

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

R-00973953

R-973953

Commissioners Present:

Public Meeting held May 22, 1997

John M. Quain, Chairman, Statement attached
Robert K. Bloom, Vice Chairman
John Hanger, Statement attached
David W. Rolka, Dissenting in part - Opinion attached
Nora Mead Brownell

Application of PECO Energy Company :
For Issuance Of A Qualified Rate :
Order Under Sections 2808 and 2812 :
Of The Public Utility Code :

Pennsylvania Public Utility :
Commission, :
Office of Consumer Advocate, :
The Environmentalists, :
Office of Trial Staff, :
Office of Small Business Advocate :
and :
Consumers' Education and Protective :
Association, *et al.*, :
Honorable Vincent J. Fumo, Senator, :
Honorable Angel L. Ortiz, Councilman, :
Allegheny Power, :
Indianapolis Power and Light Company, :
Enron Capital and Trade Resources, :
Pennsylvania Power and Light Company, :
Minority Energy Coalition, :
GPU Energy, :
Lance Haver, and :
Philadelphia Area Industrial Energy Users :
Group, :
Intervenors :
v. :
PECO Energy Company :

Docket Nos.
R-00973877
R-00973877C0001
R-00973877C0002

DOCUMENT
FOLDER

OPINION AND QUALIFIED RATE ORDER

May 22, 1997

I. Introduction and Overview

On December 3, 1996, Governor Thomas J. Ridge signed into law Act 138 entitled "the Electricity Generation Customer Choice and Competition Act" (the Act). The Act is reduced to law in the Public Utility Code (the Code), at 66 Pa. C.S. §2801, et seq. The Act provides a detailed legislative scheme for the restructuring of the Pennsylvania electric industry by, in part, allowing retail customers the opportunity to choose their generation supplier beginning January 1, 1999. (66 Pa. C.S. §2806).

A provision of the Act at 66 Pa. C.S. §2806(d) requires that each electric utility in the Commonwealth submit to the Commission a restructuring plan between April 1, 1997 and September 30, 1997. The plan will, in effect, restructure the rates, rules, regulations and practices of each jurisdictional electric utility in accordance with the intention of the Act and meet the new market structure. The ultimate goal of the restructuring is to deregulate the generation function of electric service.

In connection with the restructuring of the electric utilities, the Commission is authorized to issue a Qualified Rate Order¹ (QRO) to facilitate the recovery or financing of qualified transition expenses of an electric utility or assignee. Subsequent to the effective date of the Act, an electric utility may file an application for a QRO concurrently with, prior to, during or following the filing of its restructuring plan under Section 2806. (66 Pa. C.S. §2812(a)(2)(ii)).

Moreover, a utility has the option to request expedited review by the Commission of its request for a QRO, in which case, the Commission must render its

¹ A Qualified Rate Order is an Order of the Commission adopted in accordance with Section 2812 of the Competition Act, authorizing the imposition and collection of intangible transition charges. 66 Pa. C.S. §2812(g).

final determination on the request within 120 days after the request for expedited review. (66 Pa. C.S. §2812(b)). Applications for QROs must contain the following elements:

- (i) a complete accounting of the utility's transition or stranded costs;
- (ii) detailed information regarding the utility's proposal for the sale of intangible transition property or the issuance of transition bonds; and
- (iii) information regarding the electric utility's planned use of the proceeds.

66 Pa. C.S. §2812(a)(2)(i).

After notice and opportunity to be heard, the Commission may issue a final QRO for all or a portion of the amount of the transition or stranded costs that it determines to be just and reasonable for the utility to recover from ratepayers under Section 2804 (concerning standards) and 2808 (concerning the Competitive Transition Charge). The Commission is authorized to issue a final QRO only for the amounts which it finds to be in the public interest.² (66 Pa. C.S. §2812(a)(2)(iii)).

² The Commission must complete its review of the Application and issue its final determination by no later than nine (9) months from the filing, unless the utility requests expedited treatment under 66 Pa. C.S. §2812(b), or 15 days after the utility has filed its restructuring plan pursuant to 66 Pa. C.S. §§2806, 2812(a)(2)(iii).

II. History of the Proceeding

PECO Energy Company (PECO or Company) proffered the following history of its Application for Issuance (Application) of a QRO:

PECO filed its Application for a Qualified Rate Order on January 22, 1997 and concurrently served copies of its filing on the Offices of Trial Staff (OTS), Consumer Advocate (OCA) and Small Business Advocate (OSBA) and on the Philadelphia Area Industrial Energy Users Group (PAIEUG). The Company [PECO] also provided immediate notice of its Application to all of the other parties which actively participated in its last electric base rate case, among other interested parties, and began including bill inserts commencing with all bills issued on the date of the filing. In addition, PECO published notice of the Application in all newspapers of general circulation in its service territory and proposed that notice be published promptly in the Pennsylvania Bulletin, which it was on February 1, 1997.

(PECO M. B., p. 5). (Footnotes omitted.)

Formal Complaints in this proceeding were filed by the OCA and an ad hoc group which includes: Delaware Valley Citizens' Council for Clean Air, Citizen Action, NESIP, Pennsylvania Public Interest Research Group, Philadelphia Solar Energy Association, Sierra Club and Trout Unlimited - Pennsylvania Council (collectively referred to as Environmentalists).

The following parties were designated as intervenors: Action Alliance of Senior Citizens, Tenant Action Group, John W. Long, Jr., Consumers' Education and Protective Association (the preceding parties were all represented by the same attorney and will be referred to as CEPA), Senator Vincent J. Fumo (Senator Fumo), Councilman

Angel L. Ortiz, West Penn Power Company t/a Allegheny Power, Indianapolis Power & Light Company (IP&L), Enron Capital & Trade Resources (Enron), Pennsylvania Power & Light Company (PP&L), Minority Energy Coalition (the Coalition included the Greater Philadelphia Urban Affairs Coalition, the Hispanic Association of Contractors and Enterprises, Intercultural Family Services, Inc., the Urban League of Philadelphia, and the Partnership CDC.), Metropolitan Edison Company and Pennsylvania Electric Company (individually and collectively trading as GPU Energy) (GPU), Lance Haver and the Philadelphia Area Industrial Energy Users Group (PAIEUG). PAIEUG included Air Liquide America Corporation, Allied Signal, Inc. - Fibers Division, Boeing Defense & Space Group - Helicopters Division, The Budd Company, Ford Motor Company, Lukens Inc., Merck & Co. Inc., Nabisco Inc., Occidental Chemical Corporation, Rohm and Haas Company, Smith Kline Beecham Pharmaceuticals, Sun Company, Inc., Temple University, Thomas Jefferson University, U.S. Steel - A Unit of USX Corporation. The OTS and the OSBA participated as active parties in this proceeding.

Prehearing conferences were held on January 27, 1997, and March 4, 1997. Two public participation hearings were held on March 6, 1997, in Philadelphia. Seven days of hearings were held from March 10, 1997 through March 18, 1997, for the cross-examination of expert witnesses. Two additional public participation hearings were held on March 19, 1997, one in Media and one in Norristown.

The Administrative Law Judge's (ALJ) Recommended Decision was issued April 14, 1997. Whereupon, the following parties filed Exceptions: PECO, Senator Fumo, Environmentalists, CEPA, OCA, IP&L, and PAIEUG. Reply Exceptions were filed by the following parties: PECO, Senator Fumo, Environmentalists, CEPA, OCA, PAIEUG, OTS, OSBA, IP&L and Enron.

A. Procedural Matters³

1. Standing of Indianapolis Power and Light

PECO contends in its Reply Exceptions that IP&L lacks standing in this proceeding. PECO asserts that IP&L is not a "customer" and, therefore, lacks the requisite direct, substantial and immediate interest to possess standing. The issue of standing should have been raised by PECO in its Exceptions and not in the Reply Exceptions. Procedurally, we conclude that PECO has waived its right to object to the ALJ's ruling.

Furthermore, the Act requires this Commission to foster a competitive retail generation market. Therefore, any participant in this future market has a direct interest in the structure and rules of that market. As the owner of generation resources which it may sell in the Commonwealth, IP&L has a direct interest in this proceeding.

2. Allegheny Power Settlement

By Letter dated February 27, 1997, Allegheny Power submitted a Settlement Agreement between itself and PECO. The Settlement represents that Allegheny Power's primary concern with this proceeding was the intended use of the proceeds of the sale of the Intangible Transition Property (ITP). The Settlement also states that Allegheny Power is satisfied with the additional commitments made by PECO regarding the use of any proceeds. We find this Settlement Agreement to be reasonable and in the public interest and, as a result, it is approved.

³ On April 14, 1997, Senator Fumo, CEPA, et al., filed a Motion for Consolidation and Temporary Stay of Proceedings. Subsequently, on May 12, 1997, Senator Fumo, CEPA, et al., filed an Application for Leave to Withdraw the Motion which has been considered and is, hereby, granted.

III. Primary Recommendation

A. Expedited Qualified Rate Order Procedure

PECO requested an expedited review of its Application for a QRO⁴ pursuant to Section 2812(b)(1)(i) of the Code, 66 Pa. C.S. §2812(b)(1)(i). PECO asserted that the aforementioned Section of the Code expressly authorizes the issuance of a QRO in advance of the final approval of a utility's restructuring plan to facilitate the securitization of stranded costs. PECO's Application seeks to utilize Section 2812 of the Act to pass the benefits of securitization on to its customers at the earliest possible date. PECO anticipated that the net effect of the securitization process would be an annual rate reduction of approximately \$111 million or about \$1.1 billion over the next ten years. (PECO M.B., p. 1).

The ALJ's primary recommendation in this matter was to dismiss the filing and refer the entire matter to PECO's restructuring proceeding. (R.D., p. 17). In large part, the ALJ reached that determination based upon his theory that an expedited application for a QRO must limit itself to "uncontroversial" claims for stranded investment. In his discussion regarding PECO's Application, the ALJ stated that "Expedited QRO cases can only be completed in 120 days if the assets which are subject to the securitization are uncontroversial." (R.D., p. 17). The ALJ concluded that a fully litigated proceeding could not be concluded within that time frame given the number of standards. Accordingly, the ALJ determined that the Act could only have meant that an application for an expedited QRO must be "so clearly uncontroversial that it will allow review in the minimum time (120 days) permitted (and preferably, without a hearing)." (R.D., p. 11).

⁴ PECO seeks a QRO which will permit it to recover Qualified Transition Expenses totalling \$3.773 billion.

PECO filed an exception to the ALJ's determination that an expedited QRO must be limited to clearly uncontroversial assets. PECO asserts that a denial based upon the controversial nature of the claims at issue would "simply emasculate the statute." PECO contends that a rule that would require the Commission to side-step controversial issues would have the practical effect of conveying upon every intervenor veto power over a utility's securitization request. (PECO Exc., p. 9).

PECO also points out that although parties to this matter argued over various elements of the claim, not all parties contested the same elements or even agreed upon the adjustments advanced for a particular element. PECO suggests that given an issue of first impression under these circumstances, there is little hope of ever filing an application that would meet the ALJ's noncontroversial test. (PECO Exc., pp. 8-10).

PECO also argues that mere opposition to an issue does not require that the application be deferred in its entirety. Yet that is precisely what the ALJ would require, according to PECO. PECO asserts that it is up to the Commission to determine whether the alleged controversy is legitimate and, if so, whether interested parties have been provided an adequate opportunity to present their case. (PECO Exc., p. 10).

The Environmentalists responded by arguing, as the ALJ found, that the Act must have envisioned a noncontroversial application because of the brief time frame. They assert that the state of the record and the arguments now being made are clear indications that the Act envisioned a noncontroversial filing. (Environmentalist R.E., pp. 2-6).

In its Reply Exceptions, the OCA submits that the ALJ correctly determined that expedited securitization pursuant to the Act should be utilized for less controversial

claims which can be known and measured with reasonable certainty, and whose recovery is reasonably assured under the Act. The OCA submits that it is the size, scope, complexity and significance of PECO's request, which, when adjudicated in such an expedited fashion, is not capable of a fair and proper resolution given the allegedly insufficient record produced. The OCA urges the Commission not to make irrevocable decisions in this expedited proceeding, which could later prove unwise, given a more fully developed record, just to begin a securitization process a few months earlier than would otherwise be permitted. (OCA R.E., p. 8).

We reject, as unpersuasive, both the ALJ's recommendation and the parties' arguments which suggest a noncontroversial standard. PECO is correct in stating that such a standard renders impossible any expedited QRO filing. Controversy will exist over these matters. However, these matters are within the specific expertise of this Commission and we will fulfill our responsibilities under the Act.

We reiterate that nothing in the Act provides that an expedited QRO must limit itself to noncontroversial matters and we decline to graft such a requirement on the process here. The Act clearly states that applications for expedited securitization may be filed. Also, the Act does not limit the amount of securitization for which a utility may seek expedited review. Further, the Act plainly contemplates that there will be some contest in an expedited securitization proceeding. Section 2812((b)(1)(i) of the Act, 66 Pa. C.S. §2812(b)(1)(i), expressly provides for a determination of an expedited securitization application "[a]fter notice and an opportunity to be heard." Based upon the foregoing, we reject the ALJ's determination regarding a threshold requirement of "noncontroversial" stranded investment claims and grant PECO's Exception.

Senator Fumo, in his Exceptions, argues that the ALJ incorrectly implied that a QRO may be rendered prior to the Commission's consideration and evaluation of a utility's comprehensive restructuring plan. It is the position of Senator Fumo that the implication of the Recommended Decision is contrary to the plain language of the Act's definition of "transition or stranded costs." Senator Fumo argues that, by definition, stranded costs may only be determined as part of a utility's restructuring plan. Senator Fumo asserts that it is clear that a utility may file an application for a QRO prior to its restructuring plan, but it does not necessarily follow that a utility may receive a QRO in advance of the Commission's consideration of a utility's comprehensive restructuring plan. (Senator Fumo Exc., p. 3). Senator Fumo also excepts to the ALJ's finding that the 120-day statutory period for review of PECO's QRO mandates a resolution during the 120-day time frame.

We disagree with Senator Fumo's argument that, by definition, stranded costs are only to be determined as part of a utility's restructuring plan. We find that this assertion is incongruent with the expressed language of the Act. Pursuant to Section 2812 of the Act, expedited requests for securitization must be decided within 120 days. This is the time frame approved by the General Assembly of Pennsylvania. We do not consider it within our purview to question the propriety of this time frame. Accordingly, the Exception of Senator Fumo regarding the propriety of the Expedited QRO review is denied.

B. PECO's Securitization Request and Mitigation Efforts

PECO asserted that the approval of its securitization proposal in this case would act to significantly mitigate its stranded costs. PECO added that the mitigation initiatives it has taken to date have enabled PECO to avoid filing for a general rate

increase since 1989 and will save customers hundreds of millions of dollars in terms of avoided stranded costs. Furthermore, PECO noted that its mitigation efforts were launched well before the Act became law, and not in response to it. (PECO M.B., pp. 58-59).

The ALJ found that PECO did not meet its burden of proving that it made a reasonable effort to mitigate its stranded or transition costs pursuant to Section 2806(c)(4)(i)-(vi) of the Act. (R.D., p. 16). The ALJ concluded, based upon his review, evaluation and analysis of the record that PECO failed to make a reasonable effort to mitigate its stranded costs in the totality of the circumstances. (R.D., p. 17).

PECO, by way of Exception, contends that the ALJ disregarded substantial record evidence, and misconstrued the requirements imposed by the Act. PECO contends that the ALJ's criticisms are clearly misplaced. PECO disagrees with the ALJ's interpretation of the Act contending that the various mitigation measures enumerated in Section 2808(c)(4) do not constitute affirmative obligations with which each electric utility must comply, but instead represents a list of examples. PECO points out that the term "list of examples" was a term actually used by the ALJ in his discussion of the issue. (PECO Exc., p. 12).

In its Reply Exceptions, the OCA argues that the ALJ raised many serious concerns regarding the timeliness and adequacy of PECO's mitigation efforts. The OCA urges the Commission to ensure that all parties have the right to thoroughly address this issue in PECO's restructuring proceeding where the timeliness and adequacy of PECO's mitigation efforts can be completely reviewed. (OCA R.E., p. 8).

In their Reply Exceptions, the Environmentalists characterize PECO's actions as an effort to improve its profitability. The Environmentalists opine that PECO offers a circular view of mitigation wherein the securitization, which it must justify by proving it has mitigated, is itself a mitigation measure. (Environmentalists R.E., p. 7).

We interpret the provisions of Section 2808(c) of the Act as elements to be considered in setting a Competitive Transition Charge (CTC) and, by reference to Section 2808 within Section 2812, in ruling on a request for a QRO. We find that the failure of an electric utility to reasonably mitigate its stranded costs is not a reason, in and of itself, to dismiss a request for a QRO or a CTC. We are of the opinion that mitigation efforts may be considered in the process of determining the appropriate level of the QRO or CTC, but is not a threshold evidentiary standard for the establishment of a QRO or CTC.

Our reading of Section 2808 of the Act, leads us to conclude that the list of items contained in Section 2808(c)(4) (i)-(iv) of the Act are examples of mitigation expenses, and are not required actions pursuant to the Act. While PECO has undertaken some mitigation efforts, and no party has challenged its mitigation efforts to date, we believe that it is appropriate and in the public interest that this issue be further scrutinized in the restructuring proceeding.

Accordingly, we shall grant the Exception of PECO on this issue to the extent that it is consistent with the foregoing discussion. We shall reject the ALJ's finding and recommendation regarding PECO's mitigation efforts made pursuant to Section 2808(c)(4) (i) through (iv).

IV. Alternate Recommendation

A. Introduction

The ALJ made it clear that his primary recommendation in this matter is to deny PECO's request for an expedited QRO in its entirety, and to incorporate the record from this proceeding into the record of PECO's Application for Approval of its Restructuring Plan. Recognizing, however, that the Commission may not accept that recommendation, the ALJ provided an alternate recommendation. This alternative, if adopted, would grant PECO's request to the limited extent that it be permitted to securitize assets and issue transition bonds in the amount of \$328.078 million.

A number of legal and technical issues have been raised by the various parties concerning the alternate recommendation.

B. Legal Issues

During the course of this proceeding, various parties raised issues regarding the burden of proof, the irrevocable nature of all or a portion of the QRO, the constitutionality of the Act and the process employed in this particular proceeding, antitrust implications, the Rate Cap provided in Section 2804 of the Act and the "regulatory compact" which PECO has asserted exists between itself and the Commonwealth of Pennsylvania. We will address these matters seriatim.

1. Requirements of the Act

a. Burden of Proof

As the proponent of its Application and the QRO sought therein, PECO is the party with the burden proof. 66 Pa. C.S. §332(a). Historically, a party which has the burden of proof before this Commission is required to carry that burden by proving its case by a preponderance of the evidence. Samuel J. Lansbury, Inc. v. Pennsylvania Public Utility Commission, 572 A.2d 600 (Pa. Commonwealth Ct. 1990), petition for allowance of appeal denied 529 Pa. 654, 602 A.2d 863 (1992); See also North American Coal Corporation v. Air Pollution Commission, 279 A.2d 356 (Pa. Commonwealth Ct. 1971) (burden of proof before administrative tribunals is the same as most civil proceedings, a preponderance of the evidence). A preponderance of the evidence means that one party has provided evidence which is more convincing, by even the smallest amount, than that submitted by its opponents. Se-Ling Hosiery v. Margulies, 364 Pa. 45, 70 A.2d 854 (1954).

Before the ALJ, several parties argued that PECO must be held to a higher standard of proof than a preponderance of the evidence. For example, Senator Fumo argued that PECO must demonstrate “a clear right to relief, free from all doubt, and further show that some irreparable immediate harm will result if such relief is not provided.” (Fumo M.B., p. 22). CEPA argued that PECO “must demonstrate that it has clear right to relief, that the need for relief is immediate, that the applicant would suffer irreparable injury if not granted relief, and that the relief requested is not injurious to the public interest.” (CEPA M.B., p. 5). PECO asserted that its burden is the historical preponderance of the evidence standard. (PECO Reply Memorandum of Law, p. 9).

At Page 18 of the Recommended Decision, the ALJ determined that PECO is required to prove its case by a preponderance of the credible evidence.

The Environmentalists, and others, have excepted to the ALJ's determination that PECO's burden here is a preponderance of the evidence standard. The Environmentalists argue that an expedited QRO "is an extraordinary remedy, within the context of an extraordinary statute..." (Environmentalists Exc., p. 6). Based upon this view, the Environmentalists argue that PECO must meet its burden "with compelling evidence." (*Id.*). Similarly, Senator Fumo and CEPA argue that PECO must meet its burden by showing that it has a "clear right" to a QRO. (Fumo Exc., p. 5). (CEPA Exc., pp. 4-5). PECO responds that all three parties which filed exceptions on this issue misconstrue the nature of the Act's securitization provisions. (PECO R.E., pp. 4-5).

We have reviewed the Act in depth and can find no support for the conclusion that a higher burden of proof should be required in this action than has been historically demanded of a party before this Commission. Senator Fumo's and CEPA's arguments and authority are grounded in case law which addresses injunctive relief proceedings. Injunctive relief actions have historically imposed extremely high burdens of proof on parties seeking that form of remedy. Here, the Act provides particular standards which PECO must address in the course of its case, such as the "known and measurable" standard for stranded costs set forth in Section 2803 of the Act. However, the burden of proof by which PECO establishes those standards is a preponderance of the evidence as that term is defined by Se-Ling Hosiery, Lansbury, supra. We approach this issue with a focus on the fact that the potential irrevocability of the Commission's QRO compels us to be assured that the substantial record evidence is credible.

Therefore, the Exceptions of the Environmentalists, et al., on this issue are denied.

b. Standards

As we have noted above, PECO has the burden of proving, by a preponderance of the evidence, that the relief it seeks here should be awarded. In this matter, PECO must establish that its Application for securitization of \$3.77 billion of expenses is warranted. In reviewing PECO's Application, we must ensure that our findings and determinations are supported by substantial evidence of record.

We are mindful as we review PECO's Application that we are also making a determination that a portion of PECO's asserted stranded investment qualifies for recovery as stranded or transition costs as those terms are defined in the Act. Accordingly, we are guided by the Act's standards which provide that any amount of stranded investment that is allowed for recovery must be (1) known and measurable; (2) calculated at the net present value; (3) just and reasonable; and (4) in the public interest. 66 Pa. C.S. §§2804, 2812.

The term "just and reasonable" has been a guidepost in traditional ratemaking. The Pennsylvania Supreme Court has stated:

the term "just and reasonable" was not intended to confine the ambit of regulatory discretion to an absolute or mathematical formulation but rather to confer upon the regulatory body the power to make and apply policy concerning the appropriate balance between prices charged to utility consumers and returns on capital to utility investors consonant with constitutional protections applicable to both.

Pennsylvania Public Utility Commission v. Pennsylvania Gas and Water Co., 492 Pa. 326, 337; 424 A.2d 1213, 1219 (1980), certiori denied 454 U.S. 824, 102 S.Ct. 112, 70 L. Ed.2d 97. In the context of the Act, we deem the essence of “just and reasonable” to require the balancing of the interests of shareholders, ratepayers, and new entrants to the market as we move to a competitive electric generation market. Similarly, as we approach this proceeding with a view to the “public interest,” the “public” includes the ratepayers, the utility and its shareholders as well as participants in the emerging electric generation market.

In its Application, PECO has requested that any QRO which is issued in this proceeding be declared to be irrevocable. (Application, ¶ 23, p. 14). The Act expressly provides for our authority to provide that all, or a portion, of a QRO shall be irrevocable:

Notwithstanding any other provision of law, the Commission has the power to specify that all or a portion of a Qualified Rate Order shall be irrevocable. To the extent so specified, neither the order nor the intangible transition charges authorized to be imposed and collected under the order shall be subject to reduction, postponement, impairment or termination by any subsequent action of the Commission. Nothing in this paragraph is intended to supersede the right of any party to judicial review of the Qualified Rate Order.

66 Pa. C.S. §2812(b)(3).

The determination of whether to provide that all or a portion of a QRO is irrevocable is to be made separately from the determination of whether to grant the QRO in the first instance. 66 Pa. C.S. §2812(b)(3). Although the Act does not expressly provide standards for approval of irrevocable status within that Section, we find that this

determination should be made based upon a just and reasonable standard and whether, based upon all the evidence, a grant of irrevocable status is in the public interest. See 66 Pa. C.S. §§1301, 2812.

In making the determination of whether or not approval of irrevocable status is just and reasonable and in the public interest, we must determine whether such a grant will produce net benefits, considering the risks, over a revocable QRO. This determination must be made from the perspective of the ratepayers who will be obligated to finance the full costs of such bonds. As we have noted, PECO must establish that irrevocable status is warranted by a preponderance of the evidence and our determination must be supported by substantial evidence. Lansbury. Our determination of the irrevocable status of the QRO and the evidentiary discussion of that determination is provided infra.

2. Constitutional Issues

a. Statute

Various parties in this proceeding (e.g. CEPA, Senator Fumo, the Environmentalists) have raised issues regarding the constitutionality of the statute and the manner of its enactment. PECO asserted that this Commission does not have authority to make constitutional determinations relating to our governing statute. The ALJ agreed with PECO and declined to rule on these constitutional issues. The Environmentalists filed Exceptions relating to the constitutionality of the statute, but generally agreed with the ALJ's position. (*Environmentalist Exc.*, pp. 10-12),

In Borough of Green Tree v. Board of Property Assessments, 459 Pa. 262, 328 A.2d 819 (1974), the Pennsylvania Supreme Court stated:

Our opinions in the past have generally shown an awareness that the more direct the attack on the statute, the more likely it is that exercise of equitable jurisdiction will not damage the role of the administrative agency charged with enforcement of the act, nor require, for informed adjudication, the factual fabric which might develop at the agency level. The reason, we believe, is that the determination of the constitutionality of enabling legislation is not a function of the administrative agencies thus enabled. See Philadelphia Life Insurance Company v. Commonwealth, 410 Pa. 571, 190 A.2d 111 (1963). The more clearly it appears that the question raised goes directly to the statute the less need exists for the agency involved to throw light on the issue through exercise of its specialized fact-finding function or application of its administrative expertise.

(459 Pa. at 281; 328 A.2d at 825).

Based upon the foregoing, we affirm the ALJ's ruling and will not rule on the constitutional challenges to the statute based upon allegations regarding its enactment or its provisions regarding the ability of this Commission to provide for an irrevocable QRO. With regard to our determination of the irrevocable nature of the QRO, we will apply the standards of the Act as set forth above.⁵

Therefore, the Exceptions of Senator Fumo, et al., on this issue are denied.

⁵ We note that both PECO and the Environmentalists cite to United States v. Winstar Corp., 116 S.Ct. 2432 (1996), in support of arguments in this matter. The Environmentalists argue that Winstar provides that an irrevocable QRO would bind future General Assemblies and, therefore, violates the Pennsylvania Constitution, Article II, Section 1 (relating to powers of the General Assembly). (Environmentalists Exc., pp. 11-12). PECO argues that Winstar requires recognition of a "regulatory compact" and recovery of stranded investment. (PECO M.B., pp. 16-10; PECO R.E., pp. 10-11). As noted in this Opinion and Order, we will not determine constitutional challenges here, nor is it necessary to resolve PECO's regulatory compact arguments in the context of this proceeding.

b. Due Process

Several of the parties argued that the process involved in this matter was so abbreviated as to violate the parties' rights to due process. For example, the Environmentalists argued that although hearings were provided, they were denied the benefit of hearings due to the compressed time schedule. (Environmentalists M.B., pp. 52-53). The ALJ agreed with the Environmentalists with regard to the compressed time frame. (R.D., p. 17).

The Environmentalists filed Exceptions to the ALJ's alternative recommendation and reiterate, almost verbatim, their briefing position on the procedure in this proceeding. (Environmentalists Exc., pp. 7-9). PECO excepted to the ALJ's primary recommendation, asserting that the time frame was established by the Act. PECO argued that the parties conducted extensive discovery, submitted testimony and exhibits and had seven hearing days in which to cross examine PECO's witnesses. PECO also noted that four separate days of public input hearings were provided. (PECO Exc., pp. 4-5). In view of the discovery and actual hearing opportunities, PECO argues that due process has been observed in the context of this proceeding.

As PECO points out, the time frame within which to decide this matter is provided in the Act: 120 days. 66 Pa. C.S. §2812(b)(1)(i). Also, there is no dispute that both evidentiary and public input hearings were provided in this matter.⁶ In Barasch v. Pennsylvania Public Utility Commission, 546 A.2d 1296 (Pa. Commonwealth Ct. 1988), petition for allowance of appeal denied 523 Pa. 652, 567 A.2d 655 (1989), the

⁶ The Environmentalists make the argument that PECO's notice of its Application was deficient. (Environmentalists Exc., p. 9). However, as noted by PECO, the Environmentalists received actual notice of these proceedings and fully participated therein. Accordingly, they lack standing to raise this issue. Barasch v. Pennsylvania Public Utility Commission, 546 A.2d 1296, 1302, n. 7 (Pa. Commonwealth Ct. 1988). In any event, PECO clearly provided notice as required.

Pennsylvania Commonwealth Court provided an extensive discussion of procedural due process requirements in Commission proceedings. In that case, the Commonwealth Court followed Conestoga National Bank of Lancaster v. Patterson, 442 Pa. 289, 275 A.2d 6 (1971), and provided that due process is required in administrative actions which are adjudicatory in nature and involve substantial property rights. In the case before us, we agree with the Environmentalists that the matter is adjudicative in nature. To a limited extent, we also note that the ratepayers of PECO have substantial property rights at issue analogous to the Commonwealth Court's analysis of the ratepayer rights in Barasch. 546 A.2d at 1305. Although this case represents the determination of a rate decrease, it does involve the securitization of assets which PECO's ratepayers will be obligated to fund.

Having determined that this proceeding is adjudicatory in nature and does involve substantial property interests, what then does due process require? “[T]he essential elements of due process are notice of governmental action and an opportunity to be heard to challenge that action, although the timing of provision of these safeguards may vary depending on the circumstances.” Barasch, 546 A.2d at 1305. Our review of the schedule of this proceeding, and the evidence adduced at hearing, leads us to conclude that the parties were afforded adequate notice and a meaningful opportunity to be heard at an appropriate stage of the proceeding. A meaningful opportunity to be heard includes reasonable examination and cross examination. AT&T Communications of Pennsylvania, Inc. v. Pennsylvania Public Utility Commission, 570 A.2d 613 (Pa. Commonwealth Ct. 1990).

There is no doubt that the 120 day time schedule provided by the Act required that all parties exercise diligence in the conduct of their respective cases. That, however, is not to say that four months was too brief a period to permit meaningful record development. We agree with PECO that the process in this case, which provided

for extensive discovery and seven days of evidentiary hearings, as well as four separate days of public input hearings, provided the requisite due process protections. Our review of the schedule and the record in this matter leads us to conclude that all parties were provided with adequate notice and a reasonable opportunity to appear and be heard on the issues in this case. As we will discuss below with regard to specific elements of this case, we find that the record as developed in this proceeding is more than sufficient to enable us to reach deliberate and reasoned determinations of these issues.

Accordingly, we will deny the Exceptions of the Environmentalists relating to due process and grant the Exceptions of PECO on this issue.

3. Antitrust and Commerce Clause Issues

The Environmentalists argued before the ALJ that the requested relief “may” violate state common law of antitrust and federal antitrust law. (Environmentalists M.B., pp. 53-54). This statement is footnoted with citations to several antitrust cases at the state and federal level. No other argument is made. The ALJ did not address this issue in his Recommended Decision.

In their Exceptions, the Environmentalists repeat, verbatim, the single footnoted sentence which was in their Main Brief. (Environmentalists Exc., pp. 13-14). PECO responds by noting that there is nothing in the record to support a conclusion that there is a violation of state or federal antitrust provisions. (PECO R.E., pp. 17-18).

As was discussed above in the Section relating to burden of proof, our determinations in this proceeding must be supported by substantial evidence and the party advancing a particular proposition must prevail by a preponderance of the evidence.

Lansbury, supra. The basic premise of both those standards requires that some evidence be present on the record. The Environmentalists have not provided even a hint of the factual basis upon which they base their claim of antitrust concerns. Accordingly, their Exception relating to antitrust issues is denied.

The Environmentalists argued before the ALJ that CTC and ITC recovery violates the Commerce Clause of the United States Constitution. Although the ALJ did not address these arguments, we find that they must fail for the same reasons as the Environmentalists' argument relating to antitrust. There is simply no factual basis upon which to make such a determination. We also note in this context that the Act is expressly designed to bring competition for the electric generation market into the Commonwealth. 66 Pa. C.S. §2802. Therefore, the Exception of the Environmentalists on this issue is denied.

4. Extended Rate Cap

The OCA and PAIEUG argued before the ALJ that in the event securitization is approved in this proceeding, which will result in a non-bypassable ITC charge on customers bills for a minimum of 10 years,⁷ then the rate cap for electric generation set forth in Section 2804(4) of the Act, 66 Pa. C.S. §2804(4), should be extended to correspond for the length of the ITC charges. (OCA M.B., pp. 55-56; PAIEUG M.B., pp. 55-56). Both the OCA and PAIEUG argued the Act contemplates that both the recovery of stranded cost and the generation related rate cap are expected to last for nine years. 66 Pa. C.S. §§2808(b) and 2808(4). Accordingly, the OCA and PAIEUG argued before the ALJ that if the ITC will last longer than the 9 years

⁷ PECO has proposed to amortize the recovery of the costs associated with the issuance of transition bonds over a ten year period. PECO has also requested a 2 year window within which to issue the bonds. Accordingly, it is conceivable that, if all of the requests are granted, PECO's recovery period could extend up to 12 years beyond approval of the QRO.

anticipated in Section 2808(b), then the generation rate cap must also be extended for a similar time period.

The ALJ found that the rate cap provided in the Act could not be extended by this Commission. (R.D., p. 76). The ALJ quoted Section 2808(4)(ii) and found that the Act provided that the cap will last a maximum of 9 years, even if the ITC recovery is for a longer period of time, although the cap may be shorter if the ITC concludes sooner than the 9 year time frame. (Id.).

The OCA, PAIEUG and the Environmentalists filed Exceptions to this issue. The OCA argues that when the rate cap provision of Section 2808(4) is read in conjunction with the provisions of Section 2808(b), which provides authority to extend the collection of the stranded or transition cost recovery, then it is clear that we may extend the rate cap. The OCA asserts that by seeking an ITC which extends 10 years or longer, PECO has implicitly requested that we waive the 9-year rate cap time period. In addition, according to the OCA, nothing in either Section 2808(b) or Section 2808(4) of the Act prohibits this Commission from finding that extension of the rate cap is a necessary condition for approval of an extended recovery period for stranded or transition costs. Absent an extension of the rate cap, the OCA argues that PECO's requested extended recovery period should be denied. (OCA Exc., pp. 4-5).

Similar to the OCA, PAIEUG argues in its Exceptions that the ALJ's reading of the Act is overly restrictive. Like the OCA, PAIEUG asserts that Section 2808(b) and Section 2808(4) must be read in conjunction. Further, according to PAIEUG, the public interest standard in Section 2812(a)(2)(iii) provides authority for extension of the rate cap under these circumstances. (PAIEUG Exc., pp. 4-6). The Environmentalists join the OCA and PAIEUG and argue that there is no explicit

prohibition against a voluntary rate cap extension as a condition to the approval of an extended recovery period for the transition and stranded costs. (Environmentalists Exc., pp. 20-21).

PECO asserts that the ALJ was correct in his statutory analysis. In addition, PECO asserts that there is no record support for the assertion of the OCA and PAIEUG that ratepayers will be harmed in the event the rate cap is not extended to match recovery of stranded and transition costs. (PECO R.E., pp. 8-10).

We will deny the Exceptions of the OCA, PAIEUG and the Environmentalists on this issue. As noted by PECO, the rate cap provision in Section 2808(4) stands on its own. That Section provides that the rate cap will be in existence for 9 years or until the ITC is completed, whichever is shorter. (PECO R.E., pp. 6-7). However, the concerns regarding the time frames for recovery of stranded costs and transition costs through an ITC and its relationship to the rate cap are well founded. As we will discuss below with regard to PECO's requested two year window for the issuance of the transition bonds, we will authorize transition bond issuance for a twelve month period. We will encourage PECO to issue bonds with a maturity date of December 31, 2005, but in no event should the bonds contain a maturity date beyond 10 years from the date of issuance.

In the event any bond has a maturity date beyond December 31, 2005, the Commission's strong expectation is that, in a competitive market for electric power, the utility will not exceed the rate cap for the remainder of the collection period of the ITC. If it appears that the utility proposes to exceed the rate cap, then we shall consider all possible remedies to alleviate the situation, including but not limited to our authority under Section 2806 of the Act (relating to performance based rates) and Section 2811 of

the Act (relating to market power remediation). PECO and the OCA have jointly proposed specific language for the QRO which addresses, in part, the rate cap set forth in Section 2804 and the period of ITC collection. We will incorporate that language into the QRO which will issue here.

5. Regulatory Compact

Before the ALJ, PECO argued that denial of stranded cost recovery would effect a breach of the Commonwealth's obligations under a "regulatory compact" with PECO and constitute a deprivation of PECO's property "for which the Commonwealth would be liable under long-standing contractual and constitutional principles." (PECO M.B., p. 16). (footnote omitted). The OCA, CEPA, Senator Fumo and PAIEUG argued that there was no regulatory compact. (CEPA M.B., pp. 18-25; Senator Fumo M.B., pp. 26-29; OCA R.M., pp. 4-21; PAIEUG R.M., pp. 2-16).

The ALJ discussed PECO's argument and determined that although the Act provides an opportunity to request 100% recovery of stranded costs, there is no guarantee of a 100% recovery. (R.D., pp. 76-77). The ALJ found that to the extent that there are any constitutional ramifications flowing from the regulatory compact issue, they would not be resolved by this Commission. The ALJ also determined that the parties' concerns about a regulatory compact were misguided. The ALJ stated that the Act now governs issues surrounding stranded investment recovery. (Id.).

CEPA filed an Exception arguing that the ALJ must be reversed to the extent there is any implication that a regulatory compact exists. CEPA asserts that there must be a clear declaration that no regulatory compact exists which would justify the recovery of stranded investment. (CEPA Exc., pp. 5-6). In its Reply Exceptions, PECO

reiterated its position advanced before the ALJ. PECO asserts that a regulatory compact exists and has been recognized by this Commission and the courts. Pursuant to that regulatory compact, to the extent that the Act alters the relationship between PECO, this Commission and the public such that PECO will have stranded investment as a result, PECO argues that the stranded investment must be recovered, citing to United States v. Winstar Corp., 116 S.Ct. 2432 (1996). (PECO R.E., pp. 10-11; PECO M.B., p. 16).

This proceeding involves PECO's Application for a QRO authorizing securitization of a portion of those assets and costs which PECO asserts constitute stranded and transition costs as defined in Section 2803 of the Act. Pursuant to 66 Pa. C.S. §2812(b)(1)(i), "all remaining amounts and amounts not resolved by the commission shall be deferred for consideration in a final order regarding the utility's restructuring plan under section 2806." Because we are only addressing a portion of PECO's stranded investment claim in this proceeding, we find it unnecessary to address the parties' arguments regarding the existence of a regulatory compact in the first instance, and, secondly, whether such a compact would operate to guarantee 100% recovery independent of the Act.

Accordingly, we will deny CEPA's Exception on this issue for purposes of this expedited QRO proceeding. Our determination here preserves the opportunity for all parties to raise this issue in the context of PECO's restructuring filing, if they so desire.

C. Stranded Generation Assets

PECO's early securitization claim regarding generation assets was \$2.435 billion. This claim was approximately 68.28% of PECO's net stranded plant which was quantified to be \$3.566 billion. To establish the net stranded plant of \$3.566 billion, the

Company used estimated market electricity price forecasts presented by EDS, ICF Resources, and Putnam, Hayes and Bartlet (PHB).⁸ (PECO Exh. No. TPH-14 (Rebuttal)). PECO submitted the results of the three separate market valuation analyses in the expectation that we would accept, as reasonable bounds of future market expectations, a range of values, any one of which was more than sufficient to support the Company's requested rate reduction. (PECO M.B., p. 39). A more detailed explanation of PECO's analyses of market value is found on page 21 of the R.D.

We believe that it will be instructive at this juncture to summarize the positions of the parties on this issue. The OTS presented three adjustments to the PECO's revised December 31, 1998, stranded generation plant claim of \$3.566 billion (Exh. No. TPH-14) and advocated an allowance of \$1.6 billion. The three adjustments were: price sensitivity (\$812 million), audit adjustment (\$800 million) and rate of return (\$360 million). (OTS Exh. No. SR-1A, Sch. 3).

The OCA argued that the Company had not demonstrated the level of its generation-related stranded cost with sufficient certainty to warrant an irrevocable ratepayer commitment to securitize these costs. The OCA noted that the Act required such costs to be found just and reasonable. The OCA further contended that the determination of a "just and reasonable" level of recovery of generation assets was a highly controversial matter that should be considered in the Company's restructuring proceeding. (OCA M.B., p. 28).

The OSBA witness observed, based upon Company provided sensitivity analyses from the ICF model, that "PECO appears to have a greater potential for upside gain than downside loss in connection with a given market price change." (OSBA M.B.,

⁸ These studies will be henceforth referred to as the EDS, ICF and PHB studies.

p. 16). Based on its analysis, the OSBA recommended that the Commission refrain from approving PECO's request for early and irrevocable securitization of a portion of generation plant. (OSBA M.B., p. 33).

PAIEUG asserted that PECO's approach to market price forecasts suffered from the following four flaws and should be rejected: (1) PECO assumed that market prices would equal marginal costs; (2) PECO's forecasts presented widely divergent and hence unreliable results; (3) PECO's forecasts utilized different fuel price projections and, (4) PECO's forecasts failed to adequately reflect long run marginal cost. (PAIEUG M.B., p. 20). Because of these flaws, and because of the other problems common to all three PECO studies, PAIEUG concluded that stranded costs of no more than \$607 million should be considered for securitization related to generation assets. (PAIEUG M.B., pp. 19-20).

Enron supported proposals for securitization of only that portion of PECO's claim which had been shown to meet the standards in the statute and were sufficiently known and certain as to permit their recovery outside the context of PECO's restructuring proceeding. Enron was of the opinion that the proposal put forth by the OCA appeared to satisfy these requirements. (Enron M.B., p. 9).

IP&L took the position that PECO's entire case was unsubstantiated. IP&L maintained that all "revenues" were mere estimates, and all "costs" were mere projections. IP&L concluded that the appropriate conclusion was denial of all relief, with guidance provided to PECO on how future presentation of these issues should proceed. (IP&L M.B., p. 46).

The Environmentalists argued that PECO's analysis of the generation-related stranded costs was full of uncertainty, questionable assumptions and wild guesses. The Environmentalists concluded that the Commission could not rest an "irrevocable" decision on such a problematic case. (Environmentalists M.B., pp. 45-46).

CEPA is opposed to the method that PECO adopted for calculating the present value of its stranded generation plant costs because it rested on unproven and unprovable assumptions about electricity prices in an unregulated market in the distant future. CEPA further asserted that a valuation of the present value of stranded generation plant which rested solely on such assumptions was not "known and measurable" within the meaning of the Act. (CEPA M.B., p. 13). For these and other reasons, CEPA concluded that PECO's Application for issuance of a QRO should be rejected. (CEPA M.B., p. 44).

Senator Fumo argued that the Legislature intended to include the phrase "known and measurable" in order to ensure certainty in the Commission's decision, and to prevent utilities from inadvertently obtaining a windfall based on speculative costs. According to Senator Fumo, the evidence provided by PECO ignored this clear legislative concern. (Senator Fumo M.B., pp. 33-34). Regarding PECO's claim, Senator Fumo recommended that the Commission deny PECO's request for a QRO and defer further consideration as part of the utility's comprehensive restructuring filing. (Senator Fumo M.B., p. 46).

It is the position of PP&L that the determination of a utility's stranded costs and the way those costs were to be translated into rates was among the most fact intensive and complex of the myriad issues raised by the restructuring of the electric utility industry. Because of this complexity and the expedited nature of this proceeding, PP&L

advocated that the Commission should approve only those Qualified Transition Expenses (QTE) that were beyond controversy and defer consideration on the remaining amount to the restructuring proceedings. (PP&L M.B., p. 13).

The ALJ noted that the methodologies employed by PECO in this proceeding to quantify its claimed level of stranded generation assets have received only criticism. The ALJ also noted that two of the parties commenting on PECO's claim offered alternative positions. The OTS presented \$1.6 billion as a minimum amount for PECO's stranded generation assets claim. (OTS M.B., p. 30). PAIEUG suggested \$607 million. (PAIEUG M.B., p. 19).

The ALJ also asserted that the market studies presented were complex, inconsistent, novel and untested and, therefore, lacked credibility. The ALJ further contended that the short time frame of this proceeding did not give parties the opportunity to perform detailed and in-depth analysis of each market analysis, nor did any party have ample time to prepare and present their own studies to support an appropriate, substitute net value. In addition, noted the ALJ, while PECO's generation plant was used to serve both retail and wholesale customers, PECO only allocated its claim to retail jurisdictional customers. This failure to allocate any portion of its assets to the wholesale market further undermined the value of PECO's case. (R.D., pp. 27-28).

The ALJ recommended that we reject the OTS' recommendation and PAIEUG's proposed level of stranded generation plant as too speculative. The ALJ further recommended that PECO's \$2.435 billion claim for net stranded generation plant be denied, and deferred for consideration to the Company's restructuring proceeding. (R.D., pp. 27-28).

PECO excepts to the ALJ's recommendation. PECO agrees that the modeling of future sales of energy and capacity in an evolving deregulated market is a complex and novel undertaking. However, PECO asserts that neither the complexity nor the newness of the undertaking impugns its credibility nor that of its expert witnesses. PECO contends that the ALJ's finding that PECO's experts produced results which were "inconsistent" and "at odds with one another" (R.D., p. 18) is erroneous. PECO retorts that the fact that its three models produced somewhat different results is not the result of "inconsistencies" but rather the result of legitimate and independent differences in modeling techniques and input assumptions.

PECO argues that it is not, in this proceeding, asking that the Commission pick a specific market price estimate that could later be construed as tying the Commission's hands in the Company's future restructuring proceeding. Rather, PECO asserts that in submitting the results of three separate market valuation analyses, the Company's intention was to provide the Commission with a range of values. PECO avers that the results of any one of these market valuation analyses would be more than sufficient to support the securitization of its claimed amount (\$2.4 billion out of \$3.6 billion of total stranded generating plant costs). PECO maintains that its projections set forth reasonable bounds of future market expectations and, at a minimum, should be accepted for that limited purpose. (PECO Ex., pp. 12-14).

In its Reply Exceptions, the OCA argues that the ALJ correctly recommended rejection of PECO's requested recovery of \$2.4 billion of its estimated \$3.5 billion of stranded generating assets based on the uncertainty of PECO's estimate of its stranded cost. The OCA submits that particularly for utility-owned generating plant, the Commission must determine a level of stranded cost recovery that is just and reasonable. Section 2808(c)(3) of the Code, 66 Pa. C.S. §2808(c)(3). It is the contention of the OCA

that an expedited proceeding such as this does not allow for the development of an appropriate record upon which to base such a determination. Accordingly, contends the OCA, the ALJ has correctly recommended that PECO's claim be deferred to its restructuring proceeding. (OCA R.E., pp. 9-11).

In its Reply Exceptions, the OSBA asserts that many of the key assumptions underlying PECO's market valuation models may be incorrect. If altered, contends the OSBA, those factors can cause such enormous swings in PECO's market valuation estimates as to raise serious concerns relating to their reliability and usefulness. (OSBA St. No. 1 at 1-14). In particular, the OSBA argues that a fundamental flaw in PECO's presentation of its total stranded cost claim was its failure to subject the results of its market price models to the necessary sensitivity analyses. (OSBA R.E., pp. 3-9).

In its Reply Exceptions, PAIEUG asserts that PECO's Exception on the issue of stranded generation assets must be denied for at least three reasons. First, PAIEUG asserts that with respect to its pricing models, PECO confuses novelty and complexity with inaccuracy and unreliability. Second, PECO's claim that the disparate results achieved by its three studies are a strength reflective of legitimate differences is absurd.⁹ Third, PAIEUG contends that PECO incorrectly claims that its studies were or could have been tested and analyzed. PAIEUG avers that PECO's market price studies are inherently flawed and unreliable, and that the disparity of the results achieved by the studies amply illustrates the weakness and lack of reliability of the studies. (PAIEUG R. E., pp. 4-7).

⁹ PAIEUG notes in this regard that the operative statute requires that transition or stranded costs be "known and measurable." Section 2803 of the Public Utility Code, 66 Pa. C.S. §2803.

In their Reply Exceptions, the Environmentalists argue that PECO's Exception on this issue should be denied because there is in the record ample expert testimony to warrant the ALJ's conclusion that the three studies proffered by PECO were "complex, inconsistent, novel and untested." The Environmentalists contend that PECO could have ameliorated the time constraints. The Environmentalists argue that PECO's failure to waive the 120-day schedule indicates that the Company freely and deliberately chose to offer such complex testimony, using models never before reviewed by the Commission, within the constraints of the 120-day schedule. Accordingly, asserts the Environmentalists, PECO's Exception on this issue should be denied. (Environmentalists R.E., pp. 8-10).

The key to the resolution of this issue lies in the credibility of the market studies relied upon by PECO to support its claim in this issue.¹⁰ The question is, do we know enough, at this point in time, to conclude that these market value studies or models produce accurate results? If the answer to this question is in the negative, then no relief should be granted because the "known and measurable" standard cannot be met. If, however, we do have some level of confidence with regard to the credibility of the studies, then we must delve deeper to find the level of allowance for this claim that is the most reliable at this time.

As we have detailed in the positions of the parties outlined supra, the intervenors herein, especially the OCA and PAIEUG, made numerous factual challenges to the assumptions that were at the base of PECO's market price studies and its stranded

¹⁰ As noted supra, the three market price studies relied on by PECO were the EDS, ICF, and PHB studies. These studies used computer modeling to predict the future market price for generation over the forecast period. The EDS, ICF, and PHB studies respectively predict a 1999 market price of 2.92, 2.77, and 2.42 cents per kilowatt-hour and net stranded generating plant owned by PECO of \$3.33 billion, \$3.47 billion, and \$3.89 billion. An average of its three market price studies produces a 2.70 cents per kilowatt-hour. For a fuller discussion of the general methodology for estimating stranded generation assets, see PECO Main Brief, pp. 38-39.

generating claim. While we are of the opinion that not all of these evidentiary challenges are meritorious, we conclude that, on balance, PECO has not yet met its burden of proof that its stranded generating plant claim of \$2.435 billion is known and measurable, just and reasonable, and in the public interest.

In our opinion, PAIEUG submitted the most comprehensive evidentiary challenge to PECO's stranded generating plant claim, recommending that \$1.828 billion of the amount proposed by PECO be denied, and that approximately \$607 million be approved for securitization. Among the specific adjustments proposed by PAIEUG were the following: (1) using nuclear capacity based on 1992-1996 actual data; (2) using a 7.77% after tax discount rate; (3) using an estimated long run marginal cost of generation based on base load combined-cycle plant; (4) changing the EDS assumption of no inflation increases to the cost of new capacity; and (5) omission of the shut-down Salem nuclear plant.

After careful scrutiny of the record herein, including a consideration of the positions of the parties, we are persuaded that the evidence herein warrants securitizing \$607.355 million of PECO's generation plant stranded investment, as recommended by PAIEUG. We reach this conclusion because we are persuaded that the adjustments proposed by PAIEUG raise substantial questions that would make it unreasonable and unjust, and not in the public interest, at this time, to approve PECO's total claim of \$2.435 billion for stranded generation assets. We are further persuaded that the adjustments as proposed by PAIEUG are just and reasonable and in the public interest. We further reach this conclusion mindful of the irrevocable nature of a QRO. Our conclusion today allows PECO to securitize sixteen percent (16%) of its stranded generation claim. PECO's request to securitize the remaining amount of generation plant

is deferred without prejudice to their restructuring proceeding at Docket No. R-00973953. PECO's Exception on this issue is, therefore, denied.

D. Regulatory Assets

As of December 31, 1998, PECO will have recorded on its balance sheet generation-related regulatory assets and deferred fuel costs totaling \$2.633 billion. (PECO St. 2, p. 15; R.D., p. 28). These regulatory assets are defined by the Statement of Financial Accounting Standards No. 71, Accounting for the Effects of Certain Types of Regulation, as a cost allowable in a period other than the period in which the cost could be charged to expense by an unregulated enterprise. (PECO St. 2, p. 14).

1. Recommended Allowance

PECO requested authority to securitize a total of \$1.2 billion of its generation-related regulatory assets and deferred fuel costs which it considered stranded. (PECO Exh. No. TPH-6). PECO divided its regulatory asset claim for securitization into eight items, as summarized here and more fully discussed below. (SFAS 109 is discussed in Item 2 of Section D).

	<u>Million</u>
50% of Common Plant of Limerick	\$ 77.927
50% of Common Plant of Eddystone, Peach Bottom and Salem	6.819
Early Window Costs for Limerick 1	14.097
Early Window Costs for Limerick 2	30.134
Deferred Fuel Costs	239.462
Unamortized Loss on Reacquired Debt	75.001
SFAS No. 106	45.852
SFAS No. 109	675.550

The OCA identified four regulatory assets totaling \$514 million which it considered to be reasonable candidates for securitization in this proceeding and which would result in rate savings of approximately \$19 million. (OCA M.B., pp. 15-18; R.D., p. 30). The OCA maintained that the savings also reflected the inclusion of the deferred fuel costs which were not previously reflected in rates. (OCA M.B., p. 18; R.D., p. 30).

PAIEUG recommended that PECO be permitted to securitize \$629 million of regulatory assets in this proceeding, and the remaining amount be deferred to PECO's restructuring proceeding. (PAIEUG M.B., pp. 33, 34 and 57).

a. Carrying Charge on 50% of Limerick Common Plant

Limerick Station is a two unit generating station that utilizes common facilities. In 1986, the Commission directed PECO to defer the carrying charges and depreciation expense associated with the common plant that was in service, but not included in rate base. In 1990, the Commission allowed PECO to amortize the deferred costs over the life of Limerick 2 with a return on the unamortized balance. PECO requested that \$77.927 million of this regulatory asset be securitized at this time. (R.D., p. 31).

The OCA recommended that PECO be permitted to securitize the unamortized balance at December 31, 1997, of \$201.8 million. (OCA M.B., p. 17; Exh. No. RLC-2 Rev., p. 5). This cost was already reflected in rates and securitization would result in savings initially and over the remaining amortization period. (OCA M.B., p. 17). These carrying charges were not included in PAIEUG's recommendation for securitization in this proceeding. (PAIEUG St. No. 3, p. 8).

b. Carrying Charge on 50% of Common Plant of Eddystone, Peach Bottom, and Salem

These carrying charges arise from the Commission policy which allows only 50% of common plant in a utility's rate base for ratemaking purposes when the first unit of a multi-unit plant is placed in service. (PECO St. No. 2, p. 16). PECO requested that \$6.8 million of the carrying charges be securitized at this time. (PECO Exh. No. TPH-6).

The OCA argued that the \$18.3 million of deferred common facility costs on 50% of the Eddystone, Peach Bottom and Salem Stations, which was reflected as carrying charges and included in rates, was a reasonable candidate for securitization and would result in savings to ratepayers. (OCA M.B., p. 18, OCA Exh. No. RLC-2 Rev., p. 4). PAIEUG did not include these costs in its list of items to be securitized at this time. (PAIEUG St. No. 3, p. 8).

c. Limerick 1 and 2 Early Window Costs

The Limerick 1 and 2 Early Window Costs were deferred costs incurred by PECO from the time these units entered commercial operation until they were reflected in rates. (OCA M.B., p. 19).

PAIEUG recommended that the Limerick 1 and 2 early window claims be included in the stranded cost calculation, at a total of \$68.2 million, to reflect the present value at December 31, 1998, of PECO's future recovery under the current level of base rates. (PAIEUG M.B., pp. 47-48; PAIEUG St. No. 3, p. 8).

The OCA recommended excluding the Limerick 1 early window costs from PECO's securitization claim and deferring Limerick 2 early window costs to PECO's restructuring proceeding. (OCA M.B., pp. 20-21). The OCA noted that there was no return or interest on early window costs, so securitizing Limerick 1 early window costs would impose additional interest and would result in no savings to customers. (OCA M.B., p. 20).

d. Deferred Fuel

PECO's claim for securitization of deferred fuel costs totaled \$239 million. This included \$96 million for actual undercollected energy costs from February 1, 1996, to December 31, 1996, an earned nuclear performance bonus for calendar year 1996, and associated interest. The \$143 million balance is the projected undercollections of energy costs. (PECO M.B., p. 35). PAIEUG and the OCA agreed that \$92 million of the deferred fuel costs should be included in PECO's securitization claim. The OCA further agreed that PECO should also include the interest expense. (PAIEUG M.B., p. 46; OCA M.B., pp. 15-17).

e. Unamortized Loss on Reacquired Debt

PECO asserted that, to encourage prudent refinancing of high coupon debt, the Commission permitted utilities a return of and a return on such premiums. The Company noted that this allowance was accomplished by amortization of the costs over the life of the new issue and by adjusting the capitalization ratios and debt cost rates to allow for a return on the unamortized balance of the premiums at the average coupon rate of the new debt issued. (PECO St. No. 2, p. 17).

The OCA submitted that the portion of the regulatory asset on PECO's balance sheet consisting of \$197.7 million in tender and call premiums was a reasonable candidate for securitization and would result in ratepayer savings in the near term as well over the life of the asset. (OCA M.B., p. 15; OCA Exh. No. RLC-2 Rev., p. 2). PAIEUG did not recommend securitization of this asset. (PAIEUG St. No. 3, p. 8).

f. SFAS 106

SFAS 106 became effective January 1, 1993, and established a requirement that employers utilize an accrual method of accounting to recognize expenses associated with the provision of benefits other than pensions to retired employees. (PECO St. No. 2, pp. 23-24). PECO's allocation of SFAS 106 to generation function was based upon the proportion of generation-related labor expense to total labor expense. (PECO St. No. 2, p. 26). PECO requested that \$45.8 million be included in its securitization claim at this time. (PECO Exh. No. TPH-6).

PAIEUG proposed material adjustments to PECO's claim, including reflecting the present value of the SFAS 106 assets in stranded costs, with which PECO agreed. (PAIEUG St. No. 3.0, pp. 16-23; PECO M.B., pp. 33-34). PAIEUG quantified the 1993 and 1994 SFAS 106 deferral components at \$19.885 million and reduced the SFAS 106 deferred costs by the expected earnings on an external trust fund quantified at \$83.913 million. (PAIEUG St. No. 3.0, pp. 20-23).

The OCA recommended that the deferred SFAS 106 costs should not be securitized at this time, noting there would be a net lifetime cost associated with securitizing the SFAS 106 asset. The OCA asserted that the costs associated with the

early retirement program had not been incurred, and the Commission had not made a finding of their reasonableness. (OCA M.B., pp. 21-22).

In his discussion, the ALJ noted that Section 2803 of the Act provides the following definition:

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

The ALJ pointed out that Section 2812(a)(2)(iii) charges that the Commission should only issue a QRO for the amount of stranded costs that it determines to be just and reasonable for the utility to recover from ratepayers. In determining what amount of stranded regulatory costs PECO should be allowed to securitize at this time, the ALJ noted that he had already concluded that the legislative intent is for the Commission to allow securitization of stranded costs that are, at worst, minimally controversial and to include only items that are properly identified and quantified.

In the development of his conclusion, the ALJ submitted that the QRO will be irrevocable, thus this recommendation will impact present and future customers for the next ten years. Based on the information presented in this proceeding and the law governing the restructuring of the electric utility industry, the ALJ concluded that he could not endorse securitization of any stranded regulatory assets that could have a negative impact on ratepayers (i.e. increasing their costs rather than lowering their rates). (R.D., pp. 36-37).

The ALJ discussed the fact that witnesses on behalf of the OCA and PAIEUG took issue with certain aspects of the regulatory asset claim, but did recognize that certain regulatory assets were appropriate for securitization at this time. (OCA St. No. 1, p. 4; PAIEUG St. No. 3.0, p. 8). PAIEUG recommended that PECO be permitted to recover regulatory assets in the amount of \$629 million in this proceeding, and the OCA recommended the recovery of \$514 million. (PAIEUG M.B., p. 33; OCA M.B., p. 18). At the other extreme, the OTS recommended zero securitization of regulatory assets. (OTS M.B., p. 14).

The ALJ concluded that PECO did not meet its burden of proof in demonstrating the justness and reasonableness of the total amount of stranded regulatory assets that it sought to securitize at this time. The OCA acknowledged that four of the eight regulatory assets PECO has requested to securitize include amounts that are known and measurable and are amounts that the Commission has in the past allowed as regulatory assets. The OCA's recommendation of \$514 million includes \$220.1 million that is already reflected in rates for carrying charges and deferred depreciation on 50% of Limerick and Eddystone/Peach Bottom/Salem common plant, \$96 million that is the actual undercollected energy costs, and \$197.7 million that is based on refinancing premiums (an item which the Commission has allowed PECO a return of and a return on in the past). (OCA M.B., pp. 15-18). PAIEUG also agreed that actual undercollected energy costs could be securitized at this time. (PAIEUG M.B., p. 46).

The ALJ reasoned that to be in compliance with Section 2803 of the Act's definition of stranded cost, those amounts must be further discounted at the OTS recommended rate of 7.53% over the ten year ITC period. (R.D., pp. 37-39). (This present value adjustment is discussed in Item 3 of Section D).

The Environmentalists except to the ALJ's Alternative Recommendation which adopts the OCA's noncontroversial regulatory assets as QRO candidates, discounted to \$321.540 million. The Environmentalists maintain that the OCA's designated assets are non-plant related items and the Act prohibits their securitization because PECO never applied for the securitization of these assets. (Environmentalists Exc., pp. 17, 19).

The Environmentalists argue that:

This reading is consistent with the scope of review which the Act requires. There is a way to reconcile the limiting language of the "expedited" subsection with the clear, and broad, definition of the "transition or stranded" costs it mentions - matters presentable in analyzing the utility case are broader than what the Commission can incorporate into its relief. The language of the section can be read to **limit the relief, not the record** on which the Commission must make its findings:

....The commission shall **consider only the portion of the transition or stranded costs for which the utility requests approval** to issue transition bonds. Consideration of all remaining amounts and amounts not resolved by the commission shall be deferred for consideration in the electric utility's restructuring plan proceeding under section.¹¹

* * *

Another reason for construing "shall consider only the portion" as a limitation on relief rather than on the evidence is

¹¹ Act §2812(b)(1)(i)

the other, explicit direction that the subsection gives to the Commission, limiting it to approving:

....for a portion of the utility's transition or stranded costs that the commission **finds** would be **just and reasonable** to recover from ratepayers **under sections 2804 and 2808**.

The language requires findings of fact, under the case law addressing "just and reasonable", and, specifically, the requirements of two sections, 2804 and 2808. While §2804 is relatively simple to address-- the capped rates--§2808 presents additional issues of fact, including the determination of regulatory assets and the steps taken to "mitigate" stranded investment.

(Environmentalists Exc., pp. 19-20; emphasis added in Exception).

In Exceptions, PECO submits that its proposal to securitize \$1.2 billion in claimed stranded regulatory assets should not be denied because the specific costs which PECO is seeking to securitize not only would be recoverable in a regulated environment, but, in fact, either are currently being amortized through existing rates or have been recognized by the Commission for future recovery. (PECO Exc., p 15).

PECO asserts that the Environmentalists misinterpreted the plain language of the Act, in contending that §2812(b)(1)(i) limits the Commission to either granting or denying a utility's securitization request in its entirety. PECO submits that the language of that section says no such thing. Rather, PECO maintains that the Commission cannot grant a QRO for an amount that exceeds the Company's request. In addition, PECO maintains that *nothing in that section of the Act proscribes the Commission's exercise of discretion to alter the mix of stranded costs to be securitized, so long as those costs in total do not exceed the amount the Company requested.* PECO submits that the requirement that a utility must provide "a complete account of [its]...transition or stranded

costs" (§2812(a)(2)(i)), assures that the Commission has a complete evidentiary record to support the level and mix of stranded costs it may ultimately approve for securitization. (PECO R. Exc., pp. 18-19).

In Reply Exceptions the OCA notes that it opposed and continues to oppose PECO's request to securitize any other regulatory assets--in whole or in part--in this proceeding. Specifically, the OCA submits that PECO's request to securitize Limerick 1 and Limerick 2 Early Window costs; deferred SFAS 106 costs; "deferred" future fuel costs; and deferred SFAS 109 tax expense should be denied, and consideration of these claims deferred until the Company's restructuring proceeding. (OCA R.E., p. 12).

We accept PECO's request to securitize deferred fuel costs of \$96.162 million which represents its actual undercollected energy costs from February 1, 1996 to December 31, 1996, including its earned nuclear performance bonus for calendar year 1996 and interest. This amount is known, measurable and certain. PECO's request to securitize future fuel costs of \$143.3 million represents costs which have not yet been incurred. As such, this portion of PECO's claim is speculative. We, therefore, will include the 1996 undercollection of \$96.162 million in the approved securitization and defer the projected undercollection to the restructuring proceeding.

We accept \$179.7 million of PECO's claim to securitize unamortized loss on reacquired debt. This amount represents the December 31, 1998, estimated balance for tender and call premiums incurred by PECO. The Commission has allowed PECO both a return-of and a return-on such premiums to encourage economic refinancing of high coupon debt, and securitization of this regulatory asset will produce ratepayer savings.

We approve securitization of \$175.812 million of deferred carrying charges and depreciation expense associated with 50% of Limerick common plant, representing the estimated balance as of December 31, 1998. This cost is already reflected in rates and securitization will result in ratepayer savings both initially and over the remaining amortization period.

We also approve securitization of deferred carrying charges and depreciation expense associated with 50% of common plant of the Eddystone, Peach Bottom, and Salem generating stations. These costs, \$17.4 million as of December 31, 1998, are already reflected in rates and securitization will result in savings to ratepayers.

Therefore, we agree in theory with the OCA's recommendation regarding the following regulatory assets in the securitization at their full book value: (a) Unamortized Loss on Reacquired Debt; (b) Carrying Charges and Deferred Depreciation on 50% of Limerick Common; and (c) Carrying Charges and Deferred Depreciation on 50% of Eddystone/Peach Bottom/Salem Common Plant.

The OCA computed the value of these regulatory assets as \$417.971 million as of December 31, 1997. However, in order to be consistent with the time frame for the plant analysis, the secured amount to be approved is the estimated balance as of December 31, 1998, which is \$469.079 million for both the regulatory assets and the deferred fuel.

PECO's request to securitize deferred Early Window costs for Limerick 1 and 2 costs and SFAS 106 costs is deferred without prejudice to its restructuring proceeding at Docket R-00973953, where the controversies and factual issues presented by PECO's request can be resolved.

Accordingly, the Exception of the Environmentalists, that the Act prohibits the Commission from considering certain regulatory assets for securitization, because PECO has not asked for them, will be denied. Nothing in Section 2812(b)(1)(i) of the Act prohibits our discretion to alter the combination of stranded costs to be securitized, as long as those costs do not exceed the Company's total QRO request.

2. SFAS 109 - Tax Deferrals and Credits

Statement of Financial Accounting Standards 109, "Accounting for Income Taxes," (SFAS 109) required PECO to record a regulatory asset to reflect its right to recover deferred tax liabilities generated by the effects of tax/book timing differences that had been "flowed-through" to customers in the ratemaking process. (PECO M.B., p. 26). Other issues related to SFAS 109 are accumulated deferred income taxes and unamortized investment tax credits. (PECO M.B., p. 26). PECO sought securitization of \$675.6 million of its regulatory SFAS 109 assets. (PECO Exh. No. TPH-6).

The ALJ reviewed the positions of the parties noting that the OCA recommended that PECO's claim for securitization of its deferred tax regulatory asset not be included in this proceeding. In addition, PAIEUG recommended that PECO be allowed to securitize \$550.5 million of SFAS 109 assets and recommended that PECO's stranded costs claim be reduced by the total accumulated deferred income tax liability of \$1.0 billion. (R.D., p. 34).

The ALJ reviewed the details of PAIEUG's recommendation which included the following adjustments: the gross SFAS 109 regulatory asset should be offset with the SFAS 109 liability; recoveries from ratepayers for future taxes should be

discounted to the present value before being included as stranded costs for ITC purposes; and the accumulated deferred investment tax credit liability should be treated the same as the gross SFAS 109. (R.D., pp. 34-35).

In his analysis the ALJ concluded that the claim for stranded regulatory assets in the amount of \$675.6 million for deferred tax liabilities recorded pursuant to SFAS 109 remains controversial. The ALJ further concluded that PECO failed to bear its burden of proof and, thus, has not given reasonable assurance that these are items that should be securitized as regulatory stranded costs at this time. Thus, the ALJ recommended that the PECO's proposal to securitize deferred tax regulatory assets not be included in this proceeding. (R.D., pp. 34-39).

In its Exceptions, PECO submits that the largest single component of PECO's stranded regulatory assets consists of the deferred tax liabilities recorded pursuant to SFAS 109 which totals \$1.86 billion. For purposes of this proceeding PECO requested recovery of \$675.6 million of this identified amount. PECO maintains that while the ALJ addressed the concerns expressed by the OCA and PAIEUG regarding the Company's claim, he neglected to mention that PECO demonstrated, beyond any reasonable doubt, that the criticisms leveled by the opposing parties reflected a very fundamental misunderstanding of the operation of SFAS 109. PECO argues that its right to recover these costs is entirely consistent with existing ratemaking practice. PECO maintains that the claimed SFAS 109 costs have been fully debated, are based on record evidence, and should be accepted. (PECO Exc., pp. 15-21).

In its Reply Exceptions the OCA submits that PECO's massive claim for SFAS 109 deferred tax liability is wholly inappropriate for securitization at this time. The OCA maintains that it is necessary to deny those elements of the Company's

securitization proposal where it includes regulatory assets whose ultimate recovery are subject to significant dispute, are uncertain in amount, or have not previously been reviewed by the Commission for inclusion in rates. The OCA supports the ALJ's determination that PECO's securitization claim for SFAS 109 deferred taxes is highly uncertain and should be deferred to the Company's restructuring proceeding. (OCA R.E., pp. 14-15).

The OCA's principal concern with PECO'S claim is that it appears that the Company has failed to reflect the present value of its overall deferred tax liability owed in the future. The OCA notes that PECO's \$1.7 billion portion of its SFAS 109 regulatory asset, associated with generation plant, is the undiscounted amount of the obligation by ratepayers to indemnify PECO for future tax costs associated with deferrals where benefits were flowed through to ratepayers. The OCA maintains that this amount is not discounted and, further, is grossed-up to include the additional taxes which will be payable on the additional revenues needed to cover the deferred income taxes, or the tax-on-tax effect. For purposes of determining stranded costs on tax related regulatory assets, the OCA submits that the approach should be one of settling final accounts where ratepayers should only be required to cover the true cost of the tax indebtedness on a present value basis. (OCA R.E., pp. 15-16).

The OCA concludes that given the irrevocable nature of a securitization order, the Commission should not securitize any portion of PECO's deferred tax regulatory asset claim at this time, and it further notes that PECO has the right to renew its claim in its current restructuring proceeding. (OCA R.E., p. 19).

PAIEUG argues in its Reply Exceptions that PECO's SFAS 109 regulatory asset was computed incorrectly because (1) the Company failed to offset its gross SFAS

109 asset with the accumulated deferred tax liability recognized on PECO's balance sheet and (2) the Company failed to discount recoveries from ratepayers for future taxes to the present value as required by the definition of transition and stranded costs in the Act. (PAIEUG St. 3.0, p. 26). PAIEUG submits that the Company treated its deferred tax liabilities and SFAS 109 asset inconsistently, and PECO failed to discount its future net SFAS 109 regulatory asset, even though PECO discounted the asset for other purposes. (PAIEUG R.E., pp. 9-10).

PAIEUG asserts that the disallowance of PECO's claim to securitize SFAS 109 costs is appropriate due to its complexity; PECO's Exception must be denied. (PAIEUG R.E., p. 11):

Premised on our review of the record as developed in this proceeding and the arguments proffered, we conclude that given the irrevocable nature of a securitization order, the Commission should not securitize any portion of PECO's deferred tax regulatory asset claim at this time. The presentation of conflicting evidence by PECO, the OCA, and the PAIEUG on this issue raises question that can only be answered with further hearings. PECO's request to securitize its SFAS 109 regulatory asset claim is, therefore, deferred without prejudice to its restructuring proceeding at Docket R-973953.

Accordingly, the Exception of PECO on this issue will be denied and the recommendation of the ALJ is adopted.

3. Present Value Adjustment

In the Recommended Decision, the ALJ stated that, if we do not approve his primary recommendation to deny PECO's Application, we should, in the alternative, allow PECO to securitize only the regulatory asset amounts recommended by the OCA as

being just and reasonable. This would result in an allowance of \$514 million for this claim. The ALJ further determined that, in order to comply with the definition of stranded costs contained in Section 2803 of the Act, this amount should be discounted at the discount rate of 7.53 percent recommended by the OTS over the ten-year ITC period. Accordingly, the ALJ recommended that we permit PECO to securitize \$321.540 million of its regulatory assets claim. (R.D., pp. 38-39).

In its Exceptions, PECO argues that the ALJ erroneously and without any support in the record concluded that Section 2803 of the Act somehow requires the discounting of the \$514 million of stranded regulatory assets found reasonable by the OCA. PECO contends that the ALJ's recommended discounting should be rejected for two reasons. The first is that no party, including the OCA, ever suggested that this amount needed to be discounted. Consequently, PECO submits, the record is devoid of support for the discounting recommended by the ALJ. The second reason is that, according to PECO, discounting would be appropriate only if PECO was not entitled, under traditional ratemaking principles, to earn a return on the assets in question. PECO points out that the OCA specifically selected those items on which PECO did earn a return so as to maximize the corresponding base rate reduction. (PECO Exc., p. 21).

In its Reply Exceptions, the OCA submits that the ALJ's recommendation to discount the \$514 million in stranded regulatory assets should be rejected. The OCA concurs with PECO that the \$514 million is the proper amount to be granted as stranded regulatory assets, and that discounting regarding this issue is not appropriate. (OCA R.E., p. 19).

In considering this issue, we concur with PECO and the OCA that it is not appropriate to discount the stranded regulatory assets, as recommended by the ALJ. As

noted by PECO, the discount applied by the ALJ was improper and not conceptually sound. An updated cost of capital may be applicable to the removal of the asset from rates, and a comparable discount is part of the economic analysis to support decision making. However, neither is applicable to the balance on the books for these particular regulatory assets. Accordingly, we shall grant PECO's Exception on this issue and reject the ALJ's recommendation to perform a present value adjustment on the stranded regulatory assets which we are approving for PECO in this proceeding.

E. Rate of Return and Discount Rate

1. Introduction

The issue of rate of return arises in this proceeding for the purpose of establishing a discount rate for the securitized assets. Determining the discount rate is necessary to properly account for the changing value of money over time. Regarding a utility's rate of return, a public utility is entitled to an opportunity to earn a fair rate of return on the value of its property which is dedicated to public service. Pennsylvania Gas & Water Company v. Pennsylvania Public Utility Commission, 19 Pa. Commonwealth Ct. 214, 341 A.2d 239 (1975).

2. Capital Structure

In its initial filing in this proceeding, PECO claimed the following capital structure:

<u>Capital Structure</u>	<u>Ratio</u>	<u>Cost Rate</u>	<u>Weighted Cost</u>
Debt	55.00%	10.04%	5.52%
Preferred Stock	9.20%	10.13%	0.93%
Common Equity	<u>35.80%</u>	12.75%	<u>4.56%</u>
	100.00%		11.02%

(PECO Exh. No. ABC-7, p. 4, R.D., p. 39). Based upon this capital structure and cost rates, PECO claimed an after-tax discount rate of 8.88 percent. (PECO Statement No. 1-R, p. 5).

The position of the OTS concerning PECO's capital structure was as follows:

<u>Capital Structure</u>	<u>Ratio</u>	<u>Cost Rate</u>	<u>Weighted Cost</u>
Debt	44.60%	8.47%	3.78%
MIPS Debt*	3.19%	9.21%	0.29%
Preferred Stock	3.09%	7.70%	0.24%
Common Equity	<u>49.12%</u>	10.00%	<u>4.91%</u>
	100.00%		9.22%

*MIPS is an acronym for "Monthly Income Preferred Shares." (PECO Exhibit No. JFB-1, Sch. 9 Revised).

This resulted in an after-tax discount rate of 7.53 percent. (R.D., p. 41).

In the rebuttal stage of the proceeding PECO adopted the following position on Capital Structure ratios: Debt, 44.6 percent; MIPS Debt, 3.2 percent; Preferred Stock, 3.1 percent; Common Equity, 49.1 percent, which is essentially the same as the OTS'

position. PECO also revised its claim for the cost of common equity to be 12.10 percent, which resulted in an after-tax discount rate of 8.60 percent.

Accordingly, the OTS' witness Deardorff and PECO's witness Brennan agreed on capital structure, but not on the cost of common equity and the discount rate, which will be discussed later. The ALJ recommended use of the capital structure to which the OTS and PECO agreed as the appropriate one for this proceeding, as it represents PECO's actual capital structure on December 31, 1996. (R.D., pp. 41, 45).

We have examined the capital structure to which PECO and the OTS have agreed. We determine it to be the appropriate capital structure for use in this proceeding, in light of the fact that it represents PECO's actual capital structure on December 31, 1996. Accordingly, we approve use of the following Capital Structure ratios in this proceeding: Debt, 44.60 percent; MIPS Debt, 3.19 percent; Preferred Stock, 3.09 percent; Common Equity, 49.12 percent.

3. Cost of Debt and Preferred Stock

Both the OTS' witness Deardorff and PECO's witness Brennan agreed on PECO's non-MIPS debt cost rate as being 8.47 percent. However, these parties disagreed on the cost of MIPS debt and preferred stock. PECO claimed that the MIPS debt cost rate was 8.93 percent and the preferred stock cost rate was 9.21 percent. The OTS stated that the MIPS debt cost rate was 9.21 percent and the preferred stock cost rate was 7.70 percent. In its Main Brief, at page 20, the OTS contended that PECO did not challenge its corrections to these costs rates. (R.D., p. 42).

The ALJ recommended adoption of the non-MIPS debt cost rate of 8.47 percent agreed upon by the parties as being reasonable. He further recommended the

adoption of the MIPS and preferred stock rates of 9.21 percent and 7.70 percent as being reasonable in this proceeding.

We determine that the use of the non-MIPS debt cost rate of 8.47 percent agreed upon by the parties is reasonable. Furthermore, we conclude that PECO's claim contained incorrect costs for MIPS debt and preferred stock. Accordingly, we will adopt the cost rates of 9.21 percent for MIPS and 7.70 percent for preferred stock.

4. Cost of Common Equity

PECO's final claim for its cost of common equity rate was 12.10 percent, based on its Discounted Cash Flow (DCF) and Capital Asset Pricing Model (CAPM) analyses which resulted in costs of common equity of 12.20 percent and 11.90 percent, respectively. The OTS argued that PECO's cost of common equity was 10.00 percent, based on the OTS' DCF analysis. The ALJ recommended adoption of the OTS cost of common equity of 10.00 percent recommended by the OTS. The ALJ based his recommendation on the Commission's current use of the DCF model, and rejection of the CAPM model, for determining the cost of common equity, and his determination that the OTS barometer group was reasonable. According to the ALJ, this results in a discount rate of 7.53 percent. (R.D., pp. 42, 46-47).

In its Exceptions, PECO argues that the ALJ's recommendations of a cost of common equity of 10.00 percent and a resulting discount rate of 7.53 percent appear to be based on the ALJ's erroneous conclusion that PECO would be less risky following securitization, and that the shift of the risk from the shareholders to the customers warrants the use of the OTS' lower capital costs. PECO contends that, if the lower cost of capital proposed by the ALJ were used, it would reduce PECO's estimated stranded

costs. At the same time, PECO alleges that it would lessen the base rate reductions proposed by PECO in this proceeding. (PECO Exc., pp. 21-22).

PECO contends that the ALJ's proposed cost of common equity rate of 10.00 percent and discount rate of 7.51 percent should be rejected because the ALJ has misconstrued the effect of the securitization on shareholders and customers. PECO submits that its proposal already fully compensated customers for any risk reduction achieved through securitization. PECO points out that the OCA's witness La Capra acknowledged that one indication of the magnitude of the reduction in risk to customers is the difference between what the market pays for securitized and unsecuritized capital.

PECO further contends that the OTS' cost of common equity rate of 10.00 percent is deficient because it relies solely on the DCF method and utilizes a barometer group which is clearly less risky than PECO's. Moreover, PECO argues that the OTS' analysis is deficient because it employs dividend yield dating back to early 1996, "when no one had reason to believe that electric restructuring legislation would be enacted as quickly as it was." (PECO Exc., p. 23).

In response, the OTS supports the ALJ's recommendation and argues that PECO's Exception on this issue is without merit. The OTS points out that PECO originally claimed a discount rate of 8.88, even though its cost of capital witness in this proceeding, Mr. Brennan, testified that the appropriate discount rate for PECO is 8.66 percent. The OTS submits that the discount rate of 7.53 percent calculated by its witness, Deardorff, employing the DCF method, is based on PECO's net present value calculation to determine the current market value of PECO's generation plant. The OTS contends that the calculation of a current market value requires the use of PECO's current cost of capital as the discount rate in this calculation. (OTS R. E., pp. 3-4).

The OTS argues that the ALJ properly determined that PECO will be less risky after securitization. To support this argument, the OTS points to the testimony of PECO's own witness, Hill, who testified that approval of PECO's securitization Application would eliminate some of the uncertainty around the Commonwealth's restructuring efforts, citing PECO Statement No. 1, p. 25. (OTS R. E., p. 5).

The OTS also responded to PECO's argument that the OTS' cost of equity at 10.00 percent is too low in view of the fact that PECO's dividend yield is close to 9.00 percent. The OTS argues that the testimony of the OTS' witness Deardorff established that PECO's dividend is currently high because of the pendency of this securitization proceeding. The OTS contends that this increased risk is only short term and should not be considered in any analysis of long term capital cost rates. The OTS submits that, for this very reason, the analysis presented by its witness Deardorff relies heavily on a 52-week dividend average and not the three-month and six-month spot yields upon which PECO relies.

Regarding PECO's argument that the OTS' cost of equity determination is deficient because it relies solely upon the DCF method, the OTS contends that the ALJ appropriately found that, in numerous cases since 1988, the Commission has utilized the DCF method and informed judgment, citing Pennsylvania Public Utility Commission v. Philadelphia Suburban Water Company, 71 Pa. PUC 593, 623-632 (1989) and Pennsylvania Public Utility Commission v. Western Pennsylvania Water Company, 67 Pa. PUC 529, 559-570 (1988).

With respect to PECO's argument that the OTS used stale dividend information, the OTS points out that it employed a 52-week dividend average in order to counter the short term volatility attributable to the uncertainty of PECO's securitization filing. PECO's own calculation using a three and six month spot yield improperly inflates the dividend results. Accordingly, the OTS submits that PECO's Exception regarding this matter should be denied. (OTS R. E., pp. 6-7).

In their Reply Exceptions, the Environmentalists also contend that PECO's Exception concerning the cost rate of common equity and the discount rate should be rejected. The Environmentalists argue that, until this Commission is able to examine thoroughly the present value methodology and discount rate issues, the ALJ's alternative recommendation should be adopted.

The Environmentalists assert that PECO presented no good reason for this Commission to rely on PECO's cost of common equity from its 1989 rate case, as PECO advocated in its original Application. The Environmentalists further argue that PECO's recitation of shareholder "costs" omits a fairly obvious consideration, that "securitization removes from PECO *pro tanto* the substantial likelihood of failure in a price-competitive electric industry." (Environmentalists' R.E., pp. 12-13).

In considering this matter, we note that, in numerous recent proceedings, we have determined a utility's cost of common equity using primarily the DCF (Discounted Cash Flow) method and informed judgment. Pennsylvania Public Utility Commission v. Roaring Creek Water Company, Docket No. R-00943177 (Order entered on May 31, 1995); Pennsylvania Public Utility Commission v. Philadelphia Suburban Water Company, *supra*. Regardless of the procedure employed in determining the fair rate of return for a utility, we exercise informed judgment. Pennsylvania Public Utility

Commission v. West Penn Power Company, *supra*. Therefore, we reject PECO's argument that the OTS' reliance solely on the DCF methodology is improper in this proceeding.

Furthermore, we determine that the OTS proposed return on common equity rate of 10.00 percent and resulting discount rate of 7.53 percent is proper in this proceeding. We find the OTS' use of the 52-week dividend average methodology to be superior to PECO's use of the three-month and six-month spot yields because the 52-week dividend average is not as easily skewed by the short term risk increase, and provides a better indication of the long term capital cost rates. The evidence of record in this proceeding demonstrates that PECO's use of a dividend yield based on three and six-month time periods overstates PECO's investment risk. PECO's dividend is currently uncharacteristically high because of the pendency of the securitization proceeding. (See OTS St. No. SR-2, pp. 2-3).

We also find that the barometer group used by the OTS is more appropriate, under the circumstances in this proceeding. PECO contends that the OTS barometer group is comprised of companies which are less risky than PECO. While PECO contends that the securitization process has produced uncertainty for PECO's shareholders, nevertheless, PECO's witness Hill testified that approval of PECO's securitization Application would eliminate some of the uncertainty surrounding the Commonwealth's restructuring efforts. (PECO Statement No. 1, p. 25). The evidence of record in this proceeding establishes that PECO's witness Brennan compared bond ratings in his analysis of the barometer group risk. In contrast, the OTS' witness Deardorff examined equity issues in comparing the risks of the companies in his barometer group. (OTS Exh. 2, Sch. 3). We determine that the barometer group used by the OTS is more representative of the risk which PECO faces at this time and will adopt it in this

proceeding. Accordingly, we deny PECO's Exception concerning its cost of common equity recommended in this proceeding and adopt a common equity cost rate of 10.00 percent.

5. Conclusion

The following table summarizes our determinations regarding the appropriate capital structure and cost of capital rates to be used in this proceeding.

<u>Capital Structure</u>	<u>Ratio</u>	<u>Cost Rate</u>	<u>Weighted Cost</u>
Debt	44.60%	8.47%	3.78%
MIPS Debt	3.19%	9.21%	0.29%
Preferred Stock	3.09%	7.70%	0.24%
Common Equity	<u>49.12%</u>	10.00%	<u>4.91%</u>
	100.00%		9.22%

This results in an after-tax discount rate of 7.53 percent.

F. Equity Buy Back and Transaction Costs

1. Use of Proceeds - Special Dividend

In its Application, PECO indicated that it would use a portion of the securitization proceeds to reduce its common equity capitalization. (PECO Statement No. 4, p. 14). The OTS and the OCA proposed reducing common equity through a special dividend. PAIEUG argued that the refunding expense from the common equity buy back would be inappropriate for recovery through the ITC. PECO rejoined that

declaring a special dividend would render a portion of the Act meaningless (R.D., pp. 51-54).

The ALJ noted that a degree of flexibility is necessary for PECO and observed that PECO had promised to refund the difference to ratepayers, citing PECO Statement No 3, p. 12 and No. 4-R, p. 4. The ALJ concluded that the goal of securitization is to pass the cost of capital savings on to the customers. Therefore, the ALJ determined that this result would be best achieved through the special dividend approach proposed by the OCA and the OTS. (R.D., pp. 54-55).

In its Exceptions, PECO argues that the ALJ's recommendation to use an "imputed special dividend" approach for the purpose of calculating transaction costs, and thus avoiding the payment of "acquisition premiums," is contrary to the intent of the Act. PECO asserts that the Act specifically provides that a utility may recover acquisition premiums as part of its QTE. To support its position, PECO cites Sections 2812(g) and 2812(b)(5) of the Act, 66 Pa. C.S. §§2812(g) and 2812(b)(5), as well as the OCA Statement 1, page 54 and PAIEUG Statement 3, page 47. (PECO Exc., pp. 23-24).

In response, both the OCA and the OTS support the ALJ's recommendation. The OCA argues that the ALJ correctly rejected the inclusion of acquisition premiums as unnecessary and avoidable, and which would significantly reduce the benefits of securitization. The OCA points out that these acquisition premiums total \$100 million and represent a substantial cost to ratepayers.

With respect to PECO's argument that the Act specifically allows recovery of acquisition premiums, the OCA contends that the Act does not authorize the recovery of acquisition premiums if they are not reasonably necessary expenses. The OCA

submits that it is not reasonable to allow the recovery of excessive transactional costs which are both unnecessary and avoidable. The OCA asserts that use of a special dividend is a reasonable way to avoid these acquisition premiums. (OCA R.E., pp. 19-21).

The OCA submits that, if PECO's proposed equity premiums are included as QTE within the QRO, PECO will have no incentive to reduce or eliminate these costs for the benefit of ratepayers. Accordingly, the OCA concludes that PECO's Exception on this issue should be denied. (OCA R.E., pp. 23-24).

In its Reply Exceptions, the OTS also supports the ALJ's recommendation to reject PECO's \$100 million claim for acquisition premiums. The OTS argues that, while these costs are recoverable under the Act, as argued by PECO, the real issue is whether these costs should be incurred at all. The OTS contends that Section 2808(c)(4) of the Act requires PECO to mitigate its stranded costs, "that requirement certainly extends to a responsibility to avoid unnecessary stranded costs." The OTS contends that in this proceeding PECO has the ability and the obligation to avoid these costs by using the special dividend method. Therefore, the OTS submits that PECO's Exception on this issue must be denied. (OTS R.E., pp. 9-11).

In reviewing this issue, we conclude that consideration of PECO's Application for recovery of common equity premiums which exceed the market price should be deferred at this time. This will provide the parties with an opportunity to address this issue in greater depth in the restructuring proceeding. Accordingly, we will defer our decision on this issue to PECO's restructuring proceeding, or until such time as PECO declares and pays such premiums.

We further note that, with regard to the other issuance costs claimed in this proceeding associated with debt and preferred stock, the remaining servicing costs of \$41.8 million for debt and \$7.6 million for preferred stock, as well as the proposed issuance expense of \$23.8 million, must be prorated to reflect the level of costs approved herein for securitization. This proration is necessary because the amounts claimed by PECO were based on its original claim for stranded costs of \$3.773 billion, and here, we are only permitting recovery of \$1.098 billion.

2. Commission Right to Change Use of Securitization

In his discussion of equity buy back and transaction costs, the ALJ recommended that this Commission reserve the right to change the use of the securitization proceeds if PECO has not completed the issuance of bonds prior to completion of its restructuring case. (R.D., p. 47). The ALJ determined that the goal of securitization is to pass the cost of capital savings on to customers and concluded that this end will be best achieved through the special dividend approach proposed by the OCA and the OTS. (R.D., p. 55).

PECO excepts to this recommendation, arguing that the ALJ's recommendation is based upon a misunderstanding of the Commission's potential role regarding the use of securitization proceeds to reduce PECO's capitalization. PECO contends that the record in this proceeding contains substantial testimony that the optimal method for capitalization reduction will depend on the market conditions at the time the proceeds become available for use and can only be determined at that time. According to PECO, neither PECO nor this Commission has control over those market conditions. PECO submits that there is no evidence of record in this proceeding to establish that the requirement that PECO retain flexibility in implementing the details of its capitalization

reduction. Therefore, additional Commission intervention into this issue is not warranted. (PECO Exc., pp. 25-26).

In examining this issue, we concur with PECO that a certain degree of flexibility will be necessary in its capitalization reduction proposed in this Application. However, we believe that it is necessary at this time to expressly reserve our right to change the use of the securitization proceeds in the event PECO has not completed the issuance of bonds prior to the completion of its restructuring proceeding. This is necessary because our determination in PECO's restructuring proceeding at Docket No. R-00973953 may alter PECO's capital structure. Accordingly, PECO's Exception regarding this issue is denied.

G. Rate Design

PECO proposed to allocate its base rate revenue reduction and ITC among the various customer classes using the same methodologies which it employed in its last base rate proceeding. PECO used the four coincident peak (4CP) method to allocate the proposed base rate revenue reduction since nearly all of its claimed stranded costs are capacity related generation costs and the 4CP method was used in its last rate case to allocate such costs. (PECO St. 2, p. 42).

The OSBA generally agreed with PECO's use of the 4CP allocation method. However, the OSBA proposed that the allocation factor be modified to accommodate the different rates of return provided by the various customer classes. The OSBA asserted that it was important to incorporate actual class rates of return because most of the proposed revenue reduction is related to the system average return component of PECO's generation-related revenue requirement. (OSBA M.B., p. 26). Accordingly, the OSBA offered certain refinements to PECO's allocation methodology. (Id., p. 28).

Both the OCA and PAIEUG objected to the OSBA's proposed changes to PECO's method.

The OCA argued that the OSBA's proposal has implications for other issues, such as future rate unbundling, which could not be fully examined in this proceeding. In view of this, the OCA asserted that any consideration of an appropriate allocation method should be postponed until PECO's restructuring proceeding. (OCA St. 1R, pp. 1-2).

PAIEUG contended that the OSBA's proposal is seriously flawed and may result in inter-class cost shifting which would violate the requirements of the Act. (PAIEUG M.B., pp. 4-5)

The ALJ rejected the OCA's and PAIEUG's positions and recommended that the OSBA's modifications to PECO's proposed allocation method be approved. According to the ALJ,

Neither the OCA nor PAIEUG provided adequate proof that the OSBA's modification to the 4CP allocation factor in this case will have any meaningful effect on cost allocation and rate design in the restructuring proceeding.

(R.D., p. 64)

In its Exceptions to the ALJ's recommendation, the OCA insists that any proposed modifications to PECO's allocation methodology should await full examination in PECO's restructuring proceeding. Noting that the Act provides for unbundled rates and a rate cap, the OCA asserts that:

Without reviewing fully unbundled rates, it is unclear whether the OSBA proposal will produce results that have the potential to violate the rate cap. 66 Pa. C.S. §2804(4)

(OCA Exc., p.7)

The OCA also contends that it is not clear whether adoption of the OSBA's allocation proposal will result in the shifting of costs between customer classes, and it provides an example of how this may occur. (Id., p. 8).

We agree with the OCA's position on this issue. PECO's current rates were designed in its last base rate case to recover revenue requirements assigned to each customer class. Those revenue requirement assignments reflect different class rates of return which we approved in that case. We are concerned that an adjustment in this case, without the benefit of a full examination of unbundled rates or revenue requirement allocations, may improperly shift costs and could violate the rate cap.

Accordingly, the OSBA's proposed modification to PECO's allocation methodology will be rejected in this proceeding but will be deferred for full consideration in the restructuring proceeding. The OCA's Exception to the ALJ's recommendation on this issue will, therefore, be granted.

H. Float or Interest on Transition Bond Proceeds and ITC Revenue

Enron contended that timing delays for various transactions in the securitization process may become a source of funds which PECO could use for a competitive advantage. Specifically, Enron asserted that PECO could receive substantial

income from the float created by a delay in the use of transition bond proceeds. Enron also observed that PECO might realize a cash working capital benefit from the timing difference created by the receipt of ITC revenues from customers and the use of those funds in servicing the transition bond obligations. (Enron M.B., p. 12).

Enron contended that permitting PECO to use these funds for any purposes other than those intended by the Act would be inconsistent with the securitization provision of the Act which is designed to create competitive neutrality. In order to address its concerns, Enron proposed that any order authorizing PECO to issue transition bonds and collect an ITC should also mandate that the following measures be taken:

1. Direct that the ITC revenues collected by PECO, as well as the proceeds from the transition bonds, be deposited in trust or other restricted accounts where the funds would not be available for PECO's general corporate use, but would be invested in short term securities determined to be appropriate by either the trustee or the Special Purpose Entity (SPE).
2. To the extent that delays in the use of the ITC revenues or the transition bond proceeds produce float income, that income would be used to offset security issuance and redemption expenses that PECO proposed be charged to ratepayers through the ITC.
3. Direct PECO to provide an accounting of the float income and its offset to issuance or redemption expenses in its proposed annual true-up filing.

(Id., pp. 16-17)

The ALJ agreed with Enron on this issue, finding that it would be inappropriate and inconsistent with the Act to permit PECO to use funds derived from delays in the use of transition bonds or ITC revenues for any purpose that it chooses. The ALJ

noted that the likelihood of significant timing delays may be small, but he determined that "some provision should be made to address the possibility of such delays." (R.D., p. 68). The ALJ accordingly recommended that the measures proposed by Enron be adopted. (Id., p. 69).

PECO excepts to the ALJ's recommendation asserting that any interest earned on transition bond proceeds prior to those proceeds being used to reduce PECO's capitalization should be credited to the shareholders. (PECO Exc., p. 27). According to PECO, the purpose of securitization under the Act is not just to reduce customers bills but also to benefit shareholders by mitigating stranded costs. In this regard, PECO argues that:

The multiple purposes of securitization are carefully balanced in the Act, . . . To credit customers with the interest earned on the proceeds would undermine that careful balance by shifting dollars from shareholders to customers in a manner not contemplated by the Act.

(Id., p. 28)

As for any float or interest which might accrue on ITC revenues, PECO contends that since those revenues will be the bondholder's property the customers should not be credited with any amount. (Id., p. 29).

PECO also asserts that it would not derive any competitive advantage from the float on transition bond proceeds. On this point PECO states that:

It is impossible to imagine that a company that has no opportunity to earn a return on its investment, but which still must pay the costs associated with earning such a return,

could gain a "competitive advantage" by being allowed to earn short-term interest on its investors' own money.

(Id., p. 28)

We agree with Enron's position and the ALJ's recommendation on this issue. While any competitive edge which PECO could receive from the float on transition bond proceeds or ITC revenues may not be great, such funds would represent additional cash flow and an unwarranted, if slight, advantage over competitors just as competition is commencing. Enron is correct in its assertion that any such advantage would not comport with the Act's goal of competitive neutrality. (Enron R.E., p. 4).

As for PECO's contention that any interest on transition bond proceeds should be credited to shareholders and any float on ITC revenues is the property of the bondholders, we do not agree. Notwithstanding PECO's argument that crediting customers with any float would "undermine that careful balance" between investors and customers, we find that the primary purpose of securitization is to reduce customer bills. It would be inconsistent with the Act for PECO to use any float or interest on transition bonds or ITC revenue for any other purpose.

Accordingly, we adopt the recommendation of the ALJ on this issue, and we will direct that the measures proposed by Enron for the treatment of transition bond proceeds and float income be implemented. PECO's Exceptions on this issue will, therefore, be denied.

I. Miscellaneous Issues

1. True-up Mechanism

PECO has proposed to implement a Section 1307(a) of the Code, 66 Pa. C.S. §1307(a), true-up mechanism to projected and actual issuance and use of proceeds expenses, and stated that Section 2812(b) of the Act directed that ITC revenue be subject to reconciliation.

PECO has also stated that Transition Bonds would be issued for an amount that included estimated issuance expenses and estimated premiums and other costs associated with the repurchase of PECO's outstanding debts and reduction of equity. PECO contended that actual issuance expenses and costs would not be known until some future point and that they could be more or less than the estimated figures. PECO argued that when an ITC was established, it could not be changed; therefore, PECO requested approval for a §1307(a) type adjustment clause for reconciliation of any differences that might occur. PECO anticipated a 12-month recovery or refund period, but stated that it might request a longer period in a situation where it was seeking to recover an under-collection.

The OCA stated that, for the purposes of this proceeding and this limited securitization, it did not object to PECO's proposed reconciliation mechanism. (OCA M.B., p. 59). However, the OCA asserted that this issue should be fully reviewed and explored in the restructuring proceeding as well as the potential for cost shifting. *Id.*

Enron contended that any proceeds obtained by PECO through the "Float" should accrue to the ratepayers and not to the shareholders. (Enron M.B., p. 14). Enron

also argued that it was PECO's position that potential additional "proceeds" from the transition bonds "Float" should accrue to PECO's shareholders, not its ratepayers and, therefore, the additional income should not be recognized as offsets to the overall cost of issuance or redemption. Enron recommended that any "Float" income should be used as an offset to issuance and redemption expenses that PECO proposes to be charged to ratepayers via the ITC.

The ALJ recommended acceptance of PECO's true-up proposal, as amended by Enron and the OCA, stating that any financial benefit accrued by PECO through the "Float" should accrue to the ratepayers and be used in the true-up of the transaction costs. Further, the ALJ recommended that this issue be fully reviewed in the restructuring proceeding as suggested by the OCA. (R.D., p. 71).

We note that no Party objected to the ALJ's recommendation on this issue. Premised on our review of the record as developed in this proceeding, we conclude that it is appropriate, and in the public interest, to direct the ALJ to fully review this issue in the restructuring proceeding.

2. Two Year Window

Although PECO expects its initial issuance of Transition Bonds to be made on or about June 30, 1997, and anticipates that all of the bonds will be issued prior to February, 1998, it has requested a two year window within which to issue all of the bonds. PECO further states that the two year window is needed due to the sizable amount to be refinanced, the uncertain market conditions and the presumption that there will be more than one issuance. PECO also considers the two year window to be a reasonable compromise in order to provide minimum cost and maximum savings.

In light of the fact that there have been no criticisms filed or expressed against PECO's request, the ALJ adopted PECO's position as being a reasonable request. However, the ALJ noted that it is likely that there will be an appeal from the Commission's Opinion and Order and that, therefore, the future issuance of transition bonds may be delayed. In addition, the ALJ took official notice of the pending litigation in the case of Vincent J. Fumo, et al., v. Pennsylvania Public Utility Commission, et al., at Docket No. 269 M.D. 1997, filed March 18, 1997, wherein the complainants allege that the adoption of the Act violates the Constitution of the Commonwealth, and concluded that it was highly likely that the pendency of this suit would prohibit the marketing of any transition bonds.

Upon consideration of the record in this proceeding, and in light of the reduction in the total amount authorized for securitization, we find that PECO should be permitted not more than a twelve (12) month window for the issuance of transition bonds to run for one year from the date of entry of this Opinion and Qualified Rate Order unless otherwise modified by subsequent action of this Commission. In balancing the interests of investors and ratepayers, we find that it is in the public interest to conclude the ITC as quickly as possible. Accordingly, PECO's request for a two-year window is denied.

3. Incorporation of Record

The ALJ recommended that the record in this proceeding be incorporated into the record of the Application of PECO for Approval of its Restructuring Plan under Section 2806 of the Code at Docket No. R-00973953 because the parties should not be "required to relitigate their positions from scratch in the restructuring case." (R.D., p. 17).

PECO states in its Exceptions that it agrees with the ALJ in concept but not in practice. (PECO Exc., p. 29). However, PECO argues that since the parties to the restructuring proceeding would have the instant record available to them, that they should be required to designate, in advance, those specific portions of the record that they wish to utilize in the hope that this will minimize confusion and eliminate any due process concerns. (Id., p. 30).

PAIEUG argues that the ALJ properly recommended full incorporation of the record in the instant proceeding into PECO's restructuring proceeding. (PAIEUG R.E., p. 12). PAIEUG further argues that PECO's suggestion to require designation in advance would be time-consuming and inefficient and should be denied. (Id., p. 13).

The Environmentalists argue that the ALJ's recommendation to incorporate the instant record into the restructuring proceeding will conserve resources and should be approved. It is further argued that PECO's recommendation would have the parties undertake time-consuming surgery on the record from this proceeding whereas, the ALJ's recommendation would allow any party disputing the incorporation to move to exclude the incorporated record on the ground of unfairness. (Environmentalist R.E., p. 15).

Based on the arguments of the parties, and the record, we question whether all of the elements of this record are of value for the restructuring case since updates on many issues have been filed. As a result, it is preferable to have the parties identify the portions of the record that they desire to include in the restructuring filing, and that liberal incorporation be extended by the ALJ in that matter. Accordingly, we will reject the recommendation of the ALJ, and grant PECO's Exceptions on this issue consistent with this Opinion and Order.

4. Exit Fees

The Environmentalists, in their Exceptions, argue that, pursuant to the Act, a utility's obligations continue after assignment of transition property, which a QRO approves, except for those customers paying exit fees "in the manner and on the basis specified in the qualified rate order." 66 Pa. C.S. §2812 (b)(6)(ii). The ALJ did not address the issue of exit fees and, as a result, the Environmentalists recommend that, if the Commission does authorize a QRO and ITC, then the exit fee question should be explicitly addressed. (Environmentalists Exc., p. 21).

PECO argues that there is no necessity to impose exit fees and that nothing in the Act states that exit fees must be delineated in the QRO as a condition for issuance of a QRO. (PECO R.E., p. 19).

PAIEUG argues that the Environmentalists argument is based on a misinterpretation of the Act and there is no requirement that a QRO must address exit fees or termination charges as a condition for a QRO. As a result, PAIEUG recommends that the Environmentalists' Exception be denied on this issue. (PAIEUG R.E., pp. 14-16).

Section 2812(b)(6) of the statute provides, in pertinent part:

... If the Qualified Rate Order so provides, the obligations of the electric utility:

(i) shall be binding upon the electric utility, its successors and assigns; and,

(ii) shall be required by the Commission to be undertaken and performed by the electric utility and any other

entity which provides electric service to a person that was a customer of an electric utility located within the certificated territory of the electric utility on the effective date of this chapter or that became a customer of electric services within such territory after the effective date of this chapter and is still located within such territory, as a condition to the provision of service to such customer by such electric utility or other entity, unless the customer has paid a termination charge in the manner and on the basis specified in the Qualified Rate Order.

66 Pa. C.S. §2812(b)(6) (emphasis added).

Based on the foregoing, it is evident that there is no mandate for a discussion of exit fees in a QRO. The statute addresses a discretionary aspect of a QRO and provides that the terms of the QRO, which may include or authorize an ITC, are a condition of the provision of service to a customer unless the customer has already paid a termination charge. To the extent that a “termination charge” is referenced, it is only for the purpose of ensuring that customers who have already paid a termination charge are not required to further pay a portion of the ITC. As a result, we will deny the Exception of the Environmentalists consistent with this Opinion and Order.

5. Irrevocable QRO

The Environmentalists argue in their Exceptions that a QRO need not, and should not, be irrevocable but they do acknowledge that the Commission does have the discretion to grant or deny irrevocability, as cited earlier in this Opinion and Order. However, the Environmentalists further state that we should avoid any Constitutional pitfalls that may befall an irrevocable order and decline to declare the Order irrevocable. (Environmentalists Exc., p. 15). In addition, they also cite several “wordsmithing issues” that allegedly reflect the danger of proceeding too quickly and recommend, apparently as

an alternative, that the issue of irrevocability be put off to PECO's restructuring proceeding. (Environmentalists Exc., pp. 16-17).

PECO argues that the Environmentalists' assertions regarding the issuance of an irrevocable QRO are without any basis on the record and is contrary to the applicable provisions of the Act. In addition, PECO claims that the assertions are contrary to the testimony of its witnesses, who, on the record, explained in detail why irrevocability is necessary to realize the benefits of securitization. (PECO R.E., p. 18).

The ALJ has made no specific analysis of this issue but presented the QRO as being irrevocable in his Alternate Recommendation. (R.D., p. 37). Nonetheless, no party, including the Environmentalists, disputes the fact that it is within our discretion to issue an irrevocable Order or the contention of PECO that the irrevocability requirement is necessary to achieve the benefits of securitization.

We have reviewed the record in this proceeding concerning this issue and note that PECO, through the statement of its witness Hiller, asserted that legislation is required which creates the irrevocable right to ITC collections sufficient to fully recover QTE. PECO contended that this is necessary in order to mitigate the risk associated with a credit analysis that addresses not only the charge-off experience of PECO, as in a normal receivables securitization, but also, most importantly, the ability of PECO to generate the receivables by providing service to customers. Further, PECO asserted that it is this statutory right to future revenues which is the basis for the securitization rather than the existing receivables. (PECO Statement 5, p. 14).

Since we have the discretion to issue an irrevocable Order, doing so at this time would be in the public interest in that it would give PECO the ability to gain the

most advantageous financing. Anything less than an irrevocable Order may jeopardize this ability and, ultimately, result in higher costs to its customers. As a result of the foregoing, we will exercise our discretion and issue an irrevocable Opinion and Qualified Rate Order with respect to all issues except the time frame for issuance of the transition bonds as previously referenced in Section I(2) - Two Year Window (supra). Accordingly, the Exception of the Environmentalists on this issue is denied.

V. Conclusion and Qualified Rate Order

Based upon our review of the record and the arguments presented by the Parties to this proceeding, we conclude that it is reasonable, appropriate and in the public interest to approve, in part, PECO's Application for a Qualified Rate Order. We determine that PECO should be permitted to securitize, under the terms of this Qualified Rate Order, the amount of \$1.098 billion dollars, in a manner consistent with the terms of this Qualified Rate Order, **THEREFORE;**

IT IS ORDERED:

1. That the Application of PECO Energy Company for the Issuance of a Qualified Rate Order under Sections 2808 and 2812 of the Public Utility Code, 66 Pa. C.S. §§2808 and 2812, filed on January 22, 1997, at Docket No. R-00973877, be, and hereby is, granted, in part, consistent with this Qualified Rate Order.

2. That the Complaint of the Office of Consumer Advocate at Docket No. R-00973877C0001 be, and hereby is, sustained, in part, and denied, in part, consistent with this Qualified Rate Order.

3. That the Complaint of the Environmentalists, which is an *ad hoc* group consisting of: Delaware Valley Citizens' Council for Clean Air; Citizen Action; NESIP; Pennsylvania Public Interest Research Group; Philadelphia Solar Energy Association; Sierra Club; and Trout Unlimited - Pennsylvania Council, at Docket No. R-00973877C0002 is sustained, in part, and denied, in part, consistent with this Qualified Rate Order.

4. That any issues raised by a Party to this proceeding, which are not explicitly discussed in this Qualified Rate Order, have been duly considered and are hereby denied for purposes of this proceeding.

5. That this Commission determines that it is just and reasonable and in the public interest for PECO Energy Company to recover from its customers through Intangible Transition Charges amounts sufficient to recover the following Qualified Transition Expenses which total \$1.098 billion:

- (a) \$607.355 million in Stranded Generation Costs
- (b) \$372.917 million in Regulatory Assets
- (c) \$ 96.162 million in Deferred Fuel Costs
- (d) \$ 21.917 million in Prorata Issuance and Use-of-Proceeds Costs (exclusive of Common Equity Premiums).

6. That PECO Energy Company be, and hereby, is directed to implement a reduction in its customer rates, on the following terms: (a) a rate reduction shall be implemented only upon successful issuance of Transition Bond authorized by this Qualified Rate Order (if issuance is in one or more series, a rate reduction shall be calculated and implemented corresponding to each such series); (b) the aggregate rate reduction shall be in an amount equal to the revenue requirement currently included in the Company's rates for the Transition or Stranded Costs for which Transition Bonds have been issued on that date; (c) for such Transition or Stranded Costs that are currently in the Company's base rates, the Company shall remove from its base rates sufficient revenue requirement such that it will no longer receive either a return of or a return on those investments; (d) for such Transition or Stranded Costs that are not currently in the Company's base rates, the Company shall be prohibited from recovering in its base rates the revenue requirement associated with amortization of those expenses; (e) for the

deferred fuel balances, the Company shall settle those deferred balances; (f) the rate reduction shall be applied to customer bills using the method and allocation set forth in the Company's filing, testimony, exhibits and tariff; and (g) the Intangible Transition Charges associated with the Transition Bonds issued on that date shall be applied to customer bills simultaneously with the rate reduction. This Commission approves the supplements and changes to the Company's Electric Service Tariff, as proposed by the Company in its filing, testimony, and exhibits, to implement this reduction in its customer rates.

7. That this Commission authorizes PECO Energy Company to impose on, and collect from its customers, through non-bypassable charges applied to the bill of every customer accessing the Company's transmission or distribution network, the "Intangible Transition Charges" in an amount equal to \$1.098 billion plus an amount sufficient to provide for any credit enhancement and to pay interest, redemption premiums, if any, and servicing expenses relating to the Transition Bonds. The Intangible Transition Charges shall be collected over periods of time and in such amounts as are necessary to amortize each series of Transition Bonds in accordance with the terms thereof. Notwithstanding anything else in this Qualified Rate Order, the Intangible Transition Charges shall be collected from customers until all of the Transition Bonds are discharged.

8. That PECO Energy Company be, and hereby is, directed as follows:

a. To deposit in trust, or other restricted account, any ITC revenues and transition bond proceeds where such funds will not be available for PECO's general corporate use, but shall be invested in short term securities determined to be appropriate by the Transition Bond trustee.

b. To the extent that delays in the use of the ITC revenues or the transition bond proceeds produce float or interest income, that income shall be used to offset security issuance and redemption expenses that will be charged to ratepayers through the ITC.

c. To provide an accounting of the float or interest income and its offset to issuance or redemption expenses in all subsequent reconciliation filings.

9. That this Commission determines that PECO Energy Company's imposition on customers of Intangible Transition Charges in an amount sufficient to recover an aggregate amount of (a) \$1.098 billion of Qualified Transition Expenses, comprised of \$1.076 billion of the Company's Transition or Stranded Costs under 66 Pa. C.S. §2804 (relating to standards) and 66 Pa. C.S. §2808 (relating to Competitive Transition Charge), \$7.116 million in costs relating to the sale of Intangible Property or issuance of Transition Bonds, and \$14.801 million in costs associated with the Company's use of the proceeds (including the cost of retiring the Company's debt or equity), plus (b) an amount of Qualified Transition Expenses sufficient to provide for any credit enhancement to pay interest, redemption premiums, if any, and servicing expenses relating to the Transition Bonds in the public interest and is just and reasonable.

10. That the Intangible Transition Charges shall be applied to customer bills using the methodology and allocation set forth in the Company's filing, testimony, exhibits, and Tariff. The Company is directed to file supplements and changes to its Electric Service Tariff consistent with this Qualified Rate Order. Pursuant to 66 Pa. C.S. §2812(b)(5), this Commission authorizes the Company to make annual adjustments to the Intangible Transition Charges to ensure the recovery of revenues sufficient to fully cover the Qualified Transition Expenses consistent with this Commission's Order at Docket No. M-00960890 F.006, entered April 11, 1997. The revenues collected through the

Intangible Transition Charges shall be determined to be sufficient for this purpose if and only if the revenues collected through the Intangible Transition Charges are sufficient to amortize the Transition Bonds (after payment of accrued interest and servicing fees) in accordance with the terms thereof and as consistent with the terms of this Qualified Rate Order. For each Annual Adjustment, the Company shall file with this Commission: (a) an accounting of its collections of Intangible Transition Charges for the previous annual period; (b) a statement of any over- or under-collections; (c) the charge or credit to be added to Intangible Transition Charges during the next year to ensure that the Intangible Transition Charges revenue collections will be sufficient to amortize the Qualified Transition Expenses in accordance with the amortization schedule for the principal amount of Qualified Transition Expenses (“Projected QTE Balances”); and (d) any proposal by the Company to modify the reconciliation methodology. Pursuant to 66 Pa. C.S. §2812(b)(5), this Commission shall approve all Annual Adjustments within 90 days of the Company’s Annual Adjustment filing.

11. That this Qualified Rate Order authorizes the Company to include as part of its Qualified Transition Expenses \$21.917 million in pro rata issuance and use of proceeds costs. The Company shall effect a reconciliation between its estimate of these costs and the actual costs incurred on the following terms: (a) the Company shall establish a tracking account for all expenses incurred related to these estimated costs; (b) when the Company has completed a full accounting of actual costs, it shall file with this Commission supporting documents for those actual costs and shall state the amount by which the actual costs differ from the estimated costs; (c) at the same time, the Company shall file with this Commission a reconciliation of any over- or under-collection of such costs, including the payment or recovery of interest on over- or under-collection balances and (d) this reconciliation shall be implemented through automatic

adjustments to the Company's base rates, and not through any Intangible Transition Charges.

12. That this Commission determines that the methodology under which the Company will recover the Intangible Transition Charges authorized by this Qualified Rate Order satisfies the provisions of 66 Pa. C.S. §2812(g), which require that the methodology not shift inter-class or intra-class and that the methodology maintain consistency with the allocation methodology for utility production plant used by the Commission in the Company's last base rate proceeding.

13. That this Commission concludes that it is in the public interest to, and authorizes the Company and any Assignee to (a) assign, sell, transfer or pledge Intangible Transition Property in an amount sufficient to recover all its Qualified Transition Expenses (such term includes all right, title and interest of the Company or any Assignee in this Qualified Rate Order) and in all revenues, collections, claims, payments, money or proceeds arising from Intangible Transition Charges pursuant to this Qualified Rate Order to the extent this Qualified Rate Order and the rates and other charges authorized hereunder are declared irrevocable and (b) issue, sell and refinance, in reliance on this Qualified Rate Order, one or more series of Transition Bonds, each series with a final maturity of up to ten years, and each series in one or more classes secured by the Intangible Transition Property created by this Qualified Rate Order. The last issuance of Transition Bonds and any accompanying assignment, sale, transfer, or pledge of Intangible Transition Property under this Qualified Rate Order shall be effected within one year from the date of entry of this Qualified Rate Order. Notwithstanding the foregoing, the Company retains sole discretion regarding whether to assign, sell or otherwise transfer Intangible Transition Property created hereby or to issue or cause the Transition Bonds to be issued or refinanced. We also determine that with respect to this

timing for issuance of transition bonds, our decision relative to this issue is not irrevocable.

14. That, if the Company or any Assignee refinances the Transition Bonds, the Intangible transition Charges authorized in this Qualified Rate Order shall be adjusted in accordance with the true-up mechanism described in paragraph 10 of this Qualified Rate Order to ensure the recovery of revenues sufficient to make all interest, redemption premiums, if any, servicing expenses and principal payments with respect to Transition Bonds issued in that refinancing. The revenues collected through the Intangible Transition Charges shall be determined to be sufficient for this purpose if and only if the revenues collected through the Intangible Transition Charges provides for the amortization of Transition Bonds in accordance with any amortization schedule set forth in any prospectus or other offering document provided to the holders of the refinanced bonds.

15. That this Commission directs that PECO Energy Company use the proceeds from the assignment, sale, transfer or pledge of Intangible Transition Property and the issuance and sale of Transition Bonds principally to reduce the Company's Transition or Stranded Costs and to reduce related capitalization. The Company currently anticipates using, and this Commission hereby authorizes the Company to use, the proceeds from the assignment, sale, transfer or pledge of the Intangible Transition Property created by this Qualified Rate Order as follows: approximately \$21.917 million to be used to pay costs of issuing the Transition Bonds and costs associated with the Company's use of the proceeds; approximately \$96.162 million to be applied to reduce the Company's deferred fuel costs; and approximately \$980.272 million (less any amounts representing required credit enhancement with respect to the Transition Bonds) million to be used to reduce the Company's existing capitalization through retirement of

outstanding debt and preferred stock and the return on investment to equity holders through stock buybacks, dividends and market purchases.

16. That the Allegheny Power Settlement submitted on February 27, 1997, be, and hereby is, approved to the extent consistent with this Opinion and Qualified Rate Order.

17. That PECO Energy Company shall file with this Commission, no later than 120 days after the issuance or refinancing of Transition Bonds, a description of the final structure of each issuance or refinancing of such Transition Bonds, including the principal amount, the price at which each such series and/or class of Transition Bonds were sold, payment schedules, the interest rate and other financing costs, and the final plans for the Company's use of the proceeds of such offering, and in the case of any subsequent refinancing of Transition Bonds specifying the effect upon the rates authorized herein. Notwithstanding such filing, the final structure of each such issuance or refinancing and the related effect on rates authorized herein shall not be subject to change or revision by this Commission after the date of such issuance or refinancing.

18. That, to the extent that the Company, or any Assignee, assigns, sells, transfers, or pledges any interest in the Intangible Transition Property created hereby, this Commission authorizes the Company to contract, for a specified fee, with such Assignee for the Company to continue to operate the system to provide electric service to the Company's customers, to impose and collect the applicable Intangible Transition Charges for the benefit and account of the Assignee, to impose and collect the applicable Intangible Transition Charges for the benefit and account of the Assignee to make periodic adjustments of Intangible Transition Charges contemplated under paragraph 10 of this Qualified Rate Order, and to account for and remit the applicable Intangible

Transition Charges to or for the account of the Assignee free of any charge, deduction or surcharge of any kind (other than the specified contractual fee referred to above). This Commission also authorizes the Company to contract with the Assignee and an alternative party, which may be a trustee, that the alternative party will replace the Company under its contract with the Assignee and perform the obligations of the Company contemplated in this Qualified Rate Order. The obligations of the Company (a) shall be binding upon the Company, its successors and assigns and (b) shall be required by this Commission to be undertaken and performed by the Company and any other entity which provides electric service to a person that was a customer of the Company located within the Company's certificated territory on January 1, 1997, or that became a customer of electric services within such territory after January 1, 1997, and is still located within such territory, as a condition to providing service to such customer or municipal entity providing such services in place of the Company by the Company or other entity.

19. That this Commission hereby declares that this Qualified Rate Order shall be irrevocable for purposes of Section 2812 of the Public Utility Code, 66 Pa. C.S. §2812, and accordingly agrees that it will not directly or indirectly, by any subsequent action, reduce, postpone, impair or terminate this Qualified Rate Order or the rates and other charges authorized hereby, including, without limitation, the Intangible Transition Charges, until the Transition Bonds are fully paid and discharged. This Commission further declares that the right, title and interest of the Company and any Assignee in this Qualified Rate Order and the Intangible Transition Charges, the rates and other charges authorized hereby and all revenues, collections, claims, payments, money or proceeds of or arising from the same constitutes Intangible Transition Property. To the extent that an assignment, sale or transfer of the Intangible Transition Property resulting from this Qualified Rate Order, or the issuance of related Transition Bonds, is not affected within the period specified in paragraph 13 of this Qualified Rate Order, the provisions of this

paragraph shall lapse and terminate; provided, however, that this Commission, through subsequent application by the Company, may reinstate the irrevocability of the whole of or any portion of this Qualified Rate Order.

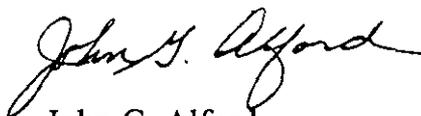
20. That, in this Qualified Rate Order, this Commission authorizes the recovery of \$1.076 billion of the Company's Transition or Stranded Costs. In accordance with 66 Pa. C.S. §2812(b)(5)(i), this Commission makes no determination in this Qualified Rate Order regarding the Company's recovery of Transition or Stranded Costs above that \$1.076 billion amount. The Commission hereby directs that the Company may, by subsequent application or applications, request this Commission to consider additional Qualified Transition Expenses and other issuances of Transition Bonds. This Commission defers consideration of any such request until such time as the Company submits such additional applications for qualified rate orders.

21. That during some or all of the period during which the Intangible Transition Charges approved by this Qualified Rate Order are being collected, the generation component of the Company's charges to customers will be limited by the provisions of 66 Pa. C.S. §2804(4) (pertaining to rate caps). For purposes of 66 Pa. C.S. §2804(4)(ii), the generation component of the Company's charges includes Competitive Transition Charges, Intangible Transition Charges, and other generation charges. In the event that the combined total of these elements would cause the generation component of the Company's charges to exceed the rate cap specified in 66 Pa. C.S. §2804(4), the Company shall retain whatever right it may have under the existing provisions of the statute to request relief from the rate cap, but in the event that it does not seek such relief or that relief is denied, the Company shall adjust the non-securitized elements of its generation charges, rather than the Intangible Transition Charges approved by this

Qualified Rate Order, to bring the charges into compliance with the rate cap provisions of 66 Pa. C.S. §2804(4).

22. That all matters not specifically disposed of in this Qualified Rate Order, are deferred to the proceeding on PECO Energy Company's restructuring application, Docket No. R-00973953.

BY THE COMMISSION



John G. Alford
Secretary

(SEAL)

ORDER ADOPTED: May 22, 1997

ORDER ENTERED: MAY 22 1997

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, Pennsylvania 17105

APPLICATION OF PECO ENERGY
COMPANY FOR ISSUANCE OF A
QUALIFIED RATE ORDER UNDER
SECTIONS 2808 AND 2812 OF
THE PUBLIC UTILITY CODE

PUBLIC MEETING-
MAY 8, 1997
MAY-97-OSA-159*
DOCKET NO. R-00973877

STATEMENT OF CHAIRMAN JOHN M. QUAIN

On January 22, 1997, PECO Energy Company (PECO) filed an expedited request for securitization of certain costs stranded by the move to competition. This is the first such securitization request submitted pursuant to the Electricity Generation Customer Choice and Competition Act (Act).

By law, my colleagues and I were required to refrain from discussing the merits of the case as of the date it was filed. The level of media interest in this request, and the mischaracterizations made by some, regarding both this filing and the Act itself, made silence difficult to maintain over the last three months. As of today, however, I am no longer required to remain silent.

Initially, I wish to correct some of those mischaracterizations. First, in my view, the Electricity Generation Customer Choice and Competition Act holds enormous promise for Pennsylvania. I fully recognize, however, that as we move to greater competition, many complex and controversial issues must be decided.

This filing represents the first such issue. It is important to keep in mind, however, that at worst, it represents a rate reduction. The only question is: by how much? Given the fact that PECO has not had a base rate reduction in over twenty years, this is not a bad place to begin implementation of the new law.

Second, much has been made of the fact that any costs securitized will remain on customer bills for ten years. Critics, however, conveniently ignore the fact that absent this landmark legislation, such costs would remain on customer bills for the next twenty to thirty years. Thus, the amount securitized through our action today will reduce the time PECO will be permitted to recover costs from its customers.

Third, this case is not, as some would describe it, an opportunity for a rate increase. The rate cap imposed by Section 2804 of the Act prohibits such a result. In fact, PECO's rate cap resulted in customers avoiding a \$125 million rate increase last December. Again, this fact has been overlooked by those who ignore the benefits generated by the Act.

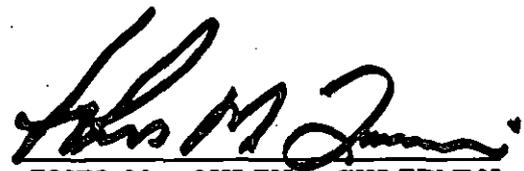
Next, I wish to address our ability to render this decision within the time frame prescribed by law. I am concerned with the comments which suggest that we should favor bureaucratic tradition over legislative intent. Such suggestions are without merit; they have no basis in business reality.

Pursuant to Section 2812 of the Act, expedited requests for securitization must be decided within 120 days. That is the law! That is the time frame approved by the Governor and the General Assembly of Pennsylvania. It is not within the province of this Commission to question the propriety of this time frame.

Moreover, let me state without equivocation that this Commission stands ready to implement all provisions of the Act in a timely and professional manner. For example, over the past 120 days (a time frame considered by many to be too short) this agency has begun implementation of the Act by issuing 20 separate orders; has conducted 10 public forums and; conducted 5 audits. Today we will issue an additional 6 orders and approve our first 3 licenses for competitive providers. This activity demonstrates a high level of professionalism by our staff and others participating in the process. Consequently, those who yearn for the, "good old days" when the bureaucracy, rather than the public interest and the market, defined the timeliness for decisions, should look elsewhere for a sympathetic ear.

I take strong exception to the suggestion that our staff, the industry and other interested parties are not up to the challenges posed by the Act. While I sit as a Commissioner of this agency and am privileged to act as its Chairman, we will not shrink from our responsibilities; nor will we make excuses that the demands of the law are too onerous.

5-8-97
DATE


JOHN M. QUAIN, CHAIRMAN

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, Pennsylvania 17105-3265

APPLICATION OF PECO ENERGY COMPANY
FOR A QUALIFIED RATE ORDER UNDER
SECTIONS 2808 AND 2812 OF THE PUBLIC
UTILITY CODE

PUBLIC MEETING -
MAY 22, 1997
MAY-97-OSA-180*
DOCKET NO. R-00973877

STATEMENT OF COMMISSIONER JOHN HANGER

INTRODUCTION

As I stated at the May 8th Public Meeting, this case starts the process of determining how much the electric rates of PECO Energy Company ("PECO") will go down. PECO's position in this case would reduce its electric rates by 3.4%. Other parties insist that PECO's rate decrease is not nearly enough, since rates would fall approximately 40% if PECO's customers received now the full benefits of electric generation competition made possible by the Electricity Generation Customer Choice and Competition Act ("Act"). Consequently, though the parties have raised many issues, the bottom line of this case is argument about the amount that PECO's rates will be cut and when rates will be cut.

For this Commission, deciding cases about how much electric rates should be decreased is a novel experience. In just the four years prior to the passage of the Act, this Commission adjudicated 6 electric base rate increase cases that were filed by four of Pennsylvania's electric utilities. In all 6 cases, an electric rate increase of some amount was a foregone conclusion. Fortunately, given the new policy of electric generation competition, electric rate increase cases are at least an endangered species, if not extinct. The Commission's new mission is to judge passionate disagreements about the appropriate level and timing of rate decreases.

DISCUSSION

On May 8th, I issued a lengthy statement that explained the basis for my decision in this case. I will now only summarize briefly the reasons for my decision and refer those interested in more detail to my May 8th statement.

PECO alleges it has \$6.8 billion of stranded investment in uneconomic plants. These stranded costs are presently in rates and ratepayers are now paying 100% of these costs when they pay their monthly electric bills.

Of PECO's \$6.8 billion of alleged stranded investment, PECO petitions in this case for a Qualified Rate Order that would allow it to securitize \$3.773 billion of expenses. If approved, PECO's Petition would securitize 68% of its stranded generating plant claim and 50% of its stranded regulatory assets.

Numerous parties challenge PECO's Petition on even more numerous grounds. Some parties urge that legal reasons justify denying entirely PECO's Petition. Still other parties such as the Office of Consumer Advocate (OCA) and the Philadelphia Area Industrial Energy Users Group (PAIEUG) factually challenge substantial portions of PECO's request but do recommend that this Commission authorize securitization of a part of the \$3.773 billion for which PECO petitions. Many of these parties argue that disallowance of some, most, or all of PECO's total stranded investment claim will reduce rates much more than the securitization of some, most, or all of PECO's stranded investment claim.

For the reasons that I set forth on May 8th, PECO's Petition to securitize \$3.773 billion should be denied. Alternatively, the record of this case supports allowing PECO securitize \$1.098 billion. This alternative recommendation is based upon the factual adjustments to PECO's Petition that OCA and PAIEUG make.

Concerning stranded regulatory assets, the Office of Consumer Advocate recommends approval of \$514 million. I accept the OCA adjustments to PECO's stranded regulatory claim but modify it to reflect the December 31, 1998 balance of the approved assets. This modification leads to approval of \$469 million of stranded regulatory assets for securitization.

Concerning stranded generating plant, I accept the factual adjustments to PECO's Petition made by PAIEUG. After making its adjustments, PAIEUG recommends securitization of \$607 million. This recommendation should be adopted.

Today's Proposed Order reflects the OCA's adjustments to PECO's regulatory assets claim and the PAIEUG adjustments to stranded generating investment. The Proposed Order allows PECO to securitize 16% of its total stranded generating claim of \$3.566 billion and 14% of its stranded regulatory claim of \$2.636 billion.

CONCLUSION

It is my duty to weigh the evidence, make only determinations that are supported by substantial evidence, and to balance the interests of all parties, including those of shareholders and ratepayers. The Proposed Order allows PECO to securitize significantly less than the \$3.773 billion it requested, but the Order's factual findings are supported by substantial evidence and reasonably

balance the interests of shareholders and ratepayers. Furthermore, the Proposed Order defers to PECO's general restructuring case most of the thorny questions, including most of the stranded investment issues.

Lastly, though some may still incorrectly believe that today's Order will raise rates for PECO's customers, that is not true. One hundred percent of PECO's stranded investment is in rates charged to ratepayers today. This decision, therefore, does not create any new or added costs for ratepayers. In fact, securitization will allow refinancing of some existing investments in order to reduce the capital or interest costs that are now charged to ratepayers. Moreover, those parties that wish to argue that some or most of PECO's stranded investment should be disallowed instead of securitized may do so in PECO's pending restructuring filing.

May 21, 1997
DATE

John Hanger
JOHN HANGER, COMMISSIONER

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, Pennsylvania 17105-3265

APPLICATION OF PECO ENERGY
COMPANY FOR ISSUANCE OF A
QUALIFIED RATE ORDER UNDER
SECTIONS 2808 AND 2812 OF
THE PUBLIC UTILITY CODE

PUBLIC MEETING -
MAY 22, 1997
MAY-97-OSA-180*
DOCKET NO. R-00973877

DISSENTING OPINION OF COMMISSIONER DAVID W. ROLKA

I respectfully dissent from the majority's decision to issue an irrevocable Qualified Rate Order (QRO) pertaining to any generation assets at this time. Instead, I submit that the Commission's decision to issue a Qualified Rate Order relating to generation assets should be revocable. I do not believe that the "known and measurable" evidentiary standard prescribed by statute has been met. Moreover, I disagree with the procedural decision to refrain from declaring that the record in this proceeding should be incorporated into PECO Energy's pending restructuring proceeding. The majority's decision imposes needless additional administrative burden on parties whose resources are already constrained.

This case is the first of its kind to have come before the Office of Administrative Law Judge of the Pennsylvania PUC and before this Commission. To my knowledge, not since 1979, has the Commission been confronted with the prospect of removing utility assets from traditional base rates (Pennsylvania Public Utility Commission, et al. v. Metropolitan Edison Company and Pennsylvania Electric Company, Docket No. I-79040308, June 15, 1979). At that time the decision of the Commission was simplified by stipulation of the parties to the use of the test years in the Respondent's last rate cases (then less than one year stale) and the incorporation of those records by reference into the then present record. That proceeding was further simplified by the absence of any attempt by any of the parties to introduce specific evidence of changes in fair value or fair rate of return. Additionally, the Respondents waived a redetermination of their capital structure and rate of return for purposes of that proceeding.

Few, if any, of those simplifications even arguably exist in this proceeding! Unlike the proceeding that unfolded in 1979, however, this Section 2812 proceeding does have the advantage of being 'pancaked' on top of a restructuring proceeding and our results here need not finally adjudicate every issue.

Irrevocability of the Qualified Rate Order

The determination to grant irrevocable status to some or all of this securitization is an issue separate and apart from the issue of determining whether to grant a QRO under Section 2812(b)(4). No specific standard is prescribed in Section 2812 to govern the

PUC's exercise of discretion to make an irrevocability decision. Accordingly, the statutory standards governing the threshold decision to issue a QRO, as set forth in Sections 2812(A)(2)(III) and 2812(B)(1)(I), must be applied to the irrevocability decision. The standard must be whether irrevocable status is in conformance with the "just and reasonable" standard, (66 Pa. C.S. §1301) and whether the grant of irrevocable status is in the public interest.

The Legislature has determined that certain transition costs and stranded costs, defined in Sections 2803 and 2808, may be recovered as part of the transition to a competitive market in electric generation and constitute costs which are just and reasonable. The definition of "transition or stranded costs" in Section 2803 mandates that such costs be (1) known and measurable; (2) determined on a net present value basis over the life of the asset or liability; (3) traditionally would be recoverable under a regulated environment; but which may not be recoverable in a competitive electric generation environment; and, (4) be determined by the Commission to remain following mitigation by the electric utility.

In considering how the public interest is served as part of the Commission's review of a request for a QRO, the Commission must also determine whether QRO irrevocability produces net benefits, considering the risks, over a revocable QRO. Such benefits should be judged not from the perspective of the issuer or purchaser of transition bonds (for which the benefits are obvious), but from the perspective of the ratepayers who will be obligated to finance the full costs of such bonds. Comparison must be made of the relative costs and risks of revocable and non-revocable QROs.

Thus the Commission's decision on granting irrevocable status must depend on the quality and certainty of the evidence before it. Whereas the Commission may base its decision upon substantial evidence, most of the issues in a QRO proceeding are based wholly or partly upon estimates of costs, future prices, future interest rates and the success of future efforts at mitigation. The Commission would ordinarily be able to rely on the best available estimates, knowing that such estimates are subject to correction by actual experience and that it would be able to make corrections if reality later sharply departed from estimated data. Irrevocability prevents such corrections for all time, and locks the Commission and the ratepaying public into estimates of costs that are by their very nature fraught with a degree of uncertainty.

The principal benefit of irrevocability is that it reduces the cost of ITC transition bonds by reducing the bondholders' risk of non-payment to the maximum extent possible. In order to determine whether the risks of irrevocability are worth the benefits, the Commission must be able to satisfy itself with a high degree of certainty. Achieving a high degree of certainty involves at least three considerations. First, the estimates of qualified transition expenses and stranded costs must be reliable and not unduly speculative. Second, irrevocable ITC transition bonds must be less expensive than traditional financing by an extent great enough to offset the greater risk to the public that it might, in the future, be called upon to pay an ITC based upon estimates of qualified transition expenses and

stranded costs which are grossly excessive and, therefore, unjust and unreasonable. Third, the public interest must be served by the Commission's acceptance, on behalf of the Commonwealth and its ratepayers, of a reasonable risk and not an excessive risk based upon unduly speculative or variable data.

Therefore, in order to assure that the "just and reasonable rate standard" is met, and to assure that the public interest is served, the Commission should not grant irrevocable status to all or any portion of a securitization unless it believes that the decision is based upon a record which demonstrates a level of qualified transition expenses and stranded costs which are reasonably known and certain, and which will result in financing costs which are significantly lower than traditional financing, at least to the extent that they compensate the public for the increased risk they assume. The Commission should not make irrevocable decisions in this expedited proceeding that a more fully developed record could later prove unwise, just to begin a securitization proposal a few months earlier than would otherwise be permitted.

I do not believe that the "known and measurable" standard has been sufficiently demonstrated. Because of this concern, I would issue a Qualified Rate Order which was *revocable* for securitization of that portion of the generation assets identified in the majority's decision, and *irrevocable* for securitization of that portion of the regulatory assets identified in the majority's decision. Such a decision would provide a more moderate response to PECO Energy's application, and would provide the needed flexibility to make adjustments, if called for, at the conclusion of PECO's restructuring proceeding

My concern over the level of uncertainty concerning the quantification of PECO Energy's generation assets, and the amount which may be stranded, appears to have been confirmed by a report prepared by our Bureau of Audits that will be publicly released today. The auditors believe that PECO's books and records contain accounting entries for plant investment and equipment that is no longer useful in utility operations. (See Docket No. D-97S001; Public Meeting agenda item MAY-97-A-19). I recognize that these staff findings are not binding on the Commission and are not part of the record in this proceeding. The report, however, points out what additional information may be available for consideration in the restructuring proceeding to assist the agency in deciding the level of PECO Energy's stranded costs in a manner that meets the "known and measurable" standard of the statute.

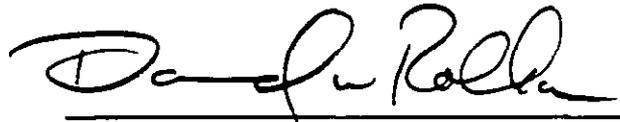
The "bottom line" question is: do we know enough to conclude that PECO Energy's market value models produce accurate results? If the answer is no, then I cannot grant irrevocable relief because the known and measurable standard cannot be met. The ALJ's analytical framework setting forth the various deficiencies of the models and his ultimate rejection thereof, was crisp, clear, well reasoned, and I agree.

***Incorporation of the Record of this Proceeding
Into the Restructuring Proceeding***

The Administrative Law Judge recommended that the record in this proceeding be incorporated into the record of the restructuring proceeding pending at Docket No. R-973953. Particularly given the number of issues that have been deferred from this proceeding to the restructuring proceeding, and the interrelationship of the various issues considered herein and to be considered in the restructuring proceeding, judicial economy counsels that the ALJ's recommendation be adopted. Instead the majority decision requires that parties designate those portions of the record that they want to have included in the restructuring proceeding. Such a requirement is time consuming and unnecessarily onerous. It requires less administrative oversight and burden to simply incorporate all of the record of this proceeding, and I can discern no prejudice to any of the parties. This may seem like a minor point now, but with the crunch of litigation deadlines facing all of the parties to the restructuring proceeding, this procedural decision imposes a tedious and otherwise avoidable task.

5-22-97

DATED



DAVID W. ROLKA, COMMISSIONER