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18 June 1997

MEM

Commonwealth of Pennsylvania
Pennsylvania Public Utility Commission
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JUN 18 1997

PA PUBLIC UTILITY COMMISSION
PROTHONOTARY'S OFFICE

Re: R-00973953
PECO Energy Company
Application for approval of a Restructuring Plan
and Consumer Education Program

To Whom It May Concern:

Please accept for filing the original and 3 copies of the testimony filed on behalf of the Department of the Navy in the above-captioned action. Please do not hesitate to contact the undersigned if there are any questions.

Respectfully submitted,

AUDREY VAN DYKE
(Associate Counsel, Litigation)
Naval Facilities Engineering Command
Acting as Attorney for
the Secretary of the Navy
(202) 685-1931

cc:(w/encl)
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19

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Department of Navy Statement No. 1

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JUN 18 1997

PA PUBLIC UTILITY COMMISSION
PROTHONOTARY'S OFFICE

BEFORE THE

PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

Direct Testimony Of

Ralph C. Smith

On Behalf of the Department of the Navy

June 1997

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JUN 25 1997

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FOLDER

Direct Testimony of Ralph C. Smith
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1 INTRODUCTION

2 Q. Please state your name and business address.

3 A. Ralph C. Smith, 15728 Farmington Road, Livonia, Michigan 48154.

4
5 Q. What is your occupation?

6 A. I am a certified public accountant and a senior regulatory utility consultant with the firm of Larkin &
7 Associates, a firm of certified public accountants and regulatory consultants.

8
9 Q. What is your educational background?

10 A. I received a Bachelor of Science degree in Business Administration (Accounting Major) with distinction
11 from the University of Michigan - Dearborn, in April 1979. I passed all parts of the C.P.A. examination
12 in my first sitting in 1979, received my CPA license in 1981, and received a certified financial planning
13 certificate in 1983. I also have a Master of Science in Taxation from Walsh College, 1981, and a law
14 degree (J.D.) cum laude from Wayne State University. In addition, I have attended a variety of continuing
15 education courses in conjunction with maintaining my accountancy license. I am a licensed Certified
16 Public Accountant and attorney in the State of Michigan. I am a member of the Michigan Association of
17 Certified Public Accountants. I am also a member of the Michigan Bar Association and the American Bar
18 Association (ABA). In the ABA I am a member of the sections of Public Utility Law and Federal Income
19 Taxation.

20
21 Q. Please summarize your professional experience.

22 A. Subsequent to graduation from the University of Michigan, and after a short period of installing a
23 computerized accounting system for a Southfield, Michigan realty management firm, I accepted a position
24 as an auditor with the predecessor CPA firm to Larkin & Associates in July 1979. Before becoming
25 involved in utility regulation where the majority of my time for the past several years has been spent, I
26 performed audit, accounting, and tax work on a wide variety of businesses that were clients of the firm.

27
28 During my service in the regulatory section of our firm I have been involved in rate cases and other

1 regulatory matters concerning numerous electric, gas, telephone, water, and sewer utility companies. My
2 present work consists primarily of analyzing rate case filings of public utility companies before various
3 regulatory commissions, and, where appropriate, preparing testimony and schedules relating to the issues
4 for presentation before these regulatory agencies.

5
6 I have performed work in the field of utility regulation on behalf of industry, state attorney generals,
7 consumer groups, municipalities, and public service commission staffs concerning regulatory matters
8 before regulatory agencies in Alabama, Alaska, Arizona, California, Connecticut, Delaware, Florida,
9 Georgia, Hawaii, Kentucky, Louisiana, Maine, Michigan, Minnesota, Mississippi, Missouri, New Jersey,
10 New Mexico, New York, Nevada, North Dakota, Ohio, Pennsylvania, South Carolina, South Dakota,
11 Texas, Washington, and Canada as well as the Federal Energy Regulatory Commission and various state
12 and federal courts of law.

13
14 Q. Have you presented any training seminars on public utility accounting?

15 A. Yes, along with two other members of the firm I presented a one-day seminar on utility accounting for the
16 Legal Services Regional Utilities Task Force in Atlanta, Georgia. We also presented a two-day seminar
17 on utility accounting for the Utility and Rate Intervention Division of the Kentucky Attorney General.
18 Individuals from that division as well as industry and consumer groups attended the seminar. In
19 September 1988, we presented a two-day seminar on utility accounting for the Office of Consumer
20 Advocate, Attorney General's Office, State of Pennsylvania. Individuals from that Division as well as
21 Pennsylvania Commission Staff members attended. Additionally, with Hugh Larkin, I presented a one-
22 day seminar on the impact of the Tax Reform Act of 1986 on public utilities. This seminar was presented
23 to personnel of the Maine Public Advocate and Maine Public Utilities Commission Staff. In 1994, I
24 presented a training seminar to the Alaska Public Utilities Commission Staff on intrastate access charges,
25 with particular focus on auditing the annual intrastate access charge revenue requirements filed by Alaska
26 local exchange carriers.

27
28 Q. Have you addressed electric utility stranded cost issues in other regulatory proceedings?

1 A. Yes. I have been participating in the California CTC proceedings. I also addressed certain mitigation
2 efforts proposed by South Carolina Electric and Gas Company in a rate case before the South Carolina
3 Public Service Commission.

4
5 Q. Have you prepared an appendix listing your regulatory experience?

6 A. Yes. Appendix I, attached hereto, provides additional details concerning my experience and
7 qualifications.

8
9 Q. On whose behalf are you appearing?

10 A. My firm is under contract with the Navy Rate Intervention Office of the United States Department of the
11 Navy to perform utility revenue requirement studies. In this proceeding, I am testifying on behalf of the
12 Navy.

13
14 Q. Please describe the tasks you performed related to your testimony in this case.

15 A. Larkin & Associates reviewed the Electricity Generation Customer Choice And Electric Competition Act
16 (the "Electric Competition Act"), which added Sections 2801 through 2812 to the Public Utility Code.
17 Larkin & Associates reviewed PECO Energy Company's ("PECO" or "Company") Competitive Transition
18 Charge ("CTC") filing before the Pennsylvania Public Utility Commission ("PPUC" or "Commission")
19 and PECO's responses to data requests in this proceeding. I also reviewed other background material,
20 including the Statement of Commissioner John Hanger dated July 3, 1996 concerning the Investigation
21 into Electric Power Competition.

22
23 Q. Have you prepared exhibits to present in support of your testimony?

24 A. Yes. With regard to the testimony contained herein, I have prepared Exhibit ___ (RCS-1), consisting of 2
25 schedules and Attachments 1 through 3, which are attached to this testimony.

26
27 Q. Were these exhibits prepared by you or under your supervision?

28 A. Yes, and they are correct to the best of my knowledge and belief.

1 Q. Please describe the scope and purpose of your testimony.

2 A. My testimony addresses PECO's claim for stranded costs and CTC and adjustments to PECO's claimed
3 amounts. I address PECO's mitigation efforts and the need for additional mitigation to reduce PECO's
4 stranded cost claim and the CTC reflected in PECO's filing. I also address PECO's requested
5 depreciation reserve shift.

6

7 PRINCIPLES FOR REVIEW OF STRANDED COSTS

8 Q. Please summarize your understanding of the principles to be applied in determining the level of stranded
9 costs that PECO may recover through the CTC.

10 A. Section 2808(C) of the Pennsylvania Consolidated Statutes sets forth the principles to be applied by the
11 Commission in determining the level of stranded costs that an electric utility, such as PECO, may recover
12 through the CTC. The text of Section 2808(C) is presented in Exhibit ___ (RCS-1), Attachment 1, for
13 easy reference.

14

15 Q. Did the July 3, 1996 Statement of Commissioner Hanger also articulate principles for evaluating recovery
16 of stranded costs?

17 A. Yes. Commissioner Hanger's Statement articulated the following ten principles for determining the
18 recovery of stranded costs:

- 19 1) Utilities must mitigate stranded costs.
20 2) Stable, expeditious transition.
21 3) Recovery of stranded investment must not increase prices above current rates.
22 4) Only "net" stranded investment should be recoverable.
23 5) Different recovery levels for different types of stranded costs.
24 6) Stranded investment recovery must be conditioned on the availability of the asset.
25 7) Stranded investment recovery plans must not compromise operating safety.
26 8) No cost shifting.
27 9) Balance fairness among utilities.
28 10) Utilities and customers must cooperate.

29

30 Q. Do certain findings of other utility regulatory commissions also provide helpful guidance on the subject of
31 how to allocate transition costs between shareholders and ratepayers?

1 A. Yes. The discussion by the California Public Utilities Commission, in R.94-04-031 et al, is particularly
2 insightful and provides some direction that would also be applicable for the consideration of stranded
3 costs in Pennsylvania. The relevant excerpt of text from that decision is provided in Exhibit ___(RCS-1),
4 Attachment 2.

5
6 Q. Based upon your review to date, does PECO's application for CTC charges as filed conform with the CTC
7 review principles identified above?

8 A. Not completely. There are a number of problems. PECO's stranded cost mitigation efforts do not appear
9 to be "commensurate with the magnitude of the electric utility's generation-related transition or stranded
10 costs" as required by §2808(C)(4). Estimates reveal that PECO's stranded costs are very large compared
11 with most other Pennsylvania electric utilities¹; thus, PECO has a correspondingly greater responsibility to
12 mitigate. PECO has not demonstrated adequately that it has minimized new capital spending, as
13 required in §2808(C)(4)(II). PECO's filing does not reflect the maximization of market revenues, as
14 required in §2808(C)(4)(V). PECO's claim for CTC is premised upon the use of the lowest market prices
15 produced by the three studies it is presenting in this proceeding.

16
17 Q. Please discuss PECO's effort to mitigate its stranded costs by accelerating depreciation of existing rate
18 base generating assets.

19 A. PECO has requested and received Commission approval to accelerate depreciation of Limerick. While
20 this could be viewed as "mitigation" as suggested in §2808(C)(4)(I), it has resulted in PECO's existing
21 rates remaining high and, as Commissioner Hanger has noted, has allowed PECO to retain approximately
22 \$90 per year that would have otherwise resulted in a rate reduction.² Since PECO's ratepayers did not

¹PECO's filing reflects CTC charges of over 4 cents per kWh for most rate classes. (See Sudamier Exhibit WFS-3). The July 3, 1996 Statement of Commissioner Hanger concerning Electric Power Competition also contained various quantifications indicating that PECO had potentially greater stranded cost amounts than most other Pennsylvania electric utilities.

²See, Statement of Commissioner John Hanger dated February 22, 1996 in Docket No. P-00950982, provided for ease of reference as Attachment 3.

1 receive the approximately \$90 million per year rate reduction that would have been indicated in the
2 absence of this accelerated depreciation "mitigation" effort by PECO, the Commission should view this as
3 a contribution by PECO's ratepayers toward stranded costs, and not a contribution by PECO's
4 shareholders.

5
6 Q. Section 2808(C)(4)(VI) indicates that issuance of securitized debt pursuant to section 2812 is another
7 mitigation effort. Please describe your understanding of what PECO has done in this regard.

8 A. My understanding is that PECO filed for a Qualified Rate Order to issue such securitized debt, and
9 PECO's request was granted in part by the Commission in Docket No. R-00973877, which allowed PECO
10 to issue \$1.1 billion of such debt. PECO's instant filing does not reflect a reduction to PECO's stranded
11 cost or CTC claim associated with this mitigation effort; however, PECO has indicated that a reduction
12 would be forthcoming once the amounts were known and the transition bonds were issued. (See PECO
13 witness Cohn's testimony, at 45.) To the extent that PECO's securitized debt issuances actually reduce
14 CTC and do not cause existing rates to remain at unnecessarily high levels, I would view this as a
15 mitigation step on the Company's part that actually helps ratepayers.

16
17 PECO'S CLAIM FOR STRANDED COSTS

18 Q. Please discuss your review of PECO's claim for stranded costs and your findings.

19 A. I have divided my discussion of PECO's claim for stranded costs into the following segments of this
20 testimony that are organized by types of cost.

21
22 Q. Where you have either not proposed an adjustment to a particular cost and/or have not discussed a cost in
23 this testimony, should that lack of an adjustment and/or discussion be taken as an endorsement of the
24 related portions of PECO's restructuring filing?

25 A. No, it should not. There are a number of areas in PECO's filing which may be problematic that I do not
26 address or for which I do not make adjustments for in this testimony. Lack of an adjustment or discussion

1 of a particular issue, however, is not intended to represent an endorsement of the treatment proposed in
2 PECO's restructuring filing.

3
4 Net Investments in Existing Generating Plants and Facilities

5 Q. What amount is PECO claiming for net generating plant and CWIP?

6 A. Prior to offsetting a market valuation against its stranded cost claim, PECO's filing at Exhibit ABC-1,
7 Schedule 1, shows \$6.688 billion for net generating plant and CWIP. PECO's Exhibit ABC-1, Schedule 2
8 shows that this \$6.688 billion amount is comprised of \$10.437 billion of plant, offset by \$4.023 billion of
9 depreciation reserve, plus \$298 million of estimated CWIP at December 31, 1998.

10
11 Q. Do you have any concerns regarding PECO's claim for net generation plant assets?

12 A. Yes, I do. It appears that PECO's projected capital expenditures include amounts related to life
13 extensions and/or plant improvements beyond those necessary to maintain the plants in operational
14 condition through the CTC recovery period.

15
16 Q. What level of capital expenditures and plant additions did PECO utilize in calculating the December 31,
17 1998 balance of generation plant in service and CWIP?

18 A. On Exhibit ABC-1, Schedule 2, page 2, PECO provided its generation related CWIP balance as of
19 12/31/96, totaling \$382.61 million. To this amount, PECO added its projected 1997 and 1998 capital
20 expenditures of \$162.732 million and \$123.834 million, respectively, and subtracted its estimated 1997
21 and 1998 plant additions of \$213.097 million and \$157.724 million, respectively. These amounts resulted
22 in PECO's projected 1997 and 1998 generation plant capital additions of \$370.821 million and its
23 projected December 31, 1998 generation related CWIP balance of \$298.355 million. Combined, these
24 amounts cause a \$284.546 million (\$370.821 million capital additions, plus \$298.335 million 12/31/98
25 CWIP, less \$382.61 million 12/31/96 CWIP) increase in stranded generation plant (including both plant
26 in service and CWIP) between December 31, 1996 and December 31, 1998.

1 Q. How did PECO estimate its 1997 and 1998 capital expenditures and plant additions?

2 A. According to the direct testimony of John Doering, Jr., projections for 1997 fossil fuel station capital
3 expenditures were based on an ongoing base level of capital expenditures increased by one-fifth of the
4 typical capital costs associated with outages. The base level of capital expenditures were purportedly
5 based on a historical level which excluded outage related capital expenditures and one-time non-recurring
6 costs. The resulting amount of 1997 capital expenditures were then escalated for future years utilizing a
7 general inflation factor.

8

9 On page 7 of his testimony, Mr. Doering describes how the capital expenditures for PECO's nuclear
10 generating units were determined. The amounts were purportedly based on normalized capital
11 requirements as budgeted for 1997 with adjustments which removed certain one-time projects. These
12 resulting amounts were then escalated utilizing a general inflation factor. Additionally, the Salem nuclear
13 unit capital expenditures were estimated by PECO's nuclear group.

14

15 Q. Do you have any concerns regarding PECO's estimated additions to plant in service for 1997 and 1998 or
16 PECO's estimated December 31, 1998 CWIP balances included in the stranded cost calculations?

17 A. Yes, I do. First of all, PECO has consistently over-budgeted for capital expenditures. PECO's projected
18 1997 and 1998 capital expenditures also may be overstated. Secondly, it appears that PECO's projected
19 1997 and 1998 capital expenditures may include amounts related to life extensions and/or plant
20 improvements beyond those necessary to maintain the plants in operating condition through the CTC
21 recovery period. It would not be not fair or equitable to PECO's future competitors to allow PECO to
22 recover costs via the CTC which serve to either extend the life of the generating plants or better the plants
23 (i.e., cost reduction measures, efficiency improvements, etc.).

24

25 Q. Please discuss PECO's history of budgeting construction costs.

26 A. In response to OTS-RB-3(a), PECO provided its budgeted and actual construction costs by year for 1987
27 through 1996. The response is broken down into several categories, included in which are nuclear
28 production and fossil/hydro production. With only two exceptions, PECO's nuclear production

1 construction costs were considerably under-budget in each of the ten years provided. The only exceptions
2 were in 1990 when PECO was \$2 million, or 1.4%, over budget and in 1996 when PECO was \$55 million
3 over budget. During the same ten year period, PECO was under budget in fossil/hydro construction costs
4 in five of the ten years, met its budget in two of the years, and was over budget in three of the years.

5
6 Additionally, in response to OTS-RS-5(a), PECO provided the total budgeted and actual production
7 capital costs, both direct and overhead costs, for the same ten year period, 1987 through 1996. For total
8 production construction costs, PECO was under-budget in eight of the ten years provided in the response,
9 with 1991 and 1996 being the only years in which PECO was over budget on a total production basis. In
10 1991, PECO was only 3.03% over budget. In 1996, PECO was 32.28% over budget due entirely to
11 nuclear production construction costs.

12
13 Q. Have you provided a schedule showing a comparison of PECO's budgeted to actual production
14 construction costs?

15 A. Yes. I have provided Schedule 1, which provides a comparison of budgeted to actual production
16 construction costs for nuclear production, fossil/hydro production and total production for the ten year
17 period 1987 through 1996.

18
19 Q. What were the results of the comparison?

20 A. As shown on the schedule and discussed above, PECO has consistently over budgeted its production
21 construction costs over the last ten years. In fact, as shown on line 12 of the schedule, PECO's production
22 construction costs have been 5.0% under budget, on average, for the ten year period 1987 through 1996.

23
24 In 1996, the actual nuclear production construction costs were 50% over budget. This amount appears to
25 be an anomaly as it is out of line with the other years. Since the 1996 nuclear production data appears to
26 include special circumstances, I have also provided on Schedule 1, the nine year average (1987 through
27 1995) percentage that production construction costs were under budget of 7.28%. The Company's track
28 record in over-estimating production capital expenditures should be taken into consideration in

1 determining the level of projected 1997 and 1998 capital additions and the December 31, 1998 balance of
2 CWIP that should be added to plant in the stranded cost calculation.

3
4 Q. Please discuss your second concern with PECO's projected 1997 and 1998 plant additions and projected
5 December 31, 1998 CWIP balance.

6 A. It appears as though several of the generation related plant additions that PECO is projecting for 1997 and
7 1998 go beyond additions that are necessary to maintain the plant through the end of the CTC recovery
8 period. In other words, several of the projects may represent betterments to the generation plant, such as
9 life extensions, cost savings measures, and projects which may improve plant efficiency.

10
11 Q. Why is this a concern?

12 A. This is a concern because allowing automatic recovery of projected 1997 and 1998 capital expenditures
13 which serve to "better" PECO's generating facilities via inclusion in stranded cost and the CTC would
14 put PECO at an unfair advantage to its competitors. Any betterments or improvements to the generation
15 plants would serve to further benefit PECO's shareholders as such efforts will make the plants more
16 competitive after the CTC recovery period is complete and competition in the generation of power is in
17 full effect. It is not likely that PECO's potential competitors will be able to make substantial
18 improvements to their existing plant during the next two years and be able to rely on automatic recovery
19 of the associated capital costs from their customers prior to the implementation of competition.

20
21 Q. Are there other reasons this is a concern?

22 A. Yes, this issue was addressed in legislation, both here and in California. In the California proceedings,
23 the CTC is being recovered by utilities, for the most part, through December 31, 2001 with competition
24 being fully implemented after that date. On August 31, 1996, the California Legislature passed Assembly
25 Bill 1890, which specifically addressed generation plant costs, along with plant additions occurring prior
26 to and during the CTC recovery period, as follows:

27 The commission shall identify and determine those costs and categories of costs for
28 generation-related assets and obligations, consisting of generation facilities...that were being
29 collected in commission-approved rates on December 20, 1995 and that may become uneconomic

1 as a result of a competitive generation market, in that these costs may not be recoverable in
2 market prices in a competitive market, and appropriate costs incurred after December 20, 1995,
3 for capital additions to generating facilities existing as of December 20, 1995, that the
4 commission determines are reasonable and should be recovered, provided that these additions are
5 necessary to maintain the facility through December 31, 2001. (California public Utilities Code
6 Section 367, emphasis added)
7

8 As quoted above, the California Legislature clearly indicated that only those generation plant additions
9 that are necessary to maintain the facility through the CTC collection period, which ends when
10 competition is fully in effect, may be recovered through the CTC.

11
12 Similarly, the Pennsylvania Code section 2808(C)(4) provides:

13 "During the transition period, electric utilities shall have the duty to mitigate generation related
14 transition or stranded costs to the extent possible."
15

16 This section then provides examples of efforts which the utilities may undertake to mitigate the generation
17 related costs. Included as an example is: "Minimization of new capital spending for existing rate base
18 generation assets." (§2808(C)(4)(II)).

19
20 Q. Do you recommend that the Pennsylvania Public Utility Commission adopt a policy limiting capital
21 additions only to those projects necessary to maintain operations?

22 A. Yes, I do. PECO's projected capital expenditures for 1997 and 1998 to be included in the stranded cost
23 calculations should be limited to those expenditures that are necessary to maintain the generation plant
24 through the date that competition goes into effect. Any projects which result in betterments or
25 improvements to PECO's generation facilities should not be allowed for automatic recovery via the CTC.
26 An appropriate means of mitigating such generation related stranded costs would be to adopt my
27 recommendation limiting the capital expenditures allowed to be included in the stranded cost calculations
28 to those necessary to maintain the generation facilities.

29
30 Q. Have you calculated an adjustment to reflect the impact of your concerns on the projected 1997 and 1998
31 plant additions and December 31, 1998 CWIP balance included in PECO's stranded cost calculations?

32 A. No, I have not. I was unable to identify which of PECO's 1997 and 1998 capital additions (totaling

1 \$370.821 million) and December 31, 1998 CWIP balance (totaling \$298.355 million) for which the totals
2 are included in PECO Exhibit ABC-1, Schedule 2, page 2, pertain to capital expenditures necessary to
3 maintain the plant and which pertain to betterments or improvements. I do note that PAIEUG-IV-2(b)
4 and (c) asked the Company to segregate construction expenditures by project and all CWIP projects closed
5 to plant in service during 1997 and 1998 between betterments and replacements. The Company provided
6 a listing of projected 1997 and 1998 generation capital expenditures by project; however, it did not
7 indicate which of the projects were related to betterments and which were replacements. All that was
8 provided in the way of description was a brief project description which, for the most part, does not
9 identify if the project is an improvement or replacement. I do note though that several of the projects
10 include the words upgrade or improvements in their description.

11
12 Q. Would you please summarize your recommendation for capital additions balances to be included in the
13 stranded cost calculation?

14 A. I recommend that the 1997 and 1998 plant additions and December 31, 1998 CWIP balance included in
15 the stranded cost calculations on PECO Exhibit ABC-1 and Exhibit TPH-7 be limited to only those
16 projects that are necessary to maintain the generation facilities. All costs associated with betterments or
17 improvements to the facilities should be excluded. Additionally, PECO's tendency to over-budget for its
18 capital expenditures should also be considered in determining the amount of 1997 and 1998 capital
19 additions and 1998 CWIP to include in the stranded cost calculations. For example, an average
20 percentage that PECO's actual capital expenditures are under budget, such as the averages calculated in
21 Schedule 1, could be applied to the amount of capital additions and CWIP determined to be necessary to
22 maintain the generation facilities in order to adjust the level of plant in service and CWIP to be included
23 in the stranded cost calculations.

24
25 Q. Have you quantified an adjustment for net generation plant at this time?

26 A. Due to lack of data on the details of construction projects permitting classification between maintenance
27 and improvement, no. However, this should not be viewed as an endorsement of the plant amounts

1 reflected in PECO's filing.

2
3 Regulatory Assets and Deferred Charges

4 Q. What amount of stranded cost is PECO claiming for regulatory assets?

5 A. PECO's filing at Exhibit ABC-1, Schedule 1, shows \$2.589 billion for regulatory assets. PECO's Exhibit
6 ABC-1, Schedule 6, which is summarized below, shows that this claim is comprised of several items, the
7 largest being a \$1.687 billion SFAS No. 109 amount relating to income taxes:

8 Component of PECO's Claim:	Amount (\$000)
9 CC on 50% Limerick Common	\$175,812
10 Unamortized Loss on Reacq Debt	\$158,311
11 Nuclear Design Basis Document	\$28,852
12 PB/Lim Water Chemistry System	\$6,692
13 Limerick 1 Declaratory Order	\$18,301
14 Limerick 2 Declaratory Order	\$67,985
15 SFAS No. 106	\$100,580
16 SFAS No. 109	\$1,687,069
17 Compensated Absences	\$16,587
18 CC on 50% Comm PB/Sal/Eddy	\$17,400
19 Electric Fuel Deferral 1996	\$109,330
20 Additional Fuel Deferral	\$202,138
21 Total PECO Claim for Regulatory Assets	\$2,589,057
22	

23
24
25 SFAS No. 109, Deferred Tax Asset

26 Q. What amount has PECO requested as stranded cost for a deferred tax asset?

27 A. As noted above, PECO has requested a \$1.687 billion SFAS No. 109 amount relating to income taxes.

28
29 Q. Have you completed your review of this request by PECO?

30 A. Not at this time. This is obviously a very large amount and should be carefully scrutinized by the
31 Commission. I reserve judgment on this portion of PECO's claim, pending review of recently received
32 discovery and completion of my analysis.

1 Nuclear Design Basis Documentation

2 Q. Has PECO requested stranded cost recovery for Nuclear Design Basis Documentation?

3 A. Yes. PECO Exhibit ABC-1, Schedule 10, page 2, shows the Company's request for \$28.852 million of
4 stranded cost for Nuclear Design Basis Documentation (NDBD). PECO is requesting both a return of,
5 and a return on, that balance.

6
7 Q. Do you agree with this PECO request?

8 A. No. PECO's response to OTS-RE-8 indicates that the NDBD project was completed in 1992, the year
9 PECO sought FERC approval to move the costs from Account 183 to Account 182.2. PECO requested
10 FERC approval for recording the NDBD costs in Account 182.2, Unrecovered Plant and Regulatory Study
11 Costs, and to amortize the costs into Account 407, Amortization of Property Losses, Unrecovered Plant
12 and Regulatory Study Costs, over the remaining lives of the applicable assets. In its response to
13 OCA-XIII-6, PECO provided a copy of the FERC accounting approval, but states that copies of PECO's
14 requests to FERC were lost in a fire; consequently, PECO has not provided copies of its requests to FERC
15 for such accounting approval. FERC approved PECO's requested accounting, with the caveat that: "If
16 recovery of any portion of the deferred costs is disallowed in any rate proceeding, such amounts shall be
17 charged to Account 426.5, Other Deductions, in the year of disallowance." PECO never made a request to
18 the Pennsylvania Public Utility Commission to defer these costs, and these costs have not been included in
19 PECO's rates. Moreover, PECO's claim relates to prior period costs which were not authorized for
20 deferral by this Commission. As such, PECO's claim may be constitute retroactive ratemaking. In sum,
21 PECO's claim for stranded cost treatment of the NDBD is highly questionable and should be rejected.

22
23 Q. What is your recommendation?

24 A. The \$28.852 million for NDBD on PECO Exhibit ABC-1, Schedule 10, page 2, should be removed.
25 Ratepayers should not be required to pay PECO for a return of, much less a return on, such cost.

1 Limerick and Peach Bottom Chemistry Systems

2 Q. What amount of stranded cost has PECO requested for Limerick and Peach Bottom Water Chemistry
3 Systems?

4 A. PECO Exhibit ABC-1, Schedule 10, page 4, shows the Company's request for Limerick and Peach
5 Bottom Water Chemistry Systems. PECO has requested \$6.692 million, amortized over the seven year
6 CTC period.

7
8 Q. Has PECO described the status of these Water Chemistry Systems?

9 A. Yes. PECO's response to OTS-RE-8 indicates that the Peach Bottom system was completed in 1991,
10 however, it did not operate as planned and was put on hold in 1992. PECO indicates further that FERC-
11 approved amortization of this project started in 1994, and, in 1995, PECO made a decision to re-start the
12 project, which PECO expects to be in operation in the spring of 1997. PECO's response to OTS-RE-8
13 also states that it started the Limerick Water Chemistry System project in 1991 and suspended it in 1992.
14 When PECO re-started the Peach Bottom project, it also re-started the Limerick project and expects the
15 Limerick project to be in service by mid-1997.

16
17 Q. Did PECO provide a copy of its requests to FERC approval to defer and amortize water chemistry changes
18 and the FERC orders dealing with those requests?

19 A. No. OCA-XIII-6 requested such information. In its response, PECO did not provide them, but indicated
20 that the requested information was among files destroyed in a fire at PECO's long-term file storage
21 location.

22
23 Q. Do you agree with PECO's treatment of the Limerick and Peach Bottom Water Chemistry Systems
24 projects?

25 A. No. The cost of these projects has not been included in rates. PECO has been unable to provide its
26 requests to FERC or the FERC orders relating to approval of a deferred accounting treatment. PECO

1 apparently did not request approval from this Commission for deferral of such costs. It appears that
2 PECO's claim relates to prior period costs and may constitute retroactive ratemaking. Moreover, because
3 of the suspension and restarting of such projects, the cost amounts reflected by PECO may include costs
4 that would not be appropriate charges to ratepayers.

5
6 Q. What is your recommendation?

7 A. The \$6.692 million on PECO's Exhibit ABC-1, Schedule 10, page 4, for Limerick and Peach Bottom
8 Water Chemistry Systems projects should be removed.

9
10 Nonpension Postretirement Benefit Underfunding (SFAS 106) and Pension Overfunding

11 Q. What amount of stranded cost is PECO claiming for a regulatory asset it established for nonpension
12 postretirement benefits related to Statement of Financial Accounting Standards No. 106 (SFAS 106)?

13 A. PECO's filing at Exhibit ABC-1, Schedule 6, shows a \$114.947 million SFAS 106 regulatory asset as of
14 December 31, 1996, based upon multiplying \$218.927 million by a 52.5% allocation to generation based
15 upon a labor allocation factor. The \$218.927 million on Schedule 6, page 2, was derived by multiplying a
16 \$232.901 million balance (which ties into the amount on PECO's FERC Form 1) by 94%. PECO
17 subtracted 1997 and 1998 amortization at \$7.184 million per year, to arrive at its estimated balance at
18 December 31, 1998 of \$100.580 million. On PECO's Exhibit ABC-1, Schedule 10, page 4, the Company
19 is proposing to amortize this ratably over seven years, for an annual cost of \$14.369 million per year.

20
21 Q. Is PECO's pension plan significantly over-funded?

22 A. Yes, it is. According to the notes to PECO's financial statements and the Company's response to
23 PAIEUG-V-13, the fair value of pension assets exceed the pension obligation by \$300 million dollars. In
24 other words, PECO's pension plan is substantially overfunded.

25
26 Q. Has PECO reflected the over-funded status of its pension plan in its stranded cost request?

1 A. No. PECO has not reflected the offsetting impact on its stranded costs or CTC associated with the
2 overfunded status of its pension plan.

3
4 Q. Is it appropriate to consider the nonpension postretirement benefit under funding as a stranded cost
5 without also considering the over-funding of PECO's pension plan?

6 A. No, not in the context of determining PECO's stranded costs. The overfunding of PECO's pension plan
7 should be considered as a mitigating factor against PECO's requested stranded cost for nonpension
8 postretirement benefits.

9
10 Q. Are you recommending that the over-funded amount in PECO's pension plan be removed from the plan
11 and applied to PECO's nonpension postretirement liability?

12 A. No. There would be some detrimental tax consequences associated with shutting down PECO's pension
13 plan. Because of the tax costs, it may not be practical to actually remove the pension plan over-funding.
14 However, in view of the over-funded status of PECO's pension plan, I am recommending that the
15 Commission deny PECO's request for additional stranded cost associated with its underfunding of
16 nonpension postretirement benefits. These are both retirement plans, and PECO should not be permitted
17 to charge ratepayers a stranded cost for the under-funded status of one benefit (nonpension benefits)
18 without fully considering the mitigating impact of the over-funded status of its pension plan.

19
20 Q. What adjustment should be made to PECO's restructuring filing?

21 A. The \$100.580 million of SFAS No. 106 on PECO Schedule ABC-1, Schedule 10, page 4, should be
22 removed.

23
24 Compensated Absences

25 Q. Please discuss PECO's inclusion of compensated absences in the regulatory assets included in its stranded
26 cost calculation?

1 A. PECO has included a projected December 31, 1998 balance of \$16.587 million for generation related
2 compensated absences in the regulatory assets included in the stranded cost calculation. The amount is
3 based on the December 31, 1996 balance of \$18.43 million amortized by \$921,000 each year in 1997 and
4 1998, resulting in the projected December 31, 1998 balance of \$16.587 million.

5
6 Q. Does PECO account for compensated absences as a regulatory asset on its books?

7 A. No. Compensated absences are not recorded as a regulatory asset on PECO's books.

8
9 Q. How does PECO account for compensated absences in its books?

10 A. In response to OTS-RE-3, PECO provided the following description of its accounting practices for
11 compensated absences:

12 Currently, the Company accounts for Compensated Absences on the balance sheet, and,
13 therefore, no accruals or amortizations are required. To the extent unused vacation time or
14 banked sick time is used it would be included in operating and maintenance expense. The
15 Company, however, does not specifically track this expense.
16

17 Thus, when employees earn the compensated absences, the Company records a deferred asset with an
18 offsetting liability on its books. The compensated absences are charged to expense when the employees
19 actually utilize the compensated absences. During the period that the amount is expensed, the deferred
20 asset and liability would be reduced by the amount expensed.

21

22 Q. How did PECO determine the annual amortization of compensated absences projected to occur in 1997
23 and 1998?

24 A. The Company was asked this question in OTS-RE-5. PECO provided the following response:

25 The Company chose an amortization period of 20 years for compensated absences as it
26 is consistent with the 20 year period used for the amortization of the transition obligation
27 associated with post retirement benefits. Generally these amounts are paid out at retirement or
28 separation from the Company. Actual experience over the past several years was not used due to
29 the 1990 and 1994 retirement programs. The company believes that the effects of these programs
30 could cause recent data to be unrepresentative.
31

1 Q. Is PECO's inclusion of accrued compensated absences in the stranded cost calculation appropriate?
2 A. No, it is not. When describing the items includable in the competitive transition charge, Pennsylvania
3 Consolidated Statutes, Section 2808(C)(1) states that "The Commission shall allow recovery of regulatory
4 assets and other deferred charges typically recoverable under current regulatory practice." (Emphasis
5 added) Under current regulatory practice, the Company's revenue requirement would include the test
6 year or an annualized level of payroll expense, including compensated absences expense. The amount
7 included in rates would not be based on the amount of compensated absences recorded by the Company as
8 a deferred asset or liability, but rather on the amount of annualized payroll inclusive of paid vacations and
9 sick time.

10
11 Q. What is your recommendation?

12 A. I recommend that the purported regulatory asset for compensated absences presented by the Company on
13 Exhibit ABC-1, Schedule 6, totaling \$16.587 million, be removed from the stranded cost calculations.
14 The corresponding amounts on PECO Exhibit ABC-1, Schedule 10, page 4, should also be removed.

15
16 Nuclear Decommissioning Costs

17 Q. What amount of stranded cost is PECO claiming for nuclear decommissioning?

18 A. PECO's filing at Exhibit ABC-1, Schedule 1, shows \$236.9 million for nuclear decommissioning.
19 PECO's Exhibit ABC-1, Schedule 4, shows the amounts PECO is claiming for each unit, which total
20 \$254.7 million, and a deferred tax offset of \$17.8 million. These amounts net to PECO's claim of \$236.9
21 million at December 31, 1998.

22
23 Q. What contingency factor did PECO use in deriving its nuclear decommissioning expense claim?

24 A. PECO's Exhibit ABC-1, Schedule 4, page 2, shows that PECO used a 10% contingency factor to derive its
25 nuclear decommissioning expense claim.

26

1 Q. What amount of nuclear decommissioning is PECO attempting to include as sunk cost in the CTC
2 calculation each year?

3 A. Over the seven year CTC recovery period, PECO is attempting to include \$33.847 million of underfunded
4 nuclear decommissioning cost each year. PECO's Exhibit ABC-1, Schedule 10, page 4, column (a),
5 shows that this claim is based upon dividing the \$236.929 million by 7. This \$33.847 million of annual
6 nuclear decommissioning cost is in addition to the annual \$36.707 million nuclear decommissioning cost
7 that PECO has reflected in its "operating assumptions" for its nuclear generating units on Exhibits TPH-3
8 through 5. Thus, PECO's filing reflects approximately \$70.554 million per year for nuclear
9 decommissioning expense.

10
11 Q. How does that amount compare with PECO's expense in current rates?

12 A. It is over three times as high as PECO's current nuclear decommissioning expense. PECO's response to
13 PAIEUG-I-9 listed its nuclear decommissioning expense from 1992 through 1996. For 1992 through
14 1995, PECO recorded nuclear decommissioning expense of \$20.225 million annually. For 1996, PECO
15 recorded nuclear decommissioning expense of \$22.949 million. PECO's restructuring claim for nuclear
16 decommissioning is more than three times higher than its 1996 expense. ($\$70.554 \text{ million} / \22.949
17 $\text{million} = 3.07$)

18
19 Q. Other than the very large increase in nuclear decommissioning cost PECO is attempting to charge, are
20 there other aspects of PECO's nuclear decommissioning cost calculation that are questionable?

21 A. Yes. There are a number of aspects of PECO's calculation which are questionable and which serve to
22 increase the Company's calculated cost. PECO's prior calculations of nuclear decommissioning expense
23 used a 7.5% rate for fund earnings. The calculation PECO has presented in its restructuring filing,
24 however, reduced this to 6.5% based on an assumption made by PECO that all funds would be
25 nonqualified. PECO's response to OTS-RB-23 states that PECO's assumed lower 6.5% return is
26 primarily due to a higher tax rate on non-qualified funds. PECO's assumption of a lower fund earnings
27 rate produces a higher decommissioning cost, which PECO is attempting to charge to ratepayers in its

1 CTC calculations.

2
3 PECO's proposed method of collecting nuclear decommissioning through the CTC may also produce an
4 undesirable effect of losing the tax deductibility of its payments into the trust funds. This is another
5 aspect of PECO's proposal which would tend to increase the cost of nuclear decommissioning. PECO's
6 witness, Mr. Cohn, testifies that the Company's ongoing decommissioning expenses could become
7 nondeductible. At page 14 of his direct testimony, Mr. Cohn states:

8 ... the on-going accrual reflected in the market value, unless specifically ordered by the
9 Commission, will not be the subject of a cost of service rate order. In any event the on-going
10 accrual would not be deposited in the Company's trust fund until after the Company's nuclear
11 units are no longer in rate base. As a consequence, it's likely that these accruals (1) could not be
12 deducted when they are deposited in the Company's decommissioning trusts, and (2) earnings on
13 these amounts will be taxed at PECO's full corporate tax rate.
14

15 PECO's response to OTS-RB-25 indicates that the amounts collected for nuclear decommissioning
16 expense, net of income taxes, would be deposited by the Company into a non-qualified trust fund. Thus,
17 the amounts being deposited into the trust fund, under PECO's assumption, would be substantially less
18 than the amounts collected, due to PECO's subtraction of income taxes from such amounts. PECO's
19 response to PAIEUG-IV-5 explains that:

20 Since generation costs would no longer be regulated, there would not be a cost of service order
21 governing the decommissioning expense that must be recovered in the market price. Once such
22 costs are no longer included in a regulated cost of service, the annual expense is no longer tax
23 deductible, and only the net of tax amount is available to be placed in a fund. Additionally, the
24 funds would no longer be qualified trusts, and earnings would be taxed at the full corporate rate
25 for federal and state income tax purposes.
26

27 Q. Can PECO's proposed treatment of nuclear decommissioning cost be viewed as a cost mitigation
28 measure?

29 A. No. The result of PECO's proposal would be to triple the present annual level of nuclear
30 decommissioning expense. PECO's proposal would charge ratepayers for a much higher level of such
31 cost by stripping away the tax benefits associated with the present method of funding nuclear
32 decommissioning, which produces tax deductions for amounts deposited into qualified trust, and higher
33 earnings on the trust fund balances associated with a lower tax rate on qualified trust fund earnings.

- 1 Q. If the IRS permitted the tax benefits presently associated with nuclear decommissioning funding to
2 continue, what would PECO propose to do with the extra monies it would collect?
- 3 A. Absent the implementation of a special surcharge option referenced on page 16 of PECO Statement No. 3,
4 PECO would keep the extra money. PECO would not return the money to ratepayers. See PECO's
5 response to OTS-RB-26.
- 6
- 7 Q. Should PECO's proposed collection of nuclear decommissioning expense, as reflected in its restructuring
8 filing, be accepted?
- 9 A. No. I strongly urge the Commission to reject PECO's proposed collection of nuclear decommissioning
10 expense, as reflected in its restructuring filing. PECO's proposed nuclear decommissioning expense
11 claim is based upon questionable assumptions, would result in excessive costs to ratepayers, and could
12 represent a substantial windfall to PECO's shareholders since PECO proposes to keep any overcollections.
- 13
- 14 Q. Has PECO suggested an alternative approach for nuclear decommissioning that would not produce the
15 substantially increased costs to ratepayers associated with PECO's assumption that the loss of tax benefits
16 associated with the present method of nuclear decommissioning cost recover?
- 17 A. Yes. PECO witness Cohn has suggested that, if nuclear decommissioning expense remains with the
18 "wires" business, then it would be part of a cost of service order, which would preserve the tax benefits for
19 nuclear decommissioning expense funding. Another potential solution to the IRS and NRC issues
20 discussed by PECO witness Cohn with regard to nuclear decommissioning would be to recover
21 decommissioning costs through a CTC which remains in effect over the remaining lives of PECO's
22 nuclear plants.
- 23
- 24 Q. What adjustment is necessary to PECO's restructuring filing to reflect keeping nuclear decommissioning
25 expense with the "wires" business and reflecting collection over the remaining lives of PECO's nuclear
26 units?

1 A. At the time of this writing, I have not yet completed my review of recently received information on this
2 issue; however, it appears that the following adjustment to PECO's restructuring filing would need to be
3 made to reflect keeping the collection of nuclear decommissioning cost with the "wires" business.
4 PECO's request for \$33.847 million of annual "sunk cost" recovery on Exhibit ABC-1, Schedule 10, page
5 4, should be removed. Additionally, PECO's nuclear decommissioning expense amounts on page 5 of
6 Exhibits TPH-3, 4, and 5, which total \$36.707 million per year, should be removed.

7
8 The revenue requirement for PECO's "wires" business would need to reflect annual decommissioning cost
9 amounts that reflect a 7.5% earnings rate associated with the use of qualified trusts and tax-deductibility
10 for contributions into such trusts. PECO's response to OCA-III-23 indicates that since January 1996,
11 PECO has been contributing \$22 million per year into its nuclear decommissioning trust funds, which the
12 IRS has determined to be deductible. The information provided in PECO's response to PAIEUG-IV-6
13 suggests that the going-forward amount for nuclear decommissioning expense to be kept with PECO's
14 "wires" business would be approximately \$22.7 million per year, where it would remain subject to cost-of-
15 service regulation. This \$22.7 million annual amount of nuclear decommissioning expense shown in
16 PECO's response to PAIEUG-IV-6, which reflects an earnings rate of 7.5% and tax-deductibility of
17 funding payments, is similar to the \$22.949 nuclear decommissioning expense PECO recorded on its
18 books in 1996. Because these amounts are similar, there would not be a need for a rate increase
19 associated with PECO's nuclear decommissioning.

20
21 Q. Does PECO's filing also have a balance of accumulated deferred income taxes (ADIT) associated with its
22 nuclear decommissioning funding?

23 A. Yes. PECO Exhibit ABC-1, Schedule 4, page 1, shows an ADIT balance of \$17.775 million as of
24 December 31, 1998 associated with nuclear decommissioning.

25
26 Q. Should the ADIT balance associated with nuclear decommissioning follow the ratemaking treatment of
27 the nuclear decommissioning expense?

1 A. Yes. Consistent with my recommendation to retain nuclear decommissioning expense with PECO's
2 "wires" business, any ADIT balance associated with nuclear commissioning should also be retained with
3 the wires business. The ADIT balance shown by PECO for nuclear decommissioning is a credit balance,
4 which means that it would reduce rate base for PECO's wires business.

5
6 Q. Instead of keeping the collection of nuclear decommissioning expense with PECO's wires business, would
7 collecting it through a CTC over the remaining lives of PECO's nuclear generating plants also be a
8 preferable alternative to the proposed treatment presented in PECO's restructuring filing?

9 A. Yes. I briefly touched upon this earlier in my testimony. One fundamental flaw with the proposed
10 treatment of nuclear decommissioning cost presented in PECO's restructuring filing is that PECO
11 increases the cost substantially and unnecessarily by eliminating the tax benefits associated with funding
12 nuclear decommissioning cost in qualified trusts. PECO's proposed treatment would produce
13 unnecessarily increased cost to ratepayers in two respects. First, it increases cost because it assumes that
14 funding amounts are no longer tax deductible. Second, it increases cost by assuming that fund earnings
15 would be taxed at a higher rate (i.e., would produce lower after-tax earnings) because the funding
16 payments would be placed in non-qualified trusts. PECO's response to OCA-III-22 states that recovery of
17 decommissioning costs over the remaining life of the units through a CTC or similar mechanism would be
18 a potential solution to the IRS and NRC issues discussed in Mr. Cohn's testimony, provided the CTC
19 could be increased for material increases in decommissioning expense, should they occur. In my opinion,
20 this would represent a reasonable alternative to the unacceptable proposal reflected in PECO's
21 restructuring filing. I would qualify the provision asserted by PECO in its response to OCA-III-22,
22 however, and provide that the nuclear decommissioning CTC could be adjusted for material changes
23 (increases or decreases) in decommissioning expense, should they occur.

24
25 Q. If the Commission accepts this alternative, how would the recommended adjustment you previously
26 described be affected?

27 A. The approximately \$22 million of nuclear decommissioning expense, instead of remaining with PECO's

1 "wires" business, would provide the basis for a nuclear decommissioning CTC, which would be collected
2 over the remaining lives of PECO's nuclear plants. PECO's request for \$33.847 million of annual "sunk
3 cost" recovery on Exhibit ABC-1, Schedule 10, page 4, would be removed from the stranded cost CTC
4 calculation, as would PECO's nuclear decommissioning expense amounts on page 5 of Exhibits TPH-3, 4,
5 and 5, which total \$36.707 million per year.

6
7 Estimated Fossil Plant Decommissioning Expense

8 Q. What amount is PECO claiming for fossil plant decommissioning cost?

9 A. PECO Exhibit ABC-1, Schedule 5, shows that PECO is claiming \$126.6 million of estimated fossil
10 decommissioning expense as stranded cost. Over the seven year CTC recovery period, PECO is
11 attempting to include \$18.086 million of estimated "stranded" fossil plant decommissioning cost each
12 year. PECO's Exhibit ABC-1, Schedule 10, page 4, column (b), shows that this claim is based upon
13 dividing the \$126.605 million by 7. This \$18.086 million of annual fossil decommissioning cost that
14 PECO is claiming as a stranded cost is in addition to the annual \$2.797 million estimated fossil
15 decommissioning cost that PECO has reflected in its "operating assumptions" for its fossil generating
16 units on Exhibits TPH-3 through 5. Thus, PECO's filing reflects approximately \$20.883 million per year
17 for estimated fossil decommissioning cost.

18
19 Q. Have estimated fossil decommissioning expenses been allowed in Pennsylvania?

20 A. No. As PECO witness Cohn states on page 17 of his testimony, under existing Pennsylvania regulatory
21 practice, neither the cost of removal nor any salvage value is recognized for ratemaking purposes until an
22 asset is retired and the cost of removal is actually incurred. The actual cost of removal less any associated
23 salvage is recorded as a deduction from accrued depreciation and is effectively amortized over the
24 remaining life of the applicable plant accounts through the operation of the remaining life depreciation
25 method.

26
27 Q. Is PECO's attempted recovery of estimated fossil decommissioning cost consistent with current regulatory

1 practice in Pennsylvania?

2 A. No, it is not. As discussed above, prospective recovery of estimated negative net salvage, including fossil
3 decommissioning expense, has not been permitted. Moreover, PECO witness Cohn mentions, at page 18
4 of his testimony, that a 1962 Superior Court decision has generally been read as barring the prospective
5 recovery of non-nuclear decommissioning costs by Pennsylvania utilities.

6
7 Q. Are there differences between nuclear plant decommissioning and fossil plant decommissioning?

8 A. Yes. There are a number of significant differences, which, taken cumulatively indicate a different
9 regulatory treatment for fossil decommissioning. Some important distinctions between nuclear and fossil
10 decommissioning, particularly as they pertain to recovery in the rates of Pennsylvania electric utilities,
11 include the following differences (this list is not intended to be exhaustive):

12
13 (1) There are significant public health and safety concerns associated with the closure of nuclear facilities
14 (i.e., associated with nuclear decommissioning) that are not associated with closure of fossil generation
15 plants.

16
17 (2) The Nuclear Regulatory Commission requires pre-funding of nuclear decommissioning expense. To
18 the best of my knowledge, there are no similar requirements for fossil plants.

19
20 (3) Estimated nuclear decommissioning expense has been allowed for ratemaking purposes under existing
21 Pennsylvania ratemaking practice, whereas estimated fossil negative net salvage, including fossil plant
22 decommissioning, has been disallowed. Fossil plant cost of removal has only been allowed for recovery
23 after-the-fact.

24
25 (4) The funds collected through rates for nuclear decommissioning are contributed into segregated trust
26 funds where they can be used solely for the purpose of paying for nuclear decommissioning, whereas any

1 funds allowed to be collected for fossil plant decommissioning would be part of general funds, to be used
2 for any corporate purpose.

3
4 (5) The Electric Competition Act specifically mentions nuclear decommissioning costs in section
5 2808(C)(1). This sections does not mention fossil decommissioning costs. Section 2803 of the act
6 mentions "retirement costs attributable to the utility's existing generating plants other than the costs
7 defined in paragraph (1)" and provides that the recovery of such costs will be determined by the
8 Commission pursuant to section 2808(C)(3). This indicates that the Act has provided for a different
9 standard for determining the recovery of nuclear decommissioning cost and fossil decommissioning cost.

10
11 (6) Nuclear decommissioning expense is tax deductible where the funds are deposited into qualified trusts
12 (as is consistent with existing Pennsylvania regulatory practice), whereas estimated fossil
13 decommissioning expense is not tax deductible.

14
15 Q. Why is tax deductibility important?

16 A. The lack of tax deductibility, other things being equal, would produce a higher cost to ratepayers.

17
18 Q. Has PECO indicated how it would use any funds received for fossil plant decommissioning?

19 A. Yes. PECO's response to OTS-RB-30 states that:

20 The funds received for fossil decommissioning, just like any other revenue received for other
21 expenses, will be part of general funds. The Company does not have plans to deposit the funds in
22 a trust for use at the time of decommissioning.
23

24 Q. What is your recommendation concerning PECO's attempt to include in the CTC \$126.6 million for
25 estimated fossil plant decommissioning cost?

26 A. I recommend that the Commission deny PECO's request. As discussed above, there are a number of
27 differences between nuclear decommissioning and fossil decommissioning, particularly as they relate to
28 ratemaking. These differences, especially when taken cumulatively, support a different ratemaking

1 treatment. Moreover, as noted, prospective recovery estimated fossil decommissioning expense is
2 inconsistent with current Pennsylvania regulatory practice, and, as suggested by Mr. Cohn on page 18 of
3 his testimony, appears to be barred by a 1962 Superior Court decision. PECO's request for \$126.6 million
4 of "stranded assets" for estimated fossil decommissioning expense should be disallowed. The \$126.6
5 million shown on PECO Exhibit ABC-1, Schedule 5, for fossil decommissioning should be removed from
6 the stranded cost and CTC calculations.

7
8 OTHER ADJUSTMENTS

9 Q. Are there other adjustments which should be made to PECO's restructuring filing?

10 A. Yes, there are. I will briefly discuss a number of such other adjustments in the following sections of my
11 testimony.

12
13 Accounts Receivable Financing

14 Q. Please discuss PECO's use of Accounts Receivable financing and how the Company has reflected the use
15 of such financing in its filing.

16 A. PECO has been using Accounts Receivable financing in the amount of \$425 million. PECO's response to
17 PAIEUG-V-19 indicates that the average cost rate for this financing was 5.45% for 1996. PECO has
18 failed to reflect the use of Accounts Receivable financing in the capital structure in its filing on the basis
19 that it had not been included in PECO's capital structure in its last rate case, Docket No. R-891364.

20
21 Q. What is your position concerning PECO's Accounts Receivable financing?

22 A. This is a relatively low-cost source of financing to PECO -- the 5.45% cost rate stated in PECO's response
23 to PAIEUG-V-19 -- is lower than the cost rate for most of PECO's other sources of capital. My position is
24 that this financing should be reflected somewhere in the ratemaking process, and that PECO's failure to
25 reflect it is unacceptable. Moreover, PECO has relied upon the fact that Accounts Receivable financing
26 was not included in its capital structure in Docket No. R-891364 as its reason for failing to reflect in it

1 PECO's current restructuring filing; however, the issue of whether and how PECO's Accounts Receivable
2 financing should be reflected for ratemaking purposes does not appear to have been addressed in the
3 Commission's decision in Docket No. R-891364.

4
5 Q. Has PECO reflected its use of Accounts Receivable financing, similar to its use of short-term debt, in its
6 calculation of the AFUDC rate?

7 A. No. PECO's response to PAIEUG-V-17 stated that PECO's rationale for excluding short-term debt from
8 the capital structure is that initially short-term debt is used to finance construction work in progress, and
9 is included in PECO's AFUDC calculation, which results in a lower AFUDC rate, thereby giving
10 customers the benefit of such financing. However, since PECO has not used Accounts Receivable
11 financing in its AFUDC rate calculation, this argument does not provide a reason for PECO's exclusion of
12 *Accounts Receivable financing from the capital structure.*

13
14 Q. *What is your recommendation?*

15 A. PECO's \$425 million of Accounts Receivable financing should be reflected in the ratemaking process.
16 Since PECO has not reflected it in computing its AFUDC rate (similar to short-term debt), it should either
17 be reflected in the capital structure at the 5.45% weighted average cost rate shown in PECO's response to
18 PAIEUG-V-19, or deducted from rate base with the 5.45% cost reflected as an element of the cost of
19 service.

20
21 Adjusted Return for "Stranded" Generation-Related Assets

22 Q. Are there any principles from the California "Preferred Policy Decision" that indicate further adjustments
23 to PECO's request?

24 A. Yes. An adjustment to set the equity return that at 90% of the cost rate for long-term debt would be
25 consistent with the principles of benefits for ratepayers and proper incentives for utilities.

1 Q. What capital cost is produced by this adjustment?

2 A. Schedule 2 shows the capital structure and adjusted cost rate for equity. The overall weighted cost is
3 reduced from 10.05% to 8.05% and the discount rate is reduced from 8.41% to 6.42%. These cost rates
4 are prior to removing the effects of the unamortized loss on reacquired debt described on page 53 of PECO
5 witness Cohn's testimony. Schedule 2 also shows that the 9.52% and the 8.02% weighted cost amounts
6 used by Mr. Cohn on PECO Exhibit ABC-1, Schedule 10, become 7.17% and 5.67% under this proposal.

7

8 Reserve Accounts

9 Q. What are reserve accruals?

10 A. Reserve accruals are typically liability accounts that are shown on the credit side of a utility's balance
11 sheet. They represent "reserves" for expenses that the utility has recorded on its books. They are typically
12 created by the utility charging (debiting) an expense account for an accrued expense and crediting the
13 reserve.

14

15 Q. Does PECO have any reserve accruals, which could potentially be used to offset some of its claimed
16 stranded costs?

17 A. Yes. PECO's filing at Schedule C-4 lists its reserve accruals, shows their balances as of December 31,
18 1996, and also states the percentage of each balance relating to PECO's electric operations. PECO has a
19 number of reserve accruals, including the following: Uncollectible Accounts, Obsolete Inventory, Property
20 Damage and Personal Injury, Storm Damage, Environmental, and Workers Compensation. PECO's
21 Schedule C-4 indicates that its reserves for Property Damage and Personal Injury and for Storm Damage
22 were started in 1996.

23

24 Q. Has PECO stated its reasoning for inclusion or exclusion of its reserve balances from its calculation of
25 stranded costs?

1 A. Yes. PECO's response to PAIEUG-V-9 stated its reasons for excluding consideration of the reserve
2 balances from its calculation of stranded costs. For Property Damage and Personal Injury and for Storm
3 Damage, PECO's reasoning for its failure to consider the reserve balances in its stranded cost calculation
4 is that "the reserve is established to normalize the impact of these expenses." PECO also asserts that
5 generally, these relate to functions other than generation. For Workers Compensation, PECO's reason for
6 failing to consider that balance in its stranded cost claim is that: "This reserve, required by law, is
7 established to fund liability claims and should not be included in the stranded cost calculation." PECO
8 also asserts its view that its shareholders have funded the reserves as the reserves were started subsequent
9 to its last rate case.

10
11 Q. Do PECO's assertions represent valid reasons for failing to consider the reserve balances as potential
12 offsets to its stranded cost claim?

13 A. No, they do not. PECO has, in fact, included the expenses associated with the expense accrual in its
14 Exhibit TPH-1, wherein PECO presents its view of its present electric jurisdictional revenue requirement.
15 PECO has included substantial amounts of expense for these reserves in its expenses on TPH-1.
16 Moreover, I disagree with PECO's claim that its shareholders funded these expenses. PECO has been
17 receiving its revenues from ratepayer payments and PECO's authorized revenues have not been reduced
18 for a rate reduction. Thus, PECO's ratepayers have continued to pay the Company the same rates, while
19 PECO recorded additional accruals of expenses on its books. Finally, it appears that substantial portions
20 of the expenses PECO has recorded for these accruals relate to PECO's electric operations.

21
22 Q. Referring to PECO's Schedule C-4, has PECO indicated to what accounts it charged the amounts in the
23 "Accrual" column?

24 A. Yes, for some of the accruals, PECO has indicated in response to OCA data requests OCA-III-7, 8 and 9,
25 that it has charged the expense accruals for the Property Damage and Personal Injury, Storm Damage,
26 Environmental, and Workers Compensation. PECO's response indicates that its 1996 expenses for these
27 three reserves were charged to FERC Accounts 925, 593, and 925, respectively. Account 593,

1 Maintenance of Overhead Lines, is a distribution expense and, thus, would not be associated with PECO's
2 generation function. However, Account 925, Injuries and Damages, is an Administrative and General
3 account, and, as such, would have some portion related to the generation function.

4
5 Q. Do you have any recommendations concerning these reserve accounts?

6 A. Yes. If the Commission agrees with PECO's suggestion that its accrual expenses associated with its
7 reserve accounts are shareholder expenses, then the accrual amounts should be removed from the expenses
8 shown on PECO's Exhibit TPH-1. On the other hand, if the Commission finds that PECO's ratepayers
9 have contributed to the build-up of these reserves, then an appropriate portion of the reserve balances
10 related to PECO's generation function should be offset against the Company's claim for stranded costs.
11 As noted above, PECO has charged the related expense accruals to Account 925 for its reserves for
12 Property Damage and Personal Injury and Workers Compensation; consequently, a portion of such
13 reserves could be appropriate as an offset to PECO's generation-related costs.

14
15 Market Valuation

16 Q. How did PECO determine its net stranded costs?

17 A. The calculation of net stranded costs was calculated by first quantifying PECO's net electric generation-
18 related costs as of December 31, 1998. From the resulting amount, PECO then subtracted the projected
19 market value of its investment in electric generating plants and facilities, expressed in present value
20 terms, as of December 31, 1998. The result was PECO's projected net stranded costs as of December 31,
21 1998, which is the amount PECO seeks to recover as CTC over seven years through 2005.

22
23 Q. Did PECO have any studies done to estimate the market price projections utilized in the second
24 component of its net stranded cost calculation?

25 A. Yes. PECO retained three separate firms to each perform market price projections for each of PECO's
26 generating facilities for each hour and each year of each facility's projected remaining service life. The

1 results of the three separate studies are presented in PECO's testimony by Dr. William Hieronymus who
2 is the Managing Director of Putman, Hayes & Bartlett, Inc., Dr. Bangalore Venkateshwara who is the
3 Vice President of ICF Resources Inc., and Mr. John Bustard who is a Senior Engineer in PECO's Bulk
4 Power Enterprises Group and presents the results of the study conducted by the EDS Utilities Division.
5 The studies resulted in average market price estimates of 3.46, 3.71 and 3.85 cents per kWh, respectively.
6

7 Q. What market valuation amounts resulted from the three separate market price estimates?

8 A. The three separate market price estimates resulted in market valuations, which are used to offset stranded
9 costs, of \$2,862,913, \$3,487,881, and \$3,650,190, respectively.
10

11 Q. Which of the three studies did PECO adopt for its net stranded cost calculations?

12 A. PECO selected the study sponsored by Dr. Hieronymus, which happens to be the study that resulted in the
13 lowest amount of market revenues at 3.46 cents per kWh. In other words, PECO selected the study which
14 resulted in the lowest amount of market value (\$2,862,913) to be offset against the stranded costs.
15

16 Q. What reasoning did PECO give for selecting the study which resulted in the lowest market value?

17 A. PECO Witness Thomas Hill gives two reasons for selecting Dr. Hieronymus' analysis. His first reason is
18 that he claims that Dr. Hieronymus' analysis "seem more in keeping with many of the market price
19 projections that were presented to the Commission during the restructuring debate that cumulated in the
20 passage of the Competition Act." (Page 14) However, Mr. Hill does not provide any comparisons or
21 factual information supporting this statement, nor does he provide any evidence substantiating that the
22 amounts presented to the Commission during the restructuring debate are consistent with current
23 circumstances in the market.
24

25 Q. What was the other reason provided by Mr. Hill for selecting the study resulting in the lowest market
26 valuation?

1 A. Beginning at page 14 of his direct testimony, Mr. Hill provides the following reasoning:

2 ...the Competition Act, while striving to equitably balance the interests of customers and
3 shareholders, tips the scale decidedly in favor of the former. This is because the uncertainty
4 regarding future market prices works to the benefit of customers. If market prices turn out to be
5 higher than PECO has estimated, customers can continue to receive service from the Company
6 and their generation rates will be capped at what, in effect, will be below-market levels. In
7 contrast, if market prices turn out to be lower than projected, customers will be free to take
8 advantage of those lower prices but PECO would be unable to recover the revenues which its
9 market valuation analyses assume will be produced.
10

11 Q. Do you agree with PECO's position that the market valuation should be based upon the study which
12 results in the lowest amount of offset to stranded costs?

13 A. No, I do not. Based on Mr. Hill's testimony, the Company did not determine which study to utilized
14 based on which it felt resulted on a more accurate analysis, but, rather, PECO based the selection on
15 which study results were most beneficial to its shareholders. Clearly this is not appropriate.
16

17 Pennsylvania Consolidated Statutes Section 2808(C)(4) states that the electric utilities have the duty to
18 mitigate generation related transition costs. The section includes examples of efforts the utilities may take
19 to mitigate the costs. Included in the examples of utility mitigation efforts was "Maximization of market
20 revenues from existing rate base generation assets." (Section 2808(C)(4)(V)) PECO's attempt to utilized
21 the lowest market valuation obtained goes against the cost mitigation requirements set forth in the Statutes
22 and serves to benefit shareholders over ratepayers.
23

24 Q. What is your recommendation?

25 A. Based upon the information reviewed to date, I recommend that the average market valuation resulting
26 from the three studies PECO had conducted be utilized in determining the level of market valuation to
27 offset against stranded costs. Use of the average results would spread the risks that the market valuations
28 are inaccurate between ratepayers and shareholders, and avoids the utilization of one particular study in
29 preference to the others. I also note that the study relied upon by PECO appears to be the outlier of the
30 three studies in that the other two studies provided results which are closer to each other.
31

1 Q. What market valuation amount results from utilizing the average of the three studies?

2 A. According to PECO's response to OCA-I-10, use of the average resulting market price in the market
3 valuation calculations results in a market valuation of \$3,333,661,000. This is \$470.748 million more
4 than the \$2,862,913,000 utilized by PECO in its stranded cost calculations. Thus, net stranded costs
5 should be reduced by \$470,748,000 in order to reflect the average projected market price.

6

7 Q. Do you have any additional concerns regarding the market valuation?

8 A. Yes, I do. There is no way to know with any certainty at this point in time what the actual market cost per
9 kWh will be when competition is in effect. The fact that three separate expert firms retained by PECO to
10 estimate the future market price per kWh recommended three different amounts with a 11.27% gap
11 between the highest amount (3.85 cents per kWh) and the lowest amount (3.46 cents per kWh)
12 demonstrates this fact. Additionally, there is a 27.5% gap between the PECO's lowest estimated market
13 valuation of \$2,862,923,000 and its highest estimated market valuation of \$3,650,190,000. It is
14 impossible to know what the market price will or what the actual market valuation will be prior to the full
15 implementation of competition.

16

17 Q. Should the estimated market price and market valuation determined as a result of these proceedings be
18 considered a firm, set amount that is not subject to change?

19 A. No, it should not. As mentioned above, it is impossible at this time to know what the actual competitive
20 market prices will be prior to the full implementation of competition. The use of even the average
21 estimated market price could result in being significantly higher or significantly lower than what the
22 actual price will be. Consequently, the parties should be permitted to readdress the market price/market
23 valuation issue after competition has been implemented. This qualification is necessary in order to protect
24 both the Company and its ratepayers.

25

26 Q. To the best of your knowledge, has the Commission addressed the potential need to reopen or review the
27 stranded costs recovery after the implementation of competition?

1 A. Yes, to some degree. In fact, Commissioner Hanger, in his written comments, stated that: "Since actual
2 recovery requirements will depend on market values, actual mitigation efforts and other variables, the
3 CTC may be adjusted based upon updated documentation." (Page 15-16, emphasis added)

4

5 CALCULATION OF CTC REVENUE REQUIREMENT

6 Q. Have you finalized your CTC revenue requirement calculation?

7 A. No, I have not. The calculation of the CTC revenue requirement is dependent upon several adjustments
8 for which I was unable to quantify the appropriate amount. For example, I recommended that the
9 projected 1997 and 1998 plant additions and the projected 12/31/98 CWIP balance included in stranded
10 costs be limited to those projects that are necessary to maintain the facilities through the point in which
11 competition is fully implemented. However, I was unable to separate the amounts included in the
12 estimated additions and CWIP balance between those costs necessary to maintain the plant and those
13 which result in betterments or improvements. The annual CTC revenue requirement can not be calculated
14 until the amounts upon which it depends have been quantified.

15

16 Q. Have you reviewed PECO's schedule which calculates the annual CTC revenue requirements, Schedule
17 10?

18 A. Yes, I have. I do note that PECO calculated the amount of CTC revenue requirements as though the CTC
19 revenues are only received annually.

20

21 Q. Is this an appropriate assumption to include in the calculations?

22 A. No, it is not. The CTC charge will be collected by PECO when it bills its customers for service, which is
23 typically on a monthly basis. This impacts the amount of CTC revenue requirement since the discount
24 rate utilized in the calculation would be applied to the total beginning of the year balance in each of the
25 seven years of the CTC recovery period, as opposed to being applied to the average amount of net stranded
26 costs or applying the discount factor on a monthly basis in the calculations. The Company's methodology

1 serves to inflate the CTC revenue requirement.

2 Q. What impact does the Company's use of the beginning of the year balance of net stranded costs have on
3 the resulting levelized annual CTC revenue requirement?

4 A. In response to Enron-I-53, PECO agreed that if the computation of the levelized annual CTC revenue
5 requirement were based on the assumption of monthly payments by customers instead of annual payments,
6 the annual levelized CTC revenue requirement, excluding GRT, would be \$1.286 billion instead of the
7 \$1.332 billion calculated by the Company. Thus, the Company's assumption of annual payments of CTC
8 charges by customers instead of monthly payments in its calculations increases the annual levelized
9 revenue requirement by approximately \$46 million.

10
11 Q. What is your recommendation?

12 A. I recommend that when the Commission decides on the appropriate level of net stranded costs in these
13 proceedings, that it determines the annual levelized CTC revenue requirement assuming the monthly
14 collection of CTC charges from customers instead of the annual collection methodology used by PECO.

15
16
17 OTHER ISSUES

18 Q. What issues do you discuss in this section of your testimony?

19 A. In this section of my testimony I discuss other issues which are relevant to PECO's filing, but which do
20 not directly impact the determination of PECO's claim for CTC.

21
22 Depreciation Reserve Shift

23 Q. Do you agree with PECO's proposed depreciation reserve shift?

24 A. No, I do not. The effect of PECO's proposal would be to shift to transmission and distribution customers
25 the costs of uneconomic generation assets and, in doing so, to cause some customers to bear costs that they
26 did not cause to be incurred. In response to Enron-I-50, PECO provided a decision by FERC, referenced

1 on page 51 of Mr. Cohn's testimony, wherein FERC rejected a similar depreciation reserve shift proposal
2 by South Carolina Electric & Gas Company, in Docket No. ER96-2637-001. I recommend that PECO's
3 requested depreciation reserve shift be denied.

4
5 Q. Does PECO's filing reflect its proposed depreciation reserve shift?

6 A. No. PECO has stated, in response to Enron-1-47, that its filing did not incorporate the effect of a
7 depreciation reserve shift. I recommend that no reallocation of PECO's reserves be permitted. Since it
8 was not reflected in PECO's filing, no adjustment to PECO's filing would be necessary to reflect my
9 recommended rejection of PECO's reserve shift proposal.

10
11 PECO's "Mitigation" Efforts versus a Rate Reduction

12 Q. Do you have any other concerns regarding PECO's rates and the commencement for collection by PECO
13 of CTC?

14 A. Yes. The focus in this proceeding is primarily upon addressing PECO's claim for stranded costs and
15 CTC; however, there is a concern that PECO's present rates may be too high, and the CTC collection for
16 PECO should commence from a starting point of lower rates for PECO electric service.

17
18 Q. Please explain Attachment 3 to your testimony.

19 A. Attachment 3 to my testimony is a copy of the Statement of Commissioner John Hanger in Docket No.
20 P-00950982, wherein the Commission granted PECO a declaratory order concerning the acceleration of
21 depreciation and amortization of certain regulatory assets associated with PECO's Limerick nuclear
22 generating station. It is important to keep in mind that some of PECO's stranded cost "mitigation"
23 efforts, such as this acceleration of depreciation, have essentially been accomplished at ratepayers'
24 expense, in lieu of significant rate reductions, as noted by Commissioner Hanger in that statement. The
25 time and data limits of this proceeding do not lend itself to a full re-evaluation of PECO's present rates,
26 and, I have not attempted at this time to re-calculate PECO's electric revenue requirement under current

1 rates. Presumably, however, the Commission will take into consideration the present high level of
2 PECO's rates and the source for some of PECO's mitigation efforts in determining an equitable allocation
3 of stranded costs between PECO's shareholders and its ratepayers, and to maintain equity between PECO
4 and other Pennsylvania utilities.

5
6 Q. Please elaborate upon the last point.

7 A. If high cost utilities, such as PECO, are permitted full recovery of their uneconomic costs, this could be
8 unfair to the low-cost, more economic utilities in the state. There is a fairness between utilities objective
9 that suggests that the low-cost utilities should be permitted to enter the competitive era in electric
10 generation with their existing economic advantage left intact. Put another way, permitting high cost
11 utilities, like PECO, to become competitive through full recovery of their stranded, uneconomic
12 investment would tend to reward utilities that made decisions to construct the uneconomic plant in the
13 past.

14
15 Q. Does that conclude your testimony?

16 A. Yes, it does.

PECO Energy Company-Electric Operations
Adjusted Return for "Stranded" Generation-Related Assets

Exhibit ___(RCS-1)
Schedule 2

Line No.	Component	Ratio	Cost	Wtd. Cost	Discount Rate
<u>A. As Proposed by PECO (TPH-1):</u>					
1	Debt	46.4%	8.52%	3.95%	2.31%
2	Preferred	3.0%	7.70%	0.23%	0.23%
3	Common	50.6%	11.60%	5.87%	5.87%
4	Totals	<u>100.0%</u>		<u>10.05%</u>	<u>8.41%</u>
<u>Adjusted for Equity Return at 90% of Long-Term Debt Cost</u>					
5	Debt	46.4%	8.52%	3.95%	2.31%
6	Preferred	3.0%	7.70%	0.23%	0.23%
7	Common	50.6%	7.67% [a]	3.88%	3.88%
8	Totals	<u>100.0%</u>		<u>8.06%</u>	<u>6.42%</u>
<u>B. As Proposed by PECO (ABC-1, Sch.10, workpaper):</u>					
9	Debt	44.6%	7.47%	3.33%	1.95%
10	MIPS	3.2%	9.21%	0.29%	0.17%
11	Preferred	3.1%	6.37%	0.20%	0.20%
12	Common	49.1%	11.60%	5.70%	5.70%
13	Totals	<u>100.0%</u>		<u>9.52%</u>	<u>8.02%</u>
<u>Adjusted for Equity Return at 90% of Long-Term Debt Cost</u>					
14	Debt	44.6%	7.47%	3.33%	1.95%
15	MIPS	3.2%	9.21%	0.29%	0.17%
16	Preferred	3.1%	6.37%	0.20%	0.20%
17	Common	49.1%	6.82% [b]	3.35%	3.35%
18	Totals	<u>100.0%</u>		<u>7.17%</u>	<u>5.67%</u>

Source and Notes

Lines 1-4: PECO Exhibit TPH-1

Lines 9-13: PECO's "Adjusted Discount Rate" workpaper for Exhibit ABC-1, Schedule 10

[a] Equity return at 90% of cost of long-term debt

[b] Equity return at 90% of cost of long-term debt

	Wtd Cost	Ratio	Cost Rate	90%
Debt inc. MIPS	3.6%	47.8%	7.57%	6.82%

Pennsylvania Consolidated Statutes
Section 2808(C)

(C) DETERMINATION OF COMPETITIVE TRANSITION CHARGE. IN DETERMINING THE LEVEL OF TRANSITION OR STRANDED COSTS THAT AN ELECTRIC UTILITY MAY RECOVER THROUGH THE COMPETITIVE TRANSITION CHARGE, THE COMMISSION SHALL APPLY THE FOLLOWING PRINCIPLES:

(1) THE COMMISSION SHALL ALLOW RECOVERY OF REGULATORY ASSETS AND OTHER DEFERRED CHARGES TYPICALLY RECOVERABLE UNDER CURRENT REGULATORY PRACTICE, THE UNFUNDED PORTION OF THE UTILITY'S PROJECTED NUCLEAR GENERATING PLANT DECOMMISSIONING COSTS AND COST OBLIGATIONS UNDER CONTRACTS WITH NONUTILITY GENERATING PROJECTS THAT HAVE RECEIVED A COMMISSION ORDER. NOTHING IN THIS CHAPTER SHALL BE CONSTRUED AS REQUIRING AN ELECTRIC UTILITY OR A NONUTILITY GENERATING PROJECT TO ENTER INTO AN ARRANGEMENT TO BUYDOWN, BUYOUT AND TERMINATE OR OTHERWISE RESTRUCTURE A CONTRACT OR AS AUTHORIZING THE COMMISSION TO REQUIRE A UTILITY TO PURSUE SUCH AN ARRANGEMENT WITH A NONUTILITY GENERATING PROJECT.

(2) THE COMMISSION SHALL ALLOW RECOVERY OF AN ELECTRIC UTILITY'S PRUDENTLY INCURRED COSTS RELATED TO CANCELLATION, BUYOUT, BUYDOWN OR RENEGOTIATION OF NONUTILITY GENERATING PROJECTS CONSISTENT WITH SECTION 527 (RELATING TO COGENERATION RULES AND REGULATIONS).

(3) THE COMMISSION SHALL DETERMINE THE LEVEL OF OTHER GENERATION-RELATED TRANSITION OR STRANDED COSTS THAT MAY BE RECOVERED THROUGH THE COMPETITIVE TRANSITION CHARGE.

(4) THE COMMISSION SHALL CONSIDER THE EXTENT TO WHICH THE ELECTRIC UTILITY HAS UNDERTAKEN EFFORTS TO MITIGATE GENERATION-RELATED TRANSITION OR STRANDED COSTS BY APPROPRIATE MEANS IN A MANNER THAT IS REASONABLE UNDER ALL OF THE CIRCUMSTANCES, INCLUDING CONSIDERATION OF WHETHER MITIGATION HAS BEEN COMMENSURATE WITH THE MAGNITUDE OF THE ELECTRIC UTILITY'S GENERATION-RELATED TRANSITION OR STRANDED COSTS. DURING THE TRANSITION PERIOD, ELECTRIC UTILITIES SHALL HAVE THE DUTY TO MITIGATE GENERATION RELATED TRANSITION OR STRANDED COSTS TO THE EXTENT PRACTICABLE. EFFORTS MAY INCLUDE THE FOLLOWING:

(I) ACCELERATION OF DEPRECIATION AND AMORTIZATION OF EXISTING RATE BASE GENERATION ASSETS.

(II) MINIMIZATION OF NEW CAPITAL SPENDING FOR EXISTING RATE BASE GENERATION ASSETS.

(III) REALLOCATION OF DEPRECIATION RESERVES TO EXISTING RATE BASE GENERATION ASSETS.

(IV) REDUCTION OF BOOK ASSETS BY APPLICATION OF NEW PROCEEDS OF ANY SALE OF IDLE OR UNDER-UTILIZED EXISTING RATE BASE GENERATION ASSETS.

(V) MAXIMIZATION OF MARKET REVENUES FROM EXISTING RATE BASE GENERATION ASSETS.

(VI) ISSUANCE OF SECURITIZED DEBT PURSUANT TO THE PROVISIONS OF SECTION 2812 (RELATING TO APPROVAL OF TRANSITION BONDS).

(5) OF EQUAL IMPORTANCE TO THE MITIGATION EFFORTS UNDER PARAGRAPH (4)(I) THROUGH (VI), THE COMMISSION SHALL CONSIDER EFFORTS UNDERTAKEN OVER TIME, PRIOR TO THE ENACTMENT OF THIS CHAPTER, TO REDUCE OR MODERATE CUSTOMER RATE LEVELS WHILE MAINTAINING SAFE AND EFFICIENT OPERATIONS.

Excerpt from California Public Utilities Commission, "Preferred Policy Decision" R.94-04-031, pp.121-122:

We derive two principles from the discussion of how to allocate transition costs.

The first is that ratepayers should benefit, at least to some degree, from our treatment of transition costs. Some of our main themes in this restructuring effort have been to give customers choice and to introduce competition with the goal of reducing rates. It would be inappropriate to require ratepayers to bear the same costs they would have borne in the absence of this reform effort, especially where those costs tend, in the new competitive framework, to distort market prices and signals.

The second is that shareholders should recover somewhat lower revenues as transition costs than they would under cost-of-service regulation. Under traditional regulation, utilities would have the opportunity to recover the amount of the original construction cost of a plant over the plant's expected useful life, plus a reasonable return tied to risk, as long as the plant remained used and useful for public utility purposes. Allowing this level of recovery in the transition to competition produces several undesirable effects. Of greatest concern is that the assurance of full recovery gives the utility no incentive to minimize transition costs. This is counter to our goal of keeping transition costs as low as possible, but it has even worse implications. If the utility is indifferent to the level of transition costs, it would in turn have an incentive to bid low in offering its generation assets' output to buyers in the Power Exchange, with the foreseeable effects of depressing the market-clearing price, squeezing the profit margins of competitors, and further increasing transition costs.

These two principles -- benefits for ratepayers and proper incentives for utilities -- can be accommodated in a recovery mechanism that reduces the return on investment-related transition costs. Recovery of transition costs imposes a significantly lower risk for recovery of these costs because, once an asset is market-valued, the utilities will not be subject to the risk that the plants will be found no longer used and useful. Thus, if we apply a reduced rate of return to these transition costs, we will appropriately reflect the lower degree of risk the utilities face. [California PUC, "Preferred Policy Decision" R.94-04-031, pp.121-122)

PETITION OF PECO ENERGY FOR
A DECLARATORY ORDER REGARDING
THE ACCELERATION OF DEPRECIATION
AND AMORTIZATION OF CERTAIN REGULATORY
ASSETS ASSOCIATED WITH THE LIMERICK
NUCLEAR STATION

PUBLIC MEETING-
FEBRUARY 22, 1996
FEB-96-L-14*
DOCKET NO. P-00950982

STATEMENT OF COMMISSIONER JOHN HANGER

The instant Petition represents a true dilemma.

On the one hand, public utilities with large investments in uneconomic plants, such as PECO's investment in Limerick, should be seeking to accelerate the depreciation of such plants so that PECO will have a chance to produce electricity from these plants at competitive market rates in the future. PECO is attempting to mitigate the costs of its past uneconomic investment now, so that it will be able to compete when customers obtain the right to choose their electricity supplier in the not-too-distant future. At least for the time being, PECO is not seeking to pass on any of the cost of the accelerated depreciation through rate increases. That is the wise and sober action to take.

Aside from Commission approval, PECO does not have free reign simply to change its depreciation schedules at whim. In order to comply with accounting standards, PECO must justify the assumptions of shortened useful life to match the accelerated depreciation schedule. PECO has in fact completed a new life span study which concludes that the additional seven years of experience since the previous study indicates that the useful life of Limerick will be ten years less than previously assumed. While such changed assumptions surely underline the unfortunate decisions that were made when PECO decided to complete Limerick, they also provide an opportunity for PECO to attempt to cut its losses.

Accounting standards also require identification of revenue sources to support the additional \$90 million "expense" on the company's books. PECO has indicated that existing rates, coupled with stricter controls on company expenses and more aggressive marketing, will be adequate to cover the additional \$90 million expense on the company's books.

Let's look at that again. PECO's rates are high enough, and its budget fat enough, that it can simply absorb a \$90 million hit when it has the incentive to do so!

That brings me to the other hand. PECO requests approval of its Petition so that it can compete as the industry becomes more competitive. Yet, PECO is doing everything within its power in order to prevent implementation of a meaningfully competitive

retail generation industry in Pennsylvania. Since retail competition and customer choice is going to happen sooner or later, not only in Pennsylvania but also across the country, it certainly makes sense for PECO to attempt to cut its losses and hedge its bets by filing a Petition such as this notwithstanding its all-out anti-customer-choice campaign.

But in these circumstances, why should this Commission grant PECO's Petition? Why shouldn't there instead be a rate case to reduce PECO's rates so that the company no longer has sufficient excess earnings or budgetary fat to absorb a \$90 million hit? Why should PECO be so flush with cash that it can afford to try to buy a more competitive neighboring utility? To those who would consider filing a Complaint to reduce PECO's rates, which remain the ninth highest in the country, perhaps a relatively small rate reduction now may be less valuable than the larger and long-term reductions in prices that will be available by taking appropriate steps to mitigate uneconomic investments on the way to a competitive market.

PECO's Petition is fundamentally unlike an otherwise similar Petition filed by PP&L, Met-Ed or Penelec. Those utilities also have uneconomic investments which should be mitigated. But unlike PECO, those utilities are actively encouraging retail competition, because they believe that a well-managed utility can thrive while all consumers benefit from customer choice and lower prices.

Why shouldn't this Commission deny the Petition or even begin rate reduction proceedings as long as PECO is doing everything within its power to stop competition? For now, I am willing to support PECO's Petition because I remain hopeful that Pennsylvania will make a reasonable and timely transition to retail customer choice. I, however, do now state that, should this Commission oppose such a transition, then I will revisit this approval. For if this state is not going to allow retail customer choice, the only reasonable thing to do is to deny the Petition and immediately begin proceedings to reduce PECO's rates.

I also come to this decision because this Commission must do its part to permit PECO to become competitive and encourage mitigation of uneconomic investment now, even if PECO is totally opposed to customer choice. There is a limit to our responsibility to PECO, however. PECO certainly should not expect that these costs ever would be imposed on consumers in a future rate case without meaningful competition and should be prepared to implement a rate cut if its advocacy against customer choice prevails.

February 22, 1996
DATED

John Hanger
JOHN HANGER, COMMISSIONER

RALPH C. SMITH
QUALIFICATIONS

Accomplishments

- Mr. Smith's professional credentials include being a certified financial planner, a licensed certified public accountant and attorney. He functions as project manager on consulting projects involving utility regulation, regulatory policy and ratemaking and utility management. His involvement in public utility regulation has included project management and in-depth analyses of numerous issues involving telephone, electric, gas, and water and sewer utilities.
- Mr. Smith has performed work in the field of utility regulation on behalf of industry, public service commission staffs, state attorney generals, municipalities, and consumer groups concerning regulatory matters before regulatory agencies in Alabama, Alaska, Arizona, California, Connecticut, Delaware, Florida, Georgia, Hawaii, Illinois, Indiana, Kentucky, Louisiana, Maine, Michigan, Minnesota, Mississippi, Missouri, New Jersey, New York, Nevada, North Carolina, Ohio, Pennsylvania, South Carolina, South Dakota, Texas, Canada, Federal Energy Regulatory Commission and various state and federal courts of law. He has presented expert testimony in regulatory hearings on behalf of utility commission staffs and intervenors on several occasions.
- Assisted the NARUC Committee on Management Analysis with drafting the Consultant Standards for Management Audits.
- Presented training seminars covering public utility accounting, tax reform, ratemaking, affiliated transaction auditing, rate case management, and regulatory policy in Maine, Georgia, Kentucky, and Pennsylvania. Seminars were presented to commission staffs and consumer interest groups.

Previous Positions

- With Larkin, Chapski and Co., the predecessor firm to Larkin & Associates, was involved primarily in utility regulatory consulting, and also in tax planning and tax research for businesses and individuals, tax return preparation and review, and independent audit, review and preparation of financial statements.
- Installed computerized accounting system for a realty management firm.

Education

- Bachelor of Science in Administration in Accounting, with distinction, University of Michigan, Dearborn, 1979.
- Master of Science in Taxation, Walsh College, Michigan, 1981. Master's thesis dealt with investment tax credit and property tax on various assets.
- Juris Doctor, cum laude, Wayne State University Law School, Detroit, Michigan, 1986. Recipient of American Jurisprudence Award for academic excellence.
- Continuing education required to maintain CPA license and CFP certificate.
- Passed all parts of CPA examination in first sitting, 1979. Received CPA certificate in 1981 and certified Financial Planning certificate in 1983. Admitted to Michigan and Federal bars in 1986.

Professional Associations

- Michigan Association of Certified Public Accountants, Committee on Management Consulting Services.
- Michigan Bar Association.
- American Bar Association, sections on public utility law and taxation.

Partial list of utility cases participated in:

Docket No. 6531	Hawaiian Electric Company (Hawaii Public Utilities Commissioners)
Application No. 90-12-018	Southern California Edison Company (California Public Utilities Commission)
Case No. 90-E-1185	Long Island Lighting Company (New York Department of Public Service)
I.90-07-037 Phase II	(Investigation of Post-Retirement Benefits Other Than Pensions) The Department of the Navy and all Other Federal Executive Agencies - Before the California Public Utilities Commission
Docket No. U-1551-90-322	Southwest Gas Corporation Before the Arizona Corporation Commission
Docket No. 6998	Hawaiian Electric Company (Hawaii Public Utilities Commissioners)
Docket Nos. 7233 and 7243	Hawaiian Nonpension Postretirement Benefits Hawaiian Public Utilities Commission
Docket No. 7700	Hawaiian Electric Company, Inc. Before the Public Utilities Commission of the State of Hawaii
Docket Nos. E-1032-93-111 & U-1032-93-193	Citizens Utilities Company - Arizona Gas Division Before the Arizona Corporation Commission
Docket Nos. E-1032-93-111 & U-1032-93-193	Citizens Utilities Company - Arizona Gas Division Surrebuttal Testimony - Before the Arizona Corporation Commission
Docket No. R-00932670	Pennsylvania American Water Company Before the Pennsylvania Public Utility Commission
Docket Nos. U-1514-93-169/ E-1032-93-169	Joint Application for Approval of the Sale of Assets and Transfer of CC&N from Contel of the West, Inc. to Citizens Utilities Company Before the Arizona Corporation Commission
Docket No. 7766	Hawaiian Electric Company, Inc. Before the Public Utilities Commission of the State of Hawaii

Case No. 93-2006- GA-AIR*	The East Ohio Gas Company Before the Ohio Public Utilities Commission
Case No. 94-E-0334	Consolidated Edison Company Before the New York Department of Public Service
Docket No. 94-0270	Inter-State Water Company Before the State of Illinois Commerce Commission
Docket No. 94-0097	Citizens Utilities Company, Kauai Electric Division Before the Public Utilities Commission of the State of Hawaii
Case No. PU-314-94-688	Application for Transfer of Local Exchanges Before the North Dakota Public Service Commission
Application No. 94-12-005-Phase I	Pacific Gas & Electric Company Before the California Public Utilities Commission
Docket No. R-953297	UGI Utilities, Inc. - Gas Division Before the Pennsylvania Public Utility Commission
Docket No. 95-03-01	Southern New England Telephone Company Before the Connecticut Department of Public Utility Control
Docket No. 95-0342	Consumer Illinois Water Company - Kankakee Water District Before the State of Illinois Commerce Commission
Case No. GR-96-285	Missouri Gas Energy, A Division of Southern Union Company Before the Missouri Public Service Commission
Docket No. E-1032-95-433	Citizens Utilities Company, Arizona Electric Division Before the Arizona Corporation Commission
Docket No. E-1032-95-473**	Citizens Utilities Company, Arizona Gas Division Before the Arizona Corporation Commission

*Testimony filed, examination not completed.

**Issues stipulated

***Company withdrew case.

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

DOCKET NO. R-00973953

RECEIVED

Testimony of

Nicholas Phillips, Jr.

JUN 18 1997

PA PUBLIC UTILITY COMMISSION
PROTHONOTARY'S OFFICE

On Behalf of

United States Department of the Navy

DUCKETED
JUN 25 1997

June 1997

DOCUMENT

Before the
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Docket No. R-00973953

Direct Testimony of Nicholas Phillips, Jr.

1 Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

2 A Nicholas Phillips. My business address is 1215 Fern Ridge Parkway, Suite 208, St. Louis,
3 Missouri 63141-2000.

4 Q WHAT IS YOUR OCCUPATION?

5 A I am a consultant in the field of public utility regulation and a principal with the firm of
6 Brubaker & Associates, Inc., regulatory and economic consultants. Our Firm and its
7 predecessor firms have been in this field since 1937 and have participated in more than
8 700 proceedings in forty states and in various provinces in Canada. We have experience
9 with more than 350 utilities including many electric utilities, gas pipelines and local
10 distribution companies (LDCs). I have testified in many electric and gas proceedings on
11 virtually all aspects of ratemaking.

12 Q PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.

13 A This information is included in Appendix A to my testimony.

1 Q ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?

2 A I am appearing on behalf of the United States Department of Navy (Navy), which is a
3 substantial purchaser of electric power from PECO Energy Company (PECo).

4 Q WHAT IS THE NAVY'S INTEREST IN THIS PROCEEDING?

5 A The decisions which will be made as a result of these unbundling proceedings will have
6 substantial ramifications for both the structure and the level of PECO's retail electric rates
7 for many years to come. While there may be further opportunities for rate structure
8 refinements in future proceedings, it is important that the key elements of the structure
9 be determined and appropriately implemented in this proceeding. Failure to capture the
10 key elements and distinguishing features in the rates adopted as a result of this
11 proceeding will only lead to complications and unnecessary contention in the future.

12 Q WHAT ASPECTS OF UNBUNDLING DO YOU ADDRESS IN YOUR TESTIMONY?

13 A I address the following key aspects of rate unbundling:

- 14 1. Class cost of service study;
- 15 2. Functional unbundling of the revenue requirement;
- 16 3. Allocation of allowed CTC to classes;
- 17 4. Unbundled rate components;
- 18 5. PECO's proposed universal service and energy conservation cost recovery
19 mechanism;
- 20 6. The treatment of the revenue consequences of securitization bonds; and
- 21 7. Procedures required to implement competition.

1 **CLASS COST OF SERVICE STUDY**

2 Q HAVE YOU REVIEWED THE BASIC METHODS USED BY PECO TO DEVELOP ITS
3 CLASS COST OF SERVICE STUDY?

4 A Yes. I have reviewed the basic methods used by PECO to develop its class cost of
5 service study sponsored by Mr. Robert Clemmer in PECO Exhibit RAC-1, Sections I, II,
6 III and IV. PECO used what is commonly referred to as the Four Coincident Peak (4 CP)
7 method of cost allocation to allocate investment associated with production and
8 transmission plant. PECO allocates production and transmission plant to classes on the
9 basis of the contribution of each class to the hourly system coincident peak in each of the
10 four summer months of June, July, August and September. PECO's monthly system
11 coincident peaks for the 1996 summer period are shown below.

	<u>Month</u>	<u>Monthly Peak (Megawatts)</u>
12		
13	June	5966 MW
14	July	6360 MW
15	August	6509 MW
16	September	6203 MW
17	Average	6260 MW

18 In contrast, the average of the remaining eight monthly peaks is only 5355 MW. PECO
19 has been and continues to be a summer peaking utility with its summer system coincident
20 peaks significantly higher than the peaks that occur in the remaining months of the year.
21 It is reasonable and appropriate to use the 4 CP method to allocate production and
22 transmission investment to customer classes.

1 Q HAVE YOU REVIEWED THE BASIC METHODOLOGY USED BY PECO TO ALLOCATE
2 DISTRIBUTION COSTS TO CUSTOMER CLASSES IN ITS COST OF SERVICE
3 STUDY?

4 A Yes. PECO allocates distribution investment based on a customer component associated
5 with a "minimum size system" and on a demand component for demand-related
6 distribution investment. PECO also directly assigns some distribution costs to classes
7 where it is exclusively used by those customer classes. Since distribution facilities are
8 generally designed to meet maximum demands on those facilities which are not
9 necessarily coincident with the system peak demand, demand-related distribution system
10 costs are allocated to customer classes on the basis of non-coincident class peak
11 demands. PECO states that it used the relationships to categorize certain elements of
12 distribution plant into a customer component and a demand component from a study
13 developed in its last electric base rate case, Docket R-891364.

14 PECO also states that each allocation schedule recognizes the voltage level of
15 service for each class. It is important that high voltage customer classes, such as the
16 Rate HT class not be allocated any secondary distribution system equipment since that
17 equipment is not used by a class that takes service at higher voltage levels. It is
18 appropriate for a cost of service study to recognize voltage levels of service by rate class
19 and to only allocate distribution facilities that are used to provide service to the various
20 classes. It is generally unnecessary for PECO to make investments or related
21 expenditures in low voltage facilities to serve the Rate HT class. PECO has appropriately
22 used this principal in its allocation of distribution facilities.

1 Q HOW DOES PECO ALLOCATE FUEL COST AND OTHER ENERGY-RELATED
2 EXPENSES TO CUSTOMER CLASSES IN ITS CLASS COST OF SERVICE STUDY?

3 A PECO allocates fuel costs and other energy-related expenses to classes of customers on
4 the basis of energy generation requirements associated with each customer class
5 including transformation and line losses. This method is appropriate.

6 Q HOW DOES PECO ALLOCATE GENERAL OR COMMON COSTS SUCH AS
7 ADMINISTRATIVE AND GENERAL (A&G) EXPENSES TO CLASSES OF SERVICE IN
8 ITS CLASS COST OF SERVICE STUDY?

9 A PECO generally allocates A&G expenses to classes based on composite allocation factors
10 internally developed in its class cost of service study. The majority of A&G expenses are
11 allocated to classes based on a composite factor derived from summing the production
12 expense, transmission expense and distribution expense, exclusive of fuel and purchased
13 power previously allocated to classes in the cost of service study. PECO calls this
14 composite factor its "EI" factor and indicates that this allocation factor recognizes the
15 relationship between labor costs and labor-related expenses. Since labor costs are
16 incurred to support the production, transmission and distribution function, it is appropriate
17 to allocate A&G expenses on this composite factor.

18 Q HOW DOES PECO ALLOCATE GENERAL PLANT INVESTMENT TO CLASSES IN ITS
19 CLASS COST OF SERVICE STUDY?

20 A PECO allocates general plant investment to classes based on a composite allocation
21 factor which it terms as "F4". Composite allocation factor F4 is derived from summing the
22 production, transmission and distribution plant previously allocated to classes in the cost

1 of service study. This factor recognizes that general plant supports the production,
2 transmission and distribution plant functions and is appropriate.

3 Q HOW DID PECO UPDATE ITS LOAD AND SALES DATA TO DERIVE ITS ALLOCATION
4 FACTORS FOR THE CLASS COST OF SERVICE STUDY BASED ON THE 12-MONTH
5 PERIOD ENDED DECEMBER 31, 1996?

6 A It is my understanding that PECO used customer load data developed from its last electric
7 base rate case, Docket R-891364, and adjusted the load data from that case to
8 correspond with changes in sales by rate class that have occurred between the two 12-
9 month periods (the last electric base rate case and the current 12-month period used in
10 this proceeding).

11 Q DO YOU GENERALLY AGREE WITH THE BASIC METHODS USED BY PECO TO
12 DEVELOP ITS CLASS COST OF SERVICE STUDY FOR USE IN THIS PROCEEDING?

13 A I generally agree with the basic methods used by PECO to develop its class cost of
14 service study presented by Mr. Clemmer. It should be noted, however, that I have not
15 had the opportunity to verify the actual calculations performed in the study.

16 **FUNCTIONAL UNBUNDLING OF COSTS**

17 Q HAVE YOU REVIEWED THE BASIC METHODS USED BY PECO TO FUNCTIONALLY
18 UNBUNDLE ITS COSTS AMONG THE PRODUCTION, TRANSMISSION AND
19 DISTRIBUTION FUNCTIONS?

20 A Yes. I have reviewed the basic methods utilized in the Functioning Assignment of Costs
21 study sponsored by Mr. Clemmer in Exhibit RAC-1, Section V and the Functional
22 Component Unit Cost study shown in Exhibit RAC-1, Section VI.

1 Certain costs are recorded in the books and records of the Company by function.
2 For example, all production plant is booked by PECO in the production category. Similarly,
3 transmission plant is booked by PECO in the transmission category and distribution plant
4 is booked by PECO in the distribution category. For cost items that are booked by PECO's
5 system of accounts by production, transmission and distribution categories, it is relatively
6 simple to functionally unbundle these costs. The unbundling by class follows the
7 allocated elements of production, transmission and distribution functions as allocated to
8 classes in PECO's class cost of service study as previously discussed. Other items, such
9 as taxes, and common costs, including administrative and general expense and general
10 plant investment, are not functionalized into the production, transmission and distribution
11 categories by the books and records of Company and require allocations to functional
12 categories.

13 **Q DO YOU AGREE WITH PECO'S FUNCTIONALIZATION OF COMMON COSTS SUCH**
14 **AS TAXES, A&G EXPENSE AND GENERAL PLANT?**

15 **A I generally agree with PECO's functionalization of taxes. PECO allocates taxes to the**
16 **production, transmission and distribution functions based on what it terms "PTD"**
17 **allocators. PTD allocators are derived from summing production, transmission and**
18 **distribution investment cost or expense items. Simply stated, PECO proportionately**
19 **spreads taxes to the production, transmission and distribution functions based on an**
20 **allocation factor derived from PTD rate base or PTD expense. This allocation method**
21 **appropriately recognizes that certain common costs are associated with each of the**
22 **functions (production, transmission and distribution).**

23 PECO's functionalization of A&G expense and general plant, however, does not
24 reasonably allocate these items to all functions.

1 Q IS A&G A SEPARATE FUNCTION?

2 A No, not in the same sense as generation, transmission and distribution. Although A&G
3 expenses are separately reported in the accounting records and reports, they do not
4 represent the performance of a separate or specific service, but rather represent support
5 or managerial level efforts that generally cut across the direct functions of transmission,
6 distribution and generation. Pensions and benefits, for example, are recorded in an A&G
7 account (Account 926), but are a function of the labor costs in each direct functional
8 category. These costs could have just as well been recorded directly to the individual
9 functions, but accounting practices have resulted in all such costs, regardless of the direct
10 function in which the employee is located, being recorded in a single account in the A&G
11 function. Other items, such as corporate officer salaries and office expense, are less
12 directly relatable to individual functions and must be allocated in one fashion or another.

13 A&G expenses typically have not been allocated on a functional basis in PECO's
14 past ratemaking proceedings because there was not particular need for such an
15 allocation. However, now that the generation function is being separated from the other
16 functions and deregulated, it is necessary to analyze in more detail the A&G expenses
17 and determine which are related to those functions that will remain under regulation
18 (T&D), and which are related to the generation function which will be deregulated. Since
19 the degree of certainty of collecting costs is much greater on the regulated side than on
20 the deregulated side, it is possible that PECO will benefit by maximizing the amount of
21 A&G expense that is associated with the function which will remain regulated. The larger
22 the share of A&G expenses that can be retained within the regulated sphere, the more
23 likely that PECO will be able to recover these expenses from monopoly functions. The
24 Commission should recognize that common costs that have historically been incurred to
25 support the production, transmission and distribution functions do not change to costs
26 only related to the transmission and distribution functions with restructuring.

1 Q HAVE YOU REVIEWED THE FUNCTIONAL ALLOCATION OF A&G EXPENSES AS
2 PROPOSED BY PECO?

3 A Yes. Exhibit RAC-1, Section V, Page 56 of 83 shows PECo's proposed allocation of A&G
4 expenses. PECo allocates Account 924, Property Insurance, on a PTD rate base
5 allocator and Account 926, Employee Pensions and Benefits, on a PTD labor allocator.
6 For these two accounts, PECo appropriately acknowledges that A&G expenses support
7 and are appropriately allocated to the production, transmission and distribution functions.
8 For all other accounts within the A&G category, PECo only allocates costs to the
9 transmission and distribution functions, and does not allocate any costs to the production
10 function. For Account 920, Administrative and General Salaries, PECo allocates no cost
11 to the production function. For Account 921, Office Supplies and Expenses, PECo
12 allocates no cost to the production function. For Account 923, Outside Services
13 Employed, PECo allocates no cost to the production function. A complete listing of A&G
14 expense categories that PECo has assigned 100% to the transmission and distribution
15 function (T&D) is shown in Table 1.

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Table 1		
A&G Expense Categories that PECO Has Assigned 100% to T&D		
<u>Account No.</u>	<u>Expense Category</u>	<u>Dollar Amount Assigned to T&D \$(000)</u>
	Operation	
920	Administrative and General Salaries	\$ 72,808
921	Office Supplies and Expenses	84,562
923	Outside Services Employed	17,162
925	Injuries and Damages	16,906
928	Reg. Comm. Exp.-PUC and FPC	6,492
929	Duplicate Charges-Credit	(3,433)
930	Misc. General Expenses and ADV	7,514
931	Rents	<u>4</u>
Total	Operation	\$202,015
	Maintenance	
935	Maintenance of General Plant	875
Total	Maintenance	875
Total		\$202,890

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Q HAS PECO SUPPORTED THE ASSIGNMENT OF THESE EXPENSES 100% TO TRANSMISSION AND DISTRIBUTION?

A In my opinion, it has not. For example, no justification has been presented for assigning 100% of administrative and general salaries to only transmission and distribution functions. If administrative and general salaries will no longer support the production function, then no analysis has been presented to establish that this level of managerial expense is required for only the the transmission and distribution functions. A similar situation exists with the other A&G expense categories.

1 Q WHAT IS YOUR RECOMMENDATION FOR ALLOCATING THESE CATEGORIES OF
2 EXPENSES THAT PECO HAS ALLOCATED 100% TO T&D?

3 A I recommend that the multi-factor formula (PTD factor) be applied to these expenses. In
4 fact, PECO used a PTD factor to allocate these same A&G expense categories to
5 customer classes in its class cost of service study. PECO's approach has inappropriately
6 allocated \$106.5 million of A&G expenses to T&D that should be allocated to the
7 production function.

8 Q DO YOU HAVE SIMILAR CONCERNS WITH PECO'S PROPOSED FUNCTIONAL
9 ALLOCATION OF GENERAL PLANT INVESTMENT?

10 A Yes. PECO has proposed to allocate all of what can be termed as ordinary accounts in
11 the general plant investment category to the distribution function. (PECO also has another
12 general plant item called "other tangible property" used for plant not provided for
13 elsewhere that is shown by PECO as a negative plant quantity. PECO allocates the entire
14 negative plant quantity to production.) PECO does not allocate any ordinary general plant
15 investment to the production function or the transmission function. The general plant
16 category includes such items as land and land rights, structures and improvements, office
17 equipment, stores equipment, tools, shop and garage equipment, laboratory equipment,
18 communication equipment and miscellaneous equipment. Although PECO appropriately
19 allocates general plant items to classes of service in its class cost of service study using
20 an allocator based on production plant, transmission plant and distribution plant, PECO
21 completely disregards that relationship and its functional unbundling study.

22 A complete listing of ordinary general and common plant categories that PECO has
23 assigned 100% to the distribution function is shown in Table 2.

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Table 2		
General and Common Plant Categories PECO Has Assigned 100% to Distribution		
<u>Account No.</u>	<u>General Plant Category</u>	<u>Dollar Amount Assigned 100% to Distribution \$(000)</u>
389	Land and Land Rights	\$ 2,484
390	Structures and Improvements	36,039
391	Office Equipment	16,370
393	Stores Equipment	64
394	Tools, Shop and Garage Equipment	8,786
395	Laboratory Equipment	19,617
397	Communication Equipment	9,070
398	Miscellaneous Equipment	<u>1,515</u>
Total		\$ 93,945
	Common Plant Appl to Electric	\$311,780

14 Q HAS PECO SUPPORTED THE ASSIGNMENT OF ALL POSITIVE GENERAL PLANT
 15 ITEMS TO THE DISTRIBUTION FUNCTION?

16 A In my opinion, it has not. It is not clear why PECO believes that all ordinary general plant
 17 including office equipment and communication equipment would be required solely for the
 18 distribution function. In addition, PECO has not justified the need for this level of general
 19 plant to support only its distribution function. PECO's approach has inappropriately
 20 allocated \$66.8 million of general plant in service to distribution that should be allocated
 21 to the production function. In addition, certain plant that is common plant allocated to
 22 electric should be functionalized to production, transmission and distribution, unless PECO
 23 can demonstrate that it is solely applicable to the distribution function.

1 Q WHAT IS YOUR RECOMMENDATION FOR ALLOCATING THE POSITIVE GENERAL
2 PLANT CATEGORIES TO FUNCTIONS?

3 A I recommend that the same type of PTD formula used by PECO to allocate general plant
4 to classes in its class cost of service study be used to allocate general plant to the
5 production, transmission and distribution functions. PECO used another composite factor,
6 F5, to allocated common plant to classes and this factor would be an appropriate method
7 to allocate common costs to all functions.

8 **PECO PROPOSED ALLOCATION OF CTC REVENUE REQUIREMENT**

9 Q HAVE YOU REVIEWED THE METHOD PROPOSED BY PECO TO ALLOCATE ITS
10 PROPOSED COMPETITIVE TRANSITION CHARGE (CTC) TO CLASSES OF
11 SERVICE?

12 A Yes. PECO's proposed allocation of CTC cost to classes is shown in Exhibit RAC-2,
13 Page 1 of 2. PECO has calculated the fixed production revenue requirement by class from
14 its Functional Component Unit Costs study shown in Section VI. Other than the previous
15 discussion regarding A&G and general plant costs, the methods employed to calculate
16 the unit cost appear to be appropriate. PECO calculates the fixed production revenue
17 requirement by rate class and derives an allocation factor on that basis. PECO's
18 requested CTC annual revenue requirement is then allocated to classes using the factor
19 derived from the fixed production revenue requirement by class. If it is determined that
20 a CTC annual revenue requirement will be allocated to classes, this allocation
21 methodology is reasonable. The production function revenue requirement is an
22 appropriate basis to allocate allowable transition costs because the allowable transition
23 costs are a function of introducing competition to the generation of electricity. The
24 transmission and distribution functions will remain a monopoly.

1 **PECO PROPOSED UNBUNDLED RATES**

2 Q HAVE YOU REVIEWED THE PROPOSED UNBUNDLED RATE HT SPONSORED BY
3 MR. WILLIAM SUNDERMEIR?

4 A Yes. The development of unbundled pricing for Rate HT is shown on Exhibit WFS-2. I
5 should note that there appears to be a typographical error for the unbundled CTC prices
6 developed on the top of Page 2 of 2 of that exhibit. The unbundled prices show different
7 amounts for the CTC than the development and derivation of the CTC prices.

8 Q IN YOUR OPINION, HAS THE UNBUNDLED RATE HT BEEN ACCOMPLISHED BY A
9 METHOD WHICH DOES NOT SHIFT INTER-CLASS OR INTRA-CLASS COSTS AND
10 MAINTAINS CONSISTENCY WITH THE ALLOCATION METHODOLOGY FOR UTILITY
11 PRODUCTION PLANT ACCEPTED BY THE COMMISSION IN PECO'S MOST RECENT
12 PROCEEDING?

13 A In my opinion, PECO's unbundled Rate HT does not shift inter-class or intra-class costs
14 and is consistent with the allocation methodology used by PECO to allocate costs in
15 PECO's most recent rate proceeding.

16 Q WHAT METHOD HAS PECO USED FOR THE UNBUNDLING OF RATE HT?

17 A The method used to unbundle Rate HT determined transmission, distribution and
18 transition costs and deducted these costs from the current rates. The residual was
19 identified as the Electric Generation prices.

1 Q DOES MR. SUNDERMEIR STATE THAT THE ELECTRIC GENERATION PRICES HE
2 HAS DERIVED AS THE RESIDUAL AMOUNT ARE MARKET-BASED GENERATION
3 PRICES?

4 A Not to my knowledge. There are problems with determining the electric generation prices
5 as a residual value. For example, the difference between the FERC-allowed transmission
6 revenue requirement and the Pennsylvania jurisdictional transmission revenue
7 requirement becomes part of that residual and is actually not associated with electric
8 generation pricing. Electric generation prices should not be a "catch-all" for differences
9 in revenue requirement determinations between FERC and Pennsylvania. The FERC has
10 made it clear that it intends to determine which facilities are transmission (as opposed to
11 distribution), and to determine the revenues which a utility may collect for the use of the
12 transmission system.

13 Q DO YOU HAVE OTHER CONCERNS WITH THE ESTABLISHMENT OF ELECTRIC
14 GENERATION PRICES AS A RESIDUAL AMOUNT?

15 A Yes. If the purpose of these proceedings is to provide for competition with respect to
16 electric generation service, the use of the residual method for obtaining this quantity could
17 cause serious problems. To my knowledge, PECO has made no claim or assertion that
18 these residuals are reflective of market-based generation prices for the immediate future
19 or the duration of the period that these rates may be in effect. If the Electric Generation
20 prices are established at a level that ensures that competition cannot exist, then these
21 proceedings will fail to allow customers the benefits of customer choice and a competitive
22 electric generation market. I recommend that Electric Generation prices be established
23 to provide for a competitive generation market and the residual be used for transition cost
24 recovery.

1 **UNIVERSAL SERVICE FUND COST RECOVERY MECHANISM**

2 **Q** WHAT IS YOUR UNDERSTANDING OF THE UNIVERSAL SERVICE FUND CHARGE
3 (USFC) PROPOSED BY PECO?

4 **A** PECO proposes the USFC to recover certain costs associated with providing universal
5 service and energy conservation for low-income customers. It is my understanding that
6 uncollectible account expense for customers in the Customer Assistance Program and
7 certain rate discounts are also included in this charge. Costs associated with the Low
8 Income Usage Reduction Program are also part of this program.

9 **Q** HOW DOES PECO PROPOSE TO APPLY ITS PROPOSED USFC?

10 **A** PECO proposes that the USFC be a kWh charge embedded in the unbundled kWh
11 distribution rate applied to residential rates. It is my understanding that the USFC is not
12 an additional charge but serves only to separately identify the portion of distribution rates
13 that will recover the Universal Service Fund program costs.

14 **Q** IN YOUR OPINION, IS PECO'S PROPOSED COST RECOVERY MECHANISM
15 APPROPRIATE?

16 **A** Yes. It is my understanding that PECO's proposal will charge those classes of customers
17 that cause the costs. It is also my understanding that this is not an additional charge but
18 a separate identification of the charge.

1 **INTANGIBLE TRANSITION CHARGE (ITC)**

2 Q WHAT IS YOUR UNDERSTANDING OF THE RELATIONSHIP BETWEEN THE
3 INTANGIBLE TRANSITION CHARGE (ITC) AND THE COMPETITION TRANSITION
4 CHARGE (CTC)?

5 A It is my understanding that the ITC can replace a portion of the CTC with a lower revenue
6 requirement, thus providing lower transition cost to customers through the securitization
7 process.

8 Q DOES PECO PROPOSE TO SIMPLY USE THE ITC TO DIRECTLY REDUCE THE CTC
9 IT HAS PROPOSED FOR EACH CLASS?

10 A No. PECO has proposed a complex procedure where it will continue to charge the CTC
11 using prices developed by Mr. Sundermeir, reducing customer bills by a Securitization
12 Rate Reduction (SRR) and then imposing a charge to recover the revenue requirement
13 associated with the ITC. Ironically, PECO indicates that these items should be billed
14 separately because the SRR is not designed using the same methodology used to design
15 the CTC. PECO indicates that combining the CTC and SRR could therefore make it more
16 difficult to explain the bill calculation to a customer. In my opinion, it is very difficult to
17 explain to a customer why the methods to collect these charges would be different in the
18 first place. Finally, PECO proposed to combine the SRR and ITC to arrive at something
19 called the "NSA" or Net Securitization Adjustment, which is separate from the CTC
20 charged to customers through the unbundled rates.

21 Q WHAT IS YOUR RECOMMENDATION IN THIS REGARD?

22 A Whatever method is used to implement the CTC should also be used for the securitization
23 process that reduces the revenue requirement associated with the CTC. The same load

1 data and sales data used to allocate the CTC should be used to allocate the offset to the
2 CTC. If there is a reason for the CTC and the ITC to be two separate items, they can be
3 maintained separately but the charges to classes or offsets to classes should be done on
4 the same exact basis. If there is any netting, it should be for the entire CTC charge as
5 reduced by the securitization process. I have not found any valid reason set forth by
6 PECO to establish two different methods to charge customers for the CTC and the ITC.

7 **PROCEDURES REQUIRED TO IMPLEMENT COMPETITION**

8 **Q WHAT IS PECO'S POSITION WITH RESPECT TO METERING CUSTOMERS UNDER**
9 **RESTRUCTURING?**

10 **A** At Page 15 of his testimony, Mr. Cucchi states that "PECo's proposal is that it would
11 continue to own, maintain and read customers' billing meters.

12 **Q IS THE PECO POSITION ON BILLING THE SAME?**

13 **A** PECO contemplates that it "will normally be responsible for billing customers for its
14 unbundled, regulated services, and for Suppliers' charges." (Testimony of Gregory A.
15 Cucchi, Page 22). At a customer's request, however, it could receive a bill from its
16 supplier for energy and a separate bill from PECO for unbundled regulated delivery
17 services.

18 **Q DO YOU AGREE WITH THESE PROPOSALS?**

19 **A** No. Just as is the case with respect to generation, there are potential benefits to
20 customers from subjecting metering and billing to competition. Indeed, unless these retail
21 functions are opened to competition, there may not be a sufficient incentive for suppliers
22 enter the market for providing service to smaller customers.

1 Q DOES MR. CUCCHI PROVIDE ANY REASONS IN SUPPORT OF MAINTAINING
2 PECO'S MONOPOLY WITH RESPECT TO BILLING?

3 A He makes four arguments in support of this position: 1) He believes it is required by the
4 Competition Act; 2) "Suppliers will come and go"; 3) PECO will be in the best position to
5 ensure that changing suppliers does not result in missed or erroneous meter readings;
6 and 4) if suppliers could provide metering, they could utilize it to impose tying
7 arrangements on customers that limit their ability to switch suppliers.

8 Q DOES THE COMPETITION ACT REQUIRE THAT METERING CONTINUE AS A
9 MONOPOLY?

10 A I don't believe so. The particular requirements that the Act imposes on Local Distribution
11 Utilities (LDUs) referred to by Mr. Cucchi do not appear to prohibit others from providing
12 such services as long as it does not result in a degradation of performance.

13 Q MR. CUCCHI'S SECOND AND THIRD ARGUMENT SUGGEST A CONCERN THAT A
14 LARGE DEPENDABLE COMPANY THAT WILL NOT GO OUT OF BUSINESS MUST
15 BE RESPONSIBLE FOR METERING. IS THIS A VALID CONCERN?

16 A No. First, I would note that PECO is not the only company that is likely to remain in
17 business for a long time. Second, creditworthiness requirements can be imposed on
18 service providers as a condition of obtaining a license to provide metering. Third, when
19 a customer changes service providers, the new provider will have the same interest in
20 making sure that the customer is properly metered as does PECO.

1 Basically, these arguments are nothing more than expressions of a paternalistic
2 attitude that the customer cannot be trusted to make sound decisions as to service
3 providers and, therefore, PECO must continue to take care of the customers with respect
4 to this service.

5 **Q IS IT POSSIBLE THAT SUPPLIERS COULD LEVERAGE THE PROVISION OF**
6 **METERING SERVICE SO AS TO TIE CUSTOMERS TO BUYING THEIR ENERGY**
7 **FROM THEM?**

8 **A**To the extent that this is possible, it provides a strong argument for allowing competition
9 for the provision of metering. Customers being forced into tying arrangements can occur
10 *only where a seller with market power in one service leverages that market power to its*
11 *advantage in related competitive areas. Clearly, only the LDUs presently enjoy the ability*
12 *to do this. That ability could most effectively be limited by allowing competition for the*
13 *provision of metering.*

14 **Q DOES PECO'S PROPOSAL WITH RESPECT TO BILLING PROVIDE ADEQUATE**
15 **CUSTOMER CHOICE?**

16 **A**No. The choice PECO offers is between letting PECO provide one bill, or receiving two
17 bills each month. The logical third alternative would be to let the customer's chosen
18 service provider issue a single bill. That bill would include the amount that PECO charges
19 that provider for PECO's unbundled distribution services.

1 Q HAVE ANY OTHER COMMISSION'S ADDRESSED THESE ISSUES?

2 A Yes. In Decision 97-05-039 dated May 6, 1997, in its generic restructuring proceedings,
3 the California Public Utilities Commission (CPUC) decided several issues related to
4 metering and billing. With respect to metering, the CPUC found that "Energy suppliers
5 should be able to provide and customers should be allowed to choose the billing and
6 metering systems that are best for their purposes, so long as the metering systems are
7 consistent with the other requirements discussed in this order." (Page 30, Conclusion of
8 Law No. 4)

9 With respect to billing, the CPUC found that distribution utilities should be required
10 to facilitate three billing options: 1) consolidated distribution company billing, which is
11 PECO's "normal" case; 2) dual billing, which is PECO's alternative choice; or 3)
12 consolidated energy supplier billing, which is the alternative I just addressed and which
13 PECO has chosen not to offer.

14 Q DID THAT DECISION DISCUSS ANY OTHER ISSUES OF PARTICULAR RELEVANCE
15 TO THE PECO PROPOSAL?

16 A Yes. An issue that was given considerable attention was the proposal of Southern
17 California Edison Company (SCE) to implement Automatic Meter Reading (AMR). The
18 CPUC was particularly concerned that such metering would be installed at customers
19 expense only to provide a barrier to entry preventing other firms from competing for the
20 provision of metering.

21 Q HOW IS THAT RELEVANT TO THIS PROCEEDING?

22 A PECO has also proposed to begin implementing AMR. If it is allowed to do so, it could
23 effectively preclude competition for this important service and insure its monopoly position

1 long into the future. Meter reading is obviously not a service that warrants monopoly
2 status. Competition may bring lower costs and efficiency to the meter reading function.
3 If AMR is allowed, some general standards should be established to provide for
4 competition in providing this service.

5 **Q PECO HAS PROPOSED THE USE OF CUSTOMER LOAD PROFILES TO MAKE IT**
6 **POSSIBLE FOR SMALLER CUSTOMERS WITHOUT SOPHISTICATED METERING TO**
7 **TAKE ADVANTAGE OF DIRECT ACCESS. DO YOU AGREE WITH THAT**
8 **PROPOSAL?**

9 **A** Yes. However, I would point out that the application of the concept of load profiles
10 requires a rather complicated, after the fact, settlement process to determine the usage
11 responsibility of each customer. PECO has provided some discussion of this process, but
12 I believe much greater detail is required. This is particularly the case with respect to the
13 allocation of responsibility for ancillary services, system losses and imbalances between
14 energy actually supplied for a particular customer and that customer's actual
15 consumption. In particular, care must be taken to insure that the allocations necessary
16 to spread these costs among load profiled customers do not spill over to affect the bills
17 of hourly metered customers for whom such allocations are not necessary.

18 **Q DO YOU HAVE ANY OTHER COMMENTS CONCERNING PECO'S DIRECT ACCESS**
19 **PROPOSALS?**

20 **A** Yes. An important aspect of customer choice is the ability of customers to aggregate their
21 loads in order to consolidate purchases from suppliers and to take advantages of diversity
22 between loads at different billing locations. It is not clear that the PECO proposal would
23 allow such aggregation. In particular, in its Pilot proposal, PECO's definition of a customer

1 is restricted to a single point of delivery. Thus, to the extent that this definition or any
2 other aspect of PECO's proposal would prevent a customer from aggregating several
3 metering locations for the purpose of purchasing energy supply, I would recommend that
4 the necessary changes be made to make such aggregation possible. In addition, it is
5 highly recommended that groups of different customers be allowed to aggregate their
6 loads to take advantage of consolidated purchases and diversity. PECO's proposals
7 should not prevent or even discourage aggregation.

8 Q DOES THIS CONCLUDE YOUR TESTIMONY?

9 A Yes, it does.

1

Qualifications of Nicholas Phillips, Jr.

2 Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

3 A My name is Nicholas Phillips, Jr. and my business mailing address is P. O. Box 412000,
4 St. Louis, Missouri 63141-2000.

5 Q PLEASE STATE YOUR OCCUPATION.

6 A I am a consultant in the field of public utility regulation and am a principal in the firm of
7 Brubaker & Associates, Inc., regulatory and economic consultants.

8 Q PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND PROFESSIONAL
9 EMPLOYMENT EXPERIENCE.

10 A I graduated from Lawrence Institute of Technology in 1968 with a Bachelor of Science
11 Degree in Electrical Engineering. I received a Master's of Business Administration
12 Degree from Wayne State University in 1972. Since that time I have taken many Masters
13 and Ph.D. level courses in the field of Economics at Wayne State University and the
14 University of Missouri.

15 I was employed by The Detroit Edison Company in June of 1968 in its Professional
16 Development Program. My initial assignments were in the engineering and operations
17 divisions where my responsibilities included the overhead and underground design,
18 construction, operation and specifications for transmission and distribution equipment;
19 budgeting and cost control for operations and capital expenditures; equipment
20 performance under field and laboratory conditions; and emergency service restoration.
21 I also worked in various districts, planning system expansion and construction based on
22 increased and changing loads.

1 Since 1973, I have been engaged in the preparation of studies involving revenue
2 requirements based on the cost to serve electric, steam, water and other portions of utility
3 operations.

4 Other responsibilities have included power plant studies; profitability of various
5 segments of utility operations; administration and recovery of fuel and purchased power
6 costs; sale of utility plant; rate investigations; depreciation accrual rates; economic
7 investigations; the determination of rate base, operating income, rate of return; contract
8 analysis; rate design and revenue requirements in general.

9 I have held various positions including Supervisor of Cost of Service, Supervisor
10 of Economic studies and Depreciation, Assistant Director of Load Research, and was
11 designated as Manager of various rate cases before the Michigan Public Service
12 Commission and the Federal Energy Regulatory Commission. I was acting as Director
13 of Revenue Requirements when I left Detroit Edison to accept a position at Drazen-
14 Brubaker & Associates, Inc., in May of 1979.

15 The firm of Drazen-Brubaker & Associates, Inc. was incorporated in 1972 and has
16 assumed the utility rate and economic consulting activities of Drazen Associates, Inc.,
17 active since 1937. In April, 1995 the firm of Brubaker & Associates, was formed. It
18 includes most of the former DBA principals and staff.

19 Our firm has prepared many studies involving original cost and annual
20 depreciation accrual rates relating to electric, steam, gas and water properties, as well
21 as cost of service studies in connection with rate cases and negotiation of contracts for
22 substantial quantities of gas and electricity for industrial use. In these cases, it was
23 necessary to analyze property records, depreciation accrual rates and reserves, rate base
24 determinations, operating revenues, operating expenses, cost of capital and all other
25 elements relating to cost of service.

1 In general, we are engaged in valuation and depreciation studies, rate work,
2 feasibility, economic and cost of service studies and the design of rates for utility services.

3 **Q WHAT ADDITIONAL EDUCATIONAL, PROFESSIONAL EXPERIENCE AND**
4 **AFFILIATIONS HAVE YOU HAD?**

5 **A** I have completed various courses and attended many seminars concerned with rate
6 design, load research, capital recovery, depreciation, and financial evaluation. I have
7 served as an instructor of mathematics of finance at the Detroit College of Business
8 located in Dearborn, Michigan. I have also lectured on rate and revenue requirement
9 topics.

10 **Q HAVE YOU PREVIOUSLY APPEARED BEFORE A REGULATORY COMMISSION?**

11 **A** Yes. I have appeared before the New Jersey Board of Public Utilities, the Public Service
12 Commissions of Indiana, Iowa, Kansas, Kentucky, Maryland, Michigan, Montana, New
13 York, North Carolina, Ohio, Pennsylvania, South Carolina, South Dakota and West
14 Virginia, the Lansing Board of Water and Light, and the Council of the City of New
15 Orleans in numerous proceedings concerning cost of service, rate base, unit costs, pro
16 forma operating income, appropriate class rates of return, adjustments to the income
17 statement, revenue requirements, rate design, integrated resource planning, power plant
18 operations, fuel cost recovery, regulatory issues, rate-making issues, environmental
19 compliance, avoided costs, cogeneration, cost recovery, economic dispatch, rate of
20 return, demand-side management, regulatory accounting and various other items.

Certificate of Service

I hereby certify that I have this day served the foregoing document on the following in the matter of Pennsylvania Public Utility Commission v. PECO Energy Company Pa. PUC Docket No. R-00973953.

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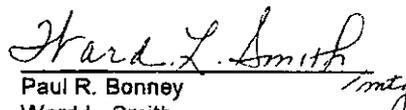
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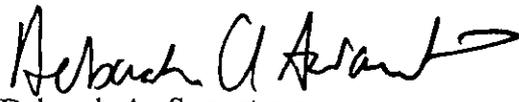
**Re: Application of PECO Energy Company For Approval
Of Its Restructuring Plan Under Section 2806
Of The Public Utility Code; Docket No. R-00973953**

Dear Mr. Bonney:

Enclosed are Allegheny Power's Answers to PECO Energy Company's
Interrogatories, Set I, Nos. 1 through 12.

Should you have any questions, please call us.

Sincerely,


Deborah A. Swanstrom

Enclosure

cc: James J. McNulty (Certificate of Service Only)
All Parties (By First Class Mail)

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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 :

Docket No. R-00973953

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CERTIFICATE OF SERVICE

PA PUBLIC UTILITY COMMISSION
REGULATORY SERVICES OFFICE

I hereby certify that I have this day served a true copy of the foregoing answers of Allegheny Power to PECO Energy Company's Interrogatories, Set I, Nos. 1 through 12 upon the participants, listed below, in accordance with the requirements of § 1.54 (relating to service by a participant).

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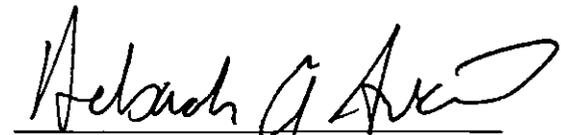
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Dated this 18th day of June, 1997.



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KJR

GARY A. JEFFRIES
Senior Attorney

June 18, 1997

By Fax and First Class Mail

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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. Bonney:

On June 16, 1997, I faxed to you CNG Energy Services Corporation's response to PECO's Interrogatories Set 1, numbered 1 through 12. This is to clarify that CNG will not be calling an expert witness in this proceeding. Therefore, it is unnecessary for CNG to respond individually to Interrogatories 1 through 12.

Sincerely,

Gary A. Jeffries
Gary A. Jeffries

001
97 JUN 20 AM 9:22
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cc: All Parties
James McNulty, Acting Prothonotary

WICKETEE

JUL 01 1997

[[pecoltr]jeffries]

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I hereby certify that I have served the foregoing document, dated June 18, 1997, by First Class Mail, upon the persons addressed below:

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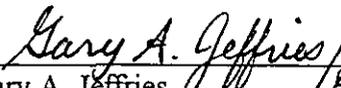
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June 18, 1997

Paul R. Bonney, Esq.
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VIA FEDERAL EXPRESS

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

Dear Paul:

Enclosed is the response of Philadelphia Area Industrial Energy Users Group ("PAIEUG") to PECO Energy Company's Interrogatories and Document Requests - Set II, to Interrogatory 20.

Very truly yours,

McNEES, WALLACE & NURICK

By


Derrick P. Williamson

DPW/jb

c: Certificate of Service
James J. McNulty, Prothonotary (Certificate of Service only)

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CERTIFICATE OF SERVICE

I hereby certify that I have this day served a true copy of the foregoing responses to interrogatories and document requests of PECO Energy Company - Set II of the Philadelphia Area Industrial Energy Users Group upon the participants listed below in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a participant).

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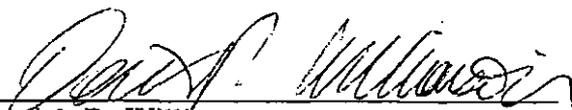
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Derrick P. Williamson

Dated this 18th day of June, 1997, in Harrisburg, Pennsylvania.



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June 18, 1997

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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 XI: OCA-XI-10 and OCA-XI-25.

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

Sincerely,

Paul Bonney

PRB/mbo
Enclosures

cc: w/enclosures
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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-8, Navy-I-9, Navy-I-19, Navy-I-34, Navy-I-35, and Navy-I-42.

Sincerely,

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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 are PECO Energy Company's Answers to the Environmentalists'
Interrogatories:

Set I Environmentalists-I-29.

Set II Environmentalists-II-90.

Set III Environmentalists-III-151, Environmentalists-III-154, Environmentalists-
III-155 through Environmentalists-III-157, Environmentalists-III-159 and
Environmentalists-III-161.

Sincerely,

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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-2.

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

Sincerely,

Paul Bonney

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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 XI: OCA-XI-10 and OCA-XI-25.

Department of the Navy's Interrogatories: Set I Navy-I-8, Navy-I-9, Navy-I-19, Navy-I-34, Navy-I-35, and Navy-I-42.

Environmentalists' Interrogatories: Set I Environmentalists-I-29. Set II Environmentalists-II-90. Set III Environmentalists-III-151, Environmentalists-III-154, Environmentalists-III-155 through Environmentalists-III-157, Environmentalists-III-159 and Environmentalists-III-161.

Office of Small Business Advocate's Interrogatory: Set I OSBA-I-2.

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Dated: June 18, 1997

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June 18, 1997

001847

VIA HAND DELIVERY

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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

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PROTHONOTARY'S OFFICE

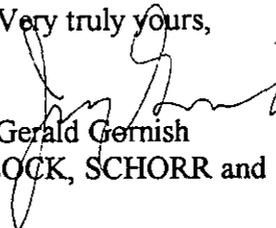
Dear Ward:

Enclosed are Enron's Answers to PECO's Set I, Nos. 3-12. Since the documents referenced in Questions 6 and 7 turned out to be more voluminous than anticipated, we have not copied and included them, but will make them available for review in our office and furnish copies of those you find pertinent.

Copies of documents are only being included with the response being sent to PECO Energy, except for the resume and list of proceedings, which are being included for all parties.

In addition, as I advised you, we do not contemplate presenting direct testimony of Richard Koda. Accordingly, we will not be responding to Interrogatory Nos. 13-22.

Very truly yours,


Gerald Gernish

For WOLF, BLOCK, SCHORR and SOLIS-COHEN

GG/lak

Enclosures

cc: James McNulty, Acting Prothonotary (Certificate of Service only)
Certificate of Service

DSB:439167.1

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

DOCKETED
JUN 24 1997

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a true copy of the foregoing documents upon the participants, listed below, in accordance with the requirements of § 1.54 (relating to service by a participant):

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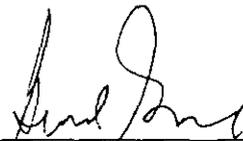
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Gerald Gornish

Dated: June 18, 1997