

PENNSYLVANIA  
PUBLIC UTILITY COMMISSION

PECO Energy Company's Application  
for Approval of its Restructuring Plan  
and Joint Petition for Partial Settlement

R-00973953

Petition of Enron Energy Services Power, Inc.,  
for Approval of an Electric Competition and  
Choice Plan and for Authority Pursuant to  
Section 2807(e)(c) of the Public Utility Code  
to Serve as the Provider of Last Resort in the  
Service Territory of PECO Energy Company

P-00971265

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MEMORANDUM OF LAW IN SUPPORT OF  
NEW ENERGY VENTURES' OBJECTIONS AND PROPOSED  
MODIFICATIONS TO PECO'S RESTRUCTURING PLAN

DOCUMENT  
FOLDER

Dated: December 2, 1997

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## INTRODUCTION

These remarkable proceedings have vividly demonstrated the potential of a competitive market to bring tangible and significant benefits to electric consumers in Pennsylvania. As is fitting for a proceeding devoted to competition, PECO's original restructuring plan (the "Restructuring Plan") and its Joint Partial Settlement (the "Partial Settlement") were challenged by the filing of a number of competitive counter-proposals and modifications, among them MAPSA's "counter offer",<sup>1</sup> the proposed modifications submitted by the Pennsylvania Electric Competition Coalition<sup>2</sup> (the "PECC" or "Coalition"), and, most dramatically, Enron's Petition to become Provider of Last Resort ("Enron's Choice Plan"). Enron's Choice Plan was challenged, in turn, by the filing of various objections as well as the Environmentalist's "Better Choice" plan.<sup>3</sup> In response, Enron reworked and significantly improved its plan. Through this process, there has emerged a vision of the promise of a competitive market to foster creativity, innovation and efficiency in the provision of energy, just as it has in the restructuring process.

But if the process has offered a vision of the benefits of competition, one of the parties has not welcomed competition. Rather than proposing changes to the Partial Settlement that would have made it workable in a competitive world, PECO instead dug in its heels and determined to defend the Partial Settlement at all costs.

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<sup>1</sup> (MAPSA, Additional Testimony of Donald Johnstone, Exhibit DEJ-1S.)

<sup>2</sup> (PECC, Exhibits SAM SRI-SR3.)

<sup>3</sup> (Environmentalists Statement 2E.)

Notwithstanding the overwhelming evidence -- to be discussed herein -- that showed that the Partial Settlement would block competition, PECO's litigation strategy has been to manipulate the numbers to hide the costs the deal will impose on the public. At the same time, PECO launched a breathtakingly pervasive advertising campaign designed to sell the public on its so-called "Pennsylvania Plan," largely by trying to incite a fear of out-of-state electric suppliers. Through this strategy PECO has attempted to give the Commission only a take-it-leave-it approach to restructuring. In this regard, PECO has taken full advantage of the fact that the Partial Settlement not only purports to bind all of the signatories to the Settlement but requires them to use their best efforts to support it.<sup>4</sup> Thus many of the parties who had taken a major role in challenging the non-competitive aspects of PECO's Restructuring Plan, have been restricted from supporting the competitive proposals prevented by MAPSA, the Coalition, Enron or the Environmentalists.

The Electric Generation Customer Choice and Competition Act (the "Competition Act") makes clear that the legislature intended to give Pennsylvania utilities a chance to cushion the transition to competition by permitting some recovery of their stranded costs.<sup>5</sup> Such a recovery was seen as a fair way to alleviate the harm that a utility might suffer if it had to absorb the full impact of competition immediately. It

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<sup>4</sup> (Partial Settlement ¶ 43 at 31 and ¶ 41 at 29.)

<sup>5</sup> See 66 P.S. §2804(14) (1996) (utilities to have a "fair opportunity" to recover the level of stranded costs the Commission determines to be just and reasonable.)

was not supposed to be utilized as a tool by which a utility could prevent competition, nor was the utility supposed to be able to use the Competition Act as a pretext for the sale of its unproductive assets in excess of their book value, thereby making a profit on the transfer. Yet, in these proceedings, PECO asks the Commission to approve an approach that would both prevent competition and let PECO recover an amount significantly greater than its full litigation claim.

In order to fully appreciate the audaciousness of PECO's position, it is necessary to carefully review the financial analysis it posits in support of the Partial Settlement. As will be seen from the following discussion, PECO has manipulated the financial analysis to support not a just and reasonable level of stranded costs, but a recovery that can only be described as punitive.

Had the Commission not been foresighted enough to order consolidated proceedings, at this point the Commission would be presented with only PECO's take it or leave it proposal. Fortunately, the Commission now has before it the full record in this restructuring case and has the complete power not simply to approve or reject one of the pending proposals but to enter an order which fully achieves the public interest. The components of that order could not be more important. At stake is not only the promise of the innovation, creativity and efficiency of a competitive market in Southeastern Pennsylvania but throughout the Commonwealth.

## ARGUMENT

### I. THE COMMISSION SHOULD EXERCISE A HEIGHTENED LEVEL OF REVIEW OF PECO'S RESTRUCTURING PROPOSALS

In reviewing the proceedings before it, the Commission should begin with the recognition that both the Restructuring Plan and the Partial Settlement have an extremely dangerous structure, and, because of that fact, the Commission must give each proposal a particularly intensive scrutiny.

#### A. There Is a Temptation For A Utility to Underestimate the Future Price of Energy

*The danger of the structure that PECO has proposed can be easily explained.* Stranded generation costs are based on the difference between the net book value of a utility's generating assets and the estimated market value of those assets in a competitive regime. Obviously, the market value of the generating assets in a future competitive environment is not known today. The methodology employed by the experts to predict that value is based on their estimates of the market prices of energy over a 25 year period. With those estimates in hand, the experts forecast the anticipated revenues the generating assets will produce and discount those revenues to present value. As might be expected given the uncertainties inherent in predicting the market of energy prices in a to-be-established market, the estimates vary significantly. Because these circumstances leave a utility a lot of room to maneuver in the valuation process, it is crucial to understand the pressures which may motivate the utility with respect to valuation.

As the prospective beneficiary of stranded cost recovery, a utility has an interest in underestimating the future market prices of electricity. This is so because the lower the projected market price of electricity, the lower the estimated present value of the utility's generating assets. Of course, the lower the value of the generating plant, the higher the stranded costs.

A utility's temptation to underestimate future market prices is not caused solely by the desire to maximize stranded cost recovery. As witness David Boonin explained persuasively, overstated stranded costs lead to overstated CTC's and, given the statutory rate cap, to understated generation credits.<sup>6</sup> A simple example illustrates this point:

Assume the bundled rate of the utility is 10¢ prior to restructuring and that after fair and even-handed unbundling and determination of stranded costs, the unbundled rates would be allocated 3¢ to transmission and distribution, 2¢ to CTC recovery and 5¢ to generation. However, if the utility underestimates the future price of electric thereby overstating stranded costs, the CTC recovery might become 4¢ rather than 2¢. In such case -- assuming no change in transmission and distribution -- the generation credit would necessarily fall from 5¢ to 3¢:

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<sup>6</sup> (NEV Statement No. 1 at 13-14.)

Table 1:  
Example of Impact of Underestimated  
 Market Price of Energy on Generation Credit

|       | <u>Bundled</u> | Fair<br><u>Unbundling</u> | Underestimated<br><u>Market Price of Energy</u> |
|-------|----------------|---------------------------|---|
| T&D   |                | 3¢                        | 3¢  |
| CTC   |                | 2¢                        | 4¢  |
| GEN   | —              | <u>5¢</u>                 | <u>3¢</u>                                       |
| TOTAL | 10¢            | 10¢                       | 10¢   |

Another reason why a utility might hope that unbundling would produce an understated generation credit is obvious; if the generation credit is less than the actual market price of generation, a competitor will not be able to compete except at a loss. Under these circumstances, an incumbent utility will enjoy an enormous competitive advantage in the deregulated market.

B. A Restructuring Plan Should Contain Checks on the Temptation To Underestimate The Future Market Price

As described above there are two reasons -- maximization of stranded cost recovery and underpricing of generation - why a utility has an interest in undervaluing its generating assets. A restructuring plan should contain provisions that check that temptation. If a plan does not contain such checks, the Commission should very carefully evaluate the danger of undervaluation under the particular proposal.

1. An Offer to Sell Generating Assets

In some states, the temptation to undervalue generating assets is offset or balanced by the express power of the Commission to force the utility to sell the generation assets. If an undervaluation would expose the utility to the risk that a third party buyer could buy its assets at the artificial valuation, there would be a check on the valuation process. Similarly, if a utility included in its restructuring plan a proposal to offer its generating assets for sale at the value used in the calculation of stranded costs, there would be a check on the temptation to undervalue the generating assets. Neither PECO's Restructuring Plan nor the Partial Settlement include this type of check. PECO's proposed sale of its generating assets to an affiliate is no check at all, rather it appears to be an accounting convenience not market value.

2. A Variable CTC Could Check The Risk of Underestimation of the Value of Generation

An offer to sell is not the only way to check the possibility of undervaluation of generating assets. Another possibility is a variable CTC; that is, a mechanism to recalculate the CTC schedule from time to time throughout the transition period depending on the market price of energy.

The Competition Act contemplates the recovery of a just and reasonable amount of stranded costs over a transition period that may be as long as nine years or, with the approval of the Commission, even longer. While a restructuring plan must provide a schedule of CTC charges for the term of the transition period, nothing in the Competition Act requires that the schedule be fixed once at the beginning and never

again adjusted. At the most basic level, a fixed rate approach guarantees inaccuracy because it ignores the fundamental relationship between the prevailing market price for generation and the CTC. All else being equal, when the value of generation assets increases because the market price of generation has increased, stranded costs decrease by the same amount. (NEV Statement No. 1, at 14). Likewise, when the market price of generation decreases, the value of the generating assets also decreases, causing stranded costs to increase. (Id.) Thus, at any point in time (eliminating discounting and levelization) there is a one-to-one relationship between a change in the value of generation and an opposite but equal change in stranded costs. (Id.)

Given the on-going effect of the energy market on stranded costs, a fixed CTC approach requires the Commission to estimate and establish a fixed price for generation in an unbundled, full service tariff, over an extended period of time, by making and locking in numerous assumptions. (Id. at 4). When estimating a price, "normal" assumptions would have to be made -- years in advance -- about such variables as weather, fuel, prices, economic conditions and supply availability. (Id.). There is almost no possibility that these normal estimated costs will produce a price at prevailing market rates at every time, let alone at most times. (Id.). Accordingly, a fixed rate CTC is inherently inaccurate.

A variable CTC approach, on the other hand adjusts the CTC from time to time based on actual market prices. A variety of variable CTC approaches are possible.

Witness Boonin described one such approach in his direct testimony.<sup>7</sup> Indeed, a similar concept is included in the restructuring plan of West Penn Power.

NEV believes that a variable CTC is a better and safer approach to restructuring. Not only does the approach eliminate much of the uncertainty and gamesmanship involved in the calculation of stranded costs but the approach is consistent with the philosophy of the Competition Act.<sup>8</sup>

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<sup>7</sup> (NEV Statement No. 1 at 15-16.) Mr. Boonin's testimony describes a mechanism that would -- on a running basis -- adjust the generation credit and CTC amount based on current market information.

<sup>8</sup> The Competition Act provides important guidance on the issue; the Act explicitly requires mitigation during the transition period. 66 P.S. §2808(c)(4) provides:

“In determining the level of transition or stranded costs that an electric utility may recover through the competitive transition charge, the Commission shall apply the following principles:

(4) . . . **During the transition period**, electric utilities **shall** have the duty to mitigate generation related transition or stranded costs to the extent practicable.”  
(emphasis added)

It is apparent that under §2808(c)(4), mitigation of stranded costs must **continue** throughout the transition period. NEV's proposal makes the mitigation associated with market conditions automatic. That is, if the market price of generation in any period is higher than the amount used to calculate the stranded cost, the excess revenues will be used directly to mitigation stranded costs by being applied to reduce the CTC for the period. The statute says that utilities “shall have the duty to mitigate stranded costs” during the transition period “to the extent practicable.” NEV's proposal shows how such mitigation is practicable.

The significance of this section is considerable. If transition period mitigation efforts are allocated to the benefit of the ratepayer, any overrecovery of CTC should be given back to the consumer.

While a variable CTC approach is certainly preferable, this is not to say that the Commission may never approve a restructuring plan that includes a fixed CTC approach. It is crucial to recognize, however, that if a plan does not contain a mechanism to adjust CTC from time to time based on the actual market price of energy, then an initial overestimate of CTC will carry forward through the full period of the transition plan. In such circumstances a utility could find itself in the enviable position of recovering an inflated CTC over the course of a multi-year transition plan, and all the while retaining its generating assets at their actual market value. An example illustrates:

Assume a utility had generating assets with a book value of \$10 billion prior to competition. Suppose that a correct estimate of the future market price of energy would produce a fair valuation of \$6 billion for those assets in the post competitive world. If that utility were to be allowed to recover 100% of its stranded costs, it would be entitled to a CTC income stream with a present value of \$4 billion. Thus, the sum of the net present value of the generating assets and CTC equals \$10 billion.

However, if the utility underestimated the market price of energy -- whether by design or mistake -- so that a valuation based on those underestimated revenues was not \$6 billion, but \$4 billion, then the utility would -- given 100% stranded recovery -- be entitled to CTC recovery with a net present value of \$6 billion. Because the utility retains its assets -- actually worth \$6 billion rather than estimated \$4 billion -- the utility could actually make a profit at the expense of the consumer -- of \$2 billion:

TABLE 2:  
Example of Over Recovery Under Fixed CTC Approach

|                   | <u>Fair</u><br><u>Valuation</u> | <u>Underestimated</u><br><u>Valuation</u> | <u>Results of</u><br><u>Under Estimate</u> |
|-------------------|---------------------------------|---|--|
| Generation Assets | 6                               | 4   | 6  |
| Stranded Assets   | <u>4</u>                        | <u>6</u>                                  | <u>6</u>                                   |
| Total Value       | 10                              | 10  | 12   |

This perverse result cannot be supported by the Competition Act but, as will be seen, it is precisely what PECO seeks to accomplish.

3. Revocability of QRO

Even if a restructuring plan were approved with a fixed CTC approach, the Commission could still theoretically -- upon petition of ratepayers -- order an adjustment to the CTC schedule if the plan turned out to permit a substantial overrecovery of CTC. While this mechanism would be far short of the type of automatic, self adjusting CTC favored by NEV, it would at least provide some check on a disastrous overrecovery of stranded costs. However, PECO's restructuring proposals do not include even that modest protection of the consumer.

As discussed in the Commission's Securitization decision, a QRO may -- though it need not -- be made irrevocable.<sup>9</sup> While an irrevocable QRO may have favorable effects on the amount of CTC that may be securitized and the rate of the new

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<sup>9</sup> Pennsylvania Public Utility Commission v. PECO Energy Co., Nos. R-00973877C001, R-00973877C002, slip op. at 74-76 (Pa. P.U.C. May 22, 1997).

borrowing, the consequences of an irrevocable QRO can be serious. If the Order is irrevocable the Commission will be deprived of any opportunity to correct even an egregious error in fixing the level of CTC recovery.

C. The Appropriate Level of Review of PECO's Proposals

The Competition Act does not dictate a single type of restructuring plan. The legislature has left considerable discretion to this Commission to determine the proper approach on a case by case basis. In approaching that review, the Commission should recognize the danger that is posed by the structure of certain types of restructuring plans. As the foregoing discussion makes clear, there is considerable danger in a restructuring plan which:

- underestimates the market prices of energy
- overestimates the utility's claim for stranded cost recovery
- contemplates the retention of the generating assets by the utility or an affiliate
- fixes the CTC over a multi-year period without a mechanism to adjust the recovery based on the actual future market prices of energy
- requires approval of the restructuring by an irrevocable QRO

Recognition of these danger signals is crucial to establishing a proper approach to reviewing a restructuring plan. NEV strongly believes that if a utility pursues a restructuring plan that does not contain real checks on the utility's temptation to underestimate the future price of energy, the Commission should give the restructuring proposal the highest possible level of scrutiny. Put another way, if a plan fixes the CTC

recovery over a multi-year period without a corrective mechanism, the Commission should resolve all doubts about future energy prices -- and, conversely, the level of stranded cost recovery -- against the utility. Because PECO's proposals have all of those danger signs, the Commission should resolve any doubts in favor of energy prices that are high enough to support competition.

## II. THE PARTIAL SETTLEMENT IS NOT IN THE PUBLIC INTEREST

### A. PECO Grossly Overrecovers Its Agreed Stranded Costs

When public hearings on the Partial Settlement were scheduled, PECO provided a bill insert to advise its customers of the principal terms of the settlement and notify them of their right to participate in the hearings.<sup>10</sup> With respect to stranded costs, the notice stated that the Partial Settlement would:

permit PECO Energy to recover \$5.46 billion in stranded assets and costs through a Competitive Transition Charge (CTC) and/or an Intangible Transition Charge (ITC) through December 31, 2008.

Despite objection that the notice failed to accurately disclose that the settlement permitted recovery of stranded costs far in excess of \$5.461 billion,<sup>11</sup> PECO refused to amend its notice.<sup>12</sup>

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<sup>10</sup> (NEV Cross Exhibit 3.)

<sup>11</sup> See letter dated October 8, 1997 from PECC to Judges Rainey and Chestnut ¶7 at 2.

<sup>12</sup> See letter dated October 22, 1997 from PECO to Judges Rainey and Chestnut ¶7 at 4 (responding to PECC's October 8 letter). See also letter dated October 27, 1997 from PECC to Judges Rainey and Chestnut (responding to PECO's October 22 letter).

At the same time that PECO was refusing to tell consumers that it would collect more than \$5.461 billion, PECO's principal witness Thomas Hill was manipulating the settlement numbers to justify the settlement. The creativity and inventiveness of Mr. Hill was breathtaking; by the close of the hearings, Mr. Hill had not only managed to suggest that PECO was not overrecovering CTC, but in fact, was losing money on the deal.

While one cannot help admire Mr. Hill's resourcefulness, the proposition which he advanced is outrageous. PECO clearly assumes that the financial analysis is too complex for the public to follow and hopes the Commission will lose track of the ball in trying to handle all the issues in the case. For this reason, it is particularly important to focus on Mr. Hill's creative number play.

Moreover, in considering whether PECO has met its burden of proof, the Commission must carefully consider the credibility of the testimony submitted by PECO's key witnesses. Hill served as the lead negotiator of the Partial Settlement, and was the principal policy and financial witness for PECO.<sup>13</sup> As this Memorandum will show, Mr. Hill's testimony on the financial issues in this case was not credible. In light of his pervasive involvement in PECO's case, the Commission cannot find that PECO has carried its burden.

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<sup>13</sup> Mr. Hill's testimony in the case was extensive. He submitted statements 1, 1-S, 1-R, 1-SR, 1-RJ, 1-SRJ, 1-E and 1-ER and testified at the hearings in October and November.

Mr. Hill's most recent position concerning the Partial Settlement is set forth in Exhibit TPH-35 which he submitted in connection with his testimony concerning Enron's Choice Plan.<sup>14</sup> TPH-35 purports to show that PECO would need to recover between \$5.872 and \$6.655 billion in order to collect the \$5.461 billion contemplated by the Partial Settlement. Hill then calculates the actual CTC recovery under the Partial Settlement and concludes it is only \$5.893 billion. He then compares the two and concludes that, even under the best of circumstances, PECO will only overrecover \$19 million, and if the various risks of the Settlement turn out to be the reality, PECO will underrecover by \$763 million. From this analysis, Mr. Hill suggests that the settlement is a fair resolution.

Nothing could be further from the truth.

A careful examination of Mr. Hill's approach reveals the manner in which he observes the truth. Mr. Hill begins with the \$5.461 billion that PECO told its customers it was recovering under the Partial Settlement. He then adjusts the \$5.461 upwards by insisting that PECO is entitled not simply to a recovery of \$5.461 billion but a return on those stranded assets in excess of the return provided by discounting PECO's future cash flows by its after tax cost of capital. Such a return would inflate PECO's claim by roughly \$563 million. Leaving aside the difficulty in interpreting \$5.461 to mean \$6.024 billion, there is no justification for this type of return on the stranded assets. Neither the Partial Settlement nor the Competition Act say a word about a return on

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<sup>14</sup> (PECO Statement No. 1-E.)

stranded assets. Indeed, Pennsylvania law only allows a return on assets that are used and useful. Stranded assets, by definition, are not used and useful.<sup>15</sup>

Mr. Hill next insists that the CTC recovery under the Partial Settlement must not simply recover the \$5.461 billion in stranded assets and a \$563 million return on such recovery, but also the costs to PECO of providing its customers with various benefits under the Partial Settlement. Indeed, Mr. Hill has the audacity to suggest that consumers should pay through the CTC:

- \$33-117 million for LILR/EER modifications
- \$107 million in 1998 early rate reductions
- \$108 million in universal service charges
- \$200-300 million in supposed losses from the T&D rate cap extension

Put another way, Mr. Hill suggests that the CTC recovery must include an additional \$448 to \$632 million, in essence, to insure that consumers fully pay for the benefits PECO supposedly is providing to induce them to settle.<sup>16</sup>

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<sup>15</sup> Moreover, PECO's stranded cost claim of \$6.8 billion was calculated assuming a return on its investment. Thus if PECO were to be permitted the return Mr. Hill proposes, it would get a double return on its stranded costs.

<sup>16</sup> For an example of the mileage PECO attempted to make out of those concessions, see PECO Energy Company's Statement in Support of the Joint Petition for Partial Settlement of Proposed Restructuring Plan an Application for a Qualified Rate Order at 3-5. Not surprisingly, nothing in the Statement reveals that consumers are paying for the touted concessions.

In sum, TPH-35 contends that in order for PECO to get the CTC recovery provided under the Partial Settlement, it is entitled not the \$5.461 stated in the notice sent to customers but to collect:

|                              |                 |
|------------------------------|-----------------|
| Agreed Stranded Costs        | \$5.461         |
| Return on Stranded Costs     | .573            |
| Reimbursement of Concessions | <u>.448-632</u> |
| Total                        | \$6.482-6.666   |

Through TPH-35, Mr. Hill is saying that PECO is entitled to recover between \$6.509 and \$6.693 under the Partial Settlement even though its public notice said it would collect only \$5.461 billion, even though its entire claim for stranded assets prior to the settlement was only \$6.8 billion and even though it has trumpeted the fact that it would have to write off \$2 billion.

If this were the only defect in Mr. Hill's financial analysis, it would be sufficient to reject the Partial Settlement. However, it is only one half of the story.. TPH-35 not only overstates PECO's financial entitlements under the Partial Settlement by nearly \$1.3 billion, but it goes on to significantly understate the amount PECO will actually recover. Mr. Hill has done this through a careful manipulation of the components of the overall financial analysis. To see what he has done, it is easiest to work backwards from Mr. Hill's estimate of the net present value of the CTC income stream used in TPH-35.

In TPH-35, Hill calculated PECO's actual recovery under the Partial Settlement to be \$5.893 billion. Witness Mitnick testifying for the Coalition exposed much of the artful maneuvering behind that calculation:

1. Mr. Hill employed an "end of the year" convention in present valuing the CTC income stream. While this convention is sensible in rate setting where revenues and expenses are both presumed to occur at year's end, it has no place in this context. Here the convention is applied to discount a CTC stream collected throughout the year. In this context, the convention underestimates the CTC revenues stream by approximately \$250 million. (Cohn Hearing Tr. at 969-970; NEV Cross Exhibit No. 2).

2. Mr. Hill values the CTC income stream as of a date four months before the date of the calculation of the stranded claim. This "apples to oranges" comparison understates PECO's recovery under the Partial Settlement by approximately \$175 million. (Id.)

3. Mr. Hill calculated the value of the Partial Settlement on a no-growth basis. Under examination, he admitted that in a confidential internal analysis he prepared to brief the President of the company and the Board of Directors, he used a .8% growth rate assumption. Moreover, PECO's most recently filed IRP used a growth assumption of over 1%. By using a no-growth assumption, rather than the IRP projections, Hill undervalued PECO's recovery by \$447 million. (PECC Ex. 1A, Schedule SAM-SR1)

4. Mr. Hill did not properly account for the benefits of securitization. Using the formula contained in the Partial Settlement, Mr. Mitnick calculated the benefit to PECO from securitization to be .3¢ per kwh each year during the term of the Partial Settlement. Mr. Mitnick calculated the value of securitization as \$685 million on a no load growth scenario and \$722 million on 1% growth scenario.<sup>17</sup>

5. In his valuation of PECO's recovery under the Partial Settlement, Mr. Hill did not count the additional funds PECO would obtain from inflated rates for transmission and distribution. Because transmission and distribution remain under the EDU's monopoly, the utility has a significant impetus to allocate to T&D charges that competitive suppliers will have to include in the prices they charge for generation. Since all consumers will pay T&D charges regardless of their generation supplier, the EDU can get two significant benefits if it allocates say, marketing costs, to T&D: the EDU's marketing budget will be subsidized by all electric users in the service territory and other suppliers will be at a pricing disadvantage for they will have to cover their own marketing costs

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<sup>17</sup> Mr. Hill's approach to financial analysis is well illustrated by his approach to determining the value of securitization. In TPH-35, Mr. Hill gives securitization a value of \$0 to \$600 million. At first, his approach in giving securitization a zero value might seem meritorious given the legal uncertainties of pending litigation. However, it must be recalled that if PECO cannot securitize, its CTC recovery will be adjusted upward for the entire transition period by .3¢ per kwh. In such event, PECO would be "compensated" for its inability to securitize by an amount which witness Hill conceded would exceed \$600 million. (Hill Hearing Tr. at 1819).

while the EDU's are subsidized by the EDU's monopoly charges. Extensive testimony at trial showed that by fixing the T&D component of the settlement above the true unbundled cost, PECO received a NPV benefit of \$723,000 million.<sup>18</sup>

The errors in Hill's calculation make a tremendous difference. Instead of a recovery of roughly \$5.461 as stated in its public notice, PECO will actually recover benefits of \$8.2 billion. The following table shows the proper calculation of the benefits received by PECO under the Partial Settlement:

**Table 3:  
Calculation Of Overrecovery**

|                                       |                |
|---------------------------------------|----------------|
| <u>Actual Recovery</u>                |                |
| Hill's Base Calculation               | \$5,893        |
| Elimination of End of Year Convention | 250            |
| Use Proper NPV Data                   | 175            |
| Benefit to PECO of Securitization     | 722            |
| Load Growth (1%)                      | 447            |
| T&D Recovery                          | <u>723</u>     |
| Actual Recovery                       | 8,210          |
| <u>Settlement</u>                     | <u>(5,461)</u> |
| <u>Hidden Overrecovery</u>            | <u>\$2,749</u> |

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<sup>18</sup> PECC Ex. 1A, Schedule SAM-SR1. Witness Mitnick based this calculation on an analysis by Enron witness Reising. Subsequent events have made clear that Mitnick underestimated PECO's benefit from the T&D cap by more than \$200 million. This point is discussed in more detail at greater length in Enron's Brief at note 44 page 26. The effect of this point is to reduce the T&D strip used by Mitnick from 2.63¢ to 2.37¢.

## B. PECO Uses An Excessive Discount Rate

PECO's overrecovery is actually greater than the \$2.749 billion shown in the above table. Mr. Mitnick's analysis presumed that the Commission should use a 8.71% discount rate in evaluating the present worth of the income stream. As pointed out, however, by witness Boonin, the discount rate used in Mr. Hill's analysis is too high. NEV Statement 1 DMB-2 at 14-15.

The issues concerning the proper discount rate were explored at length in the securitization proceedings resolved by the Commission earlier this year. In those proceedings PECO urged that a rate of 8.6% was appropriate. The Office of the Trial Staff argued that a 7.53% rate was more accurate.

In those proceedings, the parties generally agreed that PECO's after tax cost of capital was the appropriate discount rate. Moreover, PECO and OTS agreed on substantially all of the components to be used in determining PECO's cost of capital. The only material difference in their positions was the cost of common equity. On that point, PECO calculated its cost of equity to be 12.10%. OTS witness Deardorff argued that the cost was 10%. The ALJ agreed with OTS and the Commission subsequently denied PECO's exceptions. Accordingly, in the securitization proceedings the cost of common equity was determined to be 10% and the overall after tax cost of capital 7.53%.

Based on this background, witness Boonin testified that it was more appropriate to use a 7.53% discount rate rather than the 8.71% that Hill used in connection with

his analysis.<sup>19</sup> Mr. Hill's responsive testimony on this point is a good illustration of the approach he took throughout the proceedings. Confronted by Mr. Boonin's observation, Mr. Hill was indignant:

Mr. Boonin's only support for his 100% equity cost rate is a Commission finding earlier this year in PECO's securitization proceeding, which all rate of return witnesses in this case agree seriously understates PECO's current capital costs.

(PECO Statement No. 1-ER at 8). (Emphasis in original).

Given Mr. Hill's indignation, it is instructive to examine the testimony of witness Deardorff in this case. After all, it was Mr. Deardorff's testimony that the Commission credited in the securitization proceedings and, if he in fact agreed that a 10% cost of capital "seriously understates PECO's current capital costs", as Mr. Hill maintained, it would be a matter of some importance.

However, contrary to Mr. Hill's statement, Mr. Deardorff made only a slight adjustment to his cost of capital estimates - from 10% to 10.25% - and recommended that the overall discount rate be set at 7.73%. (OTS Statement No. SR-2 at 2). Similarly, OCA witness LaCapra conducted his analysis of the restructuring proposals using a discount rate of 7.53%. (Exhibit RLC-2, pg. 1 note 3). Thus, there is no understatement of PECO's capital costs.

If the Commission were to analyze the Partial Settlement using a 7.53% discount rate rather than 8.71% rate employed by Mr. Hill, the overrecovery identified above would increase from \$2,749 billion to more than \$3 billion.

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<sup>19</sup> (NEV Statement No. 1-SR).

### C. The Generation Credits Are Too Low

The Partial Settlement contains a strip of generation credits which are well below the anticipated market price of energy. Indeed, the credits are below the energy price projections of PECO's own witnesses for wholesale. The issue is explored at length by PECC witness Hull (PECC Statement 2 at 6-18) and will not be repeated herein. It should be noted, however, that in the proprietary projections that Enron's witness Kinney prepared from assumptions given to it by PECO (Statement 11-SRJ, Supp. Ex. 2 at 1), a curious phenomenon can be observed. Despite the fact that competition occurs in 1999, the projections show that under the Partial Settlement PECO maintains its entire load throughout the transition period.<sup>19</sup> The significance of this is obvious. If PECO's assumptions show no load loss, it confirms what NEV and the other suppliers have stated from the beginning - under the generation strip contained in the partial settlement there will be no competition.<sup>20</sup>

It is important that generation strip cover the wholesale price of power and also the costs of converting wholesale power to retail. As explained by witness Mitnick (PECC Statement 1 at 26 and Exhibit SAM-2), among others, wholesale prices must be

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<sup>19</sup> This can be demonstrated by comparing the "Total Electric Revenues" row for 1996-1998 with the sum of "Total Electric Revenues" and "CTC Revenues" for 1999-2008. As will be readily seen, the 1999 revenues are essentially the same as 1998 less the amount of the rate cut in that year.

<sup>20</sup> PECO may try to suggest that it is not retaining its entire load but rather it is replacing its retail sales with wholesale. This argument will not fly; the revenues reflected in the row captioned "sales to other utilities," does not reflect such a substitution. Moreover, such an approach would have to assume no difference between retail and wholesale prices - a proposition clearly at odds with the testimony.

adjusted for system load weighting (8.8%) and line losses (7%) and for capacity to adjust for load factor (60%), reserve margin (18%) and line losses on capacity (7%). (See also PECC Statement 2 at 13, which identifies the need for suppliers to cover taxes and penalties and administrative costs).

When more realistic wholesale energy and capacity figures are used to reflect the current market conditions, even higher generation credits are identified as being necessary. NEV notes that all the participants who are actually in the competitive market in this case have consistently found that generation credits in the range of approximately 3.5 to 4 cents/kWh are necessary and appropriate to enable a competitive market in 1999.

**D. The Settlement Does Not Require A True Up For Sales**

The Settlement disclaims any true up of CTC recovery based on load. While the Competition Act is silent on the question of true up of CTC based on market prices of energy, it clearly requires CTC to be trued up for sales. PECO defends this provision based on its assertion that its sales have not grown over the last 10 years. Moreover, PECO argues, the provision is fair because it requires PECO to bear the risk of declining sales during the transition period.

PECO's arguments on this point are hollow in light of the following:

- It is reasonable to expect that the rate reductions promised by the Partial Settlement will spur usage of electricity. All things equal, cheaper electricity will lead to greater usage. As witness Oliver testified: "when you have a reduction in the

effective cost, you find more dollars to invest in other activities, expanded activities. The overall environment for operating in this area improves, and you find increased business in commercial activity.” (Oliver Hearing Tr. at 1611-12).

- As noted above, PECO’s confidential internal evaluation of the settlement assumed sales growth of .8% per year. While -- as will be discussed within -- NEV was unsuccessful in obtaining full disclosure of PECO’s evaluation of the Partial Settlement, PECO was forced to produce a list of the assumptions it used to evaluate the settlement. In those confidential assumptions, despite the lack of growth in its load over the prior 10 years, PECO estimated .8% growth per annum. (Hill Hearing Tr. at 489-90).

- In PECO’s IRP filing in April of 1997 -- virtually at the same time as the filing of its restructuring plan -- it estimated sales growth of over 1% per year. Witness Hill’s attempt to distance PECO from that filing was laughable. According to Mr. Hill, the IRP filing was based on stale data nearly two years old. (Hill Hearing Tr. at 473-75). Mr. Hill’s response is silly in light of his assertion that sales have not grown in ten years; two years ago -- one supposes -- sales had not grown in eight years yet the company still projected a 1% annual sales growth.

- Finally, and most importantly, §2808(f) of the Competition Act explicitly requires true up. PECO has attempted to create authority to waive the Section by seizing on the reference to §1307(e) in §2808(F). However, §1307(e) deals with the

mechanics of a reconciliation process. It provides no support for eliminating reconciliation.

**E. The Settlement Improperly Employs A “Generation-Residual” Approach to Determining the CTC.**

As discussed by witness Johnstone testifying on behalf of MAPSA<sup>19</sup> and Baron testifying on behalf of PAIEUG,<sup>20</sup> PECO’s Restructuring Plan employed a “generation residual” approach to unbundling. That is, the generation credit is the amount left after T&D and CTC have been subtracted from the bundled rates. A generation residual approach is problematic because it does not calculate the generation credit based on the best estimate of market prices and the costs of converting wholesale power for retail delivery. In light of this fact, there is the serious risk that the resulting credit may be less than the actual market price of energy.

PECO has carried over its generation residual approach to the Partial Settlement, although in this context, the risks are even greater than in the Restructuring Plan because in the Partial Settlement PECO decided to “structure” some of the other components of the calculation by front end loading CTC recovery and rate cuts. This resulted in artificially squeezing the generation credit.

**F. PECO Has Not Provided For Mitigation**

As previously noted, the Competition Act conditions stranded cost recovery not simply on mitigation before competition but on mitigation efforts during the transition

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<sup>19</sup> (MAPSA, Exhibit DEJ-15).

<sup>20</sup> (PAIEUG Statement No. 15 at 10).

period. See note 8 supra. The Partial Settlement (like the Restructuring Plan) is devoid of a commitment to mitigate during the transition period.

**G. PECO Has Not Met Its Burden**

For all the reasons identified above, PECO has failed to meet its burden of proving that the Partial Settlement is in the public interest.<sup>21</sup>

**III. THE ENRON CHOICE PLAN IS NOT IN THE PUBLIC INTEREST**

Like the Partial Settlement, Enron's Plan is based on a fixed CTC approach without corrective mechanisms to adjust for the price of energy in the future. For this reason, Enron's Plan should also be given the highest degree of scrutiny.

As Mr. Boonin testified, Enron's Plan is a significant improvement over the Partial Settlement. (NEV Statement No. DMB-2 at 11). However, Enron's proposal was constructed within the constraints and skeleton of the Partial Settlement. Accordingly, Enron has carried over a number of objectional features from the Partial Settlement. (Id.

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<sup>21</sup> One of the most troubling aspects of these proceedings is that PECO has not provided (and not been compelled to provide) to the parties the internal documents it prepared to evaluate the Partial Settlement and the Enron Choice Plan. The ALJ's properly determined that the documents were not privileged or work product but merely represented sensitive, proprietary documents. However, instead of following the regular practice of requiring disclosure of proprietary documents under strict confidentiality protections, the ALJ's permitted PECO to withhold the documents. The ALJ's were apparently persuaded that projected financial statements prepared by a witness for Enron based on various assumptions reported by PECO were sufficient.

The error of this determination is clear and the consequences are material. In a case where the credibility of witnesses is a significant issue as it certainly is in this case, the failure to permit discovery of documents which would allow the parties to test that credibility on the core issues in the case was in error. This is particularly so in a situation where - as here- the company seeks to rely on general allegations of financial hardship that the underlying documents might well discredit.

at 7). These features are described at length in Mr. Boonin's testimony and are only briefly summarized herein.

The biggest problem with Enron's proposal is that like PECO's proposal the CTC/ITC collects more than the allowable level of stranded costs. Proof of this problem is found in the fact that in reducing the CTC/ITC income stream to a present value of \$5.461 billion the implicit discount rate is 9.66%. There seems to be no basis for this discount rate other than it produces the targeted amount of stranded cost recovery at a zero load growth assumption. Enron's CTC/ITC charges are inappropriate and force consumers to overpay for PECO's stranded costs.

Enron's proposed generation credits are also inadequate. While Enron has improved the proposed generation strip in its rebuttal filing, the numbers are still too low for a fixed CTC plan. A generation credit beginning at 3.75 cents per kilowatt hour better reflects current market conditions than the 3.48 proposed by Enron. This is in accord with the conclusion reached by PECC witnesses based upon PECO's market price estimates after adjustment to take into account all the costs related to retail delivery.

Under Enron's proposal the rate decreases are given on the front end and evaporate quickly. All things being equal, the Commission should look for sustained rate decreases rather than here today gone tomorrow rate decreases.<sup>22</sup>

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<sup>22</sup> Finally, there is no reason that there should be a single default supplier. This only creates potential market power problems. After the Commission awards across-the-board rate adjustments, procurement savings will be limited to how well an EGS can beat this generation credit. This may not be enough of a catalyst to promote wide-spread choice. A pool approach to the default supplier issue could

(continued...)

For the foregoing reasons, the Commission should conclude that Enron's proposal is not in the public interest and should not be approved.

**IV. PECO's ORIGINAL RESTRUCTURING PLAN IS NOT IN THE PUBLIC INTEREST**

Given that approval of the Partial Settlement and Enron's Plan are contrary to the public interest, the Commission must consider PECO's Restructuring Plan. However, even a cursory review of the Restructuring Plan demonstrates that it has most of the defects of the Partial Settlement and few of its benefits. The fixed CTC approach it follows results in an extremely high degree of risk that consumers will seriously overpay for stranded assets yet not even obtain a competitive market. Without going through all of the serious problems with the Restructuring Plan, it is obvious that it cannot be approved as written.

**V. THE COMMISSION SHOULD MODIFY THE RESTRUCTURING PLAN TO MAKE IT ACHIEVE THE PUBLIC INTEREST**

Given the foregoing, the Commission could simply reject the Restructuring Plan. If the Commission followed that course, PECO would presumably have 30 days to modify the Restructuring Plan and resubmit it to the Commission for final consideration.<sup>23</sup> However, the Commission also has the option to approve the

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<sup>22</sup>(...continued)  
provide this catalyst.

<sup>23</sup> 66 P.S. § 2806(f) provides that if the Commission rejects the plan - as opposed to modifying it - it shall:

. . . state the specific reasons for rejection and direct the

(continued...)

Restructuring Plan with modifications. § 2806(f) of the Electric Generation Customer Choice and Competition Act (the “Act”) is quite clear with respect to the Commission's powers:

The Commission shall review the restructuring plan filed by each electric utility and shall, after open evidentiary hearings with proper notice and opportunity for all parties to cross-examine witnesses, issue an order accepting, modifying or rejecting such plan at the earliest date possible.

66 P.S. § 2806(f) (emphasis added). If presented with a restructuring plan, the Commission need not accept every last provision; it may - indeed it should - make such changes as are appropriate to achieve the public interest. Under the circumstances of this case, it is appropriate for the Commission to exercise that power.

To facilitate the Commission’s exercise of that power, NEV has described below a set of modifications which it believes will result in a restructuring that will achieve the purposes of the Competition Act and fulfill the public interest.

A. Stranded Cost Level

We start from the proposition PECO should not be permitted to recover stranded costs in excess of \$5.461 billion. This amount reflects a modest 20% reduction from the Company’s litigation position on stranded costs. Given the numerous areas where

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<sup>23</sup>(...continued)

electric utility to file an alternative plan addressing these objections within 30 days of the entry date of the Commission Order rejecting the Plan. The Commission shall review the alternative plan, solicit comments from interested parties and issue a final order within 45 days of the filing of the revised Plan.”

PECO's assumptions and methodologies have proven to overstate its claim, such a discount is clearly called for. Indeed, as witness Boonin testified, a further disallowance is justified.<sup>24</sup> For these purposes, however, NEV assumes a stranded cost level of \$5.461 billion.

**B. Securitization**

The benefits of securitization belong to consumers. See 66 P.S. § 2808(c)(4)(vi). To maximize that benefit NEV proposes that PECO be given authority to securitize \$4 billion of the stranded assets. In order to insure that such benefit is passed along to consumers, the value of securitization should be subtracted from the allowed level of stranded costs discussed above. Witness Mitnick testified that the value of securitization of \$4 billion (on a 1% growth assumption) was \$723 million. (PECC Exhibit 1A Schedule SAM-SR 1. NEV therefore proposes that PECO be permitted to recover stranded costs of no greater than \$5.461 billion less \$723 in expected securitization benefits or a maximum \$4.738 billion.<sup>25</sup>

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<sup>24</sup> As previously discussed, there is a direct relation between the price of energy and the amount of stranded recovery. Mr. Boonin pointed out in his surrebuttal testimony that if the Commission concludes - as it must - that the generation strip in the Partial Settlement is too low, it should remember that the stranded cost level contemplated in the Partial Settlement is too high. Mr. Boonin calculated that based on appropriate increases in the generation strip, it would be appropriate to reduce the level of stranded costs to \$4.5 billion. (See NEV Statement 1-SR at 5-6).

<sup>25</sup> An alternate way to reach this result is described in Mr. Boonin's testimony where he discusses adjusting the discount rate to take account of securitization. NEV Statement DMB-2 at 14-15.

C. Generation Credits

If the Commission adopts a fixed CTC approach it is particularly important for the generation strip to contain enough headroom not to impede competition. As discussed above, it is appropriate for the Commission to resolve all doubts about the market price of energy in favor of competition. NEV suggests that the Commission adopt the following generation credits if it adopts the a fixed CTC approach:

**Table 4:**  
**Generation Credits**

| <u>Year</u> | <u>Credit</u> |
|-------------|---------------|
| 1999        | 3.745         |
| 2000        | 3.805         |
| 2001        | 3.930         |
| 2002        | 4.065         |
| 2003        | 4.200         |
| 2004        | 4.340         |
| 2005        | 4.485         |
| 2006        | 4.640         |
| 2007        | 4.880         |
| 2008        | 4.875         |

As Mr. Boonin testified (NEV Statement 1-SR at 4), this generation strip is the average of the MAPSA and Enron proposals. The strip grows about 3% per year. The 1999 level is sufficient to adjust from the wholesale cost to retail including the attendant charges for capacity, line loss, A&G and uncollectible expenses. The 1999 level is also consistent with the generation credit in the Pilot Program.

## D. CTC/ITC Design

### 1. Valuation

The CTC/ITC income stream should be designed to produce a true net present value no greater than \$4.738 billion (assumed stranded costs of \$5.461 billion less \$.723 billion in securitization benefits). In designing the income stream to deliver that value, the Commission should use the following principles:

- The Commission should assume a 1% sales growth per PECO's IRP and should require an annual sales true up to make sure that the estimates are adjusted if inaccurate.
- The appropriate discount rate should be no higher than 7.53%.
- PECO should not be permitted to earn a return on its stranded costs in excess of that already provided by the discount rate.
- The present value of the CTC/ITC revenue system should be calculated as of January 1, 1999, the same date as to which PECO calculated its claim.
- The end of the year convention should not be followed in valuing the income stream.

### 2. Length of Transition Period

The Commission should set the transition period to be the shortest period that permits the CTC to be recovered while not artificially squeezing the generation credit.

### 3. CTC/ITC Strip

Based on the following, NEV suggests the Commission provide a CTC/ITC strip as follows:

**Table 5:**  
**Proposed CTC/ITC Strip**

| <u>Year</u> | <u>CTC/ITC</u> | <u>Sales</u> | <u>CTC Adj. for GRT</u> | <u>NPV (7.53%)</u> |
|-------------|----------------|--------------|-------------------------|--------------------|
| 1999        | 2.491          | 33,569,358   | \$801,211               | \$772,649          |
| 2000        | 2.431          | 33,905,052   | 789,738                 | 708,253            |
| 2001        | 2.306          | 34,244,102   | 756,634                 | 631,047            |
| 2002        | 2.171          | 34,586,543   | 719,476                 | 558,037            |
| 2003        | 1.896          | 34,932,409   | 634,656                 | 457,778            |
| 2004        | 1.996          | 35,634,550   | 674,797                 | 452,647            |
| 2005        | 1.826          | 35,990,895   | 623,519                 | 388,962            |
| 2006        | 1.641          | 35,990,895   | 565,978                 | 328,342            |
| 2007        | 1.286          | 36,350,804   | 448,031                 | 241,716            |
| 2008        | 1.181          | 36,714,312   | <u>415,586</u>          | <u>208,511</u>     |
| Total       |                |              | \$6,429,625             | \$4,747,942        |

**E. Rate Decreases**

**I. Fixed Rate Decreases**

While fixed rate decreases will not be necessary in a fully competitive market, given the huge amount of attention that PECO and Enron have paid to this issue in their advertising and public relations campaigns, it would be a mistake for the Commission not to build fixed rate decreases into its Order. NEV suggests, however, that instead of trying to front end load the guaranteed rate increases into the first two years of the transition period, the Commission seek a more levelized approach to the fixed rate decreases. Based on the other provisions hereof, NEV believes a flat 13.5% rate decrease

can be provided for the full 10 years. If the Commission shortens the transition period, the rate decreases will be somewhat smaller.

## 2. “Early” Rate Decrease

PECO suggests that the Commission has no power to order a rate decrease prior to the commencement of competition. The suggestion is wrong. The Commission has the power to order a base rate adjustment. Indeed, the evidence clearly supports doing so immediately, nine months earlier than September 1, 1998. However, if that authority is unclear, the Commission could easily provide that if PECO does not consent to the commencement of early rate decreases, the CTC will be automatically reduced during 1999 by an amount which will equal the rate decreases that would have been given during 1998.

### F. Transmission & Distribution

As testified by witness Reising, PECO has substantially overstated its T&D rates. Because of the potential for these rates to unfairly cross subsidize competition and for the other reasons discussed in Enron's brief, the Commission should set these rates to the initial levels - 2.37 - suggested by witness Reising.

### G. Overall Rate Design

In summary, NEV proposes that the Commission modify the Restructuring Plan as follows:

Table 6:  
Overall Rate Proposal

| <u>Year</u> | <u>T&amp;D</u> | <u>Gen.<br/>Credit</u> | <u>CTC/ITC</u> | <u>Total<br/>Rate</u> | <u>%<br/>Savings</u> |
|-------------|----------------|------------------------|----------------|-----------------------|----------------------|
| 1999        | 2.37           | 3.745                  | 2.491          | 8.606                 | 13.5%                |
| 2000        | 2.37           | 3.805                  | 2.431          | 8.606                 | 13.5%                |
| 2001        | 2.37           | 3.930                  | 2.306          | 8.606                 | 13.5%                |
| 2002        | 2.37           | 4.065                  | 2.171          | 8.606                 | 13.5%                |
| 2003        | 2.37           | 4.34                   | 1.896          | 8.606                 | 13.5%                |
| 2004        | 2.41           | 4.2                    | 1.996          | 8.606                 | 13.5%                |
| 2005        | 2.44           | 4.34                   | 1.826          | 8.606                 | 13.5%                |
| 2006        | 2.48           | 4.485                  | 1.641          | 8.606                 | 13.5%                |
| 2007        | 2.52           | 4.8                    | 1.286          | 8.606                 | 13.5%                |
| 2008        | 2.55           | 4.875                  | 1.181          | 8.606                 | 13.5%                |

This approach would provide a reasonable strip of generation credits, proper T&D amounts, sustained fixed rate decreases, and would provide PECO with a stranded cost recovery which, taken together with the benefits of securitization, equal \$5.461 billion.

**H. Conditions To Stranded Cost Recovery**

As the prior months have made abundantly clear, there are many, many opportunities for a creative incumbent to slant the playing field to hinder competition. Accordingly, the Commission's order should contain a mechanism that would allow it to reduce the allocated level of stranded recovery if PECO inappropriately hinders, delays or impedes competition. While such a provision should not be used lightly.

There is considerable reason for the Commission to retain authority to reduce the level of CTC if PECO takes action which is inconsistent with the basis on which the Commission has permitted stranded cost recovery. NEV proposes that the Commission retain the power to reduce CTC recovery by up to an additional 10%:

- If PECO violates the Competition Act during the Transition Period.
- If PECO violates the interim or final code of conduct during the Transition Period.
- If PECO “declines” to provide any of the supposed extra statutory protections contained in the Partial Settlement.

The power would not be able to be used to to reduce any ITC allocated to repayment of transitions bonds once issued.

**I. A Minimum Level Of Unbundling Of Distribution Rates And Services Is Essential To Development Of A Competitive Energy Market.**

The Act provides that the Commission "shall require the unbundling of electric utility services, tariffs and customer bills to separate charges for generation, transmission and distribution." § 2804(3) (emphasis added). Accordingly, a restructuring plan "must include . . . unbundled prices or rates for generation, jurisdictional transmission, distribution and other services . . . ." § 2806(e) (emphasis added). The Act further requires those responsible for providing distribution services to furnish customers with information "contain[ing] unbundled charges sufficient to enable the customer to determine the basis for those charges." 66 P.S. § 2807(c)(1). In particular, the Commission must require distribution companies, among others, to provide customers

with a breakdown of costs sufficient "to enable customers to make informed choices regarding the purchase of all electricity services offered by that provider." 66 P.S. § 2807(d)(2) (emphasis added).

Moreover, the record clearly establishes that the need to unbundle distribution services is crucial to the formation of a competitive energy market. (See NEV Statement No. 2 at 2). Without the unbundling and competitive provision of distribution services, new market entrants will eventually be starved out of the market because margins on the sale of electricity will become too small to support a new market entrant's service delivery overheads. (Id.). Utility service providers have an unfair and improper advantage in this respect because the costs for provision of these overheads are imbedded in the utility's distribution revenue requirement and the utility does not have to compete for the delivery of those services. (Id.). Absent a requirement that distribution services be unbundled, customers' competitive alternatives will disappear, and customers will be confronted with the worst of all worlds, an unregulated monopoly. (Id.).

To shed light on this concern, NEV has presented the testimony of Nancy I. Day, who has more than 27 years of experience with the nation's largest natural gas distribution utility, Southern California Gas Company, and who was heavily involved in California's successful effort to address these issues in developing a competitive energy market.<sup>26</sup> Ms. Day testified that, over time, the primary benefits from electric industry

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<sup>26</sup> As described in detail in Ms. Day's testimony, the California Public Utility Commission recently ordered the unbundling of distribution services. (NEV Statement No. 2 at 6) (citing D. 97-05-037 and 97-05-039). The California

(continued...)

restructuring will come, not from commodity cost savings, but from changes at the customer's premises. (Id. at 2). In particular, the provision of value added services is vital to establishing sustainable business relationships with customers. (Id.). Moreover, the types of services customers want and are willing to pay for are highly competitive, not monopoly services. (Id.)

For example, from a wide array of competitive options, customers want to select those options whose value equals or exceeds their cost. If the utilities' package of services does not meet the customers needs yet the costs remain bundled the customer must pay twice, once to the utility for valueless services and once to the energy service provider for the customized package of customer-selected services.<sup>27</sup> (Id. at 2-3).

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<sup>26</sup>(...continued)

Commission did so after acknowledging that the failure to unbundle services for customers when it opened the state's natural gas market to competitive choice in 1991 prevented the program from achieving significant market penetration and led to a drastic decline in market participation due to unacceptably low profit margins. (Id. at 7-8).

<sup>27</sup> Ms. Day offered a simple example to illustrate this point. Assume that customer "Big" has many facilities located throughout the State. Historically, this customer was served by three different utilities, all of which billed for each meter served. Each utilities' billing format and rate characteristics were different. Customer "Big" employed a small staff to aggregate the utility charges by business unit and review them for accuracy. As part of his new bundle of energy services Customer "Big" wants an aggregated electricity bill, including both utility and energy service charges, subtotaled by business unit and provided on-line through the internet. Under the current system, Customer "Big" must continue to pay for the utilities to continue to send him useless billing information because their distribution services remain bundled. (Id. at 3).

**1. PECO's Restructuring Plan Fails To Provide The Minimum Level Of Unbundling Required By The Act.**

The Restructuring Plan ignores both the letter and purpose of the Act by failing to provide for the unbundling of distribution services. PECO has offered no credible explanation for its failure to unbundle any of its distribution services, let alone "all electricity services," as required by § 2807(d)(2).

Based on the express language of the Act, set forth above, and the recommendations stated by Ms. Day in her testimony, NEV requests that the Commission require, at a minimum, unbundling of the following cost elements:

1. Meters and meter reading.
2. Billing and collections (including data processing costs).
3. Customer Service.
4. Commodity Procurement, scheduling, balancing, risk management and sales.
5. <sup>1</sup> Uncollectible Expense.
6. Working Cash Allowance.

(NEV Statement No. 2 at 3).

Only with a breakdown of these basic services can PP&L comply with §§ 2807(c)(1) and (d)(2) of the Act, and only then can customers have the information they need to make informed choices about available distribution-related services.

**2. Basic Requirements Related To Billing, Metering And Cost Separation.**

Once distribution services are unbundled, the Commission will need to adopt some basic requirements, much like those adopted in California, to ensure meaningful and efficient operation of the new system. The Act clearly contemplates such

requirements by expressly providing that customers may "choose to receive separate bills from [their] electric generation supplier" and that, in any event, customer bills must contain a sufficient breakdown of charges to allow customers to make informed choices. § 2807(c), (d).

In keeping with these provisions of the Act, NEV proposes that the Commission implement the following requirements:

1. Customers may choose from three billing options as follows: utility and the alternate energy service provider provide separate bills, the utility consolidates bills for itself and the alternate energy service provider, or the alternate energy service provider consolidates bills for itself and the utility.
2. Alternate energy service providers who provide consolidated billing for the utility are responsible for payment of the billed amounts to the utility regardless of their ability to collect from their customers.
3. Utilities may impose reasonable creditworthiness requirements on alternate energy service providers who provide consolidated billing. These requirements are to be the same as those required of a similarly sized and situated customer.
4. Alternate energy service providers who provide consolidated billing must describe the utilities' charges on their bills in a manner consistent with the bill reporting standards the Commission sets for the utilities.

(See NEV Statement No. 2 at 4).

PECO's proposal fails to provide for these basic billing procedures and therefore does not comply with the Act.

As in California, alternate providers should be permitted to install their own meters provided they agree to share the metered information with the utility. (Id. at 5). The alternate provider and the utility would enter into a service agreement specifying

the nature of the information to be collected, the means for sharing data, and a reasonable approach for ensuring that the metering equipment is installed, calibrated and maintained properly. (Id.). The Commission should establish minimum standards governing open architecture for meters and communication. (Id.).

Further, the Commission should establish a timetable for use of alternate provider meters. In this regard, the Commission should, as in California, consider delaying installation of alternate provider meters for small customers by one year to phase in the various steps that must precede such a new commercial offering. (Id. at 6).

### **3. Customer Service Inquiries And Uncollectibles.**

Finally, in addition to billing, metering and meter reading, the Commission should adopt California's approach in directing utilities to identify the net customer service inquiry savings to be used to reduce customer charges in those situations where an energy supplier chooses to handle customer service inquiries. (See id.). Further, all parties should be directed to evaluate whether a universal uncollectibles pool should be established to motivate alternate service providers to serve customers who pose a higher credit risk. (See id.).

#### **J. The Commission Should Adopt Consolidated Billing To Eliminate Existing Discrimination Against Customers With Multiple Meters.**

Under the current regulatory system, the many customers who receive service on multiple meters throughout an EDU's service territory are discriminated against when compared to customers with similar loads served through a single meter. (NEV Statement No. 1 at 22). In particular, a customer with multiple meters who is on the

same rate schedule and who places the same type of non-distribution related load on the system as a single-meter customer is being charged more than that single-meter customer. (Id. at 23).

Although the Act is silent on this specific issue, it does give the Commission authority "to approve flexible pricing and flexible rates, including negotiated, contract-based tariffs designed to meet the specific needs of a utility customer and address competitive alternatives." 66 P.S. § 2806(h); see also 66 P.S. § 2804(2) ("Customers should be able to choose among alternatives such as . . . flexible pricing. . . ."). Moreover, leveling the playing field for multiple-meter customers is in keeping with the Act's undisputed purposes, among others, of creating a competitive market and promoting economic development in the Commonwealth.

To eliminate the current discriminatory effect on customers with multiple meters, NEV has proposed that alternative generation providers be permitted to treat these customers as a single service for purposes of billing for transmission and CTC-related charges. (NEV Statement No. 1 at 22). In other words, transmission and CTC-related charges would not change with the number of installations or meters, as they currently do, but with the amount of load placed on the system. (Id. at 23). For administrative ease, this billing consolidation should only be for customers of record who have multiple meters on the same rate tariff. (Id. at 24).<sup>28</sup>

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<sup>28</sup> The Commission would not need to take action with respect to generation itself because the price of generation is deregulated and the EDU already has the right to issue a customer a bill for its generation services on a consolidated

(continued...)

Elimination of this present discriminatory effect on multiple meter customers is particularly important now that competition -- and the innovation it will inevitably bring -- has been introduced into the system. (Id. at 24). More and more customers will be metered so that hourly loads can be determined, enabling consolidated billing. (Id.). Competition also challenges the necessity of demand-based billing, particularly if customers are paying for the burden they place upon the system virtually on an hourly basis. (Id.). At bottom, competition highlights the importance of electric prices in economic competitiveness, and eliminates any excuse for the type of blatant discrimination which exists under the current system. (Id.).

Accordingly, NEV proposes that the Commission adopt the following: (i) that, as testified by others, alternative generation providers be allowed to issue bills for all parts of the electric service, including those charged by the EDU; and (ii) that alternative generation providers be allowed to consolidate bills for customers with multiple meters within a single tariff. (Id. at 24). The consolidated bill will not have any impact on the distribution charge, with the exception of unbundled service for metering, billing, collections and information which shall be competitive. (Id. at 22-24). Only through this modification can the Commission prevent undue competition from occurring

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<sup>28</sup>(...continued)  
basis. (Id. at 22). Nor would this proposed change apply to distribution charges, because customers with multiple meters may impose a cost on the system that is different than a similar load from a single location associated with the distribution of the service. (Id.). Therefore, distribution charges should be billed as they are currently. (Id.).

between customers with identical loads on the same rate tariff and eliminate the discrimination that exists under the current system. (Id. at 24).

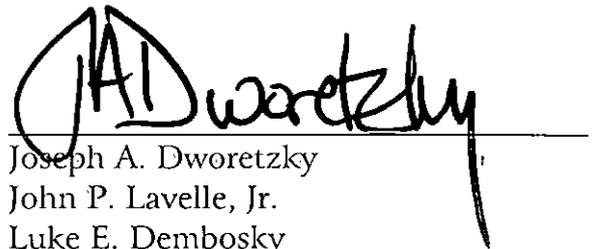
CONCLUSION

For all the foregoing reasons, the Commission should:

- Reject the Partial Settlement
- Reject the Enron Plan
- Modify the Restructuring Plan as described herein

Such an approach will serve the public interest.

Dated: December 2, 1997



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PENNSYLVANIA  
PUBLIC UTILITY COMMISSION

PECO Energy Company's Application : R-00973953  
for Approval of its Restructuring Plan :  
and Joint Petition for Partial Settlement :

Petition of Enron Energy Services Power, Inc., : P-00971265  
for Approval of an Electric Competition and :  
Choice Plan and for Authority Pursuant to :  
Section 2807(e)(c) of the Public Utility Code :  
to Serve as the Provider of Last Resort in the :  
Service Territory of PECO Energy Company :

New Energy Ventures'  
Proposed Findings of Fact and Conclusions of Law

Note: These proposed findings of fact and conclusions of law are not intended to be comprehensive; NEV has proposed findings only with respect to the specific issues covered in its Memorandum of Law.

I. Findings Relating to New Energy Ventures

1. NEV East, L.L.C. doing business as New Energy Ventures - Mid-Atlantic ("NEV") has appeared as an active party in these proceedings.

2. NEV is a national leader in the formation of retail energy power purchasers groups. NEV negotiates with energy suppliers nationwide to get the lowest electricity prices through the collective purchasing strength of its buyers' group members. The members, in turn, maximize savings and receive the individual energy supply options which they need. Membership in NEV is completely open and members pay nothing to join NEV. Members only pay NEV if and when they realize energy cost savings.

NEV Statement No. 1 at 1.

3. NEV has participated with Enron and Conectiv as a member of an informal group called the Pennsylvania Electric Competition Coalition ("PECC").

4. In these proceedings, NEV has opposed PECO's Original Restructuring Plan, the Partial Settlement and the Enron's Plan. (See NEV Statement No. 1, DMB-2 and 1-SR).

5. NEV has proposed extensive modifications to the Restructuring Plan.

## II. Findings Concerning Scope of Review

1. PECO's Restructuring Plan and the Partial Settlement contemplate a fixed CTC recovery and contain no other mechanism to correct or adjust for underestimates of the future price of energy. (NEV Statement No. 1-SR at 2-3).

2. When a restructuring plan does not contain effective mechanisms to correct for underestimates of the future market price of energy, it is appropriate for the Commission to give the plan the highest scrutiny and to resolve all doubts about generation costs and stranded recovery against the utility. (See NEV Statement No. 1-SR at 3).

## III. Findings Relating to Partial Settlement

1. PECO provided notice to its customers that the Partial Settlement would "permit PECO Energy to recover \$5.46 billion in stranded assets and costs through a Competitive Transition Charge (CTC) and/or an Intangible Transition Charge (ITC) through December 31, 2008." (NEV Cross Exhibit 3).

2. Despite objections from NEV and others that PECO would collect more than \$5.461 billion, PECO refused to correct the notice. Letter dated October 8, 1997 from PECC to Judges Rainey and Chestnut; letter dated October 22, 1997 from PECO to Judges Rainey and Chestnut.

3. The Partial Settlement permits PECO to collect substantially in excess of \$5.461 billion. (PECC Exhibit 1A, Schedule SAM-SR1 at 1).

4. In attempting to justify the amount of collections under the Partial Settlement, PECO witness Hill miscalculated the value of collection.

A. Hill improperly valued the CTC income stream as of September 1, 1998 rather than January 1, 1999. Tr. 1814. This approach understated CTC income by \$175 million. Tr. 970.

B. Hill improperly employed an end-of-the-year convention to calculate the net present value of the CTC income stream. Tr. 1814. This approach incorrectly assumed that all CTC payments are received at the end of the year rather than during the year. This approach understated CTC recovery by \$250 million. Tr. 2972.

C. Hill improperly offset concessions provided to various parties against the CTC income stream. Tr. 1814. This approach underestimated the CTC income stream by \$448 to \$662 million. TPH-35.

D. Hill improperly utilized a discount rate of 8.71% in evaluating the CTC income stream rather than the 7.53% determined in the securitization proceeding. (NEV Statement No. DMB-2 at 14-15).

E. Hill improperly failed to project for sales growth even though growth was included in the company's internal projections and in the IRP filed with the Commission. This approach undervalued CTC recovery by \$447 million. (PECC Ex. 1A Schedule SAM-SR1 and SR1C).

F. Hill improperly claimed an entitlement to a return on the \$5.461 billion in stranded costs. The amount of the return claimed was roughly \$563 million. (See Exhibit TPH-35).

G. Hill failed to account for the benefits provided in the Partial Settlement resulting from an artificially inflated rate for Transmission and Distribution. By overrecovering T&D, the Partial Settlement would provide PECO with a benefit of at least \$732,000. (PECC Exhibit 1A, Schedule SAM-SR1 and SR1C at 2).

5. Had Hill properly calculated the benefits of the Partial Settlement, he would have concluded that the settlement would provide PECO with benefits worth approximately \$3 billion in excess of the \$5.461 billion set forth in the notice. See id.

6. The Partial Settlement - like PECO's Restructuring Plan - uses a "generation residual" approach, that is, the generation credit is the amount remaining

after T&D, CTC and any fixed rate cuts are subtracted from the bundled rates. (MAPSA Exhibit DEJ-15, PAIEUG Statement 15 at 10).

7. Because the Partial Settlement permits recovery of amounts in excess of PECO's agreed stranded costs and because of "front end loading of" CTC and rate cuts, the generation credit is artificially depressed.

8. The generation strip proposed in the Partial Settlement is inadequate. (PECC Statement 2).

9. Use of the generation strip contained in the Partial Settlement would severely impede and impair the development of a competitive market in PECO's service territory. Id.

10. Generation credits should be constructed by establishing an amount which is comfortably above the level determined by adjusting anticipated wholesale price of energy for retail delivery. In adjusting for retail delivery, all reasonable costs for capacity, line loss, A&G, uncollectibles and the like should be included. (Id. PECC Statement 1 at 26 and Exhibit SAM-2).

11. When a restructuring plan does not contain effective mechanisms to correct for underestimates of the future market price of energy, it is appropriate for the Commission to give the plan the highest scrutiny and to resolve all doubts about generation costs and stranded recovery against the utility. (NEV Statement No. 1-SR at 3).

12. The generation strip proposed by witness Boonin in NEV Statement No. 1-SR is reasonable and appropriate.

#### IV. Conclusions of Law Concerning Partial Settlement

1. PECO has not met its burden of proving that the Partial Settlement is in the public interest.

2. The Partial Settlement violates the Competition Act because:

A. It does not contain a sales true up mechanism.

B. It permits PECO to recover through the CTC substantially more than the claim described in the notice.

C. It permits PECO to recover through the CTC more than PECO's total claim for stranded costs.

D. It permits PECO to recover a level of stranded costs that is not reasonable and just.

E. As interpreted by PECO, it permits PECO to recover as stranded costs items which do not meet the statutory definition of stranded costs specifically the concessions contained in TPH-35.

F. As interpreted by PECO, it permits PECO to shift the costs of concessions from a class of consumers to other consumers.

3. The Partial Settlement is not in the public interest.

4. The Partial Settlement, if implemented, would not achieve the purposes of the Competition Act.

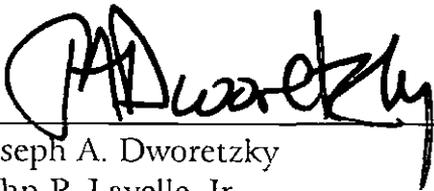
V. Conclusions of Law Relating to Modified Plan

1. The Commission has the power to modify PECO's Restructuring Plan.
2. It is in the public interest to modify the Restructuring Plan to address the defects identified by the parties; such modifications include those intended to
  - increase the generation credit
  - reduce the CTC/ITC strip
  - reduce the T&D charges
  - provide for unbundling of MBIS services
  - impose a code of conduct

VI. Conclusions of Law Relating to Rate Decreases

1. The Commission has the power to impose fixed rate decreases as part of a restructuring plan.

Dated: December 2, 1997

  
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BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

In re the Application of PECO Energy :  
Company for Approval of its :  
Restructuring Plan Under Section 2806 : Docket No. R-00973953  
of the Pennsylvania Public Utility Code :  
 :  
 :  
Petition of Enron Energy Services Power, Inc., : P-00971265  
for Approval of an Electric Competition and :  
Choice Plan and for Authority Pursuant to :  
Section 2807(e)(c) of the Public Utility Code :  
to Serve as the Provider of Last Resort in the :  
Service Territory of PECO Energy Company :

CERTIFICATE OF SERVICE

I hereby certify that on December 2, 1997, I caused a true and correct copy of the Memorandum of Law in Support of New Energy Ventures' Objections and Proposed Modifications to PECO's Restructuring Plan and Proposed Findings of Fact and Conclusions of Law via hand delivery and regular mail, upon the following counsel as noted. I further certify that the manner of service satisfied the requirements of 52 PA. Code §§ 5.75 and 1.54.

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