

R-00973953

**PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17105-3265**

Public Meeting held June 26, 1998

KJR

Commissioners Present:

John M. Quain, Chairman
Robert K. Bloom, Vice Chairman
David W. Rolka
Nora Mead Brownell
Aaron Wilson, Jr.

Application of Pennsylvania Electric Company
for Approval of Restructuring Plan Under
Section 2806 of the Public Utility Code

R-00974009
R-00974009C0001
R-00974009C0002

OPINION AND ORDER

DOCUMENT
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ATTACHMENTS

I. INTRODUCTION

A. Background

On December 3, 1996, Governor Tom Ridge signed the Electricity Generation Consumer Choice and Competition Act, P.L. 802, No. 138, effective January 1, 1997, 66 Pa. C.S. §§2801-2812 (Act). The Act restructured Pennsylvania law relating to retail electric service in the Commonwealth. Retail customers now have the ability to choose their electric generation supplier (EGS). 66 Pa. C.S. §2802(12). Previously, a consumer procured its electric service as a package from the jurisdictional public utility, or monopoly, with the authority to serve the customer's geographic region, in this case Pennsylvania Electric Company (Penelec). The package, mentioned above, included what are now the three basic components of competitive electric utility service, the generation, transmission, and distribution of electricity. The focus of this Opinion and Order is the generation portion of electric utility service. Competition in the electric generation market in the Commonwealth will be implemented in three (3) phases beginning on January 1, 1999, following the conclusion of Pennsylvania's Pilot Programs. 66 Pa. C.S. §2806(b). All retail customers of electric distribution companies (EDCs) in Pennsylvania will have the opportunity to choose their EGS by January 2, 2000. 66 Pa §2806(b)(3).

In accordance with the Act, all Pennsylvania EDCs, such as Penelec, are required to file restructuring plans for review and approval by this Commission. 66 Pa. C.S. §2806(d). *Said restructuring plans must provide for the transition from the monopolistic provision of all electric service to the competitive market for generation.* The Act requires that the restructuring plans address the following matters:

- (1) unbundled prices or rates for generation, jurisdictional transmission, distribution,

and other services; (2) the calculation and recovery of reasonable stranded costs¹ through a proposed competitive transition charge² (CTC); (3) a proposed universal service and energy conservation cost-recovery mechanism to ensure the continuation of safe and reliable service and programs for the assistance of low-income customers; (4) procedures for ensuring that retail customers have direct access to all licensed electric generation suppliers; (5) a discussion of the impacts of the proposed plan on the utility's employees; and (6) revised tariffs and rate schedules implementing the aforementioned factors. 66 Pa. C.S. §2806(e).

B. History of the Proceedings

On January 24, 1997, at Docket No. M-00960890, F0005, this Commission established a schedule for filing of the restructuring plans.

In accordance with our January 24, 1997 Order, referenced above, on June 2, 1997, Penelec filed its Restructuring Plans at Docket No. R-00974009. The filing satisfied the requirements of the Act which, as discussed more specifically above, requires each jurisdictional public utility to file a restructuring plan which addresses issues relating to direct access to electric generation suppliers, stranded costs, rate design and unbundling, consumer education, and universal service.

¹ Stranded costs, as defined by the Act, include an electric utility's known and measurable generation-related costs which would have been recoverable in the former regulated market, but may not be recoverable in a competitive electric generation market. For specific costs see Title 66 Pa. C.S. §2803 Definitions.

² Competitive transition charge, as defined by the Act, is a charge which is applied to every customer's bill and is designed to recover an electric utility's stranded costs as determined by the Commission under Sections 2804 (relating to standards for restructuring of the electric industry) and 2808 (relating to competitive transition charge). 66 Pa. C.S. §2803.

Copies of the filing were served upon all parties listed on the Executive Director's Stakeholder list, the Office of the Consumer Advocate (OCA), Office of Small Business Advocate (OSBA), and the Office of Trial Staff (OTS). There are seventeen (17) parties which have been in this case. They are: (1) AES Corporation, Inc. (2) Anthracite Regions Independent Power Producers (ARIPPA) (3) Bio-Energy (4) Community Action Association of Pennsylvania (CAAP) (5) Conectiv (6) Enron (7) Enviro (8) International Brotherhood of Electrical Workers (IBEW) (9) Mid-Atlantic Power Association (MAPSA) (10) Metropolitan Edison Industrial Users Group (MEIUG) (11) (OCA) (12) (OSBA) (13) (OTS) (14) PECO (15) Penelec Industrial Customer Alliance (PICA) (16) NEV East, Inc., and (17) Solar Turbines, Inc. Additionally, notice of the Restructuring filings were provided to both customers and the public through publication in newspapers of general circulation throughout the Company's service territory.

Penelec's proposed Restructuring Plan was subsequently referred to Administrative Law Judge (ALJ) Allison K. Turner. An initial pre-hearing conference convened in Harrisburg on June 26, 1997. Metropolitan Edison Company, Inc., (Met-Ed) and Penelec filed separate restructuring Applications, but requested consolidation for purposes of hearing and briefing. Said requests were granted by Order of July 8, 1997 wherein ALJ Turner consolidated the Restructuring filings of both companies, noted various intervention requests and complaints, and scheduled further pre-hearing and discovery conferences.³

³ Both Met-Ed and Penelec filed Petitions for the recovery of costs incurred in connection with the restructuring of various non-utility generation partners (NUGs). On August 1, 1997, we adopted an Order directing that all jurisdictional electric utilities include, as part of their restructuring proceedings, any NUG costs anticipated to be stranded as a result of electric generation competition.

It should be noted that Met-Ed and Penelec (the Companies) have requested separate decisions and we, as did the ALJ, have prepared separate decisions accordingly. It should be noted, however, that some portions of each decision are about issues that are common to both Companies. In some sections in both decisions the ALJ used the term "the Companies," and did not differentiate according to the particular decision. However, in the Company-specific sections and discussions, the individual Company is either referred to by name or as the Company.

A second Pre-hearing Order was issued by ALJ Turner on August 14, 1997. That Order established an initial procedural schedule, set procedures for intervenors, and requested a status report from the Companies regarding settlement efforts.

On August 11 and 15, 1997 the Companies filed supplemental and direct testimony. Public input hearings were held in Reading (September 23), Erie (September 25), Johnstown (October 1), York (October 7), and Easton (October 8).

Subsequently, on October 12, 1997, the Companies announced that they were pursuing the sale of their non-nuclear generating assets through an auction. They additionally agreed to an extension of the deadline for the adjudication of the restructuring proceedings beyond March 30, 1998. The Companies also requested a suspension of the corresponding procedural schedule to facilitate settlement discussions. ALJ Turner granted the request, canceled hearings and established new deadlines for the submission of rebuttal and surrebuttal testimony. On January 12, 1998, the Companies extended the time period for our review of this case until June 30, 1998.

Settlement discussions proved unsuccessful and a further pre-hearing conference was held on January 14, 1998. By Order dated January 28, 1998, ALJ Turner issued a revised procedural schedule. Upon the conclusion of the hearings the record was closed on March 10, 1998. The ALJ's Recommended Decision (R.D.) was issued May 6, 1998.

Exceptions to the Recommended Decision were filed by the following parties: Penelec, Enron, Mid-Atlantic Power Supply (MAPSA), Allegheny Power, OTS, OCA, AES Corporation, Solar Turbines, Anthracite Regions Independent Power Producers Association/York County Solid Waste, Allegheny Electric Cooperative/Pennsylvania Rural Electric Association, MEIUG, and also Hospital Shared Services/Administrative Resources, Inc. (HSS/ARI).

Reply Exceptions were filed by the following parties: Anthracite Region Independent Power Producers Association/York County Solid Waste, Allegheny Electric Cooperative/Pennsylvania Rural Electric Association, MEIUG/PICCA, MAPSA, Allegheny Power, HSS/ARI, Enron and IBEW.

We are reminded that we are not required to consider expressly or at great length each and every contention raised by a party to our proceedings. *University of Pennsylvania v. Pennsylvania Public Utility Commission*, 86 Pa. 410, 485 A.2d 1217, 1222 (1984). Any exception or argument which is not specifically addressed herein shall be deemed to have been duly considered and denied without further discussion.

The Application of Penelec is ripe for disposition.

C. Summary of Disposition

This case requires consideration of the restructuring plan of a Company uniquely situated as the transition to customer choice occurs. The involvement of substantial Non-Utility Generation (NUG) sets Penelec apart from our prior restructuring decisions. We acknowledge and appreciate the efforts of all parties in presenting their differing approaches, and we thank them for that effort.

Our process has been enunciated in other restructuring decisions, but summary repetition is appropriate, here. Our purpose is to unbundle the current rates of the Company and to establish a methodology for the assignment of stranded costs. We proceed to examine the level of rates, to determine that portion associated with distribution service, to incorporate the federal rate for transmission service, to determine the just and reasonable level of recoverable stranded costs, and to compute a Competitive Transition Charge, (CTC). The residual from this calculation is a "shopping credit" to be used by customers to compare the offers from electric generation suppliers versus the current rate of the distribution company.

The process by which the Commission is obligated to unbundle the company's rates into generation, transmission and distribution components is fundamentally a ratemaking process. Specifically, we are called upon to determine the Company's total cost of service (including capital costs), to properly allocate those costs among the generation, transmission and distribution portions of the Company's operations, and to translate those total costs into individual rates. Further, based upon expert testimony, we are required to determine what portion of the Company's assets will become uneconomic (or stranded) in the new unregulated market for generation and to develop an appropriate rate, known as the CTC, that will permit the Company to recover those stranded costs over a

reasonable period of time. These are traditional ratemaking functions as exercised by the Commission since its inception in 1913.

Our restructuring review also entails examination of universal service and conservation programs, competitive safeguards, utility and supplier interactions and the phase in of direct access.

After a review of the record, and based on the applicable reasoning set forth in this Opinion and Order, we find total stranded costs of \$.858 billion, which, using a 10.4% interest rate yields a CTC estimated at 1.55 cents/kwh for 1999. The rate will be adjusted each year for system sales growth and for the declining amortization balance of stranded costs.

Our transmission and distribution calculations results in a combined rate for 1999 of 2.007 cents/kwh. The recovery of the CTC and the transmission and distribution (T&D) charges should yield a 1999 shopping credit of 3.7 cents/kwh. Attached to this Opinion and Order are schedules detailing the basis for our calculations.

II. PHASE-IN

A. Timetable

1. Parties' Positions

Penelec proposed that the Commission adopt a schedule whereby 33% of the peak load of each customer class would be eligible for direct access on January 1, 1999; 66% of the peak load of each class would be eligible for direct access on January 1, 2000; and all of the load would be eligible for direct access on January 1, 2001. Penelec recognized that the Commission accelerated this schedule (33% on January 1, 1999; 66% on January 2, 1999; and 100% on January 2, 2000) in the PECO restructuring decision, but disagreed that it should be applied to Penelec. (R.D., pp. 197-198).

The OCA considered Penelec's proposed phase-in acceptable for residential customers, except that it recommended the use of prepaid postcards for enrollment, and automatic enrollment for those in the pilot programs. (R.D., p. 198).

PICA argued that the accelerated phase-in is clearly permissible under the Act. See 66 Pa. C.S. § 2806(b). According to PICA, the plain language of the Act only establishes deadlines by which 33%, 66%, and 100% of retail load must be provided access to alternative suppliers. PICA contended that a prompt phase-in of customer choice, as adopted by the Commission in the PECO restructuring proceeding, will "provide the benefits of competition and complete the transition process as early as possible." PECO Restructuring Order, slip op. at 48. (R.D., pp. 198-199).

Enron agreed that the Commission should adopt the same phase-in schedule as in the PECO proceeding for Penelec. (R.D., p. 199).

2. ALJ's Recommendation

The ALJ recognized the Commission's ruling, on the issue of phase-in timetable, in the PECO Restructuring Case to be policy and precedent which should be followed in this proceeding. However, the ALJ found the facts of this case to be distinguishable from the circumstances in PECO. She was also persuaded by arguments raised by Penelec regarding interpretation of Section 2806 of the Act, 66 Pa. C.S. §2806. Accordingly, the ALJ recommended that Penelec be permitted to implement its proposed phase-in schedule through the end of 1999, and suggested that an acceleration of the schedule could then "be considered during the Phase II Divestiture proceeding." (R.D., p. 201-202).

3. Exceptions

In its Exceptions, PICA objects to the ALJ's disposition of this issue. PICA argues that the ALJ's recommendation reflects a misinterpretation of the Competition Act. According to PICA, the Act provides the Commission with ample authority to direct the prompt phase-in of retail access to alternative electric generation supplies. PICA also points out that the ALJ has apparently contravened Commission precedent on this issue which was established in the PECO restructuring proceeding and reinforced in subsequent proceedings involving West Penn Power Company (West Penn), Duquesne Light Company (Duquesne), and Pennsylvania Power & Light Company (PP&L). Finally, PICA asserts that the ALJ's recommendation is contrary to the public interest which would be best served by the implementation of full retail access as soon as possible. (PICA Exc., pp. 13-17).

Enron, in its Exceptions, also opposes the ALJ's recommendation. Enron points to Commission precedent on this issue and argues that, "absent a change by the Commission with respect to previous determinations, the same accelerated phase-in schedule should also apply in Penelec's service territory." (Enron Exc., p. 27). Enron asserts that the Act authorizes the Commission to accelerate the phase-in of retail access, and it urges the Commission to continue to expand this policy to all EDC service territories. (Enron Exc., p. 31).

In its Exceptions, MAPSA supports the implementation of a rapid phase-in schedule and objects to the ALJ's determination. MAPSA notes that in previous restructuring cases the Commission has concluded that the best way to ameliorate the potential negative effects of a transition to competition was to accelerate the phase-in to the greatest extent possible under the Act. According to MAPSA, the record in this proceeding supports the same conclusion. (MAPSA Exc., pp. 10-12).

4. Resolution

We agree with the positions of PICA, Enron, and MAPSA to the extent that we conclude that a maximum of 33% of the non-coincidental peak load of each tariff class shall have the opportunity for direct access on January 1, 1999, a maximum of 66% shall be eligible for direct access on January 2, 1999, and that all customers shall be eligible for direct access on January 2, 2000. This schedule is appropriate and necessary in order to provide the benefits of direct access expeditiously. Moreover, the schedule is appropriate both to minimize competitive disadvantages among customers and among EDCs, and to facilitate an orderly transition without confusion due to different phase-in schedules for different EDCs in overlapping media markets. In addition, we believe that prompt phase-in to full

retail access will help alleviate problems for large industrial and commercial customers that are permitted to access competitive generation for only a percentage of their load.

In the restructuring proceedings considered by the Commission to date, we concluded that prompt phase-in is an appropriate, reasonable way to accommodate the statutory concerns about competitive disadvantages. PECO Restructuring Order, slip op. at 49. Consistent with the approach taken in the PECO Energy, Duquesne, West Penn Power and PP&L restructuring proceedings, we direct consistent implementation of the phase-in, as permitted by the Competition Act and advocated by various intervenors. In this way, the customers of Penelec will not be disadvantaged vis a vis customers in other parts of the Commonwealth.

We conclude that the phase-in plan that we adopt is in the public interest. We find that it will facilitate an orderly transition to competition without the confusion that would result from different phase-in schedules for different EDCs in overlapping markets.

B. Process Issues

1. Parties' Positions

PICA advocated an approach under which commercial and industrial (C&I) customers would be eligible for direct access on a first-come-first-served basis, and if any of the classes were oversubscribed, a pro rata reduction would be made to the amount of each customer's load eligible for direct access. MAPSA advocated a similar approach. (R.D., p. 202)

Penelec noted that all of the process issues related to the phase-in of direct access appeared to involve commercial and industrial customers, and that no party has objected to its proposal to phase-in direct access to residential customers on a first-come, first-served basis.

For C&I customers, Penelec proposed to use a “participating load percentage” approach, which would allow each customer to select direct access for one-third of its peak load on January 1, 1999, for the second one-third of its load on January 1, 2000, and for the remainder of its load on January 1, 2001. According to Penelec, this proposal would level the playing field for competing businesses.

Penelec contended that its proposal is the most practical means to accomplish the objective of giving customers the opportunity for direct access to competitive suppliers while alleviating the possibility of creating competitive disadvantages during the phase-in period. Penelec opposed the approach advocated by PICA and MAPSA asserting that it had potential to cause complexities, confusion and errors. (R.D., pp. 203-204).

2. ALJ’s Recommendation

The ALJ determined that the Commission has a mandate to foster the development of a competitive generation supply market. She found that the proposal supported by PICA and MAPSA, who represent the interest of large customers, is calculated to encourage more participation in this market. The ALJ recommended, therefore, that the PICA and MAPSA position be adopted. (R.D. p., 204).

3. Parties' Exceptions

Penelec contends, in its Exceptions, that the ALJ erred in rejecting its proposed phase-in process for large customers. Penelec repeats the argument that its approach to direct access for C&I customers should be adopted because it avoids errors and needless complexity inherent in the PICA and MAPSA proposals. (Penelec Exc., p. 29).

4. Resolution

We are persuaded by the positions expressed by PICA and MAPSA on this issue. We consider Penelec's arguments regarding potential errors and complexity to be speculative and somewhat self-serving. We are concerned that Penelec's proposal will not lead to the full one-third of the peak load of each customer class taking direct access during the relevant phase-in periods. We agree with the Company that it does not have the responsibility to cajole customers into making a particular choice. However, we also agree with the ALJ that the Commission has a mandate to foster the development of a competitive generation supply market.

PICA and MAPSA represent the interests of large consumers. Since their proposal are calculated to encourage more participation in this market, we find that they should be adopted. This approach shall be implemented consistent with the dates set forth in our Enrollment Procedures Order at Docket No. M-00960890F.14.

For residential customers Penelec's proposed process of first-come-first-served is adopted.

III. STRANDED COST CALCULATION METHODOLOGY

A. Introduction

The Act provides electric utilities with the opportunity to collect generation-related costs that would have been recoverable under traditional rate regulation, but may be unrecoverable (i.e., stranded) in a competitive electricity generation market. The Act identifies three broad categories of stranded costs:

- (1) regulatory assets and liabilities, unfunded nuclear plant decommissioning costs and contract obligations to non-utility generators (NUGs);
- (2) prudently incurred costs to cancel, buy out, buy down or renegotiate contract obligations to NUGs; and,
- (3) net electric plant investments and costs (including spent nuclear fuel and non-nuclear plant retirement costs), non-NUG power purchase obligations and other transition costs, including costs related to the employee impacts of industry restructuring.

66 Pa. C.S. §2803

The Act specifies that the Commission “shall allow recovery” of the costs enumerated in categories (1) and (2) above. 66 Pa. C.S. §2808(c)(1) and (2). The Commission is provided with limited discretion to determine the recoverable level of category (3) costs. 66 Pa. C.S. §2808(c)(3). (R.D., p. 16).

The position of Penelec is to divest its fossil assets through an auction process, which is presently being conducted and should conclude in 1999, with

agreements of sale and transfers. Additionally, the Company has conducted private negotiations for the sale of nuclear assets. With a successful conclusion of the asset sale, the market valuation for the assets will become known. With the planned divestiture not being accomplished in advance of the first phase-in of direct access, an interim rate must be employed for stranded cost recovery. The purpose of the case examination of Penelec's property has been to establish this interim rate.

The methodology for calculating Penelec's stranded costs and for analyzing future electric generation market conditions and pricing, and what are the best projected figures for use in making those calculations has been the subject of intense dispute in this proceeding. In determining and quantifying Penelec's stranded costs, the crucial question raised was: what is the difference between the market value of Penelec's assets (and contracts) and their net present value? (R.D., pp. 16-17).

Penelec's announced generation asset auction enters into consideration because completion of this auction process will enable a final stranded cost determination for those assets to be made on the basis of actual present values, instead of estimates. Such divestiture also offers the potential for offsetting other stranded costs of Penelec, as part of a post-divestiture second step to these proceedings. Most parties favor divestiture of assets. (R.D., p. 17).

The ALJ correctly found that Penelec's auction plans do not eliminate the need for an administrative determination of the present value of their generating assets and resulting stranded costs. As noted previously herein, such a determination would be used for setting an interim stranded cost level, pending the completion of divestiture, and with respect to any generation assets that are not sold. Absent an actual generation plant sale, determining whether and to what extent Penelec's assets may have value in the future competitive electricity market (i.e., what portion of

Penelec's investments and ongoing costs in such plants would be recoverable in a competitive market and, thus, not stranded) requires the exercise of reasonable judgment based on a thorough understanding of the factors likely to impact future electricity prices. (R.D., p.17).

In order to calculate stranded costs, it is necessary first to establish the net present value of generation and regulatory assets. Penelec proposed to do this by calculating the amount of revenues that would be received from each asset over the life of the asset and discount it back to present value (present value revenue requirements method or PVRR). The OCA advocated the asset valuation method, which starts with the net book value of Penelec's assets (and contracts), projects their values over their lives, and discounts them back to present value as of January 1, 1999. According to the testimony, each method should produce the same or comparable results, and differences are produced by different inputs, such as the discount rate. (R.D., p. 17).

The OCA, OTS, PICA, HSS/ARI and ENRON all proposed differing discount rates. However, the OTS adopted Penelec's calculation method (PVRR). (R.D., p. 18).

The net present value of the assets is subtracted from market value, represented by the revenues to be received from the sale of energy. So, the projected market price, or market clearing price, of energy must be determined. Penelec used two computer modeling programs, IMPACT and Viability, to model the future market and project prices from 1999 to 2016. The OCA (ENPRO) and PICA (the Falkenberg model, comprised of two models) used different models, and different inputs to them, which produced different results. HSS/ARI basically applied different inputs to Penelec's IMPACT model, which produced very different results. The OTS adopted OCA's market price because the Commission adopted it for PECO, and the OTS

advocated that all PJM utilities have the same market clearing price imputed to them so as to create a level playing field. PICA agreed, but argued that its models should be relied on and its market clearing prices used if the Commission holds otherwise. (R.D., p. 18).

B. Stranded Cost Calculation Methodology

1. Market Line Projections

a. Parties' Positions

Penelec's energy, capacity and all-in market clearing prices for their generating plants were developed from the perspective of how the competitive market would value the energy and/or capacity associated with the various supply sources. (R.D., p. 22).

In response to criticism that this perspective was a "wholesale" view that did not capture the viewpoint of a retail customer relying on the competitive marketplace, Penelec provided an exhibit which summarized their market line results from the viewpoint of the average retail customer i.e., based upon customer usage patterns, losses and generation reserves. The "all-in" customer market clearing prices for 1999-2008 ranged from \$26.53 to \$40.31/mwh for Penelec. The final levelized retail credit that Penelec proposed to use for the next 7 years was 3.4 cents per kwh (\$34.0 per mwh). (R.D., p. 22).

Penelec asserted that one of the most significant and compelling strengths of Penelec's market line evidence was the performance of sensitivity studies in which numerous uncertainties were varied and tested, enabling consideration of a

range of possible outcomes associated with alternative future conditions. Discrete sets of values for “High”, “Low” and “Reference” cases were calculated. Penelec argued the Reference Case values are the “most probable”, and represent Penelec’s “best estimates”. According to Penelec the Low values have only a 10% chance of being higher than the actual value. Similarly, Penelec asserted that the High values were chosen to yield only a 10% chance of being lower than the actual value. According to Penelec, this approach assures that the most probable case is selected in the context of the above low probability ranges of values. Penelec’s experts calculated an “Expected Value” market line that represents the statistical average across all possible combinations of uncertain factors. (R.D., pp. 22-23).

Penelec has based its stranded cost calculations on the Reference Case market line, even though the Expected Value line is below the Reference Case line in all years from 2003-2016. Accordingly, the Company argues that its use of the higher Reference Case thus reduced estimated stranded costs. (R.D., p. 23).

MAPSA contended that Penelec’s proposed retail generation credits (based on the market line prices) contain several serious flaws. According to MAPSA, Penelec’s calculations do not recognize the load factors at which customers would be purchasing power, and they underestimate the cost of new capacity in the years prior to 2002. MAPSA also asserted that Penelec’s method fails to incorporate a retail or sales component in the credit. (R.D., p. 23).

The ALJ considered these factors to be important. The ALJ stated that the recognition of load factors, and the sales or marketing cost component are significant factors which should be recognized. (R.D., p. 23-24).

The alleged flaws in Penelec's projections commonly identified by most of its opponents are: the low price of capacity predicted through 2003; the relatively low prices of fuel projected throughout the forecast; and, the low costs of capital and fuel cost savings projected for CC and CT units respectively. They also found Penelec's definition of the relevant market too inclusive. OCA also challenged Penelec's inflation rate used as an escalation factor as being too low. (R.D., pp. 24-25).

PICA argued that market price projections could become self-fulfilling prophecies. Higher projected market prices produce lower stranded costs. Lower stranded costs permit a higher retail generation credit. A higher retail generation credit for the duration of the seven-year CTC recovery period will attract more alternative suppliers and investment in construction of new generation because profits and higher returns on investment are better assured. To the contrary, unreasonably low market prices, with correspondingly low retail generation credits, may dampen investment in new generation because expected returns will not justify initial expenditures. PICA stated that its market price projections will better enable the Commission to fulfill its overarching obligation to "ensure continuation of safe and reliable electric service to all consumers in the Commonwealth." (R.D., pp. 28-29).

Representative George stated unequivocally that the most recent actual prices should be used over projected prices however they are generated. Presumably, he would prefer actual prices whenever they are available. (R.D., p. 29).

HSS/ARI's case attempted to show that if Penelec's market line simply is adjusted to take into account Penelec's reliance on obsolete fuel price projections, then Penelec market-clearing line exceeds most other participants' market lines. The HSS/ARI market line is in fact derived from simulations using Penelec's own

proprietary computer model, IMPACT, "corrected" by them to account for alleged erroneous inputs. (R.D., pp. 32-33).

b. ALJ's Recommendation

In the ALJ's opinion, intensive analysis and consideration of the various computer models can be counter productive. The ALJ noted that all of the models and projections in evidence have been attacked and modified or rejected by at least one of the parties. Penelec's evidence has received the harshest scrutiny because it has so many opponents. Each party, in some cases with the support of others, has demonstrated the sound elements of its approach. In the ALJ's opinion, no market line projection has been completely validated or invalidated. (R.D., pp. 20-21).

The ALJ noted that Penelec's market prices are the very lowest and that AES, HSS/ARI, and MAPSA are clustered at the high end. The ALJ found that the AES prices are not truly market prices even though they were negotiated, because there were no other players seeking to buy or sell to either party in the transaction. The ALJ found that HSS/ARI and MAPSA have produced instructive results, but they examined to few variables to produce comprehensive results. (R.D., p. 45).

The ALJ stated that adopting the OCA's all-in market line as the Commission did in PECO has appeal because PECO and Penelec would have one constant in their prices, but their remaining differences would then make the difference in their ability to compete. The ALJ agreed with Penelec's contention that market-line pricing is not a "one-size-fits-all" exercise. The ALJ did not find Penelec's results to be the best in this proceeding. (R.D., p. 46).

Because the ALJ found that the high cluster of prices exerted an upward pull, the ALJ concluded that PICA's approach was the most suitable and recommended that the Commission adopt its market line prices. (R.D., p. 46).

c. Parties' Exceptions

Penelec contends that the market line evidence relied upon by the ALJ does not reflect the best evidence of future conditions. According to Penelec, no party has provided a more systematic, coherent and consistent market line analysis than the Company. Penelec continues that its market line analysis stands alone among the parties in having performed comprehensive sensitivity analyses to derive market value results across a broad range of numerous possible combinations. (Penelec Exc., pp. 4-5).

The OTS asserts that, for various reasons, the ALJ erred in selecting PICA's market line prices for use in calculating stranded costs. According to the OTS, stranded costs should be based on the market rates approved by the Commission in the PECO Restructuring and the PP&L Restructuring. The OTS advocates adoption of the OCA market line. (OTS Exc., pp. 8-13).

The OCA contends that its market price forecasts should be adopted in this case as they were in the PECO restructuring proceeding. The OCA posits that assume different PJM market prices for utilities competing in the same market would be unfair and inherently discriminatory. (OCA Exc., pp. 2-7).

MAPSA argues that the ALJ's recommendation should be rejected because the PICA price projection is insufficient to provide for robust competition. MAPSA notes that while the ALJ acknowledged that it had identified several factors which should be recognized in determining the market price projections to be used in

this proceeding, the ALJ failed to adopt the market price projections, as adjusted by MAPSA. (MAPSA Exc., pp. 2-3).

HSS/ARI contends that the ALJ erred in recommending the adoption of a market line analysis that has several deficiencies and is not consistent with real world market prices. HSS/ARI posited that at a minimum, any market line adopted to quantify stranded costs should incorporate the latest long term natural gas price projections.(HSS/ARI Exc., pp. 3-13).

d. Resolution

Penelec's primary stranded cost case is a function of two internal proprietary models for analyzing the probability of outcomes as a result of certain material assumptions as to the future of fuel prices, inflation rates, and unit operations. We are aware that Penelec has used these models for the internal purposes of evaluating NUG contracts and buyout proposals. This case was, however, the first record-based test of the models, their operations and assumptions.

We are also familiar with the model employed by the OCA, the *commercially available ENPRO model*, and we have used it as the basis for our prior restructuring decisions. We find that it is well tested and, given reasonable assumptions, it produces reliable results for decision making.

We observe that the Industrial intervenors' model is a proprietary model of the industrial witness Falkenberg. We have seen the results of this model presented in the other restructuring proceedings and we have used it as a check on the results of the ENPRO model.

For the purposes of this case we will continue to use the OCA market line as computed by the OCA as our primary analysis. We also find Penelec modeling and the Industrial modeling useful checks on the results. Our subsequent discussion will focus on these assumptions.

2. Relevant Market

a. Parties' Positions

The OCA and the Industrials proposed the use of the PJM Interconnection as the primary market for analytical purposes. Penelec, however, proposed and analyzed a much larger geographic region encompassing PJM, the East Central Area Reliability Coordination Agreement (ECAR) and the New England Power Pool (NEPOOL) in presenting its case. Penelec did not challenge the use of the PJM as a primary market but felt that their expanded market better reflected PJM import and export capability.

b. ALJ's Recommendation

The ALJ found that Penelec's assumption of a larger geographic market gives rise to "fundamental methodological difficulties." The ALJ stated that to ensure that market price projections are not skewed, the Commission must choose a model that focuses exclusively on PJM as the relevant market. (R.D., p. 24).

c. Resolution

The PJM Interconnection is far advanced in its interconnected operations. The incorporation proposed by Penelec of the ECAR and NEPOOL

regions adds an unnecessarily speculative assumption to pricing due, in part, to the lack of functional Independent System Operator (ISO) development in those regions. We also note that each of the regions uses different reliability criteria and reserve requirements. This contributes to uncertainty regarding future pricing impacts.

Therefore, the relevant market for our analysis of this restructuring case is the PJM power pool, which is the control area governing the Penelec region, acting as both security and control center.

3. Key Input Assumptions

a. Parties' Positions

According to PICA, the disparity between the Company's stranded cost calculations and its own stems from differences in key input assumptions in market price models. PICA stated that differences in input assumptions contributed to the Company's unreasonably low price projections for energy and capacity. PICA argued that this serves Penelec's interests because lower cost inputs produce lower projected energy and capacity prices, which produce higher stranded costs for Company-owned generation and operating NUGs. (R.D., pp. 25-26).

In making its market price calculations, Penelec used a mix of forecasts for future oil gas and coal prices.

PICA and the OCA advocated the use of a single forecast as the source of pricing information. Each asserted that a single forecast would serve to eliminate uncertainty as to the interaction among price assumptions.

b. Resolution

We agree with the criticism raised by the OCA and the Industrials that the use of a single forecast as the source of pricing information eliminates uncertainty regarding the interaction among the various price assumptions.

We find that the OCA fuel prices, which are based on the Spring, 1997, Data Resources, Inc. (DRI) forecast, are reasonable for the purposes of this analysis. We have employed these price assumptions in the previous restructuring cases and we believe that a common basis of treatment is a reasonable approach to ensure that a fair result is applied to companies, suppliers and customers statewide.

With respect to new unit fuel savings, we find that Penelec has not overcome the point raised by the Industrials that the experience of Portland 5, the newest unit in the GPU system, does not support Penelec's estimated results. Further, it appears that Penelec's estimates for new unit construction were lacking costs for land and overheads, such as inventories.

We are of the opinion that these latter elements serve to bolster our reliance on the use of the OCA market price estimates.

4. Inflation Forecast

a. Parties' Positions

Penelec elected to develop its own inflation factors for use in determining market price rather than rely upon the Energy Information Agency (EIA) inflation assumptions or the DRI inflation assumptions. Penelec assumed a constant

annual inflation rate of 2.5% per year. Penelec argued that there is independent corroboration for the reasonableness of their 2.5% assumption, pointing to a comparison of long-term variable rate treasury bonds/real interest rate (riskless) against the bond principal which is indexed to the Consumer Price Index. According to Penelec, the price of these securities can be compared to the price of fixed rate bonds of comparable maturity to infer the expected inflation levels. Penelec also relied on a recent article from Business Week Magazine indicating that October and November spreads over a ten year horizon are consistent with a long-term Consumer Price Index inflation rate of 2.4%. (R.D., p. 27).

The OCA pointed out that significant other sources project higher inflation rates, notably, EIA's forecast of general inflation averages roughly 3% per year over the next several years, with the DRI spring 1997 forecast being very similar. The OCA opined that Penelec's lower inflation projection significantly lowers Penelec's projection of market energy prices, particularly in the long term, and increases the projection of stranded costs, relative to the results that would be obtained using the DRI or EIA inflation assumptions. The OCA urged that Penelec's inflation assumption be rejected and the inflation assumptions consistent with the spring 1997 DRI forecast utilized by OCA be adopted. (R.D., pp. 26-27).

HSS/ARI opposed Penelec's reference to recently published material to support its reliance upon an artificially low inflation rate, projected to continue until the year 2036. HSS/ARI maintained that predicting a 40 year projection of inflation rates upon newspaper articles during a particular six month period is a dangerous practice that distorts a broad historical perspective on inflation. According to HSS/ARI, inflation has not averaged 2.5% annually for 25 years (much less 40 years). (R.D., p. 28).

b. Resolution

Inflation estimates are a primary driver of the future price of power. Penelec has used an estimate of 2.5 % for the years in its analysis. The OCA has used its DRI based forecast, and the Industrials have used an EIA based forecast. Our purpose is to examine the estimates and to decide which basic assumption is most reasonable. We find that the OCA estimate is reasonable and should be employed. We have previously employed this estimate in our other deliberations because we have determined that it produces a fair result.

C. Asset Valuation v. PVRR

1. Parties' Positions

Penelec contended that there is an unequivocal endorsement of PVRR in the Act, and finds this in the language which specifically expresses stranded cost recovery in terms of the traditional basis upon which recovery would have been obtained absent a competitive generation market. 66 Pa. C.S. §2803. Penelec further argued that the analytical model used in Pennsylvania rate proceedings to set rates is based upon a utility's revenue requirements for a future test year. The PVRR method is framed in terms of a series of future test years, thus, according to the Company, the PVRR approach allows the Commission to apply existing rules and accepted assumptions in calculating stranded costs. (R.D., p. 37).

PICA argued that the PVRR method seeks to guarantee recovery of revenues, and thus violates the plain language of the Act.. PICA emphasized that the Act focuses on the recovery of costs, not revenues. According to PICA, competition may strand costs, but it will not strand revenues. (R.D., p. 37).

2. ALJ's Recommendation

The ALJ found that the Commission's ruling in the PECO Restructuring Order of December 23, 1997 which adopted the asset valuation method for determining the amount of utility generation plant that will be stranded, is a precedent that should be applied here. ALJ found that in the PECO Restructuring Proceeding the Commission specifically rejected the lost revenues, or PVRR, approach, and stated: "While future revenues are an important component of the future value of utility generation assets, they do not directly determine the amount of recoverable stranded utility plant." (R.D., pp. 36-37).

The ALJ disagreed with Penelec's position that the Act directs the Commission to apply traditional rules and accepted assumptions of ratemaking under regulation. to all aspects of this restructuring proceeding. The ALJ interpreted the Act as changing the traditional rules which are applicable when rate base rate of return regulation is employed. (R.D., p. 39).

The ALJ stated that the Act's valuation method is described earlier in the definition as net present value, and the recovery method is the CTC. The CTC and net present value are clearly not modeled on traditional rate of return ratemaking. (R.D. p. 39).

3. Parties' Exceptions

Penelec argued that the PECO Restructuring Order did not set precedent either requiring the use of the asset value method or rejecting the PVRR method. Penelec argues further that the PVRR method was never proposed in that proceeding,

and the PECO Restructuring Order contained no discussion whatsoever comparing or contrasting the two approaches. Additionally, Penelec contends that although the Commission did adopt the asset valuation method in other restructuring proceedings where a related asset divestiture was not imminent, there is no reason to do so in this case since divestiture is already underway. (Penelec., Exc. p. 5).

4. Resolution

As in other restructuring proceedings decided by this Commission, the Company has based its stranded cost claim on a PVRR methodology, while the OCA and Industrial intervenors have used the “asset valuation” methodology. We have examined both methodologies and note that when properly analyzed the methods produce comparable results. We are also cognizant, however, of the need to be consistent in our approach to each successive case. We will use the “asset valuation” methodology as computed by the OCA as the basis for discussing the merits of the positions of the parties subsequently herein.

Of critical concern in selecting the best methodology is this issue: what is the net present value of Penelec’s assets versus the projected market value of the assets? The asset valuation method is designed to produce results as if a sale and transfer were taking place, while the revenue requirements methodology presumes a state of continued ownership and regulated recoveries. This difference convinces us that the asset valuation methodology will be fundamentally more comparable to the results of the divestiture than the revenue requirements method.

Finally, we disagree with Penelec that the Act directs us to apply traditional rules and accepted assumptions of ratemaking under regulation to all aspects of this restructuring proceeding. We agree with the ALJ and interpret the Act

as changing the traditional rules which are applicable when rate base rate of return regulation is employed.

D. Impact of Divestiture

1. Parties' Positions

On October 12, 1997, Penelec announced its intention to divest all non-nuclear generation assets. Divestiture of non-nuclear generation assets will likely have a profound impact on the calculation and recovery of Penelec's stranded costs. Specifically, generation divestiture will permit a recalculation of stranded costs for Company-owned generation based on actual, market-determined asset values, rather than on the basis of market price projections.

Penelec proposed a two-stage stranded cost calculation to capture the effects of divestiture. In the first stage of Penelec's proposal, the Commission would establish a levelized CTC based on Penelec's requested levels of stranded costs in this proceeding. The second stage of Penelec's proposal would consist of a final accounting and ratemaking, immediately following divestiture, to reflect the impact of net divestiture proceeds upon the stranded costs resulting from this proceeding. The second-stage accounting and ratemaking would occur in a contested, on-the-record proceeding so that interested parties could make recommendations to the Commission. Although Penelec proposed a 60-day review period for the second-stage proceeding and subsequently in its Reply Brief extended its proposal to 120 days, it acknowledged that this time period is not grounded in Commission regulations or the Act, and may need to be extended.

Penelec proposed to use “net divestiture proceeds” (i.e., divestiture revenues in excess of book value) to offset other stranded costs, subject to a specific priority for offsets, as follows: (1) remaining stranded costs associated with Penelec-owned generation; (2) regulatory assets (including NUG buy-out costs); (3) nuclear decommissioning costs; and (4) NUG-related stranded costs associated with operating NUG projects. Penelec qualified the proposed use of net divestiture proceeds to offset operating NUG costs on the conditions that the outcome is reasonable and the its ratemaking proposals are addressed. Most parties generally supported Penelec's proposal to divest non-nuclear generation assets. (R.D., p. 40-41).

PICA considered Penelec's proposal to be a reasonable response to potential horizontal market power concerns and a means for more precisely quantifying stranded costs. However, PICA urged the Commission not to endorse the Companies' ratemaking formula for divestiture proceeds in this proceeding because the formula has not been fully developed. (R.D.; p. 41).

ARIPPA asserted that the operating NUGs, in this proceeding, are fearful of divestiture, and seek protections from the Commission to preserve the financial integrity of their contracts. ARIPPA stated that in addition to an auction of its owned-generation assets, Penelec is also considering divesting itself of all or some of its NUG contracts. ARIPPA asserted that NUGs could face serious financial risk if Penelec is allowed to divest NUG contracts without limitation or qualification. (R.D., p. 42).

ARIPPA stated that failure by a successor to Penelec to maintain contract payments could create a tightly wound downward spiral for NUGs that would not be easily corrected because a NUG's ability to make its own debt service payments could be impaired or project maintenance could be delayed. ARIPPA pointed to a

recent instance where PECO refused to make payments to a NUG project because the contract price was above the market price set in its restructuring proceeding as a disastrous example of the negative impact restructuring can have on a NUG. (R.D., p. 43).

ARIPPA asserted that the Commission should ensure that NUGs are afforded at least one of the following remedies in the event that Penelec or Met Ed seeks to divest itself of a NUG contract:

First, that Penelec must remain the final guarantors of performance by any purchaser. Second, NUGs should be entitled to require warranties to insure that any successor maintains the financial ability to fulfill the provisions of the contract. Finally, NUGs should maintain their contractual right to approve any successor and to obtain provisions for payments necessary for incremental contract administration and power supply coordination with the successor.

R.D., pp. 43-44.

For its part, Penelec argued that the Commission should refrain from imposing conditions on agreements to try to influence circumstances that do not even exist at this time. Penelec reiterated that they cannot unilaterally assign NUG agreements to a third party purchaser. (R.D., p. 44).

2. ALJ Recommendation

The ALJ opined that Penelec would not act in the same way as PECO did towards the Grays Ferry project. According to the ALJ, Penelec has a track record of negotiating and honoring contracts with its NUGs. Moreover, the ALJ speculated

that PECO must have made a business decision that it would be more cost effective to litigate than to honor their commitment. The ALJ opined further that the sheer number of Penelec's NUG obligations would tend to make litigation too costly to be considered a viable option.

The ALJ determined that NUGs could address their concerns in the actual negotiation of the sale of any contract and that it would be premature for the Commission to impose conditions now on potential contracts. The ALJ recommended that the Commission explore whether it can and whether it should establish a procedure to review and approve such sales. (R.D. p. 45).

3. Parties' Exceptions

Penelec asserts in its Exceptions that the Recommended Decision erroneously indicates that Penelec had defined "net divestiture proceeds" as "divestiture revenues in excess of book value". Penelec contends that this is incorrect because it would not take into account expenditures of the sale or other recognized deductions from total sales proceeds. (Penelec. Exc., p. 6).

4. Resolution

We observe that parties to this proceeding have supported the priority order for the use of proceeds proposed by the Penelec, with the clarification that stranded costs other than Company-owned generation be quantified consistent with the Commission's findings in this proceeding. ARRIPA raised a concern that Penelec would also proceed to divest its NUG contracts. Such an action is not within the scope of our jurisdiction and would be a function of any assignment conditions of the contracts.

Regarding the ALJ's Recommended Decision at page 39, we agree with Penelec's exception and clarify "net divestiture proceeds" to be "divestiture revenues in excess book value and transaction costs" (TR 723-726). We will not at this time establish a procedure to review or approve any future sale of NUG contracts.

A number of claimed regulatory assets have been conceded by Penelec as more appropriate for the divestiture proceeding and use of proceeds. In particular, the claim for Warren and Seward employees would be the subject of the divestiture proceeding.

Additionally, as part of the divestiture proceeding, we will examine the recoveries that will have occurred from the interim CTC so that the combination of net proceeds and interim CTC revenues are taken into account.

E. Summary

Considering the categories detailed above, we find the analysis performed by the OCA provides us with the most reasonable estimate of the market prices likely to be experienced during the analysis period. We will use these estimates as we proceed to discuss our determination of stranded costs for NUGs and the utility's own generation.

We have adopted the recommendation of the ALJ and rejected Penelec's PVRR methodology. Further, we have rejected the ALJ's finding that the PICA market line prices are most suitable here and shall adopt the OCA market line as

of \$23.89 per MWH for 1999 and \$26.09 per MWH for 2000, as our primary analysis.
(R.D. p. 36). Our subsequent discussion will focus on these assumptions.

IV. QUANTIFICATION AND RECOVERY OF NON-UTILITY GENERATION COSTS

Penelec claimed \$959,170,000 in Non-Utility Generation (NUG) stranded costs. \$904,380,000 of the claim relates to operating NUG costs and \$54,790,000 pertains to NUG buyouts. (R.D., p. 46).

There are two types of "NUG costs". The first category consists of amounts paid to NUGs for electricity supplied to Penelec under contracts approved by the Commission. Penelec proposed to recover these ongoing costs under the Nug Cost Rate (NCR). The second category consists of costs paid to buy-out, buy-down, or restructure obligations to NUGs. Penelec proposed to amortize these amounts over three years. Both the NCR and the buyout amounts [along with nuclear decommissioning costs] were components of the "Other Transition Charge" ("OTC") proposed by Penelec. (R.D., p. 48).

A. Quantification

1. Valuation of NUG Stranded Costs

a. Parties' Positions

Penelec contended that the asset valuation method of establishing stranded cost was particularly inappropriate for establishing NUG stranded costs. Under Penelec's rationale, it simply purchased power from NUGs and did not make a profit. With its continuing obligations under the NUG agreements and the need for ECR-type recovery, Penelec contended that it should be able to recover costs for operating NUGs over the life of the contracts. In some cases, however, these have 20 more years left to run. (R.D., p. 48).

The intervenors, particularly the OCA, argued that NUG costs were known and quantifiable, based on the stream of payments required under the contracts, and that NUG stranded costs should be treated like any other stranded cost. The OCA argued that the "once and done" asset valuation method should be applied. Thus, the OCA asserted that the same discount rate as applied to other stranded costs should be applied. The OCA proposed utilization of a 7.29% discount rate. (R.D. pp. 48-49).

Penelec proposed using an alternate method of a 3.25 % discount rate based upon the after-tax cost of a medium term Treasury bill. (R.D., p. 51).

b. ALJ's Recommendation

ALJ Turner agreed with Penelec that the PVRR might be more appropriate for the operating NUGs if it produced a revenue stream. Penelec represented that there was no revenue stream since it never had and nor did it intend to make a profit on this source of power. The ALJ noted that there was no physical asset either, but the contract price stands in as a replacement of a unit that Penelec did not itself have to build. Therefore, the ALJ recommended the asset valuation for establishing NUG stranded costs. (R.D., p. 49).

The ALJ did agree with Penelec that a lower discount rate was appropriate because these were not profit-making arrangements, and Penelec did not own the generating facilities. The ALJ pointed out that Penelec had never earned a return on its NUG contracts and purchases, so a discount rate based on its rate of return is inappropriate. Therefore, the ALJ recommended adoption of Penelec's proposed alternate 3.25% discount rate of use in establishing NUG stranded costs. (R.D., p. 50).

c. Parties' Exceptions

The OCA excepts to the ALJ's recommendation, arguing that there is no justification for discounting NUG stranded costs any differently than Penelec's other stranded costs, for which the ALJ recommended using a discount rate of 7.29%. The OCA argues that by using a lower discount rate, Penelec would be provided an opportunity to overcollect on its NUG stranded costs. The OCA contends that if the Commission were to allow Penelec to earn a return on its stranded costs higher than 3.25 percent while applying a discount rate of 3.25 percent, Penelec would stand to collect more dollars than are needed for its future NUG obligations. (OCA Exc., pp. 7-9).

The OTS objects to the ALJ's recommended NUG discount rate of 3.25%. The OTS contends that if the NUG stranded costs are discounted at 3.25% and then recovered through the CTC at a return of 7.59%, Penelec will be earning 4.34% ($7.59\% - 3.25\%$) on the unamortized balances in the CTC associated with the NUG stranded costs. (OTS Exc., p. 13).

PICA contends that a single discount rate should be applied to all of Penelec's stranded costs. PICA states that the use of a 3.25% discount rate grossly exaggerates Penelec's NUG stranded cost claims. PICA avers that CTC revenues associated with NUG stranded costs are no different from CTC revenues associated with any other type of stranded costs. (PICA Exc., pp. 3-6).

d. Resolution

In determining an appropriate discount rate for the computation of the net present value of the NUG stranded costs, our preference is to treat the stranded cost consistent with other stranded costs and to discount the payment stream at the OCA discount rate of 7.1%. Our decision to not approve a separate NUG cost rate is based upon the arguments of the parties that the above market stranded costs are to be determined as a result of this proceeding and, therefore, any decision to stretch both *the determination and recovery until 2020 is inconsistent with the Act.*

Treating these stranded costs consistently and discounting the payment stream at the OCA discount rate also stems from the need of Penelec to hold this recovered revenue for the payment of future costs for an extended period of time. Additionally, we recognize that the greatest divergence from market price to contract price is occurring at present. On that basis, the best alternative is to discount based upon the cost of capital as computed by the OCA and to provide an interest rate in the CTC on the unamortized balance of the new CTC asset. This is alternative consistent with the treatment we accorded operating NUG payments in the PP&L Restructuring Proceeding at Docket No. R-00973954.

2. Operating Projects

Along with adjusted amounts from some of the other parties, Penelec's claimed NUG stranded costs in this category are listed as follows:

<u>Party</u>	<u>Amount</u>	<u>Source</u>
Penelec	\$904.380 million	PENELEC MB Table 1 at 8
MEIUG/PICA	\$936.834	MEPI MB, Table PENELEC-1
OCA	\$906.720	OCA RB, Table (PENELEC)
OTS	\$759.883	OTS RB, Penelec Table, 1

The variation in these estimates reflects the different market price numbers and the discount rates employed. No party has proposed disallowance of the costs of any contract. Finding the proposal to be reasonable and supported by the evidence of record we shall accept them as presented.

3. NUG Buyouts

The costs incurred by Penelec to buy-out, buy-down or restructure its respective NUG obligations are set forth below:

Penelec - NUG Buy-Outs	
Altoona Cogeneration Partners -	\$5 million
LG&E/ERIE -	\$23.7 million
Cogentrix -	\$26.09 million
Total	\$54.790 million

The OCA does not agree with the calculations of the buy-out of the Cogentrix/Ringgold project. Under its calculations, the net present value of the stranded costs of the contract is slightly below the buy-out amount. The OCA has included the project in its valuation of the operating NUG stranded costs.

The buy-out provision provides us with a known and measurable impact of the contract, rather than the contract provisions which are dependent upon the production of the NUG and present value estimates. We will, therefore, approve this contract as a buy-out rather than continue the contract as an operating NUG.

B. Recovery Proposals

1. Other Transition Charge; Non-Utility Generation Cost Rate; Competitive Transition Charge; Sharing

a. Overview

Penelec based its case on the theory that reliance was placed on full, actual and timely NUG cost recovery by utilities, project developers and their lenders. Penelec reasoned that since utilities rely on clear and consistently applied principles of timely NUG cost recovery as a prerequisite to entering into these agreements, and NUG developers and their lenders rely on these contracts as the sole source of project funding, any challenge to cost recovery could be serious. (R.D., p. 51).

The ALJ pointed out that Penelec, from the outset, sought and received full rate recovery from customers of costs proposed to be incurred under NUG contracts. According to the ALJ, every major NUG contract had been conditioned upon full recovery from customers. The ALJ continued that under these circumstances, the ECR became the rational choice for recovery of NUG costs. Penelec posited that the ECR allowed for timely recovery of all NUG costs. Also, inasmuch as utility shareholders never made any investment in NUGs and never assumed any financial risk in connection with such projects, the ECR afforded utilities a direct pass-through to recover NUG-related costs from customers. (R.D., p. 51).

According to the ALJ, the Commission has consistently allowed ECR recovery of costs incurred by utilities to purchase power from NUGs. See, e.g., Re: West Penn Power Company, 62 Pa. PUC 612 (1987), Re: West Penn Power Company, 62 Pa. PUC 606 (1987), AES Beaver Valley Inc., v. West Penn Power Company, 62 Pa. PUC 177 (1986). The ALJ continued that the ECR allowed a matching of utility payments to the NUGs with cost recovery from the ratepayers. From Penelec's perspective, the ECR afforded them the only sensible way, as a direct pass-through, to recover the NUG-related costs from customers. Penelec's ECR was rolled into its base rates as of January 1, 1997, the effective date of the Act. (R.D., p. 52).

Penelec argued that the ECR, or a mechanism that accomplishes the same result, is the only collection mechanism that has been found to be legal under PURPA and Pennsylvania law to collect NUG costs for utilities. Finally, Penelec maintained that it had a vested right to the ECR, or a mechanism that provided it with full and current recovery of NUG contract costs. (R.D., p. 52).

The ALJ noted that with regard to the mechanism for recovery of these costs, the Commission intended that all of a utility's NUG-related costs shall be included in its restructuring filing. The ALJ proffered the following cite of the generic Order⁴ directing that all known and measurable NUG-related costs be included within each utility's restructuring plan:

We would note that the utilities still have the right to recover NUG-related costs and that this order does not serve to deny them any right of recovery

⁴ Utility Recovery of NUG-related Expenses Under the Act, Docket No. M-00970939 (Order entered July 18, 1997, p. 3.) (R.D., p. 53).

of these costs. We find that the law is quite clear on the utilities abilities to recover such costs; however, the mechanism by which these costs will be recovered is within the discretion of this Commission....

The ALJ continued that the Commission entered an order July 18, 1997 at Docket No. M-00970939, which clarified certain provisions of the Act which pertain to NUG stranded costs. The ALJ noted that order the Commission specifically directed “[t]hat jurisdictional electric utilities with NUG-related expenses which are known and measurable shall incorporate these costs into their restructuring plans.”

b. Parties' Positions

With regard to the costs incurred by Penelec to buy-out, buy-down or restructure NUG obligations, Penelec sought an exception to the rate cap to collect these amounts via amortization over three years. (R.D., p. 59). Penelec's proposal to recover NUG buyout costs was based upon Section 527(b) of the Code, 66 Pa. C.S. Sec. 527(b), effective in July, 1996, which provides in part that in the event a NUG project is canceled prior to completing by mutual agreement:

the public utility may recover all costs to be paid to the project developer and all costs directly related to which are prudently incurred as a result of such cancellation....

Penelec argued that this language clearly contemplated full recovery of NUG buy-out costs. Penelec then turned to the provision of the Act which authorize recovery of NUG buyout costs, namely Section 2808(c)(2) of the Act which reads:

The Commission shall allow recovery of electric utilities prudently incurred costs related to cancellation,

buy-out, buydown or renegotiation or non-utility generating projects consistent with Section 527 (relating to cogeneration rules and regulations.)

And, finally, Penelec turned to Section 2804(4)(iii)(B) cross-references Section 527 which provides in relevant part:

(iii) An electric utility may seek, and the commission may approve, an exception to the limitations [rate cap] only in any of the following circumstances:

...
(B) Either the electric distribution utility is required to begin payments under contracts...and such costs were not previously covered in the competitive transition charge or intangible transition charge....shall be recovered over a period not to exceed three years, unless the commission determines...to require a longer period due to the magnitude of such costs...

The statute provided for the possibility of an exception to the rate cap for prudently incurred costs related to the cancellation, buy-out, etc. of non-operating NUG projects. Penelec argues its proposed cost recovery period of three years is consistent with the language found in the Act. Penelec did not seek an extended recovery period. (R.D., pp. 60-61).

PICA developed a CTC approach that, to a significant extent, ameliorated Penelec's concern about potential underrecovery of NUG stranded costs. In response to Penelec's concerns about flowing NUG buy-out benefits back to ratepayers, PICA proposed that any reduction to NUG stranded costs resulting from NUG buy-outs or buy-downs should be credited to the outstanding balance of stranded costs that had not yet been collected from ratepayers through the CTC." PICA asserted that:

“This approach would permit ratepayers to receive the full benefit of any NUG contract restructuring while collecting NUG stranded costs through the CTC over a defined time period. If a NUG contract was restructured after conclusion of the CTC recovery period, it would be appropriate for the Company to retain those benefits, associated with that buy-out or buy-down. (R.D., pp. 58-59).

c. ALJ’s Recommendation

ALJ Turner recommended rejection of Penelec’s request to use a NCR because the ALJ determined that the CTC was the proper collection mechanism for stranded costs. (R.D., p. 53). ALJ Turner noted that it appears that Penelec wanted to establish the right to have an exception to the rate cap without the certainty of having any monies to collect, or at least without knowing what the amount would be. The ALJ pointed out that the Act did not create a right to a rate cap exception, it merely allowed for the possibility of one. Moreover, the ALJ stated that she read Sub-Section 2804(4)(iii)(B) in the same way as the opposing intervenors did, i.e., that it was designed to apply to costs which arise after a CTC or an ITC was established, the ALJ found that this was not the case here. In the ALJ’s opinion it would be improper to establish a CTC and a rate cap exception simultaneously. (R.D., p.61).

ALJ Turner denied Penelec’s proposal to recover its NUG buyout costs as a rate cap exception. Nor was she receptive to establishing a rate cap later simply on the grounds that known costs were withheld from the CTC at the time it was established. (Utility Recovery of NUG-Related Expenses Under the Act, M-00970939 Order of July 18, 1997). The ALJ recommended that the Commission require Penelec and others to seek securitization before considering a rate cap exception for them. (R.D., p.62).

The ALJ further recommended that the CTC/NUG cost collection mechanism proposed by PICA be adopted regarding NUG operating projects because the proposal substantially mitigates any risk to Penelec shareholders, while providing ratepayers with a reasonable degree of price certainty for the duration of the CTC recovery period. (R.D., p. 59).

d. Parties' Exceptions

Penelec argues that the ALJ erred in rejecting Penelec's request to establish a NCR to recover operating NUG costs. According to Penelec, Section 2808(1) of the Act states that the Commission "shall allow recovery" of operating NUG costs. Penelec posits that the only way to assure full recovery is through a mechanism such as the NCR. Furthermore, Penelec argues that if the Commission denies recovery of operating NUG costs, via the NCR or a similar mechanism, the Commission will be renegeing on its previous commitments to Penelec and the operating NUGs. (Penelec, Exc., pp. 6-9).

Also, Penelec argues that the ALJ erred in rejecting Penelec's request for a rate cap exception to collect NUG buyout amounts. Penelec contends that this decision violates the Act and the Commission's policy favoring mitigation of above-market NUG costs. Penelec avers that the buyout amounts consist of costs that were not reflected in rates as of the effective date of the Act. Penelec argues that Section 2808(c)(2) states clearly that the Commission "shall allow" recovery of prudently incurred buyout amounts "consistent with section 527...", and that the relevant language in Section 527 was enacted months prior to enactment of the Act. (Penelec Exc., pp. 10-11).

The OTS alleges that the ALJ erred in failing to select a stranded cost calculation for the NUG operating projects. The OTS claims that the ALJ did not quantify her recommendation for the total stranded costs to be awarded to Penelec and the methodology that would bring about that number. (OTS Exc., p. 14).

AES argues that the ALJ does not explain how the CTC proposed by PICA will have the desired equitable result. AES states that the ALJ emphasized that the CTC must be reconciled based on actual market prices to reflect the costs under approved projects, but is unclear how that will be accomplished. (AES Exc., p. 4).

ARIPPA claims that the ALJ erred on the following points: (1) the ALJ relied on both an improper and unnecessarily restrictive interpretation of the Act itself; (2) the ALJ erroneously interpreted and applied prior Commission orders; (3) the ALJ has either overlooked or grossly under-considered the significant extent to which actual NUG-related stranded costs will vary over time, therefore precluding their inclusion in a "once and done" CTC at this time; (4) the ALJ has misapplied or misinterpreted federal law with respect to the recovery of future NUG costs as well as the recovery of deferred and accumulated NUG costs. (ARIPPA Exc., pp. 7-32).

ARIPPA supports Penelec's NCR proposal, but contends that the ALJ failed to address and reject Penelec's plan to include the NCR as an item on customer's bills. (ARIPPA Exc., pp. 36-38).

Allegheny Power excepts to the Recommended Decision arguing that the ALJ erred by not allowing full recovery of NUG operating and buyout costs, contrary to the intent of the Legislature in the Act. Allegheny Power states that the Act allows for recovery of NUG buy-out costs outside of a utility's competitive transition charge. Also, Allegheny Power disagrees with the ALJ contending that

PICA's "netting" proposal violates the Act's command that utilities be allowed to fully recover stranded NUG costs and conflicts with the Public Utility Code, which provides incentives for utilities to buyout of their above-market NUG contracts. (Allegheny Power Exc., pp. 8-10).

e. Resolution

Penelec vigorously opposed the application of net present value (NPV) to NUG contracts, which they call the "once-and-done" approach. Based on the record as adopted and the arguments of the intervenors, particularly the OCA, we disagree. We find the ALJ's Recommendation that the CTC is the proper collection mechanism to be reasonable and in accord with the evidence.

We hasten to point out that the Act should be read to mean that the CTC is the proper collection mechanism for all stranded costs, including NUG costs. In arriving at a determination not to use an NCR, we are sensitive to the need of Penelec to recover its payments to its NUGs. Accordingly, we shall grant the stranded NUG costs claimed by Penelec, as adjusted herein, and we shall amortize the said costs over the CTC period. This is consistent with the specific requirements of the Act in determining the components of a CTC. See, 66 Pa. C.S. Section 2808(c)(1).

We note that Penelec petitioned to eliminate the ECR from its' tariff and roll its' energy costs into base rates. This was a voluntary action not required by the Act. By such action Penelec chose to forego an annual reconciliation of its fuel and purchased power costs including NUG related expenses. By rolling in the ECR, Penelec removed flexibility accorded the Company under the code. Such flexibility is not restored by 2808(c)(1), but we are required to fully account for

the stranded costs of the NUG contracts. We find that our treatment does provide full recovery based upon our determinations and analysis of the record presented to us.

Section 2808(c)(1) must, however, be read in conjunction with the rate cap exceptions that are accessible by any utility. Specifically, Penelec may track its NUG costs, without the provision for automatic adjustment, but exercise its right to file for recovery under the rate cap exception at Section 2804(4)(iii)(B). This is not a guarantee of recovery, but it is an opportunity for recovery if Penelec, or any utility, can convince us of the appropriateness of its claimed rate cap exception.

We will not exercise our authority under Section 508 of the Public Utility Code to reform a NUG contract after we have approved that contract. It is axiomatic that such reformation authority must be exercised prior to approval of the contract and be consistent with the Third Circuit Court's decision in Freehold Cogeneration Assoc., L.P. Board of Regulatory Commissioners of the State of New Jersey, 44 F.3d 1178 (3rd Cir.) cert. denied, 516 U.S. 816 (1995).

The OCA proposed that Penelec undertake NUG divestiture, and Penelec, in its Exceptions, has agreed that such a proposal could provide a treatment of valuation for NUG assets consistent with Penelec's proposal for divestiture of its own generating assets. We believe that Penelec should explore such a proposal by first reviewing its contracts for barriers to such an action. The unique properties of certain NUGs may be attractive to a particular electric generation supplier as it develops its portfolio of assets. Additionally, an EGS may bring a unique compensation package to the NUG which they may consider more attractive than the provisions of its current contract. We do not believe we can direct such a NUG

divestiture program due to Freehold, supra, but we could consider any reassignment, sale or transfer of a contract which resulted from such a program.

C. Request for Specific Approval of NUG Petitions

Penelec originally requested recovery of stranded costs associated with twelve NUG projects that it was unable to buy out or restructure. The twelve Penelec NUG projects include: Cambria, Colver, Conemaugh, Ebensburg, Indiana University, Lakeview, Composite, Piney Creek, Scrubgrass, Youghiogeny, Homer City Modular and AES (York County). (R.D., p. 50).

The ALJ has considered each individual project NUG at their respective docket numbers.⁵ The Altoona Cogeneration Project (P-00971215, R-00974009); The Erie Power Partners Non-Utility Generation Project (P-00971278, R-00974009); The Cogentrix (Ringgold) Cogeneration Facility (P-00981324, R-00974009); and Rubenstein Engineering, P.C. (P-00900450, R-00974009). In each of the cases, ALJ Turner recommended the collection of the costs through the CTC, consistent with the instant Restructuring case.

1. AES Agreements - Buy-outs of the York County Energy Partners, Blue Mountain Power and Altoona Cogen Projects

a. Overview

The York County Energy Partners, Blue Mountain Power and Altoona Cogen Projects were all bought out through the integrated transaction with AES. The York County Energy Partners and Blue Mountain Power Projects were Met-Ed NUG

⁵ At the request of Penelec and certain other Parties the ALJ issued separate Recommended Decisions for each PPA.

obligations. The Altoona Cogen Project was a Penelec NUG obligation. As a result of the restructuring agreements, the three projects are grouped together under the rubric of the Ironwood or AES Ironwood project. It appeared that total stranded costs would be significantly less with the buy-outs of these three projects. (R.D., p. 63).

b. Parties' Positions

The AES agreement (Ironwood) was coupled with the buyouts of York Country Energy Partners, Blue Mountain Power and Altoona Congen. Effectively, Ironwood was a replacement project for the three projects, having bought the Purchase Power Agreement (PPA) rights from the former developers. Ironwood had combined the PPA's into a larger dispatchable merchant project. Evaluation of the Ironwood project by Penelec, the OCA and the Industrials have yielded similar results in that the project would produce net negative stranded costs over its contract life and offset the above market costs of the other NUGs. HSS opposed the recognition of the project, claiming it was a new project subject to new estimates of avoided costs. HSS contended that such a position is, however, inconsistent with the actual facts of the project development. (R.D., p. 63).

The OCA had suggested amending the Ironwood contract to remove regulatory approvals language relating to any above market costs incurred claiming it to be inconsistent with the Act. Penelec and AES opposed the revision as tantamount to removing the federal protection for recovery of actual costs paid. (R.D., pp. 63-64).

c. ALJ's Recommendation

ALJ Turner stated that this issue should be decided so as to be consistent with Commission policy on collection of NUG costs under the Act. The

ALJ concluded that the condition OCA proposed was consistent with that policy and therefore recommended adopting the OCA's modifications to the AES Agreements. (R.D., p. 65).

d. Parties' Exceptions

Penelec contends that the ALJ erroneously adopted the OCA's modification to the AES Agreements, thereby eliminating Penelec's right to recover actual NUG costs. (Penelec Exc., p. 12).

The OCA asserts that since the contract results in negative stranded costs, these stranded costs should be used to offset Penelec's other NUG stranded costs. The OCA calculates that on a retail jurisdictional basis, Penelec's negative stranded costs for AES Ironwood are \$33.77 million. The OCA argues that this is the amount that should be used as an offset to Penelec's other NUG stranded costs. (OCA Exc., p. 2).

The OCA also submits that a net present value of \$4.24 million of buy-out cost recovery for the Altoona Cogen Project should be placed into Penelec's CTC to be recovered over seven years with a return provided on the unamortized balance. (OCA Exc., pp. 3-4). The OCA contends that all buy-out costs, including those for the Altoona Cogen Buy-Out, should be spread out over the full seven-year CTC period, with a return provided on the unamortized balance. (OCA Exc., pp. 4-5).

AES contends that the Recommended Decision failed to clearly establish how the proposed recovery of operating project costs provides reconciliation of the CTC to protect against underrecovery of NUG obligations. AES also asserts

that it is not appropriate for the Commission to engage in rewriting the agreement between AES and GPU. (AES Exc., p. 6-9).

HSS/ARI offers a qualified exception to the ALJ's recommended approval of the AES Agreements stating that the AES costs are excessive and the Agreements must include ratepayer protections. (HSS/ARI Exc., pp. 14-23).

e. Resolution

It is well settled that electric utilities are entitled to recovery of their NUG commitments. However, the mechanism by which the costs will be recovered is within the discretion of this Commission. Accordingly, based on the record as developed in this proceeding, we grant Penelec's Exception to the ALJ's Recommended Decision on this point. We believe our treatment of this issue will ensure full recovery of costs as is necessary under federal law. We will approve the contract as originally requested.

2. Approval of Penelec's Recovery of Costs Related to the Homer City Modular Project - P-00900450

a. Parties' Positions

Neither Penelec nor the OCA discussed this buy-out. In fact, the OCA referred to it as the one operating NUG that Penelec had been unable to negotiate with successfully. However, counsel for the NUG project group had included this project in their Main Brief, AES MB at Appendix 5, 4th document, and had requested that a Recommended Decision be issued approving it. (R.D., p. 65).

b. ALJ's Recommendation

Penelec's Petition for Full and Current Approval of Rate Under the Energy Cost Rate for Costs Paid Under the Agreement with Rubenstein Engineering, P.C., docketed at P-00970450 was consolidated with this proceeding by the Commission by its Opinion and Order of October 6, 1997, which was recognized in Interim Order No. 4, dated October 10, 1997. Unfortunately, this Petition sought approval of ECR recovery which was no longer available. ALJ Turner recommended approval of recovery of costs through the CTC. (R.D., p. 65).

c. Resolution

We note that no party filed Exceptions relative to the ALJ's recommendation on this issue. Finding same to be reasonable and in accord with the evidence we shall adopt the ALJ's recommendation.

3. Erie/LG&E Buy-out - P-00971278

a. Parties' Positions

Penelec's buy-out of the Erie/LG&E Project reduced Penelec's overall stranded costs. Neither the OCA nor any other party opposed recovery of these buy-out costs, and the OCA included them as part of Penelec's total retail stranded costs. (R.D., p. 66).

b. ALJ's Recommendation

ALJ Turner recommended that this agreement be approved. (R.D., p. 66).

c. Resolution

We note that Penelec has represented its claim for NUG buy-out costs until it can assess the results of the divestiture auction, because Penelec may be willing to offset the buy-out costs against profits from the sale. It is apparent that Penelec's buy-out of the Erie/LG&E Project will reduce the Company's overall stranded costs. Accordingly, the ALJ recommended that we approve the agreement. No party excepted to this recommendation. Finding the recommendation to be reasonable and in accord with the record evidence, it is adopted.

4. Penelec's Buy-out of The Cogentrix Project

a. Parties' Positions

This buyout was a result of Penelec's mitigation effort through its reverse Request For Proposal conducted in 1997 for NUG projects. The OCA opposed the buyout due to the lack of estimated net benefit under the OCA's assumptions. Under its calculations, the net present value of the stranded costs of the contract was slightly below the buyout amount. (R.D., pp. 66-67).

Penelec argued that the record as developed indicates that the buy-out would eliminate \$32.8 million in stranded costs based on an estimated closing date for the buy-out agreement of July 1, 1998 (R.D., p. 67).

b. ALJ's Recommendation

ALJ Turner recommended approval of this buyout.

c. Parties' Exceptions

The OCA objects to the recommendation arguing that it is not clear that this buyout will be economic and provide mitigation of stranded costs. (OCA Exc., pp. 9-10).

d. Resolution

Premised on our review of the record we find that the buyout is in the public interest. We conclude that the certainty of the buyout amount is known and measurable versus the estimated stranded cost of continuing the contract. Where there is a close call as to the net benefits, we find the security of the buyout amount is beneficial. We find the ALJ's Recommendation to be reasonable and, therefore, it is adopted.

D. Post January 1, 1997 Operating NUG deferrals

a. Overview

Prior to January 1, 1997, Penelec was recovering all NUG costs through its ECR. On January 1, 1997, Penelec rolled its ECR into base rates. (R.D., p. 67).

b. Parties' Positions

In oral surrejoinder, Penelec claimed that it was deferring operating NUG payments in the amount of \$31.2 million, with expected recovery through the NCR. This amount is claimed to be in excess of base rate recovery. (R.D., p. 67).

Penelec continued that the its capped rates did not allow recovery of all of Penelec's costs related to payments to operating NUGs, and the under-recovery would continue through 1999. Since the January 1, 1997 effective date of the Act, Penelec had been deferring all operating NUG costs in excess of amounts contained in base rates (currently \$ 31.2 million for Penelec) and, as Mr. D'Angelo testified, Penelec proposed to recover these amounts through the NCR. (R.D., pp. 67-68).

The OCA had taken a position on these costs. The OCA opposed Penelec's claim that it continued to under-recover its NUG costs under its January 1, 1997 rates. The OCA's witness Catlin performed a review of Penelec's earnings analyses which demonstrated that even after Penelec's ECR was rolled into base rates, the rates for Penelec were sufficient to cover these costs and provide a fair rate of return. (R.D., pp. 68-69).

c. ALJ's Recommendation

The ALJ had disallowed this claim with a finding that base rates were adequate to recover the amount without adversely affecting the earnings of Penelec. (R.D., p. 69).

d. Parties' Exceptions

Penelec argues that the ALJ erred in rejecting its proposal to recover its deferred NUG undercollections. Penelec argues that, rather than relying on PECO Energy, the ALJ should have relied on the Commission's Motion adopted on May 14, 1998, in the PP&L proceeding at Docket No. R-00973954. (Penelec Exc., pp. 11-12).

The NUG Group disagrees with the ALJ and asserts that precedent in PECO Energy does not require rejection of Penelec's deferred NUG cost claim. (NUG Group Exc., pp. 16-30).

e. Resolution

Quantification of this deferral in the claims of Penelec remains unclear. Penelec has a deferred fuel claim of \$8.42 million as a regulatory asset. Penelec's foundation for its NCR claim of \$904 million is taken directly from the testimony of its witness Herrigel. Exhibit GJH-7R(2). That document ties to the previously discussed joint testimony of Penelec witnesses Graves and Roberts for post-1999 NUG production.

Reviewing the record before us, we find that Penelec has failed to properly document and claim this deferral. We will, therefore, deny Penelec's Exception relative to this issue.

E. Summary

We have not adopted Penelec's proposed NCR, preferring to use a fixed term CTC rather than the life of NUG contract based NCR. We agree that

we must allow the recovery of the contract amounts due to operating NUGs to be consistent with regulatory practice and federal law. To that end, we have herein described our assumptions for the computation of the CTC allowance for operating NUGs. As with other stranded elements, we have used the OCA's discount rate to determine the 1999 value of the NUG payments and buyouts and will provide an interest rate for the unamortized balance of the CTC. Finally, we encourage Penelec to examine its NUG contracts for the opportunity to sell and/or transfer them to other entities.

V. QUANTIFICATION AND RECOVERY OF OTHER STRANDED AND TRANSITION COSTS

A. Introduction

The following table summarizes Penelec's stranded costs relating to generation assets it owns, its regulatory assets and liabilities, nuclear decommissioning obligations and its expenses to transition to electric generation competition under the Act.

Summary of Non-NUG Stranded and Transition Costs

(In Thousands)

	Penelec	<u>OCA</u>	<u>OTS</u>
Owned Generation Commitments (via CTC)			
Nuclear	99,230	70,235	40,658
Fossil	(6,560)	(425,114)	338,587
Regulatory Assets and Liabilities (via CTC)	<u>161,040</u>	<u>27,983</u>	<u>52,153</u>
	\$253,710	\$326,896	\$245,777
Nuclear Decommissioning	<u>108,960</u>	<u>67,764</u>	<u>71,343</u>
Total	\$362,670	\$298,813	\$174,434

B. Appropriate Discount Rate

Penelec claimed its after-tax cost of capital of 7.85%, incorporating a common equity value of 11.5%, as the discount rate. PICA used this rate without specifically endorsing its validity. (R.D., p. 72).

The Company and three parties addressed the discount rate. The OCA recommended adopting the 10% common equity value from the Commission's ruling in PECO; using this, the OCA derived a discount rate of 7.12% for Penelec (R.D., p. 72). The OTS proposed a discount rate of 6.94 % for Penelec, using a weighted return on common equity of 6.44%, comprised of a risk-free rate of 5.75% and a market rate of 9.75% (R.D., p. 72). Lastly, HSS/ARI proposed a 5.88% after-tax cost of capital to be used as Penelec's discount rate. (R.D., p. 74).

1. ALJ's Recommendation

The ALJ recommended that the Commission adopt Penelec's discount rate of 7.85 % for use in this case concluding that the rates on common equity and discount rates are not a one size fits all proposition. Penelec's barometer group and market signals are different than PECO's and there are other elements of the calculation that are different as well. (R.D., pp. 72-73).

2. Parties' Exceptions

The OCA submits that the 7.12 % discount rate would be more appropriate. The OCA developed this discount rate based upon common equity value of 10% which the Commission initially adopted for PECO in its May 1997 QRO. The OCA contends that in the PECO restructuring case, the Commission adopted the OCA's discount rate of 7.6 % which also contained a 10 % equity return. The OCA submits that use of a 10 % return on common equity for Penelec is reasonable and the OCA's discount rate of 7.12 % should be adopted. The ALJ, in rejecting the OCA's recommended discount rate, was concerned that Penelec's capital structure, not PECO, should be used in calculating the discount rate. The OCA maintains that it did accept the Company's capital structure and long term debt and preferred stock cost rates as set forth by the Company. (OCA Exc., pp. 10-11).

The OTS disagrees with the ALJ and asserts that the appropriate discount rate for use in this proceeding is 6.94 %. The OTS notes that it revised the discount rate for Penelec as a result of the cost of equity decreasing from 10.50 % to 9.75 % to account for changes that have occurred in the dividend component of the DCF analysis. (OTS Exc., pp. 6-7).

HSS/ARI advocates the use of an after-tax cost of capital of 5.88 %. HSS/ARI submits that the 5.88 % cost of capital is appropriate to calculate stranded cost. The use of this rate would be fully consistent with the low-risk faced by Penelec with respect to its recovery of stranded costs. HSS/ARI submits that Penelec faces a reduced risk of stranded cost recovery, *inter alia*, because of non-bypassable CTCs, the potential for accelerated depreciation and available irrevocable securitization. In addition, HSS/ARI submits that the California Public Utilities Commission (CPUC), has recognized the low risk associated with stranded cost recoveries by reducing utilities' return on equity (ROE) associated with stranded cost recoveries. Specifically, the CPUC has allowed each utility a ROE equal to the utility's embedded cost of debt, less 10%. If a utility decided to divest 100% of its generating assets, as proposed by Penelec here, the CPUC would allow the ROE to be increased to the embedded cost of debt, *i.e.*, eliminating the 10% discount. (HSS/ARI Exc., pp. 23-24).

HSS/ARI recommends that the Commission set Penelec's ROE associated with stranded cost recoveries equal to Penelec's embedded cost of debt, *i.e.*, at 7.47%. The total after-tax cost of capital would be 5.88%, which Dr. Weisenmiller recommended for purposes of calculating Penelec's stranded costs. *Id.* at 58:4-7. HSS/ARI submits that the Commission should adopt its recommendation as fully consistent with the ALJ's recognition, and the undisputed fact, that Penelec will face a low risk in recovery of stranded costs authorized by the Commission. (HSS/ARI Exc., pp. 23-24).

3. Resolution

Penelec has calculated its net present value through the use of a discount rate based on an after-tax weighted average cost of capital. Its calculation incorporates a cost of equity of 11.50% and results in a figure of 7.85% for analysis purposes. The Industrial intervenors have adopted the Company discount rate. The ALJ in adopting the Industrial intervenors' position uses a similar discount rate for Company owned generation and regulatory assets.

We find the OCA discount rate of 7.1 % is most appropriate for the purpose of our analysis and the reduced risk which results from a CTC-based recovery versus historic base rate recovery. We find the 10% cost of equity to be within the range of expected DCF results and risk premiums above the long term cost of debt. We note that the Federal Energy Regulatory Commission (FERC) has been consistently finding cost of equity to be below this rate level.

C. Company-Owned Generation

1. Introduction

A competitive auction process is already underway for the divestiture of the Penelec's non-nuclear generation facilities. Thus, the actual results will be available to replace the estimates of plant value, and can be addressed in a second step to these proceedings. This plan as outlined was acceptable to all the active parties. (R.D., p. 75).

Nevertheless, the owned-generation stranded cost calculations presented in these proceedings are important so that the Commission can establish interim rate unbundling

and stranded cost recovery, pending a successful divestiture. Interim mechanisms can be made permanent for any plant which remains unsold. (R.D., p. 75).

The OCA did not oppose Penelec's divestiture proposal but recommended that its own determination of stranded cost, not Penelec's, be used in establishing the interim CTC. The OCA contended that Penelec overstated its stranded cost claim for owned-generation related assets. (R.D., p. 75).

For the most part, the Company net book values for its property are unchallenged. From this level a market value is deducted resulting in the value of stranded cost. The Company proposal to divest its generation substitutes this administrative determination with a definitive market based valuation. The principle market value technique for our interim determination is the market lines previously discussed, and we will not reiterate those issues here. A number of other adjustments to the market values have been proposed and quantified and will be discussed here.

Penelec's owned generation assets included in stranded cost are: a share of TMI 1; five steam generating stations, Homer City 1 & 2, Homer City 3, Shawville, Seward, and Warren; three hydro facilities, Piney, Deep Creek and Seneca; and other CTs. Penelec claimed a net negative value for Homer City 1 & 2, Homer City 3, Seneca, and the CTs. Its total net positive stranded cost claim is \$92,670,000, comprised of two basic components: (1) the revenue which the Companies would have been entitled to recover for these plants under traditional rate regulation compared to (2) the revenue these plants might realize in the emerging competitive electricity generation marketplace. Each station was assumed to be in service for its life, as established in the most recently filed and accepted ADR, dated June 1997. (R.D., p. 76).

The OTS adopted the PVRR approach also, but used a very different rate of return to calculate revenues as they would be under regulation, a different discount rate, and a different cost of capital for stranded cost recovery. (R.D., p. 76).

The OCA used the asset valuation methodology and different assumptions from the Company's, including a different market price of electricity, which is a major cause of the difference in their positions. In applying the asset valuation methodology, the OCA estimated the going-forward costs for each generating plant, including fuel, operation and maintenance expenses, capital additions, administrative and general expenses, interest on working capital, and taxes other than income taxes. HSS/ARI adopted the asset valuation method, and applied a discount rate of 5.88%. (R.D., p. 77).

The industrials used the asset valuation model, and a different market price of electricity, but adopted Penelec's discount rate of 7.85%. The industrials proposed life extension rather than retirement for several units. The industrials used an equity return disallowance derived rate of 3.84% if stranded costs are found to exist. (R.D., p. 77).

2. Plant Lives and Life Extensions

a. Parties' Positions

The OCA stated that cost-effective life extension is a basic component of a utility's duty to mitigate costs. According to OCA, since the primary measure of a generating unit's market value (as opposed to its net present value for stranded costs) is the net present value of the net revenues that can be expected from the facility, life extensions which add net revenue potential by extending the life beyond the book life through cost effective measures should be included in the analysis and determination of stranded cost. (R.D., p. 78).

The industrials identified one key difference between Penelec's approach and their own approach to generation stranded cost quantification as being the computation of *remaining lives of certain generating units*. Specifically, the industrials included life extension costs of \$19.7 million in 2000, \$48.6 million in 2001, and \$3.9 million in 2003 (R.D., p. 79).

Penelec asserted that the industrials were attempting to transplant the life extensions proposal from the PECO restructuring case into this proceeding, and then to apply them to Penelec's owned generation. Penelec contended that it had used a consistent set of plant lifetime assumptions that came directly from accepted regulatory filings with the Commission, and that these are far more appropriate than those used in the PECO case. (R.D., p. 80).

b. ALJ's Recommendation

The ALJ recommended that the industrial's proposed plant life extensions for Penelec's plants should not be adopted for use in calculating Penelec's stranded costs. The ALJ stated that Penelec intends to get out of the generation business, thus if these plants are to be sold, then the new owners will make decisions about extending their useful lives. The ALJ continued that if they are not sold, Penelec will retire them as part of its changing business plan. In either event, they will not be actively operated by Penelec. The ALJ found that under these circumstances, the future market price of electricity does not have much relevancy to the lives of these plants, but retirement does. The ALJ concluded that while we cannot anticipate every outcome of the auction, in this instance, the proposed sale tends to support Penelec's analysis and conclusions. (R.D., p. 80).

c. Parties' Exceptions

Penelec repeats its assertion that it used a consistent set of assumptions that came directly from regulatory filings accepted by the Commission. Penelec objects to life extension proposals offered by other parties as improper and misplaced. Penelec contends that the ALJ adopted life extensions proposed by PECO in its restructuring case in spite of the fact that such evidence has no basis in the record of this case. (Penelec Exc., pp. 12-13).

The OCA asserts that, to be consistent her decision in the Met-Ed case, the ALJ should have adopted PICA's proposed life extensions, thereby giving identical units similar treatment between Penelec and Met-Ed. The proposed life extensions are supported by the record evidence and represent appropriate mitigation efforts. (OCA Exc., pp. 12-13).

PICA also contends that the ALJ was inconsistent in her recommendations on life extensions for Met-Ed and Penelec generating units. (PICA Exc., p. 18).

HSS/ARI argues that the ALJ's recommendation ignores studies supporting continued operation of some facilities. HSS/ARI demonstrates there is ample evidence -- including studies performed by Penelec itself when it is not trying to extract stranded costs from its customers -- to support a far different expectation of plant lives than claimed by Penelec in this proceeding. HSS/ARI submits that Penelec compounds its error by asserting that opposing participants "failed to include, or even identify, the costs associated with the life extensions they proposed." Lastly, HSS/ARI notes that the Recommended Decision did not weigh or review critical data on this issue which directly contradicts the unsupported presumption that the units will be retired. (HSS/ARI Exc., pp. 23-24).

d. Resolution

Unlike the companion case of Met Ed, the OCA proposed no life extension of Penelec's units. The Industrial intervenors proposed life extensions, but those were rejected by the ALJ. We agree that no life extensions should be included based upon this record.

The ALJ did accept an adjustment proposed by HSS to reduce the value of the future capital additions by 25% from the Penelec's estimates. This adjustment, however, appears to be arbitrary as HSS does not point to any particular addition as being necessary but merely adjusts the level of additions in total. This adjustment is not supported by the record in any way and may be irresponsible as it neglects the necessity to maintain units for reliable service and the potential need to meet more stringent environmental requirements in the future. We therefore grant the Company's exception on this issue. No adjustment is necessary to our use of the OCA valuations to reflect this decision.

3. O&M Spending Levels and Productivity Factor

a. Parties' Positions

The OCA accepted Penelec's projected O&M spending levels reflected in the development of stranded costs, but used different inflation assumptions and inserted a productivity factor of 0.2%, both of which Penelec rejected. Penelec's O&M costs were based a year-by-year work plan that recognized current and planned productivity and cost reduction efforts. (R.D., p. 81).

The OCA stated that Penelec's O&M forecasts do not include any improvements in O&M costs due to competition. (R.D., p. 81).

b. ALJ Recommendation

The ALJ recommended that the 0.2% productivity factor be adopted to reflect the competitive forces which will interact with the generating units. The Commission adopted the identical productivity adjustment, proposed by the OCA, in the PECO case.

c. Parties' Exceptions

Penelec opposes applying a productivity factor to claimed O&M costs contending that its estimate of O&M spending already assumed past increases in productivity. Penelec asserts that the ALJ's imposition of a 0.2 % productivity factor is inappropriate (Penelec Exc., p. 13).

HSS/ARI maintains that Penelec is completely wrong in claiming that the ALJ ignored Penelec's historic productivity improvements. HSS argues that to the contrary, the ALJ considered Penelec's claims at length and concluded that Penelec's historic efforts "show a mixed bag of results."

HSS/ARI submits that Penelec also ignores the fact that while its historic efforts did lead to some cost reductions, the record shows -- and Penelec admitted -- that it did not pass those savings on to ratepayers *via* a rate reduction. HSS/ARI contends that Penelec retained the savings for shareholders, earning a 13.5% return on equity since 1986, when it last filed a rate case.

HSS/ARI submits, that Penelec ignores that Section 2808(c)(5) of the Act requires the Commission to consider "efforts undertaken . . . prior to the enactment of [the Act] to reduce or moderate customer rate levels, *i.e.*, a measure that Penelec admits it did not undertake. HSS/ARI continues that Penelec also ignores that while Section

2808(c)(4) of the Act requires the Commission to consider past mitigation efforts, as an independent factor, Section 2808(c)(4) imposes an affirmative obligation upon utilities to undertake efforts during the transition period to mitigate stranded. HSS/ARI argues that this is of particular relevance because the ALJ found that Penelec's forecasts of O&M expenses did not include a productivity factor for improvements that should be caused by competition. (R. Exc., pp. 19-20).

d. Resolution

The OCA has incorporated into its estimates a productivity adjustment for future operations and maintenance expense of a 0.2% reduction to the inflation of the expense. The purpose is to reflect the competitive forces which will interact with the generating units. With the adoption of the OCA inflation levels, a productivity adjustment is also consistent with the estimates. No adjustment is necessary for our use of the OCA valuation.

4. Land Valuation

a. Parties' Positions

Penelec claimed negative land value in two places, which amounted to (\$550,000) and (\$3,500,000). Penelec calculated the value of land for stranded cost purposes based on assessed value for property taxes. (R.D., p. 83).

The OCA approach assumed that the value of land had increased at a rate of 4% per year since the related plant was constructed. (R.D., p. 83).

b. ALJ's Recommendation

The ALJ recommended that Penelec's claimed land valuation cost be included in its stranded costs. Since the assessed value of land for tax purposes in Pennsylvania is based on "market value," this measure of value is far more appropriate than OCA's annual 4% increase. (R.D., p. 83).

c. Resolution

In a similar adjustment in the PP&L restructuring case, we found that escalating land value was not appropriate. Land, ultimately, is an offset to the fossil decommissioning of the facility. As we are not permitting a recoverable claim for fossil decommissioning, we should make no adjustment for escalating land value as a stranded cost offset. The OCA valuations will be adjusted to remove the escalated land valuation.

5. Net Book Investment In Plant and Accuracy of Projections

a. Parties' Positions

HSS/ARI argued that the Commission should not assume that Penelec's net book investment in plant between 1986, when it filed its last rate case, and the effective date of the Act, represents prudent and reasonable expenditures. HSS/ARI determined that Penelec had made approximately \$294 million of capital additions. HSS/ARI asserted that the Commission could exclude all of these capital additions, but allowing as how that might be harsh, they proposed a 50% exclusion (net of depreciation) of the \$294 million in generation-related capital expenditures to balance the interests of all concerned. The adjustment would amount to a disallowance of \$147.5 million. (R.D., p. 84).

Penelec argued that its O&M expenditures were reviewed, by the Commission, subsequent to 1986. Penelec argued that there is evidence in its filing, and hence in the record, to support its historic capital additions and O & M expenditures. (R.D., pp. 84-85).

b. ALJ's Recommendation

The ALJ recommended against adopting HSS/ARI's proposed 50% adjustment to net plant investment between the years of 1986 and 1997. The Commission entered a show cause order on May 29, 1992, in response to a Joint Petition by the OCA and the OSBA at Docket No. I-00920018. Thereafter, the Commission completed a thorough investigation of Penelec's capital expenditures, O&M level and earned return. The information provided by Penelec satisfied the Commission, which entered an order on May 6, 1993 terminating its investigation. (R.D., p. 85).

c. Parties' Exceptions

HSS/ARI recommend that, to balance the interests of ratepayers and shareholders, it would be appropriate, to disallow 50% (net of depreciation) of the \$294 million in generation-related capital expenditures that Penelec made between 1986 and the present. However, HSS/ARI submits that if the Commission believes that a 50% disallowance is excessive, then the Commission can in its discretion provide for a lesser disallowance. HSS/ARI maintains that in no event should Penelec be permitted, with impunity, to shield almost \$300 million in expenditures from scrutiny over a ten-year period and then get a "free pass" to foist the entirety of those costs on ratepayers without any proof that the expenditures were reasonable. Failure to grant substantial, meaningful relief with respect to this issue would be error. (HSS/ARI Exc., pp. 21-27).

d. Resolution

We adopt the ALJ's recommendation and reject the HSS/ARI argument to adjust by 50%, net plant between the years of 1986 and 1997. We agree with Penelec's argument that the record evidence supports its historic capital additions and O & M expenditure, and that HSS/ARI has failed to submit evidence that demonstrates that Penelec's capital expenditures were not reasonable or prudent. No adjustment is required.

6. Penelec Over Budgeting -Historical Capital Budgets

a. Parties' Positions

HSS/ARI asserted that Penelec's budget amounts compared to its expenditures have been consistently high and wide of the mark. HSS/ARI argued that the Commission should be very skeptical of Penelec's projections of costs and expenditures in this case. HSS/ARI asserted that Penelec has a history of over estimating its capital budgets. HSS/ARI argued that Penelec's projected generation-related capital expenditures should be reduced to adjust for its history of over budgeting. (R.D., p. 85).

HSS/ARI recommended reducing Penelec's forecast of generation-related capital expenditures by 25%, which would reduce Penelec's projected generation plant capital expenditures by \$119 million in nominal terms over Penelec's stranded cost horizon. HSS/ARI conclusion that Penelec's inability to budget with accuracy are unrebutted. Therefore, for purposes of accounting for Penelec's projected costs, HSS/ARI assert that the Commission should reduce Penelec's capital expenditure projections by \$119 million on a nominal basis, and that this result is fully consistent with the Commission's decision in PECO (R.D., p. 86).

b. ALJ's Recommendation

The ALJ recommended that the Commission adopt HSS/ARI adjustments of \$119 million for Penelec. Assuming that the record contains information for ten years, as was used in PECO, and that produces a smaller adjustment, the ALJ recommend using the smaller amount. The Commission excluded 5% of PECO's budgeted capital additions to reflect a more reasonably likely expenditure based on its history of overbudgeting capital expenditures by at least 5% over the last 10 years. The adjustment reduced PECO generation asset book value as of December 31, 1998 by \$14 million. Therefore, the ALJ concluded that if the Commission is to adopt the HSS/ARI adjustment, and follow the PECO precedent, the Commission should reduce Penelec's generation asset book value as of December 31, 1998 by \$119 million. (R.D., p. 86).

c. Parties' Exceptions

Penelec contends that its claimed capital additions and O&M expenditures are reasonable and supported by evidence in the record. Penelec argues that the magnitude of the capital expenditure adjustment recommended by the ALJ has no support from any witness in this proceeding. In addition, Penelec maintains that if the logic of the adjustment was to prevail the amount of the adjustment would be \$21.2 million rather than the ALJ's \$119 million disallowance which has no support whatsoever in the record.(Penelec Exc., p. 13).

d. Resolution

We grant the Company exception and reverse the ALJ. Our valuation based upon the OCA need not be adjusted. The ALJ adjustment did not have support by a witness in the proceeding.

7. Penelec Over Budgeting - Projected O&M Expenses through 2016

a. Parties' Positions

Penelec projected O&M expenses for its generation plants through 2016, and for the years beyond 2016, escalating O&M expenses at an assumed 2.5% inflation rate. (R.D., p. 87).

HSS/ARI recommended that Penelec's projected O&M expenses should be adjusted by 28%, which would result in a \$16.6 million annual reduction. HSS/ARI's analysis and argument are supported by evidence submitted by AEC/PREA [in support of a different argument]. The data shows that although Penelec had budgeted almost \$4 million to replace Danger Poles, it had actually only spent \$120,000 or 3% of that amount during the first seven months of the year. (R.D., pp. 87-88).

b. ALJ's Recommendation

Nonetheless, the ALJ recommended that the Commission not adopt this adjustment projected O&M adjustment by HSS/ARI, finding that the relationship between actual and forecasted cost is not as direct and clear as that between actual and projected capital expenditures. The ALJ was not convinced that an across-the-board reduction would be fair if applied to these projected costs. (R.D., p. 88).

c. Parties' Exceptions

HSS/ARI contends that the ALJ should have adopted its proposed \$16.6 million reduction to Penelec's non-nuclear O&M expenses for the years beyond the year

2016. HSS/ARI found that, for Penelec's non-nuclear plants, Penelec's projected O&M expenses exceeded its historic costs by between 10% to 161%. HSS/ARI submits that on a levelized basis, Penelec's projected O&M expenses exceed its inflation-adjusted average actual O&M expenses by 28%, forming the basis for its proposed \$16.6 million annual expense reduction. (HSS/ARI Exc., pp. 24-25).

d. Resolution

We agree with the ALJ's recommendation not to adopt the \$16.6 million annual adjustment to Penelec's non-nuclear O&M expenses for the years beyond the year 2016. We note that the relationship between actual and forecasted cost is not as direct and clear as that between actual and projected capital expenditures. We are not convinced that an across-the-board reduction would be fair if applied to these projected costs. Therefore, the adjustment is rejected.

D. Recovery Proposals; Sharing

1. Sharing

a. Parties' Positions

The key issue here is whether Penelec should be allowed a cost of capital for stranded cost recovery of generation assets. The OCA opposed any allowance for this, basing its position on Section 1315 of the Code, and case law from Pennsylvania and New England. The OTS, on the other hand, asserted that it would allow the cost of capital allowance, but that it should be set at its determination of Penelec's risk-free cost of capital rate of 5.75 % (R.D., p. 88).

The industrials recommended an equity return disallowance, based on PP&L, supra and Section 1323 (a) of the Code, supra. An equity return disallowance would produce a return of 3.84% for Penelec. The ALJ noted that the Commission declined to accept the disallowance of return on equity as recommended by the industrials in the PECO case (R.D., p. 88).

b. ALJ's Recommendation

The ALJ recommended that Penelec's cost of capital for stranded generation costs be set at 7.24%, stating there is room for flexibility in setting a carrying rate. Both the Commission and OTS have focused on the very low risk associated with collecting the amount due under the CTC. In PECO, the Commission selected PECO's cost of long-term debt of 7.47% as appropriate because it reflects the low risk associated with the CTC. Penelec's cost of long-term debt is 7.24%, and its weighted cost of capital, long term debt 3.16%.

c. Parties' Exceptions

Penelec contends that its investors are entitled to a return on stranded generation costs, noting PP&L requested a return of 10.86 (pre-tax) on the unamortized balance of stranded costs. Penelec asserts that the return rate recommended by the ALJ is too low. (Penelec Exc., p. 13).

The OCA contends that the ALJ should not have allowed Penelec a return on its owned generation plant stranded cost. (OCA Exc., pp. 5-7).

d. Resolution

We find that Penelec's recovery of stranded costs should include a pretax return of 10.4%. A decision to deny the Company a return on its owned generation plant stranded cost would amount to a disallowance of recovery of a portion of accurately quantified stranded costs. As we have found in other restructuring proceedings, however, full recovery of these costs is just and reasonable because it balances the interests of shareholders and ratepayers. (PECO Restructuring Order, pp. 100-101). Specifically, we prefer to avoid any discretionary disallowance, instead limiting our adjustments to the Company's claims for cost recovery to those which are the most indisputable and objective. In deciding to allow the Company a return on its owned generation plant stranded costs, we are providing it with a fair transition to full competition, "while also establishing a vibrant competitive market with real economic opportunities for competitive suppliers and consumers." (PECO Restructuring Order, p. 101).

E. Regulatory Assets and Transition Costs

1. Overview

Summarized in the following table are Penelec's regulatory assets (at their book value at December 31, 1998), which the Companies propose to include in its CTC. These amounts reflect appropriate adjustments to assure recovery of only generation-related costs. In addition, those regulatory asset stranded costs which were calculated using a discount rate have been adjusted to reflect revisions to the discount rate as of the close of the record. Each item shall be discussed in detail seriatim. (R.D., pp. 90-91).

Penelec Stranded Regulatory Assets and Liabilities
(In Millions)

	<u>Penelec</u>
Fossil Generation:	
Deferred Energy	\$8.42
Plant Life Extension Study	.58
Shannon Road Ash Site	2.24
Piney Dam Restoration	1.73
Coal Miner Benefits	.73
Non-recoverable Coal	.01
Nuclear Generation:	
Design Basis Documentation	1.64
AFUDC-TMI Common Plant	.04
DOE Spent Nuclear Fuel	(1.16)
Probabilistic Risk Assessment	.80
Other Regulatory Assets	
Customer Assistance Plan	.85
Unamort. Loss on Reacq. Debt	1.93
Income Taxes (FAS109)	58.89
Unamort. ITC	<u>(19.86)</u>
Total	\$56.84

The ALJ noted that regulatory assets are specific costs which have been deferred for future Commission-authorized rate recovery. Such accounting treatment and ratemaking recovery have been an integral part of traditional electric rate regulation. (R.D., p. 91).

The ALJ averred that all claims for regulatory assets and transition costs should be stated on a net present value (NPV) basis and recommended using Penelec's claimed 7.85% after-tax cost of capital as a discount rate that should be applied to all nominal claims for regulatory assets and transition costs made by Penelec. (R.D., p. 92).

2. Deferred Energy Costs

a. Parties' Positions

In its Tentative Orders at Dockets R-00961132 and R-00961133, entered December 19, 1996 (which became effective on February 28, 1997), the PUC approved Penelec's requests to roll into base rates its ECR as of January 1, 1997. The related regulatory liability of \$8.42 million represents the overcollection balance as of December 31, 1996 which the orders required Penelec to defer for this proceeding. (R.D., p. 92)

HSS/ARI argued that instead of charging customers \$8 million for the cessation of deferred energy accounting, Penelec should be directed to credit its stranded cost claims to reflect its \$17 million windfall which it touted to investors. HSS/ARI pointed out that in a presentation to investors, less than four months after GPU's restructuring filing, Penelec noted that because of "capped rates in Pennsylvania," under which GPU "ceased deferred energy accounting," the Company enjoyed a \$.14 share earnings increase. HSS/ARI determined that the \$.14 EPS increase translated into "[a]pproximately \$17 million" in net, after tax income. (R.D., p. 92).

b. ALJ's Recommendation

The ALJ recommended that the deferred energy costs be allowed, so long as it is calculated on a NPV basis. While the ALJ acknowledges a valid point regarding HSS/ARI's argument, she did not think it eliminated Penelec's entitlement to deferred energy costs where the deferral was required by Commission order. (R.D., pp. 92-93).

c. Parties' Exceptions

HSS/ARI contends that the ALJ erred in granting regulatory asset status to Penelec's deferred energy cost claim. HSS/ARI notes that the Recommended Decision urges that the \$17 million increase in earnings be supplemented by *another \$8 million* to be collected under a CTC. (HSS/ARI Exc., p. 30).

HSS/ARI submits that this result is based upon Penelec's claims of deferred energy costs of over \$8 million. But Penelec's claim that it has costs as a result of the termination of the ECR it cannot otherwise recover is inconsistent with what GPU is telling investors. (HSS/ARI Exc., pp. 30-31).

d. Resolution

We agree with the ALJ and as a result Penelec's deferred energy cost claim will be permitted.

3. Plant Life Extension Study

a. Parties' Positions

In accordance with its 1985 rate order at Docket R-842771, Penelec was permitted to recover from customers \$260,000 per year for engineering and consulting services in evaluating the condition of Penelec's generating stations until the amount is fully amortized. Penelec included a regulatory asset claim of \$580,000 for the unamortized balance of plant life extension study costs as of December 31, 1998. (R.D., p. 93).

b. ALJ's Recommendation

The ALJ recommended that this claim be revised to be on an NPV basis. Based on Penelec's claimed discount rate of 7.85 %, the net present value of this amortization is \$0.533 million compared to the nominal balance of \$0.534 million. (R.D., p. 93).

c. Resolution

Penelec seeks recovery of \$0.58 million for the unamortized balance of plant life extension study costs as of December 31, 1998. Penelec was previously permitted to recover these costs incurred to evaluate the condition of its generating stations. The OCA believes that the claim should be revised to represent the net present value of the account. Using the OCA discount rate of 7.1%, the net present value of this claim is \$0.54 million. We accept the OCA's net present value adjustment.

4. Shannon Road Ash Site Remediation(SRASR)

a. Parties' Positions

Penelec originally claimed \$2,685,330 for the Shannon Road Ash Site for treatment, monitoring and seepage abatement costs. These costs represent the Company's estimated liability for the environmental remediation efforts at the Shannon Road ash disposal site in Erie.

The OCA proposed to adjust the claim by removing operating costs that will occur during 1997 and 1998, and by restating it on an NPV basis. Penelec adjusted the regulatory asset amount downward by \$450,000 for costs that will be expensed by the

Company during 1997 and 1998. The revised amount of the claim is \$2,240,000. (R.D., p. 94).

Penelec's total claim as originally stated included: \$200,000 per year for continued treatment and monitoring over the years 1997 through 2004; an additional \$200,000 for seepage abatement costs over the same eight-year time period (an average of \$25,000 per year); and \$885,000 for previously incurred capital expenditures. (R.D., p. 94).

HSS/ARI argued for the reduction for the 1997 and 1998 operating costs, which the ALJ accepted. HSS/ARI further argued that the amount already expended should be excluded, urging the assumption that it was already included in rates. The ALJ did not recommend adopting this further adjustment. (R.D., p. 94).

The OCA acknowledged Penelec's reduction of its original claim by \$450,000. However, Penelec is still presenting the nominal amount of the expenditures to be made in 1999 through 2004 which is inconsistent with the Act. The OCA therefore proposed that this claim be further adjusted by applying the NPV discount rate. The OCA's proposed adjusted allowance for the Shannon Road site is \$1,992,000. (R.D., p. 94).

b. ALJ's Recommendation

The ALJ recommended adoption of OCA's adjusted amount so long as it is calculated using Penelec's net of tax discount rate of 7.85%. (R.D., p. 94).

c. Parties' Exceptions

HSS/ARI contends that this item should be disallowed in its entirety. HSS/ARI also contends the R. D. allows recognition of approximately \$2 million in revenue for

SRASR. (R.D., p. 94). HSS/ARI submits that Penelec stated that SRASR “[c]osts are being deferred and are not in current rates.” HSS/ARI argues that Penelec’s stranded cost filing contains no showing that the SRASR costs have been approved for deferral by the PUC. Thus, the Shannon Road expenses do not qualify as a Regulatory Asset; there is no order from the PUC approving deferral. (HSS/ARI Exc., pp. 31-32).

d. Resolution

We find that Penelec has supported the need for recovery of this item. However, Penelec’s revised claim of \$2.24 million for its estimated liability for the environmental remediation efforts at the Shannon Road ash disposal site should be revised on a net present value basis per the OCA recommendation. Using the OCA discount rate of 7.1%, the net present value of this account is \$1.99 million.

5. Piney Dam Restoration

a. Parties’ Positions

Penelec included the unamortized portion of concrete restoration to the Piney Dam hydroelectric station in the costs for recovery. These costs are being recovered under the 1986 Penelec rate order at Docket R-860413 until 2019. (R.D., p. 95).

b. ALJ’s Recommendation

No party opposed this claim, and the ALJ recommended these costs be allowed on an NPV basis.

c. Resolution

Penelec seeks recovery of \$1.73 million for the unamortized portion of concrete restoration to the Piney Dam hydroelectric station. This unopposed claim is approved.

6. Coal Miners' Benefits

a. Parties' Positions

Penelec included a regulatory asset claim of \$730,000 for Coal Miners' Benefits. Penelec was assigned responsibility for payment of benefit premiums due to former coal miners employed by Penelec or the coal mining operations of Penelec subsidiaries. The OCA did not oppose recovery of these costs as a regulatory asset, but proposed adjustments to the amount claimed by Penelec. Penelec reduced its claim by eliminating the 1997 and 1998 premiums, which was OCA's first proposed adjustment. (R.D., p. 95).

In calculating its claimed regulatory asset, Penelec valued all future payments at their nominal value, not their net present value. The OCA asserted that using the Company's net tax discount rate of 7.85 %, would result in a regulatory asset amounting to \$579,000. Penelec did not accept this adjustment arguing that the use of nominal value, future inflation of the premiums, and/or the potential assignment of additional beneficiaries would tend to offset the need for discounting. (R.D., p. 95). In addition, Penelec challenged the assignment to it of 25 out of the 53 beneficiaries as being assignable to another employer. Such reassignments could offset the cost of future claims and premium inflation. (R.D., p. 96).

HSS/ARI argued that 50% of this claim is not known and measurable, and thus should be denied. (R.D., p. 96).

b. ALJ's Recommendation

The ALJ recommended that this claim should be stated on an NPV basis, and recommend adoption of the OCA's adjustment. (R.D., pp. 95-96).

c. Parties' Exceptions

HSS/ARI asserts that the recommended allowances should be reduced by at least 50 %. HSS/ARI submits that Penelec has not cited any PUC rate order approving the recovery from its customers of the cost of such obligations, much less deferred recovery. These costs were imposed upon Penelec in 1992; having been imposed in 1992, this item cannot be a cost arising from the transition to competition occasioned by the 1996 Act.

HSS/ARI argues that an additional barrier exists prohibiting collection of CTC revenues for this item. Penelec has claimed that almost 50% of the beneficiaries associated with the item should be attributed to another employer. Thus, even if any amount otherwise could qualify, approximately 50% of the claim does not meet the "known and measurable" criterion of the Act. Even if the Commission is inclined to grant Penelec some recognition for this item, a proportionate amount (*e.g.*, 50%) should be completely disallowed. (HSS/ARI., pp. 32-33).

d. Resolution

Penelec seeks recovery of \$0.73 million related to the payment of health and welfare benefits assigned to Penelec under the provisions of the Coal Industry Retiree

Health Benefit Act of 1992. The OCA does not oppose recovery of this claim, but does recommend that it be revised on a net present value basis. Using the OCA discount rate of 7.1%, the net present value of this account is \$0.59 million. We adopt the OCA's net present value calculation of this claim.

7. Non-recoverable Coal

a. Parties' Positions

This Penelec adjustment represented the value of non-recoverable coal in the base of stockpiles at Penelec's coal burning generating stations which is being amortized over the remaining life of the stations. (R.D., p. 96).

b. ALJ's Recommendation

No party opposed this claim, and the ALJ recommended that this claim be allowed on an NPV basis. (R.D., p. 96).

c. Resolution

Penelec seeks recovery of \$ 0.01 million representing the value of non-recoverable coal in the base of stockpiles at its coal burning generating stations amortized over the remaining life of the stations. No party challenged this claim, and it is approved.

8. Nuclear Design Basis Documentation

a. Parties' Positions

As approved by the FERC, the balance of Penelec's nuclear design costs were amortized over the life of TMI-1 until 2014, and is included in rates. Such recognition is consistent with the rate treatment afforded Met-Ed in its 1992 rate case. Penelec claimed a regulatory asset of \$1.64 million for the unamortized balance of nuclear design basis documentation (NDBD) costs. (R.D., p. 96). Penelec argued that it would be inequitable to deny it recovery of these costs as stranded when Met-Ed was allowed to claim them. (R.D., p. 99).

The OCA submits that Penelec never sought Commission approval to defer these costs as a regulatory asset. Therefore, the costs should be denied. If the Commission allows NDBD costs to be recovered by Penelec, the OCA proposes that the claim be adjusted from \$1.64 million to \$0.405 million. (R.D. p. 100).

HSS/ARI adopted OCA's position as to adjustments that should be made if the Commission allows this claim. (R.D., p. 100).

b. ALJ's Recommendation

The ALJ recommended that Penelec's claim for NDBD costs be disallowed, or in the alternative, that it be adjusted as proposed by the OCA and HSS/ARI. (R.D., p. 100).

c. Parties' Exceptions

Penelec contends that the ALJ's recommended disallowance, except for "net present value," of this claim is an error (Penelec Exc., pp. 13-14).

d. Resolution

The OCA has opposed recognition of this claim as Penelec never claimed this expense in a rate case before the Commission. Penelec also never sought an accounting order for approval of the deferral. We agree with the OCA as to the regulatory status of this claim and deny the Company's request.

9. AFUDC on TMI Common Plant

a. Parties' Positions

The ALJ stated that when TMI-1 was placed in service, a portion of the TMI Administration Building was found by the Commission to be related to TMI-2. This portion was to be excluded from rates and AFUDC was to be accrued until TMI-2 was placed in service. These balances are being amortized over the remaining life of TMI-1 (2014). (R.D., p. 100).

b. ALJ's Recommendation

No party opposed this claim, and the ALJ recommended that AFUDC on TMI Common Plant be allowed. (R.D., p. 100).

c. Resolution

Penelec had included a claim of \$.04 million related to the unamortized portion of an AFUDC accrual of a portion of the TMI Administration Building. The claim was unchallenged in this case and is approved.

10. Spent Nuclear Fuel Costs

a. Parties' Positions

Penelec claimed as a regulatory liability, an overcollection of \$1.16 million, for its disposal costs for spent nuclear fuel at TMI-1. As a result of the Nuclear Waste Policy Act of 1982 (NWPA), a future liability to the Department of Energy (DOE) was established for the long-term storage and disposal of spent nuclear fuel loaded at TMI-1 prior to April 7, 1983. To fund this future liability, Penelec has been collecting money from its current ratepayers. The Company retains these funds and accrues interest at the rate on AAA-rated municipal bonds. (R.D., p. 101).

Penelec calculated the regulatory asset associated with spent nuclear fuel by comparing its projected liability to DOE as of December 31, 1998, with the projected customer funding balance as of the same date. The customer funding balance is the amounts collected from ratepayers plus interest accrued on those contributions. (R.D. p. 101).

The OCA asserted that the Company has understated the amount of this overcollection by failing to calculate the regulatory asset or liability on a net present value basis. The OCA calculated the net present value of the future payment obligation and customer funding balance as of December 31, 1998, using the same basic model as the Company to determine the net present value as of March 31, 1998. The OCA submits that

based on Penelec's net of tax rate of return of 7.85%, the regulatory liability is \$4.976 million which should be used to reduce Penelec's overall regulatory asset claim (R.D., p. 101).

b. ALJ's Recommendation

The ALJ recommended that the OCA's adjustment, as calculated using Penelec's discount rate, be adopted. (R.D., p. 102).

c. Parties' Exceptions

Penelec asserts that the ALJ erred in her recommendation on this issue. (Penelec Exc., pp. 13-14).

d. Resolution

Penelec claims as a regulatory liability an overcollection of \$1.16 million related to its fund for disposal costs for spent nuclear fuel at TMI-1. These costs were incurred in accordance with the Nuclear Waste Policy Act of 1982, and recovery of the payments has been authorized by the Commission.

The OCA has challenged this claim by asserting that the Company has understated the amount of the overcollection by failing to calculate the net present value of the account. Using the OCA discount rate of 7.1%, the net present value of the regulatory liability for spent nuclear fuel is \$3.91 million, and we accept the OCA's net present value adjustment.

11. Probabilistic Risk Assessment

a. Parties' Positions

Penelec included a regulatory asset claim of \$0.80 million for costs associated with a probabilistic risk assessment study (PRA) of the vulnerability of TMI-1 to severe accidents, conducted in response to NRC requests (R.D., p. 102).

The OCA and HSS/ARI asserted that this claim should be disallowed on the same bases as the NBDB costs. (R.D., p. 102).

b. ALJ's Recommendation

The ALJ recommended the cost associated with a probabilistic risk assessment study be disallowed. In the event that the Commission allows these costs, the balance of deferred PRA costs should be adjusted to exclude internal labor costs because these clearly are not incremental cost which were not already recognized in rates, and the regulatory asset should be based on the net present value of the amortization of the costs over three years. (R.D., p. 102).

c. Resolution

Penelec includes a claim of \$0.80 million for costs associated with a probabilistic risk assessment study of the vulnerability of TMI-1 to severe accidents performed per NRC requests. The OCA opposes recovery of this claim as the Company never sought nor obtained approval to recover these costs in rates. The ALJ agrees with the OCA and recommends denial of the entire claim because it constitutes single-issue retroactive ratemaking. We agree with the ALJ and reject the claim.

12. Customer Assistance Plan

a. Parties' Positions

This issue represented the deferral of costs associated with the Pilot CAP Program. Deferral for future base rate recovery was received in 1994 from the PUC in a petition of Penelec for approval of the Pilot Customer Assistance Program at Docket P-00930718. (R.D., pp. 102-103).

HSS/ARI opposed recovery of these costs associated with the Pilot/CAP through the CTC, contending that Penelec did not sufficiently establish a link between CAP costs and generation costs. HSS/ARI argued that Penelec's late-developed allocation factor is too low, and should be developed using the annual cost of service of \$1 billion as an allocation base. (R.D., p. 103).

b. ALJ's Recommendation

The ALJ recommended that the proposed adjustment be rejected, and that Penelec's claim be allowed. CAP costs are generation-related because the customers included in the program are receiving generation services as well as distribution service. HSS/ARI did not present sufficient basis to discard Penelec's allocation factor. (R.D., pp. 103-104).

c. Parties' Exceptions

HSS/ARI contends that the claim should be denied because Penelec failed to link the CAP Program costs to generation activities. The collection of revenues for the CAP through the CTC is unwarranted. HSS/ARI argues that Penelec admits that this

item is not solely generation-related, and in fact Penelec has not established any particular link to generation activities. Having failed to establish any link to generation, Penelec should not recover any revenues for the item in a CTC.

HSS/ARI submits that Penelec belatedly attempted to allocate a portion of the CAP cost to the generation function. The Recommended Decision, in the single sentence justifying such an allocation, asserted that “CAP costs are generation-related because the customers included in the program are receiving generation services as well as distribution service.” R.D. at 103. HSS/ARI submits that if the Commission believes that Penelec should collect any CTC revenues for this item, at a minimum Penelec’s allocation base should be its annual cost of service (approximately \$1 billion), not simply electric operations and maintenance expense as Penelec used. (HSS/ARI Exc., pp. 33-34).

d. Resolution

Penelec seeks recovery of \$0.85 million representing the deferral of costs associated with its pilot CAP Program on an allocated basis. HSS/ARI oppose this claim contending that Penelec did not sufficiently establish a link between CAP costs and generation costs. The OCA does not oppose the claim. The ALJ rejects the HSS/ARI argument and we agree with the ALJ; therefore, we accept this claim.

13. Unamortized Loss on Reacquired Debt

The Commission has consistently permitted utilities to collect in rates the tender and call premiums paid to reacquire high coupon rate debt. As a result of this ratemaking treatment, tender and call premiums incurred by Penelec are recorded as a regulatory asset. (R.D., p. 104).

a. ALJ's Recommendation

No party opposed this claim, and the ALJ recommended that this claim be allowed on an NPV basis. (R.D., p. 104).

b. Resolution

Penelec seeks recovery of the balance of unamortized losses on reacquired debt of \$1.93 million. No party challenges this claim, and it is hereby approved.

14. FAS 109/Deferred Taxes

Penelec claimed a SFAS 109 regulatory asset of \$58.89 million. PICA proposes that this amount be adjusted to \$37.744 million, which reflects the use of net present valuing at a discount rate of 7.85% over an amortization period of 12.78 years. The OCA objected to Penelec's calculation because it is not on a net present value basis. (R.D., p. 104). PICA argued that in the PECO restructuring proceeding, the Commission expressly rejected an approach to calculate SFAS 109 taxes on a nominal value, and also including a return. (R.D., p. 105).

a. ALJ's Recommendation

The ALJ recommended that no cost of capital/carrying cost rate be applied to this claim. Penelec argued that the PECO Reconsideration Order as read by the parties cannot or should not be applied to them. Although the ALJ did not conclude that this Order clearly disallows a return, i.e., carrying cost, on this tax claim, the absence of an argument by Penelec

leaves the ALJ to conclude that the intervenors' interpretations of that Order are correct. (R.D., p. 106).

b. Parties' Exceptions

Penelec objects to the ALJ's recommended adjustment to its claim. (Penelec Exc., pp. 13-14).

The OCA asserts that if the ALJ's recommendation nor the PICA adjustment is not adopted, then its recommended adjustment to recover \$33.87 million should be approved.

The OCA quantification of SFAS 109 was based upon a plant by plant analysis of each Penelec generation station. This was the same method used in the West Penn restructuring proceeding and which was adopted by the Commission. The OCA submits that a more detailed plant by plant analysis is more accurate and may be utilized by the Commission in this event that PICA's adjustment is not adopted.

The OCA asserts that the discount rate developed by OCA should be used in stating the Company's SFAS 109 regulatory asset on a net present value basis. Based upon a 7.12 % discount rate, the Company's SFAS 109 claim is \$33.87 million under the OCA's approach. (OCA Exc., pp. 13-14).

c. Resolution

Penelec's FAS 109 tax claim has been challenged as to its net present value. Both the OCA and the Industrials would revalue claims specific to the life of individual generating units. The Company has used an average life of the asset for its valuation.

Our practice in other restructuring proceedings has been to compute the net present value as a function of the CTC recovery period, providing for straight amortization during the CTC period and discounting the asset for the period to compute the net present value. As with other stranded cost items, the Company is then compensated by our CTC interest for the period.

15. FAS 109 Taxes and ITC

The amortization of ITC is an offset to stranded cost (because it decreases cost of service), and is calculated at December 31, 1998. Investment tax credits represent benefits the Companies have taken on previous tax returns. (R.D., p. 106).

Penelec initially failed to incorporate a “tax on tax” gross-up on future ADITC amortization’s, which are treated as a regulatory liability. PICA recommended increasing the Company’s ADITC regulatory liability. The Company agreed with the PICA proposed adjustment to account for the “tax on tax” effect. Although Penelec’s quantification differed slightly from PICA quantification, PICA accepts Penelec’s quantification and incorporates the revised amount in its stranded cost calculations. (R.D., p. 107).

a. ALJ’s Recommendation

The parties’ agreed on the calculation of the “tax on tax” impacts and no party opposed this claim.

b. Parties' Exceptions

The OCA argues that Penelec's regulatory liability for unamortized ITCs should be increased to \$21.467 million. The source of the difference between the Company's calculation of ITC's and the OCA's calculation is found in several areas. First, the Company's net present value amount differs from the OCA's because the Company uses an end of the year convention while the OCA uses a mid-year convention for the timing of future cash flows. Second, the OCA used the discount rate developed by the OCA to determine the net present value of the regulatory liability.

c. Resolution

We have recomputed the ITC liability, as with the above FAS 109 discussion, ITC's are similarly reflected and discounted to be aligned to the CTC recovery period.

16. Transition Costs

Penelec's claimed transition costs are summarized in the table below:

Penelec Transition Costs
(In Millions)

	<u>Penelec</u>
VERP Costs	\$ 88.20
Warren and Seward Employee Costs	10.47
Customer Education	2.50
Reverse Auction RFP	0.05
Restructuring Filing Expense	1.27
Retail Access Pilot Program	1.38
QRO Proceeding Costs	<u>0.33</u>
Total	\$104.20

(R.D., pp. 107-108).

a. 1994 and 1996 VERP Costs

i. Positions of the Parties

In its argument before the ALJ, Penelec stated that, in 1994 and 1996, it offered to employees 55 years old and over, a Voluntary Enhanced Retirement Program (VERP). Also in 1996, an Enhanced Voluntary and Involuntary Severance Program for employees 49 years old and younger, and a Bridged Retirement Benefit for employees age 50 to 54, was offered. Penelec has included a transition cost claim of \$88.2 million for costs incurred in conjunction with the VERP which it offered in 1994 and 1996. The total amount of Penelec's claim includes \$48.438 million for the 1994 VERP offering and \$39.758 million for the 1996 offering. These amounts represent the total cost for all employees, including both generation and non-generation employees.

The OTS, OCA, HSS/ARI and MEIUG/PICA all recommend rejection of the full amount of the Company's VERP claims. (R.D., pp. 108-109).

ii. ALJ's Recommendation

The ALJ recommended the adoption of the position of the OCA, HSS/ARI, OTS and PICA and reject this claim. A similar claim was rejected by the Commission in the PECO Restructuring case as inappropriate single issue and retroactive ratemaking. (R.D., p. 109).

iii. Parties' Exceptions

In its Exceptions, Penelec states that it has included an amount of \$88.2 million in claimed transition costs for VERP costs. Penelec asserts that the Commission accepted such employee-related expenses in the PP&L restructuring case. (Penelec Exc., p. 14).

iv. Resolution

We note that Penelec seeks recovery of \$88.2 million for its 1994 and 1996 voluntary severance program costs. The Company contends that these costs relate directly to its efforts to downsize and to prepare for competition.

The OCA, OTS, and PICA all recommend rejection of the entire claim because the costs occurred prior to the adoption of the Act, the Company did not seek deferral of these costs, the request constitutes retroactive ratemaking, and the Commission rejected a similar claim in the PECO Energy restructuring case. The OCA further claims that the combined savings from the 1994 and 1996 VERP programs will more than offset total VERP costs prior to January 1, 1999. (OCA R.Exc., p. 17). The ALJ recommends rejection of this claim by the Company, and we agree. The claim is denied consistent with our decisions in the PECO Energy and West Penn restructuring cases.

b. Warren and Seward Employee Costs

i. Parties' Positions

Penelec included a transition cost claim of \$4.51 million for enhanced severance and retirement packages to Warren and Seward generating station employees. Penelec projected that it would close Warren and Seward in the year 1999 and 2000 respectively. Penelec made adjustments (which can be found in Penelec Exhibit RAD-21), reflected in the above table, to increase this claim from \$4.51 million to \$10.47 million. (R.D., p. 110).

The ALJ observed that, prior to the announcement of the divestiture, the OCA did not oppose Penelec's recovery of employee transition costs for Warren and Seward. Unlike Met-Ed's Portland and Titus plants, which were not scheduled for closure until 2004, the Warren and Seward scheduled closures were more imminent. The OCA originally accepted Penelec's claim for employee transition costs for Warren and Seward since they would have been incurred relatively soon, with limited opportunity for Penelec to mitigate costs. (R.D., p. 110).

However, in light of the pending divestiture, and for the same reasons as set forth in its opposition to Met-Ed's Portland and Titus claims, the OCA then proposed the potential employee transition costs for Warren and Seward be included and dealt with in the same manner as the potential employee transition costs associated with the divestiture of GPU's other generating units. (R.D., p. 111).

ii. ALJ's Recommendation

The ALJ recommended that this claim be rejected without prejudice, and reexamined during the divestiture phase of Penelec's restructuring. (R.D., p. 111).

iii. Parties' Exceptions

The company does not object to postponing this claim pending completion of divestiture. (Penelec Exc., p. 14).

iv. Resolution

We observe that Penelec seeks recovery of \$4.51 million, updated to \$10.47 million, representing enhanced severance and retirement packages to employees at the Warren and Seward generating stations which are planned to be closed by the year 2000. However, the Warren and Seward stations are up for sale as part of Penelec's divestiture plan.

The OCA proposes that the potential employee transition costs for these plants be included and dealt with in the same manner as the potential employee transition costs associated with the divestiture of GPU's other generating units. The ALJ agreed, rejected the claim and recommends that the claim be reexamined during the divestiture phase of this case. The company does not object to postponing this claim pending completion of divestiture. (Penelec Exc., p. 14). We agree with the ALJ's recommended treatment and deny the claim at this time.

c. Customer Education

i. Parties' Positions

Penelec included funding for their customer education program during the transition to competition. Penelec included a transition cost claim of \$2.5 million for funding a customer education program during the transition to competition.

ii. ALJ's Recommendation

No party opposed the recovery of reasonable costs for customer education as transition costs in this proceeding, and the ALJ recommended that this claim be allowed. (R.D., p. 111).

iii. Resolution

Consistent with our treatment in other cases, the exact amount will be assigned from our Customer Education Program docket. We have incorporated an allowance of \$5 per customer per year for four years for the purposes of our stranded cost determination in this case.

d. Reverse Auction RFP Costs, Restructuring Filing Expense, and Retail Access Pilot Program Costs

i. Parties' Positions

Penelec contended that Reverse RFP costs are being incurred by the Companies under the "Reverse Auction" RFP related to current NUG contracts. The Reverse

Auction RFP sought bids from NUG projects currently under contract with Met-Ed or Penelec for buy-out, buy downs or other contract restructuring. The Reverse Auction RFP is part of the Companies' continuing efforts to mitigate above-market NUG costs. Restructuring filing costs are associated with the Companies' Restructuring Plan filings before the Commission, and include legal and consulting fees in preparing and supporting the filings; employee expenses; incremental employee overtime expenses; and duplicating, transcripts and postage expenses. (R.D., p. 112).

Penelec further asserted that pilot program costs are associated with the implementation of Penelec's PowerFuture retail access pilot programs at Docket No. P-00971168. (R.D., p. 112).

ii. ALJ's Recommendation

No party opposed the inclusion of these claims, and the ALJ recommended that these claims be allowed.

iii. Resolution

We note that Penelec seeks recovery of \$.05 million incurred by the Company under its Reverse Auction RFP related to current NUG contracts. As the reverse auction is a part of Penelec's continuing efforts to mitigate above-market NUG costs, no party opposes the claim, and we grant its inclusion as a recoverable stranded cost.

Penelec also seeks recovery of \$1.27 million associated with the preparation of its restructuring filing, including legal and consulting fees it has

incurred. This claim has been unchallenged by any party to this proceeding and is approved.

Furthermore, Penelec claims it incurred \$1.38 million as a result of the implementation of its retail access pilot program, "Powerfuture." No party challenged this claim, and it is hereby approved.

e. Qualified Rate Order Proceeding Costs

i. Parties' Positions

Penelec included a transition cost claim of \$333,000 for projected Qualified Rate Order (QRO) Costs associated with a securitization proceeding before the Commission. (R.D., p. 113).

ii. ALJ's Recommendation

The ALJ recommended that the costs of a QRO proceeding should not be recognized as a transition expense at this time. Penelec has indicated that it has no plans to make a securitization filing at this time. These costs are not known and measurable. They can be included in the QRO filing when and if it is made. (R.D., p. 113).

iii. Parties' Exceptions

Penelec argues on exception that it include a transition cost claim of \$333,000 for projected QRO costs associated with a securitization case before the Commission. Penelec asserts that the ALJ's recommendation on this issue is inconsistent with other of her rulings. (Penelec Exc., p. 14).

iv. Resolution

We observe that Penelec seeks the recovery of \$0.33 for all projected costs associated with the filing of a qualified rate order request with the Commission. The Company states that it is optimistic that securitization may be available after pending appellate proceedings are finalized. The OCA opposes this claim as the Company has no present plans to make such a filing. The ALJ disallowed the claim on the basis that the related costs are not known and measurable. We agree. We note, however, that any costs for a future QRO filing should be incorporated and considered within the use of the net proceeds of the securitization bonds resulting from Commission approval of such a filing.

f. Customer Information System (CIS) Costs

i. Parties' Positions

In response to the concerns of intervenors, the Companies withdrew their requests for stranded cost recovery of these incremental costs. (R.D., p. 113).

ii. Resolution

We note that the Company has withdrawn its request for stranded cost recovery of customer information system costs and instead will seek recovery in future base rate proceedings.

E. Decommissioning Costs

1. Nuclear

a. Parties' Positions

Penelec's calculation of stranded costs includes nuclear decommissioning obligations for TMI Units 1 and 2 amounting to \$108.28 million for Penelec. The Company's argument focuses around the contingency factor, the escalation factor, and the earnings rate on trust funds. The ALJ observed that no party opposes the inclusion of nuclear decommissioning costs as stranded costs in this case. The controversies are over how much should be included, based on adjustments to the three factors just identified, and about the collection mechanism. (R.D., p. 114).

Penelec calculated a 5.5% annual escalation rate for funding decommissioning costs. This rate was calculated in accordance with the NRC's recommendation that decommissioning estimates should be site specific. The OTS also adopted this annual inflation factor for nuclear decommissioning. The OCA recommended an escalation factor 4%. This is based upon criticism of the Companies' projected costs of labor and energy as being overstated. (R.D., p. 116).

The ALJ previously recommended that the costs found to be stranded should be collected through annuitization in regulated rates. The OCA argued collecting these costs outside the CTC, but does not support including them in an Other Transportation Charge (OTC). (R.D., p. 114).

MEIUG/PICA asserted that these costs should be included in the CTC. The Companies argued the Commission allow recovery of these costs through the OTC (R.D., p. 115).

The OCA and MEIUG/PICA supported the Companies' use of a 10% contingency factor in its decommissioning cost estimates. Penelec supported the actual contingency amounts calculated by TLG Services, Inc., but have made a ratemaking policy decision to use a contingency factor of 10%. Penelec advocated that the Commission should disregard the suggestion that no contingency amount should be permitted as this would result in significant underfunding of decommissioning activities. (R.D., p. 115).

The OCA and OTS also supported the Companies' use of a 7% nuclear decommission trust fund earnings rate. The Companies asserted that MEIUG/PICA erroneously insist that an 8.5% rate should be used. (R.D., p. 115).

b. ALJ's Recommendation

The ALJ did not recommend the OTC mechanism for these costs. (R.D., pp. 114-115).

Regarding the nuclear decommissioning trust fund earnings rate, the ALJ recommended that the Commission accept the recommendation of the Penelec, OCA and OTS that 7% is a reasonable rate of return for these funds. As explained in Penelec's Brief, the tax treatment and asset allocation of nuclear decommissioning trust funds result in a lower earnings rate than the rate of return for pension and OPEB trust funds. (R.D., pp. 115-116).

The ALJ recommended that the Commission adopt Penelec escalation factor as being reasonable. In addition, the ALJ recommended that Penelec be allowed to collect these

costs over an extended period, namely the life of the asset, but not through an OTC mechanism.

c. Parties' Exceptions

Penelec proposed to collect its stranded nuclear decommissioning costs through an OTC on customers' bills. Penelec excepts to the ALJ's rejection of its OTC proposal. (OCA Exc., pp. 15-18).

In its Exceptions, the OTS argues that the ALJ's recommendation to allow a 10% contingency factor as an add-on to Penelec's nuclear decommissioning costs is not in accord with the Act. (OTS Exc., pp. 16-17).

The OCA contends that the ALJ erred in recommending adoption a 5.5 % cost escalation factor instead of its proposed 4.0 % factor. The OCA urged that the Commission adopt a more reasonable cost escalation factor of 4.0 % in conjunction with the 7.0 % trust fund earnings rate adopted by the ALJ. The 5.5 % escalation factor proposed by the Company is by far the highest rate sought by any nuclear utility in Pennsylvania. (OCA Exc., pp. 15-18).

MEIUG/PICA asserts that the ALJ erred in accepting Penelec's application of a 7.0 % trust fund earnings rate and 5.5 % escalation factor. (MEIUG/PICA Exc., pp. 1-11).

d. Resolution

We note that the ALJ has adopted the Company proposal to collect nuclear decommissioning costs through their distribution rates, similar to treatment approved in the restructuring case. Additionally, the ALJ adopted the Company positions to use a 10%

contingency factor in the decommissioning estimate, to use a cost escalation rate of 5.5% , and a trust earnings rate of 7%. The OCA has excepted to the use of a 5.5% escalation rate preferring a 4% escalation rate. The Industrials have also excepted to the escalation and to the earnings rate, arguing for an 8.5% earnings rate. The Industrials have also excepted to the use of the distribution rate, preferring recovery to be through the CTC.

We agree with the Industrials that collection should be accomplished through the CTC. Our preference is to be able to properly track any ultimate divestiture of the nuclear asset. The decommissioning trust may be a part of that transaction. By having the trust recovery and the stranded nuclear property in the CTC, only one element of rates would need to be adjusted to reflect divestiture rather than both CTC and T&D rates.

For the calculation of the asset, we accept the Company's estimates for contingency and earnings and accept the OCA cost escalation rate.

2. Fossil

a. Parties' Positions

Penelec included fossil decommissioning costs of \$130.320 million in its stranded cost calculations. Penelec argued that the Commission has traditionally allowed fossil decommissioning costs to be recovered through base rates. The Company argued that since they could not recover these costs before the plants were retired and now will not recover these costs in the future when they actually are retired, these costs are stranded and hence are recoverable through the CTC. (R.D., p. 118).

Penelec escalated the current estimate of decommissioning costs for each fossil plant to the projected price levels at the time those costs are expected to be incurred. These

projected future costs were then discounted back to a net present value amount as of January 1, 1999 to obtain the stranded cost to be recovered from ratepayers. Penelec's claim included \$141.747 million for dismantling and demolition cost estimates for its non-nuclear generation sites and \$38.146 million for ash disposal site closure costs. (R.D., p. 119).

The OTS recommended that funds received for fossil decommissioning be placed in a trust fund similar to the nuclear decommissioning trust funds that have been established. (R.D., pp. 119-120).

The OCA averred that the Companies' claimed fossil decommissioning costs are not properly included in the stranded cost calculation and are not recoverable in this proceeding. The OCA asserted that fossil decommissioning costs are not properly recovered as a stranded cost. (R.D., p. 120).

The industrials argued that prospective fossil decommissioning costs are not properly claimable as "stranded costs," within the meaning of the Competition Act, because such costs are not typically recoverable in a regulated environment. (R.D., p. 120).

MEIUG/PICA argued that recovery of prospective fossil decommissioning costs runs directly contrary to long-established precedent that has uniformly denied recovery of such costs. (R.D., p. 121).

b. ALJ's Recommendation

The ALJ recommended that their claim for fossil plant decommissioning be rejected. (R.D., p. 122).

c. Parties' Exceptions

Penelec excepts to the ALJ's recommendation on this issue. (Penelec Exc., p. 13).

d. Resolution

The Company has included fossil decommissioning costs of \$130.320 million for Penelec in their stranded cost calculations. (Penelec Exh. GJH-2R). The Company argues that the Commission has traditionally allowed fossil decommissioning costs to be recovered through base rates. This was done on a five-year average basis when the plant was decommissioned.

The ALJ rejected this claim based upon the arguments of the Industrial intervenors that the claim is speculative and not known and measurable as stranded within the definition of the Act. The ALJ also noted our rejection of a similar claim in PECO Energy and reviewed our reasoning there. The Company has excepted to the recommendation.

The ALJ properly disposed of this issue. We have reviewed the claim and our precedent in the other restructuring decisions and find no reason to depart from the rationale of our prior determinations in considering the record in this case. In addition, as the fossil units are planned to be divested, to collect for decommissioning costs at this point certainly is inappropriate.

We have examined this issue in each of our restructuring cases so far and continue to find such claims as not known and measurable given the conditions which surround a retirement decision. We reach a similar conclusion on the basis of the record here.

F. Summary

With regard to Penelec's claimed transition costs, we have denied the Company's claims with respect to the 1994 and 1996 VERP costs; the Warren and Seward Employee costs; and QRO costs.

We have permitted the Company's claims regarding Reverse Auction RFP related to current NUG contracts; restructuring filing costs; and expenditures related to the Company's Retail Access Pilot Program.

Regarding nuclear decommissioning costs, we determined that collection should be accomplished through the CTC. We accepted the Company's estimates for contingency and earnings and accepted the OCA's cost escalation rate. We disallowed the Company's fossil decommissioning claim.

Regarding Customer Education, we have incorporated an allowance of \$5 per customer per year for four years for the purposes of the stranded cost determination.

VI. MITIGATION EFFORTS⁶

A. Introduction

The ALJ observed that, under Section 2808(c)(4) of the Act, in determining the level of stranded costs the electric utility may recover, the Commission must consider the extent to which efforts were undertaken to mitigate generation-related transition or stranded costs. (66 Pa. C.S. §2808(c)(4)). An effective mitigation effort that benefits customers and shareholders should be recognized through full recovery of remaining stranded costs. A second factor guiding the Commission's consideration of stranded costs is the effort undertaken prior to the enactment of the Act to reduce or moderate customer rate levels while maintaining safe and efficient operations. This factor must be given as much weight as mitigation efforts when the Commission evaluates Penelec's stranded cost claims. Section 2808(c)(5) states:

Of equal importance to the mitigation efforts under paragraph 4(i) through (vi), the Commission shall consider efforts undertaken over time, prior to the enactment of this chapter, to reduce or moderate customer rate levels while maintaining safe and efficient operations.

(66 Pa. C.S. §2808(c)(5); R.D., p. 122).

B. Parties' Positions

Penelec argued that their mitigation efforts significantly preceded enactment of the Act and will continue through the transition period and beyond. According to Penelec,

⁶ Met-Ed, HSS/ARI and OCA were the only three parties to address this issue.

strategies to moderate customer rates have been in place well before passage of the Act and have succeeded in keeping rates notably below average Pennsylvania electric rates. Penelec asserted that its mitigation efforts have been vigorous, effective and more than commensurate with the magnitude of the costs. It also argued that the historic effort to control costs and customer rate levels has achieved that result while maintaining safe and efficient operations.

AEC/PREA asserted that Penelec's cost cutting has adversely affected the reliability of its service. HSS/ARI argued that the effectiveness of Penelec's mitigation falls far short of its claims.

Penelec maintained that the historic effort to control customer rate levels has achieved that result while maintaining safe and efficient operations. Accordingly, Penelec sought to recover of all of their claimed stranded and transition costs without any offset for failure to sufficiently mitigate.

1. NUG-Related Mitigation Efforts

Penelec contended that it has entered into far more NUG agreements than any other Pennsylvania electric utility. In fact the largest component of its stranded cost claim in this case arises out of various obligations that Penelec has incurred with non-utility generation (NUG) projects. (R.D., pp. 123-124).

Penelec argued that it has been successful in buying out or restructuring all of its unbuilt NUG projects with one exception, the Rubenstein PPA (Homer City Modular). In addition, it has succeeded in terminating an operational project. Penelec's successful NUG buy-outs are summarized below:

<u>Project</u>	<u>Buy-Out Cost</u>	<u>Savings</u>
Altoona ⁷	\$5.0 million	\$308.0 million
LG&E/Erie	\$23.7 million	\$316.0 million
Cogentrix	<u>\$26.09 million</u>	<u>\$ 33.0 million</u>
Totals	\$54.79 million	\$657.0 million

The OCA did not dispute Penelec's efforts to date to mitigate its NUG stranded costs, but submits that Penelec's proposals for NUG stranded cost recovery may prove inconsistent with Penelec's continuing duty to mitigate these costs. The OCA submitted that Penelec should consider auctioning its remaining NUG contracts as part of its divestiture process as a further method to mitigate stranded cost. (R.D., pp. 123-124).

HSS/ARI argued that Penelec's performance with respect to operating NUGs is far from optimal. HSS/ARI pointed out that before this proceeding began, Penelec had not bought out a single operating NUG. A GPU consultant's memo pointedly advocated a change in Penelec's approach to the extent that a regulatory system without recovery of NUG costs would be expected. HSS/ARI noted that Penelec's total NUG stranded cost claim is \$959,170,000, of which buyouts only amount to \$54,790,000. (R.D. pp. 125-126).

2. Non-NUG Mitigation Efforts

Penelec asserted that it mitigated its stranded costs by more than the amounts it seeks to recover in this proceeding. According to Penelec, its quantification of its non-NUG stranded costs shows they are about \$0.4 billion. Penelec's quantification of non-NUG

⁷ This buyout represents Penelec's share of the integrated AES Ironwood agreement, along with York County Energy Partners and Blue Mountain.

mitigation efforts shows a total of nearly \$1.0 billion, or two and a half times its stranded costs. (R.D., p. 129).

HSS/ARI argued that Penelec's claims of mitigation are largely meritless. According to HSS/ARI, over the last decade, Penelec has improved its bottom line -- earning an average annual equity return of 13.57%,⁸ in part by slashing its payroll by 50%⁹ and keeping the benefits of significant cost reductions and revenue increments for itself.¹⁰ HSS/ARI contended that Penelec admitted that it did not reduce its rates to reflect its cost savings, as well as reducing costs while maintaining an existing rate produces higher earnings to the utility. (R.D., p. 129).

According to Penelec, its various cost reduction and cost control strategies substantially pre-date the passage of the Act and were intensified in the early 1990's as the potential for competition in the industry was recognized. In contrast, HSS/ARI claimed that capital additions estimates created in this proceeding by Penelec's witness to quantify stranded costs¹¹ presume closing of Seward and Warren by the turn of the century, and should not include the cost of expansions of capacity to serve the future deregulated market subsidized as "stranded costs" by ratepayers. (R.D., pp. 130-131).

⁸ Weisenmiller, HSS/ARI St. No. 1, Supp. No. 1, p. 106:5-9.

⁹ *Id.*, p. 69:8-12.

¹⁰ See HSS/ARI Cross-Examination Exh. No. 21, page 3 (\$.14 EPS increase from deferred energy accounting's cessation); Tr. 734:11-18.

¹¹ Attributed to Mr. Herrigel by Mr. Carroll, *see* Penelec St. No. 3, p. 6:4-6.

The Cooperatives argued that the Act provides that past mitigation efforts may only be considered if there was no negative impact on the provision of safe and efficient (reliable) service. Section 2808(c)(5) provides:

Of equal importance to the mitigation efforts under paragraph (4), the commission shall consider efforts undertaken over time, prior to the enactment of this chapter, to reduce or moderate customer rate levels while maintaining safe and efficient operations.

(R.D., p. 131).

Specific historic mitigation efforts undertaken by Penelec are as follows:

a. O&M Costs

Penelec contended that efforts to control and reduce O&M costs have been ongoing since the 1980's. Penelec's Exhibit DC-2 compares 1986 and 1996 O&M production costs, excluding fuel as well as 1986 adjusted for inflation through 1996. Over the 1986 to 1996 period, Penelec's O&M production costs declined in nominal terms by \$22.2 million, or 22%. According to Penelec, it absorbed about \$37 million in inflation driven O&M increases from 1986 to 1996 in addition to actual reductions in O&M costs (R.D., p. 132). AEC/PREA argued that Penelec's slashing of these costs has led to inadequate service reliability. HSS/ARI argued that the amounts are overstated.

b. Reductions in Capital Expenditures

Penelec asserted that reductions in capital expenditures was given impetus through plans implemented in 1994. During the three-year period 1994 to 1996, Penelec's capital expenditures were lowered by \$189 million. Penelec argued that the minimization of

new capital spending for generation assets is one of the specific mitigation efforts the Commission should consider, according to the Act, when it judges Penelec's stranded cost claims. (66 Pa. C.S. § 2808(c)(4)(ii)). From 1990 through 1997, TMI-1's availability factor has risen from 91.6% to 99.8%. For the same period, Penelec's base load units, availability increased from 76.6% to 84.7%. AEC/PREA argued that power availability to it has suffered during this period. They focused mainly on the facilities to deliver power, not on generating facilities. Id. (R.D., pp. 132-133).

Penelec argued that it has substantiated its success in maintaining efficient operations while keeping customers' rate levels moderate, prior to enactment of the Act, and that such factors are to be given equal weight with stranded cost mitigation by the Commission in evaluating stranded cost claims under the Act. (66 Pa. C.S. §2808(c)(5)).

c. Reductions in Fossil Generation Fuel Costs

According to Penelec, the fuel procurement strategy employed by GENCO in recent years has been characterized by minimization of administrative constraints on supplier competitiveness, maximizing flexibility in fuel quality specifications and maximizing competitiveness of transportation modes, optimizing prudent use of spot market purchases, and establishing aggressive fuel cost targets for each fossil station. (R.D., p. 133). According to Penelec, this strategy produced notable successes for Penelec generating stations.

Penelec

	<u>Station</u>	<u>Action</u>	<u>Savings</u>
1.	Homer City Units	Discontinued long-term above market coal rate agreement	\$20 million
2.	Homer City	Renegotiated coal rate agreement	\$10 million through 2002
3.	Homer City	Renegotiated cost plus coal contract as fixed price contract through 2007	\$75 million through contr. life
4.	Shawville	Replaced spot purchases with short-to-medium coal contracts	\$6 million throughout contracts

For the period 1990-1996, Penelec's costs declined from 1.46 cents/kwh to 1.39 cents/kwh. (R.D., p. 134).

d. Reductions in Nuclear Fuel Costs

Penelec suggested that GPU Nuclear's fuel cost strategy for TMI-1 incorporates aggressive negotiation on the cost of uranium conversion, enrichment and fabrication, optimizing the timing of fuel and related services procurement, and maintaining and improving TMI-1's efficient operation. These efforts produced a 9% reduction in the cost of nuclear fuel from 0.64 to 0.58 cents/kwh in the period 1990 to 1996. (R.D., p. 134).

e. Reduction of Non-Fuel Materials and Supplies

Penelec contended that stranded costs were further mitigated and customer rates moderated by Penelec's reductions in materials and supplies inventory for nuclear and fossil generating stations. Penelec's station material and supplies inventories were reduced by \$9.9 million for a similar period. (R.D., p. 134).

f. Workforce Cost Reductions

Penelec contended that in 1990, it commenced initiatives aimed at reducing their workforces that succeeded in significantly reducing the total number of employees. *Principles of consideration and fairness marked the Company's attitude toward this difficult task and the great majority of the workforce reduction was achieved voluntarily. Voluntary retirement and severance packages, normal attrition or an equitable severance program were the means whereby most of the reductions were accomplished. By the end of 1996, relative to 1990 levels, Penelec's workforce was lowered by 1,588 positions or 36.6%. According to Penelec, these measures resulted in annual savings of \$346 million for Penelec.*

Penelec further asserted that, when recent realignment actions resulted in the reassignment of positions, the historic costly and inefficient layoff/bumping procedure was no longer utilized thanks to a mutual agreement between the Companies and unions. According to Penelec, work rules have been changed for new Penelec employees in line construction and maintenance by mutual agreement with the unions as part of the Company's Agile Workforce initiative. Penelec submitted that this will allow the union employees to compete with outside contractor line crews. Penelec observed that the Agile Workforce concept may be applied to additional positions in the future. (R.D., p. 135).

The Cooperatives asserted that as to past efforts involving the work force reduction, a review of the evidence shows of the total Penelec work force reduction, 30% of the employees cut were from Penelec's T&D operations. The Cooperatives contended that employee reductions of this magnitude will severely impact the preventative measures (tree trimming/pole replacements) and outage response time which directly correlate to reliability as well as the Companies' ability to handle outages¹². According to the Cooperatives, Penelec has already reduced the number of Penelec crew sites from 50 to 38 and Penelec discussed further future crew site consolidation and remote reporting (R.D., pp. 135-136).

g. Efforts to Control Employee Medical Costs

Penelec asserted that GPU, Inc. performed a systematic review of its medical insurance program for employees in the late 1980's. According to Penelec, the impact of the Companies' medical cost containment efforts can be expressed on an average cost per employee basis. GPU's costs per employee from 1989 through 1995 allegedly increased by an annual rate of 4.2% to \$3,737 per employee. For the same time period in the Northeast/Mid-Atlantic Region, medical costs rose on average 8.4% to \$4,833 per employee. (R.D., p. 136).

h. Reductions in Insurance Costs

Penelec suggested that changes to its liability, property, worker's compensation and other insurance programs have led to lower insurance costs. According to Penelec, new deductible levels and the assumption of some severe loss risks have been utilized to reduce premiums.

¹² As GPU consolidates crews, the location of the crews become further removed from certain areas of their service territory resulting in longer response times to address outages and problems.

i. Cost Savings Due to Refinancing

Penelec contended that refinancing debt and the utilization of innovative financing techniques have also produced significant cost savings for customers. Penelec replaced eleven issues of first mortgage bonds with lower cost debt. TMI-1's nuclear fuel was refinanced in November 1995 with an annual savings of fifteen basis points. Penelec asserted that these refinancing efforts resulted in more than \$11 million in annual cost savings for Penelec. (R.D., p. 137).

j. Revenue Growth and Mitigation

Penelec noted that one of the mitigation efforts explicitly recognized by the Act is the "maximization of market revenues from existing rate base generation assets." 66 Pa. C.S. §2808(c)(4)(v). By teaming with federal, state and local organizations, Penelec contended that it has attracted new businesses and encouraged growth in existing businesses by utilizing rate incentives. The economic development effort has allegedly resulted in new customers with annual incremental revenues of approximately \$10.8 million for Penelec. (R.D., p. 138).

k. Other Mitigation Accomplishments

Penelec asserted that they have also mitigated stranded costs through its acceleration of depreciation of its Seward and Warren stations by \$5.8 million annually. According to Penelec, divestiture of these assets may overtake the mitigation claimed here with regard to them. Penelec also submitted that the use of video-conferencing and a reduction in the number of fleet vehicles has lowered transportation expenses for Penelec.

Reducing the volume of low level waste at TMI-1 by 50% decreased that unit's radioactive waste disposal costs. (R.D., p. 138).

3. HSS/ARI Issues

HSS/ARI contended that a comparison of the Company's current rates to those in effect in 1986 shows that Penelec's rates have declined in real terms by 25% as measured by the Gross Domestic Product index. HSS/ARI argued that mitigation as described by the Companies in its comparison of the level of Penelec's rates with the levels of other Pennsylvania utilities' rates is meaningless. They argue that because the regions in which Penelec provides service are less urbanized, and involve lower costs for personnel-related items such as salaries, than in regions served by other utilities in the State, costs incurred by Penelec for such items should be lower, and therefore, its rates should be lower in comparison to other Pennsylvania utilities. HSS/ARI concluded that the current state of Pennsylvania's electric utility rates does not, contrary to Penelec's belief, demonstrate that Penelec has mitigated costs it otherwise was or would be incurring. (R.D., p. 139).

HSS/ARI further argued that an additional mitigation step should be used to recognize the value of the GPU trade name, which GPU presently is exploiting on behalf of its affiliated marketer. HSS/ARI argued that since the GPU name apparently has value for use in selling power supplies, GPU should be directed to offer the trade name to the highest bidder, in a fair and open auction or a request for licensing proposals. HSS/ARI contended alternatively, that GPU should be directed to reduce stranded cost claims by \$15 million if it decides not to auction the name.

AEC/PREA's requested that Penelec's CTC revenues be escrowed, pending the completion of allegedly necessary reliability improvements.

4. Summary of Mitigation

Penelec has documented its claims for historic, ongoing and future efforts to reduce costs in this proceeding. The great majority of its claimed cost mitigation occurred prior to the passage of the Act. Penelec St. 2, Supp. 2, p. 3). Penelec has quantified its NUG and Non-NUG mitigation efforts, and they are set forth on the following chart:

	<u>Penelec</u>	
	<u>Stranded</u>	<u>Mitigation</u>
	<u>Cost Claim</u>	<u>Achieved</u>
NUG	\$959.17 million	\$0.5 billion
Non-NUG	<u>\$362.67 million</u>	<u>\$1.0 billion</u>
Total	\$1.321 billion	\$1.5 billion

Total Penelec mitigation: 114% of stranded cost claim

(Penelec Exh. GJH-1R(2), p. 1; Penelec St. No. 3, p. 31).

5. Continuing Mitigation

According to OCA, Penelec did not offer any prospective mitigation efforts, other than divestiture, regarding their owned generation plants (R.D., p. 141). OCA testified that:

The Company's filing reveals that it has taken aggressive mitigation steps in the past but it needs to take further steps in the future. Its filing neglected to reflect all optimization of its existing generation, such as through both economic retirements and economic life extensions. It does not reflect any continued

reduction in real O&M expenditures in the future. Finally, it does not reflect full utilization of all its assets, as discussed below.

(R.D., pp. 141-142).

OCA asserted that the Penelec could meet its continuing mitigation obligation in two ways: (1) by reducing the costs of continued operation of producing assets, and (2) by reflecting all future value of current assets which have been funded by customers (R.D., p. 142). To reflect these mitigation possibilities, OCA recommended a life extension of the Conemaugh unit and a productivity adjustment. In addition, OCA asserts that generating assets with negative stranded costs be used as an offset to Penelec's claims for positive stranded cost. (R.D., p. 142).

C. ALJ's Recommendation

The ALJ noted that the memo from outside consultants retained by GPU characterized GPU's behavior on NUG buyouts ranging from "business as usual" to reactive and the memo advocated a change in Penelec's approach to the extent that a regulatory system without recovery of NUG costs would be expected. The judge found that this memo undercuts Penelec's assertions of historic NUG mitigation success. (R.D., pp. 126-127).

The ALJ was not persuaded by the assertion of HSS/ARI that continued the NUG contracts cliff pricing provisions. The ALJ concluded that Penelec's NUG mitigation is not as significant as is asserts, but neither is it non-existent as HSS/ARI suggests.

The ALJ also recommended rejection of AEC/PREA's proposal to escrow CTC revenues as being contrary to the Act.

The ALJ found that Section 2808 (c)(5) of the Act should not be applied to require that Penelec or any other electric utility must first prove reliable service before moving to establish that it has mitigated its potential stranded costs. The ALJ also agreed with Penelec that the Act does not condition stranded cost recovery, and by extension, mitigation, on an unspecified standard of reliability being met. Additionally, the ALJ rejected the relevancy of most of the Cooperatives' service claims as they have litigated them. The judge also disagreed with Penelec's argument that its historic rate levels also support that the *standard for entitlement to full recovery of stranded costs* has been met in this case. (R.D., p. 131).

The ALJ further concluded that the reductions in workforce by doing more with less and the philosophy of safe and reliable service while reducing costs, is according to the ALJ, a one sided view which has not and does not give any consideration to the true impact of the cuts and reductions on the customers.

The ALJ further found that the efforts of electric utilities to reduce or moderate rates prior to enactment of the Act are a factor of equal importance to mitigation in setting stranded costs. 66 Pa. C.S. §2808(c)(5). The ALJ determined that, in this respect as well Penelec has met the prerequisite to full recovery of stranded costs.

The ALJ found that there is no merit in the use of the GPU trade name. There is no documented source claimed for the \$15 million adjustment amount and assumed that it was taken from thin air. The ALJ agreed with the OCA about future mitigation, including the value of the Companies names and logos. She recommended that we direct that the Companies establish a method to license the use of the GPU name and logo. (R.D., pp. 144-145).

Regarding continuing mitigation efforts, the ALJ did not think that the Companies have shown adequate plans for future mitigation, and she disagreed that Penelec's failures in its mitigation actions is the basis to require adjustments to its capital additions for the years 1987-1996, and to require crediting other mitigation factors against stranded cost claims.

Finally, the ALJ found that there is no basis whatever to conclude that Penelec's mitigation has been lacking given Penelec's plans for divestiture, and contemplation of securitization. Therefore, the ALJ concluded that no offset should be assessed.

D. Parties' Exception

In its Exceptions, Penelec excepts to the ALJ's determination not to adjust the Company's stranded cost recovery in light of Penelec's successful mitigation efforts. (R.D., pp. 109-125). Penelec also excepts to the judge's finding that its historic mitigation results are mixed and its future mitigation plans are not adequate. Penelec also opposes the argument that it should be obligated to license or sell the GPU name. (Penelec Exc., pp. 15-17).

AEC/PREA except to the ALJ's determination that the ALJ places no burden on Penelec regarding safe and reliable service. AEC/PREA contend that past mitigation efforts may only be considered if there is no negative impact on the provision of reliable service. AEC/PREA further argue that the ALJ failed to fairly address their escrow concept for reliability improvements. (AEC/PREA Exc., pp. 6-12).

E. Resolution

In considering this issue, we conclude that Penelec has been innovative and aggressive in its mitigation efforts. It has renegotiated its long term NUG contracts to reduce its stranded costs. Its reverse RFP, while not as successful as Penelec hoped, showed innovative thinking which is the hallmark of a competitive firm. It is obvious that Penelec adopted a unique strategy for the competitive market earlier than other firms and has been pursuing strategy effectively. Based upon the record, we agree with the ALJ that although Penelec's mitigation efforts have been aggressive and innovative to date, we do not find that a special benefit should be awarded on that basis.

While Penelec is to be commended for its efforts to date, more remains to be done. Its proposed divestiture is incomplete. We await the results with anticipation that successful completion will significantly reduce the need for customer supported payments.

However, a significant challenge still faces Penelec in connection with its high-cost operating NUGs. Thus, the suggestion for a NUG divestiture program by the OCA warrants a close examination by Penelec, as well as examination of its NUG contracts and their eligibility for reassignment. Such a program must be undertaken in cooperation with the operating NUGs. Electric Generation Suppliers (EGSs) operating in the PJM market may have need of capacity assets that the NUGs can provide on an immediate basis and may be willing to structure unique financial packages to the benefit of all parties. These NUGs represent valuable Pennsylvania-based assets providing reliable power and significant local community and environmental benefits.

VII. UNBUNDLING AND RATE ISSUES

A. T&D Rates-Functionalization and Allocation

1. Parties' Position

A key part of the unbundling process is the establishment of just, reasonable and non-discriminatory Transmission and Distribution (T&D) rates that would be charged to all electric generation customers upon the implementation of restructuring.¹³

Penelec's proposal to "unbundle" the portion of its present rates associated with "Distribution" must satisfy dual requirements. It must comply both with Chapter 13 of the Public Utility Code and, at the same time, the requirement of the Electric Competition Act that Penelec's rates be unbundled and categorized as Generation,¹⁴ Transmission, Distribution and "Other Services."¹⁵ Further, Penelec's Distribution rates and their unbundling are capped at their January 1, 1997 levels for a period of 54 months starting January 1, 1997.¹⁶ (Enron MB at 10-11).

¹³ The Federal Energy Regulatory Commission (FERC), not this Commission, has jurisdiction to establish transmission rates, and the levels of those rates are not at issue here. The only issue with respect to transmission service is the identification of the cost associated with transmission service for the purpose of separating it from the rest of the bundled rate. See, PECO Compliance Filing Order at 9.

¹⁴ Penelec also refer to this component as "Production." See, e.g. Met-Ed St. 11 (Ketchum) at 6, 9, 14.

¹⁵ 66 Pa. C.S. § 2804(3); PECO Restructuring Order at 51.

¹⁶ 66 Pa. C.S. § 2804(4)(i); PECO Restructuring Order at 52.

Penelec has in fact proposed separate transmission and distribution charges, so that the term T&D rate or rates should be understood to refer to two different rates. (See, e.g., ME Exh. CLO-7R(2)).

Penelec proposed an unbundling of its current rates which began by functionalizing the most recent cost allocation study. (Penelec St. 11 at 8). These studies were then used as the basis for 1996 cost studies which functionalized costs into transmission, distribution, and production. (Penelec St. 11 at 12; OCA St. 6 at 2-3). The 1996 cost studies utilized the allocation factors from the earlier studies, with the exception of general plant and administrative and general (A&G) expenses. (Penelec St. 11 at 15). Penelec then presented additional cost studies which began with the 1996 studies, but increased the costs of distribution by refunctionalizing costs associated with NUG buyouts from the production function to the distribution function. (OCA St. 6 at 4; Penelec St. 11 at 21).

2. Penelec's Approach

In support of its rate unbundling and rate design in these proceedings, Penelec introduced the expert testimony of Malcolm Ketchum from Reed Consulting Group. (Penelec St. No. 11). In developing Penelec's cost of service and proposed rate design in these proceedings, Mr. Ketchum was guided by: (i) traditional cost of service and rate design principles; (ii) the Act; and (iii) the Commission's order on restructuring at Docket No. M-00960890, Folder 003. (Restructuring Order). (Penelec St. No. 11, p. 6). The fundamental principle defining Mr. Ketchum's efforts is that Penelec's cost of service analyses and rate design must be neutral with respect to current rates.

While the Act provides the general framework for the unbundling and rate design analyses performed by Mr. Ketchum, he focused on those portions that: (i) establish rate caps; (ii) require the unbundling of the production function; (iii) prohibit unreasonable

discrimination; (iv) require a cost recovery mechanism for universal service and conservation that is non-bypassable and competitively neutral; (v) establish the required level of unbundling; (vi) mandate that rates be designed to reflect the unbundling; and (vii) require all customers to share in transition costs. (Penelec St. No. 11, pp. 6-7).

Penelec's costs were allocated as they were in their last base rate proceedings. Mr. Ketchum unbundled the existing rates and did not "redesign them." (Penelec St. No. 11, p. 7).

After creating and calibrating the cost of service studies from Penelec's last base rate proceeding, Mr. Ketchum initiated the first step in the cost allocation process known as "functionalization." Functionalization is the assignment of rate base, expenses and certain miscellaneous revenues to the major operating functions, typically performed in reliance upon the Uniform System of Accounts and other accounting data. (Penelec St. No. 11, pp. 8-9). Functionalization is performed in two stages, with the initial cost assignments based upon information provided by Penelec. The second stage employed functionalization factors based directly on functionalized costs, such as total plant or labor expenses. (Penelec St. No. 11, p. 9-10).

The second step in the cost allocation process is "classification," which assigns functionalized rate base, expenses, and miscellaneous revenues to demand, energy, and customer components of costs. Generation and transmission plant are classified as demand-related. Distribution plant may be classified as demand and/or customer-related. (Penelec St. No. 11, p. 10).

The last step is the procedure by which costs are actually assigned to rate groups. In general, demand allocations are based on rate group demands, energy allocations

are based on rate group kilowatt hour consumption, and customer allocations are based on the number of customers. (Penelec St. No. 11, p. 11).

Mr. Ketchum developed updated cost of service studies for Penelec based upon the twelve months ended December 31, 1996, as required by the Restructuring Order. (Penelec St. No. 11, p. 12). In those studies, the major items required for cost allocation were updated. New demand studies were performed by Penelec to develop the various demand allocation factors, net system requirements, and time-weighted energy factors. In general, however, the methodological approach reflected in Penelec's prior cost of service studies has been maintained, with the level of detail and specificity in each study enhanced to facilitate rate unbundling. (Penelec St. No. 11, p. 14).

The OCA generally agreed with Penelec's unbundling methodology, except for the functionalization of NUG costs to distribution and the change in the allocation factor for A&G expense and general plant. Penelec removed the NUG costs from the distribution function in their supplemental testimony. (OCA M.B., p. 94). In addition, OCA removed certain costs that it found were improperly reflected in Penelec's cost of service based on the recommendations of OCA's witness Catlin. After removing the NUG costs from the distribution function, and reflecting its proposed adjustments, the OCA found a Company-wide T&D rate for Penelec of 2.007¢/kWh. (OCA St. 6-S, Exh. LS-8 (Penelec)).

3. Resolution

We agree with and adopt the OCA's developed rate of 2.007 cents/kWh. This is based on Penelec's deduction of the NUG costs from the distribution function and the OCA's deduction of certain costs reflected in Penelec's cost of service. After removing the NUG costs, and reflecting the adjustments recommended by the OCA, we accept a Company-

wide T&D rate for Penelec of 2.007 cents/Kwh. (R.D., pp. 145-149; OCA St. 6-S, Exh. LS-8 (Penelec)).

B. Generation Rates

1. Parties' Position

Penelec's overall generation rate can be derived by subtracting the calculated T&D rates from Penelec's overall average rate. Based upon OCA witness Lee Smith's Exh. LS-8 for Penelec, this results in a generation rate for Penelec of 5.279¢/Kwh ($7.286\text{¢/Kwh} - 2.007\text{¢/Kwh} = 5.279\text{¢/Kwh}$). (See, OCA St. 6-S, Exh. LS-8(Penelec)). This remaining rate, which represents Penelec's generation rate cap pursuant to the Act, is what is available to cover its remaining costs, i.e., their embedded generation costs. These embedded generation costs are then broken down by the costs which can be recovered at market prices, and those costs which are stranded, i.e. are in excess of market prices. The CTC proposed by the OCA is designed to recover the stranded costs within the parameters of this generation rate cap.

2. Resolution

We agree with and adopt the OCA's calculation of Penelec's overall generation rate which is derived by subtracting the calculated T&D rates from Penelec's overall average rate. Based upon OCA's Exh. LS-8 for Penelec, this results in a generation rate for Penelec of 5.279 cents/Kwh ($7.286\text{ cents/Kwh} - 2.007\text{ cents/kWh} = 5.279\text{ cents/kWh}$). (R.D., p. 149). The remaining rate, which represents Penelec's generation rate cap pursuant to the Act, is what is available to cover Penelec's remaining costs, i.e., its embedded generation costs. These embedded generation costs are then broken down by the costs which can be recovered at market prices, and those costs which are stranded, i.e. in excess of market

prices. As our practice has been to determine a CTC from the stranded costs found just and reasonable, the residual becomes a “shopping credit” for the customer to use in the market place.

C. Intervenors' Functionalization/Allocation Issues

1. Treatment of A&G Expenses and General Plant

a. Parties' Position

Penelec argued that their allocation methodology for A&G expense and general plant, which is different from the allocation methodology utilized in their last cost of service study, should be approved. In this case they use a labor allocation factor, whereas in the last rate case the factor was based on O&M elements.

The OCA opposed this change in allocation methodology because of the effect that the change had on the unbundling process. Specifically, the company change in allocation methodologies shifted about \$40 million in costs from the production function to the distribution function. (OCA St. 6, p. 9).

The OCA's witness Smith recommended that Penelec continue to use the expense/plant based allocation methodology from their last rate case in the unbundling process. (OCA St. 6-S, p. 1-2). In reply, Penelec argued that the OCA witness Smith's opposition to the use of a labor allocator here is inconsistent with her testimony in PECO where she supported the use of the labor allocator. (Penelec M.B., p. 106). However, the OCA explained thoroughly, and Penelec witness Ketchum acknowledged, that in PECO there was no allocation of the A&G expense made by PECO, even though PECO had previously used a labor allocator for these expenses. (OCA St. 6-S, p. 2; Tr. 1437). Thus, Ms. Smith

recommended a return to the labor allocator that PECO had previously used in its most recent base rate proceeding. Id.

The Commission was dissatisfied with PECO's allocation of A&G costs because too low a proportion had been allocated to the generation/production function, and directed them to follow the OCA's recommendation. (PECO Order, pp. 60-61).

b. ALJ's Recommendation

The ALJ noted since the purpose of unbundling is to separate current rates into their component parts, the allocation methodologies that were the basis of those component parts should be utilized to unbundle the rates. In this case, the allocator used by Penelec in establishing current rates was an allocator based on O&M expense and plant. Finding Ms. Smith's refunctionalization of general plant and A&G expense based on the allocators from Penelec's last cost of service study appropriate and fully consistent with the Act, the ALJ recommended that the OCA proposed O&M based allocation factor be adopted. (R.D., pp. 150-151).

The OCA also made pro forma cost of service adjustments to completely eliminate Voluntary Employee Reduction Program (VERP) costs and to reallocate Other Post Employment Benefits (OPEB) costs. The ALJ reasoned that these adjustments are logical because they carry out certain OCA adjustments proposed to stranded costs. Penelec's criticism of OCA for being selective about which of their adjustments to pursue in cost of service adjustments did not persuade the ALJ that the Commission should not consider the OCA proposals. (R.D., pp. 151-152).

The ALJ questioned the fairness of the VERP adjustment because one of the major reasons to eliminate VERP expenses from stranded costs was that they had actually

been absorbed in rates. The Intervenors alleged that the VERP expenses would have been offset by payroll and benefits savings. However, the ALJ concluded that the record does not contain any evidence as to whether the expenses were completely made up by savings. The ALJ agreed that the liabilities and credits should be tracked together, but that the balance can be included in the cost of service. (R.D., pp. 151-152).

The allocation of OPEB costs between functions is also consistent with the OCA proposed adjustment in the regulatory assets/transition costs to be included in stranded costs, and the ALJ recommended that it be adopted. (R.D., pp. 151-152).

c. Parties' Exceptions

In its Exceptions, Penelec concludes that the impact of rejecting its labor allocation factor results in shifting \$206.3 million of A&G expenses from distribution/customer services to production, with profound and costly implications. First, it creates a massive rate reduction of \$55.421 million in Penelec's distribution rates which it cannot financially withstand. Second, it increases Penelec's stranded cost claim in this proceeding by \$266.3 million. (Penelec Exc., p. 18).

Penelec argues that in the Motion of Chairman Quain adopted on March 14, 1998, in the PP&L restructuring proceeding, (Docket No. R-00973954), the Commission permitted PP&L to recover all of its A&G expenses in its stranded cost claim, in response to a similar argument made in this case by the OCA that such costs should be reallocated from distribution to the production function (Motion, pp. 30-31). (Penelec Exc., p. 19, footnote).

Penelec claims that the Recommended Decision is in error in the underlying application of the functionalization of A&G expenses. Although appearing to accept the

OCA's recommended treatment of all A&G related expenses (OCA Exh. LS-2), the Recommended Decision does not reflect that goal. The OCA's production-related A&G is \$39.050 million for Penelec. On the other hand, the production-related A&G suggested by the ALJ is \$77.6 million which adopts not only the OCA's position, but part of Enron's and the Industrials' as well. Penelec argues that this difference is unsupportable. (Penelec Exc., pp. 18-21).

The OCA concludes that Penelec's Exception to the ALJ's recommendation regarding A&G expense allocation should be dismissed. The OCA notes that Penelec moved a portion of these costs from the generation component into the T&D rate component in its unbundling process. The OCA proposed a return to the allocator used in the last rate case which resulted in a reversal of Penelec's proposal and which has the effect of returning the \$32.7 million in expenses to the generation component of unbundled rates. The OCA submits that its A&G proposal is *not* a disallowance of costs as implied by Penelec and it does not result in additional stranded costs that have not already been reflected in the OCA's analysis. (OCA R. Exc., pp. 18-19).

PICA suggests that Penelec's Exception to the A&G correction must be denied because it is a double-counting of the A&G expenses in generation stranded costs. (MEIUG/PIA R. Exc., pp. 15-16).

In addressing the ALJ's recommendation concerning OPEB and VERP the OCA maintains that the ALJ erred in failing to adopt a corresponding adjustment to T&D revenue requirements for VERP costs. The OCA notes that the ALJ adopted the OCA's proposed stranded cost disallowance of the VERP costs for 1994 and 1996. (R.D., pp. 108-110). However, the OCA argues that it is unnecessary and improper to reflect these costs as an additional, ongoing component of current rates when the costs have been offset by the savings under current rates. Therefore, the OCA concludes that the

inclusion of VERP costs in T&D revenue should be reversed and an adjustment to the T&D revenue requirement in the amount of \$44.098 million for Penelec should be adopted. (OCA Exc., pp. 18-19; R. Exc., p. 17; OCA M.B., pp. 70-71).

PICA agrees that the ALJ properly rejected Penelec's OPEB claim of \$36.65 million because it failed to demonstrate adequate and viable OPEB cost containment. (MEIUG/PIA R. Exc., pp. 12-13).

d. Resolution

We will adopt the ALJ's recommendation to accept Penelec's cost of service calculation as modified by the OCA adjustments. The OCA has raised two issues with respect to Penelec allocations. First, the OCA argues that Penelec departed from the prior cost of service treatment for allocating A&G expenses and, second, the OCA suggested removal of the 1994 and 1996 VERP expenses from the results of the study, disallowance of the future recovery of that revenue, and lowering the non-generation rate cap.

Regarding the first issue, Penelec previously allocated A&G expenses based upon O&M expense and plant. In this case, Penelec used a labor allocator for the assignment of the A&G expenses. As noted by the OCA, Penelec moved a portion of these costs from the generation component into the T&D rate component during the unbundling process. The OCA supported the prior case method which was adopted by the ALJ. We agree that the prior case method should be employed as more proper for the unbundling of the present rates. This results in a shift of expense from T&D to the generation portion and we have accounted for the increase in stranded costs which result from this adjustment in our computations

Regarding the 1994 and 1996 VERP expenses included in the cost of service unbundling, we agree with the OCA that these are one time expenses. Our historic rate-

making practice would be to remove the impact of such non-recurring expenses from rates. OCA witness L. Smith's adjustment to the Penelec study properly reflects the removal of the 1994 and 1996 expenses. By this action, the T&D rates are lowered to come into line with the ongoing level of expenses. Therefore, we will adopt the OCA adjustment to remove VERP expenses from the cost of service. In addition, we adopt the ALJ's recommendation to adopt the OPEB claim consistent with the OCA proposal.

2. Account 923 Costs

a. Parties' Position

Enron and PICA also objected to Penelec's functionalization of their A&G account for Outside Services. (Enron Brief, p. 15; MEIUG/PICA Brief, p. 65). Specifically, these parties contend that Account 923 (Outside Services Employed) have been improperly functionalized and a greater portion should be functionalized to production as follows:

The Company improperly allocated an excessive amount of Account 923 ("Outside Services Employed") to distribution revenue requirements.¹⁷ Distribution revenue requirements are comprised of distribution function and customer function costs. The Company's proposed functionalization of a significant portion of Account 923 costs to the distribution revenue requirement is clearly inappropriate because a significant portion of Account 923 costs were charged by GPU Nuclear and GPU GENCO, which are the Company's generation affiliates. Because charges by these two entities are obviously not distribution-related, the charges must be removed from the distribution revenue requirement. MEIUG St. No. 1, p. 48. Approximately \$19.300 million (Met-Ed) and \$19.507 million (Penelec) in Account 923 costs are related to nuclear and fossil

¹⁷ Penelec incurred test-year level Account 923 costs of \$39.448 million, and assigned \$34.049 million of these costs to its distribution revenue requirement. Penelec Exh. No. MRK-2-R, Sched. C-2B, p. 113.

plants and, accordingly, must be assigned to the generation function with a corresponding decrease in the distribution revenue requirement. MEIUG St. No. 1, p. 48; PICA St. No. 1, p. 47.¹⁸ These proposed reductions have been reflected in MEIUG/PICA's unbundled distribution rates and in MEIUG/PICA's calculation of generation-related stranded costs.

(MEIUG/PICA MB at 65-66).

Penelec argued that, post-divestiture, other outside services not related to production will be required; that all of A&G costs should be allocated using the same [labor] functionalizer for consistency; that examining more A&G accounts separately might lead to more cost shifting against the intervenors' interests; and, that, there is no reason to give special treatment to this account. (Penelec R.B. pp. 49-50; Tr. 1524).

b. ALJ's Recommendation

The ALJ agreed with the Industrials and Enron reasoning that the purpose of this unbundling allocation is to, as correctly as possible, allocate costs for rate design so that neither distribution nor generation customers are charged for more than they should be charged, and to establish Penelec's generation rate, as nearly as possible, on the same cost elements as the EGSs. The ALJ recommended that PICA's reallocation adjustment to Account 923 be adopted. (R.D., pp. 152-153).

¹⁸ Including the effects of gross receipts taxes, the effect on Penelec's total distribution revenue requirement is a reduction of \$20.404 million. PICA St. No. 1, p. 47.

c. Parties' Exceptions

Penelec claims that the Recommended Decision erroneously allocates and functionalizes the A&G Account for Outside Services. By accepting the arguments of the Industrials and Enron, the Recommended Decision requires Penelec to shift \$19.5 million from its distribution revenue requirements to production. Penelec maintains that if the historical precedent advocated by the OCA (and accepted by the ALJ) is correct, the Recommended Decision cannot selectively create a direct assignment for Account 923 (Outside Services Employed). (Penelec Exc., p. 21).

Enron and PIA concur that the ALJ correctly recommended that there is no reason to require distribution-only customers to pay Outside Service costs which are generation related. In addressing Penelec's argument that Outside Services were treated selectively in the Recommended Decision, Enron notes that the purpose of this proceeding is to assign expenses to the service that causes them to be incurred. It is only when functionalization of expenses is not immediately obvious that an allocation method must be used. There is no need for an allocator, historical or otherwise, where expenses, related to generation sales of electricity, are being improperly allocated to distribution costs. (Enron R. Exc., pp. 10-11; MEIUG/PIA R. Exc., pp. 16-17).

d. Resolution

The Industrial intervenors and Enron argue for a reallocation of Account 923 - Outside Services. The parties prefer a larger allocation to production to reflect clearing of GPU Nuclear and GPU Genco costs through the account. The ALJ recommended adoption of the adjustment. Penelec has excepted as single issue ratemaking and that the account should be allocated based upon labor as the other A&G accounts.

We adopt the OCA allocation based upon the prior case which already takes into account the point raised by the Industrials and Enron. No additional separate adjustment is necessary. We also recognize that changes in accounts will occur from year to year and that specific examination of account 923 without examination of the other accounts is inappropriate. The A&G adjustment proposed by the OCA is a reasonable and satisfactory resolution of this issue. Therefore, we shall reject the ALJ's recommendation and adopt the Penelec argument that an adjustment to account 923 Outside Services not be made because it is inconsistent with the balance of A&G functionalizing.

3. Sales, Uncollectibles and Customer Information Expenses

a. Parties' Position

Enron argued that sales expenses are incurred to promote the sale of additional energy to retail customers, and as such, must obviously be allocated to the generation portion of Penelec's operations to avoid cross subsidies. Enron next asserted that another category of misallocated expenses are those included in USOA accounts 908 and 909: Customer Assistance and Informational and Instructional Advertising Expenses, which total \$3.75 million. A review of these costs shows that they relate to promoting and encouraging the use of electric energy, either generally or from a safety or conservation standpoint, and does not indicate that any of the costs are directly associated with distribution-related delivery system activities. Enron next addressed the allocation of the uncollectibles expense, 100% of which are attributed to the distribution function. Enron argued that uncollectibles are associated with all services, including generation, and should have been allocated accordingly.

Penelec responded noting that, Enron's continuing criticisms of the allocation of these expenses show a lack of understanding of Penelec's cost allocation and functionalization methodology. Their approach might be described as residual design. The

fact that, for rate design purposes, a portion of the customer service revenue requirement is recovered through distribution charges does not mean that Penelec is suggesting that these costs are related to the distribution function. Penelec is not able to recover all customer-related costs through current customer charges because they must ensure revenue neutrality by maintaining the current levels of such charges. Thus, recovering a portion of the costs associated with sales expenses, uncollectibles and customer information and assistance expenses through the distribution charges is a pragmatic response to the need to maintain revenue neutrality under the Act, and at the same time to collect enough revenues to meet their requirement. (Penelec St. No. 11, Supp. 2, pp. 11-12; Penelec Brief, pp. 108).

Penelec also asserted that as a practical matter, each of these costs will continue to be incurred by Penelec in the pursuit of their normal business objectives subsequent to divestiture and as the industry transitions to more competitive generation. (Tr. 1427-1429). The ALJ found that the fact that Penelec will have divested itself of their generation assets does not mean that they will not provide an "electricity supply" service to their customers. The ALJ noted that Penelec appears to contemplate purchasing power and providing it to customers under a "market energy" charge. The power marketing function will replace the generation function. (R.D., pp. 154-155).

According to Enron, the question is not whether Penelec will continue to have such functions as sales, customer assistance and uncollectibles, but whether a major portion of these expenses should be reallocated to the production function instead of being thrown into the "distribution" category. To the extent the expenses are not customer charges, they should not be part of the unbundled distribution charge and that, therefore, should not be collected through distribution charges. According to Enron, if required to allocate these costs to production, Penelec will be forced to recover these generations related costs in the same way its competitors will be required to do, through sales of generation. (R.D., p. 155).

b. ALJ's Recommendation

The ALJ found that this approach may be temporarily acceptable to meet the exigencies of the rate cap and the need for sufficient revenues, but it will eventually have to change to more accurate allocations. The Commission has always regarded cost of service studies as more of an art form and a guide rather than as a source of actual data. However, these allocations cannot be allowed to seriously distort the generation and distribution charges so that customers are getting incorrect or, at least meaningless, price signals, and competitors are hampered in entering the market. The ALJ noted that if the distribution rate remains relatively high due to inclusion of generation related costs, and the generation rate is low because it does not include costs that it should, then customers will be less motivated to shop because they will be able to achieve only limited savings. (R.D., p. 155).

The ALJ observed that if this kind of allocation is really necessary, and the Commission accepts it, then there is good reason to set the market price of electricity component and the shopping credit higher so that there will be more room for competitors to enter. The ALJ recommended that Penelec be directed to provide more accurate allocations of expenses to these accounts, or that the Commission increase slightly the level of the shopping credit. (R.D., pp. 155-156).

c. Parties' Exceptions

Penelec maintains that the ALJ erroneously requires it to provide refined expense allocations or otherwise experience an increased retail shopping credit. Penelec submits that it is not able to recover all customer-related costs through current customer charges because it must ensure revenue neutrality by maintaining the current levels of such charges. (Penelec R.B., p. 51). Thus, recovering a portion of the costs associated with sales expenses, uncollectibles and customer information through the distribution

charge is a pragmatic response to the need to maintain revenue neutrality under the Act. (Penelec St. No. 2, pp. 11-12; Penelec M.B., pp. 108-109; Penelec Exc., pp. 21-22).

MAPSA believes that this approach unfairly penalizes a shopping customer because that customer will be paying these types of expenses twice - once as part of the distribution rate, and again in the rates charged by the customer's alternative supplier. Therefore, MAPSA argues that the ALJ correctly concluded that these expenses should be recovered by Penelec and the competitive suppliers in the same manner - through the generation rate. (MAPSA R. Exc., pp. 3-4).

Enron suggests that the ALJ erred in rejecting Enron's adjustments to remove retail sales-related costs from Penelec's unbundled distribution rate. By charging 100% of its sales, customer service and uncollectibles expenses through the distribution rate to all customers, all of which expenses are, in whole or in substantial part, related to Penelec's sale of electric generation, Penelec would effectively receive a subsidy for its generation services - giving Penelec an unfair competitive advantage, and impeding, instead of promoting, competition. Enron maintains that sales and customer service expenses should be reallocated to generation and the third category, uncollectibles, should be allocated to all three functions, rather than allowing Penelec to provide a new set of refined expense allocations. (Enron Exc., pp. 4-9; R. Exc., pp. 11-12).

Penelec contends that Enron's position ignores the fact that it will continue to incur these types of expenses in order to increase total through-put and efficient use of its T&D system and to encourage the use of that system over alternatives. With respect to uncollectibles, Penelec contends, Enron ignores the fact that Penelec, as the supplier of last resort, continues to assume the expense and risk associated with customer collections. (Penelec R. Exc., p. 20).

d. Resolution

This issue is similar to the issue raised by Enron in each of the previous restructuring proceedings we have reviewed and decided. The ALJ has not definitively provided a recommendation on this issue. Based upon the record, we conclude that Penelec has provided sufficient information to retain these account allocations at the level determined by the OCA as T&D service related. Enron has failed to demonstrate that these expenses will not be necessary for the distribution company, particularly while it performs as the provider of last resort and supports universal services. (See PECO Restructuring Opinion and Order, p. 61 (Order Entered December 23, 1997).

4. Allocation of Generation Component of Rates to Customer Classes Similar to Allocation of Purchase Power Costs

a. Parties' Position

MAPSA proposed that Penelec should have allocated the generation component of their rates to customer classes in the same way they allocate purchase power costs for purposes of unbundling. (MAPSA Brief, p. 10). Penelec responded :

The Companies allocated demand-related purchase power costs on the basis of their historically-approved production demand allocator, and energy-related purchase power costs on the basis of their historically-approved production energy allocator. These costs, like all other production costs, were allocated in the manner approved in the Companies' last base rate cases. The total production revenue requirement derived through the use of all production allocators, was then used to allocate the market energy "credit". Thus, if a class is responsible for 20% of the production revenue requirement in the cost of service, 20% of the market energy revenues are also allocated to that class. This methodology ensures that production cost responsibility is unchanged as a result of unbundling.

Penelec asserted that it is unclear why MAPSA suggests that this approach is faulty. According to Penelec, it allocated all production costs on the basis of historically-approved allocators.

b. ALJ's Recommendation

The ALJ adopted Penelec's position and recommended that MAPSA's proposal not be adopted. (R.D., p. 156).

c. Resolution

No party filed Exceptions to the ALJ's finding and recommendation on this issue. We note that MAPSA has proposed the allocation of the generation component as purchased power among customer classes. Penelec followed its historic allocation for this element of cost of service in order to minimize cost shifting among rate classes during the unbundling determinations. The ALJ agreed with Penelec and rejected the MAPSA adjustment. We agree with the ALJ that Penelec's method is the proper method to ensure that rates are properly unbundled.

5. Residual Transmission Revenue Requirement

a. Parties' Position

Enron claimed that Penelec's residual transmission revenue requirement should be eliminated entirely from distribution rates and not recovered. (Enron Brief, pp. 21-22). However, Penelec contends that although the FERC has assumed jurisdiction of the unbundled transmission function, they continue to have real non-FERC jurisdictional

transmission costs that exist and have not been eliminated. (Penelec Brief, p. 109). The fact FERC has assumed jurisdiction over certain transmission costs does not eliminate other costs that may not have been defined previously, or justify removing such costs from rates where they have been historically recovered. As Penelec witness Ketchum explained, there are several reasons why the transmission costs do not precisely match the PJM FERC filing *transmission costs, including timing, methodology and definition of transmission facilities.* (Penelec St. No. 11, pp. 23-24).

Penelec argues Enron's characterization of the treatment of residual transmission revenue requirement as "imposing" costs on captive delivery customers misses the mark. These are actual "wire costs" that are properly allocable to distribution customers. Enron's proposed elimination of the residual transmission requirement is completely unacceptable and should be rejected. (R.D., p. 157).

b. ALJ's Recommendation

The ALJ found that these costs should be allocated to the transmission function, still under the rate cap, and collected through the transmission rate from whoever pays it. (R.D., pp. 156-157).

c. Parties' Exceptions

Enron contends, the ALJ erred in rejecting its adjustment to remove this cost from Penelec's unbundled distribution rate. Instead of seeking to rectify this matter before FERC, Penelec is attempting to collect transmission revenue - in the amount of \$11,248,435 - as part of its distribution rates. To the extent that Penelec's transmission service rates do not cover all its associated costs, it should take steps before FERC to obtain rates that are compensatory. Moreover, to the extent that Penelec contends that

this expense is non-FERC jurisdictional, Penelec has completely failed to demonstrate or identify any transmission facilities which are non-FERC jurisdictional. Enron agrees they should be part of the transmission rates, but it is only FERC that can approve this inclusion and it is up to Penelec to obtain FERC's approval to collect those costs. (Enron Exc., pp. 9-10).

In response, Penelec argues that the ALJ properly rejected Enron's proposed adjustment to eliminate Penelec's residual transmission requirement from distribution rates. Penelec maintains that all distribution customers are also transmission customers - corroborating the appropriateness of recognizing the residual transmission revenue requirement in retail rates. These costs are "wire costs" that are properly allocable to distribution customers. (Penelec R. Exc., pp. 20-21).

d. Resolution

In addition to FERC based transmission charges, Penelec requested a Pennsylvania PUC jurisdictional transmission charge for costs not related to FERC jurisdiction. Enron opposed the recovery of these charges arguing that such non-FERC charges cannot be permitted. The ALJ has accepted Penelec's claim and rejected the Enron adjustment. We agree. Penelec has adequately demonstrated the existence of PUC-based transmission charges not recovered through FERC charges. Penelec, however, must assure in its compliance filing that the interaction between PJM billed charges and the Penelec charges are properly handled. Therefore, a separate statement of these charges segregating FERC-approved charges and those approved by this Commission is directed. We emphasize, however, that our order does not directly or indirectly set FERC-jurisdictional transmission charges.

D. Other Issues

1. Distribution Losses

a. ALJ's Recommendation

Penelec's revised position on line losses is that these costs should be recovered as part of the Retail Generation Credit and arranged for and paid by the supplier.¹⁹ Enron agreed that line losses are generation related and should be recovered as a separate charge to enable suppliers to competitively procure this service if they wish to do so. (R.D., p. 158).

b. Resolution

No party filed Exceptions to the ALJ's finding and recommendation on this issue. Penelec's revised position has been accepted by the parties, and the ALJ recommended its adoption. We agree. When possible, customers should be allowed to procure distribution losses from alternate suppliers. To the extent that a portion of the embedded costs allocated *to distribution losses will become stranded, such costs may be recoverable through the CTC*, if appropriate, based on the determination of stranded utility generation.

¹⁹ Penelec St. 14 at 57-59.

2. Ancillary Services

a. Parties' Position

FERC Orders 888 and 888a require transmission providers, like Penelec, to permit their customers (including suppliers) to self-provide ancillary services to the extent that it is technically feasible under applicable reliability council standards. While Penelec agrees that ancillary services must be unbundled and priced on the basis of FERC-approved rates under the PJM Open Access Transmission Tariff, Enron argued that Penelec failed to recognize that an associated adjustment is required to remove the embedded generation cost of ancillary services from Penelec's retail rate revenue requirement. (Enron M.B., p. 25; R.D., p.158).

b. ALJ's Recommendation

Enron sought to have the Commission direct Penelec to calculate the embedded generation cost of ancillary services, and this value should be deducted from Penelec's generation revenue requirements. Penelec has not opposed this request, and the ALJ recommended that the Commission so order. (R.D., p. 158).

c. Resolution

No party filed Exceptions to the ALJ's finding and recommendation on this issue. Penelec has agreed that the PJM tariff will govern this service and that its FERC transmission rate revenue requirement will reflect the embedded cost of generation which is removed from the retail generation services. We agree and adopt the ALJ's recommendation.

3. Voltage Differentiated Rates

a. Parties' Position

Enron proposed a Distribution Services Tariff (DST) which would apply to EGSs who will be responsible for making all the necessary arrangements (acting as agent) for individual or aggregated end-user customers. In conjunction with the DST, Enron proposed that rate design and applicable rates be greatly simplified, with rates designed so as to reflect the characteristics of the customer's service, including voltage level, rather than historical identification by traditional "class" of service. To demonstrate its proposal, Enron provided a sample rate design calculation for Energy Delivery Services. Revenue requirements attributable to Energy Delivery Services were summarized into customer-related and demand-related categories, and were then further segregated by customer voltage level. Notably, in that example, the demand charge component for service at secondary voltage was cumulative in that it covered demand-related costs of transmission and primary and secondary voltage facilities. (Enron M.B., pp. 25-28).

Penelec opposed this tariff because it would cause cost shifting in the situation where Enron is both agent and customer; it would be unclear who is the ultimate customer; and, the customer and transaction might end up outside the Commission's jurisdiction, in violation of the Act. Penelec noted that the Commission and its ALJs have rejected this proposal from Enron on several previous occasions.

According to Enron:

The Companies incorrectly contend that the rates proposed to be used in conjunction with the DST would cause cost-shifting. Under the DST, the EGS, acting as agent for end-users, is the customer. In that circumstance, historic customer class distinctions have little meaning. But where the EGS is not acting

as agent for the end-user, and for default customers, Met-Ed's or Penelec's class-based unbundled tariff would apply. But where the DST applies, the important thing is that Met-Ed or Penelec as EDC is appropriately compensated in aggregate by the EGS for distribution services rendered. The voltage-differentiated rate mechanism presented in Enron Exhibit 3, PDR-4, is a simple straightforward means to accomplish that objective.

Enron's Distribution Service Tariff is new and different, admittedly. But it also better suits the needs of customers and allows the Companies to track costs in a way that appropriately considers the new competitive environment. The Commission should order that it be adopted.

(Enron M.B. p. 27).

b. ALJ's Recommendation

The ALJ noted that Penelec has agreed to accept agency relationships, but that the proposed DST service would be several steps beyond the basic agency relationship Enron might establish with Penelec on behalf of a customer. The ALJ further noted that, while this tariff/service might function well in a fully competitive market, Pennsylvania is not there yet. As a result, the ALJ recommended that this issue be deferred to the negotiations to occur to develop the supplier tariff. (R.D., pp. 159-160).

c. Parties' Exceptions

Enron contends that the Commission should order Penelec to implement Voltage-Differentiated Rates. Enron excepts to the ALJ's recommendation that the Commission defer Enron's proposed DST and its associated simplified rate design. Enron notes that Penelec alleges, erroneously, that the voltage-differentiated rates will violate the cost-shifting prohibitions in the Electric Competition Act. Significantly, the ALJ did

not accept Penelec's position on this issue. Therefore, the Commission should go beyond the ALJ's recommendation that the matter be negotiated and order Penelec to file compliance tariffs incorporating Enron's proposed DST and associated voltage-differentiated rate design. (Enron Exc., pp. 11-12).

d. Resolution

Consistent with its presentation in other restructuring cases, Enron has continued its request for a voltage based delivery service tariff. We agree with the ALJ that Enron's request violates the rate cap provisions of the Act by advocating that interclass rate shifts be ordered which would result in the merger of the small general service and residential classes and eliminate the universal service protections from the residential class.

E. CTC Development/Design Issues

1. Parties' Position

The ALJ observed that the CTC is crucial to the implementation of the Act. Accordingly, the ALJ began her discussion by incorporating the OCA's explanation of the CTC and how it was calculated. The OCA stated that the CTC is the charge which the Act provides for recovery of stranded or transition costs from customers. (66 Pa. C.S. §2808). The OCA submitted that the Act allows for application of the CTC through December 31, 2005 (the "CTC recovery period"), unless the Commission, in its discretion and for good cause shown, orders an alternative payment period. (66 Pa. C.S. §2808(b)).

According to the OCA, Penelec has developed its CTC as a "residual" value each year, i.e. the difference between the sum of the T&D rates and the market based generation charges. (Penelec St. 11, p. 27). The OCA contended that Penelec has only

included its owned-generation stranded costs in what they term the CTC, using a charge called the Other Transition Charge (OTC) and the NUG Clause (NCR) for the recovery of NUG-related stranded costs and nuclear decommissioning costs. The OCA further states that, not only it, but all other intervenors oppose the implementation of the OTC and NCR as well. (OCA MB at 43-4; R.D., pp. 160-161).

The ALJ observed that Penelec, through the testimony of Mr. Carroll, has now committed to handling its NUG operating costs under the rate cap, and will not press for a separate NCR, as long as they can operate this mechanism as part of the CTC. Mr. Carroll contended that Penelec needed the NCR or some similar mechanism to collect all of their NUG costs. (Tr. 632-633, 641-647). The ALJ further related that the OCA recommended the use of a CTC designed to produce an equal percentage rate reduction for both Met-Ed and Penelec as shown on Exh. LS-8(ME) and LS-8(PN). (R.D., pp. 161-162).

As noted by the ALJ, the OCA's witness Ms. Smith testified that, for Penelec, the total levelized CTC revenue requirement is \$140.083 million, assuming a discount rate of 7.12 percent, resulting in a 3.3 percent overall rate decrease for Penelec. Exhibit LS-9(PN) shows Ms. Smith's final updated calculation of the retail CTC, designed to collect the OCA's final recommendation of \$609.971 million, exclusive of nuclear decommissioning costs, in stranded costs for Penelec. The OCA's final recommendation resulted in a company-wide CTC in 1999 of 1.703 cents per kwh, with a nuclear decommissioning charge of 0.060 cents per kwh, which would allow for an 8 percent overall rate reduction for Penelec based on the OCA's witness Doug Smith's market prices. (R.D., pp. 163-165).

Penelec argued before the ALJ that in order to permit Penelec to recover its stranded costs in seven years, Penelec found it necessary to design both a levelized CTC and a levelized retail generation credit. (R.D., p. 164). Penelec's witness Mr. Carroll testified that the levelization of the CTC for Penelec is based on the desire to provide for full stranded cost

recovery and to provide a significant incentive to customers to save money by actually competitively shopping for their electric supply.

In Penelec Exh. DC-13(R), Penelec's witness Mr. Carroll provided the levelized CTC present value revenues necessary to fully recover Penelec's stranded costs, exclusive of NUG commitments. Based on anticipated sales growth, Penelec Exh. DC-13(R) allegedly demonstrates that Penelec will collect about \$234 million over an approximate seven-year period, commencing January 1, 1999. When compared to Penelec's claimed stranded cost level of \$238.28 million, Penelec will also be able to fully collect its stranded costs, exclusive of OTC commitments, through a levelized CTC and retail generation credit. Penelec contended that, by levelizing the CTC and the retail generation credit, Penelec's customers will have an opportunity to save about 8 to 9 percent. (R.D., p. 165).

The ALJ noted that PICA proposed that the CTC component of each unbundled rate be calculated as a residual, after removing transmission, distribution, and projected market prices from current bundled rates. (MEIUG/PICA St. No. 1, p. 29). The ALJ observed that PICA's unbundling analysis includes Mr. Falkenberg's projected market prices, with adjustments to reflect service to retail load. According to PICA, under this "CTC residual" approach, projected market prices, which increase over time, are subtracted from a level, unbundled generation component (*i.e.*, the generation "rate cap"), to produce a residual CTC that decreases in direct proportion to the increases in projected market prices.

The ALJ further noted that, in contrast to Penelec, PICA proposes to recover all Commission-approved stranded costs through a CTC. PICA opposes Penelec's proposal to collect NUG stranded costs and NUG buy-out costs through a mechanism other than the CTC.

2. Reconciliation

The ALJ noted that the Act obligates the Commission to establish “procedures for the annual review of the competitive transition charge” and “reconcile the annual revenues received from the charge with the annual amortization of transition or stranded costs approved by the commission.” (See 66 Pa. C.S. § 2808(f)). The ALJ further noted that there are almost as many approaches to reconciliation developed on this record as there are to calculation. In its argument before the ALJ, Penelec proposed an annual true-up on a company-wide basis, with an actual check on market prices. The OCA would require reconciliation on a class by class basis as the best if not only way to avoid CTC “escape artists.” PICA proposed a CTC reconciliation mechanism to ensure that Penelec is given a reasonable opportunity to recover its Commission-approved stranded costs during the seven-year CTC recovery period contemplated by the Competition Act.

The ALJ observed that the possibility exists that the Penelec will not fully recover its approved level of stranded costs over a seven-year CTC recovery period. Under Section 2808 (b), if this occurs, Penelec may file a request for an extension of the CTC recovery period. 66 Pa. C.S. § 2808(b). However, the Industrials opposed any preapproval of any extension of the CTC recovery period in the context of this restructuring proceeding.

3. ALJ’s Recommendation

In considering these issues, the ALJ recommended adoption of the CTC and retail generation credit proposed by PICA. (R.D., pp. 178-179).

4. Parties' Exceptions

In its Exceptions, Penelec argues that the ALJ erred by erroneously adopting the CTC and retail generation credit proposed by PICA. Penelec contends that the ALJ failed to acknowledge the integrated relationship between the CTC and the retail generation credit. Furthermore, Penelec asserts that the ALJ erred by not recommending approval of a CTC recovery period in excess of seven years. Penelec further excepts to the ALJ's failure to use Penelec's proposed levelized CTC and retail generation credit. (Penelec Exc., pp. 22-24).

MAPSA contends that the ALJ erred in recommending use of a residual CTC methodology and asserts that the methodology used in PECO Energy, as well as the Duquesne and West Penn restructuring proceedings, should also be used in this proceeding. MAPSA also excepts to the ALJ's failure to provide any analysis of the specific rates and credits to be adopted in this proceeding, as opposed to only establishing the methodology to be used in calculating those rates. (MAPSA Exc., pp. 4-7).

The OCA excepts to the ALJ's recommendation to use the PICA methodology for calculating the CTC and retail generation credit and argues that the Commission made it clear at pages 5-6 of its recent motion regarding PP&L's restructuring plan that the CTC should not be the residual. The OCA further contends that the ALJ erred by not recommending reconciliation of the CTC on a class-specific basis (OCA Exc., pp. 19-21).

5. Resolution

In considering these issues, we note that the ALJ provided an extensive discussion of the various proposals for CTC development and design and recommends the Industrials' position for CTC development and calculation. Penelec's primary case provided for separate charges for CTC and Other Transition Charges (OTC) where the OTC is a long

term charge to reflect NUG and nuclear decommissioning costs. As will be explained in greater detail below, we reject the separate OTC and include all stranded and transition costs in collection of the CTC.

The OCA has properly described the Commission-preferred process for the CTC. We specifically develop a CTC based upon our findings of a just and reasonable recovery of proven transition and stranded costs. The residual from our determination is a shopping credit to be used by customers for comparing offers for generation services. Beyond that, reconciliation of CTC recovery should be done on a class basis reflecting actual sales.

Our design of the CTC is to provide a declining CTC, which amortizes the recoverable stranded costs over 8 years and provides for a pre-tax return of 10.4 percent on the unamortized balance. This interest rate is based upon the long term cost of debt of Penelec, with the equity portion of the capital structure adjusted for taxes. The ALJ did not recognize the effect of taxability on the equity portion of the rate, thus, we reverse in that regard and Penelec's exception is granted. The CTC shall reflect a monthly amortization, levelized for a calendar year. This method is similar to our determination in the West Penn and PP&L restructuring cases.

As we stated in West Penn, the Act requires us to determine the CTC "from the bottom up" based on the authorized recoverable stranded costs. Once the authorized recoverable stranded costs are determined, the CTC and the Transmission and Distribution component are subtracted from the total rate, to arrive at the Shopping Credit. (West Penn, p. 168).

In West Penn, we further concluded that the CTC must be calculated as the amount necessary to fully amortize the authorized recoverable stranded and transition costs over the recovery period, including a return on the unamortized principal balance. The CTC

was designed to reflect a declining CTC over the transition period ending on December 31, 2005. We determined that it was appropriate to use a declining CTC in order to properly balance West Penn's earnings in the early years of the transition period and reasonable customer savings during the entire transition period. (West Penn, p. 170). The methodology used in West Penn is appropriate in this proceeding, as well. Our calculation of the Stranded Costs, the CTC and the Shopping Credit for 1999 are presented in the attachments to this Order.

Use of the leveled CTC and Generation Credit proposed by Penelec is rejected because, in our opinion, it would stifle competition which would be inconsistent with the requirements of the Act.

With respect to the Exceptions of the OCA (OCA Exc., pp. 19-21) and MAPSA (MAPSA Exc., pp. 4-7) alleging that the ALJ erred in recommending that the CTC should be calculated as a residual, we concur with the OCA and MAPSA. We stated in West Penn that a CTC calculated "from the top down" as a residual amount bears no relation to the determination of recoverable stranded costs and must be rejected. (West Penn, p. 168). We note that the Act requires the unbundling of the embedded cost of generation so that a shopping customer would no longer pay the EDC the embedded cost of generation except for a temporary amount, the CTC, to permit the utility to recover its authorized stranded costs. The Shopping Credit, not the CTC must be the residual amount.

Regarding Penelec's Exception, at pages 22-24 of its Exceptions, that the ALJ erred in not recommending a CTC recovery period in excess of seven years, we agree. As noted above, we are authorizing Penelec to amortize its stranded costs over an 8 year period through use of a declining CTC. This will provide Penelec with the opportunity to collect revenues under the current rate cap adequate to meet all of its obligations, while at the same

time providing for a declining CTC. This results in a larger shopping credit, which increases the development of a competitive market.

Regarding the OCA's argument in its Exceptions that the stranded costs should be reconciled on a class-specific basis rather than a company-wide basis as recommended by the ALJ, we concur. We stated in Duquesne that rate class specific annual reconciliation is appropriate to avoid inter-class shifting of stranded cost recovery. (Duquesne, p. 212). That applies to this proceeding, as well.

The following table summarizes the unbundling of existing rates, the CTC and the Shopping Credit that will be available on a system-wide average basis in 1999 as a result of the Commission's decision. Each customer class will experience somewhat different results that will be finalized upon acceptance of Penelec's filing in compliance with this Opinion and Order. In the following table, "Unbundled T&D" is the rate for transmission and distribution services that customers now pay and will continue to pay. "Unbundled G" is the rate that all customers now pay Penelec for generation and only non-shopping customers will continue to pay Penelec for generation. The CTC is a transition period charge that all shopping customers will pay to Penelec to compensate for stranded costs. The Shopping Credit is the amount left over that a shopping customer will have available to purchase generation from a competitive electric generation supplier.

For Customer not Shopping:

System Average

a. Existing Bundled Rate	7.286 ¢/kwh
b. Unbundled T&D	2.007 ¢/kwh
c. Unbundled G CTC	5.279 ¢/kwh
d. Total Price Paid to Penelec (d = b + c)	7.286 ¢/kwh

For the Shopping Customer

a. Existing Bundled Rate	7.286 ¢/kwh
b. Unbundled T&D	2.007 ¢/kwh
c. Unbundled G	5.279 ¢/kwh
d. CTC	1.549 ¢/kwh
e. "Shopping Credit" (e = a - b - d)	3.730 ¢/kwh

F. Other Transition Charges (OTC)

1. Parties' Position

The ALJ observed that, in response to specific concerns raised by various parties in these proceedings, Penelec proposed to establish a new category of costs known as "Other Transition Charges" (OTC), which is intended to be a separate line item on customer's bills. (Penelec St. No. 9, Supp. 2, p. 50). The OTC would include nuclear decommissioning costs, the above-market portion of operating NUGs (i.e., the NCR amount) and prospective rate cap exceptions associated with NUG buy-outs. As noted before, Penelec has now offered to include the NCR under the CTC.

The ALJ remarked that one notable feature of the OTC is its longevity. It is designed to be in place long beyond the statutory expiration date for the CTC. Penelec argued that nuclear decommissioning collections will terminate at the end of TMI-1's life in 2014, at which point it intends to reduce the OTC by the rate of nuclear decommissioning cost

collections in effect at that time. Penelec further indicated that operating NUG project deferrals and costs are expected to decrease as contracts expire over time, providing opportunities to decrease rates and/or accelerate stranded cost recovery. Finally, Penelec stated that the proposed rate cap exceptions for NUG buy-outs will expire in three years from the effective date of its unbundled tariffs (i.e., January 1, 2002). (Penelec St. No. 9, Supp. 2, pp. 51-52). Penelec has now deferred inclusion of NUG buyout costs in rates pending the outcome of the divestiture auction. (R.D., pp. 166-167).

2. ALJ's Recommendation

The ALJ recommended rejection of all the proposed alternatives for collecting the stranded costs, including the OTC, based upon her conclusion that the CTC/retail credit methodology will most likely promote competition. (R.D., pp. 169-170).

3. Parties' Exceptions

In its Exceptions, Penelec contends that the ALJ improperly rejected its proposed OTC mechanism. Penelec argues that the use of the OTC as a separate identifiable rate recovery mechanism would provide it with an opportunity to increase its proposed 3.4 cents per kwh levelized retail generation credit as the NUG buyouts expire within three years from the effective date of its unbundled tariffs. (Penelec Exc., p. 24).

ARIPPA excepts to the ALJ's failure to address and reject Penelec's proposal to include either the NCR or the OTC component of the CTC on customers' bills. ARIPPA opposed Penelec's proposal to include the OTC as a separate line item on the customers' bills as confusing to the customers and unduly discriminatory to the NUGs. (ARIPPA Exc., pp. 36-38).

4. Resolution

In our consideration of this issue, we reject the separate OTC, as mentioned above. The CTC-Retail Generation Credit methodology is the method most likely to promote competition. Furthermore, we conclude that the Act provides that the CTC is the proper collection mechanism for all stranded costs, including NUG, nuclear decommissioning and all other stranded costs. As we stated above regarding the Company's proposed NCR, we are sensitive to the need of Penelec to recover its payments to its NUGs. Under the approach adopted in this Order, the stranded NUG costs claimed by the Company, as adjusted herein, are granted and amortized over the CTC period.

We conclude that Penelec's proposed use of the OTC to collect NUG and nuclear decommissioning costs is inconsistent with the Act. Section 2802(15) empowers this Commission to provide a single mechanism, the CTC, for the recovery of an appropriate amount of stranded costs. Section 2804(13) states that the Commission has the "duty to approve a competitive transition charge for the recovery of transition or stranded costs." Section 2808(a) states that the stranded cost recovery mechanism shall be "a competitive transition charge." Accordingly, use of the OTC to collect NUG and nuclear decommissioning costs is not provided for in the Act.

G. Retail Generation Credit

1. Parties' Position

a. Method of Determination

Relying primarily on the OCA's explanation of its approach to the retail generation credit, the ALJ observed that the retail generation credit, also known in this

proceeding as the “avoidable generation rate” and the “shopping credit,” is the amount of the rate that a customer will “shop against.” In other words, the customer will attempt to obtain electric generation service for an amount equal to or less than the retail generation credit. The ALJ remarked that, in their supplemental testimony, Penelec has recommended a retail generation credit that is levelized over the CTC recovery period, or through 2005. The ALJ further observed that, as can be seen on Penelec Exhs. DC-11R through DC-13R, Penelec is proposing a retail generation credit of 3.4 cents per kwh in 1999 through 2001, and a 3.55 cents per kwh credit from 2002 through 2005. These credits are based on Penelec’s projections of market clearing prices as summarized in Penelec Exh. DR/FG-17.

The ALJ remarked that retail generation credit for Penelec, on a company-wide basis and as proposed by the OCA, begins at 2.965 cents per kwh in 1999 and increases to 4.370 cents per kwh in 2005. (OCA St. 6-S; Exh. LS-8(PN); R.D., pp. 171-172)

The ALJ further noted that the OCA presented calculations of the retail generation credit using the methodology established by the Commission in PECO Energy. Relying on OCA Exhs. LS-8(ME) and LS-8(PN) for 1999, and applying the Commission method in PECO, the OCA’s witness Ms. Smith calculated the shopping credit to be 3.34 cents per kwh in 1999 for Met-Ed and 3.517 cents per kwh for Penelec in 1999, assuming the OCA’s level of stranded cost recovery and CTC design. (R.D., p.172).

The ALJ noted that Penelec assailed the OCA’s development of class-specific market prices as not being in compliance with the Act. Penelec asserted that the Act requires that production-related costs be allocated to rate classes exactly the way they were allocated in the past and not calculated, as proposed by Ms. Smith.

In its arguments before the ALJ, PICA proposed to calculate a retail generation credit that is consistent with expected market rates in each year of the transition. The

expected market prices that PICA uses to calculate a retail generation credit for both capacity and energy are derived from the wholesale market prices calculated by PICA's witness Mr. Falkenberg. The PICA methodology produced an escalating retail generation credit to reflect consensus projections of escalating wholesale market prices. (R.D., pp. 173-174).

b. MAPSA'S Method of Determination

The ALJ noted that MAPSA's witness, Mr. Chalfant, recommended a retail generation credit of 3.91 cents per kwh (2.18 cents energy component, 1.38 cents capacity component and 0.35 cent retail expense component). (MAPSA Statement No. 1 at 18; MAPSA Exhibit AC-1). Penelec, on the other hand, has proposed a system average retail generation credit of 3.4 cents per kwh. The ALJ noted that this credit was calculated for Met-Ed but no separate calculation was made for Penelec. Based on the discussion set forth above, MAPSA submitted that Penelec's proposal of a 3.4 cents per kwh system average retail generation credit falls severely short of Mr. Chalfant's recommendation and should, therefore, be rejected as insufficient to foster competition. (R.D., pp. 176-177).

In its arguments before the ALJ, Enron advocated application of the PECO methodology under which the Commission did not "calculate" a "retail generation credit" using any projections, guesses or assumptions about market prices but, rather, is a residual number produced after appropriately establishing the portions of Penelec's rates which are associated with T&D and the CTC. (R.D., pp. 177-178).

c. Sufficiency of Retail Generation Credit

In its argument before the ALJ, PICA contended that, if the Commission were to adopt a levelized generation credit, despite PICA's opposition, the levelized retail generation credit must be sufficient in all years to ensure that retail customers will have

reasonable access to a competitive generation market. PICA argued that, under Penelec's proposal, alternative suppliers would have to sell below cost to attract customers in Penelec's service territory, which is clearly anti-competitive and which will preclude customers from accessing alternative suppliers during the later years of the transition period.

2. ALJ's Recommendation

After reviewing all of the positions of the parties, the ALJ concluded that the CTC/retail generation credit methodology most likely to promote competition is that developed by the Industrials. (R.D., pp. 178-179).

3. Parties Exceptions

As stated above, Penelec argues in its Exceptions that the ALJ erred by erroneously adopting the CTC and retail generation credit proposed by PICA. Penelec contends that the ALJ failed to acknowledge the integrated relationship between the CTC and the retail generation credit. Furthermore, Penelec contends that the ALJ erred by not recommending approval of a CTC recovery period in excess of seven years. (Penelec Exc., pp. 22-24).

As also mentioned above, MAPSA contends that the ALJ erred in recommending use of a residual CTC methodology and asserts that the method used in PECO Energy, as well as the Duquesne and West Penn restructuring proceedings, should also be used in this proceeding. MAPSA also excepts to the ALJ's failure to provide any analysis of the specific rates and credits to be adopted in this proceeding, as opposed to only establishing the methodology to be used in calculating those rates. (MAPSA Exc., pp. 4-7).

In its Exceptions, Enron argues that the ALJ erred in recommending that the Commission pursue an administratively calculated retail generation credit based on the PICA market prices and reject the approach announced in PECO Energy. (Enron Exc., pp. 12-17).

4. Resolution

In our consideration of these issues, we note that much of our prior discussion regarding the CTC methodology and calculation is relevant here as well. Many of the issues raised here, such as the CTC methodology and recovery period, were discussed previously as they related to the CTC and will not be repeated here.

With respect to MAPSA's Exception, at pages 4-7; wherein MAPSA argues that the ALJ failed to provide any analysis of the specific rates and credits to be adopted, we note that our calculations of the Retail Generation Credit which we are authorizing in this proceeding are shown in the Attachments to this Order. As noted above, the methodology we used to calculate the CTC and Retail Generation Credit is consistent with the one we used in West Penn.

H. Competition in and Unbundling of Non-Wire Services

1. Parties' Position

In its original filing, Penelec did not propose to unbundle its non-wire services. In its argument before the ALJ, the OTS proposed that Penelec should be required to unbundle its distribution rates into components such as metering, billing, universal service, and lines. (OTS MB and RB at 118-120 and 35). Enron sought the immediate unbundling of billing, metering and other non-wires services, and the establishment of open architecture.

Penelec opposed this rush to action, and advocated the position that the Legislature intended a more deliberate, orderly development of retail electric competition. The OCA argued that Penelec should be required to provide advanced metering under tariff in the interim between this proceeding and the completion of the Advanced Meter Development rulemaking.

2. ALJ's Recommendation

In consideration of this issue, the ALJ concurred, for the most part, with Penelec's position that the Legislature intended a more deliberate orderly transition to the unbundling of non-wire services, citing five rulemakings currently in progress before the Commission to implement the Legislature's intention regarding the unbundling issues. The ALJ relied on the Commission's decision in PECO Energy to support her recommendation. However, the ALJ recommended adoption of the OCA's position that Penelec should be required to provide advanced metering under tariff in the interim between this proceeding and the completion of the Advanced Meter Development rulemaking. (R.D., pp. 179-182).

3. Parties' Exceptions

In its Exceptions, MAPSA objects to the ALJ's failure to require Penelec to unbundle metering and billing services in this proceeding and argues that Penelec should be directed to allow competitive provision of metering and billing services. (MAPSA Exc., pp. 9-10).

Enron also excepts to the ALJ's failure to recommend unbundling of metering and billing services in this proceeding. Enron argues that the Commission should, at a minimum, require Penelec to unbundle billing and metering services as an interim measure, pending promulgation of final rules. (Enron Exc., pp. 18-23).

4. Resolution

In our consideration of this issue, we note that Enron advocated additional unbundling of the non-wire services of metering, billing and collections. The ALJ rejected the proposal based upon our reasoning in the PECO Energy restructuring case and the record presented in this proceeding. We are presently concluding a number of rulemakings which will provide guidance as to the role of the EDC regarding this issue. For that reason, and based upon the record before us, we conclude that the unbundling of the non-wire services must await our experience to be gained from reviewing the EGS and EDC performance and interaction with customers during the phase-in that follows those proceedings.

However, we do not concur with the ALJ's recommendation with respect to the OCA's proposal that Penelec should be required to provide for advanced metering charge in its tariff. We must reject that recommendation because our rulemaking for advanced metering will govern this issue upon its final publication. It provides for the recovery of incremental costs of advanced meters as tariff-based charges.

I. Summary

1. T&D Rates-Functionalization and Allocation

The ALJ recommended adoption of Penelec's updated cost of service studies, as modified by the OCA. The OCA generally agreed with Penelec's unbundling methodology methodology, but made adjustments to remove certain costs improperly reflected in the cost of service and removed NUG costs from the distribution function, for a Company-wide T&D rate of 2.007 cents/Kwh. We adopt the OCA's approach.

2. Generation Rates

Penelec's overall generation rate can be derived by subtracting the calculated T&D rate of 2.007 cents/Kwh from its overall average rate of 7.286 cents/Kwh. Based upon our acceptance of the OCA's approach, the result is a overall generation rate for Penelec of 5.279 cents/Kwh.

3. Intervenors' Functionalization/Allocation Issues Treatment of A&G Expenses and General Plant

With respect to Penelec's allocations, the OCA raised the following issues: (1) Penelec departed from its prior cost of service treatment for allocating A&G expenses and (2) OCA suggested removal of 1996 VERP expenses from the results of the study, disallowance of the future recovery of that revenue and lowering the non generation rate cap.

The OCA supported use of Penelec's previously used allocation of A&G expenses, based upon O&M expenses and plant, and opposed its current use of a labor allocator for A&G expenses. As recommended by the ALJ, we adopt the position of the OCA, resulting in a shift of expense from T&D to the generation portion, and have accounted for the subsequent increase in stranded costs in our computations.

Regarding the 1996 VERP expenses, OCA's adjustment to Penelec study properly reflects the removal of the these expenses, consistent with our historic ratemaking practice. By this action, the T&D rates are lowered to come into line with the ongoing level of expenses.

4. Account 923 - Outside Services Costs

The Industrial intervenors and Enron argue for larger allocation of Account 923 to production, reflecting clearing of GPU Nuclear and GPU Genco costs through the account. Penelec has excepted to the ALJ's recommended adoption of this adjustment as single-issue ratemaking and that the account should be allocated based upon labor as are the other A&G accounts. Having adopted the OCA's allocation method, which takes into account points raised by these parties, no additional separate adjustment for Account 923 is necessary.

5. Sales, Uncollectibles and Customer Information Expenses

This issue is similar to the issue raised by Enron in each of the previous restructuring proceedings we have reviewed and decided. Based upon the record, we conclude that Penelec has provided sufficient information to retain these account allocations at the level determined by the OCA as T&D service related.

6. Allocation of Generation Component of Rates to Customer Classes Similar to Allocation of Purchase Power Costs

MAPSA proposed the allocation of the generation component as purchased power among customer classes. Penelec followed its historic allocation for this element of cost of service in order to minimize cost shifting among rate classes during the unbundling determinations. We agree with the ALJ that Penelec's method is appropriate to ensure that rates are properly unbundled.

7. Residual Transmission Revenue Requirement

Enron opposed Penelec's request for a Pennsylvania PUC jurisdictional transmission charge. We agree with the ALJ's recommendation to accept Penelec's claim. Penelec has demonstrated the existence of PUC-based charges which are not recovered through FERC charges. Penelec, however, must assure in its compliance filing that the interaction between PJM billed charges and its charges are properly handled, and a separate statement segregating FERC-approved charges and those approved by this Commission is directed.

8. Other Issues

a. Distribution Losses

Penelec's revised position to allow customers to procure distribution losses from alternative suppliers has been accepted by the parties, and the ALJ recommended its adoption. We agree. Costs which subsequently become stranded may be recoverable through the CTC, if appropriate, based on the determination of stranded utility generation.

b. Ancillary Services

Penelec has agreed that the PJM tariff will govern this service and that its FERC transmission rate revenue requirement will reflect the embedded cost of generation which is removed from the retail generation services. We agree.

c. Voltage Differentiated Rates

We agree with the ALJ that Enron's request for a voltage based delivery service tariff violates the rate cap provisions of the act by advocating interclass rate shifts.

9. CTC Development/Design Issues

Regarding the methodology and calculation of the CTC, we concluded that the Penelec's authorized CTC for 1999 is 1.549 cents per kwh, and the 1999 Shopping Credit for 1999 is 3.730 cents per kwh. We declined to approve Penelec's proposed OTC and determined that all stranded costs should be recovered through the CTC. We further declined to require Penelec to provide for an advanced metering charge in its tariff because this matter is being addressed in our rulemaking on advanced metering which will govern this issue upon its final publication.

VIII. TARIFF ISSUES

A. Unchallenged Tariff Changes

1. Parties' Positions

Penelec asserted that they have consolidated and reorganized their existing tariffs with the intent to make the operative provisions more "user friendly," which will allow for easier administration by both corporate and regional employees. As explained by the Company, the tariffs will be utilized by customers interested in understanding their options during phase-in and beyond, and by EGSs seeking to ascertain the applicable terms, conditions and prices for all services provided to them.

According to Penelec, the rules and regulations of its proposed tariffs have been consolidated into ten (10) general sections comprising twenty-seven (27) rules. (Penelec St. No. 12, pp. 11-12). These rules and regulations are apparently organized sequentially from applications for service, to extension of facilities, metering, billing, etc. According to the Company, the parties have challenged very few of their substantive provisions. The Company urged that the proposed tariffs set forth in its Exhibit CLO-4 and Exhibit CLO-4R should be approved in their entirety. The Company indicated that it expects to file a fully revised tariff, consistent with the final order, in its compliance filing. (Tr. 1468).

Enron objected to the Company's perception that the parties do not challenge its tariff provisions. Enron opined that this is not the appropriate stage of the proceeding to challenge the electric service fees since the compliance filing

stage is the appropriate time to challenge or comment upon the language and concepts in the Company's tariff. (Enron M.B., p. 34).

2. ALJ's Recommendation

The ALJ first noted that a compliance filing is made with the Commission and not the ALJ, and that an ALJ can only rule on the issues raised by the parties on the current record. As a result, the ALJ reached the following conclusion:

It seems fair to me that the substance of unchallenged tariff provisions should be approved here. If the calculations under the tariffs do not prove out to be revenue correct, or if there are errors which require correction, or if the Companies do not comply with the Commission's Orders, these matters should be addressed when the Compliance Filing is made. Since the Companies are not going to submit their final form tariffs until the Compliance Filing, I presume they have no objection to receiving opposition to the form and operation of their tariffs at that time.

(R.D., p. 184).

3. Parties' Exceptions

Penelec filed an Exception wherein it argues that to allow first-time challenges to the Company's tariff during the compliance filing will give the parties another "bite of the apple" in violation of the Company's due process rights. (Penelec Exc., p. 23).

Enron excepts to the notion that approval of unchallenged tariff provisions could foreclose challenges to Penelec's compliance filing. (Enron Exc., p. 24). Enron argues that it is "impossible to analyze the impact of many of these provisions until they are read in the context of the Commission's final order in this case and as part of Penelec's compliance filing in accordance with such an order." (Enron Exc., p. 23).

MAPSA argues along the same lines as Enron and also notes that the parties to this proceeding have only had an opportunity to review and challenge Penelec's proposed tariffs. (MAPSA R.E., p. 5).

4. Resolution

At page 184 of her Recommended Decision, the ALJ acknowledged that at the time of the compliance filing, the Company's tariff will be subject to opposition based on form and operation. To the extent that there is any disagreement on this issue, we shall adopt the Findings and Recommendations contained in the ALJ's decision. At the compliance filing stage, the parties will have an opportunity to contest the consistency of the Company's compliance with this Order.

B. Proposed Penelec Tariff Electric Pa. P.U.C. No. 77 and Proposed Supplements 108 and 109 to Tariff No. 75 - Comparison of Bundled and Unbundled Rates

1. Parties' Positions

Penelec originally filed a new Tariff No. 77 and Supplement 109 to Tariff 75, with Tariff Supplement 108 added later. Thereafter, Supplement 109

was then withdrawn, and changes were made to Tariff Supplement 108. The provisions from Supplement 109 have been incorporated into Tariff No. 77. Although Penelec has filed no proposed final form of these tariff provisions, the Company has filed proof of revenues comparing bundled and unbundled rates. (Penelec St. No. 12, 12 Supp. 1, and 12 Supp. 2; Penelec Exhs. CLO 1-7, and various revisions thereof). No party has commented on or challenged these proposed unbundled rates.

2. ALJ's Recommendation

The ALJ noted that the basic tariff supplements have gone through major changes. Citing Penelec Exh. CLO 3R(2), p. 2, the ALJ listed the unbundled rate items on the Company's bill for residential service. The ALJ speculates that the parties are awaiting the compliance filing to challenge the unbundled rates.

3. Resolution

In our consideration of this issue, we note that no exceptions were filed on this issue. Accordingly, we will adopt the ALJ's Finding and Recommendation without further comment.

C. Contract Termination Fees & Switching Fees

1. Parties' Positions

Penelec proposed in Tariff Rule 15(e) a contract termination fee applicable to all rate classes, including residential customers who return to

provider of last resort. The fee would not be invoked the first time a customer leaves "Full Service" and becomes a "Delivery Service" customer. (Penelec M.B., p. 128).

Under Penelec's proposal, every customer who returns to full service from delivery service ("shopping") would be contractually bound to remain on full service for 12 months. If a customer re-enters the competitive market before the end of the 12 month period, Penelec would charge the customer a contract termination fee for the remainder of the period in addition to all other charges. Penelec proposed calculating the contract termination fee by multiplying the maximum of generation charges during the prior 11 months by 75%. Moreover, Penelec noted that Tariff Rule 15(e) would apply to "every Delivery Service customer the company supplies with energy or energy and capacity, at any time that such customer is not a Full Service customer and/or is not taking electric service from an alternative electric supplier." (R.D., p. 186).

Penelec responded to suggestions from several parties in the proceedings that the fee is inappropriate because it is not cost-based by stating the fee was never intended to be cost-based. Penelec clarified that the contract termination fee is intended to be an incentive for customers to honor the full term of their one year commitment to stay with Penelec upon returning from an EGS since Penelec will have made commitments for capacity to supply these customers. (Penelec M.B., p. 130).

Penelec also proposed in Tariff Rule 15 a switching fee of \$9.50 to be charged every time a customer switches from one EGS (including Penelec generation) to another. Penelec contended the switching fee is designed to cover the administrative costs of opening or closing accounts, establishing electronic

data transfer and reading meters. Based upon further review, evaluation and experience gained from its Power Future Pilot Program, Penelec subsequently reduced its proposed switching fee from \$9.50 to \$4.73 for instances where a switch is requested concurrent with the customer's scheduled meter reading date. However, for switches requested on a date other than the customer's scheduled meter reading date, Penelec proposed an additional \$10.25 charge. (R.D., p. 187).

Penelec responded to the intervenors' opposition to switching fees by proposing to treat all switching fees that would otherwise be charged directly to customers during the phase-in as a "regulatory asset" which will be accumulated and deferred for future recovery until completion of phase-in. (R.D., p. 189).

The OCA expressed a concern is that Tariff Rule 15(e) would apply to residential customers who return to provider of last resort and then re-enter the competitive market before the end of the 12-month mandatory term, even if the customer's EGS failed to provide generation service and the customer, through no fault of his own, needed to return to Penelec for temporary service. (OCA M.B., pp. 109-110).

The OCA pointed out that it is unclear whether the fee is intended to recoup revenue or prevent "gaming" of the system. In either case, the OCA argued that Penelec's reasoning is not compelling since there may be no additional costs to recoup from a departing customer, or any evidence to support the company's view that the fee will have any effect on gaming. The OCA further pointed out that Penelec acknowledged the fee is not cost based. The OCA noted that the contract termination fee could be as high as \$245 and argued that the imposition of such a potentially high and unjustified fee is antithetical to the goals of the Act.

The OCA argued that the proposed switching fee, regardless of the collection method, should be rejected at this time, and recommends the issue be treated as it was in the *PECO Reconsideration Order*. (OCA M.B., pp. 111-112).

MAPSA described Penelec's proposed contract termination fee, in part, as a penalty assessed against the customer for choosing to shop for supply and argued this must not be permitted by the Commission. MAPSA opined that this fee will discourage customers from shopping for generation and "thereby delay the onset of competition for a large portion of the Companies' customer classes." MAPSA argued that the switching fee should be eliminated until Penelec provides verifiable cost justification. (MAPSA M.B., pp. 21-26).

Enron argued that the contract termination fee has not been justified and will be a barrier to competitive entry. Enron argued that switching fees should be prohibited as barriers to competition in the early stages of customer choice in accordance with the policy articulated in the *PECO Reconsideration Order* at 17. (Enron M.B., pp. 54-57).

With regard to Penelec's proposed switching fee in Tariff Rule 15, parties representing the major consumer groups and the EGSs opposed this fee as being anti-competitive and/or detrimental to their clients. (R.D., pp. 187-188).

The Environmentalists argued that the cost to administer a customer switch is at most *de minimus* but recommended that, if the Commission does allow some form of switching fee, Penelec be required to provide cost justification. (Environmentalists M.B., p. 19).

2. ALJ's Recommendation

ALJ Turner opined that both the proposed contract termination fee and switching fee "would in effect straight-jacket customers at a time when they should be participating freely." However, Judge Turner also noted that long-term it is not objectionable for Penelec to have reasonable contract termination and switching fees. ALJ Turner recommended that Penelec's proposed contract termination and switching fees be denied now, but allowed to be instituted at the end of the phase-in period. (R.D., pp. 188-189).

3. Parties' Exceptions

Penelec excepts to the ALJ's recommendation to reject until the end of the phase-in period the company's proposed contract termination fee. Penelec notes that the primary basis upon which the fee was rejected - that it would discourage participation in the competitive generation market - ignores the purpose of the fee and the potential harm that can be inflicted upon Penelec without such a fee. Penelec asserts it has demonstrated the fee is not anti-competitive and does not hinder the development of the competitive generation market. (Penelec Exc., pp. 25-26).

Moreover, argues Penelec, customers who shop for alternative supply commencing January 1, 1999 will not incur the fee for this initial exit from the company. Thus, Penelec argues that the fee is avoidable, and represents a reasonable mechanism for protecting the company from customers who would otherwise have an incentive to "game" the system. (Penelec Exc., p. 26).

Penelec also excepts to the ALJ recommendation to reject the company's proposed switching fee in Tariff Rule 15. Penelec argues the rejection is inappropriate in light of (1) the fact that costs are incurred when customers switch EGSs, and (2) the company's offer to defer the recovery and collection of all switching fees during phase-in. (*Id.*)

MAPSA excepts to the ALJ recommendation that contract termination and switching fees be permitted at the end of the phase-in period, without requiring Penelec to provide any cost justification for level of the proposed fees. MAPSA argues that cost justification should be required prior to institution of these fees. (MAPSA Exc., p. 8).

4. Resolution

The ALJ has properly resolved the issue of fees for contract termination and switching suppliers consistent with the Commission determinations in other restructuring proceedings. We find that no substantial evidence supports the need to impose any contract termination fee at this time.

Moreover, the amount of the proposed contract termination fee can be so high that it might inhibit full participation during phase-in, or significantly reduce savings for some participants, particularly residential customers. In regard to the switching fee, the imposition of this fee at the beginning of competition has the potential to unduly restrict participation.

We therefore adopt the ALJ's recommendation to deny Penelec's claim for a contract termination fee and a switching fee during the phase-in period. As with all other new costs of service related to the administration of direct access,

we do not adopt any additional charges to the customer or EGS until a finding that a net incremental cost exists. Therefore, we will allow such fees to be instituted at the end of the phase-in period upon Penelec meeting its burden to provide substantial evidence in support of the fees' amounts.

D. Exit Fees

1. Parties' Positions

Penelec proposed an "exit fee" in Tariff Rule 15 to protect the Company and its remaining customers from customers who install on-site generation which may "significantly reduce their purchases of electricity in a fashion that allows them to escape payment of the 'non-bypassable' CTC." Ultimately, the Company proposed that for customers reducing purchases by installing self-generation after January 1, 1997 (the effective date of the Act), the customer will be billed an exit fee based upon the customer's billing determinants for the 12 billing months of 1996. Accordingly, Penelec opined that the former customer's CTC obligation will be based on the rate class the customer was served under in 1996. (Penelec M.B., pp. 133-134).

PICA argued that the Company has proposed conflicting variations of the exit fee. Moreover, PICA argued further that the three variations of the Company's exit fee proposals are inconsistent with the plain language of Section 2808(a) of the Act which establishes two threshold requirements for imposition of an exit fee: (1) the existence of on-site generation that operates in parallel, and (2) a significant reduction of the Customer's purchases through the transmission and distribution network. PICA submitted that the Company's

testimony clearly establishes that its exit fee proposal is inconsistent with the Act and must be rejected. (Tr. 1559).

To the extent that the Commission would implement an exit fee proposal, PICA recommended that the application of an exit fee follow the criteria set forth in the Act and must be calculated based on the customer's usage for the current year, if that level of usage is less than the level of usage during the 12 billing months of 1996, which would ensure that all customers' CTCs are premised upon recent levels of usage. (MEIUG/PICA St. No. 1 R/S, pp. 33-34).

2. ALJ's Recommendation

The ALJ rejected the proposed tariff revision in its present form based on the opinion that the exit fee will "restrict reasonable and fair opportunities to self generate and interconnect." Although the ALJ accepted PICA's position that the proposal is unclear, the ALJ explained that her recommendation was without prejudice to the Company proposing a revised, clarified version of the rule. (R.D., pp. 189-190).

3. Parties' Exceptions

Penelec's Exception centers on the perceived lack of explanation in the decision on this issue by the ALJ. According to the Company, it makes no economic sense for a customer to incur the costs of installing self generation unless the expenditure removes a "significant" amount of load from an EDC's system. (Penelec Exc., pp. 27-28).

4. Resolution

We cannot agree with the ALJ's outright rejection of the proposed tariff revision. However, we also cannot completely accept the proposal in its present form. The Company proposal should only be applied if the service being taken by the customer declines by more than 10% from the 1996 level as a result of self generation.

Rather than a subjective application of the Company's tariff, our decision has imposed criteria for imposition of an exit fee. Despite the specificity of the Act in requiring that customers who install on-site generation pay their share of stranded costs through a CTC, the legislature has not provided this Commission with a definition of the threshold requirement that the on-site generation "significantly reduces the customers' purchases of electricity through the transmission and distribution network." 66 Pa. C.S. §2802(a).

The Company has failed to include such a requirement in its proposed implementation of exit fees. It is the intent of the Company's proposal to focus on the customers' reduction in electricity purchases. However, the Company has declined to quantify the self generation reduction. In fact, neither the Company nor PICA has made an effort to quantify a position on what constitutes a "significant" reduction. We believe that a 10% reduction from the 1996 levels is significant as contemplated by Section 2808(a) of the Act. Finally, we cannot accept PICA's calculation that the exit fee would be based upon the customer's lower billing determinants that may be established subsequent to January 1, 1997. We agree with the Company that this method could lead to a by-pass of CTC for that customer.

E. Curtailable Credits

1. Parties' Positions

Penelec proposed Rule 20 (Curtailable Options) and Rider E (Curtailable Service Rider) which will restrict such provisions as of January 1, 1999 to existing full service customers at existing locations and existing curtailable load as of December 31, 1998. (Penelec St. No. 12, Supp. 2, p. 11). In other words, neither delivery service customers nor full service customers will be permitted to take curtailable service under Rule 20 or Rider E as of January 1, 1999.

Penelec proposed further that any customer served under Rule 20 or Rider E who becomes a delivery service customer and later returns as a full service customer will not be permitted to take service under these curtailable rules or riders. Moreover, Penelec states that, after phase-in, all curtailable programs will be eliminated for all customers.

As a basis for its proposal, Penelec submitted that the continued availability of curtailable credits to customers under its prevailing tariff is not consistent with a competitive generation market, where EGSs would find it difficult to compete with Penelec so long as the current level of curtailable credits continues during the transition to full generation competition. Penelec proposed to restrict curtailable credits in the following manner:

[T]he Companies intend to allow those customers to continue to have available the curtailable credits for their remaining Full Service load. (ME and PN St. Nos. 12, pp. 10-11). However, a curtailable customer's firm service level will be increased by the

amount of the load the customer is “shopping” with EGSs. This approach affects a reasonable compromise between clearly competing interests.

(Penelec M.B., pp. 137-38).

MAPSA asserted that under proposed Tariff Rule 20 and Rider E, a curtailable customer that selects an alternative supplier loses the curtailable credits that go with that portion of the customer’s load that is being secured by an alternative supplier. MAPSA continued that curtailable customers who purchase from alternative suppliers must continue to receive the same credit as if purchased from Penelec. (MAPSA M.B., p. 27).

PICA argued even stronger that approval of Penelec’s curtailable credit restriction will result in immediate and significant rate increases, which are clearly in violation of the generation rate cap established by the Act under 66 Pa. C.S. §2804(4)(ii). PICA maintained that the difference between current market capacity prices and Commission-approved curtailable credits is irrelevant in this proceeding and cannot justify elimination of, or even any restriction on, curtailable credits. (MEIUG/PICA R.B., pp. 38-39).

PICA contended that elimination of all curtailable credits and imposition of the same CTC on firm and curtailable load will increase curtailable rates which were in effect on January 1, 1997, in violation of the rate cap set forth in Section 2804(4)(ii) of the Act. PICA explained that as a statutory mandate, changes under the rate cap “shall not exceed the generation component” that has been approved by the Commission as of January 1, 1997. PICA argued that the generation component charged to curtailable customers indicates and reflects curtailable credits. (MEIUG/PICA R.B., p. 39-40).

Finally, PICA contended that Penelec's proposal to impose a CTC/OTC on curtailable customers equal to the CTC/OTC for firm customers directly violates the anti-cost shifting provisions of the Act, under Section 2808(a), since the Company's proposal will impose a stranded costs charge on curtailable customers that exceeds the stranded costs inherently included in such a customer's current charges. (MEIUG/PICA R.B., pp. 40-42)

2. ALJ's Recommendation

Again, as with the issue on exit fees, the ALJ has concluded that the Company's proposal will discourage those customers receiving them from participating in the competitive market. The ALJ reasoned that curtailable service may be coming to an end, and curtailable credits may have to disappear. However, in rejecting the Company's proposal, the ALJ concluded that the loss of curtailable credits should not be tied to whether a customer takes part of its load from an EGS. (R.D., p. 190).

3. Parties' Exceptions

In excepting to the ALJ's recommendation, Penelec explains that curtailable credits are based upon reductions in generation costs associated with customers interrupting purchases upon request. Given the Company's intention to sell generation assets, the Company believes that the value of curtailable credits has been substantially diminished. Penelec submits that its treatment of curtailable credits is fair to diverse interests and has been completely ignored by the ALJ. (Penelec Exc., p. 27).

4. Resolution

The curtailable credits issue involves an interaction between past practice and future conditions. Curtailable credits are based upon reductions in generation costs associated with customers interrupting purchases at times upon request of the Company. The evidence of record indicates that curtailable customers were not supporting the full capacity cost of the Company nor was the Company standing ready to serve these customers. Therefore, we find that any CTC applicable to these customers must properly reflect past conditions to ensure that the rate cap provisions of the Act are not violated. The Act is quite specific on imposing a rate cap standard, which provides as follows:

... the generation component of a utility's charges to customers who purchase generation from the utility, including the competitive transition charge and intangible transition charge, shall not exceed the generation component charged to the customers that has been approved by the commission for such service as of the effective date of this chapter.

(66 Pa. C.S. §2804 (4) (II))

Despite exiting the generation function, the Company will still remain, for a period of time, a provider of generation services for a segment of their customers. Whereas curtailable service is a load management tool, the Company should only offer curtailable credits where the load management effects are retained by the EDC and not the EGS. If the EGS wants the capacity reductive effects for its capacity obligation, it can offer the reduced rate. However, in such cases, the CTC still cannot be applied as if the customer was a firm generation services customer -- that would be a barrier to competition. The CTC must be

computed to reflect the availability of curtailable credits. The Company's compliance tariff must properly recognize that new costs cannot be imposed on old curtailable customers as if they were firm customers.

We found persuasive the arguments presented by the industrials in this proceeding. A synopsis of that position is set forth below:

The Companies' proposed restrictions on, and eventual elimination of, curtailable credits are a direct violation of: (1) the "cap" on generation component charges that exists for the duration of the CTC recovery period and (2) the anti-cost shifting provisions of the Competition Act. See 66 Pa. C.S. §§2804(4), 2808(a). Moreover, the Commission recognized in other restructuring proceedings that existing discounts for curtailable service must be maintained. See PECO Order on Compliance Filing, slip op. at 35-36. The Companies' curtailable credit proposals would significantly increase curtailable customers' annual charges. For example, Penelec's data indicates that a customer with approximately 20 MW of curtailable load would realize a rate increase, via the Companies' curtailable credit proposals, of more than \$1.2 million per year (more than 12%).

(Emphasis in Original)

(MEIUG/PICA R.E., p. 21).

We also find that the Company's position that curtailable credits are not cost-justified ignores the benefit of lowering their generation stranded costs that has been derived by the Company, and that the Company's "market value" argument ignores this benefit experienced by Penelec.

F. Allocation of CTC to Customers Under Individualized Contracts

1. Parties' Positions

Penelec proposed to calculate the CTC for customers with individualized contracts based on an allocation using the percentage of CTC to the total revenues for the rate class under which the customer is served. (Penelec St. No. 12, Supp. 2, p. 14). It is the position of the Company that this proposed rate schedule strikes a reasonable balance between (i) the requirement under the Act for EDCs to charge a CTC to all customers in order to recover their stranded costs, and (ii) a customer's need for an identified CTC associated with the customer's individualized contract. (Tr. 1541).

PICA proposed a specific approach for calculating a CTC applicable to individualized contract customers as follows:

[T]he proper unbundling of an individualized contract would follow the identical method used to unbundle all rate schedules. This method would begin with the overall contract rate, remove transmission and distribution costs to produce a residual generation component and would then be further unbundled by removing a market generation charge associated with expected market prices. The resulting residual would form the CTC for the individualized contract.

(MEIUG/PICA St. No. 1 R/S, p. 39).

PICA opined that the individualized contract customers' contributions to stranded generation costs will remain at existing rate levels. (*Id.*)

2. ALJ's Recommendation

The ALJ accepted the Company's proposed method of calculation of the CTC for customers with individualized contracts finding that adoption of PICA's methodology could result in a by-pass of the CTC. (R.D., p. 170).

3. Parties' Exceptions

In excepting to the ALJ's recommendation, PICA argues that its proposal for unbundling individualized contracts is fully consistent with the Commission's approval of an identical unbundling proposal in the PECO restructuring proceeding and fully consistent with all provisions of the Act. (MEIUG/PICA Exc., pp. 12-13).

4. Resolution

We conclude that the ALJ has properly accepted the Company's proposal on this issue. Therefore, we shall adopt the ALJ's recommendation.

Based on the testimony of the Company's witness, we are persuaded that the PICA approach could result in by-pass the CTC for customers with individualized contracts. Finally, we find that the Company's proposal to change the percentage allocation of transmission, distribution, and generation costs to individualized contract customers does not violate the anti-cost shifting provisions of the Act. 66 Pa. C.S. §2808(a).

G. Change of Electric Generation Suppliers

1. Parties' Positions

Penelec proposed in Tariff Rule 27 procedures to govern customer change of suppliers which, as originally proposed, required customers to provide written request to Penelec to change EGSs "in order to prevent a customer from being switched from one supplier to another without the customer's consent." (Penelec M.B., p. 135).

Penelec opined that the experience gained from the Power Future Retail Pilot Program resulted in a revision of Rule 27 to allow oral requests from customers to transfer EGSs and to reduce the amount of information requested from a customer. (Penelec M.B., p. 135).

Penelec also proposed to allow EGSs to switch customers when the EGS provides via electronic data transfer the necessary information. To prevent unauthorized transfer of a customer from one supplier to another, Penelec proposed to notify the customer in writing of the EGS's request. Finally, Penelec proposed a fifteen (15) day notice period for changing EGSs to provide for a ten (10) day waiting period and five days to secure an actual meter reading. (Penelec M.B., pp. 135-136).

Enron supported Penelec's position to allow customers to change suppliers when the EGS provides the necessary information via electronic data transfer and through oral requests. (Enron M.B., p. 58).

The OCA initially recommended a number of interim changes regarding Tariff Rule 27 but subsequently noted in its Main Brief that the Commission *Rulemaking Order Establishing Standards for Changing a Customer's Electric Supplier*, Docket No. L-00970121 (Order entered February 27, 1998) was not in place when OCA reviewed Penelec's proposed Tariff Rule 27. Since Penelec's tariff rule on change of suppliers must be in compliance with applicable regulations, the OCA recommended that the Commission direct Penelec to revise, as appropriate, its Tariff Rule 27 to conform with the standards in the Commission Order noted above. (OCA M.B., p. 115).

The OCA identified three provisions in the *Rulemaking Order Establishing Standards for Changing a Customer's Electric Supplier* that may require revision in Penelec's proposed Rule 27. These are: 52 Pa. Code §57.172(a)(1) (relating to information requested of a customer to switch); §§57.172 and 57.175 (relating to procedures allowing a person to act on behalf of a customer), and §57.172(a)(2) (relating to 10 day waiting period). (OCA M.B., pp. 115-116). The OCA also submitted that Penelec's proposal to require a customer to pay outstanding charges in order to have their EGS switched is unnecessary. (OCA M.B., pp. 115 116).

2. ALJ's Recommendation

ALJ Turner noted that Penelec and OCA "now appear to agree on this rule in all respects, except one detail." The Judge also noted that Penelec apparently intends to follow in its tariff the standards in the *Rulemaking Order Establishing Standards for Changing a Customer's Electric Supplier*, Docket No. L-00970121 (Order entered February 27, 1998), with one exception.

Since Penelec raised no other issues in its reply brief, ALJ Turner stated that she assumes that Penelec has accepted OCA's other suggestions. ALJ Turner identified the outstanding issue to be Penelec's proposed fifteen day notice period for changing EGSs versus the OCA's contention that the regulation at 52 Pa. Code §57.172(a)(2) provides for a ten day requirement for implementing a customer's request for a change of supplier. Judge Turner recommended that Penelec modify Rule 27 to replace the 15-day period with the 10-day period since the 10-day period follows the clear directive of the regulation, and since it reduces the lag time between the request to switch and the actual switch. (R.D., pp. 190-192).

3. Parties' Exceptions

Penelec contends that the Recommended Decision improperly rejects Penelec's 15-day notice period for changing electric suppliers. Penelec asserts that the "Company's fifteen day requirement is consistent with the ten day requirement specified in 52 Pa. Code §57.172(a)(2) and is the same period currently in use in the Company's retail pilot program." Penelec points out that the fifteen day notice requirement prevents the possible supply of electricity from an EGS to a customer before the end of the required ten day waiting period. In light of this preventative aspect of the fifteen day requirement, Penelec contends that the fifteen day requirement actually provides additional protection to customers. (PN Exc., pp. 28-29).

4. Resolution

We adopt the Penelec proposal subject to modification to conform with the final IRRC-approved Commission *Order Establishing Standards for*

Changing a Customer's Electric Supplier, Docket No. L-00970121. In this way, consumers across Pennsylvania will receive consistent and fair treatment when changing suppliers.

With regard to the 15 day period for the processing of change requests, we find the 15 day period reasonable to accommodate the 10 day confirmation notice to customers, to provide verifications of the electronic data transfers and to provide adequate time for a supplier to incorporate a new customer's load profile into the suppliers scheduling of generation and transmission services.

Further, we agree with Penelec that the 15 day period is not inconsistent with the 10 day confirmation period at 52 Pa. Code §57.172(a)(2) given the time frame requirement at §57.174 (which provides that the EDC "must make the change at the beginning of the first new billing period following the 10-day waiting period").

H. Supplier Agreement v. Pro Forma Tariff

1. Parties' Positions

Penelec asserted that its proposed Supplier Agreement is a reasonable mechanism for governing the current and evolving relationship between EGSs and EDCs. The Company maintained that a contract, rather than a pro forma tariff filed with the Commission, will provide the needed flexibility when modification of the EDC/EGS relationship is required. Penelec argued that its supplier agreement has already been reviewed and approved by the Commission in the Power Future Retail Pilot Program. Penelec opined that its proposed Supplier

Agreement comprehensively addresses the details of the interaction between EGSs and EDCs. (Penelec M.B., pp. 72-73).

Enron argued that the pro forma supplier tariff establishes a clear and enforceable set of rules and procedures to govern the relationship between Penelec and EGSs seeking to deliver power to customers using the Company's distribution system. Enron noted that the Commission directed the filing of a supplier services tariff in the PECO Energy restructuring proceeding. Enron also contended that the tariff provides for standardized protocols for EDC/EGS interactions. (Enron M.B., pp. 59-60).

Enron submitted that the tariff will set forth concise and standardized protocols for supply obligation provisions, and data and information transfers. (Enron M.B., pp. 65-66). Furthermore, Enron offered that the supplier service tariff will specify necessary policies and procedures for handling customer sign-ups, switching, balancing, billing, and collections.

MAPSA responded by emphasizing that the agreement is used in the Company's pilot program and is not appropriate for governing the operational relationships that will exist in a fully competitive market. The basis for this statement is MAPSA's opinion that the proposed agreement refers to circumstances which will no longer be in effect once restructuring begins. (MAPSA M.B., p. 28).

2. ALJ's Recommendation

Before reaching a decision, the ALJ made a few points on this issue. First, the ALJ recognized that the Commission was adamant about PECO having a

supplier tariff. Although the ALJ could not determine whether this was a policy decision on the Commission's part, the ALJ did note that the Commission has rejected the requirement that binding arbitration be the sole dispute resolution method. Ultimately, the ALJ recommended that Penelec and Enron, and any other interested EGS, be directed to jointly negotiate and prepare a mutual proposed supplier tariff, and that the companies submit it with their compliance filings. (R.D., p. 192-193).

3. Parties' Exceptions

Both Penelec and Enron have filed Exceptions to the ALJ's disposition of this issue. The parties' positions remain the same in their Exceptions. Essentially, Penelec opines that the delay and expense associated with tariff filing and amendments makes that vehicle unacceptable for addressing the EDC/EGS relationship over the beginning years of full compensation. (Penelec Exc., p. 28).

In excepting to the ALJ's recommendation, Enron notes that the ALJ did recommend that Penelec be required to negotiate with Enron and other interested parties to develop a mutually agreeable supplier tariff to be submitted with the Company's compliance filing. Enron suggests that the supplier tariff approach followed by the Commission in the PECO supplier tariff proceeding be adopted. (Enron Exc., p. 24).

4. Resolution

We agree with the ALJ's recommendation to reject the Company's proposal that all interactions between Penelec and suppliers be governed solely by

agreement. Although the ALJ suggested that the Company meet with its suppliers to develop a supplier tariff proposal, we find that our recent PECO Energy supplier tariff decision can give the Company adequate guidance for the development of an appropriate supplier tariff.

We find that such a tariff will act as an informative resource to all suppliers on the Company's system, which will provide set rules and procedures to govern EDC/EGS interactions. We will direct the Company to include an appropriate supplier tariff that describes and provides for the interactions between the Company and suppliers operating on their system, as part of its compliance filing. Our disposition of this issue in this manner will address the concern that the adoption the Company's proposal will allow Penelec to execute separate agreements with individual suppliers and discriminate against one or all of its competitors.

I. Provider of Last Resort

1. Parties' Positions

According to the Company, it is not necessary to decide this issue until the second stage process, when the regulatory impact of Penelec's proposed asset divestiture will be addressed

Notwithstanding the timing of consideration of this issue, Penelec asserted that it should not be obligated to render electric service as a back-up provider for the following reasons:

- * The companies intend to divest of substantially all of their generating facilities and exit the competitive generation supply business; and
- * The generation rate cap applicable to Penelec is predicated upon the value of generating assets Penelec will no longer own.
- * It is reasonable to relieve an EDC of providing service to non-shopping customers under a generation rate cap when that EDC has sold its generating assets, customers can freely shop for new energy sources and the EDC is no longer competing for energy sales with the EGSs.

(Penelec M.B., pp. 140-41).

The OCA responded that EDCs have, pursuant to 66 Pa. C.S. §2807(e)(1), “the full obligation to serve” these last resort customers, at least during the CTC or ITC collection period or until 100% of its customers have choice, whichever is longer, unless an alternative provider is approved by the Commission.. The OCA requested that the Company provide details on pricing last resort generation service. (OCA St. No. 2, p. 47). The OCA argued that these customers should be treated fairly and not be subjected to higher than market priced generation service or unreasonable rules and regulations. (OCA M.B., p. 117).

Furthermore, the OCA emphasized that Penelec has a statutory responsibility to provide last resort service under the Act, unless an alternative provider is approved by the Commission. The OCA further emphasized that the Company has not agreed to sell its NUGS and has not sold TMI. Finally, the OCA argued that the service must be provided at the “prevailing market price.” 66 Pa. C.S. §2807(e)(3).

It was the position of Enron that under circumstances where the Company has divested itself of its generating facilities, a competitive provision of provider of last resort service should be implemented by the Commission where EGSs could bid to be the provider for default customers, and market-based pricing would be achieved through this competitive process. In any event, Enron posited that the determination of what rate is applicable to such customers should be made in the context of a rulemaking. (Enron R.B., p. 38).

PICA agreed with the OCA that divestiture should, in no way, impact Penelec's obligation to abide by the generation rate cap. (MEIUG/PICA M.B., pp. 85-86).

2. ALJ's Recommendation

The ALJ recommended implementation of the competitive bidding process advocated by Enron. The ALJ reasoned that this approach will insert competition into the process. The ALJ also found that this approach would be responsive to the concerns of the OCA that all customers have access to market-based rates. (R.D., p. 174).

3. Resolution

Although no exceptions were filed to the ALJ's Recommended Decision, we cannot accept the ALJ's disposition of this issue. The ALJ agreed with Enron that provider of last resort service should be awarded based upon competitive bid. However, we find that such a determination, at this time, is premature.

We agree with the Company that the specifics of provider of last resort service must await the second stage proceeding and the results of divestiture. However, because of continuing NUG purchase obligations, the provider of last resort service is not solely limited to the results of the current divestiture actions. We will direct the Company to include a comprehensive provider of last resort proposal as the initiation of the second stage proceeding.

J. Other Tariff Issues

1. Agency

a. Parties' Positions

Enron proposed that suppliers should be able to act as agent for the customer to procure distribution, transmission, generation, and revenue cycle services on behalf of their principal-customers, and then send customers a single bill for these services as well as to bill and collect the CTC/ITC and transfer such payments to the utility or its agent.

According to Enron, the supplier would become the customer of record by accepting orders for service from customers and initiate or continue service with the EDC at the customer's location. Thus, Enron maintained that the supplier would be directly responsible for payment to Penelec of its charges associated with distribution and transmission. The basis for Enron's proposal is its contention that consumers want the efficiency and ease of being able to choose "one-stop shopping." (Enron M.B., pp. 70-71).

As support for its proposal, Enron noted that agency is now the rule in the natural gas market. This, according to Enron, is evidence that no legal or technical bar exists to implementing the agency concept. (Enron M.B., pp. 71-72).

Penelec acknowledged that it has implemented such arrangements on a case-by-case basis wherein an EGS acts as the agent for the end-user for the provision of total electric service. (Tr. 1081). However, Penelec objected to such an arrangement being set forth in a tariff. (Penelec R.B., p. 77).

b. ALJ's Recommendation

The ALJ recommended that this issue be dealt with in the pro forma supplier tariff negotiations. (R.D., p. 195).

c. Parties' Exceptions

Enron argues in its Exception that the ALJ's Recommendation is inconsistent with the PECO Energy compliance filing order where Enron maintains that the Commission recognized expanding the definition of "customer" to include an EGS that is authorized to act as an agent on behalf of its customer. In addition, Enron asserts that its agency proposal was structured to stand on its own and not be inextricably linked to its proposal for a supplier single bill option.

d. Resolution

After careful consideration of the ALJ's Recommendation, Enron's Exceptions, and the replies thereto, we see no reason for not considering this matter in the preparation of the pro forma supplier tariff. Therefore, we will adopt

the ALJ's Recommendation to deal with this issue in the pro forma supplier tariff negotiations.

2. Customer Information; Application for Service; Complaint Resolution; Service Interruption and Outages; Termination/Payment Agreements; Restoration/Reconnection of Service

a. Parties' Positions

On pages 117 to 121 of its Main Brief, the OCA submitted recommendations and requests with respect to these subjects in the Company's tariffs. First, the OCA urged that Penelec should be directed to present a bill format in its compliance filing that adheres to the requirements of the Commission's proposed rulemaking on *Customer Information for Electricity Providers*, Pa.B., Vol. 28, No. 5 (January 31, 1998).

The OCA requested that the Commission order the Company to provide, with its compliance filing, copies of credit and deposit protocols for review. The OCA also requested that the Commission order Penelec to comply with its recommendations regarding new customer deposits. The OCA proposed that the Company be directed to provide complaint resolution procedures, relating to billing, as a part of its compliance filing.

With respect to service interruptions and outages, the OCA indicated support of the efforts of the Commission to establish a baseline of current levels of service, and provided comments to the Commission in response to the proposed rulemaking regarding *Reporting Requirements for Quality of Service Benchmarks and Standards*, Docket No. L-00970131/57-192.

The OCA requested that Penelec's tariff filings provided with its compliance filing be revised to clarify that it will follow the Commission's orders regarding termination of service. Finally, the OCA urged that Penelec not be permitted to condition restoration of service on payment of supplier charges. (OCA St. No. 2, pp. 49-50). Accordingly, the OCA proposed that Penelec should be directed to clarify this agreement in the tariffs filed with its compliance filing.

b. ALJ's Recommendation

The ALJ's concluded that Penelec has agreed with or accepted the OCA's requests and recommendations in regard to these tariffs and should file the appropriate provisions. (R.D., p. 195).

c. Resolution

There being no exceptions filed to the ALJ's recommendation, and finding her resolution otherwise reasonable, we shall adopt the ALJ's recommendation.

3. Partial Payments

a. Parties' Positions

Penelec proposed in Tariff Rule 14(c) to apply all payments made by a customer first to every component of the EDC portion of the bill and any remaining amount(s) to the EGS portion, unless otherwise agreed to in writing between Penelec and an EGS. (Penelec Exh., CLO-4, p. 49).

Enron argued that the only reasonable way to assure equitable application of partial payments is to apply on a pro rata basis. Enron contended that, “if payments are not applied on a pro rata basis, a disproportionate amount of delinquencies will be allocated to suppliers, likely leading to early discontinuance of service by the supplier and, through return to the PLR, elimination of competitive benefits to those customers- customers who may most need the price reductions offered by the competitive environment.” (Enron M.B., p. 74).

b. ALJ’s Recommendation

ALJ Turner recommended that Enron’s request to have payments applied on a pro rata basis be rejected on the basis that it is inconsistent with the Commission’s ruling in *Final Order Re: Guidelines for Maintaining Customer Services at the Same Level of Quality Pursuant to 66 Pa. C.S. §2807(d), and Assuring Conformance with 52 Pa. Code Chapter 56 Pursuant to 66 Pa. C.S. §2809(e) and (f)*, Docket No. M-00960890F0011 (July 10, 1997). (R.D., p. 196).

c. Parties’ Exceptions

Enron excepts to Judge Turner’s refusal to recommend that partial payments be applied on a pro rata basis. Enron argues that the payment method which holds that EDCs are entitled to be paid first “ will simply result in all payment-troubled customers being canceled by their EGS for non-payment without the ability even to attempt to arrange a payment plan (because any additional payments will simply go to the EDC charges).” (Enron Exc., pp. 26-27).

d. Resolution

We reject Enron's pro rata proposal for application of partial payments by customers. Penelec's procedures for applying partial payments shall comply with the guideline relating to partial payments found in the *Final Order Re: Guidelines for Maintaining Customer Services at the Same Level of Quality Pursuant to 66 Pa. C.S. §2807(d), and Assuring Conformance with 52 Pa. Code Chapter 56 Pursuant to 66 Pa. C.S. §2809(e) and (f)*, Docket No. M-00960890F0011 (July 10, 1997) (Appendix B, Guideline H).

The adoption of this order of priority for partial payments reflects our general desire that regulations and Orders pertaining to customer services issues shall control these issues. The concern that the adopted method will result in a disproportionate amount of delinquencies allocated to suppliers is mitigated by the policy that, unlike the EDC, suppliers can address and control delinquencies quickly through cancellation of contract. This does not mean that EGSs cannot choose to negotiate payment terms. Contrary to Enron's claim that the payments made to satisfy the terms of an amortization agreement "will simply go to the EDC charges", we interpret the Chapter 56 regulations at 52 Pa. Code §§56.23 and 56.24 to allow a customer to instruct the EDC to apply a portion of their payment to satisfy the terms of a payment agreement established with the EGS.

4. Metering and Billing

a. Parties' Positions

In arguing for unbundling of the metering and billing options, MAPSA opined that Penelec's continued monopoly control of the billing and

metering functions through the single bill option would reduce the level of benefits which a customer will receive from retail competition. Given that many metering technologies now are available and competitive entities can provide what has historically been monopoly services, MAPSA's position is that customers should be able to purchase metering and billing services from their competitive generation supplier, or another third party. The Company opposed this proposal.

b. ALJ's Recommendation

The ALJ recommended that this matter be deferred pending the outcome of the Commission's generic proceeding on this subject, and that no tariff provision be included in Penelec's present filing. (R.D., p. 196).

c. Parties' Exceptions

In its Exceptions, MAPSA continued that Penelec should be ordered to unbundle metering and billing services in this proceeding. MAPSA submits that the only reason for this recommendation is that the Company opposes competition of these services. Although MAPSA has acknowledged that the Commission has shown interest in considering this issue, in a rulemaking proceeding, MAPSA urges unbundling as a result of the record developed in this proceeding.

d. Resolution

We are not prepared, based on this record, to order Penelec to unbundle metering and billing services in this proceeding. Given that we are already considering these and related issues in an unresolved proposed rulemaking, *Proposed Rulemaking Order Re Advanced Meter Deployment for Electricity*

Providers, 28 Pa. B. 493 (January 31, 1998), we shall not direct Penelec to file a tariff provision on this subject. Accordingly, we are adopting the ALJ's recommendation

5. Net Metering and Interconnection

a. Parties' Positions

The Environmentalists requested that the Commission impose a net metering tariff which the Environmentalists assert is not going to be offered by the Company. In setting forth criteria for the tariff, the Environmentalists maintain that such a tariff would be a useful tool. (Environmentalists M.B., p. 18).

The Environmentalists urged the imposition of specific standards to govern the interconnection of customers and Penelec's electric system. The Environmentalists recommended several changes to the connection provisions of the tariff to remove unnecessary barriers (Environmentalists M.B., p. 19).

The Company responded by asserting that the Environmentalists are effectively requesting a new tariff provision, unrelated to any of its existing tariffs and not an unbundling requirement of the Act. With respect to interconnection standards, Penelec noted that existing tariffs already contain interconnection standards which require compliance with national standards. Furthermore, the Company contended that they have not received any complaints on this matter.

b. ALJ's Recommendation

Finding that the Environmentalists presented no evidence in the record to support these proposed tariff provisions, the ALJ recommended without reservation that these proposals be rejected. (R.D., p. 196).

c. Resolution

No exceptions were filed to the ALJ's decision on this matter. We agree with the ALJ that the present state of this record does not permit us to address the Enviros' arguments regarding tariff revisions. Also, we note the Company's position regarding its current interconnection standards and tariff provisions. Although we will not adopt the position of the Enviros in this case based upon the record before us, we note that our final rulemaking on Advanced Metering may resolve many of the issues regarding net metering and the Enviros' arguments in this case. In addition, our action here does not prevent the parties from continuing discussions in this area.

IX. CUSTOMER EDUCATION

Pursuant to 66 Pa. C.S. §2807(d)(3), each EDC, in conjunction with the Commission, prior to the implementation of any restructuring plan under Section 2806 (Implementation , pilot programs and performance based rates 66 Pa. C.S. §2806) of the Act, shall implement a consumer education program informing customers of the changes in the electric industry 66 Pa. C.S. §2807(d)(3). Specifically, Section 2807 directs that, “the program shall provide consumers with information necessary to help them make appropriate choices as to their electric service.” 66 Pa. C.S. §2807(d)(3).

A. History

In the *PECO* restructuring decision, (See *PECO*, p. 157) we concluded that a combination of state-wide and local efforts would be the most effective way of communicating with and also educating the public about restructuring. Subsequently, in our *Statewide Consumer Education Order* issued February 27, 1998, Docket No. M-00981036, we established parameters for a statewide education program. (See Consumer Ed. Order, pp. 5-6). Additionally, in our February Order, referenced above, we provided for a mass-media campaign, as part of the education effort, to raise public awareness about customer choice. (See, Consumer Ed. Order, p.5.). In order to facilitate the administration of consumer education, our February 27 Order established a Consumer Education Board (CEB) to coordinate the statewide multimedia education program. (See Consumer Ed. Order, p. 26) The Order mandates that the education programs will be funded entirely through the CTC recovery mechanism. (See Consumer Ed. Order p. 12) The charge will be assessed on a per customer basis. Since we determined that the education campaign should be implemented on both a statewide and local level, the corresponding funding should be allocated so that 65% of each EDCs education funding is dedicated to the statewide effort, and 35% of the EDCs allocation is dedicated to a

local outreach and education program. (See Consumer Ed. Order, p. 12.) To fund the statewide effort, each of the restructuring orders approved to date, specifically PECO Energy, Duquesne Light, Allegheny Power and PP&L have all provided a consumer education budget of \$5 per customer, per year, which is fully recoverable as a transition cost pursuant to the CTC, over several years (See, PECO, p.32; Duquesne, p. 316; Allegheny, p. 271; PP&L, p.70).

The statewide consumer education board is already at work on its proposals, and we expect significant, if not final, focus for the consumer education requirements by the time that Penelec's compliance filing is approved.

B. Parties' Positions

Penelec stated in its Brief that "consumer education is a priority in the restructuring of the electric industry, and the move to competition."(See M.B., p. 168) Penelec supports our initiatives in developing a statewide mass-media campaign to raise customer awareness (M.B., p.168).

While Penelec outlined their main goals relating to the education effort, the OCA, in its Statement, indicated that the Company did not set forth sufficient detail indicating how the education effort would be implemented. As such the OCA has outlined seven (7) specific deficiencies relative to Penelec's position. The OCA believes that Penelec's plan was deficient as to the following: (1) issues relating to motivating the customers to read and understand the materials, (2) the necessary scope of the educational effort (based on the current knowledge base of the customer as it relates to electric deregulation), (3) lack of time lines or interim goals and objectives to review the progress of the educational effort, (4) how to effectively use multi-media in the effort, (5) how to evaluate the overall effectiveness of the effort, (6) Penelec's focus on the role of GPU

Energy in the new market structure in customer literature, and also (7) the lack of *interaction with community, or grass roots, organizations in the development and implementation of the effort.* (R.D. at 219, citing OCA St. pp. 5-17).

C. ALJ's Recommendation

ALJ Turner stated in the Recommended Decision that Penelec should not be required to provide motivational materials to the local markets about electric competition. (R.D., p.222). Further she emphasized that 65% of the company's budgeted *consumer education funds will be dedicated to the statewide program.* ALJ Turner concluded that motivation to participate in competition is more appropriate at the statewide level. ALJ Turner further emphasized that, in a competitive environment, the companies should have discretion in how to effectively use these educational funds to inform customers about competition rather than direct them towards a particular supplier. (R.D., p. 222).

ALJ Turner agreed with the OCA's recommendation concerning focus group research. In the Recommended Decision the ALJ indicated that attention to focus groups, particularly throughout the phase in and transition periods, will identify areas where customer knowledge needs reinforcement. (RD, p. 244).

ALJ Turner noted that CBOs, in circumstances where they are not involved in designing educational materials, may be able to host meetings of focus groups to review those materials and gather commentary on proposed changes from members of the group. ALJ Turner stated that CBOs should be allowed to assist in the design and also the dissemination of materials. (R.D., p. 222-223).

In the Recommended Decision, ALJ Turner favored the use of company specific logos on local education materials, but emphasized that local programs should include the dissemination of state-wide materials and ads without any company logos on or in them. (R.D., p. 223).

ALJ Turner further recommended that Penelec should develop an evaluation program to record the effectiveness of their company specific education programs. (RD, p. 223).

D. Parties' Exceptions

Penelec takes exception to the ALJ's ruling concerning funding levels for customer education. The ALJ deferred ruling on this issue until the Company submits its compliance filing. (R.D., p. 224). Penelec maintains that their proposed \$5 million budget for customer education should be approved. Penelec further provides that if this Commission approves additional spending levels, we must provide a corresponding recovery mechanism to fund such amounts. (Exc., p. 33-34).

Enron also takes exception to Penelec's consumer education testimony, and states that we should prohibit the use of company logos on local education materials. We note that there is distinction between customer education and marketing. Enron is concerned that because customer education will be funded by the CTC and collected as a non-bypassable charge on all customers regardless of supplier, the "branding of materials which are solely intended to educate consumers is neither appropriate nor fair." (Enron Exc., p. 32-33). As we stated in our Consumer Education Order, consumer education plans "must not disparage or promote any provider of electricity or any distribution utility." (Consumer Education Order, p. 16).

Enron was the only party to file reply exceptions to Penelec's proposed consumer education effort. Enron's argument is that the GPU name gets the benefit of being the incumbent utility, which is a special advantage that was gained solely through Penelec's status as a monopoly provider, and should not simply be conferred upon the GPU Companies' affiliated suppliers. (Enron's R. Exc., p. 18). Enron further contends that [i]f, ...the name is to be used by [] affiliated suppliers, it is more than reasonable to require them to pay for its use, to mitigate both the anti-competitive effects the use of the name would have on the market, and to mitigate for consumers some of the GPU Companies' claimed stranded costs". (Enron R. Exc., p. 18). Enron's position with regard to the Recommended Decision is that the value of the name will continue to accrue to the benefit of shareholders, with no recompense made to the customers who financed it over the years. Penelec did not include the value of the GPU name in calculating their net stranded costs even though the name unequivocally does have value, as admitted by the Companies' own president. (Enron's R. Exc., p.19).

E. Funding Levels

Penelec did not include a proposed budget for its education plan in its original filing. However, the Company did provide a preliminary budget for its plan shortly before testimony was filed. (R.D., p. 223, citing, OCA St. 2, 6). Penelec proposed to allocate a portion of its total consumer education budget of \$5 million to the statewide effort over a three year period. (Penelec M.B., p. 171). The OCA, in its review of the proposed funding level, indicated that although it was a definite improvement, the level of funding suggested by Penelec may still be insufficient to support an adequate consumer education program. (R.D., p. 223). The OCA further requested that we consider increasing the budget. (R.D., p. 224) Penelec did not respond to OCA's concerns in its Reply Brief.

ALJ Turner deemed that she was unable to make a meaningful ruling on the request for an increase in Penelec's consumer education budget at that time (RD, p. 245), and deferred it to the Company's compliance filing.

F. Resolution

We agree with many of the concerns raised by the OCA with regard to Penelec's proposed local education plan. However, we believe that the shortcomings identified in this Order could be improved by effective cooperation with the CEB. Specifically, Penelec's proposed funding split of 65%/35% between statewide and local education effort respectively, is consistent with our Consumer Education Order of February 27, 1998. As further clarification, we note that Penelec has proposed a \$5 million budget for their consumer education program, which may need to be adjusted in accordance with their final plan upon review by the CEB. We note however, as a general rule, it appears to undervalue our prior restructuring orders of PECO Energy, Duquesne Light, Allegheny Power, and PP&L, which assign \$5 per customer per year as an appropriate education budget target.

As the CEB is providing guidance for the implementation of the statewide educational efforts, and will continue to advise and review each EDC's local consumer education plans, we believe the CEB will be of valuable assistance to Penelec. Accordingly, we direct Penelec to participate in the statewide consumer education program as set forth in our February 27, 1998 Order on Consumer Education. We further direct Penelec to cooperate with the CEB in the continued development of their local education program. Penelec should review the criticisms of the OCA as presented in this proceeding. As further recommendation, we strongly encourage Penelec to incorporate the CBOs into both the development and implementation of local outreach and

educational efforts. As we have previously found, CBOs can be an integral part of each EDCs local plan and should be included in the planning process where appropriate. Their insight into delivery mechanisms which are best suited to educate consumers in different communities will be invaluable. "The use of CBOs is encouraged to reach a diverse population." (See Consumer Ed. Order).

Penelec's proposed \$5 million dollars is an improvement over its initial presentation, which provided no specific funding level. However, we note that its plan will be modified as it coordinates with the CEB and addresses the OCA's concerns. As a result, Penelec's compliance filing should address the amount budgeted for the revised program, consistent with our guidelines set forth above, and in the Consumer Education Order.

Additionally, we have some concern regarding the ALJ's discussion of the manner in which the local education campaign should motivate consumers to learn about electric competition. At this stage, local education should simply be an effort to encourage customers to enroll. Through this process companies should educate customers relative to the process of supplier selection. However this effort should not be designed as a marketing effort to motivate customers to select a specific supplier.

Although recognizing the EDCs' statutory obligation to educate consumers, we are concerned with the ALJ's affirmative declaration regarding the use of company logos on educational materials. That is not an issue which we can resolve without having a more complete plan before us to review which would allow us to discern, in context, the intended use of the logo. Each of these issues will be addressed more appropriately during the CEB's review of Penelec's local plan, and also our review of the same in the Company's compliance filing.

X. UNIVERSAL SERVICE AND CUSTOMER ASSISTANCE PROGRAMS

The Act defines Universal Service as policies, protections and services that help low-income customers to maintain electric service. (66 Pa. C.S. §2803). Section 2802(10) of the Act declared that the Commonwealth "must, at a minimum, continue the protections, policies and services that now assist customers who are low-income to afford electric service." (66 Pa. C.S. §2802(10)). This mandate is echoed in Sections 2804(a) and 2807(d), establishing the duties of EDCs. The Act specifically recognizes the importance of universal service, particularly for low-income customers. Section 2804(9) of the Act charges the Commission with ensuring that universal service and energy conservation policies, activities and services are appropriately funded and available in each electric distribution territory. (R.D., p. 224-225).

A. Specific Programs

Pursuant to the Commission's Customer Assistance Program (CAP) Policy Statement, Penelec implemented a pilot CAP in 1995. Penelec did not initially propose changes in the design of the CAP Program because the pilot program evaluations were not complete. However, because of the positive experience with their CAP Programs, combined with increasing evidence from other utilities that CAP Programs are effective for assisting low-income customers, Penelec proposed to combine and expand their CAP Program beyond the pilot stage. Under Penelec's proposal, the number of participants in the CAP Program will increase from approximately 1,600 participants to 5,000 participants (2,000 in Met-Ed's service territory, 3,000 for Penelec's service territory). (R.D., pp. 226-227).

Penelec has designed and proposed a single blended CAP that will be uniform for Met-Ed and Penelec service territories. Penelec witness Horten, in her oral surrebuttal testimony, stated that Penelec and Met-Ed have adopted many, but not all, of the ideas

presented in the testimony of the OCA witness Brockway. The new blended CAP Program will include the following: reduced payments, accelerated arrearage forgiveness, increased use of CBOs and customer contacts, expanded eligibility criteria, additional conservation education, and also a shortened time period for reentry after dismissal. Penelec stated that it is waiting the outcome of its CAP Program evaluation to determine whether additional design changes will be necessary to the blended CAP. Penelec and Met-Ed stated that they will implement the blended CAP Program pending the completion of Penelec's evaluation. (R.D., pp. 226-228).

Penelec's LIURP and Met-Ed's WARM Programs are the Commission-directed low income weatherization programs that began in 1988. Since inception both LIURP and WARM have provided conservation education services, including full weatherization treatments and furnace repairs for electric heat homes, water heater replacement, refrigerator replacement, energy-saving light bulbs and other base load measures for homes without electric heat. As part of their new Universal Service plan, Penelec and Met-Ed performed a needs analysis for the LIURP/WARM Programs, and estimated that approximately 10,650 customers will require program services in Met-Ed and Penelec service territories. The Companies anticipated that they can accommodate most needs within a four year period. (R.D., pp. 228-230).

In addition, Penelec proposed to adopt the following innovations suggested by the OCA witness Brockway for the LIURP program. First, Penelec will evaluate using a "neighborhood blitz" approach to deliver program services in urban areas. This approach uses college students and members of the community for door-to-door solicitations and delivery of program services in urban neighborhoods with high concentrations of low-income households. Second, Penelec will incorporate more efficient post-installation inspection methods into the design of the LIURP program to promote cost-effectiveness. Finally, Penelec will implement a pilot program for renewable technologies within its service territory to

determine if renewable technologies can effectively assist low-income customers. (R.D., pp. 229-230).

The Environmentalists recommended that both delivery and administration of all universal service programs be provided by CBOs. For the following reasons, Penelec argued that this suggestion is impractical. Penelec witness Horten pointed out that CBOs will already have a significantly increased role in providing CAP Program services. Penelec witness Horten explained that because CBOs are small organizations with limited resources, they focus their efforts on delivering program services to customers in need. Finally, Penelec witness Horten argued that requiring CBOs to administer all universal service programs would require them to divert scarce resources from hands-on customer assistance to program administration, thus minimizing their effectiveness. (R.D., p. 236).

B. Funding Levels

The levels of funding for universal service programs, particularly the CAP and LIURP/WARM programs, were the most debated issues in the universal service arena. Parties proposed varying funding levels. These proposals are summarized as follows:

Program	1996 Funding	GPU Proposed Funding	OCA Proposed Funding	CAAP Proposed Funding
Penelec CAP	\$620,000	\$2,420,000	\$4,900,000	\$11,545,659
Met-Ed CAP	\$452,000	\$1,481,000	\$4,563,815	\$4,818,582
LIURP (PN)	\$652,000	\$972,000	\$1,962,000	\$2,500,000
WARM (ME)	\$772,000	\$1,213,000	\$1,825,526	\$1,500,000

Penelec did not dispute the need for the CAP and LIURP Programs, or the positive impact that the Programs can have for low-income customers. Penelec argued that because the CAP Program has just completed the pilot stage along with the unfavorable findings from Met-Ed's impact evaluation, it is unreasonable to increase the funding for the CAP Program beyond that proposed. (R.D., p. 235).

Based on the census estimate of 124,114 low-income income households in Penelec's service territory, and the 14,620 low-income households who have been served to date in LIURP, CAAP estimates the unserved LIURP population as just over 109,000. Assuming a reasonable target of 40% participation, CAAP identifies a target service level of 43,798 households are income eligible for LIURP. Based on this analysis, CAAP estimated that Met-Ed proposed funding levels were inadequate to meet the need in Met-Ed's service territory. CAAP recommended a total CAP Program funding of over \$16 million for both Companies, and LIURP/WARM funding marginally higher than that proposed by the OCA. (CAAP St. No. 2, pp. 9-10; R.D., p. 231).

The OCA and CAAP have also proposed increases in funding for the LIURP Programs. Penelec proposed to annually fund LIURP at \$972,000. Penelec argued that its proposal is consistent with the recent proposed rulemaking renewing the LIURP Program (Docket No. L-00960118), where the Commission specifically stated that it does not advocate any changes to program funding. (R.D., p. 235).

The OCA and CAAP argued that the Penelec and Met-Ed proposal does not meet the level of need in Penelec's service territory. Both the OCA and CAAP based their projections of need for Universal Service assistance on U. S. Census data. The OCA Witness Brockway testified that there are approximately 44,000 households in the Met-Ed territory and 110,000 households in the Penelec territory living at or below 150% of the federal

poverty level. The OCA asserted that serving 5,000 customers, or only 3.2% of Penelec and Met-Ed's low income customers, is unacceptable compared to the need. The OCA considered its recommendation that the Companies serve between 9% and 12% of their low-income households as conservative. The OCA recommended increasing enrollment to these participation levels over 3 or 4 years. (R.D., p. 234).

The OCA recommended funding of CAP at .5% of gross operating revenues, and funding of LIURP and WARM at .2% of revenues, recommending that the additional funding come from Penelec's current uncollectible costs. (R.D., p. 231).

CAAP witness Kuennen suggested that expansion of the CAP Programs could be funded by shifting the dollars associated with uncollectible bad debts to the CAP Programs. (R.D., p. 210). Penelec witness Horten testified, "...it is in the best interests of the Companies and their customers to expand the CAP Programs beyond the pilot stage by shifting funds from the low-income collections to the CAP Programs." (Penelec St. No. 13, pp. 18-19). Penelec concluded that the funding of the CAP Program it proposed strikes a reasonable and appropriate balance between traditional collection activities and Universal Service Programs. (R.D., pp. 208-209). However, Penelec witness Orner testified that reprogramming bad debts to fund the CAP program is unworkable. Penelec witness Orner also argued that CAP participants who fail to pay their bills, result in uncollectible bad debts. Finally, Penelec witness Orner argued that funding expansion of the CAP program with uncollectibles would result in additional uncollectible amounts that would have to be recovered from Penelec's other customers. (R.D., p. 234).

C. Allocation of Universal Service Charges

Penelec originally proposed to recover the costs associated with the universal service programs from all customer classes on a per kWh basis. As its ultimate proposal in

this proceeding, Penelec stated that it is willing to accept any allocation method the Commission deems appropriate in this proceeding so long as it recovers from customers all of its Universal Service Costs. MEIUG/PICA concurred with this approach, and urged this Commission to allocate universal service costs solely to the residential classes consistent with the Universal Service Order, the Act, and *PECO*. MEIUG/PICA vigorously opposed any proposal to allocate universal service costs on a kWh basis as initially proposed by Penelec. (R.D., pp. 236-237).

The OCA supported Penelec's initial proposal. However, because witness Brockway recognized that this Commission did not adopt the per kWh allocation in the Universal Service docket, she also recommended an alternative class based relative non-production revenue allocator. Ms. Brockway argued that by focusing on regulated, non-production related costs, her allocation method imposes a higher allocation on residential customers, but is still much more fair than a 100% residential allocation. (R.D., p. 236).

The OTS proposed a formula to apply a flat Universal Service Fund Charge (USFC) to all customers in all classes. The OTS submitted that a proposal to fund the USFC on a per kWh basis is unfair and discriminatory. (OTS M.B., pp. 121-124).

The OTS also proposed that the Commission direct Penelec to show universal service charges as a separate line item on the bill. The OTS argued that showing the charge separately would aid in tracking and accountability of these charges. Penelec recommended that universal service charges not be included as a separate line item. The OCA agreed with Penelec's proposal, and opposed OTS's position. The OCA witness Brockway explained, there is no justification for separately showing universal service charges on a bill when no other cost of service item is shown separately on a customer bill. The OCA witness Brockway argued that showing the charge separately may actually be misleading rather than

informative because it brings disproportionate attention to universal service costs since they are a tiny element of the bill. (R.D., pp. 239-240).

D. Portability

Penelec proposed to assign all Universal Service benefits to the EDC, unless the Commission names a different supplier of last resort. Penelec argued that this proposal is consistent with the Universal Service Guidelines. Penelec proposed to apply CAP benefits first to the distribution portion of the bill, and then to the generation portion. (R.D., p. 239). Enron witness Muench advocated completely portable Universal Service Program benefits, so that Universal Service Program benefits are allocated to each component of a low-income customer's electric bill on a pro-rata basis. Penelec opposed Enron's proposal. Penelec argued that the money that will fund its Universal Service Programs is collected from Penelec's customers on the distribution portion of the bill. Penelec also pointed out that they design, administer and monitor the Universal Service Programs, and maintain relationships with CBOs and other organizations for implementing those programs. Although Enron stated that it strongly supports Universal Service Programs, Enron stated it will not be offering its own Universal Service Programs to assist low-income customers. (R.D., pp. 240-241).

E. ALJ's Recommendation

Penelec and Met-Ed proposed to incorporate some, but not all of OCA's program design suggestions for CAP and LIURP/WARM. ALJ Turner recommended that this Commission adopt the program design changes proposed by Penelec and Met-Ed and recommended that the Commission reject the OCA's requests for further program design changes. The Judge also recommended that Penelec develop a renewables pilot program. However, the Judge rejected the OCA's request to include a detailed renewables pilot design in the compliance filing as being unreasonable. The Judge reasoned it would be

counterproductive to hurriedly design the pilot. The Judge recommended that Penelec should consult with the BCS and the OCA about the design of the renewables pilot. (R.D., pp. 228, 230-231).

ALJ Turner recommended that we reject the Environmentalists proposal to transfer the delivery and administration of all universal service program to CBOs. The Judge reasoned that it is not in the public interest to separate the responsibility and administration for a program. The Judge further opined that if this Commission holds Penelec accountable for the success or failure of these programs, then Penelec should be allowed to have sufficient control of their operations to produce desired results. (R.D., p. 236).

The ALJ recommended that the Commission accept the funding levels for CAP and LIURP as proposed by the OCA. (R.D., p. 235).

ALJ Turner declined to recommend a specific funding source or methodology for universal service costs. (R.D., p. 233).

The ALJ recommended the Commission adopt the MEIUG/PICA position to allocate the universal service costs solely to residential classes as in *PECO*. The ALJ also recommended, as in *PECO*, that the Commission adopt a reconcilable Universal Service Fund Charge, reconcilable pursuant to Section 1307(f) of the Code. 66 Pa. C.S. §1307(f) (R.D., p. 238).

The ALJ recommended that the Commission reject, as in *PECO*, the OTS position to show the USFC charge as a separate line item on the customer's bill. (R.D., p. 240).

ALJ Turner recommended that the Commission adopt Penelec's proposal to assign all universal service benefits to the EDC, unless this Commission names a different supplier of last resort. (R.D., p. 239). The ALJ recommended that we adopt Penelec's proposal to apply CAP benefits first to the distribution portion of the bill, and then to the generation portion. The ALJ reasoned the proposal is consistent with the Act. (R.D., pp. 240-241).

F. Parties' Exceptions

Penelec excepts to the ALJ's proposed levels of funding for its CAP and LIURP universal service programs. Penelec argues that "it is unreasonable to increase the funding for the CAP Program to the levels in the Recommended Decision until the Company has had an opportunity to develop a CAP Program design that is not as significantly revenue negative." Penelec submits that the ALJ provides no reason for the increase in LIURP funding. Penelec argues that the increase in LIURP funding levels is inconsistent with the Commission's recent proposed rulemaking renewing the LIURP program. Penelec submits that the rulemaking specifically held that no changes to program funding are necessary.

Penelec argues that the ALJ erred in basing the funding levels on the OCA's needs assessment. Penelec asserts that the record reflects the fact that Penelec and Met-Ed conducted a needs assessment that led to its proposed program expansions. Finally, Penelec argues that reprogramming bad debt to fund the CAP program would result in additional uncollectibles amount that could not be recovered. (Penelec Exc., pp. 34-35).

The OCA excepts to the ALJ's decision to reject the remaining OCA proposed program design changes. The OCA submits that after Penelec completes its impact evaluation, Penelec should consider whether adopting the remaining recom-

mendations of the OCA witness Brockway would increase the efficiency and effectiveness of the programs. (OCA Exc., pp. 21-24).

The OCA also disagrees with the ALJ's decision to reject the OCA's position regarding universal service cost allocation. The OCA submits that the ALJ based her decision on *PECO*. The OCA further argues it demonstrated that the current case is distinguishable from *PECO*, and therefore, requires a different result. The OCA further argues the current case is different for the following reasons: Penelec's universal service costs are new costs, the Act requires universal service costs to be non-bypassable, and universal service costs provide benefits to all customers. The OCA requests that we assign universal service costs to all customer classes. (OCA Exc., pp. 24-26).

Enron excepts to the ALJ's failure to recommend that Penelec offer portable universal service support and pro rata allocation to each component of a low-income customer's bill. Enron argues that the ALJ erred by failing to follow the Commission's precedent in *PECO*. Additionally, Enron points out that this Commission applied the *PECO* precedent in *West Penn*. Enron requests that we now require Penelec to modify its universal service program to require portable support and pro rata allocation. (Enron Exc., pp. 34-35).

CAAP agrees that the ALJ's recommendation regarding funding levels for Met-Ed's CAP and LIURP meet the requirements of the Act. (CAAP Exc., pp. 4-5). However, CAAP excepts to the ALJ's recommend funding and participation levels for Penelec's CAP and LIURP. CAAP submits that the Commission should establish funding levels more in line with the levels in *Duquesne* and *West Penn*. CAAP argues that this Commission established participation levels in *Duquesne* and *West Penn* to serve approximately 40% of the eligible low-income population. CAAP submits that a comparable level for Penelec's CAP is between \$6,814,160 and \$11,545,659 to serve between 14,313 and 16,763 customers. CAAP submits that a comparable level for Penelec's LIURP is at least \$2,440,000 to serve 41,835

customers. CAAP requests that we direct Penelec to establish funding levels for CAP and LIURP as proposed by CAAP. (CAAP Exc., pp. 5-9).

CAAP also excepts to the ALJ's failure to require Met-Ed and Penelec to increase funding and participation levels during the transition period. CAAP states the ALJ recommended the funding and participation levels stay the same during the transition period and increase to the recommended levels at the end of the transition period. CAAP recommends that this Commission adopt CAAP's or a similar schedule to increase funding and participation levels during the transition period. CAAP's schedule increases funding and participation over a four-year period. (CAAP Exc., pp. 9-10).

G. Resolution

Our review of Penelec's Universal Service proposals is necessarily guided by the language the Act. Specifically, there are three sections which contain language pertaining to Universal Service which require that: (1) ...[E]lectric service be available to all customers on reasonable terms and conditions since it is essential to the health and well being of residents, and also essential to orderly economic development. (66 Pa C.S. §2802(9)); (2) The Commonwealth must, at a minimum, continue the protections, policies and services that now assist customers who are low-income to afford electric service, 66 Pa. C.S. §2802(10) and; (3) We (the Commission) shall ensure that universal service and energy conservation policies, activities and services are appropriately funded and available in each electric distribution service territory. (66 Pa. C.S. §2804(9)).

Section 2803 defines "universal service and energy conservation" as "policies, protections and services that help low-income customers to maintain electric service. 66 Pa. C.S. §2803. The term includes customer assistance programs, termination of service protection and policies and services that help low-income customers to reduce or manage

energy consumption in a cost-effective manner, such as the low-income usage reduction programs, application of renewable resources and consumer education.” (66 Pa. C.S. §2803). Section 2804(15) further requires the restructuring plan to include an initial proposal indicating how the EDC’s universal service and energy conservation responsibility will be met. 66 Pa. C.S. §2804(15). Also, we issued our final Order establishing Guidelines for Universal Service and Energy Conservation Plans on July 10, 1997 as a guide for EDCs for the restructuring proceedings.

1. Funding and Eligibility

Penelec and Met-Ed’s CAP began as a pilot program. Met Ed initiated this program in 1994 and Penelec in 1995. Recognizing that existing programs are in the pilot stages, Penelec and Met-Ed have proposed a “blended” CAP program for both Companies which will increase the number of participants from approximately 1,600 to 5,000 (2,000 in Met Ed’s territory and 3,000 in Penelec’s territory). In 1996, Penelec spend \$620,000 for CAP and Met-Ed spend \$452,000 for CAP. Penelec proposed to increase the spending levels to \$2,420,000 for CAP. Met-Ed proposed to spend \$1,481,000 for CAP. Penelec and Met-Ed have determined need based upon a projected 50% sign-up rate of those customers eligible to participate as indicated by Financial Summary Forms used to establish payment arrangements. Penelec and Met-Ed have stated that the projected levels strike a reasonable and appropriate balance between traditional collection activities and Universal Service Programs.

The OCA proposed funding increases for CAP to \$4,900,000 for Penelec and \$4,563,815 for Met Ed. The OCA based its projections of need for Universal Service on U.S. Census Data. According to the OCA analysis, approximately 44,000 households in Met Ed territory and 110,000 households in Penelec are now living at or below 150% of the federal poverty level. Based on need, changes to program design and a 50% participation rate, the

OCA recommended that Met Ed enroll 7,000 customers in CAP and that Penelec target 7,000-11,800 customers. The OCA asserted that 5,000 customers would only be approximately 3.2% of the Companies' low income customers and is unacceptable compared to need. The OCA considered its funding proposal to serve between 9% - 12% of low-income households to be conservative, particularly if the Commission adopts the OCA's recommended 3 or 4 year increase.

Based on a census estimate of 124,114 low-income income households in Penelec's service territory and the 14,620 low-income households who have been served to date in LIURP, CAAP estimated the unserved LIURP population as just over 109,000. Assuming a reasonable target of 40% participation, CAAP identified a target service level of 43,798 households that are income eligible for LIURP. Based on this analysis, CAAP estimated that Met-Ed proposed funding levels were inadequate to meet the need in Met-Ed's service territory.

Unlike CAP, which assumes that a customer is in the program for a multi-year period, LIURP is a program that serves a customer once and then moves on to serve other customers. For this reason the program need serve a smaller number of customers in a given year to achieve a comparable level of program availability as CAP.

a. Resolution

We agree with the OCA and CAAP that the proposed funding levels for the CAP and LIURP are insufficient to meet the needs of Penelec's customers and must be expanded beyond Penelec's proposal. It is important to note that Penelec's current program is a pilot and not designed as a fully functioning program. Thus, although Penelec's proposed funding level is significantly greater than the existing funding level, it is not sufficient for a fully operational program. Accordingly, as Penelec and Met-Ed's CAP and LIURP programs

increase their enrollment to full design levels, the OCA funding levels should apply. Because the record does not include useable net costs per customer, we adopt the OCA funding levels, though not the enrollment numbers.

Met-Ed argued that the our rulemaking at Docket No. L-00960118 specifically held that no changes to LIURP program funding are necessary. However Met-Ed's interpretation of that rulemaking is misguided. Met-Ed failed to elaborate on the reasons this Commission did not propose changes to the LIURP funding at the time the rulemaking was entered. However we note that in the LIURP rulemaking, this Commission stated:

However, we must point out that each electric distribution company will be using its electric restructuring filing to establish the LIURP funding level within its universal service funding mechanism. Since the Act has invoked a process for establishing the funding level for LIURP which supersedes this regulation in this regard, we will defer the electric funding levels to the electric restructuring filings.

We conclude that the funding levels proposed by the OCA will make universal service appropriately available and funded as required by the Act, while considering the need for service, existing funding levels, administrative concerns and budget constraints. Based upon our determination that Penelec's programs should achieve the OCA funding levels upon full implementation, we will adopt Penelec's proposed spending levels for 1999 and direct the following progression:

	Met-Ed CAP	Met-Ed LIURP	Penelec CAP	Penelec LIURP
1999	\$1,481,000	\$1,231,000	\$2,420,000	\$ 972,000
2000	\$2,500,000	\$1,400,000	\$3,300,000	\$1,320,000
2001	\$3,500,000	\$1,600,000	\$4,100,000	\$1,640,000
2002	\$4,564,000	\$1,826,000	\$4,900,000	\$1,962,000

2. Cost Recovery

Section 2804(8) requires the Commission to establish “an appropriate cost recovery mechanism which is designed to fully recover the electric utility’s universal service and energy conservation costs over the life of these programs.” 66 Pa. C.S. §2804(8). We noted in our Guidelines that funding for Universal Service is not to be the last priority after rate cap or CTC considerations:

...funding for universal service and energy conservation programs should not be determined after all other funding requirements are met. The total amount of dollars available under the rate cap should be adjusted to meet all of the requirements of the Act including universal service and energy conservation.

The record before us is insufficient to conclude that implementation of the required funding levels requires any particular amount of additional funding in any given year or whether Penelec can achieve the targeted funding within the rate caps during any year in which rates remain capped. Similar to our decision in the *West Penn* restructuring order, any shortfall in Universal Service and Energy Conservation Program expenses, as determined pursuant to the Guidelines, may be recovered through a deferred regulatory asset to be collected after the rate cap expiration. As we directed in the *PECO Energy* restructuring case, there will be a reconcilable Universal Service Fund Charge that is separately identified for cost accounting but included within the distribution portion of a customer’s bill. We note that there will be no separate identification of the charge on a customer’s bill.

Initially, Penelec proposed a per kWh charge for all customer classes. Recognizing that we have not provided for an all-customer class funding of universal service in our prior restructuring orders, Penelec altered its proposal and merely stated that they

would be amenable to any cost recovery mechanism that would assure full collection of costs. MEIUG/PICA oppose any proposal to allocate costs across all classes, asserting that would constitute a shifting of costs in contravention of the Act.

The OCA urges that we adopt an alternative class based relative non-production related costs. Recognizing that this alternative will provide for a higher allocation of costs to residential customers than a total class kWh allocator, the OCA maintains that it is still better than a 100% allocator to the residential consumers.

We have determined in our past decisions that universal service funding must be allocated to the residential class. In those decisions, we have taken great pains to ensure that costs are not improperly allocated so as to shift from industrial or commercial classes to residential consumers on other items and adjustments. Similarly, in compliance with the Act, we must make certain that there is no cost shifting from residential classes to industrial and commercial classes. Accordingly, we will adopt the same allocation as in the *West Penn* restructuring case.

3. Universal Service Program Design

The first item we address here involves benefit portability and the ALJ's determination that universal service benefits are to be applied first to distribution, then to generation. In order for low-income customers to enjoy true portability and equal participation in the competitive market place, we find that universal service benefits must be applied pro-rata to the generation and distribution portions of the bill. We disagree with the ALJ's discussion which indicates that it would be inequitable to provide for a pro-rata application of universal service benefits.

We also note that Penelec and Met-Ed have adopted several modifications recommended by the OCA. In addition, the Penelec has proposed a renewables pilot. We will adopt the recommendation of the ALJ regarding the proposed renewables pilot. We agree that design should not be artificially hastened to meet the compliance filing deadline. We also agree with the ALJ that Penelec and Met-Ed need not adopt all of the OCA proposed modifications. However, it is unclear from the Recommended Decision which modifications have been accepted. Accordingly, we will direct Penelec and Met-Ed to submit their modified universal service program, including the renewables pilot consistent with the Order entered pursuant to this Motion to the Commission's Bureau of Consumer Services for review and eventual Commission approval.

4. Summary

We adopt the OCA's funding levels for CAP and LIURP. The Commission directs Penelec to gradually increase the level of funding, over four years, for CAP to \$4,900,000, and for LIURP to \$1,962,000.

We direct Penelec to recover any shortfall in Universal Service and Energy Conservation Program expenses through a deferred regulatory asset to be collected after rate cap expiration. Penelec should identify the Universal Service Fund Charge (USFC) separately for cost accounting but include the USFC within the distribution portion of a customer's bill. The USFC shall be reconcilable pursuant to Section 1307(f). The reconciliation will be based on all program costs as indicated in the Guidelines. We direct the USFC be allocated to the residential class to avoid cost shifting.

We further direct that CAP benefits must be portable. We find that Penelec must allocate the CAP discount, on a pro-rata basis, to the generation and distribution portions of the bill.

We direct Penelec that program design changes generally should be consistent with the Commission's CAP Policy Statement and the Guidelines for both CAP and LIURP, and should be submitted to the Commission's Bureau of Consumer Services for review and Commission approval.

XI. COMPETITIVE SAFEGUARDS

A. Parties' Positions

Penelec urged the Commission to adopt standards of conduct that would assure open access to electric distribution systems and would prevent cross-subsidization by ratepayers of the costs of unregulated activities. (Penelec M.B., p. 149). To that end, Penelec supported the "consensus" Code of Conduct reported to the Commission by the Working Group on Competitive Standards. (Penelec M.B., p. 165). Any additional restrictions, in Penelec's view, are not necessary to achieve the intended goals of standards of conduct. In particular, Penelec contended, that further restrictions should not be imposed absent a market power analysis demonstrating that Penelec is capable of engaging in conduct that will injure or destroy competition. (Penelec M.B., pp. 150-161).

With respect to the PECO Code of Conduct, Penelec found it generally acceptable, but argued that some of its provisions should not be applied to the Company. Specifically, Penelec asserted that the PECO provision prohibiting the EDC from selling non-power goods or services to an affiliated supplier below the higher of the market price or cost is unnecessary. In addition, Penelec objected to the requirement in the PECO Code of Conduct that EDCs simultaneously make available to EGSs all non-public market information that it provides to an affiliated supplier, maintaining that only customer information needs to be furnished. Finally, Penelec contended that the equal treatment requirements in the Code of Conduct should be limited to the provision of utility services. (Penelec M.B., pp. 165-167).

The OCA asserted that the Code of Conduct applicable to Penelec should (1) differentiate between the “transmission and distribution function” and the “generation function,” (2) seek to ensure the unregulated division is not being subsidized by the regulated division, (3) prohibit the EDC from marketing the services of the unregulated affiliate, and (4) require a methodical procedure for documenting and addressing complaints alleging violations of the Code. With those modifications, the OCA supported the use of the Code of Conduct submitted by Penelec as part of its original filing. (OCA M.B., p. 122).

Enron advocated the use of a more comprehensive Code of Conduct, such as that proposed last year by an Enron affiliate as part of a customer choice program in Oregon. Alternatively, recognizing the importance of a uniform statewide Code of Conduct, Enron urged the Commission to accept the interim rules established in the PECO restructuring proceeding. Enron asserted, however, that the Code should also contain provisions (1) clarifying the ban on joint marketing by Penelec and its affiliated suppliers, and (2) prohibiting the use of Penelec’s name in marketing by an affiliated supplier or division. (Enron M.B., pp. 83-88).

MAPSA also supported the establishment of an interim Code of Conduct patterned after the PECO standards. (MAPSA M.B. at 33-35). Similarly, PECO noted its assumption that issues relating to competitive safeguards would be resolved on a generic basis and that the restrictions imposed on it would also apply to other incumbent utilities. (PECO M.B., p. 5).

Representative George urged the development of competitive safeguards to promote competition. In particular, Mr. George argued that Penelec’s unregulated affiliate should pay for the use of the “GPU” brand name,

noting that GPU Advanced Resources was promoting itself with the track record of its regulated entities. (George M.B., pp. 4-6).

The Cooperatives emphasized the need for a level playing field, indicating that one means of assuring that result is through the development of a Code of Conduct. While the Cooperatives did not propose any particular provisions for inclusion in the Code, they asserted that Penelec has refused to cooperate with them in implementing the Act. (Cooperatives M.B., pp. 24-32).

B. ALJ's Recommendation

The ALJ agreed with the parties that an Interim Code of Conduct should be established in this proceeding. Additionally, finding that Penelec has and will continue to have market power, the ALJ concluded that the PECO Code of Conduct, modified to meet Penelec's circumstances, should be adopted. (R.D., pp. 189-190). Among those modifications, the ALJ recommended that the Penelec be required to "include rules establishing the Cooperatives' right to negotiate reasonable mutual aid agreements, and also establishing procedures for meaningful cooperative mutual system planning and design sessions at regular intervals with the Cooperatives." (R.D., p. 190).

As to Rule 1, the ALJ noted that the term "affiliate" should replace the term "supplier." (R.D., p. 190). With respect to Penelec's substantive proposed changes to Rule 1, which would narrow the scope of activities requiring non-discriminatory treatment as between affiliates and other EGSs, the ALJ suggested that they be rejected. In so ruling, the ALJ observed that in PECO, the Commission specifically required that Rule 1 apply to the provision of all customer goods and services. (R.D., p. 191).

Regarding Penelec's proposal to delete language from Rule 3 that prohibits the purchase from or sales to affiliates at either above or below cost, the ALJ also recommended that it be rejected. Finding that this language is necessary to ensure that EGSs are not unfairly disadvantaged, the ALJ found that it should be retained. (R.D., p. 191).

Although the ALJ recognized that the Commission was satisfied with a functional separation of PECO's operations, the ALJ found that GPU Advanced Resources should be structurally separate from Penelec. The ALJ's recommendation was based upon the concerns expressed by Representative George regarding the ability of GPU Advanced Resources to benefit from the track record of the regulated entities. (R.D., pp. 190-191). Additionally, in view of those concerns, the ALJ did not agree with Penelec's proposal to delete the requirement for separate direct lines of management in affiliates from Rule 5 of the PECO Code of Conduct. (R.D., p. 191).

C. Parties' Exceptions

Penelec challenges the ALJ's findings of market power. Arguing that market share is not the equivalent of market power, Penelec notes the various safeguards that already exist under state and federal law to ensure the provision of *open access and the prevention of cross-subsidization of the affiliates of regulated entities*. (Penelec Exc., pp. 27-30). Penelec acknowledges that a finding of market power is not necessary to impose an appropriate Code of Conduct that ensures open access to the distribution system for all competitors and protects from cross-subsidization, and urges the Commission to carefully review the ALJ's market power conclusions. (Penelec Exc., pp. 29-30).

Penelec also argues that Rule 1 of the Code of Conduct should be *limited to prohibiting the EDC from giving preferences only in the provision of utility services*. Similarly, Penelec disagrees with the ALJ's suggestion to retain the language of Rule 3 requiring that affiliate transactions be at market value or at cost. On both of these matters, Penelec asserts that economies of scale can be achieved through these transactions, resulting in ultimate benefits to consumers and the competitive market. (Penelec Exc., pp. 30-31).

As to the ALJ's *recommendation to require a structural separation of GPU Advanced Resources*, Penelec contends that it is beyond the Commission's statutory authority. Additionally, Penelec claims that such a requirement would stifle effective competition. (Penelec Exc., p. 30).

Enron supports the ALJ's rejection of (1) Penelec's attempt to modify Rule 1 to prohibit the EDC from giving preference to its affiliate only in the provision of utility services and (2) Penelec's proposed change in Rule 3 to allow the EDC to transfer non-power goods or services to its affiliates. (Enron R.E., pp. 16-17). As to Penelec's proposed change to Rule 4, which would limit the nature of the non-public information that must be made available to all EGSs when it is provided to a Penelec affiliate, Enron suggests that the ALJ apparently overlooked that issue in reaching her conclusions. Since the PECO Code of Conduct requires that market information be made available in this situation, Enron urges rejection of Penelec's proposed change to require that only customer information be provided. (Enron Exc., p. 32).

Additionally, Enron reiterates its position that the PECO Code of Conduct should be adopted on an interim basis. Enron urges that the PECO Code

be modified, however, to include a ban on joint marketing and a prohibition against the use of Penelec's name in marketing by affiliated supplier or divisions. (Enron Exc., pp. 31-32).

MAPSA supports the ALJ's finding that Penelec has market power, and maintains that whatever Code of Conduct is adopted in this proceeding, it must not permit Penelec to control the market in anti-competitive ways that will hinder the ability of competitive suppliers to enter the market. Therefore, MAPSA suggests the inclusion of additional protections for alternative suppliers in the Code of Conduct recommended for adoption by the ALJ. (MAPSA Exc., pp. 12-13; MAPSA R.E., p. 7).

The Cooperatives claim that Penelec has market power over its wholesale customers. (Cooperatives Exc., p. 5). On that basis, the Cooperatives contend that it is essential for Penelec to work with them on implementation issues to assure a level playing field. (Cooperatives R.E., pp. 3-4).

D. Resolution

1. An Interim Code of Conduct

At the outset, it is important to emphasize our desire to establish statewide consistency in this area. In our PECO Restructuring Order, we noted that the "fundamental mechanism by which the Act promotes competition is by giving customers a choice of their electric generation supplier and requiring EDCs to provide competitive suppliers" with open and non-discriminatory access to those customers through the transmission and distribution system. (PECO Restructuring Order, p. 125). As we observed, the "[e]ffective functioning of

competitive markets requires full access to the free flow of information and compliance with the rules of the market.” Id.

The imposition of competitive safeguards on EDCs is the vehicle by which we have sought to provide the necessary assurance to market participants that they will have a full and fair opportunity to compete successfully. Therefore, noting that no party has excepted to the ALJ’s recommendation to impose competitive safeguards on Penelec, we agree that the establishment of an Interim Code of Conduct is appropriate.

As to the particular Interim Code of Conduct that should be established, we conclude that the PEA Code, as amended and adopted by the Commission in the PECO restructuring proceeding, should be imposed on Penelec. Through selection of this Code, we seek to promote the statewide consistency that has been advocated by many parties and that we believe is critical to the successful development of a competitive generation market.

This Code shall be effective for all matters related to the January 1, 1999 phase-in and thereafter, while the Pilot Code will continue to apply only to the pilot program and only until January 1, 1999. Eventually, this Interim Code of Conduct will be replaced by the competitive safeguards that are developed through our rulemaking proceeding at Docket No. L-980132. Until such time as that occurs, this Code will be in effect.

2. Market Power Analysis

As to the parties' debate regarding the appropriateness of the ALJ's analysis and findings of market power, we do not consider it necessary to address these issues at this juncture. Specifically, the imposition of the Interim Code of Conduct approved by this Order does not require a market power analysis. Rather, the competitive safeguards that we have determined to impose on Penelec are necessary to "ensure that competition can occur on a level playing field without discrimination or inappropriate competitive advantage to any market participant." (PECO Restructuring Order, p. 125).

3. Structural Separation

Penelec excepts to the ALJ's recommendation that GPU Advanced Resources be structurally separated from Penelec. Penelec states that the Commission lacks statutory authority to require a structural separation in a restructuring proceeding. In this instance, we find that functional separation will resolve the concerns presented in this record. Thus, we will not address Penelec's arguments regarding statutory authority to direct structural separations.

However, our finding that functional separation will suffice in this instance should not be taken to mean we have little or no concerns regarding this issue. Our decision in PECO illustrates the point:

In our view, functional separation of regulated EDC functions and competitive generation functions is essential for the development of a vibrant competitive

market. Structural separation through the establishment of fully independent entities is preferable whenever possible. With the development of competitive generation, the EDC must have no reason or ability to treat its competitive supplier affiliates any differently than any other competitive supplier. Functional separation without legal separation must not provide a basis for any competitive advantages or opportunities for the marketing entity. The Commission must assert the same level of review of transactions between an EDC and its competitive entity, whether it is separately incorporated or not. The Commission must enforce competitive standards in a comparable manner whether the supplier is an independent supplier, a separately organized affiliate of an EDC or an operating division of an EDC or an affiliate.

PECO, at 128 (Order entered December 23, 1997).

Accordingly, we will decline to adopt the recommendation of the ALJ regarding structural separation, however, Penelec must take note of our ongoing concerns regarding the interaction between EDC's and their generation affiliates. We do not agree with the ALJ that Penelec must include the requirement for separate direct lines of management in affiliates in Rule 5 of the Code of Conduct in order to provide for meaningful functional separation.

4. Rule 1

With respect to the ALJ's findings concerning Rule 1 of the Code of Conduct, Penelec argues that the Company should only be prohibited from giving

preferences to affiliates in the provision of utility services. Penelec claims that any further restrictions on the preferential treatment of affiliates will handicap the utilities and are anti-competitive. We disagree with Penelec's position and therefore this exception is denied.

In PECO, we specifically required that Rule 1 apply to the provision of all customer goods and services and we believe that the same standard should be applied to Penelec. Further, we are convinced that the granting of preferences to affiliates in the provision of non-utility services is one of the "subtle ways in which one market participant might receive an inappropriate advantage over another." PECO Restructuring Order, p. 125.

5. Rule 3

Penelec next contends that the provision in Rule 3 of the Code of Conduct requiring that affiliate transactions occur at market value or cost will create market distortions in favor of EGSs. Therefore, Penelec proposes to delete this language and excepts to the ALJ's recommendation to retain it in the Code of Conduct. We agree with the ALJ. The prohibition on preferential treatment of or toward an affiliate is at the heart of the Code of Conduct, and it is essential that this provision be retained. Further, in the interests of consistency, we note that this language is included in the Interim Code of Conduct that we approved in the PECO restructuring proceeding.

6. Rule 4

As to Enron's observation about the ALJ's apparent oversight relating to Penelec's proposed change to Rule 4, we concur. While the ALJ

discussed Penelec's suggested revision to limit the nature of non-public information that must be made available to all EGSs when it is provided to an affiliate, it appears that she neglected to make a recommendation. Again, to be consistent with our ruling in PECO, we grant Enron's exception and reject Penelec's proposed change.

7. Ban On Joint Marketing

Enron objects to the ALJ's failure to modify the Interim Code of Conduct to clearly prohibit joint marketing between the Penelec and its affiliated suppliers. Enron correctly notes that in PECO, the Commission indicated that Rule 7 of the Code precludes the EDC from promoting "its competitive affiliate any differently than non-affiliated suppliers." (PECO Restructuring Order, p. 131). We are not convinced, however, that specific language prohibiting joint marketing needs to be included in the Interim Code of Conduct. Rather, we are satisfied that the broader language of Rule 7 clearly prohibits the joint marketing or joint packaging of services between the EDC and its affiliated suppliers unless the same opportunity is provided to non-affiliated suppliers. Therefore, we deny Enron's Exception.

8. Ban On Competitive Affiliate's Use of EDC Brand Name

With respect to Enron's proposed bar on the ability of affiliated suppliers or divisions to use the EDC brand name in marketing, we are not inclined to impose this restriction. In PECO, we indicated that an EDC may not allow its competitive affiliate to use its name to suggest that the EDC would provide better distribution services if power is purchased from its affiliate. Similarly, it would be inappropriate for the competitive affiliate to use the EDC

name to indicate that supply purchased from other competitors may be less reliable or that the generation services are in fact being provided by the EDC. PECO Restructuring Order, p. 131. We continue to believe that an absolute bar on the competitive affiliate's use of the EDC brand name in marketing is not necessary or desirable. Rather, we are satisfied that restrictions on the manner in which the EDC brand name is used by the competitive affiliate are sufficient to ensure a level playing field among market participants. Therefore, we deny Enron's exception.

9. Cooperatives' Concerns

As to the Cooperatives' claim that Penelec should be required to *cooperate with them in implementing retail competition*, we agree with the ALJ. Therefore, we note our adoption of her recommendation to have Penelec commit to establishing the Cooperatives' right to negotiate reasonable mutual aid agreements, and also to defining procedures for meaningful cooperative mutual system planning and design sessions at regular intervals.

E. Summary

It is necessary to have Penelec implement an Interim Code of Conduct, pending the development of competitive safeguards through final regulations. Since the fundamental principles of the rules governing the competitive market should be consistent throughout Pennsylvania, we conclude that the Interim Code of Conduct applicable to Penelec should be substantially similar to that adopted in the PECO restructuring proceeding and approved for

other EDCs. Therefore, we direct that the PEA Code of Conduct, as amended and adopted by the Commission in the PECO proceeding, be followed by Penelec, as further modified and clarified by this Order.

XII. FINANCIAL IMPACTS OF RESTRUCTURING

A. Parties' Positions

Penelec contended that the stranded cost proposals of other parties, and reductions in revenue allowances, could have a negative financial impact on the Company if adopted by the Commission. Penelec's stranded cost concerns focus on two issues: 1) whether it will be able to recover the actual amount of their NUG obligations, dollar for dollar; and 2) whether its forecast of the future market clearing price of energy will be accepted by the Commission. The market price for energy plays a significant role in the calculated stranded cost of both generation and regulatory assets. If a higher future market line than that represented as management's best estimate is adopted against which to quantify and fix NUG-related stranded costs without the operation of a regulated mechanism to capture the actual above market obligations incurred, they will not be able to fully recover their NUG-related stranded costs. Penelec asserted that less than full recovery of NUG amounts would result in an immediate and significant charge to earnings. (R.D. p. 242).

In support of this proposition, Penelec noted that through the application of FAS 5, FAS 121, and FAS 71 (also SFAS), it may be required to take a write-off if any position, other than their own, is adopted by the Commission. (R.D. p. 242). According to Penelec witnesses Herrigel and Myers, stating regulatory assets on a net present value basis, in and of itself, would result in a write-off. Mr. Myers claims that SFAS 71 requires this result, while the Company's witness Herrigel claims that SFAS 121 requires this result with respect to operating plant assets. (Tr. 1240-1241).

However, PICA asserted that SFAS 121 requires a write-off only if "a regulator excludes all or part of a cost from allowable costs." Stating a regulatory

asset on a net present value basis does not change the level of allowable costs as compared to traditional ratemaking. According to PICA, regardless of whether or not Penelec is entitled to earn a rate of return under traditional cost-of-service regulation, a net present value quantification represents full and explicit recovery of the cost and the carrying amount of the regulatory asset. (R.D. p. 243).

PICA further argued that, while Mr. Myers is correct in his statement of the contents of SFAS 71, he is “absolutely incorrect” in his application of SFAS 71. The Industrials asserted that because stating regulatory assets on a net present value basis provides for both complete recovery and a rate of return on the asset, regulatory assets will continue to be “probable of recovery at each financial statement reporting date,” consistent with SFAS 71 requirements. *Id.* In fact, the recovery of stranded regulatory assets through a CTC will be “certain,” which actually exceeds the “probable” standard in SFAS 71. (R.D. p. 243).

Penelec contended that FAS 5 will require immediate liability recognition, with a corresponding charge to earnings, if a higher future market line than that represented as management’s best estimate is adopted against which to quantify and fix NUG-related stranded costs without the operation of a regulated mechanism to capture the actual above market obligations incurred.

However, HSS/ARI argued that Penelec can at best be described as experiencing conflicting judgments about future power prices. Certainly there are conflicting data and projections about future market price of electricity on this record. (R.D. pp. 243-244).

Additionally, HSS/ARI stated that Penelec agreed that before a write off must be taken, their conclusions can change if there is a material error or obvious

change. (Tr. 1241). Penelec has endorsed EIA as a good source of fuel price data. (Tr. 1513-1514). The significant increase in EIA's long-term gas price projections which was made available subsequent to Penelec original computer model market simulations in this proceeding is an obvious change in circumstances. Witness Meyers agreed that Penelec would and should take into consideration "all available information," for instance information developed in this proceeding, before making a subsequent write-off. (Tr. 1249). Penelec's price forecasting witness appears to claim that he was unaware of the revisions to the long term EIA forecast until he took the stand. (Tr. 540). Thus, the Company's judgment based upon information available in July 1997 does not automatically compel a write off. (R.D., p. 244).

The OCA argued that the Commission should apply an "end result" test that requires a balancing of interests which must consider the effect on ratepayers as well as stockholders. The OCA argued that just as the Act requires that stranded cost be determined on a net present value of revenues recovered over the life of a company's asset, so assessment of Penelec's financial viability and the impact on consumers must be made on the same basis. The OCA would require Penelec to show specific, long-term financial harm. The OCA concluded that Penelec has simply made no showing in this proceeding that they will suffer such harm. (R.D., p. 245).

2. ALJ's Recommendation

The ALJ found the opposing arguments cogent, and concluded that write-offs would not be compelled by FAS 5, 71, and 121, even if the Commission does not completely adopt Penelec's positions. (R.D., p. 244).

Regarding the OCA's position that Penelec demonstrate long term financial harm the ALJ stated that this argument is logical, and the Commission should

consider long-term financial harm when it is deliberating on this issue. But the ALJ concluded that using long-term financial harm alone would not produce a balanced result. (R.D., pp. 245-246).

The ALJ agreed with Penelec that the Commission should be concerned about its short term financial health, because financially-healthy companies will be stronger participants in the deregulated market. The ALJ also agreed that the Commission should avoid a punitive result. From its point of view, Penelec has been fair to other stakeholders in this process. (R.D., p. 246).

Nonetheless, the ALJ did not feel that the Commission must be bound by Penelec' positions on stranded costs and the market price of electricity. It is indeed possible to decide these issues on a non-punitive, balanced basis without causing financial disaster(R.D., p. 246)..

3. Parties' Exceptions

At page 221 of the Recommended Decision, the ALJ agreed with Penelec that in considering the financial impact of a decision in this case, the relevant consideration is the "short term" impact rather than the "long-term" impact of any decision. The OCA submits in its Exceptions, that Penelec's analysis is inconsistent with the Act, and could result in windfall profits to Penelec in later years at the expense of ratepayers today. (OCA Exc., p. 27).

4. Resolution

We believe that the ALJ is correct in concluding that write-offs will not be compelled by FAS 5,71, and 121, even though we are completely adopting Penelec's stranded cost positions. We believe that the determinations which we have made in this proceeding are reasonable and in the public interest. We are not persuaded by Penelec's arguments regarding potential adverse financial impacts in either the short or the long term. In effect, Penelec presents the Commission with an all or nothing argument. Our determinations are based upon the record before us. That includes all due consideration to Penelec, its shareholders and employees, consumers and new entrants into the marketplace. A healthy, vibrant and innovative EDC is in everyone's best interest. We have struck the appropriate balance to achieve that result here.

XIII. OTHER IMPACTS OF RESTRUCTURING

A. Employee Impacts

1. Parties' Positions

Penelec addressed in its Brief and described in record testimony, its efforts, both past and present, to contain the overall impacts of restructuring and the cost related to reorganizing its work force (including severance, retraining and retirement programs costs).

IBEW expressed confidence in Penelec's commitments and willingness to work with its employees to minimize the employee impacts of restructuring and divestiture. IBEW's witness recognized that while all the details of a satisfactory arrangement had not been resolved, IBEW was satisfied that GPU was committed to treating its employees fairly. (IBEW M. B., p.24).

Representative George also expressed concern that divested fossil plants be given the best opportunity to remain open to avoid employee impacts. Mr. George pointed out that he assisted in the construction of parts of the Shawville generating plant. To minimize employee impacts resulting from the divestiture and to promote economic development, Mr. George proposed that GPU structure its plants divestiture plan in a manner that would best promote the existing use of these facilities using the current work force.

2. ALJ's Recommendation

The ALJ concluded that in light of her recommendation to reject Enron's proposals, for the time being, and based on prior Commission rulings, employee impacts were less likely to occur in the near future. However, the ALJ did not make a recommendation as to the overall employee impacts of Penelec Restructuring Proceeding.

3. Resolution

We note that no party took exception to the ALJ's recommendation relative to this issue. Since no exceptions were filed on this issue and finding the ALJ's conclusion to be reasonable, appropriate and in the public interest, we shall adopt the ALJ's recommendation regarding this issue.

B. AEC/PREA

1. Reliability

a. Parties' Positions

In the evidentiary stages of this litigation, the Cooperatives attempted to litigate possible discrimination and/or anticompetitive impact issues and evolve this proceeding into a service reliability case. The Cooperatives tried to advance issues of its pending FERC complaint into the record.

AEC/PREA maintained that in anticipation of the introduction of competition, Penelec neglected its transmission and distribution system, increasing the chances of future system reliability erosion. AEC/PREA based their contention on two grounds: (1) Penelec' reduction of the size of its workforce and (2) its assertion that Penelec has failed to fulfill the plans reflected in its 1997 budget for the replacement and reinforcement of distribution poles that are at risk of failure. (AEC/PREA St. 1, p. 8; St. 1S, p. 35).

Penelec disagreed with the AEC/PREA's position and argued that the record evidence does not support the AEC/PREA's claim. Penelec pointed out that the manpower reductions were implemented in accordance with business plans to lower costs in order to avoid the need for rate increases and to maintain profitability. Penelec emphasized that in

view of the emergence of competition, it attempted to follow its historic rate stability and at the same time to mitigate potential future stranded costs. Penelec added that the reduction of its staff is consistent with Section 2802(18) of the Act, which recognizes that staff reductions would result from industry restructuring.

b. ALJ's Recommendation

The ALJ rejected the Cooperatives' attempts and concluded that evidence and arguments on reliability of service should not be decided in the instant proceeding. The ALJ noted that these issues are presently before FERC via a formal complaint at Docket No. EL-97-10-000, and also before this Commission via mediation of this complaint.

The ALJ further concluded that the evidence did not support the Cooperatives' contention that Penelec is deliberately providing poor service.

c. Parties' Exceptions

The Cooperatives except to the ALJ's decision not to consider evidence and arguments on the issue of service reliability in this Restructuring Proceeding. The Cooperatives essentially repeat the arguments stated in its Main and Reply Briefs. (Cooperatives M.B., pp. 1-3; R.B., p. 6-16). The Cooperatives contend that Section 2802(12) of the Act demonstrates that reliability is an inherent component of the restructuring process. The Cooperatives proffer that a review of the standards for assessment and approval of each utility's restructuring plan reveals that the Legislature mandated that the Commission require and ensure safe and reliable service.

The Cooperatives support the ALJ's contention that the legislative intent of the Act was to create a competitive market while preserving and enhancing the quality of service

to customers. However, the Cooperatives are of the opinion that the ALJ's decision falls short of assuring that these goals are met by failing to consider the issue or making Penelec accountable for answering reliability concerns this in restructuring process.

The Cooperatives maintain that the Commonwealth Court in a recent decision emphasized the importance of the reliability of the T & D system to electric service and deregulation. *Indianapolis Power and Light v. Pennsylvania Public Utility Commission*, 1597 CD 1997 (Order issued May 7, 1998). The Cooperatives contend that reliability is a major issue which should be squarely addressed in the deregulation of the electric industry.

d. Resolution

In *PECO Energy, supra*, we held that service reliability issues should be considered in separate proceedings. As previously noted, the Cooperatives have filed a complaint before the FERC in which it alleged unreliable service. The Cooperatives suggest that if reliability issues are not resolved in this proceeding, service in Penelec's territory will be diminished. This concern is unfounded. The Cooperatives' arguments and positions are already before the FERC in the context of their complaint proceeding there. Also, we have embarked on several rulemakings designed to ensure continued reliability of the Commonwealth's electric system. Finally, to a very large extent, our determinations in this case are designed to ensure continued financial support of a reliable electric infrastructure.

We agree with the ALJ that much of the Cooperatives' position must be addressed in the context of a more generic proceeding such as our rulemaking at L-00970120. Accordingly, we agree with the ALJ's recommendation to refrain from addressing the Cooperatives' arguments regarding net metering and interconnection standards at this docket, noting that they may be resolved in a more appropriate proceeding.

2. Anti-Competitive Impacts and Wholesale Customers

As an electric utility, Penelec is required under Section 2804(6) of the Act to provide transmission and distribution service to “all Electric customers in its service territory and to electric cooperative corporations and electric generation suppliers, affiliated or nonaffiliated, in rates, terms of access and conditions that are comparable to the utility’s own use of its system.” In addition, Section 2805(b)(1)(iii) of the Act requires that the reliability of the transmission service provided to electric cooperative corporations be comparable to that provided at the wholesale level.

The Cooperatives are wholesale customers of Penelec. The Cooperatives did not introduce any evidence about any other of their wholesale customers and made only a small reference to other wholesale customers as municipalities in a footnote in their brief. (Cooperatives M.B., p. 62). The notation refers to similar treatment of municipalities in counting the number of customers affected by an outage. No other wholesale customer has intervened or presented evidence in this proceeding.

a. Parties’ Positions

The Cooperatives proposed that this proceeding address the Companies’ practices which, in their view, disadvantage the Cooperatives and their customers vis a vis the Companies’ customers creating unlevel playing field, contrary to the intent of the Act. (Cooperatives M.B., p. 32). The Cooperatives argued that their concerns over prejudices, discrimination and anticompetitive activities are further amplified by the GPU’s own statements on competition with the Cooperatives. (Cooperatives M.B., p. 28). According to the Cooperatives, GPU refused to provide Allegheny, a wholesale customer, the same terms

and conditions of access it afforded others. Cooperatives M.B., 30. The Cooperative further claimed that the Companies have refused to engage in discussions of joint facilities in the advent of competition and have intentionally undertaken a concerted effort to undermine the possibility of a level playing field for the Cooperatives as required by the Act. Cooperatives (M.B., p. 31).

b. ALJ's Recommendation

The ALJ reasoned that while Sections 2804(6) and 2805(b)(1)(iii) of the Act, may appear to be somewhat in conflict, they should be read together. The ALJ further concluded that in order to give full intended meaning to both provisions, they should be applied in conjunction with each other and the requirements relating to cooperatives in the two sections should be read to amplify each other.

The ALJ further concluded that no evidence was presented demonstrating Penelec's failed to comply with Section 2805(b)(1)(iii). (R.D., pp. 252-253).

c. Parties' Exceptions

The Cooperatives argue that the ALJ improperly failed to address anticompetitive impacts of Penelec's actions on wholesale customers. (Cooperatives Exc., p. 13). The Cooperatives argue that despite finding that Penelec has market power over the Cooperatives, the ALJ made no effort to address their concerns that a level playing field be established to ensure that Penelec's conduct will not be anticompetitive. The Cooperatives claim that Penelec has resisted their attempts to discuss the implementation of pilot programs designed to facilitate an orderly transition into competition. The Cooperatives views Penelec's purported resistance to assist in the development of Cooperatives' pilots as an abuse of market power intended to put the Cooperatives at a competitive disadvantage, guaranteeing

an unlevel playing field. (Cooperative Exc., p. 15). The Cooperatives assert that it is essential that the Commission address these issues in this proceeding to assure a level playing field.

d. Resolution

As previously mentioned in the Competitive Safeguards discussion section of this Opinion and Order, we do not deem it necessary, at this juncture, to address the appropriateness of the ALJ's findings of market power. In our view, the Competitive Safeguards²⁰ which we have decided to impose on Penelec will serve to "ensure that competition can occur on a level playing field without discrimination or inappropriate competitive advantage to any market participant." (PECO Restructuring Order, p. 125).

Additionally, with respect to Penelec's ability to exercise market power, Penelec's restrained by FERC's requirement to make access to its transmission facilities for retail customers and its distributions customers facilities for wholesale customers like the Cooperatives available on an open, non-discriminatory basis. We further note that the Cooperatives have filed a complaint with the FERC, in which they alleged some of the same allegations presented in this proceeding. While we do not hold that anticompetitive complaints must be deferred to the FERC, we recognize that the contract under which Penelec provides wholesale wheeling and power supply services is subject to FERC jurisdiction. *See FPC v. Southern California Edison Co.*, 376 U.S. 205 (1964); *Pike County Light & Power Co. v. Pennsylvania Public Utility Commission*, 77 Pa. Cmwlth 268 (1983). A FERC

²⁰ A rulemaking proceeding on Competitive Safeguards has been instituted at Docket No. L-980132. The Companies, as well as the Cooperatives are participants of the proceeding. Pending a final rulemaking in this proceeding, we have developed an Interim Code of Conduct with which all restructuring companies are required to comply. See Section IX of this Opinion and Order.

approved contract and tariff are subjects of the Cooperatives' pending FERC complaint against Penelec

We will adopt the ALJ's analysis and recommendation on this issue.

3. Service Levels

a. Parties' Position

AEC/PREA complained that it is receiving differential substandard service. In support of this complaint, AEC/PREA referred to a comparison of the interruptions experienced on average at AEC delivery points, which were essentially rural, to the interruptions experienced on average by all customers of the three GPU operating companies. (AEC/PREA Exhs. VFK-A, VFK-B).

In response, Penelec argued that these comparisons are not probative since they did not take into account the impact on power deliveries to rural cooperatives of the natural conditions acknowledged by AEPR's witness. Penelec further maintained that AEC/PREA failed to present evidence in support of their request that Penelec be required to take steps that would equalize the experience of different portions of Penelec's service territory with respect to the frequency and duration of service interruptions, vis-à-vis the character of the terrain. Penelec pointed out that AEPR's acknowledgment that the natural conditions surrounding the delivery of electricity to customers in rural areas affect reliability of service negates the basic premise of the AEC/PREA's position.

b. ALJ's Recommendation

The ALJ agreed with Penelec's position and recommended that AEC/PREA's claim be rejected.

c. Parties' Exceptions

The Cooperatives dispute the ALJ's disposition regarding this issue. The Cooperatives contend that Penelec's own reliability indices do not represent the true state of reliability in Pennsylvania. According to the Cooperatives, Penelec's published indices include interruptions in service only to those retail accounts served by Penelec directly. The indices, the Cooperatives maintain, exclude interruptions to retail accounts served through Penelec's facilities by way of Allegheny delivery points. (Cooperatives Exc., p. 25). The Cooperatives urges the Commission to direct Penelec in calculating reliability indices to reflect fully number of ultimate customer affected by the service interruptions.

d. Resolution

In this proceeding, the Cooperatives' witness testified that the natural conditions of the Cooperatives' rural service areas contribute to more frequent interruptions and longer restoration times than in predominantly urban areas. (AEC/PREA St. 1S, p. 37). The Cooperatives' witness further stated that it is more difficult to deliver uninterrupted service to the rural areas. (Tr. 1658, 1663). We agree with Penelec, that this evidence undermines the Cooperatives' claim.

Accordingly, we adopt the ALJ's disposition of this claim. We will deny the Cooperatives' Exceptions on this issue.

4. Impact on Competitiveness of Rural Cooperatives

a. Parties' Positions

AEC/PREA claimed that the quality of service that AEC receives from Penelec adversely affects the competitiveness of rural cooperatives. (AEC/PREA St. 1S, p. 3). The Cooperatives conceded, however, that the reliability of transmission and distribution service would impede the EGSSs' ability to compete to serve rural cooperative customers on a level paying field. (Tr. p. 1622-23).

Penelec challenged the Cooperatives' claim that the quality of Penelec' delivery service affects the cooperatives' competitiveness for new loads. Penelec urged the Commission not to address these claims in this proceeding.

b. ALJ's Recommendation

The ALJ agreed with Penelec's argument that the Cooperatives failed to show that Penelec' service to AEC is less reliable than Penelec's service to other customers under similar conditions. The ALJ, however, rejected Penelec's contention that competition among EDCs for new loads existed long before the Act and is not affected by the Act or by Penelec' restructuring plans.

The ALJ further disagreed with Penelec's assertion that AEC/PREA can pursue any such claims of anti-competitive behavior allegations stated in its complaint before FERC. The ALJ reasoned that claims of anti-competitive behavior may be heard before the Commission and do not have to be deferred to the FERC. However, the ALJ concluded that the claims of anti-competitive injury alleged by AEC/PREA are unfounded and unsupported in the record.

c. Parties' Exceptions

The Cooperatives object to the ALJ's recommendations on this issue. The Cooperatives reiterates their earlier contention that rural areas in other parts of the country have better power supply reliability than that provided by Penelec, with Pennsylvania's Cooperatives ranking in the latter 10% nationwide for reliability. (Cooperatives Exc., p. 24). The Cooperatives argue that while the rural nature of some of the service areas present challenges to operating and maintaining an electric system, Penelec should not be excused from addressing the special challenges of serving rural customers. (Cooperatives Exc., p. 26).

d. Resolution

In our view, the Cooperatives have failed to present evidence to establish that Penelec's service to the Cooperatives is less reliable than their service to other customers under similar conditions. The Cooperatives' own witness admitted that the quality of service has not effect on EGS competing to serve rural cooperatives customers. (Tr. 1623). Moreover, every EGS seeking to serve a retail customer now served by a rural cooperative will utilize the same lines to deliver its power to the consumer as well as experience the same *level of reliability in that delivery*. (Tr. 1622).

We further find that the ALJ's analysis and recommendation are supported in the record and consistent with the Act. We will adopt the ALJ's recommendation.

5. Alternative Venues

a. Parties' Positions

AEC/PREA argued that this restructuring proceeding is the proper forum to litigate the issues of reliability of service and unfair competition raised in its complaint. AEC/PREA asserted that although these issues may be considered in other venues, such as FERC and the Commission's rulemaking proceedings, these concerns are pivotal to electric restructuring and transition and should be addressed in this proceeding.

b. ALJ's Recommendation

The ALJ noted that AEC/PREA has presented its concerns in two of the alternative venues stated in the Commission's November 6, 1997 PECO Energy order. AEC/PREA filed comments at Docket No. L-00970120, the Commission Reliability Regulations Proceeding. AEC/PREA also filed a complaint against Penelec with FERC at Docket No. EL97-10-000, in which it alleged unreliable service.

The ALJ acknowledged that the contract under which Penelec provides wholesale wheeling and power supply services is subject to FERC's jurisdiction (R.D., p. 263). However, the ALJ noted that FERC's jurisdiction is not limited to rates but extends to the non-rate terms of service, including terms governing the reliability of service. The ALJ determined that all these issues, including non-rate matters are addressed in the contract for service between AEC and Penelec.

c. Exceptions

The Cooperatives challenge the ALJ's holding that their reliability issues may be pursued in other forums. The Cooperatives concede, that they have, in fact, a pending FERC proceeding which concerns reliability issues. The Cooperatives believe that, despite the availability of the other avenues of relief, they should not be foreclosed from litigating reliability issues in this restructuring proceeding.

d. Resolution

We are not persuaded by the Cooperatives' argument. Our position not to consider specific reliability concerns in these restructuring proceeding as enunciated in our November 6, 1997 Order is clear. In that Order, we held that:

Because of the interdependence of the state and regional electricity grids, reliability cannot be adequately examined in relation to a single utility system...The Commission has initiated a rulemaking at Docket No. L-00970120 to ensure the safety, adequacy and reliability of generation, transmission and distribution facilities in Pennsylvania... It is unnecessary to consider the reliability issue separately in his proceeding. if PREA, or any member cooperative is experiencing difficulty receiving reliable..service from PECO or any other utility, it [should] file a complaint with the appropriate agency.

(Re PECO Energy Co., Opinion and Order of November 6, 1997, slip op. at 7-8 (Nov. 6, 1997)).

The Cooperatives have not presented compelling reasons to warrant a departure from our position on this issue. We adopt the ALJ's recommendation and deny the Cooperatives' Exceptions on this issue.

6. Maps

a. Parties' Positions

In this proceeding, AEC/PREA requested that Penelec be required to produce copies of its system maps. This request was made during the discovery stages of this litigation. AEC/PREA also sought the maps as a form of relief in this proceeding.

b. ALJ's Recommendation

The ALJ recommended against further production of maps. The ALJ questioned AEC/PREA's motive for requesting the maps, finding that the systems maps included in the filings provided most, if not all the information the Cooperatives represented that they needed.

c. Parties' Exceptions

The Cooperatives except to the ALJ's recommendation not to require production of GPU system maps. The Cooperatives argues that despite being ordered to produce the maps under the threat of sanctions by the ALJ, Penelec only provided a state highway map which did not comply with the Cooperatives' discovery request. The Cooperatives dispute Penelec's assertion that it does not have the maps requested. The Cooperative believe that Penelec should be required to produce , in electronic format , present and annual updates of maps showing facilities within 10 miles of each of the Cooperatives' delivery points. (Cooperatives Exc., p. 28). The Cooperatives assert that directing Penelec to produce the maps which contain the information it specifically outlined is in the public interest and would facilitate joint planning. In view of GPU's market power, according to the Cooperatives, an attempt at a level playing field can be made with the aid of the maps

d. Resolution

Like the ALJ, we question the Cooperatives' real motive for obtaining the maps. We agree with the ALJ that the system maps included in the filings appear to provide the information requested by the Cooperatives. We will not order Penelec to produce additional maps. Accordingly, the Cooperatives' Exceptions on this issue are denied.

7. Omnibus Investigation

a. Parties' Positions

The Cooperatives requested that the Commission institute an investigation to address among other issues, Penelec's facilities, maintenance, tree trimming, pole and facilities inspections and replacements, etc. and their impact on reliability. (AEC/PREA M.B., p. 50). The Cooperatives maintained that this investigation is necessary to insure that GPU's efforts in Pennsylvania are at least as aggressive as that ordered in other jurisdictions and that facilities serving Cooperatives result in reliability equal to that provided to other Penelec's customers on a comparable basis. Id.

Penelec viewed the Cooperatives' request to be a concession that service issues should not resolved in the instant proceeding.

b. ALJ's Recommendation

The ALJ recommended against the initiation of a separate investigation until after the conclusion of the mediation process pending before the Commission.

c. Parties' Exceptions

The Cooperatives except to the ALJ's recommendation, arguing that the Commission should undertake a thorough on-the-record investigation addressing the adequacy and reliability of Penelec's system. (Cooperatives Exc., p. 29). The Cooperatives also urge the Commission to order Penelec to escrow a portion of their stranded cost recovery. After an investigation and audit as to what is required to provide safe and efficient service, these escrowed monies, in the Cooperatives' view, should be utilized to satisfy the statutory criteria regarding safe and efficient service.

d. Resolution

We will adopt the ALJ's recommendation on this issue. We will not make a determination whether to institute a separate investigation regarding the issues raised by the Cooperative until after the conclusion of the mediation process pending before the Commission. In our view, it is not in the public interest to institute a separate proceeding to investigate issues and concerns which may be addressed in the mediation process or during pending or future FERC proceedings. Accordingly, the Cooperatives' Exceptions on this issue are denied.

C. Environmental Issues

1. Environmental Labeling and Tracking

a. Parties' Positions

The Environmentalists proposed the development of an environmental labeling system under which all EGS selling energy in Pennsylvania are required to reveal their fuel

mix and certain air and other waste emissions to consumers. Under the Environmentalists' proposal, PJM ISO would track all energy transactions to support the labeling and disclosure system.

Penelec opposed the proposal on four grounds. First, Penelec argued that the Commission's proposed rules on Customer Information Disclosure for Electricity Providers, Docket No. L-00970126, constitute a more workable system than the Environmentalists' proposal. Penelec maintained that the Environmentalists' proposal is over reaching because it requires customers to know the source of supply mix upon request, upon entering into a sale agreement, and whenever a significant change occurs in energy sources as specified in the terms of service.

Second, Penelec asserted that the Environmentalist's proposal is flawed because the Commission lacks authority to require the PJM ISO to adopt or participate in such a labeling and tracking system. PJM operations and other wholesale services are subject to FERC jurisdiction.

Third, Penelec suggested that the Environmentalists' proposal is not cost-efficient and could cost, as projected by the Environmentalists' witness, more than \$5 billion to implement and operate the proposed tracking and disclosure system in Pennsylvania. (R.D., pp. 267-268).

Finally, Penelec asserted that air and waste emissions disclosure proposed under the system are already required by existing federal and state disclosure regulations. Clean Air Act, 42 U.S.C. §§7410 et seq.; the Clean Water Act, 33 U.S.C. §1251 et seq.; Solid Waste Management Act, 35 P.S. §§6018 et seq.; Clean Streams Law, 35 P.S. §§691.1 et seq.; Air Pollution Control Act, 35 P.S. §§4000.1 et seq.

2. Environmental Comparability

a. Parties' Positions

The Environmentalists urged the Commission to require that all power sold in Pennsylvania come from plants which meet the emissions standards for new plants. This measure is necessary, in the Environmentalists' view, to preserve and retain the environmental improvements associated with newer, cleaner plants. The Environmentalists theorized that because new plants must satisfy higher environmental performance standards than existing plants, it is less likely that new plants will be built for economical considerations.

Penelec disagreed with the Environmentalists' proposal, arguing that the Commission does not have jurisdiction over environmental issues simply because a public utility may be involved. Penelec contended that the broad authority to implement and administer environmental protection programs is vested in the United States Environmental Protection Agency and the Pennsylvania Department of Environmental Protection. Penelec opined that it would be inappropriate for the Commission to attempt to extend its jurisdiction into these areas.

b. ALJ's Recommendation

The ALJ recommended the rejection of the Environmentalists' proposals. The ALJ reasoned that the Environmentalists failed to consider Section 2802(21) of the Act, where the Legislature directed the Commission to consult with the Department of Environmental Protection regarding air quality standards issues during the transition to retail competition. The ALJ further stated that the Environmentalists did not attempt to reconcile their proposal with the Legislature mandate.

c. Resolution

We note that no Exceptions were filed on this issue. Finding that the ALJ's recommendation is reasonable and in the public interest, we will adopt it.

D. Immediate Rate Reductions

1. Parties' Positions

The OCA proposed that customers remaining under regulation be offered reduced rates, based on its proposed specific CTC, specific T&D rates and specific retail market price of generation. The OCA acknowledged that its recommendation for immediate rate reductions differs from the Commission's approach in the PECO Energy case. The OCA stated that the Commission's rejection of setting tariffed rates for non-shopping customers that were based in part on the shopping credit because it would not generate the competitive market the Act requires for all customers. The OCA also recognized that the Commission's refusal to reconsider the issue was based on its finding that no party presented evidence that PECO's tariffs that apply to customers remaining under regulated service should be changed to reflect the shopping credit.

In view of the Commission's decision in the PECO Energy Order, the OCA offered testimony to show a specific CTC, specific T&D rates and a specific shopping credit. Under the OCA's proposal, at least during the phase-in period, customers who remain with Penelec should only be required to pay the sum of these three components. The OCA projected that if the sum of these components produces rates below current rates, customers would realize savings under this approach.

HSS/ARI proposed that the Commission order an immediate reduction to that component of Penelec's rates to reflect the reduced rate base and cost of service that would result from Commission adoption of its proposal to reduce Penelec's net book investment in generation plant by 50% (net depreciation) of the \$294 million in generation-related capital expenditures Penelec made from 1987 through 1996. (HSS/ARI M.B., p. 86). In support of its proposal, HSS/ARI emphasized that while Penelec has not requested a rate increase since 1986, it failed to demonstrate in this proceeding that its generation-related capital additions made during the subject period were just and reasonable.

2. ALJ's Recommendation

The ALJ recommended that the OCA's immediate rate reduction not be included in this restructuring decision. The ALJ emphasized that the Commission's policy against providing non-shopping customers with the shopping credit is clear. The ALJ conceded that while she has recommended a modified slower phase-in in this decision, the Commission's ruling on this issue is controlling.

The ALJ declined to recommend the adoption of HSS/ARI's proposal. (R.D., pp. 84-85).

3. Parties' Exceptions

The OCA urges the Commission to reconsider its policy adopted in recent Motions in the PP&L, Duquesne and West Penn Restructuring cases. The OCA argues that non-shopping customers should be offered the shopping credit. The OCA contends that its proposed specific T&D rates, specific CTC, and retail generation credits, on sum, produces rates below current rates which if offered to non-shopping customers, Penelec customers would realize rate savings of 8%. (OCA Exc., p. 28). The OCA asserts that under the

Commission's current policy as developed in the PECO case, customers receive rate savings only if they select an alternative supplier whose charges are less than the shopping credit. As a result, the OCA opines that customers who remain with the utility, by their own volition or by circumstance, are forced to pay generation charges higher than market prices. Conversely, the OCA opines that under its approach, all customers would pay market-based prices for generation and receive the benefits of competition. (OCA Exc., p. 29).

The OCA further argues that Section 2807(e)(3) of the Act mandates that, after the phase-in period, customer who have not chosen an alternative supplier are to be served by the utility or a Commission-approved provider of last resort at "prevailing market prices" plus all reasonable costs, subject to the rate caps set forth in Section 2804(4). (OCA Exc., p. 29). The OCA supports the ALJ's recommendation to consider the use of competitive solicitations for pricing for this service. The OCA, is of the opinion, however, that regulations to govern such solicitations should be established by the Commission pursuant to 2807(e)(2). The OCA theorizes that in the interim, however, some ratepayers, which includes those customers who are unable to choose or who cannot find an alternative supplier to serve them, will not receive the benefits of the Act.. The OCA concludes that an approach which provides immediate rate relief to all customers should be adopted by the Commission.

In its Exceptions, HSS/ARI maintains that the ALJ erred in failing to recommend an immediate reduction in the unbundled generation component of Penelec's rates. (HSS/ARI Exc., p. 38). HSS/ARI asserts that its proposal is similar to that advanced by the OCA. For the reasons more fully outlined in HSS/ARI's objections to the ALJ's recommendation on the issue of T&D rates and generation rates, as discussed in Section VI of this Opinion and Order, HSS/ARI objects to the ALJ's failure to recommend adoption of HSS/ARI's proposed rate reduction.

4. Resolution

We decline to adopt the OCA's proposal. We note that the rate reduction methodology advanced by the OCA was rejected in our previously decided restructuring proceedings. (See PECO Energy Order, (December 23, 1997) and its progeny). In PECO Energy, we squarely rejected the notion that the shopping credit should be applied to non-shopping customers. Moreover, in response to request for reconsideration of our December 23, 1997 decision, we reiterated our position that "[c]ustomers who do not shop pay the tariffed rate divided into unbundled generation, transmission and distribution charges." (PECO Reconsideration Order of January 16, 1998, pp. 20-21).

We find that the ALJ's recommendation on this issue is consistent with established Commission policy and is adopted. Accordingly, we will deny the Exceptions of the Parties relative to this issue.

XIV. ORDER

IT IS ORDERED:

1. That the Exceptions filed by the various parties to the Recommended Decision of Administrative Law Judge Allison K. Turner, which was issued on May 7, 1998, are hereby granted or denied consistent with this Opinion and Order.
2. That the Recommended Decision of Administrative Law Judge Allison K. Turner, which was issued on May 7, 1998, is adopted to the extent consistent with this Opinion and Order.
3. That the Application of Pennsylvania Electric Company for approval of its restructuring plan pursuant to Section 2806(d) of the Public Utility Code, 66 Pa. C.S. 2806(d), filed on April 1, 1997 and docketed with the Pennsylvania Public Utility Commission at No. R-00974009, is hereby adopted as herein modified.
4. That Pennsylvania Electric Company shall remain the provider of last resort consistent with the determinations made herein and the requirements of 66 Pa. C.S. 2802(16) until the Commission determines otherwise, and that Pennsylvania Electric Company shall include a comprehensive provider of last resort proposal as the initiation of the second stage proceeding.
5. That Pennsylvania Electric Company shall phase-in direct access to alternative generation suppliers in the manner specified in this decision, pursuant to the following schedule:

- a. 33% of the peak load of each customer class shall have the opportunity for direct access as of January 1, 1999;
- b. 66% of the peak load of each customer class shall have direct access as of January 2, 1999;
- c. All customers shall have direct access as of January 2, 2000.

6. That the competitive transition charge authorized in the preceding ordering paragraph is subject to the following requirements:

- a. The competitive transition charge may be collected from January 1, 1999 until December 31, 2006, unless changed at the conclusion of the divestiture process.
- b. The competitive transition charge shall be calculated and applied consistent with the directives contained herein.
- c. The competitive transition charge shall be reconciled and may be modified on an annual basis as required by 66 Pa. C.S. 2808(f) and that actual market prices of electricity shall be included in the reconciliation.
- d. The competitive transition charge shall be calculated in a manner recognizing monthly receipt of competitive transition charge revenues.

7. That Pennsylvania Electric Company shall modify its transmission and distribution revenue requirement and rate structure to incorporate the adjustments, including cost allocation method, as directed herein.

8. That Pennsylvania Electric Company continue to provide service to existing customers through existing tariffs throughout the transition period, and all special contracts shall remain in force, except as modified herein.

9. That Pennsylvania Electric Company comply with the determinations contained herein relating to customer billing and metering and that Pennsylvania Electric Company reflect this action in its compliance filing.

10. That, pending the outcome of the Commission's rulemaking proceeding on a generic Code of Conduct, Pennsylvania Electric Company shall modify its proposed Code of Conduct as herein directed.

11. That Pennsylvania Electric Company's proposed Universal Service and Energy Conservation Programs are approved as modified herein.

12. That Pennsylvania Electric Company participate in the state-wide consumer education initiative, which the Commission established in its decision in the Application of PECO Energy Company at Docket No. R-00973953 (Opinion and Order entered December 23, 1997); that in its compliance filing, Pennsylvania Electric Company include a comprehensive plan for consumer education with an associated budget for both mass media and local educational efforts and set forth its proposals for its role in consumer education; and that Pennsylvania Electric Company recover the costs of its consumer education program from its ratepayers.

13. That Pennsylvania Electric Company shall, within twenty (20) days of entry of this Opinion and Order at this docket submit a compliance filing that incorporates all of the conclusions and directives contained herein, including, but not limited to:

- a. For each tariff class or schedule, the compliance filing shall:
 - i. identify the unbundled charges for generation, jurisdictional transmission and distribution service;
 - ii. identify the CTC, calculated to recover the authorized principal amount, consistent with the allocation methodology, collection period, monthly amortization, total sales, and return adopted herein; and
 - iii. identify all other adjustments necessary to the terms and conditions of service to reflect a competitive generation market as provided herein.
- b. Each tariff class or schedule shall reallocate Administrative and General expense as provided herein.
- c. The compliance filing shall also include a supplier tariff and advanced meter provisions as described herein.

14. That Pennsylvania Electric Company serve a copy of its compliance filing on all parties to this proceeding on the same date that it is filed with the Commission.

15. That all parties to this proceeding may file written comments concerning non-compliance with this Opinion and Order within seven (7) days after the filing of Pennsylvania Electric Company's compliance filing.

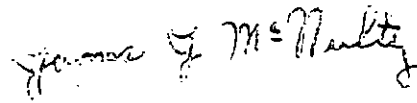
16. That, in addition to the specific requirements contained in the foregoing ordering paragraphs, Pennsylvania Electric Company shall comply with all other directives contained in this Opinion and Order, including planning to implement a filing and approval process of at least 180 days when the results of its divestiture sale are known.

17. That the Complaints filed by Pennsylvania Industrial Customer Alliance at Docket No. R-00974009C0001 and Kenneth L. Springirth at Docket No. R-00974009C0002 be and are hereby granted or denied to the extent consistent with this Opinion and Order.

18. That the relief sought by the following active intervenors: Pennsylvania Rural Electric Association, Allegheny Electric Cooperative, Inc., Office of Trial Staff, Office of Consumer Advocate, Metropolitan Edison Industrials Group, Penelec Industrial Customer Alliance, York County Solid Waste and Refuse Authority, AES Corporation, Inc., Connectiv Energy, Inc., International Brotherhood of Electrical Workers, The Environmentalists, Solar Turbines, Inc., Mid-Atlantic Power Supply Association, Enron Power Marketing, Inc., Hospital Shared Services, Inc., Administrative Resources, Inc., PECO Energy Company, ARIPPA and its various members, York County Energy Partners, Community Action Association of Pennsylvania, Office of Small Business Advocate, Blue Mountain Power, L.P., Solar Turbines and Bio-Energy Partners, is granted or denied consistent with this Opinion and Order.

19. That the inactive intervenors are hereby dismissed.

BY THE COMMISSION,



James J. McNulty
Secretary

(SEAL)

ORDER ADOPTED: JUNE 26, 1998

ORDER ENTERED: JUN 30 1998

ATTACHMENT A

Pennsylvania Electric Company Restructuring

<u>Category/Item:</u>	<u>Amount</u> (\$ Million)
Stranded Generation:	
Generating Plant Book Value	603.92
Generation Market Value	<u>(833.77)</u>
<u>Total Stranded Generation:</u>	<u>(229.85)</u>
Decommissioning:	
Fossil Decommissioning	-
Nuclear Decommissioning	<u>67.76</u>
<u>Total Decommissioning</u>	<u>67.76</u>
Net Regulatory Assets:	
Deferred Energy	8.42
Plant Life Extension Study	0.54
Shannon Road Ash Site Remediation	1.99
Piney Dam Restoration	1.73
Coal Miner Benefits	0.59
Non-Recoverable Coal	0.01
TMI-1 Administration Building	0.04
DOE Spent Fuel	(3.91)
Unamortized Loss on Reacquired Debt	1.93
Customer Assistance Plan	0.85
FAS 109 Taxes	43.47
Unamortized ITC	(14.66)
Reverse RPP Auction	0.05
Restructuring Filing	1.27
Pilot Costs	1.38
Consumer Education Costs	<u>11.5</u>
<u>Total Net Regulatory Assets</u>	<u>55.20</u>
 <u>NUG Stranded Cost:</u>	 <u>964.81</u>
 TOTAL STRANDED ALLOWANCE:	 <u>857.92</u>

ATTACHMENT B

Pennsylvania Electric Company
CTC, T&D and Shopping Credit in Cents per Kwh
Declining CTC Revenue Requirement

Docket No. R-00974009

Stranded Cost: \$ 857,919,859
Pre-Tax Return: 10.40%
Years: 8

<u>Year</u>	<u>Kwh</u>	<u>CTC Revenue Requirement</u>	<u>CTC with GRT</u>	<u>T&D Rate</u>	<u>Bundled Rate Today</u>	<u>Shopping Credit</u>
1999	13,268,000,000	196,463,670	1.549	2.007	7.286	3.730
2000	13,474,000,000	185,310,711	1.439	2.007	7.286	3.840
2001	13,684,000,000	174,157,751	1.331	2.007	7.286	3.948
2002	13,895,000,000	163,004,792	1.227	2.007	7.286	4.052
2003	14,105,000,000	151,851,833	1.126	2.007	7.286	4.153
2004	14,314,000,000	140,698,873	1.028	2.007	7.286	4.251
2005	14,522,000,000	129,545,914	0.933	2.007	7.286	4.346
2006	14,732,569,000	118,392,954	0.841	2.007	7.286	4.438
2007	14,946,191,251			2.007	7.286	5.279
2008	15,162,911,024			2.007	7.286	5.279

Notes:

GRT Gross up is $1/(1-GRT)$, or 1.0460251, to reflect payment of GRT on the GRT revenue receipt.
 The Shopping Credit is the bundled rate less the sum of the T&D rate plus the CTC with GRT rate.