

DATE: June 19, 1997

SUBJECT: R-00973953

MEM

TO: Office of Administrative Law Judge

FROM: *WJZ* John G. Alford, Secretary

APPLICATION OF PECO ENERGY COMPANY FOR  
APPROVAL OF ITS RESTRUCTURING PLAN

---

Attached is copy of a Petition for Leave to Intervene and Participate of Duke Energy Trading and Marketing, L.L.C. filed in connection with the above docketed proceeding.

This matter is assigned to your Office for appropriate action.

Attachment

cc: OTS

wjz

**DOCKETED**  
JUN 20 1997

DOCUMENT  
FOLDER



# PECO ENERGY

Legal Department

PECO Energy Company  
2301 Market Street  
PO Box 8699  
Philadelphia, PA 19101-8699  
215 841 5544  
Fax 215 568 3389

MEM

James W. Durham  
Senior Vice President  
and General Counsel

Sandra H. Byrne  
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Todd D. Cutler  
Vilna Waldron Gaston  
Gregory Golazeski  
John C. Halderman  
Mary McFall Hopper  
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Wendy Schermer  
Susan E. Sciamanna Foehl  
Jenny P. Shulbank  
Ward L. Smith  
Dawn Getty Sutphin  
Noel H. Trask  
Assistant General Counsel

Direct Dial: 215 841 4252

June 19, 1997

**By Overnight Delivery**

Tanya McCloskey  
Assistant Consumer Advocate  
Office of Consumer Advocate  
1425 Strawberry Square  
Harrisburg, PA 17120

DOCUMENT  
FOLDER

Re: Application of PECO Energy Company for Approval of its Restructuring  
Plan under Section 2806 of the Public Utility Code  
Docket No. R-00973953

Dear Tanya:

Enclosed are PECO Energy Company's Answers to the Office of Consumer  
Advocate's Interrogatories:

Set XII: OCA-XII-1 through OCA-XII-22.

If you have any questions, please call me at (215) 841-4252.

Sincerely,

*Paul Bonney/mbo*

Paul Bonney

PRB/mbo  
Enclosures

cc: w/enclosures  
Certificate of Service (w/enclosure)  
James McNulty, Acting Prothonotary (Certificate of Service Only)

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JUN 24 1997

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# PECO ENERGY

Legal Department

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Noel H. Trask  
Assistant General Counsel

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Direct Dial: 215 841 4252

June 19, 1997

### By Overnight Delivery

Audrey Van Dyke, Associate Counsel  
Naval Facilities Engineering Command  
Washington Navy Yard, Bldg 218, Room 200  
901 M Street, S.E.  
Washington, DC 20374-5018

Re: Application of PECO Energy Company for Approval of its Restructuring  
Plan under Section 2806 of the Public Utility Code  
Docket No. R-00973953

Dear Audrey:

Enclosed are PECO Energy Company's Answers to the Department of the  
Navy's Interrogatories:

Set I Navy-I-4 through Navy-I-6, Navy-I-13, Navy-I-28, Navy-I-37, Navy-I-50,  
Navy-I-57 and Navy-I-61.

Sincerely,

*Paul Bonney/mbo*

Paul Bonney

PRB/mbo

Enclosures

cc: w/enclosures  
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James McNulty, Acting Prothonotary (Certificate of Service Only)

00221

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# PECO ENERGY

Legal Department

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Dawn Getty Sutphin  
Noel H. Trask  
Assistant General Counsel

Direct Dial: 215 841 4252

June 19, 1997

### By Overnight Delivery

Kenneth L. Mickens, Senior Prosecutor  
Office of Trial Staff  
Pennsylvania Public Utility Commission  
901 North 7<sup>th</sup> Street Rear  
Harrisburg, PA 17120

## DOCKETED

### JUN 24 1997

Re: Application of PECO Energy Company for Approval of its Restructuring  
Plan under Section 2806 of the Public Utility Code  
Docket No. R-00973953

Dear Ken:

Enclosed is PECO Energy Company's Answer to the Office of Trial Staff's  
Interrogatories:

OTS-RB-7.

Sincerely,

Paul Bonney

PRB/mbo

Enclosures

cc: w/enclosures  
Certificate of Service (w/enclosure)  
James McNulty, Acting Prothonotary (Certificate of Service Only)

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# PECO ENERGY

Legal Department

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Dawn Getty Sutphin  
Noel H. Trask  
Assistant General Counsel

Direct Dial: 215 841 4252

June 19, 1997

## By Overnight Delivery

Daniel Clearfield, Esquire  
Wolf, Block, Schorr and Solis-Cohen  
305 North Front Street, Suite 401  
Harrisburg, PA 17101

Re: Application of PECO Energy Company for Approval of its Restructuring  
Plan under Section 2806 of the Public Utility Code  
Docket No. R-00973953

Dear Derrick:

Enclosed are PECO Energy Company's Answers to Enron's Interrogatories:

Set II: Enron-II-7 and Enron-II-10.

Sincerely,

Paul Bonney

PRB/mbo

Enclosures

cc: w/enclosures  
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James McNulty, Acting Prothonotary (Certificate of Service Only)

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# PECO ENERGY

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Assistant General Counsel

Direct Dial: 215 841 4252

June 19, 1997

**By Overnight Delivery**

DOCUMENT  
FOLDER

Karen Oill Moury, Esquire  
Assistant Small Business Advocate  
Suite 1102, Commerce Building  
300 N. 2<sup>nd</sup> Street  
Harrisburg, PA 17101

Re: Application of PECO Energy Company for Approval of its Restructuring  
Plan under Section 2806 of the Public Utility Code  
Docket No. R-00973953

Dear Karen:

Enclosed is PECO Energy Company's Answer to the Office of Small Business  
Advocate's Interrogatory:

Set I OSBA-I-23.

If you have any questions, please call me at (215) 841-4252.

Sincerely,

*Paul Bonney* 1/230

Paul Bonney

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JUN 24 1997

PRB/mbo  
Enclosures

cc: w/enclosures  
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James McNulty, Acting Prothonotary (Certificate of Service Only)

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# PECO ENERGY

Legal Department

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2301 Market Street  
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Ward L. Smith  
Dawn Getty Sutphin  
Noel H. Trask  
Assistant General Counsel

Direct Dial: 215 841 4252

June 19, 1997

DOCUMENT  
FOLDER

**By Overnight Delivery**

Alan J. Barak, Esquire  
1417 Blue Mountain Parkway  
Harrisburg, PA 17112

Re: Application of PECO Energy Company for Approval of its Restructuring  
Plan under Section 2806 of the Public Utility Code  
Docket No. R-00973953

Dear Alan:

Enclosed is PECO Energy Company's Answer to the Environmentalists'  
Interrogatory:

Set II Environmentalists-II-115.

Sincerely,

*Paul Bonney/mbo*

Paul Bonney

DOCKETED

JUN 24 1997

PRB/mbo

Enclosures

cc: w/enclosures  
Certificate of Service (w/enclosure)  
James McNulty, Acting Prothonotary (Certificate of Service Only)

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Certificate of Service

I hereby certify that I have this date served the following Answers by facsimile, first class or overnight/express mail, upon the persons addressed below:

Office of Consumer Advocate's interrogatories: SET III 1 THROUGH 22

Department of the Navy's Interrogatories: Set I - 4, 5, 6, 13, 28, 37, 50, 57 + 61

Environment alists' Interrogatories: SET II 115  
ENERGY INTERROGATORIES: SET II 7, 10  
OFFICE OF TRIAL STAFF INTERROGATORY OTS-RB = 7  
Office of Small Business Advocate's Interrogatory: Set I 23

Kenneth L. Mickens, Senior Prosecutor  
Charles Shields, Prosecutor  
Pennsylvania Public Utility Commission  
Office of Trial Staff  
P.O. Box 3256  
Harrisburg, PA 17105-3265

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Steven K. Steinmetz, Esquire  
Assistant Consumer Advocate  
Office of Consumer Advocate  
1425 Strawberry Square  
Harrisburg, PA 17120

Derrick Williamson, Esquire  
David Kleppinger, Esquire  
McNees, Wallace & Nurick  
100 Pine Street  
Harrisburg, PA 17108-1166  
(Counsel for PAIEUG)

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Assistant Small Business Advocate  
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Harrisburg, PA 17101

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Democratic Committee on Appropriations  
Room 545, Main Capitol Building  
Harrisburg, PA 17120  
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Community Legal Services, Inc.  
1424 Chestnut Street  
Philadelphia, PA 19102  
(Counsel for CEPA, Action Alliance of Sr. Citizens & John Long, Jr.)

Daniel Clearfield, Esquire  
Alan Kohler, Esquire  
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305 N. Front Street, Suite 401  
Harrisburg, PA 17101  
(Counsel for Enron)

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Paul Russell, Esquire  
Pennsylvania Power & Light Company  
Two North Ninth Street  
Allentown, PA 18101  
(Counsel for PP&L)

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Dilworth, Paxson, Kalish & Kauffman  
305 North Front Street, Suite 403  
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(Counsel for AARP)

Craig A. Doll, Esquire  
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Harrisburg, PA 17101  
(Counsel for Delmarva Power & Light)

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Houston, TX 77079  
(Counsel for DuPont Power Marketing, Inc.)

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David Desalle, Esquire  
Ryan, Russell, Ogden & Seltzer  
800 North Third Street, Suite 101  
Harrisburg, PA 17102  
(Counsel for GPU)

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WiseEnergy  
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Mr. Brian Kalicic  
Excel Consulting  
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St. Louis, MO 63105

Audrey Van Dyke, Associate Counsel  
Naval Facilities Engineering Command  
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Peter Bradford  
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Peru, VT 05152

Usher Fogel, Esquire  
Roland, Fogel, Koblenz & Carr, LLP  
Albany, NY 12207  
(Counsel for PPA)

Barbara Alexander  
Consumer Affairs Consultant  
15 Wedgewood Drive  
Winthrop, ME 04364

Janet Miller, Esquire  
Malatesta Hawke & McKeon  
100 N. Tenth Street  
Harrisburg, PA 17105  
(Counsel for Mid-Atlantic Power Supply Association)

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Boston, MA 02108

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J. Kennedy and Associates  
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Atlanta, GA 30328

Gary A. Jeffries, Senior Attorney  
CNG Energy Services Corporation  
One Park Ridge Center  
P.O. Box 15746  
Pittsburgh, PA 15244-0746

Richard Silkman  
163 Main Street  
Yarmouth, Maine 04096

Ralph Smith  
Larkin & Associates  
15728 Farmington Road  
Livonia, MI 48154

*Paul R. Bonney /msc*

Paul R. Bonney  
Assistant General Counsel  
PECO Energy Company  
2301 Market Street, S23-1  
Philadelphia, PA 19103  
(215) 841-4252

Dated: *JUNE 19, 1997*

# ORIGINAL

LAW OFFICES

DILWORTH, PAXSON, KALISH & KAUFFMAN-LLP

305 N. FRONT STREET

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HARRISBURG, PENNSYLVANIA 17101-1236

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MEM



CHERRY HILL, NJ  
(609) 751-8500

PHILADELPHIA, PA  
(215) 575-7000

MEDIA, PA  
(610) 565-4131

(717) 236-4812

Frederick D. Ochsenhirt

June 19, 1997

DOCUMENT  
FOLDER

James McNulty, Prothonotary  
Pennsylvania Public Utility Commission  
PO Box 3265  
Harrisburg, PA 17105-3265

Re: Application of PECO Energy Company for Approval of its  
Restructuring Plan Under Section 2806 of the Public  
Utility Code, Docket No. R-00973953

Dear Mr. McNulty:

Enclosed please find an original of the Direct Testimony of Dr. Mark N. Cooper on behalf of the American Association of Retired Persons for filing in the above-captioned action. Parties are being served in accord with the attached Certificate of Service.

Very truly yours,

Frederick D. Ochsenhirt

FDO:sd  
Enclosures

cc: The Honorable Marlane R. Chestnut  
The Honorable Charles E. Rainey, Jr.  
Certificate of Service

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JUN 19 1997

PA PUBLIC UTILITY COMMISSION  
PROTHONOTARY'S OFFICE

ORDINANCE

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

APPLICATION OF PECO ENERGY COMPANY  
FOR APPROVAL OF ITS RESTRUCTURING PLAN  
UNDER SECTION 2806 OF THE PUBLIC UTILITY CODE

DOCKETED

JUN 25 1997

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JUN 19 1997

DIRECT TESTIMONY

OF

DR. MARK N. COOPER

PA PUBLIC UTILITY COMMISSION  
PROTHONOTARY'S OFFICE

ON BEHALF OF

THE AMERICAN ASSOCIATION OF RETIRED PERSONS

DOCUMENT  
FOLDER

JUNE 20, 1997

1 **I. BACKGROUND AND OVERVIEW**

2

3 **A. QUALIFICATIONS**

4 Q. PLEASE STATE YOUR NAME, ADDRESS AND OCCUPATION.

5 A. Dr. Mark N. Cooper, President, Citizens Research, 504 Highgate Terrace,  
6 Silver Spring Maryland 20904. I am also Director of Research of the Consumer  
7 Federation of America (CFA). My testimony reflects my personal views and not  
8 those of CFA.

9

10 Q. PLEASE BRIEFLY SUMMARIZE YOUR RELEVANT EMPLOYMENT  
11 EXPERIENCE AND RESEARCH INTERESTS.

12 A. Prior to founding Citizens Research, a consulting firm specializing in  
13 economic, regulatory and policy analysis, I spent four years as Director of  
14 Research at the Consumer Energy Council of America. Prior to that I was an  
15 Assistant Professor at Northeastern University teaching courses in Business and  
16 Society in the College of Arts and Sciences and the School of Business. I have  
17 also been a Lecturer at the Washington College of Law of the American University  
18 co-teaching a course in Public Utility Regulation.

19

20 Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE PUBLIC UTILITY  
21 COMMISSIONS?

22 A. I have testified on various aspects of telephone and electricity rate making

1 before the Public Service Commissions of Arkansas, California, Colorado,  
2 Connecticut, Delaware, the District of Columbia, Florida, Georgia, Hawaii,  
3 Illinois, Indiana, Iowa, Kentucky, Manitoba, Maryland, Missouri, New Jersey,  
4 New York, North Carolina, Ohio, Oklahoma, Pennsylvania, South Carolina,  
5 Tennessee, Texas, Vermont, Virginia, and Washington, as well as the Federal  
6 Communications Commission (FCC), the Canadian Radio-Television, Telephone  
7 Commission (CRTC) and a number of state legislatures.

8 For a decade and a half I have specialized in analyzing regulatory reform  
9 and market structure issues in a variety of industries including railroads, airlines,  
10 natural gas, electricity, medical services and cable television, in addition to  
11 telecommunications. This includes approximately 125 pieces of testimony split  
12 fairly evenly among state regulatory bodies, federal legislative bodies, and federal  
13 administrative bodies.

14

15 Q. HAVE YOU TESTIFIED ON UNIVERSAL SERVICE ISSUES?

16 A. With respect to universal service and lifeline issues, I have presented  
17 testimony in Connecticut, Florida, Hawaii, Illinois, Manitoba, Mississippi, New  
18 York, North Carolina, Ohio, Oklahoma, South Carolina and Texas as well as  
19 before the FCC and CRTC.

20 I have conducted several major studies of universal services including  
21 Universal Service: An Historical Perspective and Policies for the 21st Century  
22 (The Benton Foundation and the Consumer Federation of America, 1996),

1 Protecting the Public Interest in the Transition to Competition in Network  
2 Industries in (The Electric Utility Industry in Transition (Public Utilities Reports  
3 and the New York State Energy Research Development Authority, 1994),  
4 Consumers with Disabilities in the Information Age: Public Policy for a Dynamic  
5 Market (The Dole Foundation, 1993), Utility Lifeline Programs: Prevalence and  
6 Performance (American Association of Retired Persons and the Consumer  
7 Federation of America, 1991), Expanding the Information Age for the 1990s: A  
8 Pragmatic Consumer Analysis (American Association of Retired Persons and the  
9 Consumer Federation of America, 1990), The Telecommunications Needs of  
10 Older, Low Income and General Consumers in the Post-Divestiture Era,  
11 (American Association of Retired Persons and the Consumer Federation of  
12 America, 1987), Low Income Households in the Post-Divestiture Era: A Study of  
13 Telephone Subscribership and Use in Michigan (Michigan Divestiture Research  
14 Fund, 1986), and Energy and Equity: Rising Energy Prices and the Living  
15 Standards of Lower Income Americans (Westview, 1982).

16

17 Q. HAVE YOU TESTIFIED ON CONSUMER PROTECTION ISSUES?

18 A. I have served as an expert witness on consumer protection and done  
19 research on a number of industries.

20 In telecommunications, I was the expert witness for the People's Counsel  
21 in cases involving fraudulent marketing of local exchange service in Pennsylvania  
22 and Florida. While those cases were settled through stipulations, testimony

1 developed in them was filed in the Department of Justice case dealing with the  
2 divestiture of AT&T. On behalf of the Consumer Federation of America I filed  
3 comments on consumer protection on in the transition to competition in California.  
4 On behalf of the Public Interest Advocacy Center, I have filed testimony on  
5 quality control standards before the CRTC. I conducted research for the National  
6 Association of Attorneys General regarding consumer protection in the sale of  
7 800 and 900 number services.

8 In electricity I have testified before the Public Service Commission of  
9 Texas and the New York State Energy Research and Development Authority on  
10 restructuring.

11

12 Q. ON WHOSE BEHALF ARE YOU TESTIFYING?

13 A. On behalf of the American Association of Retired Persons, I have reviewed  
14 the Commission orders dealing with restructuring and the Application of PECO  
15 Energy Company for Approval of Its Restructuring Plan Under Section 2806 of  
16 the Public Utility Code.

17

18 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

19 A. In my testimony I present a comprehensive approach to universal service  
20 and consumer protection policies that I believe are necessary to protect the  
21 interests of residential ratepayers as the electric utility industry transitions to a  
22 more competitive model. I then evaluate the company's proposal in terms of this

1 proposal.

2           Restructuring represents a major change in an industry that is vital to  
3 consumers and the public health and welfare. There are hard questions  
4 confronting policy makers which cannot be assumed away and the answers  
5 provided to date are inadequate. Residential ratepayers must insist on realistic,  
6 detailed solutions to these problems. For the average consumer to benefit from  
7 deregulation of electricity, policy makers must have a clear set of goals and be  
8 guided by specific principles.

9           In my testimony I offer a comprehensive approach to universal service and  
10 consumer protection. In many respects my proposals go beyond the guidelines  
11 offered by the Commission, but I believe that they are consistent with the  
12 Consumer Choice Act. To the extent that my recommendations go beyond the  
13 guidelines, I urge the Commission to amend its tentative conclusions and  
14 guidelines.

15           Even without a change on the part of the Commission, however, the  
16 companies should adopt my proposals. Every company is free to propose more  
17 extensive programs to promote universal service and more vigorous consumer  
18 protections.

19

20 Q.   HOW IS YOUR TESTIMONY ORGANIZED?

21 A.   In Chapter II, I analyze the nature of electricity services, the historical  
22 *pattern of their delivery and the implications of electricity restructuring for two key*

1 public policy areas -- universal service and consumer protection. Attachment  
2 MNC-1 presents a summary of the factors I cite which create a need for vigorous  
3 policies to promote universal service and ensure adequate consumer protection. I  
4 then recommend a new paradigm for consumer protection. Attachment MNC-2  
5 summarizes the elements of this paradigm.

6 In Chapter III, I discuss policies to ensure universal service.

7 In Chapter IV, I discuss the consumer protection policies that are necessary  
8 to ensure consumers are not abused in the new market for electricity. Attachment  
9 MNC-3 identifies all of the major policy elements discussed in my testimony.

10 In Chapter V, I review the recent law and initial guidelines published by the  
11 Commission. I demonstrate the consistency between my recommendations and  
12 broad policy goals recently enacted in Pennsylvania.

13 In Chapter VI I evaluate the Company's proposal. The proposals before  
14 the Commission have barely begun to address the hard questions. Therefore, the  
15 bulk of my testimony outlines the fundamental principles that should be adopted by  
16 the companies and the Commission.

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**II. THE NEED FOR MORE VIGOROUS POLICIES  
TO PROMOTE UNIVERSAL SERVICE AND  
CONSUMER PROTECTION IN THE  
TRANSITION TO COMPETITION**

7  
8

**A. PUBLIC POLICY FOR UTILITY NECESSITY SERVICES**

9 Q. WHAT ARE THE PRIMARY PUBLIC POLICY ISSUES IN THE AREA  
10 OF UNIVERSAL SERVICE.?

11 A. *The primary purpose of public policy in the area of utilities, such as*  
12 *telephone, electricity and natural gas service, is to ensure that all consumers are*  
13 *able to purchase reliable supplies of these necessities in adequate quantities to*  
14 *meet their basic needs at affordable rates. These services are considered*  
15 *necessities and have been delivered as regulated utilities for almost a century.*  
16 *Although public policy is moving away from monopoly delivery of these services,*  
17 *the services are still necessities and the fundamental commitment to universal*  
18 *service remains.*

19

20 Q. HAS REGULATION DEALT WITH CONSUMER PROTECTION  
21 BEYOND THE ISSUE OF THE SETTING OF RATES?

22 A. *Although price has been the focal point of regulation, it must be recognized*  
23 *that public utility commissions have traditionally gone well beyond simply setting*  
24 *rates in the regulation of the sale of these services. There were behavioral*

1 consequences of monopoly control over a necessity service that required the  
2 regulation of the terms and conditions of service.

3 Without this second layer of oversight, monopolists would exploit their  
4 market power in ways other than excessive earnings. Revenues would be  
5 maximized from those services which were the most basic monopoly services -- i.e.  
6 had the lowest elasticity of demand. The franchise value would be maximized by  
7 extending the monopolistic reach as far as possible into kindred and related  
8 services. Thus, regulation of how specific services are offered to individual classes  
9 of customers and at what prices has always been a part of regulation.

10 Regulation went farther, into the transaction between the company and its  
11 most captive customers. The monopoly transaction itself allows a unique  
12 opportunity to interact with customers. For this reason, regulation has always  
13 included qualitative measures of franchise performances -- such as speed of  
14 response, presentation of information, billing detail, etc.

15

16 Q. WHY IS INCREASED CONSUMER PROTECTION SO IMPORTANT  
17 IN THE TRANSITION TO COMPETITION?

18 A. The transformation of a utility service with no substitutes into a commodity  
19 is a major change for consumers. They have never shopped for this service. The  
20 introduction of competition changes the nature of this service and opens a range of  
21 questions.

22 Markets do not necessarily produce socially acceptable outcomes with

1 respect to the ubiquitous availability of service. How will universal service be  
2 ensured?

3 Because these services have been provided as a utility, quality, features and  
4 functionalities were regulated and controlled. Should uneven service quality be  
5 tolerated in the market? Can consumers learn to evaluate these commodities?

6 In many states because these services were regulated as utilities, their  
7 status under consumer protection statutes may be unclear. In the transition to  
8 competition policy makers must ensure that these services are fully covered, not  
9 only by general consumer protection statutes, but also by additional consumer  
10 protections.

11 To the extent that the transformation to competition is partial, the  
12 remaining areas of monopoly or market power are a source of concern in the  
13 transition. To the extent that the legacy of monopoly creates points of leverage  
14 and vulnerability, they should be addressed by public policy.

15 For a significant transition period, the terms and conditions of such  
16 purchases must be closely scrutinized and controlled.

- 17 o Consumers must be assured the same wide  
18 availability of services at affordable prices.
- 19
- 20 o They must be ensured that the reliability of the  
21 services they receive is at least as high as it is today.
- 22
- 23 o They must be assured that as they are forced to  
24 make purchase decisions about electricity, they are  
25 provided at least the same level of protection from  
26 fraud and abuse as they have today.
- 27

1           The National Association of Regulatory Utility Commissioners (NARUC)  
2   has recently adopted a policy statement with respect to universal service in the  
3   electricity industry:

4           Because electricity service is vital for health, safety, and economic  
5   opportunity, universal service is a cornerstone of the public interest.  
6   Customers are entitled to access to reasonably priced power and to  
7   a forum for dispute resolution.

8  
9           Electric service is a basic need. Therefore, preserving and  
10   protecting the public interest in a restructured electric industry  
11   should include assuring that consumers have access to an adequate  
12   supply of electricity to satisfy their basic needs at a reasonable  
13   price. Policy-makers should continue to address the needs of low-  
14   income customers. The health and safety of all consumers is  
15   paramount.

16  
17           NARUC went on to define the issue of consumer protection  
18  
19   during restructuring broadly.

20  
21           Consumers should be protected from anti-competitive behavior,  
22   undue discrimination, poor service, and unfair billing and  
23   disconnection practices. In a restructured industry, certain  
24   consumer protections should be preserved, particularly those that  
25   guard against undue discrimination, failure to meet minimum  
26   service quality and safety requirements and other unfair business  
27   practices. In a competitive environment, other consumer abuses  
28   such as deceptive marketing practices should also be prevented.  
29   Associated with these issues are questions of service quality,  
30   providers of last resort and the obligations of distribution  
31   companies.

32

33   **B. THE COMMODITY AND THE TRANSACTION**

34

35   Q.   WHAT SPECIFIC FACTORS CREATE THE NEED FOR GREATER

1 CONSUMER PROTECTION?

2 A. The fundamental need for heightened consumer protection stems from the  
3 nature of the service provided and the historical context of its delivery (see  
4 Attachment MNC-1). Consumers are unprepared for the commodification of these  
5 utility services. Three sets of factors make the sale of these services problematic --  
6 the consumer, the transaction and the seller.

7

8 Q. PLEASE DESCRIBE THE PURCHASE OF SERVICES IN AN  
9 EMERGING COMPETITIVE ENVIRONMENT.

10 A. Electricity remains a necessity. It has a low elasticity of demand. There  
11 are no close substitutes. This suggests that consumers have little bargaining power  
12 in the transaction.

13 One of the reasons society cares so much about the price and quality of  
14 utility services is that we cannot do without them. Use of utilities is a basic  
15 determinant of the quality of life at the end of the twentieth century and must be  
16 universally available. It is not enough for the wires to pass by people's homes, if  
17 they cannot afford to actually consume what they need. It is not good enough  
18 that people continue to purchase these utilities, but at a cost that puts a strain on  
19 their household budget. We mean a decent level of consumption on a reliable  
20 basis, without suffering deprivation because of how much it costs.

21 Once this fundamental commitment is embraced as the central tenet of  
22 public policy toward utilities, concern moves on to the secondary aspects of public

1 policy -- like economic efficiency in production, customer choice in consumption,  
2 and optimization of output. The goal of providing universal, reliable, affordable  
3 service should be accomplished in the most efficient manner possible, but no  
4 amount of economic efficiency gain is worth cutting people off and leaving them  
5 alone in the dark to freeze.

6

7 Q. ARE THE CONDITIONS OF PURCHASE OF THESE SERVICE  
8 UNIQUE?

9 A. Yes. Consumers frequently purchase these commodities under  
10 considerable time constraints. Frequently, the need to get service is urgent.  
11 People change service only when they have to because they have moved their place  
12 of residence. Therefore, they are under internal pressures to make sure that they  
13 get connected. Where one is seeking to reconnect utility service because of a  
14 move, the customer is likely to be highly motivated and focused. The customer  
15 needs to make a purchase (rather than the seller needing to make a sale). This  
16 reverses the typical roles and makes the customer vulnerable to exploitation. The  
17 customer is likely to be highly receptive to a sales pitch.

18 Traditionally, consumers have not been presented with an array of choices  
19 for the underlying basic service. Moreover, many of the bells and whistles that will  
20 be sold as part of a package have not been bundled before or were easily separable.  
21 Now the consumer is faced with packages that are difficult to sort out.

22 Consumers have not been subject to marketing pressures at the point-of-

1 sale in the past. As utility services they were not heavily sold and the incumbents  
2 did not do a great deal of promotion or selling.

3

4 Q. WHAT CHARACTERISTICS OF THE TRANSACTION MAKE THE  
5 CONSUMER VULNERABLE TO ERROR OR ABUSE?

6 A. Since the transaction is conducted over the phone, electronically, there is  
7 little opportunity for point-of-sale information gathering. No immediate record of  
8 the transaction exists.

9 The billing pattern for these services is also problematic. There is a  
10 disconnection between the purchase and the bill. Many weeks may elapse between  
11 the purchase and the bill. Further, the bill may make it difficult to identify exactly  
12 what costs how much.

13 The cost itself is a monthly charge, which may appear small on a recurring  
14 basis, but over the course of the year adds up. The smallness of the monthly  
15 charge and the difficulty of sorting the bill out renders pre-purchase information  
16 gathering and post-purchase follow up less likely.

17

18 Q. WHAT CHARACTERISTICS OF THE SELLER MAKE THE  
19 SITUATION DIFFICULT FOR CONSUMERS?

20 A. Sellers can definitely exploit a situation of less than effective competition  
21 for these services. For many services being offered to consumers, not only have  
22 there not been alternatives available in the past, but the alternatives available in the

1 future may be hard to find, and difficult to evaluate. Exploitation of incumbency  
2 and the legacy of having provided a franchise service provides a point of leverage  
3 over the transaction. Consumers may have difficulty separating the basic services  
4 that they must purchase from the bells and whistles that are optional. Marketers  
5 will make this more difficult. Sellers will also exploit their position of authority  
6 and expertise.

7

8 **C. POLICY IMPLICATIONS**

9 Q. WHAT DO YOU CONCLUDE ABOUT THE TRANSACTION?

10 A. Urgency, time pressure, a lack of alternatives, a small expenditure spread  
11 out over time all lead to less effective consumer decision making, make consumers  
12 vulnerable to pressure tactics, and make post-purchase complaints less likely.

13 As a result, I believe that we need a new paradigm for consumer  
14 protection. The new paradigm for consumer protection must actively cover the  
15 three aspects of a sale I have discussed above which are typically recognized as  
16 important in consumer decision making and market performance. These include:

- 17 o Pre-purchase facilitation
- 18 o Point-of-sale protections
- 19 o Post purchase remedies

20 The new paradigm should also cover activities that affect both the  
21 consumer and the seller as they conduct the transaction. By addressing each of the  
22 stages of a purchase decision and both parties to the transaction, I identify six

1 specific areas for public policy action (see Attachment MNC-2).

2           There are several major areas that are in need of special attention. For the  
3 long term we must bring forward the fundamental universal service commitments  
4 and utility protections that have long been associated with these necessity services.  
5 Because they are so important, I will discuss the general universal service policies  
6 as a separate area in the next chapter. These are a core set of public policies. In  
7 addition, we have developed a set of transaction protections to ensure access to  
8 these services. These must be preserved.

9           For the long term, we must also ensure that former utility services are  
10 subject to the full array of consumer protections generally available in the state.  
11 There must be no possibility that because these services were once or are now  
12 partially regulated by the Commission they can be exempted from routine  
13 consumer protections.

14           In the short term, we must also have a transition plan. These are utilities  
15 and necessities. We must be sure that the marketplace can work effectively to  
16 provide them to consumers. A vigorously competitive marketplace does not exist  
17 today. There is some question about how vigorous it can ever be. There is also  
18 some question about how effective consumer decision making will be. Until we  
19 can conclude that the marketplace is vigorously competitive and consumers can  
20 make informed choices among a wide array of services, additional specific  
21 consumer protections are necessary. Educational efforts will be particularly  
22 important.

1 Q. HOW SHOULD CONSUMER PROTECTION POLICY BE  
2 DEVELOPED?

3 A. I believe that the approach to consumer protection must be pro-active, as  
4 well as reactive, which is the traditional approach to consumer protection.  
5 Moreover, because this is an emerging area, I believe that ongoing input from  
6 advisory boards or task forces should be formed to recommend specific steps to  
7 accomplish consumer protection.

8 The advisory bodies should include representatives of the major agencies  
9 engaged in consumer protection and the delivery of utility services, service  
10 providers, and all classes and categories of customers.

11 They should provide both advisory and monitoring functions. These  
12 functions should include advice on universal service for people and institutions. It  
13 should include definitions of services to be made available, expansion of the  
14 services included over time, cost models and recommendations for discounts. It  
15 should provide advice on how to reach targeted populations and it should monitor  
16 changes in universal service and issue periodic reports.

17 It should also play a role in consumer protection, helping to develop the  
18 form and content for information dissemination and educational campaigns. It  
19 should also have the task of compiling data on the status of consumer purchases  
20 and competition in the market.

1

**III. UNIVERSAL SERVICE**

2

3 **A. AFFORDABLE SERVICE FOR ALL**4 **Q. HOW DO YOU DEFINE AFFORDABLE SERVICE?**

5 A. Affordability and service must be specified more carefully if the goal of  
6 universal service is to be properly articulated and achieved. Because electricity is a  
7 necessity, the goal of universal service policy is to ensure a reasonable quality of  
8 life, not bare survival. Therefore, a basic level of service to meet daily needs must  
9 be included in the concept of what is affordable.

10 Because electricity is a necessity, people will pay more for it than other  
11 commodities. Compared to non-necessities, the elasticity of demand is low. The  
12 mere fact that people continue to pay for service does not mean it is affordable.  
13 Therefore, affordable means at rates that do not strain the household budget. In  
14 fact, the primary dictionary definition of afford invokes this very concept of the  
15 relative burden -- "to manage to bear without serious detriment."

16 Because electricity is a necessity and has been delivered under conditions  
17 of monopoly, the potential to charge customers a great deal, and thereby generate  
18 very high profits, exists. Just because rates are affordable does not mean they are  
19 reasonable and exploitation of market power in an unregulated market must be  
20 prevented.

21 Thus, universal service should be defined as

22 *the availability to all Americans of a reasonable level of electricity*

1 service at prices that do not strain household budgets or result in  
2 excess profits for electricity suppliers, or result in subsidies for large  
3 consumers  
4

5 The concept of universal service has traditionally rested upon a  
6 commitment by a single provider to ensure that service will be available. Service  
7 was made available on a non-discriminatory basis to all at rates that were deemed  
8 fair and reasonable. This obligation to serve commitment in the franchise  
9 monopoly environment must be transformed into an effective and equitable  
10 provider of last resort arrangement in a competitive environment.  
11

12 Q. WHAT GENERAL POLICIES SHOULD BE ADOPTED TO PROMOTE  
13 UNIVERSAL SERVICE?

14 A. The accomplishment of universal service has always been primarily the  
15 result of policies to ensure affordability for all Americans. With increases in  
16 income, the general affordability of service has improved over the years. As a  
17 result, greater attention has focussed on specific groups who have difficulty  
18 affording services. These targeted programs have received greater attention in  
19 recent years, particularly in telecommunications.

20 It is absolutely critical not to lose sight of the underlying commitment to  
21 universal service for all consumers as the electricity market transitions to  
22 competition. Affordability of service is not simply a low income problem. There  
23 may well be areas in the state in which "cost-based" rates would be unacceptably  
24 high for households well above "low income" levels. Rates could be lowered for

1 all consumers in such "high cost" areas, not just the low income residents of such  
2 areas.

3 Electricity is almost universally available in our society because costs have  
4 been shared by all customer classes of a utility. Restructuring threatens this  
5 outcome by forcing and allowing customers to purchase their own power. A clear  
6 public policy to ensure affordability must be put in place. Policies must also ensure  
7 that people who are low income or who live in high cost areas are able to afford  
8 service. We must create an integrated program to ensure service to all people. We  
9 must not lose sight of the need to provide reasonably priced service to all people,  
10 even as we pay particular attention to low income consumers with prevention of  
11 service cut-offs, discounts for households in need, and low income weatherization.

12

13 Q. HAVE SIMILAR UNIVERSAL SERVICE POLICIES BEEN ADOPTED  
14 FOR OTHER UTILITY SERVICES?

15 A. Yes. This is a well established practice in the telecommunications industry.

16 Affordability for the general population has been maintained by policies  
17 which recover a larger share of joint and common costs from customer classes  
18 with the ability to spread costs over products sold to the public at large or on  
19 services which are not considered basic services. This is the cornerstone of  
20 consumer protection which was recently enacted in the Telecommunications Act of  
21 1996. Section 254 (k) contains the following language.

22 The Commission, with respect to interstate services, and the States,

1 with respect to intrastate services, shall establish any necessary cost  
2 allocation rules, accounting safeguards, and guidelines to ensure  
3 that services included in the definition of universal service bear no  
4 more than a reasonable share of the joint and common costs of  
5 facilities used to provide those services.

6  
7 The Conference Report adopts Senate report language which went even  
8 farther --

9 The Commission and the states are required to establish any  
10 necessary cost allocation rules, accounting safeguards, and other  
11 guidelines to ensure that universal service bears no more than a  
12 reasonable share (and may bear less than a reasonable share) of the  
13 joint and common facilities used to provide both competitive and  
14 noncompetitive services (Conference Report, p. 129).

15 A similar concept is directly applicable in electricity. Indeed, such a strong  
16 commitment to affordability is even more appropriate for electricity since there are  
17 no close substitutes for this necessity.

18 Substantial joint and common costs in the electricity industry could well be  
19 allocated away from basic service. Requiring higher mark-ups on services which  
20 are considered non-basic does not mean subsidies are involved. As long as a  
21 service covers its incremental costs and makes some contribution to joint and  
22 common costs, it is neither the source, nor the recipient of a subsidy.

23 Joint and common costs are costs which are incurred in the provision of  
24 more than one service or for the purposes of providing services to more than one  
25 customer. They are shared by services, customers or customer classes. The  
26 principle is that any cost which is shared between customers, classes of customers  
27 or services are to be considered joint and common costs. These would include  
28

1 costs associated with facilities, general overhead, services (such as planning) and  
2 functionalities (such as coordination).

3 Stranded costs, to the extent that they are deemed recoverable, can also be  
4 considered shared, since the basis on which uneconomic costs are recoverable is a  
5 purported "social obligation" which is certainly shared among all ratepayers. My  
6 view of stranded costs, without making any conclusion that recovery of such costs  
7 has any legitimacy, is that if they exist they must be "shared" costs. Claims to  
8 recovery of stranded costs are typically based on a claim about a so-called "social  
9 compact" between ratepayers and utilities.

10 Therefore, to further universal service policy, recovery of stranded costs  
11 could be structured in such a way as to recover larger shares of such costs from  
12 non-basic services. This could be accomplished by recovering a larger share of  
13 such costs from non-residential customer classes and by recovering a larger share  
14 from non-basic services within customer classes.

15

16 Q. IN YOUR PREVIOUS ANSWER YOU ARGUED FOR TREATING  
17 STRANDED COSTS AS COMMON COSTS "WITHOUT MAKING ANY  
18 CONCLUSION THAT THE RECOVERY OF SUCH COSTS HAS ANY  
19 LEGITIMACY." WHAT POSITION HAS AARP TAKEN ON STRANDED  
20 COST RECOVERY?

21 A. In several recent proceedings at the federal and state levels AARP has  
22 developed a comprehensive analysis of stranded costs and made recommendations

1 for the treatment of stranded costs in the transition to competition. That position  
2 can be briefly summarized as follows.

3           There is no guaranteed return of or on capital implicit or explicit in the  
4 current rates paid by consumers. Claims that a ‘regulatory compact’ or  
5 constitutional protections bind ratepayers to make utilities whole for every penny  
6 of investment they have made or every obligation they have incurred have no  
7 economic or legal basis. Utilities are obligated to provide economic service. They  
8 are required to be efficient and have no claim to recover inefficient costs.  
9 Efficiency would be the outcome of a competitive market and that is the outcome  
10 which regulation strives to achieve.

11           Management exercises substantial discretion in the decision to make  
12 investments and incur contractual obligations. Management must bear the  
13 responsibility for its own actions. The burden of strategic actions or mistakes  
14 should be borne by stockholders, not ratepayers.

15           Even where management decisions are found to be prudent, that is no  
16 guarantee of a return on or of capital. Every Commission that has allowed an  
17 investment to be included in rate base has also assigned that investment a rate of  
18 return far above the risk free level in our society (the T-Bond rate). The  
19 assignment of a return which includes a substantial risk premium clearly indicates  
20 that there were no guarantees being offered. If a return of or on capital were  
21 guaranteed, the Commission would have assigned a return without a risk premium.

22           Utilities have also been compensated with a virtual guarantee against

1 bankruptcy.

2 Virtually every utility in the country has, in fact, enjoyed a return far in  
3 excess of a risk-free level and has, therefore, been compensated for risks.

4 Unanticipated outcomes on the demand-side (reductions in demand due to  
5 recessions or changes in behavior patterns) or the supply-side (changes in fuel  
6 prices or technology) are part of the risk for which utilities have been  
7 compensated.

8 New revenue opportunities must be taken into account in determining  
9 responsibility for investments, such as sales outside of the service territory which  
10 will be opened up.

11 Given this view of the relationship between ratepayers and stockholders,  
12 AARP recommends a case-by-case analysis of stranded costs. Management  
13 responsibility must be presumed, unless specific legislative mandates over precise  
14 terms and conditions of investment or purchase commitments was exercised. To  
15 the extent that unanticipated factors have caused the stranding of costs, AARP  
16 recommends that ratepayers and stockholders share stranded costs. Ratepayers  
17 should be responsible for no more than 50 percent of stranded costs and,  
18 depending on an evaluation of management responsibility, legal requirements and  
19 financial factors, could be held responsible for less than 50 percent.

20 After stranded costs are reasonably estimated and responsibility  
21 ascertained, utilities can be the beneficiaries of opportunities to mitigate stranded  
22 costs or incentives to improve operating efficiencies. Ratepayers should be the

1 beneficiaries of any reductions in the share of stranded costs allocated to them  
2 through securitization.

3

4 **B. TARGETED PROGRAMS**

5 Q. WHAT SPECIFIC PROGRAMS SHOULD BE ADOPTED TO ENSURE  
6 THE AFFORDABILITY OF SERVICE FOR LOW INCOME HOUSEHOLDS?

7 A. Without losing sight of the affordability of service for all, it is appropriate  
8 to devote more detailed attention to targeted programs.

9 The Telecommunications Act of 1996 established a Federal State Joint  
10 Board to consider how to promote universal service. It recommended a very  
11 aggressive policy. It has proposed a major expansion of the lifeline and link up  
12 programs. The discount rate for low income households proposed by the Joint  
13 Board amounts to over 50 percent of the national average rate for basic service.

14 Similar programs to ensure the availability of service for specific groups  
15 should also receive significant attention in electricity. The preferred approach to  
16 low income programs is a percentage of income program (PIP) that targets an  
17 affordable limit that low income households should pay. These programs have  
18 proved difficult to implement, however. Instead, deep discounts for eligible  
19 households should be offered.

20 I believe that there must be a standard or basic service package developed  
21 which is covered by a PIP or deep discount program and made available to all who  
22 qualify. This standard package should provide for a reasonable level of

1 consumption and should not be “punitively” restrictive.

2 It is not possible to state a specific level of consumption for every  
3 household in the service territory. This would vary by the size of the household.  
4 It might also vary according to the status of the household. Households with older  
5 or disabled members might require higher levels of energy consumption to  
6 preserve their health. As a general frame of reference for determining the needs of  
7 typical households, we can start from the amount of electricity consumed by  
8 median income households of various types.

9 Defining the strain on the household budget can best be done with respect  
10 to expenditures. This leads to the percentage of income standard as the basis for  
11 determining affordability. The percentage of income devoted to a necessity by  
12 middle income households is a good starting point for determining what is  
13 affordable. Lower income households should not be required to spend more than  
14 that percentage of income.

15 The basic service package should be available to all consumers at a  
16 reasonable cost. The low income program involves a discount off of generally  
17 affordable rates, to reflect the fact that low income households are unable to afford  
18 services that non-low income households are able to afford. A discount program  
19 should strive to ensure that low income households devote no more of their  
20 income to electricity than average households.

21 Eligibility should follow the eligibility for the telecommunications lifeline  
22 program. The automatic enrollment approach which has been applied to

1 telecommunications in some states should be applied to the low income  
2 weatherization program. Any household enrolled for public assistance in the state  
3 should be automatically enrolled. Both the basic service package and the  
4 weatherization program should be included.

5

6 **C. PROVIDER OF LAST RESORT OBLIGATIONS**

7 **Q. WHAT SPECIFIC POLICIES SHOULD BE ADOPTED TO PROMOTE**  
8 **UNIVERSAL SERVICE?**

9 **A.** The obligation to serve has been a cornerstone of utility service and should  
10 remain so. Every consumer should have a provider who has the ultimate obligation  
11 to provide the basic necessity service. This would include the responsibility to  
12 maintain the facilities necessary to deliver electricity, as well as the actual purchase  
13 and delivery of electric service.

14 By default, the monopoly utility was the provider of last resort but the price  
15 paid may have been too high because of inefficient investment and preclusion of  
16 competition. Monopoly utilities have shielded inefficiencies and excess profits behind  
17 internal transfers made in the name of universal service and provider of last resort  
18 obligations.

19 The commitment to universal service should be maintained, but the approach  
20 to achieving it can change. Monopoly utilities have decided the cost of universal  
21 service through their internal investment decisions, but the line between what was  
22 done in the name of universal service and what was done in response to corporate

1 investment preferences was difficult to draw.

2

3 Q. WHAT POLICIES DO YOU RECOMMEND TO ENSURE THAT  
4 ELECTRIC SERVICE REMAINS UNIVERSAL?

5 A. There must be a provider of last resort designated for each area of the state.  
6 Public policy will simply not allow electricity service to be unavailable in an area.

7 The provider of last resort could be an incumbent utility (or part of it) or a  
8 new entrant. Whether or not distribution and transmission services become  
9 competitive, there must be an entity responsible for the maintenance of the facilities  
10 necessary to provide electricity service. At the outset, the incumbent utility will be  
11 responsible for distribution, transmission and generation. The incumbent may shed  
12 the obligation to ensure generation for every customer served by its transmission and  
13 distribution system, if the Commission certifies a new entity to be the provider of last  
14 resort. For the foreseeable future, it appears that distribution and transmission will  
15 remain monopoly services of a single entity.

16 The provider of last resort obligation may result in costs that are deemed  
17 unaffordable for specific customers or in specific areas of the state. The commission  
18 may designate such areas as "high cost" and eligible for support from a universal  
19 service fund. The provider of last resort would be allowed to receive support to  
20 cover the difference between the cost of service and the rates charged. To the extent  
21 that an area is a "high cost" area, there should be only one service provider allowed  
22 to draw funds from a subsidy pool to support service. It makes no sense from a

1 public policy or efficiency point of view to subsidize the existence of more than one  
2 supplier in a high cost area who is drawing a subsidy.

3

4 Q. HOW MUCH SHOULD THE PROVIDER OF LAST RESORT BE  
5 ALLOWED TO RECOVER FROM THE HIGH COST FUND?

6 A. The amount to be recovered from the fund to meet provider of last resort  
7 obligations should be no larger than the lesser of the difference between the  
8 benchmark costs and rates in effect in the area or any documented revenue shortfall  
9 in the aggregate. If the company is earning its authorized rate of return in the  
10 aggregate, it is not suffering any loss due to the obligation to serve that it bears. If  
11 the company is earning its allowed rate of return through the rates it charges the  
12 public and then the Commission allows it to draw additional funds from the universal  
13 service fund, for its provider of last resort obligations, the company will immediately  
14 be in a situation of excess earnings.

15 The provider of last resort must demonstrate the prudence of investments  
16 which it claims have been made to meet its provider of last resort obligations. The  
17 costs it claims to need subsidies must be prudently used and useful. The provider of  
18 last resort should not be allowed to earn a return on capital that is no longer used and  
19 useful.

20 All revenues associated with investments must be included in any calculation  
21 of specific revenue shortfalls. The eligible area must be defined to include reasonably  
22 contiguous or immediately adjacent areas with lower cost or higher revenues.

1           On a going forward basis, providers of last resort must not be allowed to  
2 enjoy a risk free investment that earns a risk premium. Being paid for costs from a  
3 "social obligation pool" removes those revenue streams from market risk. Rate of  
4 return earned on high cost fund investment should be lower than company wide rate  
5 of return.

6

7   **D. FUNDING UNIVERSAL SERVICE**

8

9   Q.   HOW DO YOU RECOMMEND PAYING FOR UNIVERSAL SERVICE?

10

11   A.   There should be one fund from which all of the programs which are intended  
12 to achieve universal service should draw. In addition, to the extent that there are  
13 costs associated with the transition to competition which would create impediments  
14 to achieving the goal of competition, these too should be paid for from this fund.

15           From the point of view of universal service, the fund would be the source of  
16 revenues for the following:

- 17           o   High cost areas  
18  
19           o   Life line for individuals  
20  
21           o   Any other programs that the Commission decides are  
22 necessary to ensure that all the citizens have access to  
23 electric service.  
24  
25           o   Unique costs resulting from the implementation of  
26 competition.  
27

1

2 Q. HOW WOULD THE UNIVERSAL SERVICE FUND BE COLLECTED?

3 A. The accomplishment of universal service is a social goal that serves all  
4 members of society, producers and consumers, therefore all should contribute.5 The lives of consumers are enhanced as a result of electricity consumption.  
6 Businesses in the state benefit too, since they are able to sell more goods and services,  
7 their employees are better off, and their productivity is higher as a result of the  
8 accomplishment of this goal.9 The producers of electricity also benefit from universal service, since it  
10 expands their market. This is especially true of new sources of electricity outside of  
11 the state, which are seeking new business opportunities as a result of the opening of  
12 the state market to competition. Therefore, all sources of electricity should contribute  
13 to universal service.14 All electricity produced in the state, delivered to the state or consumed within  
15 the state should contribute to the universal service fund on a competitively neutral  
16 basis. The most likely entity to collect and manage the fund would be an independent  
17 system operator (ISO). This entity is likely to be set up to maintain reliability and  
18 competitively neutral functioning of the network. With an independent system  
19 operator in place, it would be most efficient and effective for the ISO to assess all  
20 electricity suppliers at a uniform rate. Since the ISO has account of every KWH sold  
21 and is likely to have knowledge of all self-generation (as part of its obligation to  
22 ensure reliability), this would eliminate any possibility that anyone would escape the

1 charge.

2 Assessing suppliers also allows them to decide how to recover the universal  
3 service costs. Some might pass it through in the form of usage charges. Some might  
4 pass it through in the form of customer charges. Still others might not pass it through  
5 in an effort to gain market share. The above approach is the one that is emerging  
6 for telecommunications. By federal law, all telecommunications providers must  
7 contribute in a competitively neutral manner to the universal service fund. Neutral  
8 third parties are being established at the federal and state levels to administer the  
9 funds. All sources of revenue (intra and interstate) are being included in the  
10 calculation of the fund. A broad range of services are being supported by the fund.

11

12 Q. DO YOU THINK COGENERATORS SHOULD BE REQUIRED TO  
13 CONTRIBUTE TO UNIVERSAL SERVICE?

14 A. Yes, as a matter of principle, they should. They benefit from the achievement  
15 of universal service just as all others. Their needs are likely to be taken into account  
16 when the ISO plans for and seeks to maintain reliable operation of the system. Failing  
17 to impose an equal universal service obligation on this source of electricity will give  
18 it a competitive advantage.

19

20 Q. PLEASE SUMMARIZE YOUR PROPOSALS ON AFFORDABLE  
21 SERVICE AND THE ALLOCATION OF JOINT AND COMMON COSTS TO  
22 PROMOTE UNIVERSAL SERVICE.

1     A.     The analysis embodied in the above statement goes through a series of steps  
2     which can be generally summarized as follows (see Table 4).

- 3           1. It starts from the economic cost of production.
- 4           2. Joint and common costs are calculated..
- 5           3. Joint and common costs are allocated to non-residential classes based on  
6     economic and public policy considerations.
- 7           4. The residual is allocated to the residential class.
- 8           5. Recovery of these costs within the residential class is determined on the  
9     basis of economic and public policy considerations.
- 10          6. Stranded costs are calculated.
- 11          7. A determination about the recoverability of stranded costs is made.
- 12          8. If stranded cost recovery is allowed, stranded costs should first be  
13     apportioned between stockholders and ratepayers.
- 14          9. The ratepayer share of stranded costs should then be allocated between  
15     customer classes. We recommend total consumption as the starting point for this  
16     allocation. Total consumption can be justified on both economic and public policy  
17     grounds. The overwhelming majority of stranded assets are generation assets, which  
18     are directly related to consumption. Allocating stranded costs on the basis of  
19     consumption would also tend to allocate a lighter share to the residential class. Using  
20     consumption also enables policy makers to recover part of the burden of stranded  
21     costs from self-generators. Self generators should contribute to promoting affordable  
22     service for economic and public policy reasons. Their historic demand was one cause

1 of stranded costs. They are no less responsible than other customers. They benefit  
2 from the provision of universal service, as do all member of society. Cost causative  
3 analysis should be undertaken to establish the baseline for allocation. However, a  
4 higher proportion could be allocated to non-residential classes by multiplying non-  
5 residential consumption by a social policy factor.

6 10. The remaining stranded costs apportioned to ratepayers would be  
7 allocated to residential customers.

8 11. To minimize the recovery of these costs on basic service they could be  
9 recovered in an inverted fashion (recovering larger shares from residential customers  
10 with higher levels of consumption).

11 12. To further promote universal service, low income customers could be  
12 excused from the recovery of stranded costs.

1           **IV. A NEW APPROACH TO CONSUMER PROTECTION**

2

3    Q.    WHAT IS THE PURPOSE OF THIS CHAPTER?

4    A.    This Chapter describes the consumer protections policies, in additional to  
5    universal service, which are necessary to ensure a smooth transition to a competitive  
6    market.

7

8    **A. CONSUMER-ORIENTED POLICIES**

9

10   Q.    PLEASE DISCUSS THE NEEDS FOR CONSUMER EDUCATION.

11   A.    We must develop price and quality information that is understandable by and  
12   useful to residential ratepayers. We cannot expect the marketplace to do this for us.  
13   In telecommunications we have had over a decade of “so-called” competition and we  
14   still do not get good information from industry members. Instead, we have fairly  
15   elaborate and entirely inadequate “public interest” efforts to develop information. The  
16   Commission should require, as a matter of public policy, that such information be  
17   made available. One of the jobs of the advisory bodies should be to help develop the  
18   guidelines. Both the format and the content of the presentation of information should  
19   be subject to oversight.

20   I believe that there are four steps to conducting a successful consumer education  
21   campaign.

22           First, the Commission must encourage the development of materials to enable

1 consumers to make effective choices. Initially, consumers should be alerted to the  
2 fact that competition is coming. They must be made aware that new decisions are  
3 coming. Consumers must be provided information on price, quality and features that  
4 facilitate comparisons across providers.

5 Second, outreach efforts should be conducted. These should rely on general  
6 advertising as well as community-based efforts.

7 Third, the Commission should monitor the effects of education efforts.  
8 Surveys to assess the extent of consumer knowledge and the best means to improve  
9 areas of weakness should be conducted. Audits of company efforts should also be  
10 carried out.

11 Fourth, each provider should be required to prepare a plan for consumer  
12 education. The plan should cover materials, outreach and monitoring.

13

14 Q. WHAT UTILITY ASSURANCES DO YOU RECOMMEND?

15 A. Delivering electricity services under a competitive model on the supply-side  
16 does not change its fundamental demand-side characteristics. It is still a basic  
17 necessity, for which there are no substitutes. Electricity is still subject to strong public  
18 policy mandates for universal service. Therefore, the broad range of protections for  
19 utility services must be preserved. In addition to the programs discussed earlier with  
20 respect to ensuring affordability of service, utility protections essentially ensure the  
21 availability of service to all. We regulate the transaction between service providers  
22 and customers to ensure that they are not denied services, except for very good cause

1 and even then, not at times when the service is particularly vital. Specific policies in  
2 this area include

3 Application

4 Credit

5 Deposit

6 Disconnection

7 Collection

8 Dispute resolution

9 Partial payment

10

11 Q. PLEASE DESCRIBE THE NEED FOR POLICIES TO ENSURE FAIR  
12 MARKETING.

13 A. Marketing fairness involves protection against abuse of consumers and  
14 provision of reasonable opportunities to benefit from the introduction of competition  
15 into the industry. If the marketplace becomes fully competitive, these protections  
16 may no longer be necessary.

17 Giving customers the opportunity to make choices is only part of the problem.

18 Because these utility services are complex commodities for which consumers have not  
19 had to actively shop for a century or more, their ability to make informed choices is  
20 limited. Structures and institutions must be created to protect them in the transition  
21 to a competitive market and to ensure they have adequate information to make  
22 informed choices, once they gain the skills to do so.

1           **Privacy Protection:** Information about billing, payment history and  
2 consumption patterns must be under the control of the customer. To the extent that  
3 exchange of such information is necessary for efficient billing, it should be made  
4 available to the parties with whom the customer has contracted for service.

5           **Sales Practices:** Customers must be protected against abusive marketing  
6 practices. Regulations should explicitly outlaw slamming (changing service providers  
7 without the written permission of the customer) and other fraudulent or abusive  
8 marketing practices (unauthorized upgrade of services, pressure tactics, bait and  
9 switch tactics, negative options, etc.) Rules should be enacted on notification and  
10 language requirements. Standards for information included in marketing should be  
11 set. A cooling off period should be specified. There are a range of marketing  
12 practices which must be precluded.

13                   Slamming  
14                   False billing  
15                   Fraud in advertising or labeling  
16                   Unfair collection practices  
17                   Pressure tactics  
18                   Redlining

19           **Billing Practices:** Delivery of bills and billing information should be  
20 stipulated. This should include frequency of billing and notice, information and billing  
21 detail, format and language requirements

22           Policies to promote fair marketing and prevent fraud should be both reactive

1 and proactive. With the advice of the Task Force, the Board should develop  
2 *guidelines for marketing and advertising at the point of sale*. It should conduct studies  
3 to ascertain the state of marketing and sales practices. For example, an aggressive  
4 anti-slamming program should be conducted. This would include implementing  
5 procedures for preventing slamming (such as third party verification). At the same  
6 time, consumer protection agencies in the state should have the authority and  
7 resources to periodically obtain lists of customers from service providers and  
8 randomly sample those customers to ascertain whether they have the services and the  
9 service providers that they expected to have.

10

11 Q. PLEASE DISCUSS THE PRINCIPLE OF NON-DISCRIMINATION IN  
12 THE TRANSITION TO COMPETITION.

13 A. A fundamental principle that must be preserved as the electric utility industry  
14 is restructured is that all classes of customers should benefit from improvements due  
15 to structural changes in the industry. Electric industry restructuring should be done  
16 in a way that benefits all customer classes fairly and does not unduly disadvantage any  
17 customer class nor preserve any undue cross-class subsidy.

18 To ensure that all classes of customers benefit from restructuring, the  
19 Commission should ensure:

- 20 1) Relative fairness between customer classes. Large disparities in the  
21 quality or cost of service must be resisted.  
22  
23 2) Non-discrimination within customer classes. Similarly situated  
24 customers must be treated similarly.

1           3)     User pays principle. Entities or customer classes who cause costs to  
2                    be incurred (who use facilities) and obtain the associated benefits  
3                    should bear the corresponding cost burden.

4  
5           4)     Fair treatment of investors. Investors must be given an opportunity  
6                    to earn a return which is commensurate with the risk that they face.

7  
8           NARUC addressed this issue in its policy statement.

9  
10           All customer classes should have access to electricity suppliers and  
11           applicable laws and rules should require all electricity suppliers to  
12           compete fairly. Non-discriminatory availability of service, including  
13           ancillary services, back-up power and interconnection services, should  
14           be assured for all firm service customer classes.

15  
16  
17    Q.     HOW DO YOU PROPOSE TO BALANCE THE INTERESTS OF  
18           RATEPAYERS AND STOCKHOLDERS IN THE TREATMENT OF STRANDED  
19           COSTS?

20    A.     I have described this in the discussion of universal service.

21

22    Q.     PLEASE DISCUSS THE FACILITATION AND RESOLUTION OF  
23           DISPUTES?

24    A.     I have pointed out a number of factors which may reduce the willingness and  
25           ability of consumers to pursue disputes with telecommunications service providers,  
26           even though they have been wronged. Without effective dispute registering  
27           procedures, abusive practices are likely to persist because of the difficulty of pursuing  
28           post-purchase remedies. Therefore, it is important to provide support for the  
29           registering of complaints.

1           There are four steps in the complaint process -- intake, investigation,  
2 resolution, and redress.

3           Companies should be required to provide 800 number services and notification  
4 of dispute procedures. The lead state consumer protection agency should also have  
5 a centralized dispute handling service.

6           Policies to protect consumers from unfair or rapid loss of service during the  
7 adjudication process must be in place.

8

9    **B. SELLER-ORIENTED POLICIES**

10

11    Q.    PLEASE DISCUSS THE PRE-PURCHASE POLICIES THAT YOU  
12 RECOMMEND FOR SELLERS.

13    A.    In the transition to competition, it is important to require all sellers to be  
14 certified and licensed. This will ensure that they are subject to the consumer  
15 protection policies. It is a central step in ensuring that they adhere to reliability  
16 policies and consumer protection policies.

17           Licensing and certification should cover several broad areas. All companies  
18 should be required to demonstrate their technical, financial and managerial capabilities  
19 to provide the services for which they seek certification. Histories of prior complaints  
20 and problems should be made available. Bondings should be required to cover  
21 penalties for failure to meet reliability and marketing standards. Penalties should be  
22 known in advance.

1

2 Q. WHAT ARE THE ISSUES IN RELIABILITY?

3 A. For most Americans, electricity is reasonably priced and quite reliable. Over  
4 98 percent of all residences in America have electricity and their service is interrupted  
5 for significant periods of time less than once every year. One of the cornerstones of  
6 regulated utility services has been a policy to promote reliability. Public policy has  
7 sought to regulate service up to what is generally considered a high level of quality  
8 and residential and small commercial consumers have not been allowed to pay less for  
9 less reliable service. Interruptions or deteriorations of service are major events that  
10 trigger both public outcry and frequently regulatory review.

11 The introduction of competition into utility industries invariably raises quality  
12 concerns. Is the level of service mandated by the regulated monopoly situation simply  
13 too high (too expensive) to prevail in a competitive marketplace? Will consumers  
14 understand that they are paying less (more) for a lower (higher) quality of service?  
15 Will companies driven by profit maximizing behavior cut corners?

16 NARUC's recently adopted language on reliability and safety captures the  
17 fundamental public policy position.

18 The safety, reliability, quality, and sustainability of electric service  
19 should be maintained or improved in a restructured electric industry...  
20 Public policy should ensure the integrity of the electric grid and  
21 encourage prudent long-term resource planning, acquisition, and  
22 utilization.  
23

24 Q. WHAT IS THE BEST WAY TO ENSURE A HIGH LEVEL OF

1 RELIABILITY?

2 A. There are at least two crucial aspects to implement this policy.

3 First, minimum standards should be established and imposed on the  
4 marketplace. No one should be allowed to contract for or sell electricity without  
5 meeting these standards. The network is too integrated and too vulnerable to allow  
6 substandard transactions to take place.

7 Second, penalties for failing to meet quality standards should be severe.

8 Given the direction that most discussions of "restructuring" take, there will  
9 almost certainly be an independent system operator with the responsibility of  
10 maintaining the reliability of the electricity grid in a specific area. Current reliability  
11 functions of the local utility will be transferred to and/or split between several  
12 entities. An independent entity (an independent system operator or ISO) may run  
13 the regional and/or statewide network. Responsibility for the reliability of local  
14 distribution will reside in another entity.

15 Regardless of how responsibility is structured, each entity should have full  
16 legal authority to ensure that quality standards are met. Binding contracts that are  
17 fully secured (bonded) should be required. The independent system operator should  
18 be required to bind both parties (seller and purchaser) to any private transactions that  
19 use the public grid.

20 The simple notion of transferring responsibility for reliability to a new entity  
21 or asserting that the PSC will exercise its continuing authority over service quality in  
22 a complex deregulated market requires more careful consideration. What

1 functionalities will be subject to standards? How will the standards be set? How will  
2 they be enforced?

3 Even if private actions (complaints and lawsuits) are to be the primary  
4 mechanism for imposing quality performance on the network, customers will have to  
5 know to whom they should complain. We should have mechanisms to resolve  
6 problems before we end up in court. Service providers and the courts will have to  
7 know what the expectations are.

8 To the extent that there is a central entity vested with the responsibility of  
9 ensuring minimum standards of quality, that entity should have adequate authority,  
10 power and resources to accomplish its goal. It should articulate specific standards to  
11 be met and establish substantial penalties for failure before the fact. Therefore, public  
12 policy should clearly outline at least the following steps in ensuring the oversight over  
13 reliability:

14 The Commission should institute a process for making recommendations for  
15 standards. It should include input from all consumer and producer segments that  
16 would be affected by the standards.

17 The Commission should preserve the authority to license service  
18 providers.

19  
20 It should codify its policy on imposing penalties, so that all service  
21 providers are on notice about the consequences of failure to adhere to  
22 standards.

23  
24 The Commission must have adequate resources to conduct  
25 investigations.

26  
27 *System performance for former utility services should cover at least*

- 1 three major areas,
- 2
- 3 Normal operating performance --Technical operating
- 4 standards
- 5
- 6 Outage and repair -- catastrophic breakdown and
- 7 recovery standards
- 8
- 9 Business office performance (objective and
- 10 subjective).
- 11
- 12

13 Q. WHAT ACTIVE POLICIES TO ENSURE A COMPETITIVE MARKET  
14 SHOULD BE IMPLEMENTED?

15 A. There are two areas where the Commission and other state agencies must be  
16 active -- the creation and monitoring of competition.

17 The cornerstone of consumer protection is consumer sovereignty. The ability  
18 of consumers to exercise informed choices in the marketplace is considered essential  
19 to the efficient functioning of a market.

20 NARUC has offered the following observation on consumer  
21 sovereignty.  
22

23  
24 Customers should have the opportunity to make informed choices  
25 among electricity providers and services... The potential for  
26 competition to improve economic efficiency rests on having multiple  
27 service providers as well as informed consumers. Market  
28 development should be guided in a way that increases the role of  
29 competition among energy service providers and the role of choice for  
30 customers. Customers acting in their own self-interest, when  
31 presented with a variety of market choices, will tend to arrange their  
32 consumption to maximize their welfare, save costs and enhance their  
33 satisfaction.

34  
35 Large industrial customers are vigorous advocates of bilateral transactions --

1 individuals buying from other individuals by themselves. They have the resources to  
2 readily become informed consumers. There is serious question whether individual  
3 residential ratepayers will be able to purchase power on their own, or whether  
4 suppliers would be interested in selling to them because of the unappealing load  
5 characteristics of residential consumers and the high transaction costs of dealing with  
6 them. The Commission must actively promote competition for residential ratepayers.  
7 There is serious doubt about whether we can really create a level playing field for  
8 large industrial and small residential consumers, so that residential consumers have a  
9 realistic chance of getting the benefits of competition. In a restructured market, can  
10 individual consumers actually purchase power without being saddled with high costs  
11 of metering and expensive middlemen?

12         There must be institutions and mechanisms in place to ensure that residential  
13 ratepayers can purchase low cost power. The role of aggregators has been given  
14 considerable attention. Residential customers are the least likely to benefit from  
15 competition. They need a head start or large corporations and institutional users will  
16 gobble up the lower priced power. It will not be easy for a century old monopoly,  
17 with tight regional transmission markets and a tendency to be dominated by large  
18 firms, to become rapidly competitive to achieve the benefits of restructuring. There  
19 must be clear conditions to promote competition and to preserve regulation where  
20 competition does not become effective. Strict enforcement of anti-trust laws, non-  
21 discriminatory access to bottleneck facilities, and specific definitions of what  
22 constitutes competition must be put in place before deregulation takes place.

1           The Commission and other state agencies (perhaps the Attorney General) will  
2 inevitably have the task of ascertaining how competitive the marketplace is.  
3 Therefore, it should undertake an aggressive program of market monitoring. The  
4 areas covered should include prices, profits, quality, product development, market  
5 shares, entry and exit. Subject to the necessary proprietary guarantees, all market  
6 participants should be required to report these factors to the board so that it can  
7 develop a complete and current picture of the status of competition. A summary  
8 report should be prepared on an annual basis. Relevant market segments should be  
9 identified such as residential/small business basic and enhanced, large business basic  
10 and enhanced, etc.

11

12 Q.   HOW DO YOU PROPOSE TO PROMOTE COMPETITION FOR  
13 RESIDENTIAL RATEPAYERS?

14 A.   Each utility should run a year long pilot in which a variety of aggregation  
15 approaches for residential ratepayers should be actively promoted and assessed to  
16 ascertain whether residential ratepayers can have effective access to the competitive  
17 market in electricity. At the end of the trial, the Commission should determine if the  
18 approaches were in fact effective in achieving access to competitive providers of  
19 electricity for residential ratepayers.

20

21 Q.   WHAT ROLE SHOULD ENFORCEMENT PLAY?

22 A.   Each of the five policy areas outlined is intended to prevent or discipline

1 abusive practices without enforcement. This has not proven adequate in the  
2 telecommunications industry since divestiture. Enforcement has been continual in  
3 both the local and long distance markets. One of the problems is that penalties are not  
4 adequate. I would urge the Commission and the Task Force, to establish severe  
5 penalties for abusive practices. Losing a court case must result in more than a slap  
6 on the wrist, or abuses will persist.

7

8

9

10

11

1           **V. UNIVERSAL SERVICE AND CONSUMER PROTECTION**

2                                   **IN CHAPTER 28**

3

4    Q.     WHAT IS THE PURPOSE OF THIS CHAPTER?

5    A.     In this chapter I review AARP's recommendations in terms of the recently  
6    enacted changes in Chapter 28. Where the Commission has issued initial guidelines  
7    to implement the new law, I also consider how these relate to AARP  
8    recommendations.

9

10   Q.    DO YOU BELIEVE THAT YOUR AGGRESSIVE PROGRAM TO  
11   ENSURE UNIVERSAL SERVICE AND PROVIDE CONSUMER PROTECTION  
12   IS CONSISTENT WITH THE RECENTLY ENACTED RESTRUCTURING  
13   LEGISLATION?

14   A.    Yes. Both the general thrust of the legislation and the specific policies  
15   adopted in each of the areas I review is consistent with my proposal for more  
16   vigorous policy. I would encourage the Commission to support this policy, even  
17   though its tentative guidelines do not go far enough in a number of areas. Companies  
18   certainly have the right, under the law, to propose a specific restructuring plan like the  
19   one I recommend and the Commission could certainly approve such a plan. I believe  
20   that the spirit and letter of the law is more consistent with the aggressive program I  
21   have proposed than the one that has been put on the table by the company. The  
22   Commission's guidelines are just that, guidelines, and more aggressive approaches can

1 be proposed by the Companies.

2

3 A. GENERAL POLICY

4

5 Q. PLEASE EXPLAIN WHY THE GENERAL POLICY IN THE RECENTLY  
6 ENACTED LEGISLATION IS CONSISTENT WITH YOUR  
7 RECOMMENDATIONS.

8 A. I would point to four repeated themes in the law. First, the law reiterates and  
9 repeats its commitment to reliable, affordable service available on reasonable terms.

10 As long as safe and affordable transmission and distribution service is  
11 available at level of reliability that are currently enjoyed by the citizens  
12 and businesses of this commonwealth -- s.2802 (3).

13

14 Electric service is essential to the health and well-being of residents,  
15 to public safety and to orderly economic development; and electric  
16 service should be available to all customers on reasonable terms and  
17 conditions -- s.2802(9).

18

19 Second, while the traditional concepts of reasonable, reliable service at  
20 affordable rates provides the minimum standard that must not be violated as change  
21 is implemented, the goal is to improve the situation --

22 Rates for electricity in this commonwealth are on average higher than  
23 the national average, and significant differences exist among the rates  
24 of Pennsylvania electric utilities.

25 Competitive market forces are more effective than economic  
26 regulation in controlling the cost of generating electricity.

27 The cost of electricity is an important factor in decisions made by  
28 businesses concerning locating, expanding and retaining facilities in  
29 this Commonwealth.

30 This Commonwealth must begin the transition from regulation to  
31 greater competition in the electricity generation market to benefit all

1 classes of customers and to protect this Commonwealth's ability to  
2 compete in the national and international marketplace for industry and  
3 jobs (s.2802 (7)).  
4 Things are supposed to get better.

5 Third, the universal service policy enacted by the legislature establishes the  
6 current policies in the state as only a minimum.

7 The Commonwealth must, at a minimum, continue the protections,  
8 polices and services that now assist customers who are low income to  
9 afford electric service -- s.2802(10).

10  
11 The Commission and the companies could certainly propose more vigorous  
12 programs than the minimum. I suggest that the minimum is not sufficient to  
13 accomplish the purposes of the new law. When legislators state that this is the  
14 minimum that should be done, they clearly contemplate the fact that the regulators  
15 would find that more is necessary. The floor should not be assumed to also be the  
16 ceiling.

17 Fourth, the new law uses exactly the same language with respect to customer  
18 service and consumer protection.

19 Consumer Protections and Customer Service . -- The electric  
20 distribution company shall continue to provide customer service  
21 functions consistent with the regulations of the commission, including  
22 meter reading, complaint resolution and collections. Customer service  
23 shall, at a minimum, be maintained at the same level of quality under  
24 retail competition -- s.2807(d).

25  
26 Thus the purpose is to take the current situation and improve upon it,  
27 preserving all of the fundamental utility, universal service, and consumer protection  
28 principles that have been put in place in the past as a minimum. The benefits of  
29 restructuring are not only to be achieved in terms of price (since the law puts a cap

1 on current rates) but also in the quality of service including transactions in the market  
2 place. This becomes even more apparent when we review the policy adopted in each  
3 of the twelve specific areas I have identified for vigorous public policy.

4

5 **B. CONSUMER**

6 **1. UNIVERSAL SERVICE**

7 Q. PLEASE DESCRIBE THE NEW LAW'S UNIVERSAL SERVICE  
8 POLICY.

9 A. Although the law identifies low income households as a focal point of public  
10 policy ("at a minimum" preserving current policies), there is a broad commitment to  
11 affordability for all (as noted above) and availability for all.

12 Electric distribution companies should continue to be the provider of  
13 last resort in order to ensure the availability of universal electric  
14 service in this Commonwealth unless another provider of last resort  
15 is approved by the Commission -- s.2802(16)

16

17 The total charges of an electric distribution utility for services to any  
18 customer who purchases generation from that utility shall not exceed  
19 the total charges that have been approved by the Commission for such  
20 service as of the effective date of this chapter -- s.2804(4).

21

22 These two fundamental policy protections apply to all consumers. It is crucial  
23 in implementing policy not to allow the floor to become a ceiling or the ceiling to  
24 become a floor. I suggest that the ceiling the legislature placed on rates should not  
25 be considered a floor. The rate ceiling is the minimal protection against doing harm,  
26 but there is every hope and intention that the law would do good. Rates cannot go  
27 above current levels, they should come down.

1           The universal service policies identified in the law to be targeted at low  
2 income households are broad in scope, as is my proposal.

3           The purpose is to be promoted by continuing universal service and  
4 energy conservation policies, protections and services; and full  
5 recovery of such costs is to be permitted through a non-bypassable  
6 rate mechanism -- s.2802(17).

7  
8           “Universal Service and Energy Conservation.” Policies, protections  
9 and services that help low-income customers to maintain electric  
10 service. The term includes customer assistance programs; termination  
11 of service protection and policies and service that help low-income  
12 customers to reduce or manage energy consumption in a cost effective  
13 manner, such as the low income usage reduction programs,  
14 application of renewable resources and consumer education -- s.2803.

15  
16  
17   Q.       HOW DO YOU EVALUATE THE COMMISSION’S TENTATIVE  
18 ORDER ON UNIVERSAL SERVICE AND ENERGY CONSERVATION IN  
19 LIGHT OF YOUR READING OF THE LAW AND YOUR  
20 RECOMMENDATIONS?

21   A.       The tentative order essentially brings forward current policies as a minimum  
22 and seeks to make sure they are consistent with the new law (Pennsylvania Public  
23 Utility Commission, Tentative Order Re: Guidelines for Universal Service and Energy  
24 Conservation Programs Made Pursuant to 66 Pa. C.S. s.2803, s.2802(17), s.2804(8)  
25 and s.2804(9), Docket No. M-00960890 f 0010, April 25, 1997 (hereafter, Universal  
26 Service Tentative Order). It does not preclude moving beyond that minimum, as I  
27 believe the law contemplates and encourages. There are a few important points I  
28 would stress in recommending that companies propose, and the Commission approve,

1 more than the minimum.

2 Universal service policies should be a permanent feature of regulatory  
3 structure, not simply "multi-year." (Universal Service, Tentative Order, II. A.)

4 Clearly the structure of programs outlined by the Commission dealing with  
5 rates, provides a bedrock of support which is a "minimum" as outlined in II.C.1.  
6 There is a fundamental step that I recommend utilities take, which the Commission  
7 has not required, but certainly has not precluded. Eligibility criteria should be based  
8 only on income (Universal Service Tentative Order, II. B.). That is, each of the rate  
9 relief programs proposed by the company includes in its eligibility criteria a "special"  
10 circumstance beyond limited household income. The household must be payment  
11 troubled or have a special need. I propose a program, similar to that recently adopted  
12 for telecommunications at the federal level, which relies solely on income as a criteria.

13 I believe that a distressed payment program should stand side-by-side with the  
14 general discounts for low income households, not be superseded by it.

15 As required by the new law, funding should be provided in a competitively  
16 neutral way. As pointed out in my proposal, the benefits of universal service accrue  
17 to all citizens in Pennsylvania. Therefore, I believe that my recommended per kwh  
18 approach is consistent with the law and the Commission's order (Universal Service  
19 Tentative Order, II. F.).

20

21 Q. HOW WILL YOUR UNIVERSAL SERVICE PROGRAM FIT UNDER  
22 THE PRICE CAP?

1 A. If the funding is financed on a kwh basis, the cost will be relatively small. If  
2 the Commission adopts my recommendation on the sharing of the responsibility for  
3 stranded costs, there will be no problem with the price cap. Indeed, if the  
4 Commission requires the utility to bear even a small share of the responsibility of  
5 stranded costs, there would be more than adequate room under the price cap to fund  
6 the program.

7

## 8 2. EDUCATION

9 Q. WHAT ARE THE POLICIES ON CONSUMER EDUCATION IN THE  
10 STATUTE?

11 A. There is no clearer indication that the law recognized the need for proactive  
12 policies to help the public benefit from restructuring in the electric utility industry than  
13 the education policy it enacted.

14 Prior to the implementation of any restructuring plan under section  
15 2806, each electric distribution company, in conjunction with the  
16 Commission, shall implement a consumer education program  
17 informing customers of the changes in the electric utility industry. The  
18 program shall provide consumers with information necessary to help  
19 them make appropriate choices as to their electric service. The  
20 education program shall be subject to approval by the Commission --  
21 s.2807(d)(3).

22

23 I have outlined the aggressive program that I believe is necessary to  
24 accomplish this goal of the new law.

25

26 Q. WHAT HAS THE COMMISSION PROPOSED ON EDUCATION

1 EFFORTS?

2 A. The Commission has outlined the program for education in two areas. Very  
3 general observations about the full range of consumer protection issues I have  
4 identified are covered in Pennsylvania Public Utility Commission, Tentative Order Re:  
5 Guidelines for Maintaining Customer Service at the Same Level of Quality Pursuant  
6 to 66 Pa. C.S. s.2807, and Assuring Conformance with 52 Pa. Code Chapter 56  
7 Pursuant to 66 Pa. C.S. s.2809(E) and (F), Docket No. M-00960890 f 0011  
8 (hereafter, Consumer Protection Tentative Order). The Commission has certainly  
9 identified all of the areas in which policy is necessary. It has not specified the content  
10 of policy in most of these areas. Therefore, the proof is in the proposals that the  
11 companies put forward.

12 The Commission has also identified *certain* additional educational steps which  
13 should be taken with respect to low income households associated with their  
14 participation in lifeline programs Universal Service Tentative Order, II. C. 4). It  
15 covers both general questions (such as how to exercise choice) and specific low  
16 income issues (eligibility, etc.). It outlines some brief steps to help ensure effective  
17 functioning (outreach, etc.).

18

19 **3. UTILITY ASSURANCES**

20 Q. WHAT IS THE POLICY ON UTILITY ASSURANCES?

21 A. As previously noted, the law identifies the full range of utility protections  
22 currently in place as the minimum that should be done. The funding mechanism is

1 also generally specified.

2 The Commonwealth must, at a minimum, continue the protections,  
3 polices and services that now assist customers who are low income to  
4 afford electric service -- s.2802(10).

5  
6 The purpose is to be promoted by continuing universal service and  
7 energy conservation policies, protections and services; and full  
8 recovery of such costs is to be permitted through a non-bypassable  
9 rate mechanism -- s.2802(17).

10

11

12

13 Q. HOW HAS THE COMMISSION DEALT WITH THIS ISSUE?

14 A. It has brought forward current practices. It does not recommend changes in  
15 these policies at present. However, a fundamental problem will be to assure that these  
16 policies can continue to effectively be implemented with multiple suppliers of services  
17 (Consumer Protection Tentative Order, paras. 11-14).

18

19 **4. FAIR MARKETING**

20 Q. WHAT IS THE POLICY ON MARKETING?

21 A. The law calls for general consumer protections and identifies some of the  
22 specific areas that I mention.

23 Customer Billing. -- Subject to the right of an end-use customer to  
24 choose to receive separate bills from its electric generation supplier,  
25 the electric distribution company may be responsible for billing  
26 customers for all electric services consistent with the regulation of the  
27 Commission, regardless of the identity of the provider of those  
28 services -- s.2807(c).

29

30 (1) The Commission shall establish regulations to ensure that an  
31 electric distribution company does not change a customer's electricity  
32 supplier without direct oral confirmation from the customer of record

1 or written evidence of the customer's consent to a change of supplier.

2

3 (2) The Commission shall establish regulations to require each electric  
4 distribution company, electricity supplier, marketer, aggregator and  
5 broker to provide adequate and accurate customer information to  
6 enable customers to make informed choices regarding the purchase of  
7 all electricity services offered by that provider. Information shall be  
8 provided to consumers in an understandable format that enables  
9 consumers to compare prices and services on a uniform basis --  
10 s.2807(d).

11

12 Q. WHAT IS THE COMMISSION POLICY IN THIS AREA?

13 A. As I noted, the Commission has identified a number of areas of concern. It  
14 has not generally selected specific approaches to these consumer protection issues in  
15 (Consumer Protection Tentative Order, III.C. 3-8).

16

17 **5. NON-DISCRIMINATION**

18 Q. WHAT IS THE POLICY ON NON-DISCRIMINATION?

19 A. As previously noted, the law requires non-discrimination in the benefits  
20 provided across customer classes. It also prohibits discrimination, by fording negative  
21 results that unfairly burden one customer class.

22 The Commission shall require that restructuring of the electric utility  
23 industry be implemented in a manner that does not unreasonably  
24 discriminate against one customer class to the benefit of another --  
25 s.2804(7).

26

27 **6. DISPUTE HANDLING**

28 Q. WHAT IS THE POLICY ON DISPUTE HANDLING?

29 A. The law does not specifically deal with this issue. It falls under the general  
30 policy of preserving current consumer protections.

1 Q. WHAT POLICY HAS THE COMMISSION ADOPTED?

2 A. The Commission has outlined a dispute resolution process that generally is  
3 consistent with my recommendation -- requiring notification, exchange of information,  
4 etc. (Consumer Protection Tentative Order, III. C. 9).

5

6 **C. SELLER**

7 **7. STRANDED COSTS**

8 Q. WHAT IS THE POLICY ON STRANDED COSTS?

9 A. The law has essentially brought forward existing legal treatment of stranded  
10 costs.

11 The Commission is empowered under this chapter to determine the  
12 level of transition or stranded costs for each electric utility and to  
13 provide a mechanism, the competitive recovery charge, for recovery  
14 of an appropriate amount of such costs in accordance with the  
15 standards established in this chapter -- s.2802(15).

16  
17 "Transition or stranded costs." An electric utility's known and  
18 measurable net electric generation-related costs, determined on a net  
19 present value basis over the life of the asset or liability as part of its  
20 restructuring plan, which traditionally would be recoverable under a  
21 regulated environment but which may not be recoverable in a  
22 competitive electric generation market and which the Commission  
23 determines will remain following mitigation by the electric utility --  
24 s.2803.

25

26 Consistent with s.2808 (relating to competitive transition charge), the  
27 Commission has the power and duty to approve a competitive  
28 transition charge for the recovery of transition or stranded costs it  
29 determines to be just and reasonable to recover from ratepayers --  
30 s.2804(13).

31

32 The key policies here are to invoke traditional treatment of costs with specific

1 reference to just and reasonable. The traditional concept in Pennsylvania is a used and  
2 useful standard.

3 In dealing with the unique situation of evaluating stranded costs during a  
4 transition, the Commission is given leeway in dealing with mitigation efforts.

5 The Commission shall consider the extent to which the electric utility  
6 has undertaken efforts to mitigate generation-related transition or  
7 stranded costs by appropriate means in a manner that is reasonable  
8 under all of the circumstances, including consideration of whether  
9 mitigation has been commensurate with the magnitude of the electric  
10 utility's generation related transition or stranded costs. During the  
11 transition period, electric utilities shall have the duty to mitigate  
12 generation related transition or stranded costs to the extent practicable  
13 -- s.2808(c)(4)  
14  
15

16 Q. WHAT POSITION HAS THE COMMISSION TAKEN?

17 A. The Commission has not issued any specific decisions with respect to stranded  
18 costs. In the securitization proceeding it did not grant over two-thirds of PECO's  
19 request.  
20

## 21 8. LICENSING/CERTIFICATION

22 Q. WHAT IS THE POLICY ON LICENSING AND CERTIFICATION?

23 A. The Commission is granted broad authority on certification which is consistent  
24 with my recommendations.

25 Electric generation suppliers will be required to obtain licenses,  
26 demonstrate financial responsibility and comply with such  
27 requirements concerning service as the commission deems necessary  
28 for the protection of the public -- s.2802(14) (see also s.2806(3)).  
29  
30

1

2 **9. RELIABILITY**

3 Q. WHAT IS THE POLICY ON RELIABILITY?

4 A. As previously noted, the law requires the current level of reliability to at least  
5 be maintained. The reliability language is repeated several times in great detail.

6 Reliable electric service is of the utmost importance to the health,  
7 safety and welfare of the citizens of the Commonwealth. Electric  
8 industry restructuring should ensure the reliability of the  
9 interconnected electric system by maintaining the efficiency of the  
10 transmission and distribution system -- s.2802(12).

11

12 [T]he independent system operator or its functional equivalent should  
13 set, and the Commission shall set, through regulations, inspection,  
14 maintenance, repair and replacement standards and enforce those  
15 standards -- s.2802(20).

16

17 "Reliability." Includes adequacy and security. As used in this  
18 definition, "adequacy" means the provision of sufficient generation,  
19 transmission and distribution capacity so as to supply the aggregate  
20 electric power and energy requirements of consumers, taking into  
21 account scheduled and unscheduled outages of system facilities; and  
22 "security" means designing maintaining and operating a system so that  
23 it can handle emergencies safely while continuing to function --  
24 s.2803.

25

26

27 **11. COMPETITIVENESS**28 **a. Customer Choice**

29 Q. WHAT IS THE POLICY ON CUSTOMER CHOICE?

30 A. My particular focus is on residential customers. My recommendation to  
31 ensure that the pilot demonstrates that retail access for residential ratepayers will  
32 work is consistent with the authority given to the Commission.

1 Retail access pilot programs. -- As of the effective date of this  
2 chapter, the Commission has authority to order electric utilities to  
3 submit proposals for retail access pilot programs to begin April 1,  
4 1997. The Commission shall provide guidelines for retail access pilot  
5 programs by order.  
6

7 (1) In order to determine whether all customer classes can benefit  
8 from competitive markets, utilities shall tailor proposed retail access  
9 pilot programs to accommodate the specific geographic, demographic  
10 and socioeconomic characteristics of their customer base. Retail  
11 access pilot programs must include an equal opportunity for the  
12 broadest practical direct access by all customer classes to electric  
13 generation suppliers -- s.2806(G)  
14

15 At the extreme, under the law one can argue that until the Commission finds,  
16 as a result of the pilot, that retail access "benefits all classes of customers," it cannot  
17 allow the process to go forward. It can reject the restructuring plan and require  
18 another one be written. While I do not necessarily anticipate that the Commission will  
19 be forced to this extreme, I phrase it this way to underscore the importance of  
20 demonstrating the efficacy of the model to residential consumers.  
21

## 22 **b. Market Monitoring**

23 Q. WHAT IS THE POLICY ON MONITORING THE MARKET?

24 A. The law contains a vigorous program on market monitoring.

25 Monitoring Competitive Conditions. -- The Commission shall monitor  
26 the market for the supply and distribution of electricity to retail  
27 customers and take steps as set forth in this section to prevent anti-  
28 competitive or discriminatory conduct and the unlawful exercise of  
29 market power. s.2811(A)  
30  
31

## 32 **12. ENFORCEMENT**

1 Q. WHAT IS THE POLICY ON ENFORCEMENT?

2 A. The law outlines a vigorous and coordinated enforcement strategy.

3 Referrals and Intervention -- If as a result of an investigation  
4 conducted under this section, the Commission has reason to believe  
5 that anti-competitive or discriminatory conduct, including the unlawful  
6 exercise of market power is preventing the retail electricity customers  
7 of this Commonwealth from obtaining the benefits of a properly  
8 functioning and workable competitive retail electricity market, the  
9 Commission, pursuant to its regulations, shall:

10

11 (1) refer its findings to the Attorney General, the United States  
12 Department of Justice, the Securities and Exchange Commission or  
13 the Federal Energy Regulatory Commission -- s.2811(D).

1 **VI. EVALUATION OF THE PECO RESTRUCTURING PROPOSAL**

2

3 Q. WHAT IS THE PURPOSE OF THIS CHAPTER?

4 A. In this chapter I review the PECO restructuring proposal in light of AARP's  
5 recommendations for sound public policy in restructuring and the recently enacted  
6 statute.

7

8 Q. WHAT IS YOUR CONCLUSION ABOUT THE PECO PROPOSAL?

9 A. The PECO proposal is severely deficient in a number of major areas. I will  
10 focus on three broad areas. The first is stranded costs, which has a tremendous  
11 impact on the affordability for all customers and the fundamental benefits that the  
12 Consumer Choice Act sought to deliver to all ratepayers. The second is the low  
13 income proposal. The third involves several aspects of the consumer protection  
14 proposal.

15

16 **A. STRANDED COSTS**

17

18 Q. PLEASE DESCRIBE THE IMPORTANCE OF STRANDED COSTS IN  
19 THE PECO PROPOSAL.

20 A. The most fundamental flaw in the PECO proposal is its treatment of stranded  
21 costs. PECO has taken the rate cap in the law and assumed that it is a rate floor  
22 which can be used to guarantee full recovery of utility costs. In so doing, it robs

1 ratepayers of any benefits of the new Act. PECO has taken no responsibility for its  
2 massively above market, uneconomic costs. It has structured its rate proposal to  
3 virtually ensure that competitors will not be able to enter the market because the price  
4 it would allow to be paid for generation is extremely low. As a result, it destroys the  
5 fundamental goal of the legislation, which is to deliver benefits to all classes of  
6 ratepayers. Residential ratepayers cannot possibly benefit under PECO's proposal  
7 and will almost certainly suffer because a competitive market will never get going.

8         The most fundamental problem is the proposal to absolve utility management  
9 and stockholders from all responsibility for above market costs. Essentially, PECO  
10 has assumed that every penny of capital cost and expense for its uneconomic assets  
11 must be recovered first. After the utility is made whole, it then allows the market to  
12 start to operate.

13         The price that PECO's approach will allow for competitive generation is lower  
14 than the market clearing price it has assumed for the estimation of stranded costs. As  
15 a result, only competitors who can beat the most efficient price by 25 percent or  
16 more, could ever sell any electricity. At the same time, PECO, which is producing  
17 electricity at more than 100 percent above the economic cost of production, is  
18 recovering every penny of its uneconomic costs. This is a gross perversion of the  
19 spirit and letter of the law.

20

21 Q.       ISN'T IT TRUE THAT IF PECO ASSUMES A HIGHER PRICE FOR  
22 GENERATION AND FILLS IN WITH STRANDED COSTS, YOU END UP IN

1 THE SAME PLACE?

2 A. Yes and no.

3 Yes, if you assume that PECO should be allowed to just price up to the cap  
4 to make itself whole. But that is the wrong assumption.

5 No. Because if PECO assumes a higher price for generation, which is not  
6 guaranteed to it, and a lower charge for stranded costs, at least consumers have a  
7 realistic chance of finding a supplier who can beat the assumed cost of generation.

8 If the Commission is going to let the rate cap be used to shield the utility  
9 income against any market impacts, it should at least give consumers a fighting chance  
10 of realizing market benefits. The least it could do is choose the highest market  
11 clearing price it can to calculate stranded costs and to insist that price be used in the  
12 rate cap calculation. This would give the market a chance to develop and the  
13 consumer a chance to benefit from it. However, I do not believe the "make-whole"  
14 approach chosen by PECO should be allowed in any event.

15

16 Q. WHY DO YOU REJECT PECO'S INTERPRETATION OF THE  
17 OBLIGATION OF THE COMMISSION TO ALLOW MAKE-WHOLE  
18 STRANDED COST RECOVERY?

19 A. PECO's main witness on stranded costs, Mr. Sidak, has totally misinterpreted  
20 the nature of stranded costs and the implication of the statute for stranded cost  
21 recovery. Mr. Sidak asserts and assumes, incorrectly, that the stranding of costs is  
22 the result of a change in regulatory mechanisms. That simply is not the case.

1           The utility has traditionally and continuously been under the obligation to  
2 deliver electricity service that is economic. That obligation existed prior to any  
3 change in approach to regulation and continues to exist. Under the traditional  
4 obligation, PECO was failing miserably to deliver economically priced service. The  
5 considerations introduced by restructuring only make the uneconomic nature of  
6 PECO's delivery of electricity obvious and palpable, they do not create the  
7 fundamental failure on PECO's part.

8           Uneconomic costs were never recoverable under traditional regulation. They  
9 were always subject to disallowance. The fact that PECO has been recovering some  
10 of those costs for a period of time has never meant that all of those costs were  
11 recoverable forever. The fact that the Commission approved some rates over half a  
12 decade ago does not mean that those rates were not reviewable. The fact that the  
13 Commission (and the legislature) invokes competition as a more precise regulatory  
14 mechanism for determining what is economic, does not change or create the  
15 requirement that the utility provide economic service -- that obligation has always  
16 been at the heart of traditional regulation. The law notes that competition is just  
17 another mechanism for controlling costs (s.2802 (5)).

18           By improperly blaming current uneconomic costs on a "regulatory switch" Mr.  
19 Sidak has misrepresented the nature of traditional regulation. Regulation never  
20 indemnified utilities against the changes brought on by technological progress.  
21 Regulation never protected utilities from either supply-side or demand-side  
22 competition. A showing of prudence, even if there had been one, never guaranteed

1 recovery of costs. Just like companies in a competitive marketplace, a utility is  
2 required to continually review the efficiencies of its operation compared to those  
3 around it and in light of new and emerging technologies. Even utility witnesses  
4 recognize this fact.

5 In planning its existing generation, PECO's objective was to provide  
6 safe, reliable and economic service to its customers. (Testimony of  
7 Gregory A. Gucchi, p. 38).

8  
9

10 Q. WHY HAS PECO FAILED TO REDUCE COSTS TO ECONOMIC  
11 LEVELS?

12 A. The flaw in most utility analyses, and the flaw in Mr. Sidak's analysis, has been  
13 to assume that utilities had to be paid first. Utilities have asked the question, "after  
14 I am paid, how can I lower the cost of service?" The proper question that regulation  
15 imposes on utilities -- the question that the competitive marketplace imposes on all  
16 producers -- is simply "how can I lower the cost of service -- period?"

17 PECO should have been aggressively finding ways to reduce its costs,  
18 including the retirement and write-down of existing facilities which embodied  
19 inefficient technologies. For decades there have been off-the-shelf technologies with  
20 much lower costs than PECO management chose to incur. PECO cannot justify  
21 uneconomic costs with a claim that social obligations are the cause, when other  
22 approaches to accomplishing the same goal at a much lower price were available.  
23 PECO cannot claim that "the regulator made me do it." Regulation only required  
24 PECO to serve customers. It did not require PECO to do so at extremely high costs.

1 Quite the contrary, it required PECO to do so in the least cost fashion possible.  
2 Analysis of other entities shows that others were able to accomplish this goal at much  
3 lower costs.

4

5 Q. HOW SHOULD PECO'S CLAIMS TO COST RECOVERY BE  
6 EVALUATED?

7 A. Having established the fact that PECO only has a claim to recover the efficient  
8 costs of production and that the Commission has never been required to allow the  
9 recovery of uneconomic costs, we turn to the question of how to measure the  
10 economic costs of production. There are two relevant standards that should be  
11 considered.

12 One standard is the "most efficient producer standard." Under routine  
13 assumptions about competitive market behavior, this would be the market clearing  
14 price. In essence, we ask "at what price would competitive supply clear the market."  
15 This is a relevant consideration because competition would force producers to  
16 continuously evaluate and choose the most efficient technology. In a competitive  
17 market, if you get stuck with an inefficient technology, you suffer inadequate returns  
18 or losses until you lower your costs.

19 A second standard is the "most efficient utility standard." This standard  
20 recognizes that certain obligations were placed on utilities. While they might have  
21 been able to choose the most efficient plant for any specific decision about a specific  
22 increment of supply, they may also have been required to make decisions that were

1 not strictly least costs in the aggregate for policy reasons. For example, they might  
2 be required do things a competitive profit maximizer might not do, such as to have  
3 a larger reserve margin, a different resource mix, or a higher level of reliability.  
4 However, it is crucial not to confuse the fact that a utility was required to have more  
5 capacity with the fact that it paid too much for that capacity. The former is a policy  
6 obligation, the latter is a management mistake.

7 The divergence between the "most efficient producer standard" and the "most  
8 efficient utility standard," if there is any, will vary depending on policy and the nature  
9 of decision making. Both should be examined by the Commission to determine which  
10 costs to allow. Any divergence should be carefully analyzed by the Commission.

11

12 Q. HOW DOES PECO FARE BY THESE STANDARDS?

13 A. Poorly by either standard. Both the "most efficient producer" or "most  
14 efficient utility" standard indicate that PECO is producing electricity at grossly  
15 uneconomic costs. These would not be recovered from ratepayers under traditional  
16 forms of rate making and they should not be recovered in the transition to  
17 restructuring.

18 PECO's production costs, excluding regulatory assets, are over twice as high  
19 as the market clearing price.

20 Nearby utilities have achieved must lower production costs. For example, 100  
21 miles away, Baltimore Gas and Electric and Potomac Electric Power Company serve  
22 large metropolitan areas. PECO's generation costs are about 50 percent higher than

1 these company's costs. PECO's production costs are about 50 percent above the  
2 lowest cost producer in Pennsylvania. PECO's production costs are about 50 percent  
3 above the national average. PECO's production costs are about one-third higher than  
4 the state-wide average production cost for Pennsylvania, excluding PECO.

5 By any standard, PECO fails the test of providing economic service.

6

7 Q. HAS PECO BEEN BEARING THE CONSEQUENCES OF ITS  
8 INEFFICIENCIES?

9 A. Not a great deal. Although PECO has clearly failed to provide economic  
10 service, it has been earning almost full recovery of its capital and a healthy return on  
11 its capital. Since 1990, when the last base rate case was completed, PECO has  
12 enjoyed a return of and on capital of close to \$6 billion. If the current above market  
13 costs are any indication, consumers have been charged uneconomic costs of almost  
14 that magnitude.

15

16 Q. WASN'T PECO REQUIRED TO WRITE OFF PART OF ITS  
17 INVESTMENT?

18 A. Yes, but not nearly enough. Competitive sector companies frequently write  
19 off assets to bring their costs into line with efficient production. PECO's write-off  
20 was very small, less than five percent of its total assets and not nearly enough to bring  
21 costs down to efficient levels.

22

1 Q. WHAT IS THE MAGNITUDE OF UNECONOMIC COSTS SUBJECT TO  
2 DISALLOWANCE?

3 A. To estimate these uneconomic costs, in the current context we must separate  
4 out two categories. Given the legislative language on the recovery of regulatory  
5 assets and certain transition costs, these must be treated separately. PECO separates  
6 them out as I do below.

7 Attachment MNC-5 gives order of magnitude estimates of the potential  
8 disallowances (Appendix A provides supporting detail). In this analysis, I assume  
9 non-utility producers have no regulatory assets and add PECO's estimate to the  
10 market price of production. I assume other utilities have regulatory assets equal to  
11 PECO's.

12 Using any of the most efficient producer or utility standards, the disallowance  
13 would equal the entirety of PECO's claimed stranded generation costs. PECO  
14 claimed \$3.8 billion of stranded generation costs, the most efficient producer analysis  
15 indicates just about all of this is uneconomic compared to utilities. Even the non-  
16 PECO statewide average would indicate uneconomic costs of approximately two-  
17 thirds of the claimed stranded generation costs. PECO has simply not provided  
18 economic service compared to its fellow utilities.

19 It is interesting to note that even using a broad national standard -- the  
20 national average -- PECO's claimed stranded costs would all be uneconomic.

21 It is interesting to analyze the sources of these uneconomic costs. It is  
22 important to note that the market value that PECO has estimated for the output of its

1 facilities equals roughly the operating costs of those facilities. In competitive markets  
2 where producers are under stress (e.g. during a recession or a period of changing  
3 technology) operating costs become the floor below which they will not go. As long  
4 as output covers the variable costs of production and makes at least some  
5 contribution to fixed costs, it pays to keep producing. PECO's operating costs are  
6 actually close to the operating costs of other utilities.

7 Its capital charges are much higher. Return of and on capital contribute about  
8 equally to its uneconomic costs.

9

10 Q. IN YOUR ANALYSIS YOU ADD REGULATORY COSTS DIRECTLY  
11 INTO THE ESTIMATE OF THE COST OF PRODUCTION. DOES THAT MEAN  
12 YOU ACCEPT PECO'S ESTIMATE?

13 A. I have only accepted PECO's estimate of regulatory costs for purposes of the  
14 discussion and to simplify the discussion of generation costs. I am not agreeing or  
15 disagreeing with PECO's claims. I have not analyzed these in detail in this case.

16 However, there is one principle I believe the Commission should apply in  
17 evaluating PECO's claims, which seems to be in conflict with its approach. To the  
18 extent that regulatory assets involve interest free loans, all of the benefits of those  
19 loans should be returned to ratepayers. If the regulatory asset involves taxes or other  
20 charges that were collected from ratepayers, under the pretext that they would be paid  
21 to the government but they were not, it is the ratepayers who lost the use of those  
22 moneys in the first place. The utility should not be made worse off as a result of the

1 accounting treatment, but it should not profit from the use of ratepayer money.

2 I believe that the Commission should scrutinize PECO's claims for recovery  
3 of regulatory assets in this vein.

4

5 Q. WHAT DO YOU RECOMMEND?

6 A. AARP has taken the position that ratepayers should be held responsible for,  
7 at most, 50 percent of stranded costs. As discussed throughout my testimony,  
8 management must be responsible for their share of stranded costs where management  
9 discretion was exercised. It is consistent with the Pennsylvania law to hold ratepayers  
10 responsible for regulatory assets (over which management had no discretion), as long  
11 as the Commission applies the principle I mentioned earlier. AARP also recognizes  
12 that certain financial obligations are binding on utilities in terms of their debt. The  
13 Commission should take this into account as well.

14 In this case, a disallowance of the full value of stranded generation assets, as  
15 supported by the most efficient utility or producer analysis (\$3.8 billion or \$380  
16 million per year), would lower PECO's interest coverage to about 1.8. This is in the  
17 range where bond covenants begin to restrain the utility's ability to float new debt.  
18 Over time, however, the constraint would ease.

19 If the state-wide average is used, a disallowance of \$2.4 billion (\$240 million  
20 per year, would result in an interest coverage in the range of 2.3.

21 I believe that regulatory assets should be recovered, after they are scrutinized  
22 and that at least \$2.4 billion should be disallowed.

1 Q. HOW SHOULD STRANDED COSTS TO BE RECOVERED FROM  
2 RATEPAYERS BE ALLOCATED?

3 A. I have a concern that the method used to allocate stranded costs will place an  
4 unjustified burden on residential ratepayers. As my previous analysis shows, the  
5 problem arises because the stranded costs are associated with a specific type of asset  
6 and category of costs -- capital costs associated with base load generation facilities.  
7 The cost methodology allocates these costs to customer classes on the basis of  
8 contribution to peak load. In the case of PECO, it over allocates capital costs to the  
9 peak. Since the residential class consumes a much higher percentage of energy at the  
10 peak, they bear a disproportionate burden of capital costs.

11 Residential ratepayers will be placed at a disadvantage in the transition to  
12 competition. Residential ratepayers will be in the market for peak load power, while  
13 they bear a significant share of costs for base load power. They must pay the higher  
14 operating costs of peak load power, while they pay the capital costs of stranded  
15 generation plant.

16 Given the language of the law, I am not certain that the Commission can  
17 address this problem, but it should recognize the burden that has been placed on  
18 residential ratepayers. Because the recovery of stranded costs assigns these  
19 uneconomic costs disproportionately and permanently to the residential class, while  
20 the market opportunities to lower costs are likely to be better for base load power in  
21 the future, this methodology may have the effect of shifting costs onto the residential  
22 class. This is certainly something that the Commission should monitor as the

1 competitive market develops. If the combination of the allocation methodology and  
2 the development of market forces shifts costs onto residential ratepayers, the intent  
3 of the law would be frustrated.

4

5 **B. LIFELINE PROGRAMS**

6

7 Q. HOW DO YOU EVALUATE PECO'S LIFELINE PROGRAM?

8 A. I believe that it is inadequate in two areas -- eligibility for benefits and the  
9 funding mechanism.

10

11 Q. WHAT IS THE PROBLEM WITH ELIGIBILITY?

12 A. While PECO does the minimum required by the law, as previously noted, I  
13 believe that it should drop the requirement for bill payment problems for participation.  
14 All low income households should receive the discounts presently made available, if  
15 they are certified as eligible by the criteria I outlined.

16 Providing broad based eligibility will certainly reduce the burden on low  
17 income households. PECO's current benefit structure reflects ability to pay, so  
18 expanding the program will target benefits to those who need it most.

19 The analysis of lifeline programs in Pennsylvania shows that the discounted  
20 rates cover the variable cost of service and make a contribution to fixed costs. Thus,  
21 for the social and economic reasons I outlined earlier, I believe that eligibility should  
22 be broadened.

1 Q. WHAT IS THE PROBLEM WITH THE FUNDING MECHANISM?

2 A. PECO's proposal to raise universal service funds only from residential  
3 ratepayers is inconsistent with the law and the Commission's recommendation. As  
4 I have pointed out, all customer classes benefit from universal service. All should pay.  
5 I believe that consumption should be used as the base for raising funds.

6

7 C. CONSUMER PROTECTION

8

9 Q. WHAT IS THE PROBLEM WITH PECO'S CONSUMER PROTECTION  
10 PROPOSALS?

11 A. Basically they are undefined. PECO says it will do what the Commission  
12 orders in its final decision. It could have outlined a program of its own. Moreover,  
13 where it did offer some specifics, as with the "Code of Conduct," there is very little  
14 substance offered. In addition to my earlier recommendations, there are two areas  
15 of the PECO proposal that cause me concern -- supply-side safeguards and allocation  
16 of competitive opportunities.

17

18 Q. PLEASE EXPLAIN WHAT YOU MEAN BY SUPPLY-SIDE  
19 SAFEGUARDS?

20 A. By supply-side safeguards, I mean the rules and regulations which will govern  
21 the interaction between suppliers in the mixed competitive/monopoly environment.  
22 My earlier comments focused on the interaction between consumers and suppliers, but

1 I believe PECO's proposal organizing the supply-side of the market is inadequate.

2 I believe that the only way to prevent abuse of bottleneck facilities -- i.e. the  
3 remaining monopolies in transmission and distribution -- is to achieve divestiture. To  
4 the extent that this is not required or accomplished through voluntary means, I believe  
5 a substantial regulatory apparatus must be put in place. This apparatus must set the  
6 terms and conditions and oversee two sets of transactions, those

7 (1) between the incumbent monopoly subsidiaries and competitors

8 (2) between the incumbent monopoly subsidiaries and its generation affiliate.

9 Attachment MNC-6, which draws from the recently enacted  
10 telecommunications model, identifies the key elements in this regulatory apparatus.

11 I urge the Commission to insist that these protections be in place before competition  
12 opens.

13

14 Q. PLEASE DESCRIBE WHAT YOU MEAN BY THE ALLOCATION OF  
15 COMPETITIVE OPPORTUNITIES.

16 A. I am also concerned about the proposal to randomly assign residential  
17 customers for retail access. I believe that this will make it more difficult for marketers  
18 to attract residential business. They will not be able to advertise widely, since many  
19 consumers will not be able to choose them. The natural selection process, in which  
20 those who are most likely to want to try a new supplier will be short circuited. Many  
21 early adopters will be ineligible for choice since they would not be randomly selected.

22

1           PECO suggests that a random selection process is necessary to ensure  
2 fairness, predicated on the assumption that choice will be oversubscribed and it is not  
3 fair to allow those who are better-informed and more willing to act to get the benefits  
4 at the expense of the less informed and less willing. I fear the opposite with random  
5 assignment. Residential competition will be impeded.

6           Discrimination is a potential problem, but it should not be solved by  
7 undermining competition. The Commission should establish public policy requiring  
8 the offer of service to all potential subscribers in an area on non-discriminatory rates,  
9 terms and conditions and let consumers self-select into the market.

10

11   Q.     DOES THIS CONCLUDE YOUR TESTIMONY?

12   A.     Yes.

ATTACHMENT MNC- 1

FACTORS CREATING THE NEED FOR  
ADDITIONAL CONSUMER PROTECTION IN THE  
TRANSITION FROM UTILITY TO COMMODITY

PRE-PURCHASE

LOW ELASTICITY OF DEMAND  
UTILITY HISTORY  
HOMOGENEITY OF PRODUCT  
ABSENCE OF MARKETING  
LACK OF INCENTIVE TO SHOP  
MONTHLY BILL  
TIME CONSTRAINT  
INCUMBENCY ADVERTISING & ADVANTAGE

POINT-OF SALE

ELECTRONIC BILLED  
TIME CONSTRAINT  
LACK OF SUBSTITUTES  
LIMITED PRESENTATION OF INFORMATION  
BUNDLING OF FEATURES

POST-PURCHASE

LACK OF INCENTIVE TO COMPLAIN  
MONTHLY BILL  
LACK OF TRANSACTION RECORD  
UNCERTAINTY ABOUT REDRESS  
MULTIPLE RESPONSIBILITIES FOR SERVICE

ATTACHMENT MNC-2

AREAS OF CONSUMER PROTECTION IN THE TRANSITION  
FROM UTILITY TO COMMODITY

	<u>CONSUMER</u>	<u>SELLER</u>
<u>PRE- PURCHASE</u>	UNIVERSAL SVC EDUCATION	STRANDED COSTS LICENSING/CERTIFICATION RELIABILITY
<u>POINT- OF-SALE</u>	UTILITY SERVICE FAIR MARKETING NON-DISCRIMINATION	COMPETITIVENESS CUSTOMER CHOICE MARKET MONITORING
<u>POST- PURCHASE</u>	DISPUTE HANDLING	ENFORCEMENT

**ATTACHMENT MNC-3**  
**PUBLIC POLICIES TO PROMOTE UNIVERSAL SERVICE**  
**AND PROVIDE CONSUMER PROTECTION**  
**IN THE TRANSITION FROM UTILITY TO COMMODITY**

**BUYER: PRE-PURCHASE**

UNIVERSAL SERVICE  
    GENERAL POPULATION  
    PRINCIPLES FOR ALLOCATION  
        OF JOINT AND COMMON COSTS  
    LOW INCOME  
        DISCOUNT PROGRAMS  
        STANDARD OFFER SERVICE  
        UTILITY ASSURANCES  
    PROVIDER OF LAST RESORT/HIGH COST AREAS  
        DESIGNATION  
        HIGH COST FUNDS  
            PARTICIPATION  
            SUBSIDY CALCULATION  
    UNIVERSAL SERVICE FUND  
        COLLECTION  
        DISTRIBUTION

EDUCATION  
    MATERIALS  
        DECISION MAKING  
        COMPARISONS  
            PRICE  
            QUALITY  
            FEATURES

    PLANNING  
    OUTREACH  
    MONITORING

**BUYER: POINT OF SALE**

UTILITY CONSUMER PROTECTIONS  
APPLICATION FOR SERVICE  
CREDIT  
DEPOSIT  
DISCONNECTION  
COLLECTION  
DISPUTE RESOLUTION  
PARTIAL PAYMENT

MARKETING PROTECTIONS  
FAIR MARKETING  
ABUSIVE MARKETING PRACTICES.  
SLAMMING  
UNAUTHORIZED UPGRADE OF SERVICES  
PRESSURE TACTICS  
BAIT AND SWITCH TACTICS  
NEGATIVE OPTIONS  
BILLING PRACTICES  
DELIVERY OF BILLS  
BILLING INFORMATION  
BILL FORMATS  
LANGUAGE REQUIREMENTS  
NON-DISCRIMINATION  
PRIVACY  
BILLING  
PAYMENT HISTORY  
USAGE

**BUYER: POST-PURCHASE**

DISPUTE HANDLING  
INTAKE  
INVESTIGATION  
RESOLUTION  
REDRESS

**SELLER: PRE-PURCHASE**

STRANDED COST RECOVERY

LICENSING AND CERTIFICATION

TECHNICAL, FINANCIAL AND MANAGERIAL CAPABILITIES  
HISTORIES OF PRIOR COMPLAINTS AND PROBLEMS  
BONDING FOR RELIABILITY AND MARKETING  
PENALTIES KNOWN IN ADVANCE

RELIABILITY

STANDARDS

NORMAL OPERATIONS  
OUTAGE  
BUSINESS OFFICE

PENALTIES

REVIEW OF PERFORMANCE  
ENFORCEMENT PROGRAM  
SPECIFICATION OF PENALTIES

**SELLER: POINT-OF-SALE**

MARKET STRUCTURE

VERTICAL MARKET POWER  
HORIZONTAL MARKET POWER

COMPETITIVE OPPORTUNITIES

PREFERENCE  
AGGREGATION

MARKET MONITORING

DEFINE MARKETS  
GEOGRAPHIC  
PRODUCT

MEASURE MARKET COMPETITIVENESS  
STRUCTURE

MARKET SHARES  
ENTRY AND EXIT

CONDUCT

COMPLAINTS, DISPUTES  
DISCRIMINATION, REDLINING

PERFORMANCE

PRICES  
PROFITS  
QUALITY  
PRODUCT DEVELOPMENT

**SELLER: POST-PURCHASE**

ENFORCEMENT  
ADEQUATE RESOURCES  
MEANINGFUL PENALTIES

**ATTACHMENT MNC-4****USING UNIVERSAL SERVICE POLICY TO DETERMINE THE  
RECOVERY OF JOINT AND COMMON AND STRANDED COSTS  
AND PRESERVE AFFORDABILITY**

1. Calculate Economic Costs of Production

**JOINT AND COMMON COSTS ALLOCATION**

2. Estimate Joint and Common Costs
3. Allocate Stranded Costs to Non-residential  
-->  $(Kwh + ?)/Kwh$  to Non-residential
4. Allocate Residual to Residential  
-->  $(Kwh - ?)/Kwh$  to Residential
5. Recover joint and common costs from residential ratepayers

**STRANDED COST ALLOCATION**

6. Estimate Stranded Costs
7. Decide on Recoverability of Stranded Cost
8. Apportionment Between Stockholders and Ratepayers  
--> 50 % to Stockholders  
--> 50 % to Ratepayers
9. Allocate Stranded Costs to Non-residential  
-->  $(Baseload\ Kwh + ?)/Baseload\ Kwh$  to Non-residential
10. Allocate Residual to Residential  
-->  $(Baseload\ Kwh - ?)/Baseload\ Kwh$  to Residential
11. Minimize Impact on Basic Service to Assure Affordability  
--> Inverted Charges
12. Promote Universal Service for Targeted Groups  
--> Exempt Low Income from Stranded Cost Recovery

**ATTACHMENT MNC-5**  
**ESTIMATES OF PECO'S UNECONOMIC GENERATION COSTS**

(STRANDED COSTS EXCLUDING REGULATORY ASSETS) <sup>a/</sup>

STANDARD	<sup>b/</sup> COST (in \$/kwh)	<sup>c/</sup> TOTAL (in million \$)	ANNUALIZED (in million \$)
MOST EFFICIENT PRODUCER	.028	4071	407
MOST EFFICIENT UTILITY			
IN STATE	.025	3635	364
NEIGHBORING STATE	.027	3925	393
AVERAGES			
NATIONAL	.026	3780	378
STATE-WIDE	.017	2472	247

<sup>a/</sup> Assumes that (1) the market clearing price calculated by PECO does not include regulatory assets (since non-utilities do not have such assets) and (2) utilities have equal amounts of regulatory assets. Per PECO's analysis, regulatory assets are assumed to be equal to \$2.98 billion or \$0.0188/kwh levelized over 10 years.

<sup>b/</sup> Costs for 1995 derived from Appendix A.

<sup>c/</sup> Uses PECO's estimate of total stranded costs (\$6.8 billion or \$0.0468 per kwh) levelized as the base.

**ATTACHMENT MNC-6**

**CONDITIONS FOR INTERCOMPANY TRANSACTIONS**

**ASSURING NON-DISCRIMINATORY DEALINGS WITH COMPETITORS**

RATES, TERMS, AND CONDITIONS  
TARRIFS IN PLACE  
COST-BASED RATES

PERFORMANCE STANDARDS  
EQUAL FOR ALL  
EXCLUSIONS

FULLY LOADED FUNCTIONING  
TESTS/PILOTS  
INTERNAL  
INTER-COMPANY  
AUTOMATED INTERFACES  
EFFECTIVE FUNCTIONING  
TIMING FOR  
ORDER  
PROVISION  
MAINTENANCE  
QUALITY/RELIABILITY

**AFFILIATE SAFEGUARDS**

STRUCTURAL SEPARATION  
1) INDEPENDENT COMPANY  
2) ACCOUNTS  
3) OFFICERS, ETC.  
4) NON-RECOURSE IN FINANCE  
5) ARMS LENGTH TRANSACTIONS

NON-DISCRIMINATION  
1) PROCUREMENT OR PROVISION OF  
GOODS, SERVICES, FACILITIES,  
AND INFORMATION  
2) ACCOUNTING PRINCIPLES  
3) COST ALLOCATION

PROHIBITION ON JOINT MARKETING

1) RULES FOR PRESENTATION OF ALTERNATIVES

COMMISSION AUTHORITIES AND INSTITUTIONS

MONITORING

ENFORCEMENT

APPENDIX A

The data used for the comparison between utilities was taken from the Department of Energy statistics because a uniform set of numbers across utilities was desired. The first column reports the number from the DOE publication. The second column converts these numbers to a per kwh number by dividing by the total number of kwh sold. No allocation to customer classes was undertaken.

The third column for each utility allocates the capital charges plus net income to the major categories of production cost -- steam, nuclear, other transmission, and distribution (including customer). Capital costs are allocated in proportion to the plant listed at the bottom of the table. The fourth column converts these total costs to kwh costs by dividing by the total number of kwh sold.

The same methodology is applied to each of the utilities.

The Table shows the calculation for each of the comparisons contained within the text. It also shows the methodology applied to PECO's 1996 cost study. The results are quite close. The key point of methodological significance is the allocation of capital costs between generation and other functions. Based upon the plant investment, I have allocated 76 percent of capital costs (depreciation, amortization, taxes and net income) to generation. This is identical to the allocation of depreciation in the 1996 cost study.

CERTIFICATE OF SERVICE

ORIGINAL

I, Frederick C. Ochsenhirt, hereby certify that I have this day caused a true copy of the foregoing to be served upon the parties of record in Docket No. R-00973953 in accordance with the requirements of 52 Pa. Code Section 1.54 (relating to service by a participant), in the manner and upon the parties listed below.

Dated at Harrisburg, Pennsylvania, May 21, 1997.

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