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Pennsylvania Public Utility Commission

Application of PECO Energy Company for
Approval of its Restructuring Plan Under
Section 2806 of the Public Utility Code

Docket No. R-00973953

Testimony of

Donald E. Johnstone

On Behalf of

Mid-Atlantic Power Supply Association

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Brubaker & Associates, Inc.
St. Louis, MO 63141-2000

1 Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

2 A My name is Donald E. Johnstone and my business address is 1215 Fern Ridge
3 Parkway, Suite 208, St. Louis, MO 63141-2000.

4

5 Q BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

6 A I am a principal with the firm of Brubaker & Associates, Inc. Brubaker & Associates,
7 Inc. and its predecessor firms have provided a wide range of economic and
8 regulatory consulting services for many years. More details are set forth in Appendix
9 A to this testimony.

10

11 Q ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?

12 A I am appearing on behalf of the Mid-Atlantic Power Supply Association.

13

14 Q WHAT IS THE PURPOSE OF YOUR TESTIMONY?

15 A The purpose is to address issues important to the development of a competitive retail
16 market for electric generation and, more specifically, to make recommendations in
17 regard to the generation supply rate and the several actions and protections that are
18 necessary to develop a level playing field among competing generation
19 suppliers. My testimony is in the context of the current circumstances that exist in
20 Pennsylvania.

21

22 Q PLEASE SUMMARIZE YOUR TESTIMONY.

23 A My testimony may be summarized as follows:

- 1 1. The Commission, in this proceeding, should require several important
2 changes in the PECO restructuring plan. These changes are necessary to
3 foster the development of a market for retail generation supply in which
4 competitive forces will operate for the benefit of consumers.
- 5 2. As a product of history, PECO begins the new era with vertical and horizontal
6 market power derived from its monopoly position in the market. There must
7 be changes in the restructuring plan to reduce the probability of continuing
8 market power that would thwart retail competition.
- 9 3. There must be a generation rate component higher than that proposed by
10 PECO to provide a reasonable opportunity for competition to flourish during
11 the initial transition and during the period of transition charges to consumers.
- 12 4. Costs must be appropriately allocated between the continuing monopoly
13 services and competitive services. Specific problems are identified.
- 14 5. There should be a more explicit code of conduct as set forth in Exhibit DEJ-1.
15 This is necessary to promote fair and equitable treatment among competitors
16 and to head off any inappropriate uses of sensitive business information.
- 17 6. Billing and metering procedures must not provide any unfair burden or
18 unwarranted benefits for either PECO or new suppliers. New suppliers should
19 have the right to install and read billing meters and should not be precluded
20 from providing customers with a single bill for supply and delivery services.

21
22 **INTRODUCTION**

23 **Q IS IT YOUR UNDERSTANDING THAT A COMPETITIVE RETAIL MARKET FOR**
24 **ELECTRIC GENERATION IS THE GOAL OF THE COMMONWEALTH OF**

1 **PENNSYLVANIA?**

2 A Yes.

3

4 **Q IN ECONOMIC THEORY, WHAT ARE THE CHARACTERISTICS OF A**
5 **COMPETITIVE MARKET?**

6 A A competitive market is characterized by multiple buyers, multiple sellers, low
7 barriers to market entry and low transaction costs. In the absence of one or more of
8 these conditions, a buyer or seller may have the ability to distort the performance of
9 the market through unilateral action.

10

11 **Q HOW SHOULD THE RESTRUCTURING BE APPROACHED BY THE**
12 **COMMISSION?**

13 A There is a limited period of time during which a structure must be implemented that
14 will allow for competitive forces to operate on competing suppliers. In addition, the
15 competitive retail generation market must evolve from a concept to a reality. The
16 market powers formerly enjoyed by PECO must be broken down and, if possible,
17 eliminated as they relate to the competitive retail generation market.

18

19 **Q WHAT SHARE OF THE RETAIL MARKET DOES PECO PRESENTLY ENJOY?**

20 A By definition, PECO has been a regulated monopoly with 100% market share.

21

22 **Q DOES PECO HAVE MARKET POWER?**

23 A Yes. However, historically PECO's market power has been restrained by the
24 regulation of the Commission.

1 Q DOES PECO POSSESS MORE THAN ONE TYPE OF MARKET POWER?

2 A Yes. PECO has both what is characterized as "vertical market power" and what is
3 characterized as "horizontal market power". Vertical market power exists if there is
4 the ability to distort the competitive market through control of inputs to the production
5 process or product transportation routes. PECO's ownership of the transmission and
6 distribution system, as well as generation, results in vertical market
7 power. Horizontal market power is characterized by the ability to distort competitive
8 outcomes as a result of a dominant position in the market for a single end use
9 product or service. With a 100% market share, PECO certainly has horizontal
10 market power.

11

12 Q IS IT IMPORTANT TO CONSIDER BOTH VERTICAL AND HORIZONTAL MARKET
13 POWER IN THE EVALUATION OF THE PECO RESTRUCTURING PLAN?

14 A Yes. If competitive forces are to be relied upon to control the price of electricity
15 supplies, then it is important that both the vertical and horizontal market power of
16 PECO be eliminated during the transition period.

17

18 Q HOW SHOULD THE VERTICAL MARKET POWER OF PECO BE MINIMIZED OR
19 ELIMINATED IN THE RESTRUCTURING PLAN?

20 A Simply stated, the new suppliers that will be coming to the market must have the
21 same ability to use the monopoly services and delivery systems that PECO has.
22 There will need to be significant changes to the administration and operation of the
23 business to accomplish this goal. I will address a number of issues related to vertical
24 market power later in my testimony.

1 **HORIZONTAL MARKET POWER-PRICE CONSIDERATIONS**

2 **Q HOW SHOULD THE HORIZONTAL MARKET POWER OF PECO BE ADDRESSED**
3 **IN THE CONTEXT OF THE RESTRUCTURING?**

4 **A**The Commission must assure that there are no unnecessary or inappropriate
5 impediments to the ability of the new suppliers to enter the market and to compete.
6 Most fundamentally, the unbundled rate structure and prices should encourage, not
7 preclude competition. Once the transition is over, it will be more difficult to address
8 the remaining market imperfections because the continuing provisions of the
9 Competition Act that address market power do not offer direct remedies.

10
11 **Q WILL THE RESTRUCTURING PROPOSAL OF PECO LEAD TO A FULLY**
12 **COMPETITIVE RETAIL GENERATION SUPPLY MARKET?**

13 **A**No, there is reason for concern. PECO has proposed a generation rate that could
14 easily stifle competition. The rate would be so low that alternative suppliers are much
15 less likely to develop. With competition stifled, a high market share would be
16 maintained by PECO and that would mean PECO would have near monopoly market
17 power in the new retail generation market. The promise of competition would have
18 been thwarted, and consumers would then face the unregulated market power of
19 PECO.

20
21 **Q PLEASE SUMMARIZE THE METHOD FOLLOWED BY PECO TO DEVELOP THE**
22 **GENERATION RATE COMPONENT.**

23 **A**PECO has unbundled the proposed rates into four components: distribution,
24 transmission, a generation rate and a competitive transition charge. The

1 transmission, distribution and generation functional costs were developed from a
2 functionalized class cost of service study. Separately, an analysis was performed to
3 develop a competitive transition charge using a net present value approach. Finally,
4 the generation rate was developed by subtracting the distribution component, the
5 transmission component and the CTC component from the total present rate. In
6 other words, the generation rate is the remainder.
7

8 **Q WITH THE PECO APPROACH TO UNBUNDLING, IS THERE ANY REASON TO**
9 **BELIEVE THAT THE GENERATION RATE WILL BEAR A RATIONAL**
10 **RELATIONSHIP TO THE MARKET PRICE FOR THE SAME SERVICE?**

11 **A** No. There is no reason to expect an appropriate relationship between the market
12 price that may prevail and the proposed generation rate component of the unbundled
13 rates.
14

15 **Q WHAT IS THE PECO FORECAST OF MARKET PRICE FOR THE YEAR 1999?**

16 **A** PECO developed a forecast system average market price for the year based on the
17 assumption that each one of the system generating units would be replaced with
18 power and energy at the market prices (according to a forecast selected by PECO).
19 In fact, three such forecasts were prepared for PECO by three separate consultants.
20 Table 1 sets forth the three prices. They range from a low of 2.45¢ per kWh to 2.84¢
21 per kWh on the high end. The high forecast is 16% higher than the low forecast.
22 Thus there is a range of forecasts.

1

<u>PECO Consultant -</u>	<u>Price per kWh</u>
PHB	2.45¢
ICF	2.81¢
EDS	2.84¢
High as a percent of low	+16%

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In developing the competitive transition charge, PECO used the lowest of the three forecasts, that which begins in 1999 with the system average market price of 2.45¢.

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By assuming that the lower forecast is appropriate, the value of the generation plants based on the forecast market prices is lower. Consequently, the amount of the generation plant cost which exceeds the market price is larger and use of the lowest forecast of market prices produces the highest possible CTC.

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10

11 Q

HOW DOES THE RESIDENTIAL RATE COMPONENT PROPOSED BY PECO COMPARE TO THE FORECAST OF SYSTEM AVERAGE PRICES FOR 1999?

12

13 A

In order to make this comparison, the electrical losses, which are incurred in moving power from generation to the customer meter, must be added to the system average prices. Those losses are 10.3%. Thus, the forecast system average prices for 1999 must be increased by 10.3% and the range of system average forecast prices increases to a level of 2.70¢ per kWh to 3.13¢ per kWh. These may be compared to

14

15

16

17

1 the proposed residential rate component of 2.6¢ per kWh.

Table 2		
Residential Comparison of Proposed Rate and Forecasted 1999 System Average Price		
	Amount	Percent Above Proposed Rate
Proposed Rate	2.6¢	
Forecast Prices (With 10.3% losses)		
PHB	2.70¢	4%
ICF	3.10¢	19%
EDS	3.13¢	20%

2
3 Under any of the forecasts, the system average price, which is based on the system
4 average load factor, is significantly higher than the generation rate component of the
5 residential rate. This means that PECO will have a competitive advantage since its
6 proposed generation rate will be significantly less than any of the forecasts for market
7 prices. At the same time, all of its generation costs that exceed the 2.6¢ will be
8 collected through the proposed competitive transition charge.

9
10 **Q PLEASE EXPLAIN THE PROBLEM WITH THE GENERATION RATE**
11 **COMPONENT PROPOSED BY PECO FOR GENERATION SUPPLY.**

12 **A** First, PECO proposes a generation rate that will remain constant, while the several
13 forecasts that have been submitted by PECO all show that the market price will be
14 increasing significantly in the next several years. Second, the approach allows
15 PECO to establish an artificially low and anti-competitive price for its generation,

1 subsidized by its ability to recover a large portion of its fixed production costs in the
2 form of a transition charge (either a competitive transition charge or an intangible
3 transition charge or both). Third, as a result of the generation rate component being
4 low, it is quite likely that the artificially low rate would undercut the market price. As a
5 consequence, competition would be stifled, the competitive market would not
6 develop, and PECO would maintain a very high market share. In other words, PECO
7 would retain horizontal market power. If this condition were allowed to persist,
8 customers, at the end of the transition period, would find that the monopoly was still
9 largely intact. The Commission would then be in the position of seeking new
10 solutions to the horizontal market power problem when the opportunities that are
11 present as a part of the restructuring plan are gone.

12
13 **Q IS IT YOUR OPINION THAT PECO MUST LOSE RETAIL GENERATION MARKET**
14 **SHARE?**

15 **A** Yes. By definition, a competitive market must have, among other things, many
16 suppliers and any one or any few must not dominate. That is why there must, at a
17 minimum, be a level playing field as to prices, costs, terms and conditions to allow
18 new suppliers to become sufficiently established.

19
20 **Q PLEASE PROVIDE AN EXAMPLE WHICH ILLUSTRATES THE PROBLEM.**

21 **A** Please consider the residential rate as an example. Under the PECO proposal, there
22 is a transmission rate of approximately 0.5¢, a distribution rate of approximately 5.1¢
23 and a competitive transition charge (CTC) of 4.8¢. For the purpose of this illustration,
24 I will ignore the customer charge and the charges for usage over 500 kWh in the

1 summer. (This simplification will not change the conclusion and is, therefore,
2 appropriate for the purpose of illustration.) The sum of the transmission rate, the
3 distribution rate and the CTC amounts to 10.4¢ per kWh. The other significant
4 component of present rates is the cost of generation. PECO proposes a rate
5 component of 2.6¢ for generation. Hence, the total cost is 13.0¢. The calculation
6 may be summarized as follows:

Table 3	
Unbundled Rate Component	Proposed Residential Rates
Transmission (T)	0.5¢
Distribution (D)	5.1
Competitive Transition Charge (CTC)	<u>4.8</u>
Subtotal (T, D, CTC)	10.4¢
T, D, CTC	10.4¢
Generation Rate Component	<u>2.6</u>
Total	13.0¢

7
8 **Q ASSUMING ALL OF THE VARIOUS OTHER ISSUES WERE FAVORABLY**
9 **RESOLVED SO THAT THERE WAS EQUAL ACCESS TO THE CUSTOMER**
10 **THROUGH THE DISTRIBUTION SYSTEM, WOULD A NEW SUPPLIER BE ABLE**
11 **TO COMPETE BASED ON PRICE?**

12 **A** It is unlikely. The system average market price for 1999 used in the CTC calculation
13 is 2.45¢ per kWh. Adjusting only for the residential losses of 10.3% (electrical losses
14 incurred between the point of generation and the point of delivery at the customer
15 meter) the lowest 1999 forecast cost of power is 2.7¢ on a system average basis.
16 This 2.7¢ market price needs to be compared to the 2.6¢ generation rate component

1 (more detailed comparisons will follow). Any customer shopping on price would take
2 the proposed generation rate and any new supplier would be put in an unrealistic
3 position. The new supplier would have to somehow obtain power at a price lower
4 than the market and would have to supply that power to a customer with a
5 below-average load factor. The new supplier in this situation would also have to
6 absorb all of its marketing and transaction costs. Needless to say, this presents a
7 competitive problem.

8
9 **Q WHAT ARE THE OTHER FORECASTS OF MARKET PRICE SUBMITTED BY**
10 **PECO?**

11 **A** There are two others which were prepared by EDS and ICF. They are 2.84¢ per
12 kWh and 2.81¢ per kWh, respectively. After accounting for residential losses, these
13 forecasts of the system average market price for 1999 both translate into
14 approximately 3.1¢ per kWh at the residential meter. Thus, in order to compete for a
15 residential customer, a new supplier under these forecasts would have to deliver an
16 electrical supply to residential customers at a price 16% less than the forecast
17 system average market price while absorbing all marketing and transaction costs.
18 The problem faced by the new suppliers is illustrated in the following table. The
19 delivered cost from a new supplier would range from 13.1¢ per kWh to 13.5¢ per
20 kWh, depending on which of the PECO forecasts is assumed to be correct.

1

Table 4		
<u>Unbundled Rate Component</u>	<u>1999 Residential Cost With Power at System Average Market Price</u>	
	<u>Best Case</u>	<u>Worst Case</u>
T, D, CTC	10.4¢	10.4¢
New Supplier Generation Cost	<u>2.7¢</u>	<u>3.1¢</u>
Total	13.1¢	13.5¢

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Thus, according to the forecasts supplied by PECO, new suppliers would have a problem. With the regulated rate of 13.0¢, new suppliers would face competition from a regulated rate that was below the forecast market price of 13.1¢ to 13.5¢. From the perspective of the development of a competitive market, the in-roads into the PECO 100% market share would be limited and the monopoly would be preserved.

9

Q PLEASE SUMMARIZE THE PECO UNBUNDLED RATE PROPOSAL AND THE IMPACT OF THIS PROPOSAL ON COMPETITION IN 1999.

10

11

A PECO has proposed unbundled rates for the transmission, distribution, and generation components of service. The generation component is further broken down into a competitive transition charge and a generation rate component.

12

13

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17

At the same time, PECO has provided three forecasts of generation market prices. The generation rate component for residential customers, 2.6¢ per kWh, is the only part of the rate exposed to competition and it is lower than all three of PECO's forecasts of market price.

1 If a customer was to choose a new supplier with the market average price, the
2 customer's average rate would go up, not down. Instead of the PECO rate of 13.0¢,
3 the customer's choices would range from 13.1¢ to 13.5¢. These would be poor
4 choices.

5 The result of the PECO procedures and proposal is to give PECO a distinct
6 price advantage. The high CTC results in a low generation rate and the stranded
7 costs would be zero instead of the amount claimed; virtually no load would be lost.
8

9 **Q WILL THE SITUATION IMPROVE AS TIME GOES BY?**

10 **A** No. All three of the PECO forecasts show that market prices will increase. For
11 example, by the year 2001 the prices will increase, as compared to 1999, by 27% to
12 36%. That produces the following result.

Table 5		
<u>Unbundled Rate Component</u>	<u>2001 Residential Cost With Power at System Average Market Price</u>	
	<u>Best Case</u>	<u>Worst Case</u>
T, D, CTC	10.4¢	10.4¢
New Supplier Generation Cost	<u>3.6¢</u>	<u>4.0¢</u>
Total	14.0¢	14.4¢

13 Thus, the residential cost, with generation from a new supplier priced at the market
14 average price for the PECO system, would be in the range of 14.0¢ to 14.4¢,
15 depending on which of PECO's forecasts is relied upon. At the same time, the PECO
16

1 rates would continue to offer customers an option to pay 13.0¢.¹ Thus, in order to
2 compete, a new supplier would have to absorb all marketing costs, all transaction
3 costs and also incur a loss of 1.0¢ to 1.4¢ on the power supplied. Even then, the
4 customer would only break even.

5
6 **Q WHAT SORT OF PROBLEMS WOULD THE PECO PROPOSAL LEAD TO?**

7 **A** First, due to the continuing rate cap and the proposal for a fixed CTC, the 2.6¢
8 generation rate component would continue in effect until the CTC terminated.
9 Second, assuming market prices for generation increase according to any or all of
10 the PECO forecasts, new suppliers would have little or no realistic opportunity to
11 compete. Third, the access of customers to a "competitive market" would
12 constructively be a fiction. The access would be in name only. Consequently,
13 throughout the period these rates remain in effect and PECO would be collecting the
14 proposed CTC, its market share would remain intact. Competition would begin in
15 reality only after the CTC was eliminated when PECO too would have to price its
16 power at the market price. At that time, the customer would be faced with the
17 prospect of an unregulated near monopoly with horizontal market power derived from
18 a very high market share.

¹The generation component of the rate is capped through 2005, unless the CTC terminates at an earlier date. Thus, the 13.0¢ rate would generally continue to be available subject to changes in the T&D components that would raise the 13.0¢, 14.0¢ and 14.4¢ rate by identical amounts.

1 Q **WHEN IS THE APPROPRIATE TIME TO ADDRESS THIS PROBLEM?**

2 A Now is the time. The restructuring plan must provide the opportunity for a
3 competitive retail generation supply market to evolve during the period of transition
4 charges while rates are capped. Afterwards, the Commission's ability to influence
5 that market, even if it is not a "competitive market" as envisioned, is drastically
6 limited.

7
8 Q **WHAT IS A SOLUTION?**

9 A There must be an appropriate generation supply rate that will allow a competitive
10 retail generation supply market to evolve while meeting the various requirements of
11 the Competition Act. This means that the CTC component of the generation supply
12 cost must be lower and the generation rate component must be higher so as to avoid
13 undercutting the market. Also, assuming that market prices increase according to
14 any or all of the PECO forecasts, the generation rate component will need to increase
15 in future years.

16
17 Q **WHAT CONSIDERATIONS ARE RELEVANT TO THE DEVELOPMENT OF AN
18 APPROPRIATE GENERATION SUPPLY RATE COMPONENT?**

19 A I believe there are several important considerations. First, of course, this rate
20 component must be just and reasonable. Second, the price paid by consumers
21 should be determined by competitive forces, not the artificially low proposed rates
22 that would undercut the market. Third, the generation supply component of the
23 unbundled rate must be high enough to provide a reasonable opportunity for the
24 competitive market to develop. Fourth, and finally, in the context of the stranded cost

1 standards of the Competition Act, there is, in the context of mitigation, an obligation
2 to maximize market revenue from existing generation. An artificially low generation
3 rate component would do just the opposite. It would minimize market revenue and
4 maximize the transition charges.

5
6 **Q IS IT POSSIBLE TO DEVELOP A GENERATION SUPPLY COMPONENT WHICH**
7 **WILL BE RESPONSIVE TO THE FOUR CONSIDERATIONS YOU HAVE**
8 **OUTLINED?**

9 **A** Yes. In the simplest possible terms, the generation supply component needs to be
10 based on market considerations that will allow a competitive market to develop. It
11 simply cannot be determined with the method PECO has followed wherein the
12 generation rate component is the residual after transmission, distribution and CTC
13 charges are subtracted from the existing rates.

14
15 **Q ARE THERE MULTIPLE FORECASTS OF THE MARKET PRICES?**

16 **A** Yes. As noted above, PECO has submitted three forecasts, and it is likely that
17 others will be submitted.

18
19 **Q WHAT DRIVES THE FORECAST UP AFTER THE FIRST FEW YEARS?**

20 **A** All of the forecasts assume escalation in fuel prices. They also forecast increases in
21 the price of capacity.

1 Q PLEASE EXPLAIN WHY THE FORECAST OF THE CAPACITY PRICE IS LOWER
2 THAN THE COST OF NEW CAPACITY IN THE EARLY YEARS.

3 A Due to the current surplus of installed capacity above that needed for reliability
4 purposes, the price in the wholesale market has been driven downward due to
5 competitive forces. Of course, without retail competition, there is no retail market at
6 this time.

7
8 Q GIVEN THE CONSIDERATIONS YOU HAVE DESCRIBED, DO YOU HAVE A
9 RECOMMENDATION IN REGARD TO THE DEVELOPMENT OF THE
10 GENERATION COMPONENT OF RATES?

11 A Yes. The generation rate component should be based on a forecast of market
12 energy prices and a market-oriented forecast of the cost of new capacity. In addition,
13 I recommend that the generation supply component, the generation rate and the
14 CTC, be reviewed not less than every two years, and that progress toward a
15 competitive retail market be assessed at those intervals.

16
17 Q HOW SHOULD THE FORECAST OF MARKET ENERGY PRICES AND THE
18 FORECAST OF THE MARKET COST OF NEW CAPACITY BE USED TO
19 ESTABLISH THE GENERATION COMPONENT OF RATES UNDER THE
20 VARIOUS SERVICE SCHEDULES?

21 A The following procedure should be followed:

- 22 1. Develop the supply costs based on a market analysis that states the capacity
23 cost per Kw and the energy cost per kWh separately. The energy component
24 should be based on a forecast of market energy prices. The capacity cost
25 should be based on the market cost of new capacity and should be stated to
26 include the cost of generation reserves needed to provide for reliable service.

1 The capacity component for non firm service must be limited to reflect the
2 character of service.

3
4 2. For each rate schedule, apply the loss adjusted energy supply cost in the
5 maximum detail available (for example, on and off peak by season), and
6 apply the loss adjusted capacity cost to the peak demand of each class.
7

8 **Q PLEASE ILLUSTRATE THE DEVELOPMENT OF A GENERATION RATE**
9 **COMPONENT UNDER YOUR RECOMMENDATION.**

10 **A** I will illustrate the computation for the residential example discussed above. The rate
11 is 4.14¢ and the details are set forth in Exhibit DEJ-2.

Table 6	
Summary of Recommended Residential Generation Rate Development	
Energy Component, including losses, and usage profile	2.60¢
Capacity component, including reserves and losses	<u>1.54¢</u>
Total	4.14¢

12
13
14 **Q PLEASE DESCRIBE EXHIBIT DEJ-2.**

15 **A** The exhibit sets forth, as an example, the development of the residential generation
16 rate component based on a forecast of the 1999 market. For the purpose of
17 illustration only, I have used the ICF forecast, which is in the middle of the three
18 forecasts submitted by PECO.

19 According to the forecast, the system average market energy component is
20 2.29¢ per kWh. I adjusted this by an approximate amount to reflect the usage profile

1 of the residential class. For the purpose of illustration, the assumed impact of the
2 usage profile is 0.07¢ for a subtotal of 2.36¢. This subtotal was further adjusted to
3 reflect the class electrical delivery losses of 10.3%, which amount to another 0.24¢.
4 The total energy component is the sum of the pieces and amounts to 2.60¢.

5 The capacity component is based on the market cost of new capacity. I have
6 estimated that the market cost of new capacity which underlies the forecast is \$42.00
7 per kWh. To this I added an assumed 18% reserve requirement which increases the
8 cost by \$7.56 to a subtotal of \$49.56. This amount was adjusted to reflect class
9 electrical losses of 10.3%. The addition of losses increases the cost to \$54.66 per
10 kW year. This amount is converted to a kWh charge by application of a 45%
11 residential class load factor. The capacity cost per kWh is 1.56¢.

12 The total generation rate component is the sum of the 1.39¢ capacity
13 component and the 2.60¢ energy component for a rate of 3.99¢.

14
15 **Q IS THERE A RELATIONSHIP BETWEEN YOUR RECOMMENDATION AND THE**
16 **STRANDED COST RECOVERY PROPOSED BY PECO?**

17 **A** Yes. My discussion of the CTC is for the purpose of describing the implications of my
18 recommendations for the CTC procedure proposed by PECO. As I have explained,
19 the generation rate component is too low. A higher generation rate component
20 consistent with my recommendations will reduce the stranded cost to a level below
21 that calculated by PECO, other considerations being the same.

1 Q PLEASE EXPLAIN THE IMPACT OF THE HIGHER GENERATION SUPPLY RATE
2 COMPONENTS THAT YOU RECOMMEND ON THE DETERMINATION OF
3 STRANDED COST?

4 A To the extent that PECO makes the retail sales, a higher rate would decrease the
5 stranded cost. In the event that PECO could not make the sale by reason of the
6 market price being lower than the generation rate component, an affiliate could make
7 the sale at the retail market price. The stranded cost would still be reduced, but not
8 quite to the same extent. Of course, at the same time, there would be the benefit
9 that the price would have been set by a market in which new suppliers have a
10 reasonable opportunity to compete for the sale. In the event that PECO and its
11 affiliates should lose the retail sale entirely, it would have the opportunity to sell the
12 power at the wholesale market price. Consequently, accepting for discussion
13 purposes only the forecast of market price used by PECO, the stranded cost
14 computed by PECO would be the absolute upper limit and the stranded cost, in
15 comparison, would be reduced under my proposal.

16
17 Q WOULD THE FACT THAT PECO WAS AT RISK FOR SOME PORTION OF THE
18 REVENUES DERIVED FROM THE RETAIL GENERATION RATE MEAN THAT
19 PECO WOULD BE DENIED THE OPPORTUNITY TO RECOVER ITS STRANDED
20 COST AND TO EARN A REASONABLE RETURN?

21 A No. But the fact that PECO would be at some risk would certainly increase the
22 incentive to PECO to engage in additional mitigation so as to achieve the maximum
23 return possible under the conditions.

1 Q ARE YOU MAKING ANY RECOMMENDATIONS AS TO THE AMOUNT OF
2 MITIGATION THAT IS POSSIBLE, OR THE AMOUNT OF STRANDED COST
3 THAT POTENTIALLY EXISTS AND OUGHT TO BE CHARGED TO CUSTOMERS?

4 A No, I am not, although it is clear that a market price, if allowed to develop without
5 being undercut with an artificially low generation rate component set by regulation,
6 would lower the stranded cost.

7

8 **GENERATION COST ALLOCATIONS**

9 Q HAS PECO PROPOSED ANY COST ALLOCATIONS THAT WOULD
10 INAPPROPRIATELY LOWER THE COST OF GENERATION WHILE INCREASING
11 THE COST OF DELIVERY SERVICES?

12 A Yes.

13

14 Q WHAT WOULD BE THE LONG TERM RESULT OF HOLDING DOWN THE
15 GENERATION COMPONENT AT THE EXPENSE OF DELIVERY SERVICES?

16 A The result would be a competitive advantage for PECO at the expense of customers
17 and all other suppliers. Thereby, additional influences that would tend to maintain a
18 high level of market share would exist. For all of the reasons addressed in regard to
19 the rate for generation, this would be counter-productive to the development of a
20 competitive market.

1 Q WHAT HAS PECO DONE IN ITS CLASS COST OF SERVICE STUDY THAT
2 WOULD INAPPROPRIATELY INCREASE THE COST OF DELIVERY SERVICES
3 WHILE REDUCING THE COST OF GENERATION?

4 A There are elements of the Administrative and General (A&G) expenses and General
5 and Common Plant categories that have been assigned 100% to the delivery
6 functions. There has been no showing by PECO that these costs are related solely
7 to delivery and are not in any way related to generation.

8
9 Q PLEASE IDENTIFY THE A&G EXPENSE CATEGORIES THAT PECO HAS
10 ASSIGNED 100% TO DELIVERY.

11 A The categories include Account Nos. 920, 921, 923, 925, 928, 929, 930 and 931.
12 These accounts include A&G Salaries, Office Supplies and Expenses, Outside
13 Services Employed, Injuries and Damages, Regulatory Commission Expenses,
14 Duplicate Charges/Credits, Miscellaneous General Expenses and ADV, and Rents,
15 for a total of \$202 million. In addition, maintenance Account 935, Maintenance of
16 General Plant, in the amount of \$875,000, is assigned 100% to delivery service.

17
18 Q ARE THERE GENERAL AND COMMON PLANT CATEGORIES THAT HAVE BEEN
19 ASSIGNED 100% TO DISTRIBUTION?

20 A Yes. Account Nos. 389, 390, 391, 393, 394, 395, 397 and 398 have been so
21 assigned. These general plant categories include Land and Land Rights, Structures
22 and Improvements, Office Equipment, Stores Equipment, Tools, Shop and Garage
23 Equipment, Laboratory Equipment, Communication Equipment and Miscellaneous
24 Equipment. The total of these accounts is \$94 million. Also, \$312 million of common

1 plant is assigned to the distribution function. There is no explanation of the
2 assignment of all of this plant to distribution and it is unlikely that such an approach
3 could be supported. Also, it is inconsistent with the approach used in the PECO
4 class cost of service study, which used a combination of production, transmission
5 and distribution plant to allocate general plant among the classes.

6
7 **Q PLEASE SUMMARIZE THE ISSUES YOU HAVE IDENTIFIED THAT WILL TEND**
8 **TO PROLONG THE MARKET POWER OF PECO AT THE EXPENSE OF THE**
9 **DEVELOPMENT OF A COMPETITIVE RETAIL GENERATION SUPPLY MARKET.**

10 **A** PECO has made several proposals including a price for generation supply that is too
11 low and several cost allocations that inappropriately increase the cost of delivery
12 services while artificially decreasing the cost of generation. These actions will hinder
13 the development of a competitive retail generation market and result in inflated costs
14 for consumers.

15
16 **VERTICAL MARKET POWER**

17 **Q EARLIER IN YOUR TESTIMONY, YOU RAISED THE ISSUE OF VERTICAL**
18 **MARKET POWER. WHY IS VERTICAL MARKET POWER IMPORTANT?**

19 **A** Vertical market power, if retained by PECO, will inhibit the ability of customers and
20 new generation suppliers to get together in the market. This will tend to preserve the
21 PECO monopoly at the expense of customers and new suppliers.

1 Q WHAT ISSUES WILL YOU ADDRESS THAT RELATE TO VERTICAL MARKET
2 POWER?

3 A The issues are the code of conduct, metering, billing, and the lack of a supplier tariff.
4

5 Q WHAT IS THE PURPOSE OF THE CODE OF CONDUCT THAT HAS BEEN
6 PROPOSED BY PECO?

7 A It is important that all suppliers have comparable access to the PECO delivery
8 systems. Since PECO will retain ownership and control of these facilities that are
9 vital to the development of the competitive retail generation market,
10 nondiscriminatory access and operation will be critical. In this regard, PECO has
11 proposed a Code of Conduct.
12

13 Q HAVE YOU REVIEWED THE CODE OF CONDUCT?

14 A Yes, I have.
15

16 Q HOW DOES IT COMPARE TO THE CODE OF CONDUCT FILED BY THE
17 PENNSYLVANIA POWER AND LIGHT COMPANY IN DOCKET NO. R-00973954?

18 A Both proposed codes address the relationship of PECO and any affiliated generation
19 supplier to non-suppliers and to the employees within the Company that fulfill the role
20 of the local distribution utility. However, the PP&L proposal is more explicit in
21 expectations and enforcement.

1 Q DO YOU RECOMMEND A PARTICULAR CODE OF CONDUCT?

2 A Yes. I recommend, for PECO, a Code of Conduct that is very similar to that
3 proposed by PP&L. I have made changes to adopt PECO nomenclature, but I have
4 otherwise left the PP&L proposal intact. My specific recommendation is attached at
5 Exhibit DEJ-1.

6

7 Q WHY DO YOU RECOMMEND THE MORE EXPLICIT CODE OF CONDUCT?

8 A The Code of Conduct will facilitate the achievement of comparable service between
9 and among PECO and its future competitors in the generation supply
10 business. Thus, the more explicit statement of requirements and expectations is
11 important to the development of the competitive retail market.

12

13 Q IS THERE ANY PROBLEM WITH THE APPROACH THAT PECO HAS FOLLOWED
14 WITH RESPECT TO METERING OF CUSTOMER LOADS?

15 A Yes. PECO proposes to own, maintain and read all customer billing meters.

16

17 Q WHAT IS THE PECO POSITION IN REGARD TO BILLING?

18 A PECO proposes to be responsible for billing customers for the unbundled regulated
19 services and for suppliers' charges, unless otherwise requested by the
20 customer. The only option is that the customer could receive a separate bill from the
21 supplier and a separate bill from PECO for the unbundled regulated delivery services
22 and transition charges.

1 Q ARE THERE PROBLEMS WITH PECO'S PROPOSALS WITH RESPECT TO
2 METERING AND BILLING?

3 A Yes. In essence, PECO proposes that it maintain an absolute monopoly with respect
4 to metering and the only exception in regard to billing is that expressly provided by
5 the Competition Act. One problem is that there is no reason for a PECO monopoly in
6 metering. Other parties have the capability and could provide the service. Another
7 problem with the PECO approach is that it would tend to stifle innovation in the
8 evolving retail electric supply market. This is true because more advanced forms of
9 metering may be able to cost-effectively facilitate more efficient generation supply
10 pricing and usage efficiencies. But under the PECO plan, any innovative metering
11 could easily end up being needlessly redundant and costly. Instead, what is needed
12 is a set of appropriate metering standards so that the evolving retail generation
13 market may flourish.

14 The PECO proposal with respect to billing eliminates a logical alternative. It is
15 clear that it is a convenience to customers to receive one bill for all electrical
16 services. But under the PECO proposal, that is a convenience that can be offered
17 only by PECO.

18 In another matter related to billing, PECO has proposed, to the extent that a
19 customer might send in a partial payment, that PECO be allowed to recover its costs
20 of its services first. Thereby PECO would be provided with yet another advantage.
21 Instead, the revenue should be shared pro rata after reasonable administrative costs
22 are covered.

23 Taken in total, the metering and billing provisions are less than what is
24 needed to promote more efficient energy supplies and to foster the development of a

1 more competitive retail electric supply market.

2
3 **Q DOES PECO HAVE ANY PROVISIONS THAT WILL INCREASE THE COST FOR**
4 **THIRD PARTY SUPPLIERS AS COMPARED TO PECO OR A PECO AFFILIATED**
5 **SUPPLIER (A PECO SUPPLIER)?**

6 A Yes. PECO proposes to charge non-affiliated suppliers 90¢ per bill, but there is no
7 such proposed charge for PECO as a supplier. This is inappropriate.

8
9 **Q PLEASE EXPLAIN WHY IT IS INAPPROPRIATE TO HAVE A DIFFERENT**
10 **CHARGE FOR THE NEW SUPPLIERS.**

11 A PECO is charged with the responsibility of providing comparable services to the new
12 suppliers. In other words, the service provided to others must be equivalent to the
13 service it provides itself. Since PECO proposes to charge 90¢ per bill to all new
14 suppliers and nothing to PECO as a supplier, this can only lead to one of two
15 conclusions. Either the rate is discriminatory and therefore inappropriate, or the level
16 of service being provided to the other entities is not comparable to that being
17 provided to PECO and, therefore, inappropriate.

18
19 **Q WOULD IT NOT BE MORE EFFICIENT FOR PECO TO PROCESS A BILL FROM**
20 **PECO'S IN-HOUSE DATA?**

21 A In the context of a regulated monopoly, all such efficiencies ought to have been
22 pursued. However, under a standard of comparable service, the situation is different.
23 It is apparent that the billing system will need to be enhanced to accommodate
24 different forms of rates. After it is enhanced, PECO, as well as the new suppliers, will

1 have the ability to use the options.

2 Henceforth PECO should have available to it, should use, and should pay for
3 the billing system in the same manner as the new suppliers. The costs should
4 therefore be shared proportionately among all suppliers, including PECO.

5 In addition, new suppliers should not be precluded from offering customers a
6 single bill. Provisions should be made for new suppliers to acquire and pay for
7 delivery services on behalf of their customers. Any other approach results in a
8 competitive disadvantage.

9
10 **Q PLEASE SUMMARIZE YOUR TESTIMONY IN REGARD TO VERTICAL MARKET**
11 **POWER.**

12 **A** Under the PECO plan there are several proposals that will tend to promote, or at
13 least not adequately protect from, a continuation of the existing vertical market power
14 of PECO. Market power, whether vertical, horizontal or some other form cannot be
15 condoned by policy, plan or procedure when there is underway a transition to
16 reliance on forces in a market that must be workably competitive if the goals of the
17 Competition Act are to be attained.

18
19 **Q HAVE YOU REVIEWED THE PECO TARIFF FOR THE SERVICES THAT WILL BE**
20 **PROVIDED TO NEW GENERATION SUPPLIERS?**

21 **A** No. PECO has not, at this time, proposed such a tariff, and its proposal is, therefore,
22 deficient at least to that extent. It is imperative that provision be made for adequate
23 review of the tariff since it will address important aspects of the PECO relationship to
24 its future competitors in the generation sector. For example matters relating to terms

1 and conditions of services, metering, billing and information exchange must be
2 addressed.

3

4 Q DOES THIS CONCLUDE YOUR TESTIMONY?

5 A Yes, it does.

Qualifications of Donald E. Johnstone

1

2 **Q PLEASE STATE YOUR NAME AND ADDRESS.**

3 **A** Donald E. Johnstone. My business mailing address is P. O. Box 412000, St. Louis,
4 Missouri 63141-2000.

5 **Q PLEASE STATE YOUR OCCUPATION.**

6 **A** I am a consultant in the field of public utility regulation and am a principal in the firm of
7 Brubaker & Associates, Inc., regulatory and economic consultants.

8 **Q PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.**

9 **A** In 1968, I received a Bachelor of Science Degree in Electrical Engineering from the
10 University of Missouri at Rolla. After graduation, I worked in the customer engineering
11 division of a computer manufacturer until I entered the United States Air Force in 1969.
12 From 1969 to 1973, I was an officer in the Air Force, where most of my work was related
13 to the Aircraft Structural Integrity Program in the areas of data processing, data base
14 design and economic cost analysis. Also in 1973, I received a Master of Business
15 Administration Degree from Oklahoma City University.

16 From 1973 through 1981, I was employed by a large midwestern utility and worked
17 in the Power Operations and Corporate Planning Functions. While in the Power
18 Operations Function, I had assignments relating to the peak demand and net output
19 forecasts and load behavior studies which included such factors as weather, conservation
20 and seasonality. I also analyzed the cost of replacement energy associated with forced
21 outages of generation facilities. In the Corporate Planning Function, my assignments
22 included developmental work on a generation expansion planning program and work on

1 the peak demand and sales forecasts. From 1977 through 1981, I was Supervisor of the
2 Load Forecasting Group where my responsibilities included the Company's sales and
3 peak demand forecasts and the weather normalization of sales.

4 In November 1981, I joined Drazen-Brubaker & Associates, Inc., and in April 1995,
5 I continued my consulting work at the firm of Brubaker & Associates, Inc. Since 1981, I
6 have participated in the analysis of various utility rate cases, including the analysis and
7 preparation of cost of service studies and rate analyses. In addition to rate cases, I have
8 participated in electric fuel and gas cost reviews and planning proceedings, policy
9 proceedings, market price surveys, generation capacity evaluations, and assorted matters
10 related to the restructuring of the electric and gas industries.

11 I have testified before the state regulatory commissions of Delaware, Hawaii,
12 Illinois, Iowa, Kansas, Massachusetts, Missouri, Montana, New Hampshire, Ohio,
13 Pennsylvania, Tennessee, Virginia and West Virginia.

14 The firm of Brubaker & Associates, Inc. provides consulting services in the field
15 of energy procurement and public utility regulation to many clients, including large
16 industrial and institutional customers, some utilities, and on occasion, state regulatory
17 agencies. More specifically, we provide analysis of energy procurement options based
18 on consideration of price flexibility, and reliability as related to the needs of the client;
19 prepare rate, feasibility, economic and cost of service studies relating to energy and utility
20 services; prepare depreciation and feasibility studies relating to utility service; and assist
21 in contract negotiations for utility services.

Code of Conduct

The relationship of the PECO generation supply group, a competitive generation affiliate, or marketing group, or division (a PECO supplier) and the group of employees that fulfill the role of the local distribution utility (LDU) in supporting organizations and energy suppliers will be governed by the following code of conduct which is intended to control dissemination of confidential customer information, restrict access to competitive information, prevent cross-subsidies between regulated and unregulated departments, and prevent discrimination practices.

Segregation of and Restricted Access to Information

1. The following information shall be considered confidential and access to this information shall be limited to only those employees involved in the administration of energy supply by non-affiliated suppliers for the purpose of customer billing, supply scheduling and reconciliation, supplier payments, and customer assistance.

- Supplier pricing and billing information;
- Supplier customer lists;
- Individual customer consumption;
- Identity of the supplier of a participating customer.

2. The LDU group will release information to a supplier concerning individual customer account history and individual customer consumption only after written approval from the customer.

Assignment of Responsibilities

1. Employees in the PECO Supply group will not be assigned any responsibilities within the LDU group and vice versa.

Accounting and Cost Allocations

1. Costs associated with the PECO Supply and LDU groups will be kept separately.

2. Charges for services between the PECO Supply group, LDU group and other internal service organizations will be provided at fair and non-discriminatory prices.

Comparability

1. The LDU group will not condition any discount to a customer or condition any deviation from standard terms of service to a customer on the purchase of energy from PECO Supply group.

2. The LDU group will make meter reading, billing and other customer assistance services available to all non-affiliated suppliers and PECO suppliers at the same non-discriminatory rates, terms and conditions.

3. The LDU group will process requests for access by all generation suppliers in a non-discriminatory manner.

4. The LDU group will apply tariff provisions in a non-discriminatory manner.

Communications to Employees and Enforcement

1. The code of conduct will be communicated throughout the LDU and PECO Supply groups, and other internal service organizations.

2. The code of conduct will be incorporated into the Company's Standards of Integrity.

3. Periodic audits of the code of conduct will be conducted to ensure compliance.

4. Violations of the code of conduct will result in disciplinary action administered in accordance with PECO policy.

5. As deemed appropriate, employees involved in the administration of energy supply by non-affiliated suppliers and having access to competitive information will sign a confidentiality agreement prohibiting improper disclosure of competitive information.

Dispute Resolution Process

1. The LDU group will establish a procedure for receiving, recording and resolving complaints concerning this code of conduct.

Residential Generation Rate Design
Example Based on 1999 Costs

LineEnergy ComponentAmount

1	System average market energy component	2.29¢
2	Adjustment to reflect class usage profile (assume +3% for illustration)	<u>0.07¢</u>
3	Subtotal	2.36¢
4	Adjustment to reflect class electrical delivery losses (assume 10.3%)	<u>0.24¢</u>
5	Total	2.60¢

Capacity Component

6	Market cost of new capacity per kW	\$42.00
7	Reserve Requirement (assume 18%)	<u>7.56</u>
8	Subtotal	49.56
9	Adjustment to reflect class electrical losses (assume 10.3%)	<u>5.10</u>
10	Total	\$54.66

11	Convert to a kWh charge for energy only rates (45% load factor)	1.39¢
----	---	-------

Summary

12	Energy	2.60¢
13	Capacity	<u>1.39¢</u>
14	Generation Rate Component	3.99¢

R-00973953

R-00973953(001)-00007

MAPSA STATEMENT NO. 1-R

Philadelphia 10-15-97
GST

Pennsylvania Public Utility Commission

Application of PECO Energy Company
for Approval of its Restructuring Plan
Under Section 2806 of the Public
Utility Code

Docket No. R-00973953

DOCUMENT
FOLDER

Rebuttal Testimony of

Donald E. Johnstone

PHILADELPHIA OFFICE

OCT 22 11 06

DOCKETED

On Behalf of

OCT 22 1997

Mid-Atlantic Power Supply Association

July 1997
Project 6765

Brubaker & Associates, Inc.
St. Louis, MO 63141-2000

Rebuttal Testimony of Donald E. Johnstone

1 Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

2 A My name is Donald E. Johnstone and my business address is 1215 Fern Ridge
3 Parkway, Suite 208, St. Louis, MO 63141-2000.

4

5 Q ARE YOU THE SAME DONALD JOHNSTONE WHO PREVIOUSLY SUBMITTED
6 DIRECT TESTIMONY IN THIS PROCEEDING?

7 A Yes, I am. My qualifications and experience are set forth in Appendix A to my direct
8 testimony.

9

10 Q HAVE YOU REVIEWED THE DIRECT TESTIMONY OF MR. STEPHEN BARON
11 WHO APPEARS ON BEHALF OF THE PHILADELPHIA AREA INDUSTRIAL
12 ENERGY USERS GROUP?

13 A Yes, I have.

14

15 Q DO YOU HAVE ANY CONCERNS WITH THE PROCEDURE HE HAS PROPOSED
16 FOR THE DEVELOPMENT OF THE GENERATION RATE COMPONENT TO BE
17 APPLIED TO THOSE CUSTOMERS WHO CONTINUE TO PURCHASE POWER
18 AND ENERGY FROM PECO?

19 A While there are some areas of agreement between his proposal and that of MAPSA,
20 there are also some differences both in regard to the development of the capacity
21 component of the rate and in regard to the energy component of the rate.

22

1 Q WHAT ARE THE DIFFERENCES IN REGARD TO THE CAPACITY COMPONENT?

2 A There are two. First, Mr. Baron has used a market price for capacity in the early
3 years of the period that is significantly less than the cost of new capacity. If the
4 forecast used by Mr. Baron turns out to be too low, the development of a competitive
5 market will be inhibited because PECO will have a price advantage. In addition, in
6 the event that a need for new capacity develops within that time frame, the price
7 would effectively be capped by the regulated PECO generation rate and the "market
8 price" would not support the addition of new capacity, potentially leading to a capacity
9 shortage.

10 A second problem with Mr. Baron's approach is that he has used the 4CP
11 allocation factor to develop the amount of capacity that is required for each customer
12 class. The use of the 4CP factor assumes that all of the diversity benefits that are
13 present on the PECO system today can be maintained when the native load is no
14 longer being furnished by a single supplier. That will not be the result. The sum of
15 the peak loads of the individual suppliers will inevitably be larger than the coincident
16 peak load of the system as it exists today. Assuming the same customer load and
17 the same reserve margin, somewhat more capacity will be required. However,
18 PECO has used a lower reserve margin going forward. While there are many factors
19 to be considered in regard to reserve margin, the loss of diversity is a factor that
20 would tend to support a lower reserve margin. Thus total capacity required to
21 maintain reliability will not increase due to this consideration.

1 Q PLEASE SUMMARIZE THE POINTS YOU HAVE MADE WITH RESPECT TO
2 CAPACITY COST PROVISIONS PROPOSED BY MR. BARON.

3 A I recommend two changes in order to be consistent with my initial recommendations
4 and to allow for competition to develop without unnecessary restrictions. First, the
5 capacity cost in each year should be consistent with the cost to install new capacity.
6 Second, I recommend for each class that the class peak load and the class
7 contribution to the four coincident peak load be averaged when developing the
8 capacity cost allocation for each of the customer classes.

9

10 Q DO YOU HAVE ANY COMMENT WITH RESPECT TO THE ENERGY
11 COMPONENT OF THE GENERATION RATE AS DEVELOPED BY MR. BARON?

12 A It appears Mr. Baron has used a system average load profile to develop the energy
13 rate. Instead, the class-specific usage pattern should be used. That is necessary in
14 order to properly capture the energy cost associated with each customer class in the
15 context of a market-based approach to cost.

16

17 Q DOES MR. BARON PROPOSE ANY REVIEW OF THE CTC AND GENERATION
18 RATE COMPONENTS?

19 A No, he does not, and that is a point with which I disagree. If the CTC is extended, the
20 generation rate component will need to be reviewed and possibly adjusted so that the
21 generation rate as set forth in the PECO tariff remains in sync with the market price.
22 Mr. Baron's proposal does not do this.

23

1 Q ARE THERE ANY REASONS WHY THE GENERATION RATE IN THE PECO
2 TARIFF MUST BE EQUAL WITH THE FORECAST OF MARKET PRICE IN ANY
3 GIVEN YEAR?

4 A No. Mr. Baron's approach would hinder the development of a competitive market.
5 There must be other considerations to the development of the generation rate.

6
7 Q PLEASE EXPLAIN THE OTHER CONSIDERATIONS.

8 A First, there is mitigation of stranded costs. Mitigation will diminish the need for
9 stranded cost recovery. Mitigation includes activities to reduce cost and increase
10 efficiency. Second, there must be consideration of an incorrect forecast of market
11 load requirements and market price. The customers ought not to bear the avoidable
12 risk of capacity shortages created by the effect of a constrained market price. Third,
13 there is a question of whether the company should receive protection from
14 competitive forces in regard to the difference between a capacity price that reflects
15 the cost of new capacity as opposed to a capacity price that is lower in the short run
16 due to excess capacity. A competitive market would provide no such protection. One
17 question then is: When should PECO begin to bear this effect of competitive forces?
18 Finally, there is the question of the timing of the stranded cost recovery. Stranded
19 costs are computed not just over the time period that the CTC and the generation
20 rates will be in effect, but rather over an extended period of time. Given that the CTC
21 is authorized to remain in effect through 2005, it does not follow that there can be or
22 ought to be a one for one linkage as suggested by Mr. Baron. While the early
23 termination of stranded cost recoveries under the totality of Mr. Baron's

1 recommendation is a positive, that must be balanced against the effect on the
2 development of a competitive market while the proposed generation rates are in
3 effect.

4

5 **Q DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

6 **A** Yes, it does.

Philadelphia 10-15-97
GST

Pennsylvania Public Utility Commission

Application of PECO Energy Company for
Approval of its Restructuring Plan Under
Section 2806 of the Public Utility Code

Docket No. R-00973953

DOCKETED
OCT 22 1997

Additional Testimony of

Donald E. Johnstone

On Behalf of

Mid-Atlantic Power Supply Association

FILED IN THE OFFICE
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FOLDER

September 1997
Project 6765

Brubaker & Associates, Inc.
St. Louis, MO 63141-2000

1 has been submitted in this proceeding. MAPSA's counter offer was summarily
2 rejected by PECO.

3 I also will offer testimony in response to criticisms made in several rebuttal
4 testimonies submitted on behalf of PECO. These rebuttal testimonies have been
5 designated by PECO as evidence in support of the Partial Settlement.

6
7 **MAPSA's Counter Proposal to the Partial Settlement**

8
9 **Q IS THE PARTIAL SETTLEMENT IN THE PUBLIC INTEREST?**

10 **A** No. The fundamental problems with the Partial Settlement are (1) it is
11 anti-competitive, due to an effective generation rate (or a "Default Energy and
12 Capacity Offer", as explained below) that is too low, and (2) it lacks necessary
13 operating protections against favoritism to PECO. Both problems give PECO a
14 competitive advantage. In the market created by the Partial Settlement, competition
15 will exist in name, but not in economic reality.

16 It is important that customers have efficient access to multiple suppliers in a
17 competitive retail market so that competitive forces can operate to hold down prices
18 in the future. Since the restructured electric industry will rely solely on competitive
19 forces to control generation prices after the transition period, both the transition
20 prices and the terms and conditions of service must not provide a competitive
21 advantage either to PECO or to any of the new power suppliers. Advantage to any
22 one supplier would translate into higher prices inasmuch as competition would be
23 restrained. In other words, the new structure should protect competition, but not
24 competitors.

1 Q HAVE YOU REVIEWED THE MAPSA COUNTER PROPOSAL TO THE PARTIAL
2 SETTLEMENT?

3 A Yes. It is attached to this testimony as Exhibit DEJ-1S.
4

5 Q WHY IS IT APPROPRIATE FOR THE COMMISSION TO CONSIDER THE MAPSA
6 COUNTER PROPOSAL?

7 A The Commission is confronted with the responsibility to approve a transition plan that
8 will fulfill the requirements of the Pennsylvania Electricity Generation Customer
9 Choice and Competition Act (Competition Act or Act). Under the terms of the Act,
10 competition must evolve to the point that it will be adequate to regulate the price of
11 electricity by the end of the transition period. The issue brought before the
12 Commission by MAPSA in its Counter Proposal addresses what may be the most
13 fundamental point of the Act -- the development of workable competition.

14 To be sure, MAPSA members have a direct and vested interest in the
15 transition to competition because it will either create an opportunity for them to
16 compete or, if constructed poorly, will close the door on competition for MAPSA's
17 members and for the majority of the PECO customers for the next ten years. Thus,
18 the interest of MAPSA is not just its own, but also that of the public under the
19 structure created by the Competition Act. Many consumers have agreed to a
20 settlement that will significantly reduce rates and will provide a rate cap through
21 2008. They are apparently satisfied today, but they are entitled to more. They are
22 entitled to a transition to a vibrant retail generation market and, at this point, the
23 Commission alone is in the position of seeing that they get that to which they are
24 entitled.

1 The MAPSA Counter Proposal undertakes to adjust the Partial Settlement, an
2 agreement that attempts to resolve many of the issues for a number of the parties.
3 The intent of MAPSA is to leave untouched as much of the Partial Settlement as
4 possible. While a proposal to adjust even a partial settlement cannot be undertaken
5 lightly, MAPSA's approach has been to leave intact all provisions of the Partial
6 Settlement except those which must be adjusted to provide for fair competition.
7

8 **Q ARE YOU RECOMMENDING THAT THE MAPSA COUNTER PROPOSAL BE**
9 **ADOPTED AS A MODIFICATION OF THE PARTIAL SETTLEMENT?**

10 **A** Yes. The MAPSA Counter Proposal preserves most elements of the Partial
11 Settlement, and the changes are intended to improve the likelihood of full-fledged
12 competition as envisioned by the Competition Act. In particular, the MAPSA Counter
13 Proposal preserves PECO's ability to recover the transition costs provided for in the
14 Partial Settlement. The immediate 10% rate reduction given to customers and the
15 rate caps for future years also are preserved.
16

17 **Q WHAT ARE THE MAJOR CHANGES TO THE PARTIAL SETTLEMENT THAT ARE**
18 **PROPOSED IN THE MAPSA COUNTER PROPOSAL?**

19 **A** MAPSA proposes to modify only a limited number of the terms of the Partial
20 Settlement. Two major changes are (1) a higher revised "Default Energy and
21 Capacity Offer", which becomes the credit for customers selecting alternative
22 suppliers, and (2) a lower distribution rate.

1 Q WHAT IS THE DEFAULT ENERGY AND CAPACITY OFFER?

2 A As used in this testimony, the Default Energy and Capacity Offer equates to the
3 "Standard Offer" set forth in the MAPSA Counter Proposal and to the "Energy and
4 Capacity Cap" set forth in Column 4 of Table A (Schedule of System-Wide Average
5 Rate Decreases) at Page 8 of the Partial Settlement. The Default Energy and
6 Capacity Offer represents the number (in cents) of the fully delivered price of energy
7 and capacity, including all costs incurred by suppliers. This is the price that new
8 suppliers must beat in order to provide savings to customers and to compete in
9 Pennsylvania.

10

11 Q DOES THE MAPSA COUNTER OFFER ADDRESS ANY OTHER PORTIONS OF
12 THE PARTIAL SETTLEMENT?

13 A The Counter Proposal also addresses metering, billing and code of conduct
14 provisions important to the ability of customers to receive electricity from non PECO
15 suppliers under reasonable and efficient terms and conditions.

16

17 Q WHAT IS THE BASIS FOR THE MAPSA REDUCTION OF THE DISTRIBUTION
18 RATE CONTAINED IN THE PARTIAL SETTLEMENT?

19 A The distribution rate included in the Partial Settlement exceeds PECO's distribution
20 costs because it includes Company overheads that should have been allocated, in
21 part, to the generation function. In addition, the rate includes costs associated with
22 sales functions or "customer service", including costs for meters, administrative and
23 general expense (A&G), customer accounts and sales expenses. Portions of these
24 costs related to production must be unbundled and removed from the distribution

1 charge. While PECO made some adjustments in its rebuttal testimony, the problems
2 remain. With respect to A&G, the better procedure is to functionalize costs
3 consistent with past allocation procedures. For example, both production and
4 distribution functions will share the same meter. Therefore, I recommend a 50/50
5 allocation of customer related costs between the two functions. As compared to the
6 revised PECO cost of service, the PECO distribution rates are at least 3.8 mills
7 above cost. Thus, the 4 mill reduction to the distribution component of rates
8 proposed by MAPSA in the Counter Proposal is the more accurate rate proposal.

9
10 **Q IS MAPSA PROPOSING THAT PECO NOT BE ALLOWED RECOVERY OF THESE**
11 **COSTS?**

12 **A** No. Under the MAPSA Counter Proposal, those 4 mills per kWh would be
13 transferred to the CTC for collection. Although the 4 mill adjustment would more
14 properly belong in the generation rate, that would more severely impact the economic
15 balance of the Partial Settlement as it was negotiated by the parties.

16
17 **Q WHAT ARE THE REASONS FOR RECOMMENDING ADJUSTMENTS TO THE**
18 **DEFAULT ENERGY AND CAPACITY OFFER IDENTIFIED IN THE PARTIAL**
19 **SETTLEMENT?**

20 **A** First, adjustments must be made based on PECO's rebuttal testimony. These
21 adjustments are discussed later in this testimony. Second, adjustments must be
22 made based on additional insights gained with respect to the retail generation
23 market.

1 Q WHAT ADDITIONAL INSIGHTS ARE YOU REFERRING TO?

2 A It has become more apparent that the prices in the emerging retail generation market
3 must be sufficient to recover more than just the wholesale cost of power. The
4 wholesale cost must be adjusted by the consideration of load factor and losses as
5 described in my direct and rebuttal testimonies. In addition, various costs of
6 operating a business in the retail generation market must also be recovered in the
7 retail price. Examples of these costs include marketing, determination of aggregated
8 load to be served, forecast of aggregated load, scheduling of power to meet the load,
9 reconciliation of supply with loads and related imbalance costs, collection, bad debt,
10 and the cost of compliance with Chapter 56 of the Commission's regulations. The
11 settlement rates for distribution and the Default Energy and Capacity Offer must be
12 adjusted accordingly.

13

14 Q WHAT IS THE ESTIMATED LEVEL OF THE RETAIL BUSINESS COSTS?

15 A First, based primarily on an analysis of the PECO class cost of service study, I
16 estimate a portion of these costs at approximately 3.8 mills for a large alternative
17 supplier that has the advantage of economies of scale. The costs would be higher
18 for smaller suppliers and during the startup of any new retail electric generation sales
19 business. In addition, the cost of reconciliation and balancing could easily add
20 another 1 mill.

21

22 Q WHAT IS THE IMPORTANCE OF THESE COSTS IN THE CONTEXT OF THE
23 PARTIAL SETTLEMENT?

24 A These costs are real and serve to further illustrate the concerns that MAPSA has with

1 the Partial Settlement. Under the terms of the Partial Settlement, the generation rate
2 cap extends through 2008. Throughout this period, the difference between the
3 generation rate cap and the transition charges would be the maximum that
4 customers would be willing to pay.

5
6 **Q PLEASE EXPLAIN WHY THE RATE FOR THE DEFAULT ENERGY AND
7 CAPACITY OFFER PROPOSED BY MAPSA IS REASONABLE.**

8 **A** The MAPSA proposal set forth in Schedule A of Exhibit DEJ-1S (the MAPSA Counter
9 Proposal) is consistent with the rates produced under the procedure recommended in
10 my direct testimony, as revised in this testimony. This recommendation is
11 summarized on Exhibit DEJ-2S which is attached hereto. The revisions are
12 explained in more detail later in this testimony but, in summary, I have incorporated a
13 more current loss factor, a better estimate of the effect of usage patterns, and an
14 explicit estimate of the retail business costs.

15
16 **Q HOW DOES EXHIBIT DEJ-2S COMPARE WITH EXHIBIT DEJ-2 WHICH WAS
17 ATTACHED TO YOUR DIRECT TESTIMONY?**

18 **A** Based on additional information, I have (1) revised the percentage adjustment used
19 to reflect the class usage profile; (2) adjusted the class electrical losses to reflect the
20 current loss study; and (3) added a component to account for retail business costs.

21
22 **Q WHAT IS THE RESULT OF THE CHANGES YOU HAVE MADE, AS REFLECTED
23 ON EXHIBIT DEJ-2S?**

24 **A** I now recommend a rate for the Default Energy and Capacity Offer of 4.38¢ for the

1 residential class. I estimate the system average rate would be approximately 4.0¢.
2 This is consistent with the MAPSA Counter Proposal.

3
4 **Q WHAT DOES THE 4.38¢ DEFAULT ENERGY AND CAPACITY OFFER**
5 **REPRESENT?**

6 A This represents the maximum price a residential retail customer would have to pay
7 for generation.

8
9 **Q HOW DO THE RATES IN THE MAPSA COUNTER PROPOSAL COMPARE TO**
10 **THE RATES YOU HAVE DERIVED?**

11 A In comparison, the MAPSA Counter Proposal has essentially the same distribution
12 rate and Default Energy and Capacity Offer (i.e., generation rate) as I have
13 calculated on Exhibit DEJ-2S. The Default Energy and Capacity Offer, as explained
14 previously, is the price that new suppliers must beat to provide savings to customers
15 and compete in Pennsylvania. In regard to this price, suppliers would be accepting
16 some risk that the PECO market price forecasts are wrong. This is a risk amplified
17 by use of a ten-year forecast.

18 To the extent that prices rise above forecast levels, PECO could still end up
19 undercutting all suppliers because PECO has proposed to reduce the CTC only for
20 customers that purchase generation from PECO. This is a risk to MAPSA under the
21 Counter Proposal; however, it illustrates that MAPSA has not made a counter
22 proposal that protects it while exposing PECO.

1 Q WHAT IS ACCOMPLISHED BY THE SUBSTITUTION OF A HIGHER DEFAULT
2 ENERGY AND CAPACITY OFFER?

3 A MAPSA's proposed Default Energy and Capacity Offer accomplishes two important
4 goals: (1) it makes the potential for competition a reality, and (2) it provides
5 continuity and equity for those customers participating in the Pilot phase of the
6 transition to competition.

7 With respect to the potential for meaningful competition, the credits that
8 customers of alternative suppliers would receive under the Partial Settlement are
9 simply insufficient to permit alternative suppliers to participate in the market. Without
10 the development of competition during the transition period contemplated in the
11 Partial Settlement, customers will not have choices and PECO will emerge from the
12 transition as an unregulated, virtual monopoly supplier of power and its customers
13 will suffer as a result.

14

15 Q WHAT WOULD BE THE IMPACT ON PARTICIPANTS IN THE PILOT PROGRAM
16 UNDER THE TERMS OF THE PARTIAL SETTLEMENT?

17 A With respect to the concern for continuity and equity for Pilot customers, the Partial
18 Settlement would reduce the credit that the Commission approved for those
19 customers by more than 1¢ per kWh. This would represent an immediate increase of
20 over 10% for an average participating customer. This also could affect competition
21 both in the short term and in the long term in that it may deter customers who wish to
22 participate in the Pilot.

1 Q HOW DOES THE MAPSA COUNTER PROPOSAL DEAL WITH THESE
2 PROBLEMS?

3 A The MAPSA Counter Proposal begins with the approved total credit received by Pilot
4 customers and escalates it at 3.0% per year for inflation, beginning in 1999. The
5 need to attract alternative suppliers is thus addressed, since the Pilot credit was
6 established with that concern in mind.

7

8 Q THE REBUTTAL TESTIMONIES OF PECO WITNESSES WILLIAM F.
9 SUNDERMEIR AND ALFRED A. MILLER¹ CONTAIN SEVERAL CRITICISMS OF
10 THE RECOMMENDATIONS MADE IN YOUR DIRECT TESTIMONY. HAVE YOU
11 REVIEWED THESE REBUTTAL TESTIMONIES?

12 A Yes, I have.

13

14 Q DO YOU HAVE ANY COMMENT ON THE REBUTTAL TESTIMONIES OF THESE
15 GENTLEMEN?

16 A Yes, I will respond to their criticisms of my recommendations for the design of the
17 unbundled generation rate.²

¹ PECO has designated these Rebuttal Testimonies as evidence in support of the Partial Settlement.

² The discussion contained in the balance of this testimony with respect to the "PECO proposal" and the recommendations for the design of the unbundled generation rate refers to the rate proposals as set forth in PECO's restructuring filing and in direct and rebuttal testimonies filed in this proceeding, rather than to the proposal for generation rates as is contained in the Partial Settlement.

1 Q DOES MR. MILLER DEFEND PECO'S PROPOSAL FOR GENERATION RATES
2 THAT ARE LEVEL FOR THE ENTIRE TRANSITION PERIOD?

3 A Yes. He correctly observes that my primary contention is that PECO's approach will
4 hinder competition. His only response however is an assertion that competition
5 would not suffer under the PECO proposal, but rather that customers would suffer
6 under my recommendation and other non-levelized recommendations because they
7 would pay more. He is incorrect in his contention that customers would pay more
8 than the rate cap under my recommendation and incorrect in his assertion that
9 competition would not suffer under the PECO proposal.

10

11 Q MR. JOHNSTONE, WOULD CUSTOMERS PAY MORE THAN THE RATE CAP
12 UNDER YOUR RECOMMENDATION FOR CALCULATION OF THE GENERATION
13 RATE?

14 A No. The beginning premise is that the same rate cap must be observed under any of
15 the proposals. Thus, customers would pay more only if they made an irrational
16 economic choice that they would not have made under the PECO proposal. This is
17 true for several reasons. First, I did not disagree with the rate cap amount applicable
18 to the total generation component. Consequently, if a customer chooses generation
19 service from PECO, the customer will pay the same total rate under either the PECO
20 proposal or my recommendation. However, there is a more realistic opportunity that
21 the customer will pay less under my recommendation if PECO is not chosen as the
22 generation supplier.

1 Q WHY IS THERE A MORE REALISTIC OPPORTUNITY THAT CUSTOMERS WILL
2 PAY LESS UNDER YOUR RECOMMENDATION?

3 A This is so because the generation rate component (i.e., that which is avoidable if the
4 customer chooses a third party supplier) is higher in each year and is designed to
5 provide a reasonable opportunity for customers to make such a choice without
6 suffering economically. In fact, under the PECO proposal, it is virtually impossible for
7 customers to choose an alternative supplier unless the PECO forecast of market
8 price turns out, when we have the benefit of hindsight, to have been seriously
9 overstated. Since that is the only condition under which customers would have an
10 economical opportunity to shop for competitive suppliers under the PECO proposal, I
11 believe the conclusion that PECO's proposal hinders competition is unavoidable.
12 Accepting PECO's proposal will lead to the consumers paying the maximum possible
13 rates under the rate cap. Thus, customers will be worse off in two important respects
14 under the PECO proposal. First, they will pay more during the transition period and,
15 second, they will suffer in the long run due to the lack of a market in which
16 competitors have made any significant inroads against the monopoly market position
17 of PECO.

18

19 Q WILL THERE BE A SHORTFALL IN THE COLLECTION OF STRANDED COSTS
20 UNDER YOUR RECOMMENDATION?

21 A No. I would note that the amount of stranded costs to be collected is yet to be
22 determined, and that Mr. Sundermeir's response refers to the PECO proposal, which
23 is the highest estimate of stranded costs that has been proposed. I would disagree
24 with the estimate to the extent that it provides no opportunity for PECO to obtain the

1 maximum revenue possible based on a market price. Instead, it systematically
2 undercuts the market price so that stranded costs would be nearly zero for each of
3 the years of the transition because customers could not economically choose an
4 alternative supplier. With an unpersuasive twist of logic, Mr. Sundermeir attempts to
5 characterize this result as a customer benefit. There is no support for such
6 characterization when the reality of the PECO proposal is denial of the opportunity for
7 consumers to make economical choices.

8
9 **Q COULD YOUR RECOMMENDATION RESULT IN A LOWER LIMIT ON THE**
10 **AMOUNT THAT COULD BE SECURITIZED?**

11 **A** That is a possible result, and it would not be inappropriate. From the perspective of
12 consumers and alternative suppliers, it would be inappropriate and inconsistent with
13 the public interest to allow securitization to impede the development of a competitive
14 retail generation market.

15
16 **Q DOES MR. SUNDERMEIR DISAGREE WITH ELEMENTS OF YOUR**
17 **RECOMMENDED DESIGN OF THE GENERATION RATE?**

18 **A** Yes. His rebuttal and a counter proposal based on the premise of annually
19 increasing generation rates is set forth in Exhibit WFS-8. The points on which he
20 disagrees with my recommendation as set forth in my direct testimony include:
21 (1) the method for determining market energy price by class, whether the
22 computation should be based on hourly data or simply on and off peak energy usage;
23 (2) energy losses; (3) losses associated with peak demand; and (4) my use of a load

1 factor based on the average of the non-coincident and coincident class peak
2 demands.

3 In the case of the two points he raises with respect to energy, I tentatively
4 agree and will modify my recommendation accordingly. In the case of the latter two
5 points which relate to demand charges, I will explain why his rebuttal is off the mark
6 and why my recommended method should stand.

7
8 **Q PLEASE EXPLAIN YOUR CURRENT POSITION WITH RESPECT TO THE**
9 **ENERGY COMPONENT OF THE GENERATION RATE.**

10 **A** I originally recommended that the forecast of hourly market energy prices be applied
11 to the forecast of hourly load of each class. Mr. Sundermeir suggests that the data is
12 available by on and off peak periods, but not hourly. Assuming this to be true, I
13 agree that the use of on and off peak energy usage and market prices is a step in the
14 right direction. This method increases the residential energy price by 0.26%, based
15 on historical data, as compared to the 3.0% that I had used only as a proxy on
16 Exhibit DEJ-2. Based on Mr. Sundermeir's presentation, it is apparent that the
17 0.26% is a better approximation of the correct result for the residential class.
18 Consequently, I agree with this aspect of his rebuttal testimony and modify my
19 recommendation accordingly. This modification is set forth on Exhibit DEJ-2S. The
20 same procedure should be followed for the other classes.

21 With respect to energy losses, the issue turns on what constitutes the
22 appropriate loss factor to use. There is no dispute as to the appropriate procedure to
23 follow in the application of the loss factor. The 10.3% loss factor I used in my direct
24 testimony is based on the historical data for 1996 presented in PECO exhibits.

1 However, I agree with Mr. Sundermeir's proposal to use the most recent loss study.
2 That means using a 9.35% loss factor for the residential class and using an
3 analogous procedure for the other classes.
4

5 **Q DO YOU AGREE WITH MR. SUNDERMEIR'S CLAIM THAT THERE SHOULD BE**
6 **NO ADJUSTMENT FOR ELECTRICAL LOSSES IN THE DETERMINATION OF**
7 **THE CAPACITY COMPONENT OF THE GENERATION RATE?**

8 **A**No. Losses incurred in the retail delivery of capacity are a physical reality that could
9 not possibly be reflected in the forecast of wholesale market prices. Hence, the loss
10 adjustment is necessary. The capacity requirements at the time of peak load would
11 vary somewhat from the average energy losses, but the energy loss factor is a
12 reasonable approximation in the absence of class specific capacity loss factors.
13 Hence, I recommend the use of the energy loss factor for the residential class and
14 the same procedure with respect to losses for the other classes. This is my
15 recommendation, absent the availability of a class specific demand loss factor, which
16 would further improve accuracy if it were available.
17

18 **Q DO YOU STAND BY YOUR INITIAL RECOMMENDATION WITH RESPECT TO**
19 **THE USE OF A CLASS LOAD FACTOR BASED ON THE AVERAGE OF CLASS**
20 **NON-COINCIDENT PEAK DEMAND AND CLASS COINCIDENT PEAK DEMAND?**

21 **A**Yes. There will be a loss of diversity when the system load is disaggregated by virtue
22 of there being multiple suppliers. The use of the average of the non-coincident and
23 coincident peak loads accounts for this consideration in an estimated fashion.

1 Over time, the reserve percentage will be reviewed and this, along with all
2 other considerations appropriate to the calculation of reserves, will result in new
3 reserve requirements. PECO proposed use of an 18.0% reserve component in lieu
4 of the current 18.3% reserve requirement. My procedure is logically consistent with
5 the lower 18.0% reserve projection, and I stand by my original recommendation in
6 this regard. In the absence of accounting for increased diversity, a higher reserve
7 margin would be required.

8
9 **Q DOES THIS CONCLUDE YOUR TESTIMONY?**

10 **A** Yes, it does.

**MID-ATLANTIC POWER SUPPLY ASSOCIATION'S
COUNTER OFFER
TO PECO SETTLEMENT PROPOSAL**

On August 19, 1997, the Mid-Atlantic Power Supply Association ("MAPSA") received for the first time a settlement proposal negotiated by PECO Energy Company ("PECO") with many, if not most of the parties to PECO's restructuring case. MAPSA believes that the August 19, 1997 proposal makes commendable progress in many areas. MAPSA also recognizes the value it presents to the negotiating parties. However, MAPSA believes the one aspect of a restructured environment not adequately served by the proposal is competition. Under the proposal as outlined by PECO, MAPSA believes that no alternative suppliers will be able to compete with PECO for 5-7 years after implementation. For this reason, MAPSA is unable to support the settlement as currently drafted.

With that in mind, MAPSA makes the following counter proposal. MAPSA believes that the approach set forth below preserves the basic benefits negotiated by the parties to date, while making certain adjustments necessary to enable full-fledged competition to begin in 1999, as envisioned by the enabling act. Special care was taken to ensure that PECO is able to recover the full \$5.5 billion of stranded costs negotiated for, and that customers will be able to save at least as much, at least as soon, as negotiated by customer interests.

1. Recognizing the effort by many parties that went into crafting the "pre-MAPSA" settlement proposal, MAPSA wishes to preserve as much of the original settlement as possible. Therefore, MAPSA agrees to all parts of the settlement not specifically "countered" in this document.
2. MAPSA's proposal is committed to providing PECO sufficient CTC revenues to recover \$5.5 billion on a net present value basis.
3. MAPSA's proposal is committed to meeting the yearly bill caps, and providing the guaranteed rate reductions, negotiated by the parties representing customer interests.
4. With these constraints in mind, MAPSA proposes the attached schedule of charges for the CTC/ITC combination (Schedule A). These charges, in turn, lead to the Default Energy and Capacity Offer (called the Energy and Capacity Cap in the PECO proposal) listed on Schedule A. MAPSA also has forecast load growth of 2% per year, upon which CTC/ITC charges can be assessed.
5. MAPSA's Default Energy and Capacity Offer is based on the customer participation credits approved by the Commission on August 21, 1997 for the Pilot phase of competition. It takes the total credit (for energy, capacity and "participation") approved for PECO for the Pilot, and grows that number 3% per year for inflation, starting in 1999. MAPSA can see no logic in offering Pilot customers a savings

incentive in 1998, only to "yank the rug out from under them" in 1999 by reducing the savings by over \$.01 per kwh. Furthermore, the ability of alternative generation suppliers to compete with a utility still collecting some of its generation costs through a CTC/ITC, will not change suddenly in 1999. The same amount of "credit" (or its competitive market analog, the "energy and capacity cap") will still be necessary.

6. If PECO chooses to offer energy via its regulated business entity, the price must take the form of the Default Energy and Capacity Offer. This rate may not be discounted. This applies equally to customers that voluntarily choose the regulated entity, and to customers served under the "supplier of last resort" role. PECO may compete on a totally free market basis for customers via Horizon, or other affiliate.
7. MAPSA believes that the distribution rate agreed to in PECO's settlement proposal is too high, and includes allocations of costs that will support generation, sales and marketing functions. Furthermore, as this rate will continue unchanged until PECO files a future rate case, it is extremely important to ensure that it does not overrecover the appropriate costs for distribution service. Therefore, MAPSA proposes that the distribution rate be \$.0224, which MAPSA believes most accurately reflects the appropriate cost. In order to compensate PECO for the lost revenue, MAPSA has added the amount to the CTC. With this addition, the net present value of all monies collected via the CTC is now projected to be \$5.8 billion in MAPSA's proposal.
8. MAPSA proposes that PECO agree to the attached metering and billing proposals (Attachment 1) on an interim basis, until the issue is finally decided generically on a statewide basis.
9. MAPSA proposes that PECO agree to adopt the attached Code of Conduct (Attachment 2) on an interim basis, until the issue is finally decided generically on a statewide basis.
10. MAPSA proposes that it and PECO agree to a series of meetings to adopt interim operating and supplier interaction rules, for use until the issue is decided generically on a statewide basis. These meetings should begin no later than September 1997, and should continue no less frequently than monthly until issues are satisfactorily resolved. MAPSA proposes that the parties agree that ultimate resolution must take place no later than June 1998.

MAPSA strongly believes that this proposal preserves the core of the bargain negotiated by other parties prior to its involvement in the settlement discussions, and makes only the adjustments absolutely necessary to allow alternative generation suppliers a fair opportunity to compete for customers, beginning in 1999. MAPSA believes this proposal advances the interests of competition without harming the interests of other parties. We look forward to hearing the reactions of all interested parties.

SCHEDULE A
MID-ATLANTIC POWER SUPPLY ASSOCIATION'S
COUNTER OFFER
TO PECO SETTLEMENT PROPOSAL

Year	Xmission	Distribution	CTC	Std. Offer	Bill Cap	Gen. Cap	Total Usage	CTC Revenues
1998				3.89				
1999	0.51	2.24	2.19	4.01	8.95	6.20	33,780,905,000	\$740,916,589.37
2000	0.51	2.24	2.07	4.13	8.95	6.20	34,456,523,100	\$714,317,835.82
2001	0.51	2.24	2.45	4.25	9.45	6.70	35,145,653,562	\$860,819,670.50
2002	0.51	2.24	2.62	4.38	9.75	7.00	35,848,566,633	\$939,867,226.79
2003	0.51	2.24	2.69	4.51	9.95	7.20	36,565,537,966	\$983,767,954.67
2004			2.61	4.64		7.25	37,296,848,725	\$971,633,844.29
2005			2.52	4.78		7.30	38,042,785,700	\$957,076,850.77
2006			2.41	4.93		7.34	38,803,641,414	\$936,046,421.29
2007			2.76	5.08		7.84	39,579,714,242	\$1,094,154,410.65
2008			2.61	5.23		7.84	40,371,308,527	\$1,054,565,306.18
								Nominal Revenue
								\$9,253,166,110.32
								Interest Rate 8.80%
								Net Present Value - \$5,827,542,701

**ATTACHMENT 1
MID-ATLANTIC POWER SUPPLY ASSOCIATION'S
COUNTER OFFER
TO PECO SETTLEMENT PROPOSAL**

NEW SECTION. **Metering and Billing Options.** The customer shall have several metering and billing options. Billing options shall include complete billing from the Distribution Utility, independent separate billing by the Distribution Utility and the Electric Generation Supplier for respective services, and complete billing from the Electric Generation Supplier for all services as described in Attachment 1. Metering options shall include metering by the Distribution Utility, parallel metering by the Distribution Utility and the Electric Generation Supplier, and metering by the Electric Generation Supplier as described in Attachment 1.

The Distribution Utility, Electric Generation Suppliers and other interested parties will establish billing format protocols, billing schedules and other details of the billing cycle. Requirements of Chapter 56 will be met. The parties to this Partial Settlement agree to form a Working Group to establish the necessary systems by July 1998 so that customers, the Distribution Utility and the Electric Generation Suppliers will have sufficient time for education and implementation of these metering and billing options.

**ATTACHMENT 1
MID-ATLANTIC POWER SUPPLY ASSOCIATION'S
COUNTER OFFER
TO PECO SETTLEMENT PROPOSAL**

Metering and Billing Principles of Settlement
--

I. Billing

The end-use customer shall have the option of selecting one of three billing options:

1. **Complete Billing from the Distribution Utility.** At the customer's option, the Distribution Utility will calculate, bill and handle cash flow as an agent for Electric Generation Suppliers.
2. **Independent Separate Billing.** At the customer's option, both the Distribution Utility and the Electric Generation Supplier will independently calculate, bill and receive payment for respective products and services supplied. The customer will receive two separate bills.
3. **Complete Billing from the Electric Generation Supplier.** At the customer's option, the Distribution Utility will bill the Electric Generation Supplier for distribution and ancillary services supplied to the customer. The Electric Generation Supplier will in turn calculate, bill the end-use customer and handle cash flow as an agent for the Distribution Utility.

The billing entity will fully reimburse the non-billing entity for services billed by the non-billing entity in the event of partial payment by the customer.

The Distribution Utility and Electric Generation Suppliers will establish billing format protocols, billing schedules and other details of the billing cycle. These will be in conformance with the requirements of Chapter 56.

II. Metering

The end-use customer shall have the option of selecting one of three metering options:

1. **Distribution Utility Meter.** At the customer's option, the Distribution Utility will own, maintain, and read the meter at the customer's delivery point. Access to this information will be available to Electric Generation Suppliers in accord with established format protocols, reading schedules and billing cycles.

2. **Parallel Meters.** At the customer's option, the Electric Generation Supplier will install, own, maintain and read a second meter that will be in accordance with meter and installation standards as defined and used by the Distribution Utility. This meter can be used for customer information, balancing, load following or any combination of ancillary offerings that the Electric Generation Supplier may supply to the end-use customer. The Distribution Utility meter will always be the meter to which the billing quantities will be adjusted.

3. **Electric Generation Supplier Meter.** At the customer's option, the Electric Generation Supplier will own, maintain, and read the meter at the customer's delivery point. Such meters will comply with all meter specifications and installation standards as defined by the Public Utility Commission, applicable law and engineering practices. Access to this metered information will be available to the Distribution Utility in accord with established format protocols, reading schedules and billing cycles.

**ATTACHMENT 2
MID-ATLANTIC POWER SUPPLY ASSOCIATION'S
COUNTER OFFER
TO PECO SETTLEMENT PROPOSAL**

NEW SECTION. PECO agrees to abide by the interim Code Of Conduct contained in ATTACHMENT 2 until such time as the Public Utility Commission adopts a different Code of Conduct or otherwise modifies this interim Code.

**ATTACHMENT 2
MID-ATLANTIC POWER SUPPLY ASSOCIATION'S
COUNTER OFFER
TO PECO SETTLEMENT PROPOSAL**

INTERIM CODE OF CONDUCT

The relationship of the PECO generation supply group or a competitive generation affiliate or marketing group or division (a "PECO Generation Supplier" or "PECO Supplier"); a competitive distribution services affiliate or marketing group or division (a "PECO Competitive Distribution Services Supplier" or "PECO Supplier"); and the employees that perform the role of local electric distribution utility ("EDU" or "PECO EDU") will be governed by the following Code of Conduct which is intended to control dissemination of confidential customer information, restrict access to competitive information, prevent cross-subsidies between regulated and unregulated departments and prevent anti-competitive and discriminatory practices.

1. Employees of PECO EDU who have responsibility for managing and operating the distribution system shall not be shared with a PECO Supplier.
2. PECO EDU and the unregulated affiliates, PECO Suppliers, shall operate from physically separate locations and operate separate computer and information systems to avoid potential inadvertent sharing of information.
3. PECO EDU may share resources with PECO Suppliers for non-operational functions such as legal, accounting and other non-operational services under the conditions that:
 - PECO EDU will specifically identify the personnel, assets or services which it intends to share and seek Commission approval of such sharing. Such applications for approval will describe the accounting controls that will be utilized to prevent possible cross-subsidization;
 - Any shared resources shall be fully and transparently allocated between PECO EDU and the PECO Suppliers;
 - PECO EDU accounts and records shall be maintained such that the costs incurred by or on behalf of a PECO Supplier are separately and clearly and identified; and
 - The Commission will retain the authority to investigate or audit these areas to ensure that no subsidization occurs in the future.
4. PECO, in its role as the PECO EDU, shall not give a PECO Generation Supplier any preference over a non-affiliate in processing a request by a customer for service.

5. PECO, in its role as the PECO EDU, shall not give a PECO Competitive Distribution Services Supplier any preference over a non-affiliate in processing a request by a customer for service.
6. PECO EDU shall not give a PECO generation Supplier or a PECO Competitive Distribution Services Supplier any preference over a non-affiliate in processing a request by a non-affiliated generation or distribution services supplier for access or service.
7. PECO EDU shall not condition or tie in any way the provision of any regulated utility services (distribution, generation or other) on the purchase of any service from a PECO Supplier.
8. PECO EDU shall supply services and apply the rules, terms and conditions and other provisions of its tariffs to non-affiliates in the same manner it applies them to a PECO Supplier.
9. PECO EDU shall not sell non-power goods or services to a PECO Supplier at a price or consideration below the cost or market price, whichever is higher, for said goods or services unless such goods or services are offered to non-affiliated suppliers on the same terms, conditions and pricing. PECO EDU will not purchase non-power goods or services from a PECO Supplier at a price above the market price for said goods and services.
10. PECO EDU shall simultaneously make available to all non-affiliate suppliers any market, pricing or operational information that it provides to a PECO Supplier.
11. PECO EDU will make meter reading, billing and other customer assistance services available to all non-affiliated suppliers and PECO Suppliers at the same non-discriminatory rates, terms and conditions.
12. Neither PECO EDU nor a PECO Supplier may directly or by implication represent that:
 - the regulated distribution services provided by PECO EDU are of superior quality when power or other services are purchased from a PECO Supplier; or
 - that the power and related services are being provided by PECO EDU rather than a PECO Supplier; or
 - that the power or services purchased from a non-affiliated supplier that is not a PECO Supplier may not be reliably delivered; or
 - that any advantage, including discounts or other terms of service, accrues to the customer in the use of utility services as a result of the customer purchasing power or other services from a PECO Supplier.
13. PECO EDU will not provide sales leads to PECO Suppliers and will refrain from giving any appearance that PECO EDU speaks on behalf of a PECO Supplier.

14. PECO EDU shall consider confidential the following information:

- Supplier pricing and billing information;
- Supplier customer lists;
- Individual customer consumption;
- Identity of the supplier of a participating customer.

Upon written request, a customer may request information regarding consumption and services provided to the customer's home or facilities.

15. This Code of Conduct will be communicated throughout PECO EDU and PECO Suppliers and other internal service organizations and appropriate procedures will be implemented to ensure compliance, including but not limited to:

- Incorporation of this Code of Conduct into the Company's Standards of Integrity;
- Employees having access to competitive information will sign confidentiality agreements prohibiting improper disclosure of competitive information;
- Periodic audits of the Code of Conduct will be conducted to ensure compliance; and
- Violations of the Code of Conduct will result in disciplinary action administered in accordance with PECO policy.

16. PECO EDU will establish and file with the Commission a procedure for receiving, recording and resolving complaints alleging violation of this Code of Conduct.

Residential Generation Rate Design
Example Based on 1999 Costs

<u>Line</u>	<u>Energy Component</u>	<u>Amount</u>
1	System average market energy component	2.29¢
2	Adjustment to reflect class usage profile (0.26%)	<u>0.01¢</u>
3	Subtotal	2.30¢
4	Adjustment to reflect class electrical delivery losses (9.35%)	<u>0.22¢</u>
5	Total	2.52¢
	<u>Capacity Component</u>	
6	Market cost of new capacity per kW	\$42.00
7	Reserve Requirement (assume 18%)	<u>7.56</u>
8	Subtotal	\$49.56
9	Adjustment to reflect class electrical losses (assume 9.35%)	<u>4.63</u>
10	Total	\$54.19
11	Convert to a kWh charge for energy only rates (45% load factor)	1.38¢
	<u>Summary</u>	
12	Energy	2.52¢
13	Capacity	1.38¢
14	Retail Business Costs	<u>.48¢</u>
15	Generation Rate Component (also the recommended Default	
16	Energy and Capacity Offer)	4.38¢