

R-00973953

PECO STATEMENT NO. 1-R
Phila 10/14, 10/15/10/16/97
L. Holbert

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

REBUTTAL TESTIMONY
OF
THOMAS P. HILL, JR.

~~EXTRA
COPY~~

Summarizing The Opposing Parties' Positions
And Evaluating Their Likely Impact On PECO;
Providing An Overview of PECO's Rebuttal Case;
Commenting On Miscellaneous Adjustments To PECO's
Stranded Cost Claim; Updating PECO's Stranded
Cost Analyses; And Responding To "Sharing" Proposals

OFFICE

July 18, 1997

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OCT 22 1997

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REBUTTAL TESTIMONY OF THOMAS P. HILL, JR.

I. INTRODUCTION

1

2 Q. **Please state your name and business address.**

3 A. Thomas P. Hill, Jr., PECO Energy Company ("PECO" or the "Company"), 2301 Market
4 Street, P.O. Box 8699, Philadelphia, PA 19101-8699.

5 Q. **Have you previously participated in this proceeding?**

6 A. Yes. I submitted direct testimony (PECO St. 1) and various supporting exhibits (Exhibits
7 TPH-1 through TPH-14) with PECO's April 1, 1997 restructuring filing. A statement of
8 my qualifications is contained in my direct testimony. In addition, I later submitted
9 supplemental direct testimony (PECO St. 1-S) and an accompanying exhibit (TPH-15) in
10 which I responded to certain questions posed by Commissioner Hanger.

11 Q. **What is the purpose of your rebuttal testimony?**

12 A. I will first summarize the positions taken by the opposing parties and, in the process, will
13 discuss the implications to PECO and the community if PECO is denied substantial
14 *stranded cost recovery*. I will then provide an overview of PECO's rebuttal case, briefly
15 comment on certain adjustments to PECO's stranded cost claim and update PECO's
16 stranded generating plant analysis. Finally, I will address, from a policy standpoint,
17 certain "sharing" proposals that have been advanced and will explain why those proposals
18 are contrary to the Competition Act..

1 recovery of such costs in broader terms (e.g., IPL and AARP), only three parties have set
2 forth comprehensive proposals -- the OTS, the OCA and PAIEUG. These proposals,
3 however, are not always presented on a consistent basis. Accordingly, they must be
4 restated in such a way that the Commission has a common point of reference.

5 **Q. What do you mean when you say that the parties have not presented their**
6 **recommendations on a consistent basis?**

7 **A.** In its restructuring filing, PECO followed a two-step process. First, it quantified its
8 stranded costs as of January 1, 1999. Once those costs were known, PECO calculated the
9 revenue requirements associated with recovering those costs over a seven-year
10 (1999-2005) transition period, this latter step involving the computation of a recovery of
11 and a return on its stranded costs. The figures presented by the OTS, OCA and PAIEUG
12 combine adjustments to both components of the analysis and, as a result, it is not always
13 clear whether such parties are proposing reductions to or the disallowance of certain
14 stranded assets or, alternatively, are taking issue with the manner in which PECO has
15 sought to recover them through its CTC, or both.

16 **Q. Have you been able to isolate and distinguish between the types of adjustments**
17 **proposed by the OTS, the OCA and PAIEUG?**

18 **A.** Yes. Exhibits TPH-16 through TPH-18 were prepared for that purpose. Exhibit TPH-16
19 depicts the first step of the process that I alluded to previously, namely the quantification,
20 at January 1, 1999, of the stranded assets for which the opposing parties would allow
21 recovery. The differences between the amounts claimed by PECO and the opposing

1 parties' recommendations are attributable to (1) the proposed elimination of certain items
2 in their entirety (e.g., post-1996 deferred fuel, fossil decommissioning) and (2) reductions
3 reflecting proposed adjustments to the stranded value of those assets (e.g., generating
4 plant). As can be seen on Exhibit TPH-16, the opposing parties' valuations of PECO's
5 recoverable stranded costs, as originally filed, range from \$3.7 billion (PAIEUG) to
6 \$4.9 billion (OTS). Or, viewed differently, these parties would deny PECO recovery of
7 between \$3.1 billion (PAIEUG) and \$1.9 billion (OTS) of its \$6.8 billion of claimed
8 stranded costs.

9 **Q. Please describe Exhibits TPH-17 and TPH-18.**

10 A. Having quantified PECO's recoverable stranded costs, the OTS, OCA and PAIEUG then
11 superimpose "sharing" proposals -- either in the form of a reduction to or an outright
12 denial of a return on those costs. Exhibit TPH-17 provides a narrative description of how
13 each party would effectuate its "sharing" concept, while Exhibit TPH-18 shows the
14 impact of such "sharing" proposals on a revenue requirements basis. As Exhibit TPH-18
15 confirms, the net effect of the opposing parties' recommendations is a revenue
16 requirement adjustment, in present value, ranging from \$4.3 billion (PAIEUG) to
17 \$3.2 billion (OTS). When stated in percentage terms, PAIEUG would allow only 36% of
18 the claimed amount, the OCA 42% and the OTS 53%.

19 **Q. What implications do these proposals have in terms of PECO's financial viability?**

20 A. At my request, J. Barry Mitchell, PECO's Vice President of Finance and Treasurer,
21 analyzed the impact on PECO's future financial indicators (e.g., bond ratings, cash flow,

1 earnings, dividend) if the opposing parties' recommendations were adopted. As
2 Mr. Mitchell explains in his rebuttal testimony (PECO St. 20-R), the results would be
3 catastrophic. Indeed, as he notes, the OCA and PAIEUG disallowance proposals would
4 result in a write-off of at least \$798 million, with an associated charge to earnings of over
5 \$2.00 per share. In addition, under the opposing parties' proposals, the Company would
6 have negative net cash flow in 1999 of at least \$558 million. Cumulative net cash flow
7 for the transition period would also be negative under all three proposals, by at least \$1.1
8 billion and perhaps as much as \$2.2 billion. Earnings per share would plummet and the
9 Company's mortgage bond rating would likely be reduced to junk bond status for the
10 duration of the transition period.

11 While I am reluctant to predict the tangible, real-world consequences of such action, I
12 will say that the repercussions would be far more severe than the fallout of PECO's
13 Limerick 2 base rate proceeding, when PECO was forced to (1) reduce its employee ranks
14 by 37%, (2) shave in half its funding of charitable organizations, (3) pull back on ongoing
15 economic development initiatives and (4) cut its dividend by 45%.

16 **Q. You previously stated that certain parties would impose severe restrictions on**
17 **PECO's ability to compete in the future. Please elaborate.**

18 **A.** Enron and others have advanced a variety of proposals which, if adopted, would seriously
19 impair PECO's viability as a competitive generation supplier in a deregulated world.
20 These recommendations, which are purportedly designed to blunt an alleged
21 "incumbency" advantage, include, but are not limited to, (1) a ban on the use of PECO's

1 name by non-monopoly business units, (2) a moratorium on PECO's ability to enter into
2 long-term supply agreements and (3) stringent restrictions on the interaction and transfer
3 of information between affiliated entities. In addition, the Environmentalists apparently
4 would have PECO subsidize alternative (e.g., "green") generation suppliers. As
5 explained by Mr. Sidak (PECO St. 10-R), these proposals would not enhance
6 competition, but are designed to further weaken PECO, which, in turn, would have an
7 adverse effect on competition and, more importantly, an adverse effect on consumers.

8 **Q. Is there any reason to believe that Enron or other alternative suppliers need to**
9 **handicap PECO in order to vigorously compete for electric sales?**

10 **A.** No, there is not. For example, in its 1996 Annual Report to shareholders, Enron touted
11 itself as "one of the largest integrated natural gas and electric companies in the world", as
12 "the top natural gas and electricity wholesale marketer in North America" and as "the
13 most successful developer of energy infrastructure in the world". At December 31, 1996,
14 Enron's total assets were greater than PECO's. For the year 1996, Enron's operating
15 revenues approximated \$13.3 billion, or more than three times PECO's. Perhaps more
16 instructive, Enron predicted in its 1996 Annual Report that its new retail energy
17 marketing business, within five years, would alone "generate revenues equal to or greater
18 than our total 1996 revenues". In view of the foregoing, it seems particularly
19 inappropriate for Enron to seek to enlist this Commission's support to assist it in
20 exercising its considerable and rapidly expanding financial muscle at the expense of
21 Pennsylvania's jurisdictional utilities.

1 Q. **When viewed in their entirety, what impact would these proposals have on PECO?**

2 A. They would leave PECO crippled financially and forced to compete with one hand tied
3 behind its back. Indeed, if the opposing parties' recommendations are adopted in whole
4 or substantial part, the future for Pennsylvania's energy industry is extremely bleak. In
5 my view, the interests of the Commonwealth would be poorly served if more corporate
6 headquarters were closed down and more jobs exported to other States, which, at least to
7 date, have not opened their borders so that PECO and Pennsylvania's other electric
8 utilities can compete on an equal footing.

9 Q. **In your view, would such or similar results be consistent with the objectives of the**
10 **Competition Act?**

11 A. No, they would not. Section 2804(14) of the Competition Act provides as follows:

12 The transition to a competitive generation market shall be orderly, protect
13 electric system reliability, be fair to ratepayers and provide the investors in
14 Pennsylvania electric utilities with a fair opportunity to fully recover the
15 amount of transition or stranded costs that the commission determines to
16 be just and reasonable.

17 As I and other rebuttal witnesses explain, the cumulative effect of the opposing parties'
18 proposals would (1) make it difficult, if not impossible, for PECO to survive the
19 transition to competition, (2) jeopardize system reliability and (3) deny PECO's
20 shareholders the recovery of a just and reasonable level of their investment.

1 Q. **Why do you believe that the opposing parties' proposals implicate system**
2 **reliability?**

3 A It is critically important to recognize that while in a competitive world other generation
4 suppliers may come and go, depending upon their ability to maximize profits and
5 contribute to the "bottom line", the Competition Act requires that PECO stand ready to
6 serve as the "supplier of last resort". In addition, PECO will continue to play a critical
7 role in the delivery of energy services and must maintain and upgrade, as necessary, its
8 transmission and distribution systems. If PECO's financial condition is reduced to the
9 point where it has difficulty accessing the capital markets on reasonable terms, as
10 Mr. Mitchell indicates could occur, PECO's ability to fulfill its statutory obligations for
11 the benefit of the public would be imperilled. Moreover, if similar proposals are
12 advanced in other Pennsylvania electric restructuring proceedings and given serious
13 consideration, the reliability of electric service throughout the Commonwealth could be at
14 risk.

15 Q. **Do you have any concluding remarks regarding this portion of your rebuttal**
16 **testimony?**

17 A. For many years, PECO has provided safe and reliable service to the residents of
18 Southeastern Pennsylvania. It presently enjoys a well-deserved reputation as one of the
19 most effective and efficient operators of electric generating plants in the United States; is
20 an environmental leader in terms of its overall generating plant portfolio; provides far
21 more financial assistance to low-income customers than any other utility in the

1 Commonwealth; is a major contributor to charitable and community-based organizations
2 through the donation of funds and the active involvement of its employees; and plays a
3 major role in the ongoing economic revitalization of the Delaware Valley. I cannot
4 believe that the General Assembly intended to turn its back on Pennsylvania's
5 jurisdictional utilities, such as PECO, so that out-of-state utilities and power marketers
6 could benefit at their expense.

7 **III. OVERVIEW OF PECO'S REBUTTAL CASE**

8 **Q. It seems clear from the foregoing that PECO vigorously objects to certain of the**
9 **opposing parties' recommendations. Are there any proposals which PECO can**
10 **accept to limit the issues which must be resolved by the ALJs and, ultimately, the**
11 **Commission?**

12 **A. Yes. PECO has carefully analyzed the opposing parties' testimony. Where appropriate,**
13 **modifications have been made to the Company's restructuring plan. For example,**
14 **Mr. Cohn (PECO St. 3-R) has reduced PECO's stranded cost claim for nuclear**
15 **decommissioning expense to reflect earnings on 1997 and 1998 trust fund contributions.**
16 **In like fashion, Mr. Clemmer has revised his cost of service study to correct minor errors**
17 **and to address certain points raised by Mr. Kalcic and others. Moreover, Ms. Kray**
18 **(PECO St. 16-R) and Ms. King (PECO St. 17-R) have made it clear that PECO is**
19 **amenable to revisiting its Universal Service and Consumer Education proposals to**
20 **accommodate suggestions that have been made. In short, PECO recognizes the fluid**

1 nature of the restructuring process and is eager to work with the parties to resolve
2 differences.

3 **Q. Please identify the specific subject areas that PECO witnesses cover in their rebuttal**
4 **testimony.**

5 **A.** PECO's rebuttal witnesses address the following major subject areas:

- 6 • Quantification/Recovery Of Stranded Costs
- 7 • Allocation Of Costs And Rate Unbundling
- 8 • Universal Service
- 9 • Consumer Education
- 10 • Economic Impact On Community

11 The nature of the testimony provided with respect to each of the foregoing areas is
12 summarized below.

13 **A. Quantification/Recovery Of Stranded Costs**

14 By way of overview, Mr. Mitchell (PECO St. 20-R) examines the "bottom line" effect of
15 the opposing parties' proposals on PECO's financial integrity. As noted previously, he
16 concludes that their recommended disallowances, if adopted in whole or substantial part,
17 would cripple PECO and make it virtually impossible for PECO to raise capital in the
18 future on reasonable terms.

19 Later in this testimony, I will respond to certain "sharing" proposals (purportedly
20 grounded in economic and/or ratemaking "policy"), each of which, not surprisingly,
21 would require PECO shareholders to absorb substantial additional stranded costs. Other
22 PECO witnesses include Mr. Sidak (PECO St. 10-R), who explores the constitutional

1 dimensions of stranded cost recovery, and Dr. Hieronymus (PECO St. 6-R), who
2 responds to the "Tobin's Q" theory advanced, once more, by IPL witnesses Brehm and
3 Lewellen.

4 Specific adjustments to PECO's stranded **regulatory assets** have been recommended by
5 Messrs. Catlin, Gill, Kollen, Ralph Smith and Weakley. Mr. Cohn (PECO St. 3-R)
6 addresses these proposals and explains why they should be rejected. In addition, and with
7 respect to issues posed by SFAS 109 (deferred taxes), Mr. Cohn's testimony is
8 supplemented by Mr. Warren (PECO St. 9-R), as well as by accounting experts Benjamin
9 A. McKnight of Arthur Andersen LLP (PECO St. 19-R) and James W. Sharpe of Coopers
10 & Lybrand (PECO St. 23-R), each of whom concurs that PECO has properly calculated
11 and claimed its stranded SFAS 109 costs and that the adjustments proposed by Messrs.
12 Catlin and Kollen would require a significant write-off by the Company.

13 PECO's claim for stranded **generating plant costs** has been challenged by Messrs.
14 Falkenberg and Douglas Smith, who introduce alternative model-based market price
15 projections, and by Messrs. Johnstone and Schoengold, who develop their own non
16 model-based market price estimates. PECO's market price experts -- Dr. Hieronymus
17 (PECO St. 6-R), Mr. Bustard (PECO St. 4-R) and Judah L. Rose (PECO St. 22-R) of
18 ICF^{1/} -- critique these submissions, noting various shortcomings of the opposing parties'

^{1/} Dr. Venkateshwara, who was responsible for the initial ICF market price analysis, has left ICF and Mr. Rose has taken his place for purposes of sponsoring ICF's rebuttal testimony.

1 models and unreasonable assumptions which cause them to substantially overstate the
2 future price of energy and capacity. PECO's experts also present updated market price
3 projections, correcting certain errors and, in an effort to narrow the issues, adopting
4 certain of the less controversial assumptions used by the opposing party witnesses. In
5 addition, Mr. Brennan (PECO St. 11-R) updates his cost of capital analysis and calculates
6 the appropriate discount rate to be utilized. I discuss the effect of these updates on the
7 market value of PECO's generating facilities later in my rebuttal testimony.

8 Finally, PECO's quantification of its stranded **nuclear and fossil decommissioning costs**
9 has been criticized by various witnesses. Mr. Cohn accepts several of the adjustments
10 which have been proposed and makes appropriate revisions to the claimed amounts. He
11 and Mr. LaGuardia (PECO St. 8-R) also explain why certain other recommendations,
12 such as the elimination of a contingency component, should be rejected. In addition,
13 William M. Stout (PECO St. 24-R) describes how electric utilities outside of
14 Pennsylvania estimate, and recover through current depreciation accruals, the future cost
15 of removing fossil generating stations from service.

16 **B. Allocation Of Costs And Rate Unbundling**

17 Issues relating to PECO's **functionalization and allocation of costs** have been raised by
18 Messrs. Baron, Johnstone, Kalcic, Reising, Schoengold and Tabors and Ms. Lee Smith.
19 In response, Mr. Clemmer (PECO St. 12-R) has rerun his cost of service study to correct
20 inadvertent errors identified during discovery. Mr. Clemmer also explains why it would

1 be inappropriate to assign a significant amount of additional administrative and general
2 expense or common plant costs to the production function, but also notes that some
3 additional allocation of such costs is appropriate and has been reflected in his updated
4 study. Finally, Mr. Cohn responds to arguments advanced by Mr. Schoengold and
5 Ms. Smith that a portion of PECO's stranded costs should be allocated to wholesale
6 customers. As to this latter issue, I would simply note that, on July 16, 1997, PECO
7 experienced an all-time peak demand for electricity, confirming the point made by
8 Messrs. Cohn and Cucchi in their direct testimony -- namely, that PECO requires all of its
9 existing generating capacity to satisfy the needs of its retail customers.

10 PECO's **unbundled rates** have also been questioned by a number of opposing party
11 witnesses. In his rebuttal testimony (PECO St. 2-R), Mr. Miller defends PECO's
12 proposal to establish a levelized CTC, explains why it would be inappropriate to fully
13 unbundle certain special contracts and rate riders, and responds to recommendations that
14 the rate cap and/or CTC recovery periods should be extended. Mr. Sundermeir
15 (PECO St. 13-R) presents revised unbundled rates, reflecting Mr. Clemmer's updated
16 cost allocations and other changes accepted by PECO, and addresses various rate design
17 issues, including service fees and conjunctive billing. Mr. Xander (PECO St. 14-R)
18 responds to proposals regarding the structure and the reconciliation of the CTC, and the
19 recovery of stranded costs from on-site generators. Lastly, Messrs. Cucchi and Clemmer
20 address requests that non-wires services (i.e., metering and billing) be unbundled and
21 deregulated.

1 Several parties have also expressed concerns over the **terms and conditions of service**.
2 Enron, in particular, would impose stringent restrictions which, if adopted, would
3 severely inhibit PECO's ability to compete in a deregulated marketplace. Mr. Cucchi
4 describes how PECO will comply with its proposed Code of Conduct and discusses the
5 adverse impact that the additional restrictions recommended by Enron and others would
6 have on PECO's competitive generation supply business units. Mr. Sidak explains why
7 Enron's attempt to "competitively handicap" PECO through the imposition of these
8 unnecessary and burdensome restrictions would produce anticompetitive results and
9 therefore is contrary to customers' best interests. Mr. Pratzon discusses PECO's
10 approach to retail transmission access, the treatment of ancillary services and other
11 FERC-related matters. In addition, Mr. Pratzon and Ms. King address certain proposals
12 of the Environmentalists.

13 C. Universal Service

14 OCA witness Brockway and Environmentalists witness Colton have submitted extensive
15 comments regarding PECO's proposed Universal Service program. In addition, Messrs.
16 Bowen, Cooper and Metro, Ms. Smith and Ms. Day have suggested specific revisions to
17 individual features of that program. Ms. Kray (PECO St. 16-R) discusses eligibility
18 criteria, the inclusion of "renewables", the use of prepayment meters and the participation
19 of community-based organizations. Mr. Xander, in turn, addresses recommended funding
20 levels and the application of the rate discount to separate billing components. As
21 Ms. Kray explains, the Company's program meets and substantially exceeds the

1 Commission's July 11, 1997 Universal Service Guidelines. In addition, PECO has
2 proposed a significant expansion of its customer assistance program in terms of size and
3 expenditure levels above what is recommended by the Commission.

4 **D. Consumer Education**

5 Several witnesses, including Messrs. Bowen and Cooper and Ms. Alexander, have
6 recommended that the Consumer Education function be turned over to the Commission
7 or an independent third-party. Mr. Colton, on the other hand, offers specific criticisms of
8 the program submitted by PECO. PECO anticipates that Consumer Education issues will
9 be resolved through the promulgation of regulations/guidelines of state-wide
10 applicability. As explained by Ms. King (PECO St. 17-R), PECO does not oppose a
11 state-wide approach, provided that utilities are given an opportunity to have meaningful
12 input into the process and to offer consumer education programs to their customers on
13 utility-specific issues.

14 **E. Economic Impact On Community**

15 Dr. Silkman, testifying on behalf of Senator Fumo and certain consumer groups, has
16 presented the results of an analysis he performed using a model developed by Regional
17 Economic Models, Inc. ("REMI"), which purports to show the impact on the Philadelphia
18 area economy if substantial cuts are made to PECO's electric rates. Robert A. Leone, a
19 Professor of Operations Management at the Boston University School of Management
20 (PECO St. 18-R), evaluates the REMI model, identifies flaws in Dr. Silkman's

1 application of the model, and concludes that Dr. Silkman has significantly overstated the
2 effect of PECO's rates on the regional economy.

3 Q. **Do you have any comments regarding Dr. Silkman's analysis beyond those issues**
4 **addressed by Dr. Leone in his testimony?**

5 A. Yes. While Dr. Silkman claims that lower electricity prices will result in a large increase
6 in jobs in the Philadelphia area, that view is not supported by survey data from
7 independent third parties. For example, Coopers & Lybrand's 1995 Pennsylvania
8 Economic Survey of members of the Pennsylvania Chamber of Commerce reported:

- 9 • When asked to list the eight biggest issues facing business in
10 Pennsylvania, utility costs did not even make the list.
- 11 • When companies which had left the state were asked their reasons for
12 doing so, utility costs did not make the list of top reasons. Indeed,
13 Business Climate, Business Taxes, and the Combination of Workers'
14 Compensation and Health Insurance were the top reasons listed.

15 Similar results were reported by Dun & Bradstreet in its 1995 survey of small businesses.
16 In that survey, small businesses listed their 16 largest business concerns -- utility costs
17 were not even mentioned. A 1995 survey by Industryweek revealed that access to
18 utilities was only the 9th most important consideration in selecting a new business site.
19 These studies strongly suggest that electricity costs are not a major factor in job location
20 decisions.

1 **IV. MISCELLANEOUS ADJUSTMENTS TO**
2 **PECO'S STRANDED COST CLAIM**

3 **Q. Mr. Hill, several witnesses have criticized PECO's treatment of certain**
4 **administrative and general expenses and common plant costs. Please comment.**

5 **A. Messrs. Baron, Johnstone and Phillips and Ms. Smith all claim that PECO should have**
6 **allocated more administrative and general expense and common plant costs to the**
7 **production function. As Mr. Clemmer explains in his rebuttal testimony, PECO, in**
8 **response to these comments, has allocated an additional \$31 million of administrative and**
9 **general expense and an additional \$234 million of net general and common plant costs to**
10 **production. I would note that any allocation of additional plant and/or expenses to the**
11 **production side of the ledger will further increase PECO's stranded costs.**

12 **Q. Messrs. Kollen and Ralph Smith contend that PECO could further reduce its**
13 **stranded costs by treating its "overfunded" pension costs as a form of stranded**
14 **benefit. Please comment.**

15 **A. Mr. Cohn discusses the flaws of these proposals in his rebuttal testimony. As he points**
16 **out, the funding status of PECO's pension plans is fully taken into account by PECO's**
17 **actuaries in calculating its annual pension expense liability. Accordingly, the adoption of**
18 **this proposal would require an offsetting upward adjustment to annual pension expense,**
19 **thereby increasing PECO's operating costs, reducing the market value of its generating**
20 **facilities and increasing its stranded costs.**

1 Q. Finally, Mr. La Capra has proposed a 0.2% productivity factor offset which would
2 reduce PECO's estimated "going-forward" costs to reflect "further efficiencies" in
3 operating PECO's generating facilities (OCA St. 1, p. 10). Do you agree with this
4 recommendation?

5 A. No, I do not. As I discussed in my direct testimony (PECO St. 1, pp. 21-22), PECO has
6 made tremendous strides in terms of improved productivity over the past seven years and,
7 largely because of those initiatives, does not presently anticipate any further reductions in
8 the staffing levels at its generating plants. Moreover, benchmarking studies demonstrate
9 that PECO compares very favorably to other utilities in terms of standard measures of
10 productivity. Thus, even if PECO were able to continue to improve its productivity, it
11 seems equally likely and perhaps more logical to assume that other utilities would
12 experience productivity gains of the same or greater magnitude. If this were the case,
13 market prices would be lower, which, in turn, would offset any productivity gains in
14 terms of calculating stranded costs.

15 Q. Are there any other reasons why Mr. La Capra's 0.2% productivity factor should
16 be rejected?

17 A. Yes. First, the inflation projections that were used for purposes of my analysis are based
18 on estimates independently developed by a recognized source (DRI/McGraw-Hill World
19 Energy Service, U.S. Outlook, Fall Winter 1996-97, October 1996). These inflation
20 projections were then applied to each of the seven different variables in my analysis on
21 both the revenue side and the cost side. This approach provides a consistent framework

1 and a consistent perception of future inflation trends. Mr. La Capra has chosen to adjust
2 the inflation assumption with respect to only one of these seven variables, O&M costs,
3 because it lowers the Company's stranded investment calculation. However, one could
4 just as easily argue that innovation and technology will cause market revenues to escalate
5 at a rate slightly below the inflation rate. In fact, if a 0.2% offset is applied to market
6 revenues, this would increase the Company's stranded costs by more than \$230 million.
7 Moreover, if the 0.2%-offset is applied consistently to all seven variables in the model,
8 PECO's stranded investment is increased by more than \$140 million. Rather than make
9 these kinds of arbitrary changes, I am proposing that no adjustments be made to the
10 independently developed DRI/McGraw-Hill figures. This provides a consistent, unbiased
11 framework for determining stranded costs.

12 Second, the Company has utilized O&M projections in its analysis which are even lower
13 than recent actual costs in the interest of conservatism and to capture the kind of
14 efficiency incentive that Mr. La Capra discusses. To then propose an additional
15 efficiency incentive on top of that reflected in the Company's analysis is an unreasonable
16 double hit which should be rejected.

17 **V. UPDATE OF STRANDED GENERATING PLANT ANALYSIS**

18 Q. **Mr. Hill, is the Company revising its initial \$6.8 billion stranded cost claim?**

19 A. No, it is not.

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REJOINDER TESTIMONY

OF

THOMAS P. HILL, JR.

Regarding Objections To The Joint Petition
For Partial Settlement Of PECO Energy
Company's Proposed Restructuring Plan And
Application For A Qualified Rate Order

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OCT 22 1997

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1 REJOINDER TESTIMONY OF THOMAS P. HILL, JR.

2 I. INTRODUCTION

3 Q. Please state your name and business address.

4 A. Thomas P. Hill, Jr., 2301 Market Street, Philadelphia, PA 19103.

5
6 Q. By whom are you employed and in what capacity?

7 A. I am employed by PECO Energy Company ("PECO" or the "Company") as Vice
8 President and Controller.

9
10 Q. Have you previously participated in this proceeding?

11 A. Yes. I submitted direct testimony (PECO St. 1) and various supporting exhibits (Exhibits
12 TPH-1 through TPH-14) with PECO's April 1, 1997 restructuring filing. A statement of
13 my qualifications is contained in my direct testimony. I later submitted supplemental
14 direct testimony (PECO St. 1-S) and an accompanying exhibit (TPH-15) in which I
15 responded to certain questions posed by Commissioner Hanger. On July 18, 1997, I
16 submitted rebuttal testimony (PECO St. 1-R) and accompanying exhibits (Exhibits
17 TPH-16 through TPH-25) in which I updated PECO's stranded cost claim and responded
18 to various proposals advanced by other parties to this proceeding. Finally, on September
19 17, 1997, I submitted supplemental rebuttal testimony (PECO St. 1-SR) and
20 accompanying exhibits (Exhibits TPH-26 through TPH-28) in which I explained why, in
21 PECO's view, approval of the August 27, 1997 Joint Petition For Partial Settlement Of

1 PECO Energy Company's Proposed Restructuring Plan And Application For A Qualified
2 Rate Order (the "Joint Petition") is in the public interest.

3
4 Q. What is the purpose of your rejoinder testimony?

5 A. I will first provide an overview of the principal objections to the Partial Settlement which
6 have been expressed by the Pennsylvania Electric Competition Coalition and others and
7 will briefly respond to each. I will then explain why approval of the Joint Petition is in the
8 public interest and why the "counter-proposals" presented by the Coalition and the Mid-
9 Atlantic Power Supply Association ("MAPSA") are not. Next, I will address, in a more
10 detailed fashion, specific arguments which have been advanced in opposition to the Partial
11 Settlement. Finally, I will respond to certain questions raised by the Commission in its
12 October 2, 1997 Tentative Order with respect to ancillary services and transmission
13 service terms and conditions.

14
15
16 **II. OVERVIEW OF PRINCIPAL OBJECTIONS**
17 **TO THE PARTIAL SETTLEMENT**

18
19 Q. Which parties submitted testimony in opposition to the Partial Settlement?

20 A. Testimony objecting to the Partial Settlement was filed by the Pennsylvania Electric
21 Competition Coalition, MAPSA, the Environmentalists and the Municipal Intervenors
22 Group (the "Municipal Intervenors"). The Coalition consists of three entities -- Enron

1 Power Marketing, Inc., Conectiv Energy and New Energy Ventures (collectively referred
2 to hereinafter as "Enron") -- each of which intends to market energy and/or capacity in
3 PECO's service territory. MAPSA comprises a number of independent power suppliers,
4 including Enron, who similarly plan to compete for electric sales in the Commonwealth.
5 The Environmentalists have questioned the reasonableness of the Partial Settlement on
6 several grounds. However, in light of ongoing discussions, the Environmentalists have
7 agreed that PECO's responsive testimony, if necessary, may be filed on October 13, 1997.
8 The Municipal Intervenors have simply reiterated their previously stated concerns over
9 unbundled street lighting rates.

10
11
12 **Q. Please provide an overview of the principal objections to the Partial Settlement**
13 **expressed by Enron and MAPSA and PECO's reaction to each.**

14 **A.** Enron and MAPSA object to the Partial Settlement essentially on three grounds. First,
15 they contend, without benefit of any meaningful support, that the Partial Settlement will
16 stymie the development of a competitive generation market. As I will discuss, the energy
17 and capacity rate caps set forth in the Joint Petition are entirely consistent with and
18 supported by (1) the analysis conducted by Dr. Hieronymus, (2) the range of price
19 forecasts submitted by other Pennsylvania electric companies in their restructuring
20 proceedings, (3) contemporaneous market-derived data and (4) the generation credit
21 established by the Commission in PECO's recent Pilot Program proceeding.

1 Enron further argues that PECO will derive unintended (and, according to Enron,
2 unwarranted) benefits from the Partial Settlement, including an alleged overrecovery of
3 the \$5.461 billion of stranded costs which the Joint Petition would permit the Company to
4 recover. As Mr. Cohn demonstrates, Enron's attempt to quantify the relative costs and
5 benefits of the Partial Settlement is so replete with errors, omissions and faulty
6 assumptions as to be of no probative value whatsoever.

7
8 Finally, Enron appears to oppose the Partial Settlement because it does not address, much
9 less resolve, issues relating to PECO's proposed Code of Conduct, metering and billing.
10 As to this particular objection, I would merely note that the Commission, on October 2,
11 1997, issued a Tentative Order which states (p. 4) that certain issues, including Code of
12 Conduct and metering and billing, "are best addressed in statewide proceedings to
13 eliminate the possibility of inconsistent results in different restructuring proceedings."
14 Pursuant to that Order, Enron and others had the opportunity to file comments by
15 October 6, 1997 if they believed that these issues should be dealt with in the restructuring
16 case. In any event, if the Commission ultimately decides to remand these issues to the
17 restructuring proceedings, this proceeding has an established schedule for the submission
18 of testimony, hearings and briefing on those issues.

1 III. SUMMARY OF PECO'S RESPONSE

2
3 Q. Why do you believe that the Partial Settlement should be approved?

4 A. The Partial Settlement should be approved because it is in the public interest. As I
5 explained in my supplemental rebuttal testimony, the Partial Settlement represents a fair
6 compromise of diverse and competing goals and objectives. Enron witness Mitnick's
7 attempt to paint the Partial Settlement as "PECO's proposal" is, therefore, both
8 misleading and disingenuous. As Mr. Mitnick is well aware, the Partial Settlement
9 constitutes a consensus position developed not only by PECO and the OTS, but by
10 advocates for residential customers (OCA and Senator Fumo), small commercial
11 customers (OSBA), large industrial customers (PAIEUG), low-income customers
12 (CEPA and Senator Fumo), retired citizens (AARP) and the U.S. government (Navy).
13 The enthusiastic and unified support of these various constituencies alone speaks volumes
14 to the merits of the Partial Settlement.

15
16 Q. Are there any other reasons why the Partial Settlement is in the public interest?

17 A. Yes. The Partial Settlement would provide PECO's customers the largest rate
18 reduction proposed by any electric utility in the nation in connection with the transition to
19 retail competition. Moreover, that rate reduction is assured, and not founded on empty
20 promises or contingent on "what ifs". As such, the Partial Settlement protects customers
21 against upward price pressures, while allowing them to enjoy fully the lower market prices
22 that competition may bring, thus shifting the risk of adverse future market uncertainties to

1 PECO and its shareholders. In addition, the Partial Settlement (1) offers substantial rate
2 relief to industrial customers, thereby stimulating economic development throughout the
3 Southeastern Pennsylvania region, (2) implements a significant expansion of PECO's
4 universal service programs, which will be of tremendous value to low-income customers
5 who experience difficulty in paying their electric bills and (3) promotes the development of
6 renewable energy services.

7
8 **Q. Are there any features of the Partial Settlement which could not be realized if this**
9 **proceeding were fully litigated?**

10 **A. Yes. As I discussed in my supplemental rebuttal testimony, there are at least three extra-**
11 **statutory components of the Joint Petition that are achievable only through settlement: (1)**
12 **all customers will receive a 10% rate reduction four months prior to the scheduled advent**
13 **of retail competition in Pennsylvania; (2) two-thirds of PECO's customers will be able to**
14 **shop for generation a year earlier than they otherwise would; and (3) the rate cap on**
15 **transmission and distribution rates will be extended by thirty months. I would also note**
16 **that the Statements in Support filed by other Joint Petitioners identified additional benefits**
17 **to customers that could not be realized after full litigation, including (1) the customer rate**
18 **savings are guaranteed, regardless of what actually occurs with market prices, (2) the**
19 **generation rate cap is extended for several years, and (3) universal service is expanded**
20 **beyond the levels required by the Electric Competition Act.**

21

1 Q. But don't Enron and MAPSA argue that their "counter-proposals" will provide
2 customers these and additional benefits?

3 A. Yes, they do, but only after putting the rabbit back in the hat. Enron and MAPSA assume
4 that they can massage the Partial Settlement in ways to maximize their potential
5 profitability and, at the same time, leave intact all of the concessions to which PECO has
6 committed. Indeed, it is this selective manipulation of terms and conditions which allows
7 the marketers to claim that customers somehow will be better off if the energy and
8 capacity caps set forth in the Joint Petition are **increased**. Not surprisingly, however,
9 when the smoke clears and all the shells are turned over, the answer becomes self-evident:
10 Enron and MAPSA would simply take money from the pockets of PECO's shareholders
11 (many of whom are Pennsylvania residents) through reduced Competitive Transition
12 Charges and drop it into the marketers' coffers to cover their incremental costs and
13 provide them a sufficient "margin" (i.e., profit).

14
15 Q. Messrs. Mitnick and Johnstone obviously disagree with your analysis, claiming that
16 PECO will fully recover its allowed level of stranded costs even under their counter-
17 proposals. Please comment.

18 A. Messrs. Mitnick and Johnstone totally confuse the level of stranded costs which the Joint
19 Petition would permit PECO to recover with the revenue stream needed to support that
20 recovery. As Mr. Cohn explains, the stranded costs recoverable under the Partial
21 Settlement consist largely of assets upon which PECO is entitled to earn a return. Under
22 the Partial Settlement, those costs would be recovered over a ten-year period and,

1 therefore, the revenue requirement imposed by the stranded cost recovery (i.e. the revenue
2 stream which Messrs. Mitnick and Johnstone discount) includes the pre-tax return on the
3 unrecovered balance. In addition, the ten-year revenue stream would be subject to gross
4 receipts tax at 4.4%, a fact ignored by the opposing party witnesses. Messrs. Mitnick and
5 Johnstone also employ wholly unrealistic sales levels in their calculations and,
6 consequently, artificially overstate the amount of stranded costs that PECO would actually
7 have the opportunity to recover. As a result, the implication that PECO should be
8 indifferent to their counter-proposals is seriously misleading.

9
10 **Q. Please summarize why you believe the Enron and MAPSA counter-proposals should**
11 **be rejected.**

12 **A. As I stated previously, the Partial Settlement represents a negotiated package that required**
13 **concessions and sacrifices by all of the Joint Petitioners. If any of that delicate balancing**
14 **of interests is destroyed, as Enron and MAPSA propose, this case will proceed to full**
15 **litigation and customers will suffer in the end. In the process, customers would lose the**
16 **benefits of the extra-statutory concessions to which PECO has agreed as part of the**
17 **Partial Settlement.**

1 IV. CRITIQUE OF SPECIFIC OPPOSING PARTY ARGUMENTS

2
3 A. Reasonableness Of Generation Prices

4
5 Q. Messrs. Mitnick and Johnstone assert that the energy and capacity rate caps set
6 forth in the Joint Petition substantially understate future market prices and will
7 therefore thwart the development of meaningful competition. Do you agree?

8 A. No, I do not. As Dr. Hieronymus demonstrates in his rejoinder testimony (PECO
9 St. 6-RJ), the energy and capacity caps are generally consistent with the results of his July
10 1997 market clearing price analysis when his wholesale price projections are translated
11 into retail (i.e. delivered) rates. For purposes of his analysis, I provided Dr. Hieronymus
12 with adjusted Energy and Capacity Rate Caps extracting certain customers which are not
13 relevant for purposes of the comparison. Specifically, I removed the sales and generation-
14 related revenues associated with customers on the Large Interruptible Load Rider (LILR),
15 the Economic Efficiency Rider (EER) and customers with Rule 4.6 contracts. These
16 customers represent less than one hundredth of one percent of PECO's total customer
17 base and have unique circumstances which make their inclusion in Dr. Hieronymus'
18 comparison inappropriate.

19
20 For example, under the terms of the Partial Settlement, for those LILR customers that
21 choose to remain with PECO for their energy supply, the energy charge will be the PJM
22 market clearing price for on-peak usage and the HT end block for off-peak usage. Thus,

1 alternative suppliers will compete against these rates, not the fully built-up retail energy
2 and capacity prices developed by Dr. Hieronymus. EER and Rule 4.6 customers have
3 already received discounts based on competitive alternatives. For customers who can
4 choose to access competitive supply, suppliers will have to compete against the
5 discounted rates provided by the Company. Accordingly, the discounted generated-
6 related revenues have been excluded for purposes of the system average comparison.

7
8 **Q. Are you aware of any independent confirmation of the reasonableness of Dr.
9 Hieronymus' projections?**

10 **A.** Yes. PECO recognizes that Dr. Hieronymus' projections constitute but one view of
11 future market conditions. Accordingly, I have examined the market price projections
12 submitted by other Pennsylvania electric utilities in support of their restructuring plan
13 filings. That data has been assembled and is presented in matrix form in Exhibit TPH-29.

14
15 **Q. Please describe Exhibit TPH-29.**

16 **A.** Exhibit TPH-29 lists, for each year of the period covered by the Partial Settlement, the
17 wholesale price of energy and capacity projected by Dr. Hieronymus (utilizing,
18 alternatively, the DRI and EIA fuel forecasts), as well as by consultants retained by the
19 Pennsylvania Power & Light Company (PP&L), GPU, Inc., West Penn Power Company
20 (APS), the Duquesne Light Company (DQE), and Pennsylvania Power Company (PPC).

21

1 Q. What do you conclude from Exhibit TPH-29?

2 A. I conclude that Dr. Hieronymus' findings are well within the range of projected values.

3

4 Q. Enron witnesses Mitnick and Hull further contend that there must be sufficient

5 "headroom" under the energy and capacity rate caps to allow alternative suppliers

6 to compete. Please comment.

7 A. Dr. Hieronymus refutes this assertion in his rejoinder testimony and, in the process,

8 explains why it is necessary and in the public interest to have a "tight cap" during the first

9 several years of the transition from regulation to competition.

10

11 Q. You earlier implied that contemporaneous market-derived data also supports the

12 reasonableness of the Joint Petition's energy and capacity rate caps. Please explain.

13

14 A. PECO is constantly engaged in the purchase and sale of energy and capacity at the

15 wholesale level. In addition, in preparing for the implementation of its retail access Pilot

16 Program, the Company has become aware of the prices being quoted by other generation

17 suppliers for retailed delivered power. That body of information is evaluated by

18 Mr. Freeman in his rejoinder testimony (PECO St. 26-RJ) and confirms the reasonableness

19 of the price projections which I previously discussed.

20

21 Q. Messrs. Mitnick and Johnstone each claim that the initial 2.8¢ energy and capacity

22 rate cap is at least a cent less than the "credit" which customers, on average, can

1 **expect to receive under PECO's retail access Pilot Program. Do you agree?**

2

3 A. I agree that the difference between the average Pilot credit of 3.9¢ and the 2.8¢ energy
4 and capacity rate cap exceeds one cent. This comparison, however, is particularly
5 inappropriate and reflects yet another manipulation of figures in a way that can only
6 mislead. Put simply, and as Messrs. Mitnick and Johnstone know full well, the generation
7 credits offered in the Pilot and the rate discounts offered in the Partial Settlement are
8 virtually identical. In both the Pilot and the Partial Settlement, there is an energy and
9 capacity "credit" of approximately 2.8¢; in both, there is an additional "credit" or
10 "discount" of approximately 1¢; in both programs, the total reduction to the average bill is
11 approximately 3.9¢. The difference between the two is that in the Pilot Program, the
12 additional 1¢ is referred to as the "Customer Participation Credit" and was ordered by the
13 Commission, whereas in the Partial Settlement it is called a "rate discount" and is offered
14 voluntarily by PECO.

15

16 Q. **What is the true generation credit embedded in the 3.9¢ Pilot figure?**

17 A. As I noted above, approximately 1¢ of the Pilot generation credit is the "Customer
18 Participation Credit". This "Credit" has nothing to do with anyone's projection of future
19 market prices, but rather is a payment that the Commission required utilities to make to
20 stimulate interest in the Pilot Program. The actual generation credit embedded in the total
21 Pilot credit is about 2.85¢. This is virtually identical to the rate discount built into the
22 Partial Settlement for the first two years. As demonstrated by Exhibit TPH-30, since the

1 Customer Participation Credit under the Pilot and the rate discount offered under the
2 Partial Settlement are virtually the same, customer rates offered under the Pilot and the
3 Partial Settlement are virtually identical.
4

5 Q. Enron witness Douglass claims that capacity is simply not available at this time and,
6 consequently, should be priced out at the current PJM installed capacity deficiency
7 penalty of \$58.40 per kilowatt year. Is Mr. Douglass correct?
8

9 A. No. As Mr. Freeman points out, capacity continues to be actively traded within the PJM.
10 Moreover, since Mr. Douglass filed his testimony, he has in fact been able to purchase 70
11 megawatts of capacity for the month of November at prices well below the PJM deficiency
12 penalty.
13

14 Q. Please comment upon the opposing parties' assertion that the energy and capacity
15 rate caps set forth in the Joint Petition are understated because PECO has failed to
16 allocate sufficient administrative and general costs to the generation function.

17 A. This issue is addressed in detail by Mr. Clemmer in his rejoinder testimony (PECO St. 12-
18 RJ), wherein he explains why any additional reallocation of administrative and general
19 costs from the transmission and distribution side to the generation function would be
20 inappropriate. Supplementing Mr. Clemmer's observations, I would note that the
21 transmission and distribution charges proposed in the Partial Settlement were carefully
22 reviewed and accepted by the representatives of the consumers who will pay them

1 regardless of whom they select as a generation supplier. In addition, those charges are
2 capped until January 1, 2004. If those charges are acceptable to customers, they should
3 be acceptable to Enron and MAPSA.

4
5 **Q. Is it likely that the cost to PECO of providing transmission and distribution service**
6 **will approximate 2.63¢ per kilowatthour (kwh) for the next eleven years as Mr.**
7 **Mitnick implies in his Exhibit SAM-8?**

8 **A. No.** First of all, the 2.63¢ figure manufactured by Messrs. Mitnick and Reising seriously
9 understates PECO's current transmission and distribution costs. Moreover, and as Mr.
10 Cohn points out, the Company's transmission and distribution costs have increased by
11 approximately 20% over the past seven years. Also, as Mr. Clemmer explains in his
12 rejoinder testimony, current transmission and distribution costs will soon include
13 significant new expenditures for computer and billing systems that PECO must acquire to
14 enable suppliers like Enron to service retail customers. To suggest that these costs will
15 remain flat from now through the year 2008 is simply not credible.

16
17 **Q. Is there any other reason why the opposing parties' proposals should be rejected?**

18 **A. Yes.** While Enron and MAPSA are quick to criticize the energy and capacity rate caps in
19 the Joint Petition, the alternative figures which they propose are off the radar screen in
20 terms of the objective evidence which has been submitted during the course of this case.
21 For example, and as shown in Exhibit TPH-31, the first year (1999) generation prices
22 proposed by the Enron and MAPSA are anywhere from 17.5% to 34.1% higher than the

1 prices projected by the OCA and PAIEUG, both of whom are parties to the Joint Petition,
2 when the latter prices are restated to reflect the costs of retail delivery.

3
4 **B. Relative Costs/Benefits Of The Partial Settlement**

5
6
7 **Q. Mr. Mitnick discusses at length the relative costs and benefits of the Partial**
8 **Settlement to PECO, going so far as to assert that the proposed rate cuts and**
9 **\$2.0 billion write-off of stranded costs will create a net present value benefit to**
10 **PECO. Please comment.**

11 **A.** In addition to being severely flawed, Mr. Mitnick's analysis exposes Enron's true concern
12 -- that PECO will remain a viable competitor in the future. Throughout his testimony, Mr.
13 Mitnick explores in great detail what he perceives to be the impact of the Partial
14 Settlement on Enron and on PECO. What is glaringly absent is any serious evaluation of
15 what may be best for customers. As I stated previously, the issue before the Commission
16 is whether the Partial Settlement is in the public interest. Indeed, its effect on Enron's
17 future profitability is, at best, a secondary consideration.

18
19 **Q. What's wrong with Mr. Mitnick's analysis?**

20 **A.** First, there are several serious conceptual flaws. For example, and as previously noted,
21 Mr. Mitnick erroneously compares the allowed level of stranded costs with a discounted
22 revenue stream. As Mr. Cohn explains, this fundamental mistake alone renders

1 meaningless Mr. Mitnick's "findings". In addition, Mr. Mitnick (1) improperly discounts
2 future CTC collections to January 1, 1999, rather than September 1, 1998 when the initial
3 rate reduction would be implemented (a \$175.0 million error); (2) gives PECO credit for
4 non-existent tax benefits (a \$500.0 million to \$1.0 billion error); and (3) fails to take into
5 account the costs and benefits of other aspects of the Partial Settlement (e.g., expansion of
6 universal service programs, early rate reduction, extension of transmission and distribution
7 rate cap) (a \$600.0 million error). Not surprisingly, each of these errors serves to
8 understate the value of the Partial Settlement for customers and to understate the cost of
9 the Partial Settlement to PECO.

10
11 **Q. Are there any other problems with Mr. Mitnick's calculations?**

12 **A. Yes.** In several of his exhibits, Mr. Mitnick utilizes sales projections taken from PECO's
13 1997 Annual Resource Planning Report (ARPR). Those sales projections were developed
14 in 1995, are not supported by historical experience and no longer reflect PECO's
15 expectations. As a result, they are no longer being used for planning purposes.

16
17 **Q. Mr. Mitnick further contends that securitization will generate benefits which should**
18 **be flowed through to customers, but are not under the Partial Settlement. In**
19 **addition, both Mr. Mitnick and Ms. Hull imply that PECO will be able to utilize the**
20 **proceeds from securitization to preempt competition. Please comment.**

21

1 A. As Messrs. Cohn and Warren explain, Mr. Mitnick's proposed flow-through of alleged tax
2 savings associated with securitization is fallacious and illogical. In addition, the
3 Commission should reject the suggestion that securitization will provide PECO a massive
4 "war chest" which it can then use to preempt competition. Again, as Mr. Mitnick and Ms.
5 Hull are or should be aware, the proposed Qualified Rate Order attached as Appendix D
6 to the Joint Petition imposes severe restrictions on PECO's use of the proceeds of
7 securitization, consistent with the terms of the Electric Competition Act -- the proceeds
8 must be used principally to reduce PECO's capitalization and stranded investment (that is,
9 to buy back debt and equity).

10
11 Q. **Mr. Mitnick appears to assume that PECO will securitize the entire \$4.0 billion**
12 **amount authorized by the Partial Settlement. Please comment.**

13 A. It is far from clear, at this stage, how much of the \$4.0 billion amount PECO will be able
14 or will choose to securitize. The answer will depend on many factors, including market
15 conditions, tax and accounting pronouncements and cash flow considerations.

16
17 Q. **Has PECO performed any analysis to demonstrate that it will not overrecover its**
18 **allowed level of stranded costs?**

19 A. Yes. That analysis is set forth in Mr. Cohn's Exhibit ABC-13 and indicates that, on a
20 present value revenue requirements basis, PECO will have to achieve substantial benefits
21 from securitization and experience unanticipated sales growth to offset the costs of the
22 other components of the Partial Settlement and recover the \$5.461 billion of stranded

1 costs provided for under the Partial Settlement.

2
3 C. Street Lighting Rates

4
5 Q. Mr. Crist, testifying on behalf of the Municipal Intervenors, contends that the
6 Partial Settlement's proposed SL-E location charges are so high that they will
7 preclude SL-E customers from "meaningful" participation in direct access. Mr.
8 Crist further claims that the "minimal" reductions proposed in the Partial
9 Settlement provide "no real opportunity" for SL-E customers to save money. Please
10 comment.

11 A. Certainly. Under the Partial Settlement, effective September 1, 1998 SL-E customers
12 would receive the same 10% total bill reduction available to PECO's other customers.
13 Also, effective January 1, 1999, the Company would substantially reduce the SL-E
14 location charge 23% from \$10.01 per light to \$7.66. Over the term of the Partial
15 Settlement, the charge will be further reduced to \$6.81, for a total reduction of 32%.

16
17 Q. Mr. Hopkins, also appearing on behalf of the Municipal Intervenors, claims that
18 Newtown Township, an SL-E customer, paid \$118,077.96 in location charges in 1996
19 and would still pay \$110,763.60 in location charges in 1999 under the Partial
20 Settlement. Is Mr. Hopkins correct?

1 A. No. Although Mr. Hopkins states that he based his calculations on 1205 lights, i.e. the
2 number of lights on Newtown Township's system served by PECO as of August 1997, his
3 yearly location charge total of \$118,077.96 was computed not on the basis of 1205 lights,
4 but on 983 lights ($983 \times \$10.01 \times 12 \text{ months} = \$118,077.96$). Using that same number of
5 lights, effective January 1, 1999 the Township's location charges would not be
6 \$110,763.60 as he claims, but \$90,357.36 ($983 \times \$7.66 \times 12 \text{ months}$), a 23% reduction.

7
8 Q. **What is the reason for this discrepancy?**

9 A. To compute the 1999 projected reduction, Mr. Hopkins chose to base his calculations on
10 1205 lights rather than the 983 figure he had used for the 1996 total. Similarly, his
11 \$98,472.60 figure for the year 2008 is based not on 983 lights but on 1205 lights. Had
12 Mr. Hopkins used the 983 figure consistently, he would have obtained a yearly charge in
13 2008 of \$80,330.76, or a reduction of 32%.

14
15
16 **V. QUESTIONS RAISED BY THE COMMISSION'S**
17 **OCTOBER 2, 1997 TENTATIVE ORDER**

18
19 Q. **Has the Commission asked the parties to address "ancillary services" in this**
20 **proceeding?**

1 A. Yes. In its October 2, 1997 Tentative Order granting the Joint Signatories' Petition to
2 Suspend Consideration of Certain Issues, the Commission requested clarification
3 regarding ancillary services and "whether the unbundling of rates and establishment of the
4 CTC have been correctly accomplished by the Partial Settlement."
5

6 Q. **Did Enron raise similar issues in any of its testimony in opposition to the Partial
7 Settlement?**

8 A. Yes. Enron witness Reising renewed his claim that certain costs associated with ancillary
9 services should be removed from the Partial Settlement's CTC charges.
10

11 Q. **How will PECO treat ancillary services under the Partial Settlement?**

12 A. The Partial Settlement contains three categories of charges, all of which are capped at the
13 level, on average, reported on Table A. -- a CTC charge; transmission and distribution
14 charges; and an energy and capacity charge. All of these charges are the result of
15 negotiations among the Joint Petitioners and are therefore not necessarily precise
16 reflections of the exact cost amounts that PECO would be able to recover based on its
17 own cost of service and market value studies. Accordingly, to address ancillary services,
18 PECO need only identify the category or categories of charges in which it will assume
19 ancillary services are included.
20

21 Q. **What are the specific ancillary services and how will PECO treat them under the
22 Partial Settlement?**

1 A. The FERC has determined that there are six services ancillary to the provision of
2 transmission service over which it has jurisdiction. These are:

3

4 1. Scheduling, System Control and Dispatch Service

5 2. Reactive Supply & Voltage Control from Generation Sources

6 3. Regulation and Frequency Control

7 4. Energy Imbalance

8 5. Operating Reserve - Spinning Reserve

9 6. Operating Reserve - Supplemental Reserve Service

10

11 When PECO is providing generation and transmission service, PECO will not assess any
12 additional charge on any customer to recover the costs associated with these services.

13 Rather, PECO's recovery of the costs of these services will be through the rates set forth
14 in the Partial Settlement. Since the costs associated with three of these services --

15 regulation and frequency control, energy imbalance, and operating reserve - spinning

16 reserve -- are included in the model Dr. Hieronymus used to project the market price of

17 energy and capacity, PECO will recover these costs, if at all, through its market energy

18 and capacity charges. PECO will recover the costs associated with the remaining three

19 services through its capped transmission charges.

20

21

22 Q. But hasn't PECO previously stated that it would remove ancillary service costs from

1 its bundled rates, meaning that PECO should reduce one or more of the charges
2 listed on Table A?

3 A. Mr. Pratzon so indicated in his rebuttal testimony. However, that was in the context of a
4 fully contested proceeding in which PECO proposed and expected to recover all of its
5 stranded and other costs supported by its market value and cost of service studies.
6 PECO's expectation now is different. Under the Partial Settlement, PECO will have the
7 opportunity to recover amounts that reflect a compromise among the Joint Petitioners.
8 PECO's current commitment, under the Partial Settlement, is that it will not assess any
9 additional charges for ancillary services, and that it will recover those costs through its
10 capped energy and capacity or transmission charges. Accordingly, there is no need to
11 reduce any of the charges in Table A by any amount associated with ancillary services.

12
13 Q. Will retail customers pay PECO unbundled transmission charges if they obtain
14 supply from a competitive supplier?

15 A. Not if PECO's expectations regarding transmission service come to fruition. PECO
16 expects that by the beginning of the phase-in to direct access in 1999, the PJM will have
17 the systems in place to accommodate direct requests for transmission service from eligible
18 customers under the PJM Open Access Tariff. Under that tariff, an eligible customer can
19 be either a competitive supplier or an end-use retail customer that can satisfy all of the
20 requirements of the tariff. If a competitive supplier obtains transmission directly from the
21 PJM, then PECO would not charge the supplier's customers for transmission service -- the
22 supplier would do so. Similarly, if an end-use customer obtains service directly from the

1 PJM, that end-use customer would not pay PECO an unbundled transmission rate either.

2

3 Q. What if the PJM is not able to accommodate such direct requests for transmission
4 service?

5 A. As long as the PJM cannot accommodate such requests, as will be the case during
6 PECO's Pilot, PECO will act as agent for suppliers, and obtain all of the required
7 transmission service from the PJM. If that is necessary, PECO will develop and submit for
8 FERC approval an appropriate agency agreement that deals with the situation as it exists
9 at that time. If the arrangement calls for PECO to continue charging customers for
10 transmission, PECO will comply with the transmission rate cap set forth in the Partial
11 Settlement. As soon as the PJM is able to handle direct requests, however, PECO would
12 discontinue this agency service to enable suppliers or customers to get their own
13 transmission service should they choose to do so.

14

15 Q. Once the PJM is fully able to accommodate direct requests for transmission service,
16 will PECO charge any retail customers for transmission service?

17 A. Yes. PECO will be the supplier of last resort through the transition period. To serve
18 "supplier of last resort" customers, PECO will have to do what any other supplier will
19 have to do -- obtain transmission service from the PJM to enable service of such
20 customers' loads. To recover the costs it incurs to obtain transmission for supplier-of-
21 last-resort customers, PECO will impose unbundled transmission charges that will not
22 exceed the capped levels set forth in Table A through the year 2003.

1 Q. Did the Commission, in its October 2, 1997 Tentative Order, request that the parties
2 address any other issues in the context of this proceeding?

3 A. Yes. The Commission requested that the parties brief all issues that the Electric
4 Competition Act requires utilities to address in their restructuring plan filings. In
5 particular, the Commission requested that the parties address "procedures for ensuring
6 direct access" and employee impacts. PECO will address these issues in its Briefs.

7
8 With regard to procedures for ensuring direct access, PECO previously explained, in its
9 Comments to the October 2, 1997 Tentative Order filed on October 6, 1997, that it
10 believes the Commission should address these issues in the context of PECO's Pilot
11 proceeding. In that proceeding, PECO has proposed and submitted to the Commission a
12 document entitled "PECO Energy Customer Choice Pilot Policies and Procedures" for use
13 during the Pilot. The policies and procedures set forth therein will be the starting point for
14 the development of final policies and procedures to ensure direct access. A copy of
15 PECO's comments to the October 2, 1997 Tentative Order, as well as the Pilot Policies
16 and Procedures themselves (not including informational appendices), are attached as
17 Exhibit TPH-32.

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VI. CONCLUSION

Q. Do you have any other comments that you would like to make with respect to the opposing parties' testimony?

A. Yes. I believe that the Electric Competition Act was designed to balance the interests of numerous parties, and had numerous purposes to reflect that balance. For example, the Act was designed to lower rates for consumers, to introduce competition into the industry over a transition period, to protect consumers during that transition period through rate caps, and to provide for the just and reasonable recovery of stranded investment. The Partial Settlement does all of those things. Enron and MAPSA, however, apparently are not content with this balance, but instead want PECO, its customers and its shareholders to subsidize their attempts to compete. Indeed, it is clear that what Enron and MAPSA are saying in this proceeding is that the only way to drive generation prices down in the long-term is to drive those prices up in the short-term, with Enron and MAPSA using the short-term excess prices to subsidize their long-term competitive efforts. This is not what the General Assembly had in mind, and it certainly is not in the public interest.

I would also state that when this Commission was investigating competition and establishing the policy framework for all of the events that have followed, Enron came before the Commission and stated in no uncertain terms that it was prepared to compete without such subsidization. Enron's Senior Vice-President of Regulatory Affairs, Mr. Steven Kean, told the Commission that there would be three sources of savings, or "net

1 benefits", that would be available under retail competition: (1) lower cost bulk power
2 brought in from other regions of the country; (2) low supplier costs -- "somebody who has
3 lower overhead, lower costs, somebody who is lean and mean and requires a very small
4 margin"; and (3) the offering of services other than the "standard rates" being offered
5 today.^{1/} Mr. Kean asked the Commission to implement competition in order to achieve
6 these "net benefits".

7
8 Now competition is the law, and Enron is telling us that: (1) there is no lower cost bulk
9 power available; (2) its supplier costs are going to be high, and it needs relief from the rate
10 caps in order to cover those costs and its margins, and (3) the "other services" it was
11 prepared to offer will not enable it to compete head-on.

12
13 These are classic bait and switch tactics, and Enron should not be allowed to use them
14 here in Pennsylvania. Enron asked that competition be implemented and made broad
15 promises that competition would result in specific benefits. Now Enron is attacking the
16 Partial Settlement on the grounds that none of those benefits will exist and that it needs
17 additional help and subsidization to compete. It would be very poor public policy to
18 condone such behavior by an entity which wants to be a major player in consumer affairs
19 in the Commonwealth.

20

^{1/} Transcript of testimony of Mr. Steven Kean before the Pennsylvania Public Utility
Commission, February 1, 1996, pp. 991-992.

1 Q. Does that conclude your rejoinder testimony?

2 A. Yes, it does.

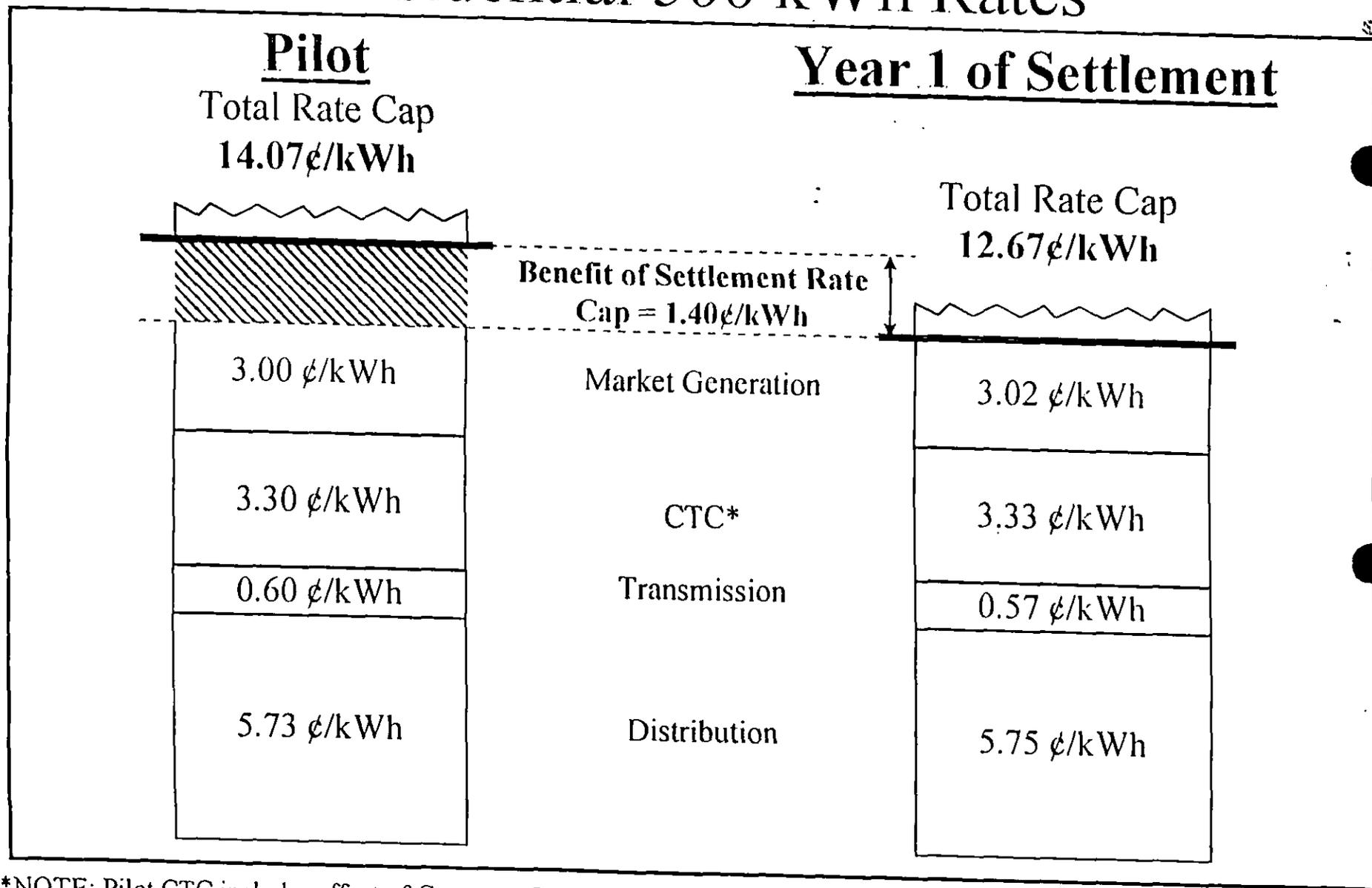
**Wholesale Market Price Forecasts of
Other Pennsylvania Companies
¢/kWh**

Year	PHB-DRI	PHB-EIA	PP&L	GPU	APS (a)	DQE (a)	Penn Power (a)
1999	2.20	2.21	2.45	2.35	2.06	2.27	2.22
2000	2.44	2.41	2.63	2.64	2.23	2.37	2.27
2001	2.75	2.71	2.83	2.78	2.42	2.48	2.37
2002	2.88	2.81	2.97	2.90	2.63	2.59	2.48
2003	3.02	2.92	3.06	3.03	2.85	2.71	2.60
2004	3.16	3.03	3.15	3.17	3.10	2.83	2.73
2005	3.30	3.16	3.10	3.30	3.37	2.96	2.87
2006	3.44	3.29	3.21	3.38	3.47		3.01
2007	3.58	3.43	3.47	3.46	3.57		3.16
2008	3.73	3.58	3.58	3.51	3.69		3.31

(a) Includes 0.4¢ in transmission charges

PECO Energy Company

Residential 500 kWh Rates



*NOTE: Pilot CTC includes effect of Customer Participation Credit and Settlement CTC reflects 10% discount.

**COMPARISON OF ENRON AND MAPSA 1999 RETAIL PRICES
TO
OCA AND PAIEUG WHOLESALE PRICES CONVERTED TO RETAIL**

	<u>1999 Retail Price</u>	<u>% Higher than OCA</u>	<u>% Higher than PAIEUG</u>
ENRON	4.01	34.11%	23.01%
MAPSA	3.83	28.09%	17.48%
OCA	2.99	---	---
PAIEUG	3.26	---	---



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October 8, 1997

By Hand Delivery

Honorable Marlane R. Chestnut
Honorable Charles E. Rainey, Jr.
Administrative Law Judges
1302 Philadelphia State Office Building
1400 West Spring Garden Street
Philadelphia, PA 19130

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

RECEIVED
PHILADELPHIA STATE OFFICE
OCT 10 1997

Dear Judge Chestnut and Judge Rainey:

Attached is PECO Energy's Rejoinder Testimony in Support of the Joint Petition for Partial Settlement:

Thomas P. Hill, Jr.	PECO St. No. 1-RJ
Alan B. Cohn	PECO St. No. 3-RJ
William H. Hieronymus	PECO St. No. 6-RJ
Robert A. Clemmer	PECO St. No. 12-RJ
James I. Warren	PECO St. No. 9-RJ
Michael S. Freeman	PECO St. No. 26-RJ

The Joint Petitioners are engaged in active settlement discussions with the Environmentalists and expect to conclude those discussions shortly. The Environmentalists have agreed that, if settlement is not reached, the Joint Petitioners may file testimony in response to the testimony submitted by Environmentalist witnesses Shoengold and Biewald in hand on Monday, October 13th. PECO in turn will make its witnesses available for cross-examination by the Environmentalists on Wednesday, October 15th and Thursday, October 16th (i.e., at least two days after the responsive testimony is filed next Monday).

Sincerely,

Paul Bonney
PRB/mbo
Attachments

cc: Certificate of Service
Jim McNulty, Acting Secretary (cover ltr. only)

Certificate of Service

I hereby certify that I have this date served the following Rejoinder Testimony in Support of the Joint Petition for Partial Settlement, Docket No. R-00973953 by facsimile, first class or overnight/express mail, upon the persons addressed below:

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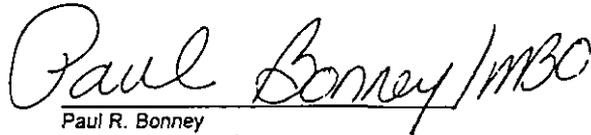
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Dated: October 8, 1997

R 00973953

PECO STATEMENT NO. I-SR

Phila 10/14, 10/15, 10/16/97
E. Holbert

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

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

SUPPLEMENTAL REBUTTAL TESTIMONY

OF

THOMAS P. HILL, JR.

**Regarding The Joint Petition For Partial
Settlement Of Proposed Restructuring Plan
And Application For A Qualified Rate Order**

DOCKETED
OCT 22 1997
UTILITY SERVICE OFFICE

**DOCUMENT
FOLDER**

**SUPPLEMENTAL REBUTTAL TESTIMONY
OF THOMAS P. HILL, JR.**

Q. Please state your name and business address.

A. Thomas P. Hill, Jr., PECO Energy Company ("PECO" or the "Company"), 2301 Market Street, Philadelphia, PA 19103.

Q. What is your current position at PECO?

A. I am Vice President and Controller.

Q. Please describe your educational background.

A. I graduated from Lehigh University in 1970 with a B.S. in Industrial Engineering. I received my Master of Business Administration from Lehigh University in 1974. In 1986, I completed the Executive Development Program at Cornell University's Johnson Graduate School of Management.

Q. Have you previously participated in this proceeding?

A. Yes. I submitted direct testimony (PECO St. 1) and various supporting exhibits (Exhibits TPH-1 through TPH-14) with PECO's April 1, 1997 restructuring filing. A statement of my qualifications is contained in my direct testimony. I later submitted supplemental direct testimony (PECO St. 1-S) and an accompanying exhibit (TPH-15) in which I responded to certain questions posed by Commissioner Hanger. In addition, on July 18, 1997, I submitted rebuttal testimony (PECO St. 1-R) and accompanying exhibits (Exhibits TPH-16 through TPH-25) in which I updated PECO's stranded cost claim and responded to various proposals advanced by other parties to this proceeding.

Q. What is the purpose of your supplemental rebuttal testimony?

A. On August 27, 1997, PECO and ten other parties filed with the Presiding Administrative Law Judges a Joint Petition For Partial Settlement Of PECO Energy Company's Proposed Restructuring Plan And Application For A Qualified Rate Order (the "Joint Petition"). The purpose of this testimony is to explain why approval of the Joint Petition without modification is in the public interest.

Q. Why, in PECO's view, is approval of the proposed Partial Settlement in the public

interest?

A. The principal reasons why PECO believes that the proposed Partial Settlement is in the public interest are set forth in PECO's August 27, 1997 Statement In Support Of The Joint Petition, a copy of which has been appended to my supplemental rebuttal testimony as Exhibit TPH-26. As noted in the Company's Statement, the proposed Partial Settlement provides that (1) customers will receive significant rate reductions; (2) the advent of customer choice and competition will be accelerated; (3) universal service coverage will be substantially expanded; (4) statewide consumer education initiatives will be augmented; (5) PECO's financial integrity will be preserved; (6) the funding of nuclear decommissioning obligations will be assured; (7) the securitization of stranded assets will be facilitated; (8) substantial litigation and associated costs will be avoided; and (9) a cloud over the Electric Competition Act will be reduced.

Q. Are there any other factors which you believe should be considered by the Presiding Administrative Law Judges and the Commission?

A. Yes. The Partial Settlement contains extra-statutory concessions on PECO's part which will further enhance the transition to competition, including: (1) a 10% rate reduction which will become effective four months prior to the advent of retail competition in Pennsylvania; (2) the acceleration, by a year, of the dates on which two-thirds of PECO's customers would otherwise be entitled to shop for generation; and (3) the extension, by an

additional thirty months, of the cap on PECO's transmission and distribution rates.

Q. Why are these concessions important?

A. They are important because, under the Partial Settlement, PECO's customers are **guaranteed** substantial rate relief while, at the same time, are provided the opportunity to achieve even greater savings depending on competitive market conditions. If the market price for capacity and energy clears at levels below those set forth in Table A to the Joint Petition, customers will be free to avail themselves of those lower prices. If, on the other hand, market prices escalate beyond current expectations, customers will be shielded from such increases through the end of the year 2008 by virtue of the agreed-upon generation rate caps. This combination of rate relief, rate protection and freedom to shop assures that customers will derive significant benefits irrespective of how competitive markets evolve.

Q. Does this conclude your supplemental rebuttal testimony?

A. Yes, it does.

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY	:	
COMMISSION	:	
	:	
v.	:	DOCKET NO. R-00973953
	:	
PECO ENERGY COMPANY	:	

PECO ENERGY COMPANY'S STATEMENT
IN SUPPORT OF THE JOINT PETITION FOR
PARTIAL SETTLEMENT OF PROPOSED RESTRUCTURING PLAN
AND APPLICATION FOR A QUALIFIED RATE ORDER

...

TO THE HONORABLE MARLANE R. CHESTNUT AND CHARLES E. RAINEY, JR.
(THE "PRESIDING ADMINISTRATIVE LAW JUDGES"):

Nine months ago, the General Assembly enacted, and Governor Ridge signed, the Electricity Generation Customer Choice and Competition Act (66 Pa. C.S. §§ 2801 et. seq.)(the "Electric Competition Act"). Through the tireless coalition-building efforts of Chairman John M. Quain, the Electric Competition Act pieced together the statutory framework needed to implement Governor Ridge's strategic vision of restructuring the Commonwealth's electric industry.

Like the Electric Competition Act, the Joint Petition for Partial Settlement of PECO Energy Company's Proposed Restructuring Plan and Application for a Qualified Rate Order (the "Joint Petition") represents the culmination of long and difficult negotiations by and among a broad range of parties. Despite their diverse interests, however, the Joint Petitioners, in an

extraordinary showing of cooperation and determination, have been able to craft an agreement that will place Pennsylvania at the forefront of the nation's move to retail electric competition.

PECO Energy Company ("PECO" or the "Company") submits that the Partial Settlement is fully consistent with the letter and the spirit of the Electric Competition Act in that it (1) provides meaningful rate relief; (2) promotes customer choice and open retail competition; (3) maintains and, indeed, substantially expands upon existing customer assistance programs; (4) commits PECO to augment any Statewide consumer education program with utility-specific initiatives; and (5) permits PECO an opportunity to recover a just and reasonable level of stranded costs and, thereby, to preserve its financial integrity. For these and the other reasons set forth below, PECO requests that the Joint Petition be approved without modification.

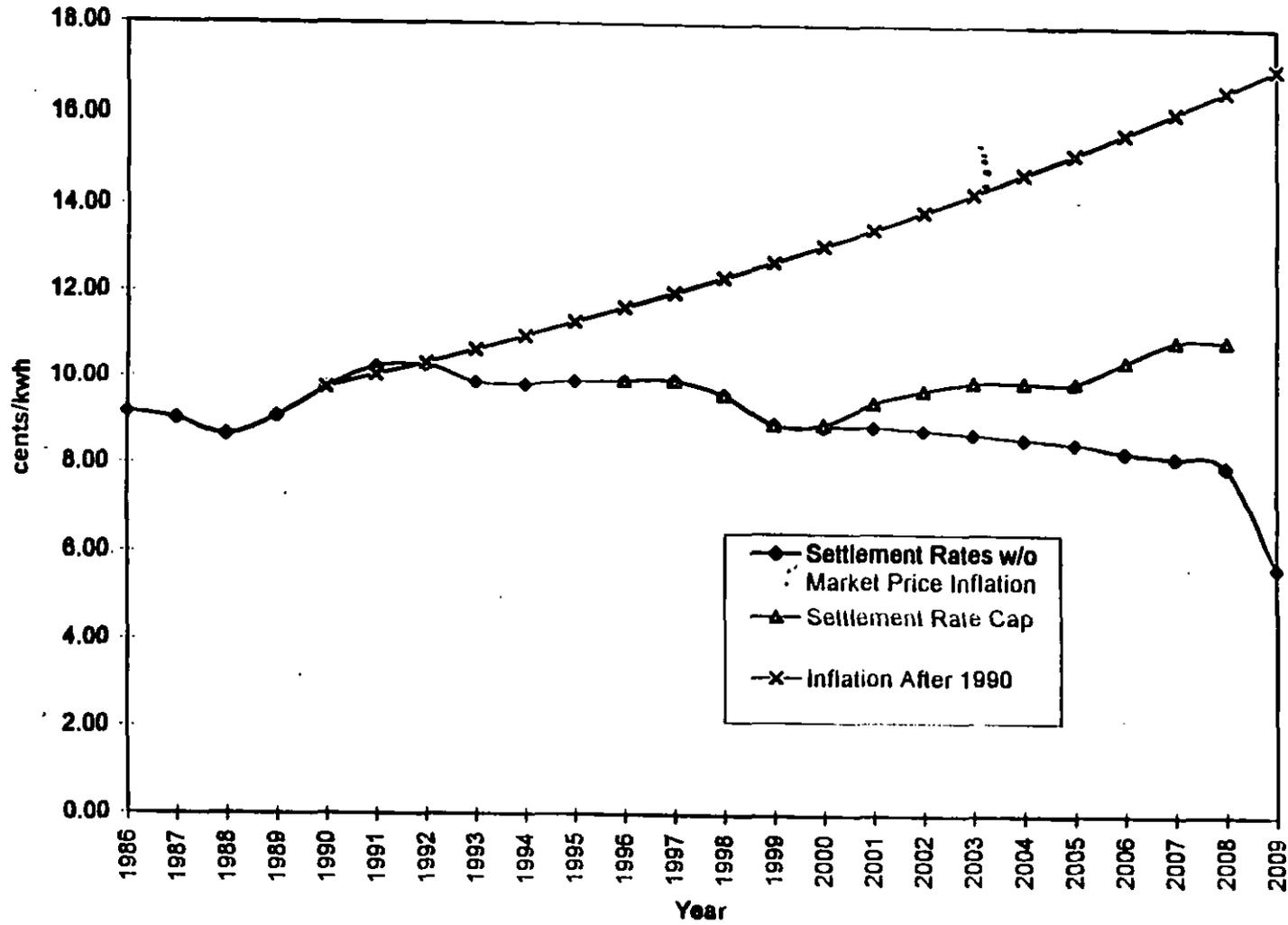
1. Customers Will Receive Significant Rate Reductions. The Partial Settlement provides for a guaranteed 10% across-the-board rate reduction effective September 1, 1998, or four months prior to the advent of retail competition in Pennsylvania, and additional annual reductions in the competitive transition charge extending through December 31, 2008. PECO believes that such reductions are the largest – and the earliest -- to which any electric utility in the country has publicly committed in order to advance the transition to competition.

Customers will further benefit from PECO's agreement to extend the statutorily-imposed "caps" on its transmission and distribution rates from June 30, 2001 to January 1, 2004 and on its generation rates from December 31, 2005 to December 31, 2008. Since PECO has also committed to remain the "provider of last resort" through December 31, 2008, customers who continue to purchase their electric generation supply from PECO will enjoy a virtually unprecedented era of rate stability. In fact, as illustrated on the graph on the next page, for the 15

years ending in 2005, PECO's average system charges on a nominal basis will remain near or below its 1990 charges. Rates will continue to be capped at a slightly higher level until 2008 – for a total of 18 years of rate stability. The benefit to customers can best be appreciated by comparing the settlement rate levels to the rates adjusted since 1990 to reflect inflation: the average per kilowatt-hour ("kwh") charge in the year 2008 will be 34% less than inflation-adjusted rates if the Company's charges are at the settlement rate cap; the comparative levels could be as much as 52% below inflation-adjusted levels if the market price of energy and capacity does not inflate during competition.^{1/}

¹ Further assuming no intervening increase in transmission or distribution rates.

PECO Energy Company-Electric Operations
Actual/Projected Settlement Charges Compared to Inflation After 1990
 in cents/kwh-System Average Rates



2. The Advent of Customer Choice and Competition Will Be Accelerated. The Partial Settlement accelerates the transition to competition such that **all** of PECO's customers will have direct access to alternative generation suppliers by the year 2000, **a year earlier than mandated by the Electric Competition Act.** Under the Joint Petition, one-third of the Company's customers will be able to choose suppliers on January 1, 1999, another third on January 2, 1999, and the final third on January 2, 2000. Moreover, PECO's agreement to (a) separate its generation functions from its regulated transmission/distribution functions and (b) file tariff provisions to facilitate the installation and operation of renewable energy will promote the development of fair and open competition.

3. Universal Service Coverage Will Be Substantially Expanded. The Partial Settlement builds upon PECO's successful Customer Assistance Program ("CAP") Rate pilot and provides for open enrollment for eligible customers in that program, subject to an initial maximum participation level of 100,000 customers which will be reviewed as this level is approached. As such, PECO's existing customer assistance programs, which already dwarf those of all other electric utilities in the Commonwealth, could more than double their enrollment in the next several years.

4. Statewide Consumer Education Initiatives Will Be Augmented. The Partial Settlement calls on the Joint Petitioners to cooperate with one another in developing a Commission-approved Consumer Education Program. PECO also commits to augment any Statewide Consumer Education Program with its own initiatives to provide Company-specific information to its customers.

5. **PECO's Financial Integrity Will Be Preserved.** The Partial Settlement requires PECO to write off at least \$2.0 billion of stranded assets and costs. Significantly, however, the Partial Settlement is intended to preserve PECO's long-term financial integrity which is critically important if PECO is to (a) continue to provide safe and reliable transmission and distribution service and (b) fulfill its obligations as provider of last resort for those customers who choose not to purchase power from an alternative supplier.

6. **The Funding Of Nuclear Decommissioning Obligations Will Be Assured.** The Partial Settlement enables PECO to recover a \$234 million deficiency in nuclear decommissioning funds and establishes a tracking mechanism which will ensure that sufficient funds are collected should projected decommissioning cost levels change from current estimates.

7. **The Securitization Of Stranded Assets Will Be Facilitated.** The Partial Settlement provides for the Commission to issue a Qualified Rate Order authorizing PECO to securitize up to \$4.0 billion of its recoverable stranded assets and costs. The opportunity to refinance existing debt and/or to buy back preferred stock and common equity will enable PECO to fulfill the rate reductions set forth in the Joint Petition.

8. **Substantial Litigation And Associated Costs Will Be Avoided.** The Partial Settlement amicably resolves a number of important and contentious issues raised in the proceeding and frees up the Joint Petitioners to explore additional areas of potential compromise.

9. **A Cloud Over The Electric Competition Act Will Be Reduced.** The Partial Settlement provides for the withdrawal by some parties of various actions currently pending

before the Commonwealth Court which challenge the constitutionality of the Electric Competition Act. This is a substantial step toward resolving these court challenges without litigation. If these cases were to be litigated to conclusion, it is possible that customers could be denied the benefits of competition for years.

In summary, PECO believes that the Partial Settlement advances the interests of all stakeholders and submits that prompt approval of the Joint Petition will send a strong message to suppliers and consumers alike that Pennsylvania has opened its doors to the new era of retail electric competition.

...

Respectfully submitted,



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Dated: August 27, 1997

Certificate of Service

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

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Dated: September 17, 1997

P-009739531 R-00973453C0001-
C0007

PECO STATEMENT NO. 1-SRJ

Phila 10/14/97
C. Helmut

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

~~EXTRA
COPY~~

SUPPLEMENTAL REJOINDER TESTIMONY

OF

THOMAS P. HILL, JR.

Regarding Objections To The Joint Petition
For Partial Settlement Of PECO Energy
Company's Proposed Restructuring Plan And
Application For A Qualified Rate Order

RECEIVED
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SUPPLEMENTAL REJOINDER TESTIMONY OF THOMAS P. HILL, JR.

Q. Please state your name and business address.

A. Thomas P. Hill, Jr., 2301 Market Street, Philadelphia, PA 19103.

Q. By whom are you employed and in what capacity?

A. I am employed by PECO Energy Company ("PECO" or the "Company") as Vice President and Controller.

Q. Have you previously participated in this proceeding?

A. Yes. I submitted direct testimony (PECO St. 1) and various supporting exhibits (Exhibits TPH-1 through TPH-14) with PECO's April 1, 1997 restructuring filing. A statement of my qualifications is contained in my direct testimony. I later submitted supplemental direct testimony (PECO St. 1-S) and an accompanying exhibit (TPH-15) in which I responded to certain questions posed by Commissioner Hanger. On July 18, 1997, I submitted rebuttal testimony (PECO St. 1-R) and accompanying exhibits (Exhibits TPH-16 through TPH-25) in which I updated PECO's stranded cost claim and responded to various proposals advanced by other parties to this proceeding. On September 17, 1997, I submitted supplemental rebuttal testimony (PECO St. 1-SR) and accompanying exhibits (Exhibits TPH-26 through TPH-28) in which I explained why, in PECO's view, approval of the August 27, 1997 Joint Petition For Partial Settlement Of PECO Energy Company's Proposed Restructuring Plan And Application For A Qualified Rate Order (the

"Joint Petition") is in the public interest. Finally, on October 8, 1997, I submitted rejoinder testimony responding to objections to the Joint Petition expressed by Enron and the Mid-Atlantic Power Supply Association ("MAPSA").

Q. What is the purpose of your supplemental rejoinder testimony?

A. The purpose of my supplemental rejoinder statement is to respond to the supplemental testimony submitted by Environmentalists witnesses Biewald and Schoengold.

Q. Please summarize the testimony submitted by Messrs. Biewald and Schoengold.

A. Mr. Biewald essentially focuses on three issues -- (1) nuclear decommissioning cost recovery and funding procedures, (2) the treatment to be accorded spent nuclear fuel expense and low level radioactive waste storage costs and (3) environmental disclosure. Mr. Schoengold evaluates the Partial Settlement on the basis of its alleged impact on the environment, customers and competition and its consistency with the Electric Competition Act. To a large extent, however, Mr. Schoengold's supplemental testimony simply repeats points made in his direct testimony to which PECO has already responded.

Q. With respect to nuclear decommissioning, Mr. Biewald would establish specific procedures to address possible decreases in the required funding amount and would impose restrictions on the use of decommissioning funds to ensure that they are used for decommissioning activities. Do you object to either of these proposals?

A. No, I do not. In fact, PECO would be pleased to work with the Environmentalists to develop appropriate language for inclusion in a Commission Order approving the Partial Settlement.

Q. **Mr. Biewald further contends that any requested increase in decommissioning cost recovery should “trigger a cost-benefit analysis” of the economics of continued operation of the nuclear unit in question. Please comment.**

A. As the party with the burden to justify any increase in rates, PECO will determine what proof it needs to submit in order to support a claim for additional nuclear decommissioning costs. In some instances, this may entail a “cost-benefit analysis” of the kind envisioned by Mr. Biewald; in other instances, such an analysis may not be required. In any event, intervening parties would always be free to present evidence on the economics of continued operation if they saw fit to do so.

Q. **Mr. Biewald next argues that the costs associated with the temporary and permanent disposal of spent nuclear fuel should be recovered through market revenues and not be lumped together with nuclear decommissioning costs/funds. Do you agree?**

A. With regard to permanent disposal of spent nuclear fuel, I agree that these costs should be recovered through market revenues. I disagree, however, that PECO needs to create a separate spent nuclear fuel fund for this purpose since dollars are already remitted directly

to the Department of Energy on a fixed cents per kilowatt-hour basis as the fuel is consumed. Costs associated with temporary disposal of spent nuclear fuel have been reflected in the analysis of Mr. LaGuardia as a normal cost of decommissioning.

Q. Mr. Biewald urges the Commission to “read out” of the Partial Settlement’s transmission and distribution rate increase provisions the recovery of low-level nuclear waste costs. Please respond.

A. PECO has committed, in the Partial Settlement, to dispose of low-level radioactive waste in a timely manner, consistent with NRC regulations. It is the Company’s intent to continue routine shipments of low-level waste resulting from the ongoing operation of our plants. At the end of plant life, the cost of decommissioning will include disposal of low-level waste as described by Mr. LaGuardia and does not reflect an inordinate buildup at the end of service life.

Q. Finally, Mr. Biewald discusses at length the need for “environmental disclosure”. Please comment.

A. Mr. Biewald’s observations are substantially the same as those which he offered in his direct testimony. Since Ms. King addressed his proposals in her rebuttal testimony (PECO St. 17-R), no further response is required.

Q. You previously indicated that other PECO witnesses have already addressed many of the issues raised by Mr. Schoengold in his supplemental testimony. Is that

correct?

A. Yes. The rebuttal testimony submitted by the following PECO witnesses provides a sufficient response to most of Mr. Schoengold's arguments: Dr. Hieronymus, as to the quantification and "sharing" of stranded costs (PECO St. 6-R); Mr. Cohn, as to the appropriate allocation of stranded costs between wholesale and retail customers (PECO St. 3-R); Mr. Bustard, as to targeted transmission and distribution system planning and additional mitigation potential (e.g., DSM) (PECO St. 4-R); and Mr. Brennan, as to historic returns achieved by PECO's shareholders (PECO St. 11-R).

Q. To which portions of Mr. Schoengold's supplemental testimony will you respond?

A. I will address the following contentions: (1) that the Partial Settlement will enable PECO to recover more than the agreed-upon amount of stranded costs; (2) that securitization will provide PECO a massive cash infusion which can be used for anti-competitive purposes; (3) that the \$2.3 billion valuation placed on the transfer of PECO's generating facilities to a non-regulated affiliate understates their market value; and (4) that PECO should contribute \$24 million of securitization proceeds toward conservation and renewable resource projects.

Q. Is Mr. Schoengold correct in asserting that PECO will likely overrecover its stranded costs under the Partial Settlement?

A. No, he is not. In fact, Mr. Schoengold has made the same mistakes that Messrs. Mitnick and Johnstone made in their analyses and that Mr. Cohn and I described in our rejoinder testimony -- (1) the erroneous comparison of stranded asset costs with a discounted stream of revenues required to recover those costs, recoup the necessary taxes on that revenue stream and earn a return on the unamortized balance; (2) the use of unsupportable assumptions, including estimates of future sales which will not materialize; and (3) the failure to recognize and consider the costs to PECO of other components of the Partial Settlement.

Q. Mr. Schoengold also contends that the securitization provisions of the Partial Settlement will enable PECO “to effortlessly outspend [competitors] in advertising and temporary customer discounts” (p. 16). Is there any truth to this assertion?

A. No, there is not. As Mr. Schoengold should be aware, the Electric Competition Act imposes stringent restrictions on the use of securitization proceeds. The Qualified Rate Order attached as Appendix D to the Joint Petition is entirely consistent with the Act and would preclude PECO from using such funds in the manner contemplated by Mr. Schoengold.

Q. Mr. Schoengold argues that PECO’s generating facilities have a market value in excess of the \$2.3 billion transfer price set forth in the Joint Petition. Please comment.

A. Mr. Schoengold reaches this conclusion by comparing the implicit per kW valuation of PECO's generating facilities, which he calculates to be \$250, to the corresponding price recently paid by US Generating for certain NEES plants, which he claims to be \$320 per kW. What Mr. Schoengold neglects to mention is that the NEES units were all fossil or hydro plants, while the value assigned to PECO's facilities represents an average figure for nuclear, fossil and hydro units. If nuclear units are stripped out of the calculation, the implicit value assigned to PECO's fossil and hydro facilities under the Partial Settlement is \$383 per kW, or substantially above the market price realized by NEES.

Q. Finally, Mr. Schoengold suggests that \$24 million of securitization proceeds should be directed toward conservation and renewable resource projects. Do you agree?

A. No. The purpose of the securitization proceeds, as defined in the Electric Competition Act, is to principally reduce its stranded costs (repurchase of debt and equity). There is no provision under the Act made for special funding of such projects.

Q. Does that conclude your supplemental rejoinder testimony?

A. Yes, it does.