes a CAP budget of $14.75 million. The Environmentalists argued that Duquesne violates the Commission's universal service guidelines by adding eligibility criteria for CAP. The Environmentalists argued that it is improper for Duquesne to use the "prioritization" factors in the Commission's guidelines as eligibility criteria. The Environmentalists argued that the Company improperly rejects 95% of the eligible households because it uses improper eligibility criteria. (R.D., pp. 763-767). The Environmentalists recommended that the Commission direct Duquesne to revise its

universal service plan to include the policies, protections and services[27] cited in the Guidelines. (R.D., p. 767).

The Environmentalists believed that Duquesne's LIURP is seen as one of the state's most cost effective programs. (R.D., pp. 801). The Environmentalists supported the testimony of Roger Colton and his estimate of an "appropriately funded and available" annual LIURP budget of $2.21 million . (R.D., pp. 766-767). The Environmentalists contended 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 program. The number of customers estimated to be eligible for LIURP is 21,226. (R.D., pp. 763, 765).

The Environmentalists urged the Commission to direct Duquesne to develop and offer a renewable energy pilot program as a component of its universal service program. The Environmentalists recommended that the pilot include renewable technologies such as domestic water heating, solar photovotaics, wood-fired water and/or space heating. (R.D., pp. 805).

CAAP recommended that the Commission direct Duquesne to develop and implement a full scale CAP designed to serve 13,251 low income households annually with funding set at $10,459,556 annually. CAAP maintained that Duquesne's proposed CAP underestimates annual households in need by 11,921 and annual funding requirements by $9,221,812. CAAP argued that the US Census data for Duquesne's

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[27] Final Order Re: Guidelines for Universal Service and Energy Conservation Programs (Order entered July 11, 1998), Docket No. M-00960890F0010, Section B(1), at 29-30 and Appendix C.

service territory shows that as many as 104,057 households are income eligible for CAP. (R.D. 767-775).

CAAP supported an annual LIURP budget of $4.5 to serve 3,949 households. CAAP argued that Duquesne's proposed LIURP underestimates annual households in need by 3,249 and annual funding requirements by $3,800,845. CAAP determined its proposed participation levels by using 1990 US Census data and the Commission's 40% participation goal. (R.D., pp. 770-772).

CAAP recommended that the Commission direct Duquesne to establish the following annual budgets: $50,000 for training and technical assistance for its network of service providers, $100,000 to fund a central research and development program to seek out new techniques, evaluate national trends, and $300,000 to develop and institute a low income renewables pilot program. (R.D., pp. 774-775).

B. Cost Allocation and Rate Design

1. Positions of the Parties

Duquesne proposed to allocate and collect the universal service charge by rate class on a cents per kWh basis based on allocated distribution costs for each rate class. Duquesne disagreed with the OTS suggestion that this charge be unbundled from the Distribution Charge because it is contrary to PECO. (R.D., p. 776).

The OTS disagreed with the Company's proposed application of the universal service charge and its presentation on customers' bills. The OTS also opposed the position of DII. The OTS recommended that this charge should be on a customer

basis, rather than on a per kilowatt basis. The OTS reasoned that by applying a universal service charge based upon kilowatt usage, and applying the charge to all rate classes, high volume users would bear an excessive burden which would be discriminatory. The OTS proposed a formula to apply a flat universal service charge ($1.76) to all customers in all classes. Finally, the OTS recommended that the universal service charge should appear as a line item on the customers' bills. (R.D., pp.777-780).

The OCA recommended that all customer classes contribute equitably to universal service programs. The OCA recommended that the Commission adopt an non-production revenue allocation of universal service costs. (R.D., pp. 782-783). The OCA disagreed with the OTS position that the universal service charge should appear as a separate line item on a customer's bill. The OCA argued that in PECO, the Commission approved PECO's proposal to embed the universal service charge in the distribution charges and to separate it for accounting purposes only. (R.D., pp. 786).

The OSBA argued that the universal service charge as proposed by the Company is in violation of the Competition Act. The OSBA recommended that the Commission order the Company to amend its filing such that universal service costs are allocated in a manner that is consistent with the rate treatments contained in the Company's most recent base rate case. The OSBA also disagreed with the OCA recommendation for use of a non-production revenue allocator, and requested the Commission to reject it. The OSBA asserted the allocation of universal service costs should be consistent with the Company's last rate case. The OSBA also asserted that its proposal would properly allocate 83% of the universal service costs to the residential class. (R.D., pp. 786-790).

DII supported Duquesne's proposal to allocate universal service costs to classes based on the allocation currently embedded in each rate class bundled rates in the last base rate proceeding. DII opposed the OCA recommendation to allocate universal service costs or a non-production demand basis. DII argued that the Commission reiterated the need for consistency with the prior rate case allocation of universal service costs in PECO. (R.D., pp. 790-793)

The Environmentalists supported Duquesne's proposal to collect the costs of its universal service programs in the rates of all ratepayers. (R.D., pp. 793-795).

Enron disagreed with Duquesne's proposal to retain all universal service support towards payment of universal service customer bills so that no portion would be allocated to suppliers serving eligible customers. Enron supported allocating universal service benefits to each component of a customer's bill. Enron supported the Commission's approach in the PECO order. In PECO, the Commission approved PECO's proposed universal service plan that included portable support. (R.D., pp. 755-757).

C. ALJ's Recommendations

ALJ Corbett agreed with the Company's proposed eligibility and funding levels for its universal service and conservation programs. The ALJ reasoned the funding and eligibility levels appear to comply with the requirements of the Act and the Commission's Guidelines on Universal Service and Energy Conservation and recommended that the Commission accept these levels without modification. (R.D., p.776).

The ALJ agreed with the Company's proposal to allocate universal service costs on a cents per kWh to classes based on the allocation currently embedded in each rate class' bundled rates in the last base rate proceeding. The ALJ reasoned the Company's proposal conforms with the Act, the Commission's Universal Service Guidelines and PECO. The ALJ recommended that the Commission accept this proposal without modification. (R.D., p.795).

The ALJ agreed that with the Company's proposals for the CAP, LIURP, renewables, and energy conservation. The ALJ reasoned the Company's proposals conform with the Act, the Commission's Guidelines on Universal Service and PECO Energy. The ALJ recommended that the Commission approve these proposals without modification. (R.D., p.805).

D. Arguments on Exceptions

The OTS excepts to the ALJ's decision to reject the OTS position that the universal service charge be recovered by applying a uniform fixed charge of $1.85/month to all customers in all classes of service. The OTS argues that historical experience shows that a flat universal service charge is most fair. The OTS also argues that basing a universal service charge on energy usage is unfair and penalizes high volume users. The OTS argues all customers and customer classes should evenly share the burden. (OTS Exc., pp. 19-21).

The OTS excepts to the ALJ's failure to recommend that Duquesne's proposal concerning universal service cost recovery be shown as a separate line item on

customer bills. The OTS argues that the primary reason to show this charge separately is to inform customers of the composition of their bills. (OTS Exc., pp. 21-22).

The OSBA agrees with the ALJ's conclusion that the universal service costs should be allocated on a cents per kWh basis consistent with the allocation currently embedded is each rate class' bundled rates from the Company's last base rate proceeding. However, the OSBA excepts to the ALJ's conclusion that Duquesne's proposal for allocating universal service costs is consistent with the methodology employed in Duquesne's last base rate proceeding. No company witness claimed that its approach would replicate the methodology employed in Duquesne's last rate base proceeding.

The OSBA constructed a table that shows in the last base rate proceeding the residential class was allocated 83.2% compared with 46.8% in Duquesne's current proposal and, and the non-residential class was allocated 16.8% of the universal service compared with 53.2% in the current proposal. The OSBA argues that the proposed increase to the non-residential class is discriminatory. Section 2804(7) prohibits unreasonable discriminatory treatments against one class to the benefits of another. In Universal Service Order, the Commission recognized §2804(7) prohibits cost shifting among classes. The OSBA recommends that the Commission reject the ALJ's conclusion and direct Duquesne to modify its proposed allocation so that it confirms with the currently embedded costs in each rate class from the Company's last base rate proceeding. (OSBA Exc., pp. 8-12).

The OCA excepts to the ALJ's decision that Duquesne's proposed eligibility and funding levels for its universal service programs comply with the Act and Commission Guidelines. For several reasons, the OCA submits that Duquesne's

proposal does not meet the requirements of the Act, and is not consistent with the Guidelines or PECO. The OCA argues that:

1. Duquesne's definition of eligibility for universal service programs is too narrow to meet the needs of the low-income community and recommends that Duquesne broaden its eligibility criteria to include non-delinquent high risk customers because this group is unable to work outside the home to increase their family income;

2. Duquesne's low-income customers pay a higher percentage of their monthly incomes (25% for general use customers and 38% for heating customers) compared with average income customers (3% for general use customers and 4% for heating customers);

3. Duquesne's own estimates show a need to expand services beyond the current levels. Census data shows that about 117,000 households in Duquesne's service territory have incomes below 150% of the federal poverty guidelines; and

4. Although the Commission approved PECO's proposal, it also noted that the level of participation may not be enough because the latest census data showed that PECO serves 250,000 low-income households.

The OCA recommends that the Commission adopt the OCA proposal to expand eligibility and to establish specific enrollment levels for universal service programs. The OCA recommends the Commission direct Duquesne to establish the following annual funding levels: CAP funding at $5,525,00 to service 24,000 households and LIURP funding at $2.2 million. (OCA Exc., pp. 22-27).

The OCA excepts to the ALJ's decision that Duquesne's proposal for its CAP design conforms with the Act, the Guidelines and PECO. The OCA argues that its design recommendations for change are necessary to effectively promote the goal of

universal service. The OCA recommends that the Commission direct Duquesne to do the following: increase funding and eligibility levels, reduce payments, relax eligibility criteria, reduce arrearage repayments, conduct a full impact evaluation, and provide portability of eligibility. (OCA Exc., pp. 27-29).

The OCA excepts to the ALJ's decision that Duquesne's proposal for its LIURP design conforms with the Act, the Guidelines and PECO. The OCA recommends that the Commission direct Duquesne to increase funding and eligibility levels. (OCA Exc., pp. 29-30).

The OCA excepts to the ALJ's decision that Duquesne's renewable proposal is adequate. The OCA submits that Duquesne did not include a renewables pilot as part of its restructuring plan. The OCA argues that the General Assembly intended to test the viability of renewable resources by including renewables in the list of potential universal service programs contained in the Act. In PECO, the Commission ordered PECO to implement the renewables pilot proposed by OCA witness Brockway. The OCA requests the Commission to direct Duquesne to implement the renewables pilot proposed by OCA witness Brockway. (OCA Exc., pp. 30-32).

The Environmentalists except to the ALJ's decision to accept Duquesne's eligibility criteria, funding levels and program design of its universal service programs. The Environmentalists argue that Duquesne violates the Commission's universal service guidelines by adding eligibility criteria for CAP. The Environmentalists argue that it is improper for Duquesne to use the "prioritization" factors in the Commission's guidelines as eligibility criteria. Duquesne identified 115,055 low-income, payment troubled households. Because of Duquesne's additional eligibility criteria, Duquesne suggests that only 5,731 customers appear eligible for CAP. The Environmentalists argue that the

Company rejects 95% of the eligible households because it uses improper eligibility criteria. The Environmentalists recommend that the Commission direct Duquesne to fund its universal service programs at $17.49 million. (Environmentalists Exc., pp. 7-8).

The Environmentalists except to the ALJ's decision to accept Duquesne's proposal not to include a renewables pilot as part of its universal service plan. 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. (Environmentalists Exc., pp. 8).

Enron excepts to the ALJ's failure to recommend that Duquesne offer portable universal service support and pro rata allocation to each component of a low-income customer's bill. The ALJ errs by failing to follow the Commission's precedent in PECO and recommend that Duquesne modify its universal service program to require portable support and pro rata allocation. Enron recommends the Commission require Duquesne to modify its universal service plan to provide portable support and pro rata allocation. (Enron Exc., pp. 37-38).

CAAP excepts to the ALJ's decision to establish a funding level for CAP at $500,000 to serve 1,600 customers and a funding level for LIURP at $700,000 to serve 700 customers. CAAP argues that these levels are insufficient to meet the Act and the Commission's Universal Service Guidelines. CAAP argues that CAAP, the OCA, and the Environmentalists provided expert testimony that established the level of need for CAP and LIURP. CAAP recommends that the Commission adopt the following annual funding and enrollment levels: $5.57-$10.5 million for CAP to serve 13,251-24,000 households and $2.2-$4.5 million for LIURP to serve 2,200-3,950 households. (CAAP Exc., p. 1-3).

E. Resolution

The Act includes many provisions designed to ensure that electric service is universally available in Pennsylvania as we make the transition to a competitive generation market. Section 2802(9) declares that "electric service is essential to the health and well-being of residents, to public safety, and to orderly economic development, and electric service should be available to all customers on reasonable terms and conditions." Section 2802(10) declares that "the Commonwealth must, at a minimum, continue the protections, policies and services that now assist customers who are low- income to afford electric service." Section 2803 defines "universal service and energy conservation" 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."

Section 2804(9) of the Act requires that "the Commission shall ensure that universal service and energy conservation policies, activities and services are appropriately funded and available in each electric distribution service territory. Section 2804(15) requires the restructuring plan to include an initial proposal indicating how the EDC's universal service and energy conservation responsibility will be met. On July 10, 1997, the Commission issued a Final Order establishing Universal Service and Energy Conservation Guidelines (Guidelines) for such programs as part of each utility restructuring plan.

1. Funding and Eligibility.

Duquesne requested the Commission to accept the design of its CAP plan. Duquesne proposed to maintain the following annual funding and enrollment levels for each universal service program: CAP funding at $550,000 for 1,600 participants; Smart Comfort (LIURP) funding at $700,000 for 700 participants; CARES funding at $60,000 for approximately 4,500 participants; Consumer Credit Counseling Service funding at $6,000 for approximately 710 participants.

The record includes several assessments of the low-income population and the need for Universal Service and Energy Conservation programs in Duquesne's service territory. OCA used census data to document that there are approximately 117,000 customers below 150% of the federal poverty guidelines in Duquesne's service territory. This is the number meeting the income eligibility standards in the Guidelines. Duquesne stated it has 115,000 low-income households who are payment-troubled and identified 26,000 low-income customers whose arrearages are three times the average residential bill. In addition, Duquesne indicated that it had identified 25,334 low income customers on payment agreements. As CAAP indicated, our Guidelines indicate a general target for Universal Service programs of serving 40% of eligible households.

a. CAP

The OCA supported a full-scale program that makes a reasonable effort to serve 50% of the eligible households. Because of budget constraints, the OCA suggested that a more appropriate target is about 24,000 households. The OCA proposed a three-year expansion of the CAP program to serve 24,000 customers annually at an annual cost of $5,725,000, or approximately $238 per customer. The OCA bases its funding proposal for

CAP on a budget of 0.5% of gross revenues. We find that OCA's proposal, however, does not reflect the fact that generation will be competitive, and gross revenues will decline to reflect only transmission, distribution, and CTC revenues.

The CAAP proposed that the Company can realistically expand its CAP program to serve 13,500 customers. The Environmentalists proposed that the Company's universal service programs be funded at $17.49 million annually.

A CAP provides alternatives to traditional collection methods for low-income payment troubled customers. A CAP is designed to be a more cost-effective approach for dealing with issues of customer inability to pay than are traditional collection methods. The overall goal of the CAP program is to secure more revenue from the affected customers at lower cost by providing a bill that a poor customer can fully pay. Currently, Duquesne expends funds on traditional collection methods and for write-offs of uncollectible amounts. The Company spends in excess of $12 million in these efforts. We find that the redirection of existing low-income uncollectible and other collection expenses can substantially fund increased CAP participation.

The Commission finds that Duquesne's CAP proposal does not meet the level of need in its service territory. Based upon a review of the record and the contentions of the parties, we direct the Company to expand CAP. So that Duquesne can adequately address administrative issues raised by expanding enrollment, we believe it is reasonable to take a measured approach and to expand the program over four years. Using an average gross cost of $343 per customer, we direct Duquesne to increase the CAP program to serve 15,000 customers with a budget of $5,275,000. We find that the average cost of $343 per customer is a gross program cost that does not include any of the avoided costs of traditional collections, such as uncollectible expense, payment agreements and similar costs.

The scheduled impact evaluation should provide net costs of serving a CAP customer as well as recommendations for improving the cost-effectiveness of the program. The net costs consider the avoided costs of traditional collections. We conclude that a funding level of $5,275,000 will make universal service appropriately available and funded as required by the Act, while considering the need for service, existing funding levels, administrative concerns and budget constraints.

Consistent with the four-year schedule specified herein, the Company should expand the CAP program to meet the community's needs. The Company could enroll as many as 4000 new customers in its first year of operation post-restructuring. This would correspond to the CAP expansion supported by the Company's proposed merger partner, Allegheny Power.

b. LIURP

The Company's LIURP program has been in place for a number of years and serves 700 customers annually at an average program cost of $1,000 per customer. The Company proposed to continue to fund LIURP services at the same annual level of $700,000. Duquesne estimated that 21,226 households need LIURP services. (DLC universal service proposal, p. 5). This LIURP program is unique in its emphasis on base consumption reduction due to the lack of heating customers in the territory. Natural gas companies primarily provide LIURP services for heating in DQE's territory.

The OCA and the Environmentalists have proposed to expand the annual funding of this program to $2,200,000. CAAP supported an annual LIURP budget of $4.5 million to serve 3,949 households. CAAP argued that Duquesne's proposed LIURP

funding and enrollment levels underestimates annual households in need. CAAP stated that it determined its proposed participation level by using 1990 US Census data and the Commission's 40% participation goal as stated in the Guidelines.

Unlike CAP, which assumes that a customer is in the program for a multi-year period, LIURP is a program that serves a customer once and then moves on to serve other customers. For this reason the program needs to serve a smaller number of customers in a given year to achieve a comparable level of program availability as CAP.

The Commission finds that LIURP has been one of the Commonwealth's most successful programs for assisting low income customers. The Commission has found that LIURP reduces bad debt by reducing customers' bills. Customers who receive LIURP services are able to pay their entire bill plus contribute to their arrearage. LIURP services also increase the health and safety of the household and neighborhood. The Commission finds that Duquesne's LIURP proposal does not meet the level of need in its service territory as required by the Act.

Based upon a review of the record and the contentions of the parties, we direct the Company to expand its LIURP, over the next four years to serve 1750 customers annually at a cost of $1,000 per customer. Because of the benefits that LIURP provides and the existing need, we find that enlarging the service provided by the LIURP program over four years to the higher level of funding of $1,750,000 is reasonable. This schedule should accommodate the need for improved program capacity without sacrificing quality while meeting program needs and budgetary considerations.

In summary, we direct Duquesne to fund its LIURP and CAP programs according to the following schedule.

Year	CAP Dollars	LIURP Dollars
1999	$1 million	$1 million
2000	$2.245 million	$1.25 million
2001	$3.85 million	$1.5 million
2002	$5.275 million	$1.75 million

2. Cost Recovery

Section 2804(8) requires the Commission to establish "an appropriate cost recovery mechanism which is designed to fully recover the electric utility's universal service and energy conservation costs over the life of these programs." The Commission's Guidelines do not permit the funding for Universal service to be the last priority after rate cap or CTC considerations. The record is insufficient to conclude that implementation of the required funding levels requires any particular amount of additional funding in any given year or whether the targeted funding can be achieved within the rate caps during any year in which rates remain capped.

Consistent with the ALJ's discussion and recommended decision, we accept the Company's cost allocation and rate design for universal service charges. As we directed in PECO, the Commission also directs that the Universal Service Fund Charge (USFC) shall be reconcilable pursuant to Section 1307(f). The reconciliation will be based on all program costs as indicated in the Guidelines. The ALJ rejected the OTS' argument to direct the Company to allocate universal service charges on a per customer basis rather than on a cents per kWh basis as proposed by Duquesne. The Commission

finds that the OTS' proposal would shift current costs of the universal service charges. Under the OTS' proposal, the Company's largest customers would pay the same as its smallest customer. The ALJ also rejected the OTS proposal to show the universal service charge as a separate line item on the customer bill. The Commission finds that the ALJ's treatment of this issue is consistent with PECO Energy.

In PECO Energy, the universal service charge is separate for accounting purposes, but included in the distribution portion of the customer bill. Finally, the ALJ rejected the OSBA argument that Duquesne's proposal for allocating universal service costs is not consistent with the methodology used in the Company's last base rate proceeding. The Commission finds that under the OSBA's proposal the non-residential class may be allocated a lesser percentage of universal service costs, but the distribution rates of the non-residential class will be the same under both methods. Each class' distribution rate is reached by subtracting the universal service cost allocation from each class' share of the total distribution costs. Thus, if the universal service cost allocation percentage for the non-residential class rises, the distribution rate is reduced, and if the allocation percentage lowers, the class distribution rate is higher. However, the Commission concludes that the total costs paid by the class remains the same.

3. Programs

The Commission adopts the Company's universal service program design. The Company's design complies with the Act and the Commission's Guidelines on Universal Service as modified herein. Although the eligibility rules should be designed to be consistent with the Commission's Guidelines, the Company may prioritize enrollment pursuant to the Guidelines as well.

Enron excepted to the ALJ's rejection of its proposal that Duquesne offer "portable universal service support" and a pro rata allocation to each component of a low-income customer's bill. We believe Enron misunderstood the Judge's recommendation. The Judge stated that the Commission agreed with the Enron position. The ALJ explained that the PECO's proposed restructuring plan included portable support within its universal service plan proposal. The Judge stated, "In PECO Energy, the Commission approved PECO's proposed universal service program without modification on this point." (R.D., pp. 756). The Commission finds that the universal service benefits should be portable so that a customer may choose a competitive supplier without losing benefits. Consistent with the ALJ's discussion and recommended decision, we adopt the Judge's recommendation without modification.

The OCA and the Environmentalists recommended that the Commission adopt the renewables pilot proposed by the OCA's witness Brockway. The Environmentalists also recommended that Duquesne participate in the Department of Energy and Utility Photovoltaic Group collaborative program known as "Million Solar Roof Program". This national program is specifically designed to accelerate commercialization of photovoltaic systems by increasing the economy of scale of production. The program includes federal grants and consumer loans to finance customer installation of photovoltaic system on their roofs. Loans are offered by participating companies at an interest rate 0.5% higher than the participating company's cost of capital.

This program has the potential to encourage the use of solar power and to facilitate its commercial application as a renewable resource in the DQE territory. The Act at §2803 specifically includes renewable programs as a provision of universal service. The Commission directs Duquesne to examine this partnership program and assess its

incremental costs for participation as an alternative to the OCA's renewable Pilot. We agree that the program has potential and the Company should develop a loan level of $250,000 for the DQE territory. We permit Duquesne to recover the Company's costs under their proposed Universal Service cost recovery mechanism.

4. Resolution Summary

The Commission directs Duquesne to increase the CAP program to serve 15,000 customers at a funding level of $5,275,000 and to increase the LIURP program to serve 1750 customers at a funding level of $1,750,000. We direct Duquesne to expand these programs over a four-year period to reach the maximum enrollment and funding levels. The Commission adopts the Company's cost allocation and rate design for universal service charges. The Commission also adopts the Company's universal service program design although the eligibility rules and enrollment prioritization must be consistent with the Commission's Guidelines. Finally, we have ensured that universal service benefits are portable and directed Duquesne to develop a loan level of $250,000 to participate in the "Million Solar Roof Program".

X. CUSTOMER EDUCATION

Pursuant to 66 Pa. C.S. §2807(d)(3), each electric distribution company (EDC), in conjunction with the Commission, prior to the implementation of any restructuring plan under Section 2806 of the Act, shall implement a consumer education program informing customers of the changes in the electric industry. Section 2807 (d)(3) specifies that "The program shall provide consumers with information necessary to help them make appropriate choices as to their electric service."

A. Scope of Customer Education

1. Positions of the Parties

All parties agree that a statewide approach to consumer education is the best method of ensuring that customers have the knowledge to make informed choice in the marketplace. Duquesne proposed that there should be statewide customer education as well as local, Company-specific education; and argued that the resultant duties should be shared between the Commission and the EDC. (Duquesne St. 6-R at 27, See, also, PECO Energy, Slip Op. at 156).

The OCA's witness Ms. Alexander noted that Duquesne's plan has a number of deficiencies. She stated that the plan omitted substantive information on goals, objectives and budget for consumer education. Some deficiencies include: Duquesne's materials do not motivate, their research only measures awareness, focus groups mainly explored their company image, no timelines or interim goals, does not describe how the company will work with community based organizations, does not describe their evaluation, and does not propose a budget. The Environmentalists stated that consumer

information are important components of the Act. Enron contended that consumer education should be conducted on a statewide basis. (R.D., pp. 807-810).

2. ALJ's Recommendation

The ALJ recommended that the Commission should direct Duquesne, as part of its compliance filing, to submit a customer education plan that conforms to the PECO Energy Order. (R.D., pp. 814-815).

3. Arguments on Exception

At pages 8-9 of their Exceptions, the Environmentalists contend that the Company failed to present details about the goals, objectives, strategies, programs and procedures as part of their education plan. Instead of leaving details to the compliance filing, the Environmentalists assert that the Commission should specify elements to be addressed by the Company's plan. They further support greater direction on the budget and proposed a budget for the four year program of at least $5 per customer.

No replies were filed to the Environmentalists' Exception regarding scope of customer education.

4. Resolution

In considering this matter, we note that we adopted an Order, entered February 27, 1998, for the Creation and Implementation of a Statewide Consumer Education Program for Electric Restructuring in the Commonwealth of Pennsylvania, Docket No. M-00981036. That Order established a Consumer Education Board (CEB)

which will address the details of the EDC's individual education plans. Each EDC has been asked to submit their education plan to the Commission's CEB according to a schedule beginning in May 1998. The CEB will make any recommendations to the EDC. A majority vote of the CEB is necessary in order to obtain approval of each EDC plan. If there are no objections to the plan approved by the CEB, then it will be deemed approved five days after the Board acts. Although the CEB will have review and advisory authority, the Commission will retain authority over the final content of all consumer education.

B. Funding Levels and Recovery

1. Positions of the Parties

Duquesne contended that if the Commission directed it to increase education funding during the transition period, as proposed by some, then Duquesne should be permitted to recover those expenses as transition costs. The OCA did not dispute such recovery. The Environmentalists argued that Duquesne should have an education budget of at least $5 per customer, noting that PECO's education budget is $5.33 pursuant to PECO Energy. The Environmentalists further argued that funding this budget should be allocated 65% (statewide education) and 35% (local education), which the Commission adopted in PECO Energy. (R.D., pp. 818-819).

2. The ALJ's Recommendation

The ALJ recommended that the Commission should direct Duquesne to provide a budget in its compliance filing, and that the 65%/35% allocation ratio used in PECO Energy should be used for Duquesne as well.

3. Arguments on Exceptions

The Environmentalists except to the ALJ's failure to provide more direction for Duquesne's customer education plan, as well as his failure to recommend that the education budget be funded at a level of at least $5 per customer. (Environmentalists' Exc., p. 9). There were no replies to this Exception.

4. Resolution

In considering this matter, we note that the precise cost for Duquesne's consumer education program will be determined through the CEB. Until that figure is determined, Duquesne will assume funding at $5 per residential customer for 4 years, for a total of $15.5 million. We will adopt a final number upon acceptance of Duquesne's compliance filing. We authorize full recovery of this amount as a transition cost.

XI. MISCELLANEOUS ISSUES

A. *Uniform Environmental Standards*

1. Environmental Comparability

In order to create a level playing field for all market participants, the Environmentalists contended that the Commission should implement uniform environmental standards that all retail suppliers must meet in order to sell power in Pennsylvania.[28] The Environmentalists asserted that at present there is considerable disparity between the emission standards applied to generating units of different vintages or located in different states or regions. Furthermore, the Environmentalists argued that restructuring could have a dramatic impact on the air quality in Pennsylvania if it encourages generators of relatively dirty power who are subject to less stringent environmental regulations to increase production. The Commission must ensure that the introduction of competition to the electric industry in Pennsylvania does not result in dirtier air and the attendant harm to the environment and public health. (R.D. p. 828).

2. DII

DII was of the opinion that this requirement is unnecessary and could hinder development of a robust competitive market. DII further stated that one of the goals of the Act is to provide businesses with a cost-effective market in which to operate, 66 Pa. C.S. §§2802 (4)-(7), and that businesses in Pennsylvania will not be provided with a cost-effective environment if restrictions are levied on

[28] Env. St. 1.0 at 3-5.

electricity supply that surrounding states do not place on that supply. DII argued that this proposal must be rejected. (DII R.B. at 49).

B. Aggregation

1. PRA

The PRA noted that this Commission should ensure and require Duquesne to permit aggregation of customer load. As indicated by PRA's 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. PRA argued that a failure to require Duquesne to permit aggregation will frustrate the intent of the Legislature and the Act. The PRA further argued that Duquesne should be required to affirmatively permit customers who have multiple sites to aggregate their load. The PRA also asserted that since at a future date 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. (PRA M.B. at 71).

C. Consumer Information

The Environmentalists argued that under the terms of the Act, the Commission is required to facilitate informed customer choice by issuing regulations ensuring that the information supplied to consumers is in an understandable format that enables consumers to compare prices and services on a uniform basis.[29]

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[29] 66 Pa. C.S. §2807(d)(2).

In sum, the Environmentalists argued that the Commission should require all retail suppliers to provide accurate, verifiable and uniform information about the sources and environmental impacts of the power they sell. The generation of electricity has tremendous impacts on the environment and customers are interested in the environmental implications of their electricity purchases. Only by requiring the provision of relevant information can the Commission ensure that customers can make informed and meaningful choices in a competitive marketplace. (R.D. pp. 822-825).

D. The Sustainable Development Fund

Since the PECO securitization proceeding, the Environmentalists have been advancing a proposal to the Commission for a Sustainable Development Fund to finance and promote energy conservation and efficiency, renewable energy and other clean-energy technologies. The Environmentalists contend that Pennsylvania should be making a modest investment in its sustainable energy future. (R.D. pp. 826-827). The Environmentalists proposed that the Sustainable Development Fund be financed by all suppliers through an annual contribution equal to one percent (1%) of their gross revenues. On a statewide basis, this would provide annual funding of approximately $22 million.

E. The Conservation Loan Fund

The Environmentalists recommended that Duquesne establish an energy loan program to help its residential customers make energy efficiency improvements to their existing or new facilities. The Environmentalist's asserted

that loans would be given priority on the basis of electricity savings, system reliability benefits, customer class contributions and need. The Loan Fund would receive an initial capitalization from Duquesne at a level equal to 2% of the Company's stranded cost recovery.[30]

F. ALJ's Recommendation

The ALJ concluded that the various miscellaneous issues raised in this Section either are not strictly required by the Act or are inappropriate for consideration in this restructuring application. The ALJ added that, of course, the Commission may decide that a particular issue deserves further scrutiny, in which case a generic proceeding may determine the merits of the matter.

G. Parties' Exceptions

The Environmentalists argued on exception that the testimony that they presented speaks to the need to address additional aspects of informed customer choice, namely, the need for disclosure of key air and other waste emissions to consumers in a standard and easy to comprehend label. The Environmentalists asserted that in this connection electricity generation has a tremendous environmental footprint. Notably, many electricity suppliers are positioning themselves to fill the "green power" niche, and many suppliers are interested in marketing a clean product, while, unfortunately, others will be green in name alone. The Environmentalists averred that the mandatory disclosure of environmental attributes will: (1) allow verification of the claims; (2) provide

[30] Env. St. 1.0 at 9.

customers with information on "dirty" suppliers; and (3) make comparisons between suppliers easier.

Finally, the Environmentalists excepted to the ALJ's failure to recommend adoption of the following of their proposals: (1) the Million Solar Roof proposal; (2) the Conservation Loan Fund, and (3) the Environmental Comparability Requirement. (Env. Exc., pp. 9-12).

H. Resolution

While we accept many of the concerns raised by the Environmentalists, we cannot agree that we should adopt several of its proposals in this proceeding. As discussed, we have adopted the Environmentalists recommendation that Duquesne participate in the DOE Million Solar Roof Program. The federal Environmental Protection Agency and Pennsylvania's Department of Environmental Protection establish emission regulations and it would be inappropriate for this Commission to do so. Many of the concerns raised by the Environmentalists concerning consumer information are addressed in the Rulemaking that governs these issues. We do not agree that the record supports consumer funding of the proposed sustainable development or Conservation Loan Fund at this time.

Lastly, we agree with PRA that Duquesne may not inappropriately restrict aggregation. As discussed, we have required Duquesne to facilitate consolidated billing.

XII. CONCLUSION

On the basis of the reasoning set forth in this Opinion and Order, as supported by the record in this proceeding, we conclude that Duquesne's stranded costs is $1.332 billion. Using an 11-percent return on the unamortized balance, this computes to a CTC initially estimated to be 2.58 cents per kwh for 1999. This rate will be reconciled each year for system sales. Our transmission and distribution calculations result in a 1999 rate of 2.37 cents per kwh. This rate declines to 2.24 cents per kwh in the year 2000 due to the merger reduction. Duquesne currently provides service at a bundled rate of 8.93 cents per kwh. The recovery of the CTC and the transmission and distribution charges should yield a 1999 shopping credit of 4.00 cents per kwh. Attachments A through E appended to this Opinion and Order provide the details for these calculations.

We further determine that the ALJ and the parties to this proceeding have compiled a thorough record that allows us to make a reasoned decision regarding the restructuring of Duquesne. Therefore, we conclude that the restructuring requirements of the Act have been met. Finally, we emphasize the vital importance of membership for Duquesne and APS in a functional Independent System Operator which meets the standards of the FERC as well as those of this Commission.

XIII. ORDER

THEREFORE, IT IS ORDERED:

1. That the Exceptions filed by the various Parties to the Recommended Decision of Administrative Law Judge John H. Corbett, Jr., herein, which was issued on March 25, 1998, are hereby granted or denied, consistent with this Opinion and Order.

2. That the Recommended Decision of Administrative Law Judge John H. Corbett, Jr., which was issued herein on March 25, 1998, is adopted, as modified by this Opinion and Order.

3. That the Application of Duquesne Light Company for approval of its restructuring plan pursuant to Section 2806(d) of the Public Utility Code, 66 Pa. C.S. §2806(d), filed on August 1, 1997 and docketed with the Pennsylvania Public Utility Commission at No. R-00974104, is hereby approved, as modified, by this Opinion and Order.

4. That Duquesne Light Company shall remain the provider of last resort consistent with the determinations made herein and the requirements of 66 Pa. C.S. §2802(16).

5. That Duquesne Light Company shall phase-in direct access to alternative generation suppliers in the manner specified in this Opinion and Order, pursuant to the following schedule:

a. 33% of the peak load of each customer class shall have the opportunity for direct access as of January 1,1999;

b. 66% of the peak load of each customer class shall have direct access as of January 2, 1999;

c. All customers shall have direct access as of January 2, 2000.

6. That, beginning on July 1, 1998, Duquesne Light Company shall conduct an open enrollment period for residential customers on a first come first served basis. If less than 33% enrollment occurs by August 14, 1998, Duquesne Light Company shall notify all volunteers of their participation in the phase-in beginning January 1, 1999. If more than 33% enrollment occurs, Duquesne Light Company shall have a Commission approved independent party conduct a lottery to determine which customers may participate in the January 1, 1999 phase-in.

7. That in the event the proposed merger of DQE, Inc., Allegheny Power System, Inc., et al., at Docket No. A-110150F00015, is not consummated within eighteen months of entry of this Opinion and Order, Duquesne Light Company must divest itself of its generating assets to determine the value of its stranded assets in the following manner:

a. Within ninety days of entry of this Opinion and Order, Duquesne Light Company shall file with the Commission a plan of divestiture, together with a proposal for addressing its continuing obligation to serve under the rate cap.

c. Pursuant to Commission direction, all interested Parties shall have an opportunity to respond to either or both proposals.

d. Commencing January 1, 1999, Duquesne Light Company is permitted to collect an interim competitive transition charge from customers applying the same rates and credits approved in the pilot program for customers electing direct access during this interim period.

e. The interim CTC shall expire upon replacement by the CTC developed based on the results of divestiture of Duquesne generation assets as specified herein. Duquesne Light Company shall calculate a competitive transition charge to recover any remaining stranded costs until December 31, 2005. Depending upon the result of the divestiture, the time period for recovery of stranded costs may be adjusted. The general approach used in the Application of PECO Energy Company at Docket No. P-00973953 (Opinion and Order entered December 23, 1997) will be used herein as consistent with the above determinations and findings.

f. The competitive transition charge may be collected from January 1, 1999 until December 31, 2005 or for such other period of time as the Commission deems appropriate upon adoption of the CTC following divestiture.

8. That in the event the merger is consummated or no divestiture plan is filed and approved by the Commission, and consistent with the determinations and findings herein, the interim CTC shall not be used and Duquesne Light Company is permitted to recover, through the application of a competitive transition charge to customers' bills, the amount of stranded costs, subject to its compliance filing, as specified herein.

9. That the competitive transition charge authorized in the preceding Ordering Paragraph is subject to the following requirements:

a. The competitive transition charge may be collected from January 1, 1999 until December 31, 2005.

b. The competitive transition charge shall be calculated and applied consistent with the directives contained herein.

c. The competitive transition charge shall be reconciled based on actual sales and may be modified on an annual basis as required by 66 Pa. C.S. §2808(f).

d. Any reconciliation and modification of the competitive transition charge shall be done on a customer class basis.

e. The competitive transition charge shall be calculated in a manner recognizing monthly receipt of competitive transition charge revenues.

10. That Duquesne Light Company shall modify its transmission and distribution revenue requirement and rate structure to incorporate the adjustments, including cost allocation method, as directed in this Opinion and Order.

11. That Duquesne Light Company shall continue to provide service to existing customers through existing tariffs throughout the transition period, and all special contracts shall remain in force, on their terms and consumers shall be protected by applicable rate cap except as modified herein.

12. That Duquesne Light Company shall comply with the determinations contained herein relating to customer billing and metering and that Duquesne Light Company reflect this action in its compliance filing.

13. That Duquesne Light Company shall include a net metering, consistent with this Opinion and Order.

14. That, pending the outcome of the Commission's rulemaking proceeding on a generic Code of Conduct, Duquesne Light Company shall modify its proposed Code of Conduct as herein directed.

15. That Duquesne Light Company's proposed Universal Service and Energy Conservation Programs are approved as modified by this Opinion and Order.

16. That Duquesne Light Company participate in the state-wide consumer education initiative, which the Commission established in its decision in

the Application of PECO Energy Company at Docket No. P-00973953 (Opinion and Order entered December 23, 1997); that in its compliance filing, Duquesne Light Company include a comprehensive plan for consumer education with an associated budget for both mass media and local educational efforts and set forth its proposals for its role in consumer education; and that Duquesne Light Company recover the costs of its consumer education program from its ratepayers.

17. That Duquesne Light Company shall, within twenty (20) days of entry of this Opinion and Order, submit a compliance filing that incorporates all of the conclusions and directives contained in this Opinion and Order, including, but not limited to:

a. For each tariff class or schedule, the compliance filing shall:

1. Identify the unbundled charges for generation, transmission and distribution service;

2. Identify all other adjustments necessary to the terms and conditions of service to reflect a competitive generation market as provided herein, including the identification of the tariff specific shopping credits, CTC rate, and T&D Rate.

18. That Duquesne Light Company shall unbundle its contracts for distribution, transmission, and generation charges.

19. That Duquesne Light Company shall file an original and eight (8) copies of its compliance filing to the Commission. An electronic version (in Microsoft Word 6.0) shall accompany the filing.

20. That Duquesne Light Company serve a copy of its compliance filing together with any required supporting data and analysis on all Parties of Record to this proceeding by hard copy and with electronic versions attached consistent with prior Commission directives relative to electronic versions (in Microsoft Word 6.0) on the same date that it is filed with the Commission.

21. That all Parties to this proceeding may file written comments concerning non-compliance with this Opinion and Order within seven (7) days after the filing of Duquesne Light Company's compliance filing.

22. That, in addition to the specific requirements contained in the foregoing Ordering Paragraphs, Duquesne Light Company shall comply with all other directives contained in this Opinion and Order.

23. That the complaints filed by the Office of Consumer Advocate (at Docket No. R-00974104C0001), the City of Pittsburgh (at Docket No. R-00974104C0002), the Community Action Association of Pennsylvania (at Docket No. R-00974104C0003), the Duquesne Industrial Intervenors (at Docket No. R-00974104C0004), the Low Income Advocate Parties, the Environmentalists, and the Pittsburgh Chapter of the NAACP at this docket are granted or denied consistent with in this Opinion and Order.

24. That the complaint of David Hughes v. Duquesne Light Company, filed with the Commission at Docket No. C-00945953, is hereby denied.

25. That Duquesne Light Company shall segment the Rate GS/GM class into "Small Rate GS/GM" and "Large Rate GS/GM" using 40 kw load as a breakpoint unless a more appropriate breakpoint is established via a detailed billing frequency analysis of all Rate GS/GM accounts.

BY THE COMMISSION,

James J. McNulty
Secretary

SEAL

ORDER ADOPTED: MAY 21 1998

ORDER ENTERED: MAY 29 1998

Duquesne Light Company
CTC, T&D and Shopping Credit in Cents per kwh
Level CTC Revenue Requirement with kwh consumption as indicated (See Notes)
Stranded: $ 1,331,567,100
Pre-Tax Return: 11.00%

Year	kwh consumed	CTC Revenue Requirement	CTC Rate With GRT	T&D Rate	Bundled Rate Today	Shopping Credit
1999	13,177,788,000	$ 325,379,610	2.58	2.345	8.93	**4.00**
2000	13,396,872,000	$ 319,546,841	2.50	2.219	8.93	**4.22**
2001	13,617,726,000	$ 313,038,414	2.40	2.219	8.93	**4.31**
2002	13,845,956,000	$ 305,776,838	2.31	n/a	n/a	**4.40**
2003	14,082,528,000	$ 297,674,961	2.21	n/a	n/a	**4.50**
2004	14,331,564,000	$ 288,635,545	2.11	n/a	n/a	**4.61**
2005	14,816,469,501	$ 278,550,098	1.97	n/a	n/a	**4.75**

Notes:

GRT Gross up is 1/(1-GRT), or 1.0460251, to reflect payment of GRT on the GRT revenue receipt.

Annual kwh is taken from Duquesne Light Co. Exceptions, and 2005 is extrapolated from this exhibit.

The ECR roll-in is included in the determination of bundled rates.

Attachment A

Stranded Cost Allowance
($Millions)

Duquesne Light Restructuring

Category/Item:	Amount
Book Value:	
Generating Plant Book Value	$ 852.03
Beaver Valley 2 Lease PV	$ 300.35
M&S Fuel Related Sunk Costs	-
Working Capital	$ 61.53
Costs Independent of Operation	-
Generation Market Value	$ (110.95)
Merger Savings	$ (152.28)
Total Stranded Generation:	**$ 950.68**
Decommissioning:	
Nuclear Decommissioning	$ 42.96
Fossil Decommissioning	-
Total Decommissioning	**$ 42.96**
Regulatory Assets:	
FAS 109 (including Plant reversal)	$ 179.00
Post '05 Unamortized Debt Costs	$ 18.67
Pre '06 Unamortized Debt Costs	$ 9.61
Deferred Rate Synch. (Early Window)	$ 23.50
Deferred Employee Costs	$ 14.24
Deferred Nuclear Maintenance	$ 1.90
US DOE Decommissioning	$ 3.25
Deferred Coal Costs	-
Deferred Caretaker Costs	-
Pre-Accrued Nuclear Outage	-
BV2 Training Costs	$ 1.58
Low Level Radioactive Waste	$ 2.27
Coal Cost Equalization	$ 0.12
Transition Costs	$ 10.59
SFAS 106 Deferral	$ 1.97
Deferred Fuel Costs	$ 6.73
Other Regulatory Assets	$ 0.53
Consumer Education	$ 10.00
Sale-Leaseback Tax Effect (Gain)	$ 55.13
Deferred Rate Synch. Costs	-
BV2 Tax Effect	$ 0.17
Total Regulatory Assets:	**$ 339.26**
PA Jurisdictional % (1-FERC Allocation)	99.900%
TOTAL STRANDED, WITH MERGER AND JURISDICTIONAL ALLOCATION	**$ 1,331.567**

Attachment B

Total CTC Revenue Requirement

Total CTC Revenue Requirement: Return Of & On Stranded + Return On Unamort. Deferred Tax Balance *DLC gets return on unamortized Deferred Tax Balance (See DLC Statement No. 2, Clayton Testimony).*					
				Monthly Return:	Annual Return:
	Stranded	$ 1,331,567,100	$ 22,799,673	0.9167%	11.000%
Month	Monthly kwh	Stranded Beg. of Month	Stranded Revenue Requirement	Deferred Tax Revenue Req.	Total Monthly Revenue Req.
1	1,098,149,000	$ 1,331,567,100	$ 22,799,673	$ 4,522,326	$ 27,321,999
2	1,098,149,000	$ 1,320,973,459	$ 22,799,673	$ 4,486,348	$ 27,286,021
3	1,098,149,000	$ 1,310,282,709	$ 22,799,673	$ 4,449,408	$ 27,249,081
4	1,098,149,000	$ 1,299,493,961	$ 22,799,673	$ 4,412,129	$ 27,211,802
5	1,098,149,000	$ 1,288,606,316	$ 22,799,673	$ 4,374,508	$ 27,174,181
6	1,098,149,000	$ 1,277,618,867	$ 22,799,673	$ 4,336,543	$ 27,136,216
7	1,098,149,000	$ 1,266,530,701	$ 22,799,673	$ 4,298,230	$ 27,097,903
8	1,098,149,000	$ 1,255,340,892	$ 22,799,673	$ 4,259,565	$ 27,059,238
9	1,098,149,000	$ 1,244,048,511	$ 22,799,673	$ 4,220,546	$ 27,020,219
10	1,098,149,000	$ 1,232,652,616	$ 22,799,673	$ 4,181,169	$ 26,980,842
11	1,098,149,000	$ 1,221,152,258	$ 22,799,673	$ 4,141,432	$ 26,941,105
12	1,098,149,000	$ 1,209,546,481	$ 22,799,673	$ 4,101,330	$ 26,901,003
13	1,116,406,000	$ 1,197,834,317	$ 22,799,673	$ 4,060,860	$ 26,860,533
14	1,116,406,000	$ 1,186,014,792	$ 22,799,673	$ 4,020,020	$ 26,819,693
15	1,116,406,000	$ 1,174,086,922	$ 22,799,673	$ 3,978,805	$ 26,778,478
16	1,116,406,000	$ 1,162,049,712	$ 22,799,673	$ 3,937,212	$ 26,736,885
17	1,116,406,000	$ 1,149,902,161	$ 22,799,673	$ 3,895,238	$ 26,694,911
18	1,116,406,000	$ 1,137,643,258	$ 22,799,673	$ 3,852,880	$ 26,652,553
19	1,116,406,000	$ 1,125,271,982	$ 22,799,673	$ 3,810,133	$ 26,609,806
20	1,116,406,000	$ 1,112,787,302	$ 22,799,673	$ 3,766,994	$ 26,566,667
21	1,116,406,000	$ 1,100,188,179	$ 22,799,673	$ 3,723,460	$ 26,523,133
22	1,116,406,000	$ 1,087,473,564	$ 22,799,673	$ 3,679,526	$ 26,479,199
23	1,116,406,000	$ 1,074,642,399	$ 22,799,673	$ 3,635,190	$ 26,434,863
24	1,116,406,000	$ 1,061,693,615	$ 22,799,673	$ 3,590,448	$ 26,390,121
25	1,134,810,500	$ 1,048,626,133	$ 22,799,673	$ 3,545,295	$ 26,344,968
26	1,134,810,500	$ 1,035,438,866	$ 22,799,673	$ 3,499,729	$ 26,299,402
27	1,134,810,500	$ 1,022,130,716	$ 22,799,673	$ 3,453,744	$ 26,253,417
28	1,134,810,500	$ 1,008,700,575	$ 22,799,673	$ 3,407,339	$ 26,207,012
29	1,134,810,500	$ 995,147,324	$ 22,799,673	$ 3,360,508	$ 26,160,181
30	1,134,810,500	$ 981,469,834	$ 22,799,673	$ 3,313,247	$ 26,112,920
31	1,134,810,500	$ 967,666,968	$ 22,799,673	$ 3,265,554	$ 26,065,227
32	1,134,810,500	$ 953,737,576	$ 22,799,673	$ 3,217,423	$ 26,017,096
33	1,134,810,500	$ 939,680,497	$ 22,799,673	$ 3,168,851	$ 25,968,524
34	1,134,810,500	$ 925,494,562	$ 22,799,673	$ 3,119,834	$ 25,919,507
35	1,134,810,500	$ 911,178,589	$ 22,799,673	$ 3,070,367	$ 25,870,040
36	1,134,810,500	$ 896,731,386	$ 22,799,673	$ 3,020,447	$ 25,820,120
37	1,153,829,667	$ 882,151,751	$ 22,799,673	$ 2,970,069	$ 25,769,743
38	1,153,829,667	$ 867,438,469	$ 22,799,673	$ 2,919,230	$ 25,718,903
39	1,153,829,667	$ 852,590,315	$ 22,799,673	$ 2,867,925	$ 25,667,598
40	1,153,829,667	$ 837,606,054	$ 22,799,673	$ 2,816,149	$ 25,615,822
41	1,153,829,667	$ 822,484,436	$ 22,799,673	$ 2,763,899	$ 25,563,572
42	1,153,829,667	$ 807,224,204	$ 22,799,673	$ 2,711,169	$ 25,510,842
43	1,153,829,667	$ 791,824,086	$ 22,799,673	$ 2,657,957	$ 25,457,630
44	1,153,829,667	$ 776,282,800	$ 22,799,673	$ 2,604,256	$ 25,403,929

Attachment C

Total CTC Revenue Requirement

Total CTC Revenue Requirement: Return Of & On Stranded + Return On Unamort. Deferred Tax Balance
DLC gets return on unamortized Deferred Tax Balance (See DLC Statement No. 2, Clayton Testimony).

				Monthly Return:	Annual Return:
	Stranded	$ 1,331,567,100	$ 22,799,673	0.9167%	11.000%
Month	Monthly kwh	Stranded Beg. of Month	Stranded Revenue Requirement	Deferred Tax Revenue Req.	Total Monthly Revenue Req.
45	1,153,829,667	$ 760,599,053	$ 22,799,673	$ 2,550,064	$ 25,349,737
46	1,153,829,667	$ 744,771,538	$ 22,799,673	$ 2,495,374	$ 25,295,047
47	1,153,829,667	$ 728,798,937	$ 22,799,673	$ 2,440,183	$ 25,239,856
48	1,153,829,667	$ 712,679,921	$ 22,799,673	$ 2,384,487	$ 25,184,160
49	1,173,544,000	$ 696,413,147	$ 22,799,673	$ 2,328,279	$ 25,127,952
50	1,173,544,000	$ 679,997,262	$ 22,799,673	$ 2,271,557	$ 25,071,230
51	1,173,544,000	$ 663,430,897	$ 22,799,673	$ 2,214,315	$ 25,013,988
52	1,173,544,000	$ 646,712,674	$ 22,799,673	$ 2,156,547	$ 24,956,220
53	1,173,544,000	$ 629,841,200	$ 22,799,673	$ 2,098,251	$ 24,897,924
54	1,173,544,000	$ 612,815,071	$ 22,799,673	$ 2,039,420	$ 24,839,093
55	1,173,544,000	$ 595,632,870	$ 22,799,673	$ 1,980,049	$ 24,779,722
56	1,173,544,000	$ 578,293,165	$ 22,799,673	$ 1,920,135	$ 24,719,808
57	1,173,544,000	$ 560,794,512	$ 22,799,673	$ 1,859,671	$ 24,659,344
58	1,173,544,000	$ 543,135,456	$ 22,799,673	$ 1,798,653	$ 24,598,326
59	1,173,544,000	$ 525,314,524	$ 22,799,673	$ 1,737,075	$ 24,536,748
60	1,173,544,000	$ 507,330,235	$ 22,799,673	$ 1,674,934	$ 24,474,607
61	1,194,297,000	$ 489,181,089	$ 22,799,673	$ 1,612,222	$ 24,411,895
62	1,194,297,000	$ 470,865,576	$ 22,799,673	$ 1,548,936	$ 24,348,609
63	1,194,297,000	$ 452,382,170	$ 22,799,673	$ 1,485,069	$ 24,284,742
64	1,194,297,000	$ 433,729,334	$ 22,799,673	$ 1,420,617	$ 24,220,290
65	1,194,297,000	$ 414,905,513	$ 22,799,673	$ 1,355,575	$ 24,155,248
66	1,194,297,000	$ 395,909,141	$ 22,799,673	$ 1,289,936	$ 24,089,609
67	1,194,297,000	$ 376,738,635	$ 22,799,673	$ 1,223,695	$ 24,023,368
68	1,194,297,000	$ 357,392,399	$ 22,799,673	$ 1,156,847	$ 23,956,520
69	1,194,297,000	$ 337,868,823	$ 22,799,673	$ 1,089,387	$ 23,889,060
70	1,194,297,000	$ 318,166,281	$ 22,799,673	$ 1,021,308	$ 23,820,981
71	1,194,297,000	$ 298,283,132	$ 22,799,673	$ 952,605	$ 23,752,278
72	1,194,297,000	$ 278,217,721	$ 22,799,673	$ 883,272	$ 23,682,945
73	1,214,002,901	$ 257,968,377	$ 22,799,673	$ 813,304	$ 23,612,977
74	1,214,002,901	$ 237,533,414	$ 22,799,673	$ 742,694	$ 23,542,367
75	1,214,002,901	$ 216,911,131	$ 22,799,673	$ 671,437	$ 23,471,110
76	1,214,002,901	$ 196,099,810	$ 22,799,673	$ 599,527	$ 23,399,200
77	1,214,002,901	$ 175,097,719	$ 22,799,673	$ 526,957	$ 23,326,630
78	1,214,002,901	$ 153,903,108	$ 22,799,673	$ 453,723	$ 23,253,396
79	1,214,002,901	$ 132,514,213	$ 22,799,673	$ 379,817	$ 23,179,490
80	1,214,002,901	$ 110,929,254	$ 22,799,673	$ 305,233	$ 23,104,906
81	1,214,002,901	$ 89,146,432	$ 22,799,673	$ 229,966	$ 23,029,639
82	1,214,002,901	$ 67,163,935	$ 22,799,673	$ 154,009	$ 22,953,682
83	1,214,002,901	$ 44,979,931	$ 22,799,673	$ 77,356	$ 22,877,029
84	1,214,002,901	$ 22,592,574	$ 22,799,673	$ -	$ 22,799,673

Attachment C

Buildup of Deferred Tax Revenue Requirement
See page 1 of Attachment C for Revenue Requirement result

Month	Monthly kwh	$ 493,344,701 Def. Tax Principal	Return: 11.000%	Return Of + On $ 8,447,263	Def. Tax Amort.	Running Total:
1	1,098,149,000	493,344,701	4,522,326	$ 8,447,263	3,924,937	
2	1,098,149,000	489,419,764	4,522,326	$ 8,447,263	3,992,680	7,917,617
3	1,098,149,000	485,389,926	4,486,348	$ 8,447,263	4,029,838	11,947,455
4	1,098,149,000	481,323,149	4,449,408	$ 8,447,263	4,066,778	16,014,233
5	1,098,149,000	477,219,092	4,412,129	$ 8,447,263	4,104,057	20,118,289
6	1,098,149,000	473,077,415	4,374,508	$ 8,447,263	4,141,677	24,259,966
7	1,098,149,000	468,897,772	4,336,543	$ 8,447,263	4,179,643	28,439,609
8	1,098,149,000	464,679,816	4,298,230	$ 8,447,263	4,217,956	32,657,565
9	1,098,149,000	460,423,196	4,259,565	$ 8,447,263	4,256,621	36,914,185
10	1,098,149,000	456,127,556	4,220,546	$ 8,447,263	4,295,640	41,209,825
11	1,098,149,000	451,792,540	4,181,169	$ 8,447,263	4,335,016	45,544,841
12	1,098,149,000	447,417,786	4,141,432	$ 8,447,263	4,374,754	49,919,595
13	1,116,406,000	443,002,931	4,101,330	$ 8,447,263	4,414,856	54,334,451
14	1,116,406,000	438,547,605	4,060,860	$ 8,447,263	4,455,325	58,789,776
15	1,116,406,000	434,051,439	4,020,020	$ 8,447,263	4,496,166	63,285,942
16	1,116,406,000	429,514,059	3,978,805	$ 8,447,263	4,537,381	67,823,322
17	1,116,406,000	424,935,086	3,937,212	$ 8,447,263	4,578,973	72,402,296
18	1,116,406,000	420,314,138	3,895,238	$ 8,447,263	4,620,947	77,023,243
19	1,116,406,000	415,650,832	3,852,880	$ 8,447,263	4,663,306	81,686,549
20	1,116,406,000	410,944,780	3,810,133	$ 8,447,263	4,706,053	86,392,602
21	1,116,406,000	406,195,588	3,766,994	$ 8,447,263	4,749,192	91,141,793
22	1,116,406,000	401,402,862	3,723,460	$ 8,447,263	4,792,726	95,934,519
23	1,116,406,000	396,566,203	3,679,526	$ 8,447,263	4,836,659	100,771,179
24	1,116,406,000	391,685,207	3,635,190	$ 8,447,263	4,880,995	105,652,174
25	1,134,810,500	386,759,470	3,590,448	$ 8,447,263	4,925,738	110,577,912
26	1,134,810,500	381,788,579	3,545,295	$ 8,447,263	4,970,890	115,548,802
27	1,134,810,500	376,772,122	3,499,729	$ 8,447,263	5,016,457	120,565,259
28	1,134,810,500	371,709,681	3,453,744	$ 8,447,263	5,062,441	125,627,700
29	1,134,810,500	366,600,835	3,407,339	$ 8,447,263	5,108,847	130,736,547
30	1,134,810,500	361,445,157	3,360,508	$ 8,447,263	5,155,678	135,892,224
31	1,134,810,500	356,242,219	3,313,247	$ 8,447,263	5,202,938	141,095,163
32	1,134,810,500	350,991,587	3,265,554	$ 8,447,263	5,250,632	146,345,794
33	1,134,810,500	345,692,824	3,217,423	$ 8,447,263	5,298,763	151,644,557
34	1,134,810,500	340,345,490	3,168,851	$ 8,447,263	5,347,335	156,991,892
35	1,134,810,500	334,949,138	3,119,834	$ 8,447,263	5,396,352	162,388,244
36	1,134,810,500	329,503,319	3,070,367	$ 8,447,263	5,445,818	167,834,062
37	1,153,829,667	324,007,581	3,020,447	$ 8,447,263	5,495,738	173,329,800
38	1,153,829,667	318,461,465	2,970,069	$ 8,447,263	5,546,116	178,875,916
39	1,153,829,667	312,864,510	2,919,230	$ 8,447,263	5,596,955	184,472,872
40	1,153,829,667	307,216,249	2,867,925	$ 8,447,263	5,648,261	190,121,133
41	1,153,829,667	301,516,212	2,816,149	$ 8,447,263	5,700,037	195,821,169
42	1,153,829,667	295,763,925	2,763,899	$ 8,447,263	5,752,287	201,573,456
43	1,153,829,667	289,958,909	2,711,169	$ 8,447,263	5,805,016	207,378,472
44	1,153,829,667	284,100,680	2,657,957	$ 8,447,263	5,858,229	213,236,701

Attachment D

Buildup of Deferred Tax Revenue Requirement
See page 1 of Attachment C for Revenue Requirement result

Month	Monthly kwh	$ 493,344,701 Def. Tax Principal	Return: 11.000%	Return Of + On $ 8,447,263	Def. Tax Amort.	Running Total:
45	1,153,829,667	278,188,751	2,604,256	$ 8,447,263	5,911,929	219,148,630
46	1,153,829,667	272,222,629	2,550,064	$ 8,447,263	5,966,122	225,114,752
47	1,153,829,667	266,201,818	2,495,374	$ 8,447,263	6,020,811	231,135,564
48	1,153,829,667	260,125,816	2,440,183	$ 8,447,263	6,076,002	237,211,566
49	1,173,544,000	253,994,117	2,384,487	$ 8,447,263	6,131,699	243,343,265
50	1,173,544,000	247,806,211	2,328,279	$ 8,447,263	6,187,906	249,531,171
51	1,173,544,000	241,561,582	2,271,557	$ 8,447,263	6,244,629	255,775,799
52	1,173,544,000	235,259,711	2,214,315	$ 8,447,263	6,301,871	262,077,670
53	1,173,544,000	228,900,073	2,156,547	$ 8,447,263	6,359,638	268,437,308
54	1,173,544,000	222,482,138	2,098,251	$ 8,447,263	6,417,935	274,855,243
55	1,173,544,000	216,005,372	2,039,420	$ 8,447,263	6,476,766	281,332,009
56	1,173,544,000	209,469,236	1,980,049	$ 8,447,263	6,536,136	287,868,145
57	1,173,544,000	202,873,185	1,920,135	$ 8,447,263	6,596,051	294,464,196
58	1,173,544,000	196,216,671	1,859,671	$ 8,447,263	6,656,515	301,120,711
59	1,173,544,000	189,499,138	1,798,653	$ 8,447,263	6,717,533	307,838,243
60	1,173,544,000	182,720,028	1,737,075	$ 8,447,263	6,779,110	314,617,353
61	1,194,297,000	175,878,776	1,674,934	$ 8,447,263	6,841,252	321,458,605
62	1,194,297,000	168,974,813	1,612,222	$ 8,447,263	6,903,963	328,362,569
63	1,194,297,000	162,007,563	1,548,936	$ 8,447,263	6,967,250	335,329,818
64	1,194,297,000	154,976,447	1,485,069	$ 8,447,263	7,031,116	342,360,935
65	1,194,297,000	147,880,879	1,420,617	$ 8,447,263	7,095,568	349,456,503
66	1,194,297,000	140,720,268	1,355,575	$ 8,447,263	7,160,611	356,617,113
67	1,194,297,000	133,494,018	1,289,936	$ 8,447,263	7,226,250	363,843,363
68	1,194,297,000	126,201,528	1,223,695	$ 8,447,263	7,292,490	371,135,854
69	1,194,297,000	118,842,190	1,156,847	$ 8,447,263	7,359,338	378,495,192
70	1,194,297,000	111,415,391	1,089,387	$ 8,447,263	7,426,799	385,921,990
71	1,194,297,000	103,920,513	1,021,308	$ 8,447,263	7,494,878	393,416,868
72	1,194,297,000	96,356,932	952,605	$ 8,447,263	7,563,581	400,980,449
73	1,214,002,901	88,724,019	883,272	$ 8,447,263	7,632,914	408,613,363
74	1,214,002,901	81,021,137	813,304	$ 8,447,263	7,702,882	416,316,245
75	1,214,002,901	73,247,645	742,694	$ 8,447,263	7,773,492	424,089,736
76	1,214,002,901	65,402,896	671,437	$ 8,447,263	7,844,749	431,934,485
77	1,214,002,901	57,486,237	599,527	$ 8,447,263	7,916,659	439,851,144
78	1,214,002,901	49,497,009	526,957	$ 8,447,263	7,989,228	447,840,372
79	1,214,002,901	41,434,546	453,723	$ 8,447,263	8,062,463	455,902,835
80	1,214,002,901	33,298,177	379,817	$ 8,447,263	8,136,369	464,039,204
81	1,214,002,901	25,087,225	305,233	$ 8,447,263	8,210,952	472,250,156
82	1,214,002,901	16,801,006	229,966	$ 8,447,263	8,286,219	480,536,375
83	1,214,002,901	8,438,830	154,009	$ 8,447,263	8,362,176	488,898,552
84	1,214,002,901	0	77,356	$ 8,447,263	8,438,830	497,337,381

Buildup of Duquesne Light's T&D Rate

Setp:		
1	Lahtinen Distribution (Duquesne Statement 5)	$ 253,687,253
	remove: *Losses*	$ (10,432,197)
2	Lahtinen Transmission (Duquesne Statement 5) with ancillary services included:	$ 50,315,742
3	Merger related Distribution savings per OCA witness Kahal:	$ (15,800,000)
	Total T&D Revenue Requirement with Merger Savings	$ 277,770,798
	Total T&D Revenue Requirement w/out Merger Savings	$ 293,570,798
4	OCA's retail kwh for 1999	12,519,000,000

Total T&D Rate, cents/kwh, with Merger Savings	**2.219**
Total T&D Rate, cents/kwh, w/out Merger Savings	**2.345**

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, Pennsylvania

DUQUESNE LIGHT COMPANY
APPLICATION FOR APPROVAL OF
RESTRUCTURING PLAN FILED
AUGUST 1, 1997

PUBLIC MEETING -
MAY 21, 1998
MAY-98-OSA-229*
DOCKET NO. R-00974104,
ET AL.

STATEMENT OF COMMISSIONER JOHN HANGER

This final order marks the start of a new day for the families and businesses of Duquesne Light Company. During my many visits to Pittsburgh, the customers of Duquesne Light Company have made it clear that they need relief from the second highest average rates in Pennsylvania. That relief is now on the way.

This decision empowers customers with a system average shopping credit of 4.00 cents per kilowatt-hour in 1999. The shopping credit will rise to about 4.22 cents per kilowatt-hour in 2000 if the merger is completed. These shopping credits could allow customers to cut their total electric bills by about 15%.

The shopping credits in this decision are higher than the pilot program system average shopping credit of 3.76 cents per kilowatt-hour that has been in effect since November 1, 1997. Approximately 26,000 customers in the Duquesne service territory have already chosen new electric suppliers and have cut significantly their electric bills using the pilot shopping credits. Consequently, the final order shopping credit of 4.00 cents will create more vigorous competition that can only benefit consumers even more.

This decision is particularly good news for long-suffering residential customers who have paid the highest electric rates of any customer class. Residential customers will have a shopping credit higher than the system average credit of 4.00 cents per kilowatt-hour, though the exact amount is not yet set. Unlike many larger users, residential customers have been completely captive ratepayers and have not received the special discount rates that larger users have leveraged from Duquesne by threatening to generate their own electricity. Today's decision that ends the monopoly may benefit most residential customers.

In this case, there does exist one complication that creates some uncertainty. If the merger is not completed and Duquesne pursues divestiture of its generation plants, the system average pilot shopping credit of 3.76 will continue until the sale of generation plants is completed. At that point, the shopping credit will be recalculated to reflect the result of the sale.

If Duquesne does pursue divestiture, Duquesne must address many issues that the order lists. Included in that list is the impact on its employees. Duquesne employees have worked in some cases at

the company for decades. They have families. They are part of communities. Just as treating fairly consumers and shareholders is important, treating fairly the employees of Duquesne is vital.

If there is no sale of generation plants, the final order treats fairly the shareholders of Duquesne by awarding $1,331,567,000. of stranded cost recovery. This large amount of stranded cost recovery will insure that Duquesne has an opportunity to make a successful transition to competition and to retain the financial strength needed to insure reliable electric service.

Stranded costs will be collected through a competition transition charge (CTC) set at a system average rate of 2.58 cents per kilowatt-hour in 1999. Stranded costs will be recovered from January 1, 1999 to December 31, 2005.

All these stranded costs have been and are included in the rates that customers have been and are paying. These stranded costs are not new costs or new charges. This is a critical point. But for the transition to competition, customers would have continued to pay for stranded costs for the next 30 years and would not have had the price reductions that the shopping credits will produce.

Apart from shopping credits and stranded cost recovery, this decision contains many other important provisions. The final order requires consumer education and provides a $10 million budget. A certain amount of confusion is inevitable as competition begins but this massive consumer education program will help ease the transition for consumers.

The decision expands universal service protections for low-income families. Electricity is a necessity of life. The Act requires universal service programs and this decision increases the universal service protections and services. These provisions are and will be literally life savers.

The final order also includes new environmental initiatives involving renewable energy and net metering. These initiatives combined with the ability of customers to now choose green power open new avenues for consumers to benefit the environment through their own daily energy choices.

The final order also implements the statutory rate caps for the unbundled generation, transmission, and distribution rates. These statutory rate caps will protect those customers that do not shop, and no customer is required to shop.

Most importantly, this decision will improve the economic environment of Pittsburgh. This decision will cut energy costs and help families and businesses pay their bills. It will help create and preserve jobs. This is no small matter in a globally competitive economy where average income Pennsylvania families work from January 1 to early February to just pay all their utility bills.

When I began urging that Pennsylvania should end the retail electric monopoly, I said that retail competition could be implemented in a way that helped all consumers, assisted the environment, protected vulnerable families, and treated fairly utilities. This decision does that. The promise of the Electricity Generation Customer Choice and Competition Act, therefore, is kept.

May 21, 1998
DATED

John Hanger
JOHN HANGER, COMMISSIONER