COMMONWEALTH OF PENNSYLVANIA

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December 2, 1997

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Office of the Prothonotary
Pa. Public Utility Commission
North Office Building
P. O. Box 3265
Harrisburg, PA 17105

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PROTHONOTARY'S OFFICE

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

Dear Prothonotary:

Enclosed for filing are the original and nine (9) copies of the Main Brief on behalf of the Office of Small Business Advocate in the above-docketed proceeding. A computer diskette (in WordPerfect 6.1 format) is also enclosed.

As evidenced by the enclosed certificate of service, two copies have been served on all active parties in this case. If you have any questions, please do not hesitate to contact me.

Sincerely,

Bernard A. Ryan, Jr.
Small Business Advocate

Enclosures
cc: John J. Quain, Chairman (w/diskette)
Robert K. Bloom, Vice-Chairman (w/diskette)
John Hanger, Commissioner (w/diskette)
David W. Rolka, Commissioner (w/diskette)
Norma Mead Brownell, Commissioner (w/diskette)
John P. Povilaitis, Law Bureau (w/diskette)
Cheryl Walker Davis; OSA (w/diskette)
Hon. Marlane R. Chestnut
Hon. Charles E. Rainey, Jr.
Parties of Record
Mr. Brian Kalcic

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BEFORE THE

PENNSYLVANIA PUBLIC UTILITY COMMISSION

Application of PECO Energy Company For Approval Of Its Restructuring Plan Under Section 2806 Of The Public Utility Code	:	Docket No. R-00973953
Petition of Enron Energy Services Power, Inc.	:	Docket No. P-00971265

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MAIN BRIEF
OF THE
OFFICE OF SMALL BUSINESS ADVOCATE

DOCKETED
DEC 04 1997

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Dated: December 2, 1997

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INTRODUCTION

On April 1, 1997, PECO Energy Company ("PECO" or "Company") filed its Restructuring Plan pursuant to the Electricity Generation Customer Choice and Competition Act, 66 Pa.C.S. §§2801-2813 (the "Competition Act" or "Act"). As modified during this proceeding, PECO projects that its stranded costs will amount to approximately $7.4 billion.

The Office of Small Business Advocate ("OSBA") filed a Notice of Intervention on April 14, 1997 and actively participated in this proceeding. In accordance with the procedural schedule, the OSBA submitted the Direct Testimony and Rebuttal Testimony and Exhibits of Brian Kalcic. These pre-filed documents were admitted into the record by stipulation during the evidentiary hearing on October 16, 1997.

By this Main Brief, the OSBA supports the Joint Petition for Partial Settlement that was filed with the Commission on August 27, 1997 and responds to some specific criticisms of that Partial Settlement raised by the Pennsylvania Electric Competition Coalition ("PECC"). Additionally, the OSBA's Main Brief highlights our major concerns about the "Enron Choice Plan" filed on October 7, 1997.

SUMMARY OF ARGUMENT

The critical issue now before the Commission is whether the Joint Petition for Partial Settlement submitted by several active parties, including the Office of Small Business Advocate, is in the public interest and should be approved. In our view, the Commission should have no difficulty arriving at the proper determination of this question. Simply stated, approval of the Joint Petition would accomplish the express objectives of the Competition Act. In particular, the Partial Settlement provides for movement toward retail choice in the electricity generation market while resolving many complex transitional issues in a manner that balances the interests of various diverse parties, including customers and the electric utility. Accordingly, adoption of the Partial Settlement would be in the public interest.

Further, the OSBA is satisfied that the Partial Settlement would adequately protect the interests of small businesses during the transition to a competitive generation market. Specifically, implementation of the provisions of the Partial Settlement would enable PECO's small business consumers to begin almost immediately to realize many significant benefits envisioned during the passage of the Competition Act.

While some favorable aspects of the Partial Settlement could have been achieved through full litigation of this case, such as a reduction in the level of estimated stranded costs, many other important features go well beyond the statutory mandate and would be possible only through approval of the Joint Petition. For instance, absent approval of the Joint Petition, PECO would have no obligation to provide rate reductions prior to the onset of retail choice or to guarantee that substantial rate relief continue into the next decade. Nor would PECO be required to freeze transmission and distribution rates at their current levels for several years. Moreover, by providing an opportunity for all of PECO's customers to obtain direct access earlier than required by the statute,

the Partial Settlement is particularly beneficial to small business customers. This acceleration will ensure that small businesses have a fair opportunity to choose their electricity generation supplier at the onset of retail choice.

By contrast, the proposal Enron submitted in October (and later substantially revised just prior to the final hearings) that has come to be known as the Enron Choice Plan is, in essence, an effort by Enron to supplant PECO as the "electric company" in Southeastern Pennsylvania during the period of transition from regulation to competition for those PECO customers who can not or do not choose an alternate supplier of electricity. There are a multitude of public policy and legal flaws in the Enron Choice Plan that warrant the dismissal of Enron's petition by the Commission. Beyond those sound reasons for rejecting the Enron Choice Plan, the Commission should recognize that Enron's grand scheme will not work because it depends on PECO's voluntary agreement to several proposals that PECO can not and will not accept.

The Office of Small Business Advocate strongly endorses the adoption of the Joint Petition for Partial Settlement. Through its various provisions, the Partial Settlement delivers a package to the Commission that not only fulfills the stated objectives of the Competition Act, but also enhances the inherent benefits of competition that were envisioned by that law and expedites the delivery of those benefits to PECO's electric consumers.

ARGUMENT

I. Overview of Key Provisions of Competition Act

By Act 138 of 1996, known as the Electricity Generation Customer Choice and Competition Act ("Competition Act" or "Act"), the Pennsylvania General Assembly added Chapter 28 to the Public Utility Code. 66 Pa.C.S. §§2801-2813. In promulgating this legislation, the General Assembly declared that "[t]his Commonwealth must begin the transition from regulation to greater competition in the electricity generation market to benefit all classes of customers and to protect this Commonwealth's ability to compete in the national and international marketplace for industry and jobs." 66 Pa.C.S. §2802(7) (Emphasis supplied). The legislature also stressed the importance of resolving the many transitional issues in a manner that is "fair to customers, electric utilities, investors, employees of electric utilities, local communities, nonutility generators of electricity and other affected parties." 66 Pa.C.S. §2802(7) and (8).

Through this amendment to the Public Utility Code, the legislature established some basic standards and procedures designed to provide for direct access by retail customers to the competitive market for the generation of electricity, while maintaining the safety and reliability of the electric system for all parties. 66 Pa.C.S. §2804. Further, recognizing that electric utilities have incurred certain costs as a result of long-term investments in generation facilities and long-term power supply agreements which "may not be recoverable in a competitive market," the legislature empowered the Commission to determine the level of each utility's stranded costs and to provide a mechanism for the electric utility to recover a just and reasonable amount of those costs. 66 Pa.C.S. §2802(15).

The stranded cost recovery mechanism created by Chapter 28 is the Competitive Transition Charge ("CTC"). Although Section 2808(b) authorizes the collection of the CTC from transmission and distribution customers through

December 31, 2005, the Competition Act affords electric utilities and the Commission an opportunity to extend this recovery period.

During the period while electric utilities are recovering stranded costs through the imposition of a CTC, ratepayers enjoy certain protections under the Competition Act. Specifically, if either an electric distribution utility is still collecting a CTC or some of its customers still lack direct access, it may not increase its transmission and distribution charges for any of its customers, whether they purchase generation from the electric distribution utility or an alternative generation supplier, prior to June 30, 2001, fifty-four months after the effective date of the Act. 66 Pa.C.S. §2804(4)(I). Further, as long as an electric distribution utility is recovering stranded costs through a CTC or some of its customers are ineligible for direct access, it is precluded from increasing the generation rates above 1996 levels for any of its customers who continue to purchase generation from the utility, prior to December 31, 2005, nine years after the effective date of the Act. 66 Pa.C.S. §2804(4)(ii).

A final provision of the Act that is particularly important to small business customers is Section 2806, which provides for the implementation of direct access through a three-year phase-in period beginning on January 1, 1999. Under this section, one-third of the peak load of each customer class must have the opportunity for direct access as of January 1, 1999, while two-thirds of the peak load is eligible for direct access as of January 1, 2000. All customers of electric distribution companies will have direct access to a competitive generation supply by January 1, 2001. 66 Pa.C.S.§2806(b).

Although the Competition Act suggests that customers be selected on a "first-come-first-served basis" to attain direct access during the first two years, it gives the Commission discretion to choose a different approach. In doing so, this statutory provision explicitly recognizes the need to examine

other phase-in methods so as "to prevent competitive disadvantages among similarly situated customers within a customer class." 66 Pa.C.S. §2806(b)(4).

II. PECO's Stranded Cost Calculations

Through the testimony of Thomas P. Hill, Jr., Vice President and Controller of PECO, the Company presented its calculation of stranded costs, segregated into four categories: generation plants, generation-related regulatory assets, nuclear decommissioning costs and other transition costs. According to Mr. Hill's testimony, PECO's original estimate of its total stranded costs, after mitigation, amounted to approximately $6.8 billion on a net present value basis. PECO Stmt. No. 1 at 9-10. Subsequently, as a result of updating fuel price forecasts and making changes suggested by various intervenors in this proceeding, PECO increased its stranded cost projection to roughly $7.461 billion. PECO Stmt. No. 1-R at 20-22; PECO Stmt. No. 4-R at 12-15; PECO Stmt. No. 6-R at 2-4.

Explaining PECO's method for determining its net stranded costs, following mitigation, Mr. Hill noted that the process involved two computations. First, PECO quantified its net electric generation-related costs, as estimated at December 31, 1998. Second, PECO calculated the market value of its investment in electric generating plants and facilities, as expressed in present value terms as of that same date. PECO Stmt. No. 1 at 9.

To estimate "the market price which PECO's facilities would likely command in a competitive market," the Company relied on market price projections derived from three different valuation analyses. As explained by John F. Bustard, Senior Engineer in the Bulk Power Enterprises Group of PECO, one study was performed by EDS Utilities Division ("EDS"), the second analysis was conducted by William H. Hieronymus on behalf of Putnam, Hayes & Bartlett, Inc. ("PHB") and the third market value estimate was prepared by ICF Resources Inc. ("ICF"). PECO Stmt. No. 4 at 4. Originally, those analyses projected that the future market value of

PECO's generating facilities would be $3.65 billion (EDS),[1] $3.488 billion (ICF),[2] and $2.863 billion (PHB).[3]

Utilizing the PHB market value estimate to develop its stranded cost claim, PECO subtracted $2.863 billion from its depreciated investment in generation plant of $6.668 billion to arrive at anticipated stranded generation plant costs in the amount of $3.825 billion. PECO Stmt. No. 1 at 14. When that figure was combined with the other categories of PECO's stranded costs, its original stranded cost calculation was $6.8 billion. PECO Stmt. No. 1 at 15.

During the rebuttal phase of the proceeding, PECO presented its updated stranded cost projection, with Mr. Hill explaining that it was necessary to correct certain errors in the initial studies, to reflect more current data, and to facilitate a comparison of the various market valuation figures that had been submitted by PECO and other parties. PECO Stmt. No. 1-R at 20. According to the updated PECO exhibits, the revised EDS[4] market valuation is $2.777 billion, while the modified ICF[5] and PHB[6] studies produce market value estimates of $2.657 billion and $2.303 billion, respectively. Further, if those models incorporate fuel price forecasts reported by the Energy Information Administration, in lieu of the figures produced by DRI/McGraw-Hill World Energy Service, they produce

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[1] PECO Exhibit TPH-3.

[2] PECO Exhibit TPH-4.

[3] PECO Exhibit TPH-5.

[4] PECO Exhibit TPH-19.

[5] PECO Exhibit TPH-20.

[6] PECO Exhibit TPH-21.

market valuations of $2.122 billion (EDS),[7] $2.274 billion (ICF),[8] and $1.865 billion (PHB).[9] See PECO Stmt. No. 1-R at 20-21.

Subtraction of the revised PHB market value estimate of $2.303 billion from the figure of $6.688 billion, which represents PECO's depreciated investment in generation plant, produces stranded generation plant for PECO of $4.5 billion, compared to the original estimate of $3.825 billion. Although the incorporation of this lower market value estimate and other minor adjustments produces a total stranded cost figure of roughly $7.46 billion, PECO did not seek to upwardly adjust its stranded cost claim in this proceeding. Rather, as Mr. Hill explained, PECO simply provided this information to demonstrate the conservative nature of its $6.8 billion stranded cost claim. PECO Stmt. No. 1-R at 21.

III. Joint Petition for Partial Settlement

A. Overall objectives and priorities of Competition Act

In determining the acceptability of the terms contained in the Joint Petition for Partial Settlement, it is important that the Commission consider the overall objectives of the Competition Act and the priorities established by that statute. In particular, through passage of the Competition Act, the General Assembly recognized the need to develop a mechanism that would enable electric utility retail customers to choose their electricity generation suppliers. Hoping that competition in this market would eventually result in savings in electricity costs by Pennsylvania's residents and businesses, the legislature established a legal and procedural framework that would set this transition in motion.

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[7] PECO Exhibit TPH-22.

[8] PECO Exhibit TPH-23.

[9] PECO Exhibit TPH-24.

Clearly, the legislature envisioned that the movement to retail choice would require diligent and time-consuming efforts on the part of all affected entities. Specifically, through the provision of a lengthy timetable over which stranded cost recovery should occur, the Competition Act contemplated that competition in the electricity generation market would develop over the span of several years. Further, by the creation of a phase-in process during which customers would become eligible for retail choice, the legislature recognized that the potential benefits flowing to customers from competition in the electricity generation market would occur in a gradual manner. Overall, a review of the key provisions of the Competition Act reveals a legislative intent to provide electric consumers with a vehicle that would lead to an open competitive generation market, recognizing that the development of that market would take a period of time. See generally 66 Pa.C.S. §§2802, 2804, 2806 and 2808.

Another theme that transcends the Competition Act is that along the path toward full competition, the interests of electric utility customers should prevail over all other considerations. See generally 66 Pa.C.S. §§2802, 2804 and 2807. For example, after expressly declaring the need to begin the transition from regulation to greater competition in the electricity market to benefit all classes of customers, the General Assembly listed the affected parties who must be treated fairly during the transitional process, placing "customers" at the top of the list. 66 Pa.C.S. §2802(8). The legislature also emphasized the importance of ensuring that reliable electric service is available to all customers on reasonable terms and conditions and that electric utilities provide high-quality customer service. 66 Pa.C.S. §2802(9) and (12).

B. Fulfillment by the Joint Petition of the General Objectives and Priorities Established by the Competition Act

Based upon the general objectives and priorities established by the Competition Act, the Commission should review the Joint Petition for Partial

Settlement to determine whether it would provide an effective mechanism enabling the transition from regulation to greater competition in the electricity generation market to begin. Additionally, the Commission should consider whether the Joint Petition establishes a process for ensuring that customers' interests are paramount during this transition.

The OSBA submits that through a careful balancing of the interests of customers with those of PECO and other affected parties, the Joint Petition for Partial Settlement successfully develops a workable framework in which those primary objectives of the Competition Act would be fulfilled. Importantly, the Joint Petition accomplishes those goals, while also significantly enhancing the benefits of electric generation competition that the legislature anticipated. Moreover, the Partial Settlement substantially expedites the time frame over which those benefits are delivered to customers.

Providing a succinct summary of the key provisions of the Partial Settlement, Mr. Hill testified as follows:

> [T]he proposed Partial Settlement provides that (1) customers will receive significant rate reductions; (2) the advent of customer choice and competition will be accelerated; (3) universal service coverage will be substantially expanded; (4) statewide consumer education initiatives will be augmented; (5) PECO's financial integrity will be preserved; (6) the funding of nuclear decommissioning will be assured; (7) the securitization of stranded assets will be facilitated; (8) substantial litigation and associated costs will be avoided; and (9) a cloud over the Electric Competition Act will be reduced.

PECO Stmt. No. 1-SR at 3. In addition to this comprehensive delineation of the basic elements of the Partial Settlement, Mr. Hill highlighted the "extra-statutory concessions on PECO's part which will further enhance the transition to competition, including: (1) a 10% rate reduction which will become effective four months prior to the advent of retail competition in Pennsylvania; (2) the acceleration, by a year, of the dates on which two-thirds of PECO's customers would otherwise be entitled to shop for generation; and (3) the extension, by an

additional thirty months, of the cap on PECO's transmission and distribution rates." PECO Stmt. No. 1-SR at 3-4.

Stressing the importance of these concessions, Mr. Hill observed that "PECO's customers are **guaranteed** substantial rate relief while, at the same time, are provided the opportunity to achieve greater savings depending on competitive market conditions." PECO Stmt. No. 1-SR at 4. As Mr. Hill explained, "[i]f the market price for capacity and energy clears at levels below those set forth in Table A to the Joint Petition, customers will be free to avail themselves of those lower prices." PECO Stmt. No. 1-SR at 4. By contrast, if "market prices escalate beyond current expectations, customers will be shielded from such increases through the end of the year 2008 by virtue of the agreed upon generation rate caps." Id. Summarizing, Mr. Hill observed that "[t]his combination of rate relief, rate protection and freedom to shop assures that customers will derive significant benefits irrespective of how competitive markets evolve." Id.

In testimony submitted by the Philadelphia Area Industrial Energy Users Group, Stephen J. Baron likewise stressed the value conferred on customers by the Joint Petition for Partial Settlement. Highlighting many of the same aspects of the Partial Settlement, Mr. Baron testified that the interests of consumers and the value to them of having the Joint Petition approved "should be the primary consideration of the Commission in evaluating the reasonableness of the proposed settlement." PAIEUG Stmt. No. 1SS at 2. Providing testimony on behalf of State Senator Vincent J. Fumo and CEPA et al.,[10] Richard H. Silkman also outlined the important consumer benefits incorporated in the Partial Settlement. Following a detailed discussion of each of those provisions, Mr. Silkman concluded that the Partial Settlement "is in the ratepayer's best interest; it compares very

[10] Other parties in this consumer group are Tenant Action Group, John W. Long, Jr. and ACORN.

favorably with what has been achieved for consumers in other states, either through legislation or negotiated settlements; and it is better than what would have been achieved through continued litigation of this case." CEPA Stmt. No. 1 at 18.

C. Specific Terms of Joint Petition

1. PECO's agreement to write-off $2 billion in anticipated stranded costs

By the terms of the Joint Petition for Partial Settlement submitted on August 27, 1997, "PECO agrees not to seek recovery of at least $2.0 billion of its total stranded assets and costs, which shall be treated as a disallowance of regulatory assets in that amount." Joint Petition, Paragraph 17. Given PECO's updated stranded cost figure of $7.461 billion, this provision of the settlement agreement affords it an opportunity to recover $5.461 billion. PECO Stmt. No. 3-RJ at 8-10; PECO Exhibit ABC-13.

In conjunction with this level of stranded costs, the Partial Settlement establishes a mechanism by which PECO can recover that amount. Although the tariff sheets setting forth the rates for each class are contained in Appendix B of the Joint Petition, Table A on page 8 of the Joint Petition sets forth system-wide information, providing the general parameters of the unbundling process that are necessary to implement its terms.

As shown on Table A, the Partial Settlement establishes the system-wide charges for transmission, distribution, and generation that would be imposed through the end of 2008. Within the generation rate cap, the Partial Settlement designates a portion to cover the Competitive Transition Charge or the Intangible Transition Charge, with the remainder representing an "Energy & Capacity Cap." Through these energy and capacity caps, which are based upon PECO's projections of future market prices, PECO is guaranteeing that customers, on average, will

not pay more for the market generation component of rates than is shown for each year of the transition period.

PECO's willingness to forego collection of $2 billion of its claimed stranded costs, in conjunction with the incorporation of the specified energy and capacity caps, implicitly addresses the key criticism of PECO's Restructuring Plan identified by the OSBA's expert witness, Brian Kalcic. In particular, during the litigation of this proceeding, Mr. Kalcic questioned the validity of PECO's stranded cost claim, contending that sensitivity analyses should have been performed to establish reasonable bounds on PECO's market price estimates. OSBA Stmt. No. 1 at 4-14. Concerned about the potential for PECO "to have a greater potential for upside gain than downside loss in connection with a given market price change," Mr. Kalcic suggested that the Commission consider implementing a market value/stranded cost adjustment so as to implicitly share the risks associated with the uncertainty of future market price estimates between customers and shareholders. OSBA Stmt. No. 1 at 14.

Under the Partial Settlement, PECO has effectively consented to a sharing of these risks. Specifically, through foregoing the opportunity to collect all of its claimed stranded costs and by acceding to caps on market generation prices, PECO has recognized the potential for market prices to rise above its current projections and has agreed to protect customers from such unexpected increases. Under a scenario where market prices ultimately exceed PECO's expectations, the $2 billion reduction provides a significant cushion to ensure that customers are treated fairly throughout the transition period. Accordingly, the OSBA's primary concern about the need to further validate PECO's stranded cost claim is resolved by this feature of the Partial Settlement.

Further, the OSBA notes that the opportunity for PECO to recover stranded costs in the amount of $5.461 billion reflects substantial compromise on the part of all signatory parties to the Joint Petition. Indeed, a review of the record

reveals that compared to PECO's original stranded cost claim of $6.8 billion and its updated claim of $7.46 billion, other intervenors submitted stranded cost estimates of $3.672 billion (PAIEUG), $4.363 billion (OCA) and $4.889 billion (OTS). See PECO Exhibit TPH-16.

While those estimates span a wide range of potential stranded costs, the final settlement figure of $5.461 is very close to the mid-point of those various proposals. For instance, on average, the stranded estimates provided by PAIEUG, OCA and OTS would approximate $4.308 billion. Averaging that figure with PECO's original estimate of $6.8 billion would produce a stranded cost figure of roughly $5.554 billion. Other averaging exercises produce similar results.[11]

Although these simple arithmetic calculations may be of somewhat limited value because they fail to reflect the specific bases for assumptions underlying each claim, they do serve a useful purpose. Specifically, these illustrations support the conclusion that the level of stranded cost recovery contemplated by the settlement reflects a fair resolution of the parties' widely diverse positions on this issue.

Overall, the OSBA is satisfied that the level of stranded cost recovery contemplated by the Joint Petition, when viewed in conjunction with the remaining provisions of the Partial Settlement, is reasonable and should be approved. While affording PECO an opportunity to collect nearly 75% of its claimed stranded costs, the Partial Settlement also recognizes the importance of PECO's shareholders bearing some of the risks associated with future market price uncertainty. Through substantial compromise on the difficult question of an appropriate level of stranded cost recovery, and in exchange for other specific

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[11] As a further example, if PECO's updated claim of $7.461 billion is averaged with $4.308 billion, the result is $5.885 billion. If each of the three intervenors' proposal is afforded equal weight when averaged with PECO's $7.461 billion claim, the result is $5.096 billion. We note that the mid-point between $5.885 billion and $5.096 billion is $5.491 billion, which is extremely close to the settled amount for stranded cost recovery.

aspects of the Partial Settlement, PECO and the signatory parties have reached a fair resolution of this most contentious issue.

2. Rate decreases

A most significant feature of the Joint Petition for Partial Settlement that benefits consumers, including small businesses, is the 10% rate decrease slated for September 1998. Through this substantial rate reduction implemented four months prior to the introduction of electric competition in Pennsylvania, PECO's customers would immediately begin to realize benefits flowing from promulgation of the Competition Act.[12] By achieving this rate decrease through an across-the-board reduction to all billing determinants and applying it to all retail rate classifications, the Partial Settlement ensures that all customers who are affected by the Competitive Transition Charge would enjoy this savings. Specifically, a typical small business customer with monthly consumption of 3600 kWh and 25 kW of demand would realize a decrease in its monthly bill of roughly $76.[13]

Further, under the Partial Settlement, when PECO functionally unbundles its retail electric rates on January 1, 1999, this 10% rate reduction would be preserved and would continue in effect for two more years, through December 31, 2000. Beyond that time period, PECO would guarantee overall rates in 2001 and 2002 that are 5% and 2%, respectively, lower than rates in effect on December 31, 1996. See Joint Petition, Table A, at page 8.

While additional savings might be available to customers, including small businesses, who begin obtaining direct access to generation supplies on January

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[12] Although we recognize that the 10% reduction is contingent upon the removal of any legal impediments to securitization of a certain level of assets by PECO, and could be lowered to a 7% reduction if such impediments exist, the OSBA will refer throughout this Main Brief to the rate decreases provided by the Partial Settlement, assuming fulfillment of this condition.

[13] This small business customer's current monthly bill would be $763.74, which can be derived from Rate GS General Service, in Appendix B. With a 10% reduction, the bill would be lowered to $687.37.

1, 1999, PECO's assurance of lower rates for all customers is a critical component of the Partial Settlement. Further, as shown on Table A of the Joint Petition (page 8), significant savings can be expected for customers beyond 2002, assuming the accuracy of the long-term market generation prices incorporated in the Joint Petition. See Joint Petition at pages 8-10.

As Mr. Hill observed, this aspect of the proposed Partial Settlement would "provide PECO's customers **the largest rate reduction** proposed by any electric utility in the nation in connection with the transition to retail competition." PECO Stmt. No. 1-RJ at 5. Indeed, Mr. Silkman testified that based upon his experience in other jurisdictions where restructuring activities are ongoing, "consumers have generally received no real rate relief..." CEPA Stmt. No. 1 at 4.

3. Extension of transmission and distribution rate caps

Another important provision of the Joint Petition is the extension of the transmission and distribution rate cap beyond the period required by the Competition Act. While the statute precludes increases in transmission and distribution rates before June 30, 2001, PECO has extended this protection to ratepayers until January 1, 2004. As a result of this stipulation, small business customers served by PECO would continue paying the same charges for transmission and distribution services through 2004 that they were paying when the Competition Act was enacted. In fact, Mr. Silkman noted that "PECO's rates for transmission and distribution will be frozen for 7 years at their 1996 levels." CEPA Stmt. No. 1 at 15. Observing the clear benefit of that provision to ratepayers, Mr. Silkman testified that he knows of "no other state that has imposed this lengthy a stay-out term on any of its utilities." Id.

4. Extension of generation rate caps

Similarly, PECO has agreed to extend the generation rate cap protections afforded by the Competition Act, which would have otherwise expired at the end

of 2005. In particular, the Partial Settlement provides for a cap on PECO's generation rates for an additional three years, at slightly higher levels than required by the Act for the preceding period. Thus, small business customers are assured of stability in generation rates as the electric industry changes to accommodate retail competition. Mr. Silkman also stressed the importance of this three-year extension, commenting that it "represents a potentially valuable insurance policy for ratepayers, as it provides protection against significant energy price increases." CEPA Stmt. No. 1 at 15.

5. No reconciliation for sales

Another consumer protection embodied in the Joint Petition would shield customers from future increases to reflect variations in sales. Through establishing fixed total CTC/ITC charges in Table A of the Joint Petition, PECO has agreed to forego the reconciliation of its stranded cost recovery with its sales during the collection period. Instead, PECO will bear the risk (and likewise realize any benefits) of changes in the level of sales. Although Section 2808(f) of the Competition Act appears to envision an annual reconciliation, it also refers to Section 1307(e) of the Public Utility Code for further guidance on this matter. A review of Section 1307(e) indicates that upon a showing of good cause, the Commission may determine that annual rate adjustments are not necessary to reflect under-collections or over-collections. 66 Pa.C.S. §1307(e).

Clearly, in the present situation, sufficient good cause has been shown for departing from an annual reconciliation process. Specifically, PECO has expressed its willingness to waive that right, and any value or risk associated with this provision has been considered by the signatory parties as part of the comprehensive settlement proposal. The OSBA is particularly supportive of shifting the risks associated with sales variations to PECO, in exchange for rate certainty and stability. Moreover, given the declining sales over the past

several years, and the elimination of the impact of weather variations on rates, the OSBA considers it prudent to have embedded the concept of reconciliation in the prices established by the Joint Petition. See COMM-I-4.

Additionally, as Mr. Silkman noted, it is likely that sales growth during the term of the Partial Settlement will be negative. Pointing to "a number of factors that are likely to contribute to negative sales growth over the next ten years," Mr. Silkman specifically mentioned ongoing improvements in technology that are leading to more efficient energy consumption by very large users. CEPA Stmt. No. 1 at 7-8.

6. Accelerated opportunity for customers to obtain direct access

A key element of the Joint Petition from the standpoint of small business customers relates to the phase-in process. PECO's original proposal was to phase-in one-third of the General Service class peak load January 1, 1999 and two-thirds on January 1, 2000. After an open enrollment period, any over-subscription would be resolved on a first-come first-served basis.

Although that approach generally comported with the directives of the Competition Act, PECO has agreed to accelerate the opportunity for all customers to obtain direct access. Specifically, under the Partial Settlement, PECO would allow customers representing two-thirds of the peak load to choose an alternative generation supplier on January 2, 1999, while all remaining customers would be eligible for direct access on January 2, 2000.

Despite its apparent compliance with the Competition Act, PECO's original phase-in approach raised two concerns for small business customers. First, PECO's proposal had the potential to cause competitive disadvantages among small business customers within the General Service class. Second, nothing in PECO's plan would have prevented or limited the ability of a few large commercial customers to dominate the available load.

a. Competitive concerns

With respect to the potential for competitive distortions, the OSBA notes the possibility that one small business might obtain direct access earlier than its competitors, allowing it to enjoy an unfair advantage over those other businesses. Given the tight profit margin under which many small businesses operate, and the impact that a lower electricity bill might have on that margin, it was important to address this concern. Simply by accelerating the opportunity for all of its customers to obtain direct access, PECO has virtually eliminated the potential for competitive distortions. To the extent that some do occur, the effect on the livelihood of small businesses will not be as significant, particularly since any disadvantages will be of a shorter duration. Further, the small businesses who are not eligible for direct access in the first phases would be enjoying the rate reductions guaranteed by the Joint Petition during that time. See COMM-I-2.

b. Domination by large customers

The second aspect of PECO's original proposal that concerned the OSBA was the lack of any provision to address the possibility that a few large commercial customers would dominate the available load in the early phase. Given the fact that PECO has one very large, diverse General Service class, which includes a vast range of types and sizes of businesses and other entities, the potential for this occurrence was particularly acute. Indeed, the OSBA estimated that if only the largest commercial customers were included in the first one-third of the available General Service peak load, they would comprise about 1.3% of the total rate class. Under that scenario, where over 98% of the commercial customers would have been excluded from participating in direct access during the first year, small businesses would not have been fairly represented. OSBA Stmt. No. 1 at 20-21.

To ensure that small business customers have a fair chance of being able to choose their electricity generation supplier from the onset of retail choice, Mr. Kalcic suggested that the General Service class be divided into two sub-classes, defined as above and below 40 kW of demand, only for purposes of implementing the phase-in to competition. OSBA Stmt. No. 1 at 22-24. By incorporating this recommendation, the Partial Settlement ensures that small businesses are fairly represented in the portion of General Service load that has the opportunity to enjoy direct access to alternative generation supplies at the earliest possible date.

D. Broad consumer and governmental support for Partial Settlement

As a result of the many provisions of the Partial Settlement that directly benefit customers, it enjoys very broad support from a wide spectrum of groups and entities who represent the interests of consumers. Specifically, the signatories to the Joint Petition represent a variety of diverse factions of consumers, including residential customers, small business customers and large industrial customers. As Mr. Baron commented, "[t]he fact that these customer groups, representing the vast majority of PECO's customers have agreed to the settlement is substantial evidence as to the justness and reasonableness of the settlement." PAIEUG Stmt. No. 1SS at 3.

Additionally, numerous consumer-oriented witnesses offered strong support for the Partial Settlement at the public input hearings held on October 9 and 10, 1997. A summary of the testimony presented by some of those witnesses, particularly those referring to small business interests or economic development, is set forth below.

Courtney Yelle, who is the Director of Consumer Protection in Bucks County, testified that approval of the Partial Settlement would result in "a great benefit to Bucks County electric users." Tr. 289. Further, Ms. Yelle opined that in addition to saving consumers money, the guaranteed 10% rate reduction

would "induce other businesses to come to the Delaware Valley and also strengthen industry that currently resides in the area by reducing the cost of doing business." Tr. 290. As she aptly concluded, "[t]he settlement is far too important to be rejected or stalled." Tr. 290.

Blaine Stoddart, the Executive Director of West Philadelphia Partnership Community Development Corporation, made similar observations, particularly focusing on the favorable effect the Partial Settlement would have on the local business community and economic development in the Greater Philadelphia region. He urged the Commission to approve the Joint Petition. Tr. 330.

Also endorsing the Partial Settlement was Al Taubenberger, President of the Greater Northeast Philadelphia Chamber of Commerce. Mr. Taubenberger observed that the settlement process had the benefit of receiving input from many diverse interest groups and he recognized the importance of accelerating the transition to competition as provided for by the Partial Settlement. Noting the "great opportunity for small businesses in Northeast Philadelphia to see lower electric rates as a result of the settlement," Mr. Taubenberger indicated that "[t]hese savings will allow small businesses in Northeast Philadelphia to remain competitive and could be a catalyst in attracting and creating new jobs." Tr. 337-339.

Providing further support for the Partial Settlement was Robert Powelson on behalf of the Chester County Chamber of Business and Industry, whose organization is comprised of 1100 businesses. Urging approval of the Partial Settlement, on the basis that it is "fair and equitable," Mr. Powelson opined that the rate reduction would "allow for greater economic development throughout the Greater Philadelphia region." Tr. 214.

Additionally, the OSBA notes that the Partial Settlement enjoys the support of many elected officials. Besides Senator Fumo, who has actively participated in this proceeding and has sponsored testimony in support of the Partial

Settlement, several other elected officials from the Philadelphia area spoke at the public input hearings in support of the Partial Settlement. Christine Tartaglione, Senator in the Second District of Philadelphia, praised the Partial Settlement. Although she did not support the Competition Act because of its lack of any provisions guaranteeing savings for customers, she indicated that with those assurances set forth in the Partial Settlement, she could offer her full support for competition in the electricity generation market. Tr. 303-304.

Representing the 150th Legislative District in Montgomery County, John Lawless also indicated his lack of support for the Competition Act due to the absence of guaranteed lower rates. As he testified, the Partial Settlement "provides solid assurances that we will see meaningful rate reductions if it is approved by the Public Utility Commission." Tr. 195-196. Further, noting that the legislative intent was to lower electric prices and that competition was the vehicle to achieve that goal, he opined that "communities, businesses and industries will greatly benefit from this drop in price and...we need to do this as soon as possible." Tr. 196.

Aaron Wilson, Mayor of Chester County, also testified in support of the Partial Settlement. Mayor Wilson observed that this agreement "was reached by groups located right here in Delaware Valley" and urged the Commission to embrace the opportunities presented by the Partial Settlement for significant consumer benefits. Tr. 197.

E. Market Generation Prices used in the Partial Settlement

The market generation prices that would be implemented under the Partial Settlement are shown on Table A of the Joint Petition at page 8. Specifically, column (4) of Table A sets forth the "Energy and Capacity Cap" applicable during each year of the ten-year initial transition period. As Table A shows, the market generation prices utilized by the Partial Settlement begin at 2.80¢/kWh in 1999 and culminate at $5.57¢/kWh in 2008.

The chief criticism lodged by the Pennsylvania Electric Competition Coalition ("PECC") against the Partial Settlement is its contention that these market generation prices are inadequate. Testifying for the PECC, Mr. Mitnick has suggested that the energy and capacity rate caps incorporated in the Partial Settlement substantially understate future market prices and will therefore thwart the development of meaningful competition. PECC Stmt. No. 1 at 20.

Summarizing his response to PECC's concerns about the market generation prices utilized by the Partial Settlement, Mr. Hill testified as follows:

> [T]he energy and capacity rate caps set forth in the Joint Petition are entirely consistent with and supported by (1) the analysis conducted by Dr. Hieronymus, (2) the range of price forecasts submitted by other Pennsylvania electric companies in their restructuring proceedings, (3) contemporaneous market-derived data and (4) the generation credit established by the Commission in PECO's recent Pilot Program proceeding.

PECO Stmt. No. 1-RJ at 3. As Mr. Hill concluded, the use of higher market generation prices would simply "simply take money from the pockets of PECO's shareholders (many of whom are Pennsylvania residents) through reduced Competitive Transition Charges and drop it into the marketers' coffers to cover their incremental costs and provide them a sufficient 'margin' (i.e, profit)." PECO Stmt. No. 1-RJ at 7.

Describing PECC's position as an attempt to reconfigure the three components of the overall cap, Dr. Hieronymus noted that essentially PECC seeks to decrease the transmission, distribution and CTC/ITC charges, while increasing the energy and capacity caps ("ECC"). As he observed, "[i]n negotiating the settlement, there clearly had to be a tradeoff between the level of the overall cap, CTC recovery, the ECC and, to a lesser extent, the payment for regulated electric distribution company (EDC) services." PECO Stmt. No. 6-RJ at 3.

1. Basis for Energy and Capacity Caps

With respect to the reasonableness of the market generation prices utilized by the Partial Settlement, Dr. Hieronymus demonstrated that those "energy and

capacity caps are generally consistent with the results of his July 1997 market clearing price analysis when his wholesale price projections are translated into retail (i.e. delivered) rates." PECO Stmt. No. 1-RJ at 9. See PECO Stmt. No. 6-RJ at 5-6; PECO Exhibit WHH-9. Although Dr. Hieronymus agreed that there will be little headroom between market generation costs and the energy and capacity caps during the first several years of the transition to competition, he explained that "this is necessary if the overall cap is to fulfill its functions of assuring rate decreases and recovering the appropriate level of stranded costs." PECO Stmt. No. 6-RJ at 7.

Dr. Hieronymus explained that a tight cap on energy and capacity prices is necessary to protect customers, by ensuring that even if market electricity prices "are higher than the level that was forecasted when the CTC was agreed," the CTC will not be over-recovered. Through illustrating the effect of various changes on CTC recovery, Dr. Hieronymus demonstrated that the use of the energy and capacity caps incorporated by the Partial Settlement ensure that the risks associated with uncertainty in future market price estimates are borne by PECO, rather than its customers. PECO Stmt. No. 6-RJ at 7-8.

Mr. Silkman's testimony echoed many of Dr. Hieronymus' points on this issue. Pointing to the lessons learned "over the past 25 years in trying to forecast energy prices," he stressed the growing importance of the role "that unforeseen factors and events will play...the farther out in the future we try to predict energy prices." CEPA Stmt. No. 1 at 12. In view of the risks created "for electric ratepayers as the price of electricity shifts from an embedded cost basis under traditional regulation to the competitive market following industry restructuring," he concluded that the generation rate caps embodied in the Partial Settlement provide necessary "protection for ratepayers from increases in energy prices." CEPA Stmt. No. 1 at 12-13.

Mr. Silkman referred to the energy and capacity rate caps as a "critical insurance policy for ratepayers that offer substantial protections against potential abuses of market power in the generation market and potential rapid increases in energy prices." CEPA Stmt. No. 1 at 9. Despite his recognition of the widely-held belief in the industry "that competition will result in lower prices than would otherwise prevail," he believes that "it is prudent to protect (insure) ratepayers against the possibility that competition may result in unanticipated price increases." Id. Although Mr. Silkman acknowledged the possibility that competition in the generation market will benefit ratepayers, he warned that it would be "imprudent to put all of our 'eggs' in the competition basket without providing ratepayers effective protection against unwarranted or unforeseen price increases." CEPA Stmt. No. 1 at 10.

Dr. Hieronymus further testified that it would not be in the customers' interest to utilize higher energy and capacity caps as a way of funding potential competitors' selling, general and administrative costs and profits. As he observed, "[t]he purpose of introducing competition is to reduce customer costs and improve product quality, not to add an additional cost of service to be recovered on a cost-plus basis." PECO Stmt. No. 6-RJ at 9. Noting that the success of retail competition will hinge upon the ability of new suppliers to provide a better product or provide the same product at a lower cost than the former franchise monopoly, Dr. Hieronymus appropriately placed the burden on new entrants to find a way to add value to customers. Id.

Responding to claims that entrants will have a difficult time competing unless they can sell power at a price at least 5 percent below PECO, Dr. Hieronymus stressed that "[t]he importance of competition is not that competitors succeed, but that their presence disciplines market prices and offerings." PECO Stmt. No. 6-RJ at 11. Since there is little doubt that entrants will achieve at least some market penetration, he concluded that it would be inappropriate for

the Commission to provide an "artificial price incentive to switch suppliers." PECO Stmt. No. 6-RJ at 11-12.

2. Comparison of PECO's market price forecasts with other sources

In recognition of the fact that Dr. Hieronymus' market price projections constitute only one view of future market conditions, Mr. Hill examined the market price forecasts submitted by other Pennsylvania electric utilities in support of their restructuring filings. A review of that data, which is presented in matrix form in PECO Exhibit TPH-29, demonstrates that "Dr. Hieronymus' findings are well within the range of projected values." PECO Stmt. No. 1-RJ at 11. For instance, in 1999, the PHB-DRI wholesale market price forecast is 2.20¢/kWh, which is approximately the average of other electric utilities' forecasts ranging from 2.06¢/kWh to 2.45¢/kWh. By 2005, the PHB-DRI projection is 3.30¢/kWh, while most other forecasts are much lower. Similarly, the PHB-DRI forecast for 2008 is substantially higher than all other forecasts for that year. See Exhibit TPH-29.

As further support for the reasonableness of the Joint Petition's energy and capacity rate caps, Mr. Hill noted that in preparation "for the implementation of its retail access Pilot Program, the Company has become aware of the prices being quoted by other generation suppliers for retailed delivered power." PECO Stmt. No. 1-RJ at 11. An evaluation of that information by Michael S. Freeman, a supply manager on PECO's National Energy Team, confirmed the reasonableness of the price projections relied on for the Partial Settlement. PECO Stmt. No. 1-RJ at 11; PECO Stmt. No. 26-RJ at 3-4. Moreover, Mr. Freeman observed that "[t]he energy and capacity caps should not be set at a level such that competitive suppliers can experience a windfall from the outset of retail access." PECO Stmt. No. 26-RJ at 4.

3. Comparison of energy and capacity caps with average PECO Pilot credit

As to the comparison made by Mr. Mitnick of the initial 2.8¢/kWh energy and capacity cap in the Partial Settlement and the average PECO Pilot credit of 3.9¢/kWh, Mr. Hill noted that it "reflects yet another manipulation of figures in a way that can only mislead." PECO Stmt. No. 1-RJ at 12. Demonstrating the inappropriateness of that correlation, Mr. Hill explained that "the generation credits offered in the Pilot and the rate discounts offered in the Partial Settlement are virtually identical." Id. As Mr. Hill noted, the only difference between the two is that "in the Pilot Program, the additional 1¢ is referred to as the 'Customer Participation Credit' and was ordered by the Commission, whereas in the Partial Settlement it is called a 'rate discount' and is offered voluntarily by PECO." Id. Observing that this 1¢ of the Pilot generation credit "has nothing to do with anyone's projection of future market prices, Mr. Hill clarified that true generation credit "embedded in the total Pilot credit is about 2.85¢." Id. Mr. Hill then concluded that "customer rates offered under the Pilot and the Partial Settlement are virtually identical." Id. at 13; PECO Exhibit TPH-30.

4. Impact of Partial Settlement's energy and capacity caps on small business customers

Based upon the market price assumptions utilized by the Partial Settlement for purposes of unbundling current rates and calculating CTCs, the OSBA has considered the likelihood of small businesses gaining access to lower-cost generation supplies during the transition period. In particular, since the assumed generation market price is the amount with which small businesses would be able to "shop" for alternative supplies, we have attempted to assess the probable impact of the Partial Settlement's market price assumptions on the success of those efforts by PECO's small businesses.

Relying on the tariff sheets for the General Service class that are included in Appendices B and C of the Joint Petition, we have calculated the energy and capacity caps applicable to small business consumers. In 1999, a typical small business customer with 25 kW of demand using 3,600 kWh per month would pay PECO an average generation charge of approximately 3.9¢/kWh, as compared to the system average generation price of 2.8¢/kWh. Assuming that such a customer could purchase generation from an alternative supplier for 1¢/kWh less, or at a price of about 2.9¢/kWh, it would save an additional $432/year, or 5.9%, over the discounts implemented by the Partial Settlement. In other words, that customer's monthly bills in 1999 would be nearly 16% lower than its 1996 bills.[14] Based upon the evidence submitted by Mr. Freeman, describing recent examples of retail deals offered by suppliers "at or just above the wholesale energy prices" in New England, it appears that some small businesses may very well have such opportunities to enhance their savings. See PECO Stmt. No. 26-RJ at 6-8.

Further, since the Partial Settlement utilizes increasing market price assumptions over the transition period, a typical small business customer would be paying a generation charge of over 5¢/kWh by 2003. In the OSBA's view, such a generation charge should provide the small business customer with an ample opportunity to find an alternative supplier who would be willing to provide generation at a lower cost. See PECO Stmt. No. 26-RJ at 2-8.

5. Summary

While some of the opposing parties would prefer higher energy and capacity caps than are set forth in the Partial Settlement, the caps agreed upon by the signatory parties are reasonable, particularly in light of the various projections submitted by PECO, as well as PECO's recent experience in the market

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[14] See General Service Rate Schedules in Appendices B and C of Joint Petition,

and the estimates produced by other electric utilities in their restructuring proceedings. Further, to the extent that the gap between the market generation prices embodied in the Partial Settlement and the market price forecasts is relatively narrow in the early years of the transition, these energy and capacity caps are necessary to adequately protect consumers during the development of a competitive generation market. Particularly when viewed in the context of the Partial Settlement's resolution of PECO's Restructuring Plan, the assumptions relating to future market generation prices ensure that customers enjoy the benefits of electric competition, with limited exposure to the risks associated those changes, as a competitive generation market develops during the transition period.

IV. The ENRON Choice Plan

A. General Observations

On October 7, 1997, some six weeks after the filing of the Joint Settlement Petition, a previously unknown affiliate of Enron Corp. filed the Petition of Enron Energy Services Power, Inc. For Approval of an Electric Competition and Customer Choice Plan and for Authority Pursuant to Section 2807(e)(3) of the Public Utility Code to serve as the Provider of Last Resort in the Service Territory of PECO Energy Company (the "PLR Petition" or the "Enron Choice Plan"). The Commission subsequently consolidated the PLR Petition with the Joint Settlement Petition in order to consider both at the same time.

While Enron's publicity effort after filing the PLR Petition focused on the larger rate cuts it promised PECO customers in the first several years of the transition to generation competition, the PLR Petition also included the

following essential elements, each of which Enron said must be approved by the Commission without change (PLR Petition, ¶ 35,(b)):[15]

(1) The substitution of Enron Energy Services Power, Inc., a newly incorporated affiliate of Enron Corp., in place of PECO as the Provider of Last Resort ("PLR") in the PECO service territory (PLR Petition ¶ 23(h));

(2) A revised table of generation credits for the transition period, with higher credits in the initial years and lower ones in the later years as compared to the schedule of such credits established in the Partial Settlement (PLR Petition ¶ 23(g));

(3) An unbundled distribution service tariff drafted by Enron but to be applied to PECO (PLR Petition ¶ 23(b));

(4) A Power Purchase Agreement ("PPA") drafted by Enron under which PECO would be required to sell Enron whatever energy and capacity Enron required to discharge its duties as PLR (PLR Petition ¶ 23(j));

(5) An MBC Services Agreement, also drafted by Enron, under which PECO, using PECO employees and facilities, would provide metering, billing, collection and similar services under Enron's name to default customers (PLR Petition ¶ 23(k)); and

(6) A requirement that PECO securitize its entire allowed stranded costs of $5.461 billion by issuing transition bonds in that amount bearing a stated interest rate of 9.66% (PLR Petition ¶ 23(l)).

The grandiose plan that Enron cobbled together to block the Partial Settlement has been substantially revised since it was filed last October, with

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[15] Enron initially reserved the unconditional right to withdraw the Choice Plan at any time (Enron PLR Petition, ¶ 35(e)). Enron may now be willing to "eliminate or modify" a number of the many conditions that were included with the original version of the Enron Choice Plan, including the right to withdraw the Choice Plan at any time. See EESPI Stmt. No. 1-R, at pp. 39-40. But see Tr. 1258 where Enron appears to revert to its original position concerning its right to withdraw the Choice Plan.

the latest version being described in the rebuttal testimony served by Enron on November 12, 1997.[16] Regardless of those drastic revisions to a number of the plan's key features, however, the Enron Choice Plan continues to be fatally flawed.

The Choice Plan is replete with legal and policy deficiencies, as will be shown in summary fashion below (and almost certainly in greater detail in PECO's brief). But even if those numerous shortcomings could be rectified between now and January 1, 1999, the Enron Choice Plan would remain a boat that will not float. Everyone, including Enron (See EESPI Stmt 1, at p. 22), agrees that Enron's plan can not be implemented without PECO's consent and cooperation. And PECO has made it abundantly clear that, for good and sufficient reasons, it will provide neither its consent nor its cooperation. In its own words, Enron's overall plan is to "step into PECO's shoes in many respects relating to the provision of electric service to PECO's customers." PLR Petition, Introduction, at p. 7. Only an inveterate Pollyanna could actually expect PECO's management and shareholders to participate willingly in its own destruction by agreeing to the terms Enron calls for in those two contracts.

B. Some Specifics - Shortcomings of the Enron Choice Plan

The Enron Choice Plan, in whatever version one decides to review and analyze it, is a badly flawed and incomplete proposal for bringing PECO customers into the rapidly approaching era of generation choice. The many deficiencies in Enron's proposal will no doubt be pointed out (in more or less detail) in the briefs filed by the other signatories to the Joint Settlement Petition. Here the

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[16] The rebuttal testimony version apparently is the one Enron now wants the Commission to approve. Tr.1399. In an obvious effort to err on the side of sending a more rather than a less inclusive record to the Commission, the presiding Administrative Law Judges denied PECO's motion to strike those portions of Enron's rebuttal evidence that substantially revised the Enron Choice Plan as compared to that plan as it was set forth in Enron's case-in-chief. In the OSBA's view, allowing such a last-minute recasting of the Choice Plan is contrary to the explicit limitations on rebuttal evidence set forth in 52 Pa. Code §5.243(e). That portion of Enron's rebuttal testimony should not have been allowed into the record in this proceeding.

OSBA proposes to catalogue and briefly describe only a few of the more significant defects, emphasizing those that would jeopardize the consumer protections that are either provided by the Act or voluntarily included in the Partial Settlement. The OSBA will also show that it is impossible to implement Enron's proposals for restructuring PECO as proposed in the Enron Choice Plan.

1. Enron as the Provide of Last Resort.

Enron, a newly incorporated and not yet licensed Electric Generation Supplier that has no employees and neither owns or controls any generation assets at all (Tr. 1389), has requested that it, not PECO, be the Provider of Last Resort in the PECO service territory when the phase-in to competitive generation service begins on January 1, 1999. If that is permitted to happen, PECO customers who either can not then shop for an EGS, or who simply do not do so (whether by choice or by default), would suddenly find themselves receiving electric service through an upstart supplier they probably never heard of (at least not before they receive their first electric bill in 1999). Customer confusion, already quite likely simply because of the fundamental change from monopoly to competition, will be even greater for those default customers who discover that their long-time electric company, PECO, has been replaced without their approval or consent.

More importantly, the Act imposes an obligation to serve (or, more accurately, continues the existing obligation to serve) on the incumbent electric utility, at least until the utility's collection of its CTC (or ITC) has been completed. 66 Pa. C.S. §2807(e). It would be inconsistent and duplicative for PECO to bear that statutory responsibility while an alternative EGS has been designated as the Provider of Last Resort in PECO's distribution service territory.

Moreover, Section 2802(16) of the Act indicates a legislative preference for the incumbent electric utility to continue serving as the PLR in its service

territory. The Act does authorize the Commission, **after the transition period has been completed**, to either continue the electric distribution company in that role or designate another approved supplier in its place. 66 Pa. C.S. Section 2807(e)(3). The Act does not, however, contemplate the premature termination of PECO's statutory obligation to serve simply to enhance Enron's competitive position. For the Commission to designate this newest addition to the Enron collection of companies as the supplier of generation service to those of PECO's customers who, for whatever reason, have not yet designated an EGS when direct access becomes available after January 1, 1999 would be neither good law nor good policy.

There is no clear legal authority for the designation of an alternative PLR at the dawn of the competitive era. Even if there were, Enron obviously can not discharge the obligations of the PLR unless it has acquired a contractual right to call on PECO to deliver the electric service demanded by the default customers. No such right now exists or is likely to come into existence before January 1, 1999.

2. The Revised Generation Credits.

The Enron Choice Plan essentially reverses the table of generation credits that are established in the Partial Settlement. Under Enron's proposal, the generation portion of PECO's unbundled rates (sometimes called the "generation rate cap" or the "generation credit") is set higher in the early years and then lower in the later years as compared to the comparable schedule in the Partial Settlement. The higher credits in the early years are required, according to Enron, because the market price of energy in those years will be higher than the generation credits called for in the Partial Settlement, thus making it unlikely in Enron's view that competitive suppliers will enter the Pennsylvania market. The record here shows otherwise.

There is abundant evidence in this record to demonstrate that the retail market price for electricity in the early years of competition will be lower, not higher, than the generation credits that are established in the Partial Settlement. Dr. Hieronymus, in his testimony prepared for the final set of hearings, noted that Enron's witnesses who testified about the expected market price of power "...have substantially overstated the market price in a competitive generation market in the near term and hence the bulk power costs that would have to be paid by a retail competitor." PECO Stmt. No. 6-E, p. 2. Mr. Freeman, a PECO supply manager directly involved in the marketing of electric power as part of PECO's National Energy Team, testified at those final hearings that numerous customers in the PECO territory have received quotes for generation service that are below the caps in the Partial Settlement. PECO Stmt. 26-E, pp. 4-6, 11.

Moreover, the Enron approach of forecasting future market prices by determining what those prices would have to be in order to convince electric generation suppliers to build new generating plants in this area completely ignores the surplus of generation resources that now exists in the PJM region. As Dr. Hieronymus pointed out in his testimony regarding the Enron Choice Plan, as long as that generation surplus persists, and it is likely to continue until 2001, the owners of existing generating assets in this region will continue to sell electric power in bulk at prices that will attract competitive suppliers into Pennsylvania. PECO Stmt. 6-E, pp. 3-4.

The generation credits that are called for in the Partial Settlement will insure the development of a competitive market. That market undoubtedly will become more robust as we move through the transition period, as market prices move up under the pressures of inflation and the costs of the transition to competition are paid down through the CTC and ITC. Admittedly, this newly authorized market for electric generation will not be fully developed at the dawn

of the competitive era. The Act, however, contemplates an orderly move, not a "flashcut," to competition. The Partial Settlement facilitates just such a conversion from regulation to competition. Sacrificing PECO's financial integrity simply to give its new competitors a giant headstart by endorsing the device employed in the Enron Choice Plan of setting the generation credits far above any realistic projection of future energy prices certainly is not what the Act contemplates.

3. PECO's Unbundled Distribution Tariff.

Enron has also provided as part of its Choice Plan a distribution tariff that Enron wants PECO to adopt in connection with its restructuring. PECO witness Sundermeir (PECO Statement No. 13-E, pp. 2-24) enumerates and describes the many shortcomings of that distribution tariff drafted by Enron, and the PECO brief undoubtedly will discuss those deficiencies in greater detail.[17] But two aspects of Enron's proposals relating to the Enron Choice Plan warrant comment here as well.

a. The potential for premature termination of the statutory rate cap protection for customers.

As explained by Mr. Kingerski, Enron's expert witness on the distribution tariff that Enron drafted for PECO, once a customer selects an EGS as its supplier of generation service, that EGS, not the person or business who is the actual user of the electricity, is deemed to be PECO's customer **for distribution services.** Tr. 1685, 1689, 1800. Mr. Kingerski explained that the tariff provisions Enron proposes would apply to the relationship between PECO as the distribution company and the EGS, not the actual end user of the electric service. Under Mr. Kingerski's approach, therefore, the statutory rate caps that

[17] While Enron drafted a tariff for PECO, it proposes no such tariff for itself. Enron has made it abundantly clear from the beginning of this proceeding that it has no intention of becoming a public utility in Pennsylvania, even if its petition to replace PECO as the PLR is granted, so no tariff will be required for Enron. See PLR Petition, ¶ 35(h).

keep PECO's distribution service rates from exceeding their year-end 1996 levels until mid-2000 (and several years longer under the Partial Settlement) would only limit what PECO can charge the EGS for distribution services. What price that EGS then turns around and charges the end user (who is, of course, the real customer for those distribution services) would simply be a matter of contract between the actual customer and the EGS. Tr. 1690. That result is both awkward and nonsensical. More importantly, it threatens the consumer protections incorporated into the Act, protections that are particularly important for PECO's smaller volume residential and business customers.

It is almost inconceivable that Enron would seriously contend that the rate caps set forth in Section 2804(4) of the Act were intended to benefit an EGS, not the residential, commercial and industrial customers who choose to purchase their electric power from that EGS. But that is what Enron apparently believes should be the result. Enron's approach would nullify the carefully crafted transmission and distribution rate caps the Legislature included in the Act.

b. Enron's last-minute proposals for substantial reductions in PECO's transmission and distribution rates are, in actuality, just an alternative method of financing the Choice Plan's additional customer discounts.

Before filing rebuttal testimony drastically revising the Enron Choice Plan in response to the numerous challenges to that proposal raised by witnesses for the Joint Petitioners, Enron had maintained that the larger rate discounts it proposed would be paid for by taking the "...hidden benefits in the Partial Settlement from PECO." (See the PLR Petition, Introduction, at p. 3.) That contention was abandoned, however, when Enron's rebuttal testimony was filed on November 12, 1997.

When Enron found it necessary to make a series of last-minute changes to its initial securitization proposals to correct the many defects contained in those proposals, the huge windfall profits that Enron previously expected to

realize from securitization evaporated. Given those changes to Enron's securitization plans, the additional customer discounts promised in the Choice Plan no longer could be financed with part of Enron's anticipated securitization profits. So Enron, in its revised Choice Plan, belatedly proposed substantial reductions in PECO's T&D rates, even though the initial version of Enron's Choice Plan had assumed the very same T&D rates called for in the Partial Settlement.

On cross-examiniation, Steven J. Kean, Senior Vice-President of Governmental Affairs for Enron Corp., was asked to consider the revenue impact of Enron's last-minute proposals to reduce PECO's combined T & D rates by 7.4 mills per KWH. Based on PECO's average revenues per KWH of just under 10 cents, Mr. Kean agreed that Enron effectively was now suggesting a 7.44% reduction in PECO's average revenues per KWH. And that reduction just happens to match, almost to the mill, the differences in the customer discounts between those called for in the Choice Plan as compared to the ones established in the Partial Settlement! See Tr. 1402-1408.

Obviously, Enron recognized that correcting the numerous defects in its original securitization proposals would significantly reduce the profits it had expected to realize via the securitization process. Because the original Enron Choice Plan anticipated using a portion of those profits to finance the additional customer discounts promised in the Choice Plan, Enron had to come up with a new funding source for those discounts to protect its own anticipated profits under the Choice Plan. So Enron simply revised the Choice Plan to use some of PECO's revenues from the T&D rates to cover the cost of the additional customer savings that Enron had previously promised to PECO's customers.

This last minute switch in the way Enron proposes to fund its Choice Plan starkly illustrates the fundamental difference between the Partial Settlement and the Enron Choice Plan. The Partial Settlement represents a series of compromises by the settling parties following extensive negotiations about a number of hotly

disputed issues. Those compromises have been accepted by the settling parties because the overall result under the Partial Settlement is acceptable to each of them. The Enron Choice Plan, on the other hand, is simply a declaration by one party as to how it wants these complex issues resolved, a declaration that obviously favors Enron at every turn. There is no evidence in this record to show that any other party, not even the other marketers who have opposed the Partial Settlement, has accepted all of the provisions that constitute the Enron Choice Plan. When a party only has to negotiate with itself, as Enron did here, it is a simple matter to compensate for problems encountered with one part of the proposal by unilaterally and arbitrarily changing another feature of the original proposal. That is precisely what Enron belatedly has proposed with regard to PECO's T&D rates. Of course, the signatory parties to the Joint Partial Settlement did not have the luxury of modifying the negotiated provisions of the Partial Settlement simply by announcing a different approach more in accord with their views on any particular issue.

4. Enron's proposals that PECO execute a Power Purchase Agreement ("PPA") and a Metering, Billing and Collections Agreement ("MBC Agreement") to enable Enron to fulfill its obligations under the Choice Plan, will not be agreed to by PECO.

While Enron apparently is both **willing** and **eager** to take on the dual roles of Provider of Last Resort and supplier of customer billing and related services, it just as obviously is **not able** to do so without PECO's help. Enron therefore proposed to obligate PECO contractually to supply the personnel and facilities that are required (i) to generate all of the electric power Enron must acquire from time to time in order to meet its PLR responsibilities, and (ii) to provide metering, billing and related services (in Enron's name, of course) under the Choice Plan. To accomplish that result, Enron drafted a pair of one-sided contracts that it contends PECO should willingly accept. Not surprisingly, PECO

declared, as recently as the last round of hearings two weeks ago, that it has absolutely no intention of signing either of those proposed contracts.

One can see just how far both the PPA and the MBC Agreement are tilted in favor of Enron from even a cursory review of the testimony of PECO witnesses Pratzon and Crowe (PECO Statements Nos. 21-E and 29-E). Those witnesses carefully dissect and discuss the contract proposals that were put forward by Enron as essential elements of its Choice Plan. Mr. Pratzon concludes that Enron's PPA is "one-sided, oppressive and confiscatory." PECO Stmt. 21-E, p. 3. Mr. Crowe, reviewing Enron's proposed MBC Agreement, points out that it, like the PPA, also is grossly one-sided and insulates Enron from all financial risks by shifting those risks to PECO. Mr. Crowe also notes that the MBC Agreement effectively precludes Commission oversight of these fundamental customer service functions and is anti-competitive. PECO Stmt. 29-E, p. 11. For all of those reasons, PECO can not accept either the PPA or the MBC Agreement, and neither should the Commission.

The arrangements set forth in those two proposed contracts, when viewed in the context of Enron's overall plan to displace PECO as the PLR while simultaneously reducing its distribution revenues in the arbitrary manner that Enron suggested in its rebuttal testimony, pose a very serious threat to the economic vitality of PECO. That threat in turn calls into question PECO's ability to continue functioning effectively as the electric distribution company for Southeastern Pennsylvania. J. Barry Mitchell, Vice President of Finance and Treasurer of PECO, succinctly described that threat to PECO's financial well-being when he was asked to summarize his conclusions about the impact of the proposed Enron Choice Plan on PECO's financial integrity:

> "First, the Enron Plan is not in the best interest of consumers and will not promote competition because it will destroy the financial integrity of PECO Energy. This will

> seriously impair the Company's ability to provide safe, reliable service to customers -- who under the Enron Plan must rely on the Company, and only the Company, for that service -- and to be a healthy, viable competitor in the emerging electric marketplace.
>
> Second, the securitization proposal described in the Enron Plan and related testimony is not achievable. Therefore, the Enron Plan, which is totally dependent on securitization, will not provide the savings to consumers promised by Enron or, indeed, any savings at all.
>
> Finally, the 'project finance' structure of Enron under the Enron Plan and the lack of financial accountability of Enron, even to the Commission itself, is inappropriate and inadequate to satisfy the obligation to serve consumers which is the essential role of the provider of last resort." PECO Stmt. 20-E, pp. 2-3.

Under extensive and vigorous cross-examination, Mr. Mitchell persisted in his contention that the Enron Choice Plan would prove financially disastrous to PECO if it were implemented as Enron has proposed.

Anyone who might have harbored any lingering questions about PECO's intentions regarding the PPA and the MBC Agreements had those doubts dispelled when Thomas P. Hill, Vice President and Controller of PECO, testified during the final round of hearings on November 18, 1997:

> "Q. But just to be clear, Mr. Hill, what is PECO's position regarding whether it will enter into the PPA or MBC service agreement, agreements that ENRON has proposed?
>
> A. I have read the testimonies of PECO witnesses Pratzon and Crowe, which address the -- those particular contracts of PPA and the services agreement, and I have also listened to the cross examination, particularly of Mr. Kean yesterday and other ENRON witnesses today, and just so that we are clear in the record, the company indicates that it would not sign either of those contracts offered in the ENRON Choice Plan, either the original plan or the revised plan, for the reasons set forth in those testimonies, and I believe supported by the cross examination of the ENRON witnesses." Tr. 1811.

The PPA and MBC agreements are the linchpins upon which Enron absolutely depends for its proposal that it supplant PECO as the Provider of Last Resort when the transition to a competitive generation market begins. For the reasons discussed in detail by PECO witnesses Hill, Mitchell, Pratzon and Crowe in their

testimony (PECO Stmts. 1-E, 20-E, 21-E and 29-E), the unequivocal declaration by PECO that it will not execute those one-sided agreements obviously is the only way that PECO could possibly respond to Enron's contract proposals.[18]

The Enron Choice Plan has many shortcomings, several of which are discussed briefly here and others of which will be further detailed in the briefs to be filed by the other signatories to the Joint Partial Settlement. In the final analysis, the Choice Plan must be seen as promising what Enron can not deliver. The Commission should not fall into the trap of approving such an ill-conceived and unworkable proposal at this critical juncture when Pennsylvania's citizens, individuals and businesses alike, are facing dramatic changes in how they will receive their electric service in the future.

[18] Enron apparently recognizes that PECO can not be compelled to execute either of the proposed contracts. Its argument that PECO should voluntarily enter those contracts because PECO will recover $5.461 billion in stranded costs under the Enron Choice Plan (the same amount, of course, that PECO will recover under the Partial Settlement) is not at all persuasive. Enron's argument assumes that no competitive market will develop under the Partial Settlement, a claim that was thoroughly refuted in the testimonies of PECO witnesses Dr. Hieronymus (PECO Stmt. 6-E) and Mr. Freeman (PECO Stmt. 26-E), Senator Fumo, CEPA et al Witness Dr. Silkman (Sen. Fumo CEPA et al Stmt. 3) and AARP witness Dr. Cooper (AARP Stmt. 2).

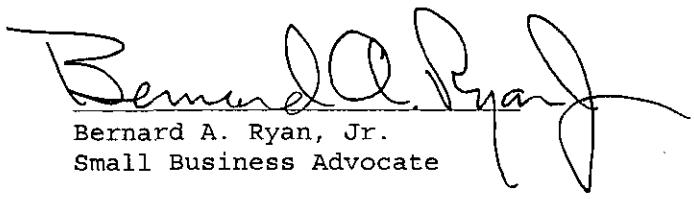
CONCLUSION

The Partial Settlement presents the Commission with a vehicle for moving PECO and its customers smoothly into and through the period of transition from monopoly to competition that is contemplated by the Act. It represents a very careful balancing of the interests of all of the stakeholders, recognizing the overarching emphasis the Act places on the protection of consumers of electric service, whether large or small, as Pennsylvania moves to a new regime of competitive generation markets. With the Commission's approval of the Partial Settlement, even more protections will become available to residential and small business customers as this transition goes forward.

The Enron Choice Plan is not a viable alternative to the Partial Settlement because it will not work. The only thing that the Choice Plan can accomplish, should the Commission endorse it as the roadmap for moving PECO and its customers into the new world of competitive generation service, will be increased uncertainty and the loss of the additional consumer protections that PECO agreed to provide when it joined in the Partial Settlement.

The Office of Small Business Advocate respectfully requests that the Commission approve the Joint Petition for Partial Settlement as it was filed with the Commission on August 25, 1997.

Respectfully submitted,



Bernard A. Ryan, Jr.
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Dated: December 2, 1997

APPENDIX A

PROPOSED FINDINGS OF FACT
AND
CONCLUSIONS OF LAW

The Office of Small Business Advocate endorses and joins in those Proposed Findings of Fact and Conclusions of Law attached to and submitted with the Brief of PECO Energy Company that relate to the Joint Petition for Partial Settlement as well as those that relate to the Enron Choice Plan. The OSBA does not endorse or join in any other requests for findings of fact or conclusions of law included in the Appendix to PECO's Brief that either relate to PECO's litigation positions in this case or to issues that are not resolved in the Joint Petition for Partial Settlement (issues about which the OSBA has not taken any position in these proceedings).

Because the diskettes to be supplied with PECO's Brief in this case will include, among other things, PECO's request for findings of fact and conclusions of law that are endorsed by and incorporated by reference into this brief, those requests are not included on the diskettes that will be delivered to the Commission with the OSBA Brief in these proceedings.

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Application of PECO Energy Company For Approval Of Its Restructuring Plan Under Section 2806 Of The Public Utility Code	:	Docket No. R-00973953
Petition of Enron Energy Services Power, Inc.	:	Docket No. P-00971265

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