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February 6, 1998

ORIGINAL

James McNulty, Prothonotary
Pa. Public Utility Commission
P.O. Box 3265
Harrisburg, PA 17105-3265

DOCUMENT FOLDER

Re: Pennsylvania Power & Light Company's
Restructuring Plan
Docket No. R-00973954

KJR

Dear Mr. McNulty:

Enclosed for filing please find an original and nine (9) copies of the Main Brief of the International Brotherhood of Electrical Workers, Local 1600, in the above-referenced proceeding. A copy of this document has been served on Administrative Law Judge Kashi and all parties of record, as shown on the attached certificate of service.

Sincerely,

Scott J. Rubin, Esq.

Enclosures

cc: Hon. George Kashi, ALJ (with diskette)
All parties of record

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BEFORE THE
COMMONWEALTH OF PENNSYLVANIA
PUBLIC UTILITY COMMISSION

ORIGINAL

APPLICATION OF PENNSYLVANIA POWER AND LIGHT COMPANY FOR APPROVAL OF ITS RESTRUCTURING PLAN UNDER SECTION 2806. OF THE PUBLIC UTILITY CODE	:	DOCKET NO. R-00973954

MAIN BRIEF
OF THE
INTERNATIONAL BROTHERHOOD OF ELECTRICAL WORKERS
LOCAL 1600

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DATED: FEBRUARY 12, 1998

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Introduction and Summary of Argument

This brief is submitted on behalf of International Brotherhood of Electrical Workers, Local 1600 ("IBEW"). IBEW is the bargaining representative for more than 4000 employees of the Pennsylvania Power and Light Company ("PP&L"). IBEW St. 1 at 1. In this proceeding, IBEW is representing the interests of its current members as well as approximately 2000 retirees, both as employees of PP&L and as consumers of electricity within PP&L's service territory. *Id.* IBEW presented the testimony of one witness, its president William Schmitt, who prepared IBEW Statement 1 and testified at the hearing on August 21, 1997.

IBEW has directed its attention in this case to one issue: the ability of non-utilities to provide billing and metering services for PP&L's regulated distribution of electricity. Several prospective marketers of electricity, including Enron Power Marketing, Inc. ("Enron"), Mid-Atlantic Power Supply Association ("MAPSA"), and New Energy Ventures ("NEV") (collectively referred to herein as "Marketers"), have proposed that they should be permitted to own, operate, and maintain customers' electric meters and provide all billing and collection services for PP&L's regulated, distribution service.

In particular, Marketers argue that they should be allowed to provide – at each individual Marketer's option – all or any portion of the billing, metering, and collection services for PP&L's provision of regulated, distribution service. IBEW strongly opposes this attempt by Marketers to provide a few distribution services to a select group of electricity consumers.

Initially, in Section X.D.8.a, IBEW explains that it is unlawful for an entity that is not a public utility either (1) to render a bill for utility service or (2) to own, operate, and maintain a

meter that is used for providing utility service.[1] The legal requirements imposed by the Public Utility Code for the billing and metering of utility services cannot be waived by this Commission and can be met only by a public utility. Needless to say, the Marketers, by definition, are not public utilities.

In Section X.D.8.b, below, IBEW discusses two recent Commission decisions that reach the conclusion that billing, metering, meter reading, and other customer service functions must be provided by a regulated public utility. While these decisions did not fully address the legal analysis that is presented by IBEW in this case, they reach a conclusion that is fully consistent with IBEW's analysis: only a regulated public utility can bill for tariffed distribution charges and provide metering, meter reading, and related customer services.

Moreover, as IBEW demonstrates in Section X.D.8.c, below, even if it were lawful for non-utilities to meter and bill for utility services, the Marketers' proposals in this case are grossly unfair both to PP&L and to consumers. The result of adopting the Marketers' proposals would be to increase PP&L's cost of providing service and to decrease the overall quality, reliability, safety, and efficiency of electric service.

IBEW requests, therefore, that the Commission, act in this case, as it has in other cases, to prohibit non-utilities from providing billing, metering, and other services associated with the regulated distribution of electricity. Such services must be provided only by PP&L, as the regulated distribution utility.

---

[1] In accordance with the Administrative Law Judge's Briefing Order, IBEW is numbering the sections of this brief to be consistent with the common brief outline. The issues presented in this brief could be placed in either of two sections in that outline: Section X.D.8 (supplier provision of billing and agency services) or Section X.E.1 (unbundling of metering, billing, and collection rates and services). In an effort to streamline this brief, all arguments are being presented under Section X.D.8. IBEW shows Section X.E.1 in this brief with just a cross-reference to the argument presented in Section X.D.8.

ARGUMENT

X. CODE OF CONDUCT AND COMPETITION ISSUES

D. ADDITIONAL COMPETITIVE RESTRICTIONS PROPOSED

8. THE COMMISSION SHOULD NOT PERMIT ALTERNATE SUPPLIERS TO BILL FOR DISTRIBUTION SERVICES AND BE THE SOLE CONTACT FOR CUSTOMER SERVICE

a. IT IS UNLAWFUL FOR NON-UTILITIES TO RENDER A BILL FOR UTILITY SERVICE OR TO OWN, OPERATE, AND MAINTAIN UTILITY METERS.

Numerous provisions of the Public Utility Code and the Commission's regulations require that billing and metering for public utility services must be provided by a public utility. As a consequence, Marketers must be prohibited from billing or metering public utility services.

Before discussing the specific legal restrictions, it is important to note that when IBEW uses the term "public utility services" it is referring only to the regulated transmission and distribution of electricity by PP&L. That is, IBEW's position is that it is unlawful for anyone other than PP&L to bill for and meter PP&L's electricity distribution service. IBEW does not dispute the ability of non-utilities to provide their own bills solely for the supply of electricity or for other non-utility services.

The legal analysis of this issue must begin with the definition of "public utility." As amended by the Electricity Generation Customer Choice and Competition Act (Act 138 of 1996, P.L. 802; hereafter "the Act"), Section 102 of the Public Utility Code, 66 Pa. C.S. § 102, excludes "electric generation supplier companies" from the definition of public utilities. The Act also defines "electric generation supplier" as "a person or corporation" that "sells to end-use customers electricity or related services utilizing the jurisdictional transmission or distribution facilities of an electric distribution company." 66 Pa. C.S. § 2803. In contrast, that same section

defines an "electric distribution company" to be a "public utility" that provides "facilities for the jurisdictional transmission and distribution of electricity to retail customers." *Id.*

Thus, as a preliminary matter, jurisdictional transmission and distribution services must be provided to end-users of electricity by an electric distribution company. That electric distribution company, PP&L in this case, must be a public utility.

The next step in this analysis is to determine whether billing and metering services are part of the "distribution services" that are provided by a public utility. Again, Section 102 of the Public Utility Code provides the answer. That section of the Code defines "service" to include "any and all acts done, rendered, or performed, and any and all things furnished or supplied, and any and all facilities used, furnished, or supplied by public utilities ... in the performance of their duties under this part to their patrons, employees, other public utilities, and the public ...." Further, Section 102 defines "facilities" to include "all plant and equipment of a public utility, including all tangible and intangible real and personal property without limitation, and any and all means and instrumentalities in any manner owned, operated, leased, licensed, used, controlled, furnished, or supplied for, by, or in connection with, the business of any public utility." It also should be noted that Commonwealth Court has held that the terms "service" and "facilities" as used in the Public Utility Code are to be broadly construed. *Country Place Waste Treatment Co., Inc., v. Pa. Public Utility Commission*, – Pa. Commonwealth Ct. –, 654 A.2d 72, 76 (1995).

Thus, when the Act speaks of "distribution services" that are provided by a public utility, that term is defined to include all acts performed and all property used by the utility in serving its customers and the public. There is no question that the electric meter is property that is "used ... or supplied by public utilities" in providing regulated electric distribution service to their

customers. There also is no question that the rendering of a bill for distributing electricity is an "act done" in providing regulated electric distribution service to the utility's customers.

In other words, under the Public Utility Code, the metering and billing for the distribution of electricity are part of the provision of service by a public utility. As of this point in time, PP&L is the only public utility that is authorized to provide electric distribution service within its service territory. Any Marketer (or other entity) that desires to meter and bill for electric distribution service first must receive a certificate of public convenience and necessity to provide public utility service. 66 Pa. C.S. § 1101.

This interpretation of the law is fully consistent with numerous other provisions in the Public Utility Code and in the Commission's regulations. The following provisions evidence a strong legislative intent that only a public utility should be permitted to bill for and meter utility services. The Commission's regulation of such billing and metering services is pervasive precisely because such services are essential to the provision of utility service. As IBEW explains in the following paragraphs, if such services are provided by Marketers and other non-utilities, then the Commission would not have the statutory authority to regulate those services.

Chapter 15 of the Public Utility Code (Service and Facilities) contains several provisions that require a public utility to bill for and meter utility services. Initially, Section 1504 gives the Commission the authority to regulate: "(2) ... the measurement of quantity, quality, pressure, initial voltage or other condition pertaining to the supply of the ***service*** of any and all ***public utilities***. (3) ... the examination and testing of ***such service***, and for the measurement thereof. (4) ... the accuracy of all meters and appliances for measurement. (5) ... the examination and testing of any and all appliances used for the measurement of any ***service*** of any ***public utility***." 66 Pa. C.S. § 1504 (emphasis added). That is, the Commission's authority to regulate the metering of

electricity, including the testing of meters, applies only to meters that are used to provide "service" by a "public utility." If the Commission were to permit non-utilities, such as Marketers, to provide metering services, the Commission would have no authority to regulate the non-utilities' meters.

Section 1507 of the Code requires every "public utility, furnishing service upon meter" to maintain records of the meters' accuracy, as well as equipment "for testing and proving the accuracy of meters furnished by such public utility for use." Moreover, the Commission is required to approve and inspect these meter testing facilities. 66 Pa. C.S. § 1507. Importantly, though, these testing and record-keeping requirements apply only to a "public utility" that furnishes "service." Once again, if the Commission desires to ensure that all electric meters are tested in a certified laboratory, the meters must be "furnished by" a "public utility." The Commission has no jurisdiction over measuring devices that are used by entities that are not public utilities.

Similarly, Section 317 of the Code permits the Commission to restrict the amount that "public utilities" may charge "for the testing of their instruments of precision and measuring apparatus." 66 Pa. C.S. § 317(b). Here again, the Commission cannot regulate the amount that is charged for testing a meter by any entity that is not a "public utility."

The Code contains several other provisions that empower the Commission to regulate the rendering of bills by "public utilities" but that do not apply if a non-utility were to render a bill for a utility service. Section 1509 of the Code sets forth restrictions on the billing procedures that are used by "a public utility as defined in paragraph (1)(i), (ii), (vi), or (vii) of the definition of 'public utility' in section 102 ... to its service customers ..." 66 Pa. C.S. § 1509. For example, this section contains requirements concerning the allowable time period for paying a

utility bill and the way in which information must be displayed on the utility bill. However, these restrictions apply only to "public utilities" that are delineated in specified portions of the definition in Section 102 of the Code. As was noted previously, Marketers are specifically excluded from that definition. Thus, the Commission's statutory ability to regulate the content and payment period on a bill for electric distribution service exists only when the bill for such service is "rendered by a public utility."

Similarly, Subchapter B of Chapter 15, 66 Pa. C.S. §§ 1521-1533, sets forth billing, collection, and termination requirements that must be met for public utilities that supply service to leased, residential premises. However, these provisions are limited to "public utilities as defined in paragraph (1)(i) and (ii) of the definition of 'public utility' ..." 66 Pa. C.S. § 1522(a). Thus, again, because Marketers are not defined as public utilities, they are not subject to the statutory provisions regarding the discontinuance of utility service to leased premises. In order for these statutory provisions to apply to electric distribution service, the bill and meter for that service must be provided by a public utility.

All of these provisions of the Public Utility Code are designed to protect consumers and to ensure that a minimum level of regulated, utility service is provided within the Commonwealth. It is possible to implement these provisions only if a public utility is responsible for the electric meter and renders the bill for electric distribution service.

In passing the Act, the General Assembly was aware of these restrictions when it permitted electric generation suppliers the right to bill for their own services and nothing more. In Section 2807(c), the Code provides: "Subject to the right of an end-use customer to choose to receive ***separate bills from its electric generation supplier***, the electric distribution company may be responsible for billing customers for ***all electric services***, consistent with the regulations

of the commission, regardless of the identity of the provider of those services." 66 Pa. C.S. § 2807(c) (emphasis added). That is, the statute does not permit electric generation suppliers to bill for ***all services***; that right is reserved to the distribution utility. Instead, the generation supplier only has the ability to render a separate bill for the services that it provides and then only if the customer requests it.

Section 2807(c) then sets forth requirements for how the electric distribution utility must perform the billing for services provided by others. These provisions cover the form and content of the bill, the furnishing of data to the distribution utility, and the allocation of payments. 66 Pa. C.S. §§ 2807(c)(1) to 2807(c)(3). Importantly, the Code does ***not*** contain comparable provisions that define similar obligations for electric generation suppliers performing the same function. *See* 66 Pa. C.S. § 2809. The absence of a parallel obligation for generation suppliers provides further support for the conclusion that the statute does not permit anyone other than the distribution utility to bill for distribution services.

In addition, there is no doubt that distribution utilities are required to provide other services that are directly related to the billing function. Section 2807(d) states:

> The electric distribution company ***shall continue*** to provide customer service functions consistent with the regulations of the commission, including meter reading, complaint resolution and collections. Customer services shall, at a minimum, be maintained at the same level of quality under retail competition.

66 Pa. C.S. § 2807(d) (emphasis added). It is difficult to understand how it would be possible for the electric distribution utility to continue providing these services unless it is also the entity that is billing for the services that it provides. This is particularly true for complaint resolution and collections, both of which are directly related to the actual bill that the customer receives.

Further, several important provisions in the Commission's regulations do not apply to electric generation suppliers. Under the Act, the only provisions of the Commission's

regulations that are made directly applicable to generation suppliers are the "standards and billing practices" found in 52 Pa. Code Ch. 56. 66 Pa. C.S. § 2809(b). It makes sense for these requirements to apply if the generation supplier is going to render a separate bill for service that it provides, as customers may request pursuant to 66 Pa. C.S. § 2807(c).

However, the Act does not provide that the requirements in Chapters 57 and 58 of the Commission's regulations apply to generation suppliers. Specifically, these regulations contain the following requirements, among others, with which electric distribution utilities must comply:

- Limitations on the fees for meter testing, 52 Pa. Code § 57.22;
- Procedures for adjusting bills for meter errors, 52 Pa. Code § 57.24;
- Procedures for engaging in sales promotion practices, 52 Pa. Code §§ 57.61-57.67;
- Maintenance of customer records that enable the utility to implement a low-income usage reduction program, 52 Pa. Code Ch. 58.

Each of these requirements, among the many others that appear in Chapter 57, apply only to public utilities that provide electric distribution service. As was noted previously, that term does not include the Marketers or other electric generation suppliers. Moreover, it would be extremely difficult, if not impossible, for electric distribution utilities to comply with many of these requirements if the electric distribution utility is not the entity that renders the bill to the customer, performs collection efforts, and is otherwise the primary contact point with the customer.

Furthermore, there is nothing in the Act that requires a different result. Numerous provisions of the Act state that the purpose of the Act is to provide for competition in the supply of electric generation to customers. For example:

- "Because of advances in electric generation technology and federal initiatives to encourage greater competition in the wholesale electric market, it is now in the public interest to permit retail customers to obtain direct access to a ***competitive generation market*** ..." 66 Pa. C.S. § 2802(3) (emphasis added).

- "The purpose of this chapter is to modify existing legislation and regulations and to establish standards and procedures in order to create direct access by retail customers to the competitive market for ***the generation of electricity*** ..." 66 Pa. C.S. § 2802(12) (emphasis added).

- "The procedures established under this chapter provide for a fair and orderly transition from the current regulated structure to a structure under which retail customers will have direct access to a ***competitive market for the generation and sale or purchase of electricity***." 66 Pa. C.S. § 2802(13) (emphasis added).

- "This chapter requires electric utilities to unbundle their rates and services and to provide open access over their transmission and distribution systems to allow competitive suppliers to ***generate and sell electricity*** directly to consumers in this Commonwealth. The ***generation of electricity*** will no longer be regulated as a public utility function except as otherwise provided for in this chapter." 66 Pa. C.S. § 2802(14) (emphasis added).

- "It is in the public interest for the ***transmission and distribution of electricity to continue to be regulated as a natural monopoly*** subject to the jurisdiction and active supervision of the commission." 66 Pa. C.S. § 2802(16) (emphasis added).

That is, there is nothing in the Act, or anywhere else in the Public Utility Code, that authorizes any entity other than a public utility to furnish an electric meter or to render a bill for electric distribution service. On the contrary, there are numerous provisions in the law that require that only a public utility can provide such services for its customers.

In summary, it is unlawful for any entity other than PP&L to provide a meter and render a bill for the electric distribution services that PP&L provides.

B. RECENT COMMISSION DECISIONS REINFORCE THE REQUIREMENT THAT ONLY PP&L IS AUTHORIZED TO PROVIDE BILLING, METERING, AND METER READING SERVICES FOR ITS CUSTOMERS.

Within the past few months, the Commission has addressed this question on two separate occasions. Both times, the Commission has held that the electric distribution company (EDC) is the only entity that is authorized and permitted to provide metering and meter reading services, and it is the only entity that is authorized and permitted to bill for regulated distribution charges. . .

First, on November 24, 1997, the Commission issued a Proposed Rulemaking Order that requires each EDC to own, install, and maintain all electric meters used to serve its customers. *Rulemaking re Advanced Meter Deployment for Electricity Providers, 52 Pa. Code §§ 57.250-57.257*, Docket No. L-00970128 (Pa. PUC Nov. 24, 1997). In that Order, the Commission concluded "that metering should remain a regulated function of the EDC at this time. Metering can remain a regulated function of the electric distribution utility, retaining all existing requirements and procedures for meter installation, reliability, safety, accuracy and the like." *Id.*, slip op. at 12.

Second, in its recent decision involving the restructuring of PECO Energy Co., the Commission reached a similar conclusion. *Application of PECO Energy Company for Approval of its Restructuring Plan Under Section 2806 of the Public Utility Code and Joint Petition for Partial Settlement*, Docket No. R-00973953 (Pa. PUC Dec. 23, 1997), *modified on other grounds*, slip op. (Jan. 16, 1998). In that decision, the Commission rejected Marketers' attempts to bill for PECO's distribution services and to take responsible for metering and related services. Specifically, regarding billing, the Commission held: "We ... cannot conclude that it is appropriate to unbundle billing based on this record. Therefore, PECO shall provide all billing services, including billing for generation services, unless a customer indicates a preference to receive a separate bill directly from the supplier for generation services." *Id.*, slip op. at 139. On the issue of metering, the Commission referred to its rulemaking docket (discussed above) and held that "we do not believe that it is necessary to unbundle metering as a competitive service at this time. ... While PECO, as a regulated EDC, shall be responsible for all physical work related to the meter, the customer and/or the EGS [electric generation supplier] may select the qualified

meter to be used and shall pay as a regulated rate any net incremental cost incurred by PECO as a result of the metering choice." *Id.*, slip op. at 140-141.

In summary, on the only two occasions where the Commission has addressed this issue, it concluded that billing, metering, meter reading, and other customer service functions must be provided by as a regulated distribution service by a public utility. There is absolutely no reason to reach a different result in this case.

c. Even if it Were Lawful for Non-Utilities to Bill and Meter Utility Services, the Marketers' Proposals in This Case Must be Rejected.

Even if the law did not prohibit the Marketers from metering and billing for electric distribution services, the evidence of record in this case demonstrates that it is not in the public interest for metering and billing services to be provided by the Marketers. The Marketers' proposals, therefore, must be rejected.

The Marketers' Proposals are Unprecedented.

On the first day of hearings, Enron sponsored the testimony of Dr. John Mayo, a professor of economics at the University of Tennessee, who proposed that utility customers should be able to decide who bills them for the distribution services that PP&L provides. Enron St. 2.0 at 24, Tr. 592 (8/18/97). However, Dr. Mayo agreed that the seller of a product – not the customer – decides how it will bill the customer and provide other customer service functions. Tr. 593-595 (8/18/97). In fact, as the following colloquy demonstrates, he was unable to identify any other instance in our society where the seller of a product is required to permit someone else to bill its customer and provide other customer services:

> JUDGE KASHI: No, that's not the question. Should PP&L be required to let someone else bill for services that PP&L provides?
>
> THE WITNESS: The answer is, not exclusively, but the opportunity to do so, yes.

BY MR. RUBIN:

Q. Dr. Mayo, are you familiar with any other service in our economy where a seller of a good or service is required to let someone else handle the billing, payment or customer service?

A. Not as I sit here right this minute, no.

Tr. 596 (8/18/97).

Later in the hearings, Enron witness Bowen agreed that he was unaware "of any entity that states as a separate line item on its bills the costs for billing." Tr. 1321 (8/22/97). Instead, the witness testified, both within the utility industry and in all other portions of the marketplace, the costs of billing customers and otherwise providing customer service are included in the price of the product. Tr. 1321-1322 (8/22/97).

The notion of "customer choice" sounds appealing, but as Dr. Mayo and Mr. Bowen both noted, it is unprecedented in this country when it comes to billing services. Customers do not choose who will send them a bill; the company that provides the service decides how it will bill its customers.

The Marketers' Proposals Do Not Allow Customers to Choose.

As the hearings continued and several more witnesses addressed this issue, it became apparent that the Marketers were not really interested in customer choice anyway. Instead, the Marketers want to be able to control the billing and metering process.

Enron witness Reising makes that abundantly clear in his proposed "Distribution Services Tariff." Enron Exh. 3.1, PDR-8. This proposed tariff sets out the rules that Enron would like to see govern the relationship between PP&L (the "EDC" in the tariff), Marketers (the "Customer" in the tariff), and the utility customer (the "End User" in the tariff). Those proposed rules make it clear that the Marketers would be able to choose who serves the customer. Specifically, proposed rule 10.1 states: "The Customer [that is, the Marketer], or at its election, the EDC [that

is, PP&L] shall be the Meter Service Provider and shall provide, own and maintain any meter or meters required in the supply of service." The rules continue, giving the Meter Service Provider the responsibility for reading meters and for rendering bills to End Users (that is, to PP&L's customers). *Id.*, Rules 11.1 to 11.4. Importantly, there is nothing in Enron's proposed tariff that would allow the End User to decide who provides it with a meter, bill, or other customer services. Under the proposed tariff, that choice rests solely with the Marketer.

Enron's position is reinforced by the provisions in its proposed "Electric Generation Supplier Tariff" sponsored by its witness Coles. Enron Exh. 7, LRC-2. That tariff also fails to give PP&L's customers any choice about who provides them with billing and metering services; instead, the Marketers are the only ones who have any choice. Specifically, proposed Rule 4.5 states: "Suppliers shall be responsible for billing all services to the Customer, including the EDC's charges for Energy Delivery Service, Transmission Service, Ancillary Services and other related charges, unless ***the Supplier elects***: (1) to have the EDC bill its charges separately to the Customer or (2) to have the EDC bill all charges including all of the Supplier's charges." *Id.*, page 6 (emphasis added). In other words, Enron's proposal is to give the Marketer the choice of billing options. Neither PP&L nor its customers would have any choice in how PP&L meters or bills its customers.

The Marketers' Proposals Violate the Law.

The Marketers' proposal cannot be adopted. This proposal violates the provisions of the Act. Section 2807(c) specifically states that the customer has "the right ... to choose to receive separate bills" from the Marketer and PP&L. 66 Pa. C.S. § 2807(c). That section also states that if the customer fails to choose to receive separate bills, then PP&L is responsible for rendering bills for all electric services. *Id.* Thus, the Marketers' proposal to give themselves the right to choose billing and metering options must be rejected as violating the provisions of the Act.

The Marketers' Proposals Result in Unwarranted Discrimination.

Not only do the Marketers' proposals violate the express language of the Act, they also would result in unwarranted discrimination among similarly situated utility customers. By giving a Marketer the power to choose whether it will provide billing or metering services to a customer, the Marketer is free to skim off those customers that can be served at relatively low cost; leaving higheR-cost customers to be served by PP&L. IBEW witness Schmitt addressed these concerns as follows:

> Today, we have a system that ensures that everyone receives electric service of the same high quality. Customers who live in remote areas, who have low incomes, or who have special needs receive the same service at the same cost as customers who live in densely populated areas and make no demands on our customer service personnel. This type of universal service at a uniform price will be in serious trouble if we let other companies pick and choose the customers they want to provide revenue cycle services to. I have no doubt that Enron or NEV or one of the other potential suppliers could provide customer service to ***some*** of our customers at less than our ***average*** cost of providing customer service. So could PP&L. But that's not the point. Right now, PP&L employees are able to provide high-quality customer service to ***all*** of our customers. The monthly customer charge is the same for every customer who takes the same type of service. It doesn't matter if a customer calls us five times a month or once every ten years; it doesn't matter where they live or what their income is. The low-cost customers make it possible to serve the high-cost customers at the same price and same high quality. If competitors are allowed to skim off the low-cost customers (higher incomes, fewer demands, living in more densely populated areas), then it will not be possible to continue serving the higher cost customers at the same price, because the average cost will increase significantly.
>
> It's similar to the way that the U.S. Postal Service is set up. The goal is to provide a service (first class mail) to everyone at the same price. Of course others could deliver mail in New York City at less than the average, nationwide cost of delivering mail. But those people are not also willing to provide service to rural Montana or Alaska at the same price. Serving the high-cost customers is made possible by the ability to also serve the low-cost customers.
>
> Exactly the same thing is true for PP&L's revenue cycle services. It's possible to provide a full range of customer services – metering, meter reading, billing, collections, and customer service – at the same price to everyone only because we serve everyone. Take away our low-cost customers and the average cost to serve the remaining customers will increase.

IBEW St. 1 at 10-11 (emphasis in original).

Incredibly, Enron and the other Marketers do not dispute that they intend to discriminate among customers. Mr. Shapiro, Enron's Vice President of Governmental Affairs, testified that Marketers should be able to charge different rates for the distribution of electricity to customers who receive the same class of service. Tr. 1615-1618 (8/26/97). Indeed, he stated: "Given that not all customers are similarly situated, have different electricity requirements, different needs, I think it's very likely that there will be some differentiation in terms of the price that's proposed to various customers." Tr. 1618 (8/26/97). Moreover, Enron does not believe that the amount it bills customers for distribution charges should be subject to any regulation by the Commission. Tr. 1618-1619 (8/26/97). *See also* IBEW Cross Exh. 2 (8/26/97), where Enron states that "suppliers should be able to bill its customer however it chooses."

Enron witness Jacobson reinforces the Marketers' intention to discriminate among customers and select those who are least costly to serve. The witness testified that PP&L would be required to provide billing, metering, and other customer service, and that it would be required to provide those services at a regulated, average price. Tr. 1354 (8/22/97). Marketers, however, have the option of selecting those customers that they want to serve, and doing so under prices that are not regulated. *Id.* Mr. Jacobson also agreed that it would not make sense for a Marketer to provide billing and metering services to a particular customer if the Marketer's cost of serving that customer exceeded the utility's average cost, but it would make sense where the Marketer's cost were less than the utility's average cost. Tr. 1359-1360 (8/22/97).

The Marketers' Proposals Do Not Increase Economic Efficiency and Would Increase the Average Cost of Providing Service.

Mr. Jacobson also suffers from the mistaken belief that Marketers' cream skimming would improve the efficiency of the electric distribution system. As Mr. Jacobson testified:

> Q. Let me try a real simple example. Let's assume obviously hypothetically that PP&L has three customers, just so we can do all this in our heads here.

And to provide metering service to one customer costs it 50 [cents], and another customer costs it a dollar and another customer costs it $1.50.

So the average cost of servicing these three customers would be a dollar, is that right?

A. Right.

Q. ... Let's assume that Enron could serve the 50 cent customer who is paying a dollar, because the rates are based on average cost, Enron could serve it at a cost of 90 cents.

So that customer's bill would go down by a dime. But does that mean that Enron is providing the service more efficiently than PP&L is providing it?

A. I believe it does. I believe it does mean we are.

Tr. 1362-1363 (8/22/97).

Obviously, Enron's view of economic efficiency is incorrect. Under this simple example, the total cost of providing metering service increases from $3.00 ($0.50 + $1.00 + $1.50) to $3.40 ($0.90 + $1.00 + $1.50), increasing the average cost from $1.00 per customer to $1.13 per customer. Even worse, if a Marketer is permitted to skim off the lowest cost customer, the average cost to the remaining customers would increase to $1.25. This is not economically efficient and it is not in the public interest.

Simply, the Marketers believe that they should be permitted to bill utility customers for ***regulated, distribution services*** at any price they choose – without regard to PP&L's tariffed rate for providing such service. Under the Public Utility Code, PP&L would be powerless to respond to the Marketers' efforts to skim off its lowest cost customers. Section 1304 prohibits a "public utility" from discriminating among similarly situated customers or from charging a rate that is either higher or lower than its tariffed rate. 66 Pa. C.S. § 1304. *See also* 66 Pa. C.S. § 1303, requiring public utilities to adhere to the provisions in their tariffs. But because the Marketers are not "public utilities" they believe that they should be allowed to charge different rates for precisely the same regulated, distribution service. Moreover, the effect of such pricing tactics

would be to increase the average cost of serving those customers who are left on the PP&L system.

The real world is substantially more complicated than this simple, three-customer example. In the real world, under the Marketers' proposal, PP&L would be required to maintain its entire infrastructure for billing, metering, and other customer service functions. As Enron witness Shapiro admits, PP&L would need to maintain a customer service call center (Tr. 1624-1627), the ability to deal with payment-troubled customers (Tr. 1627-1628), the ability to physically terminate service to customers (Tr. 1628-1629), and the capability to bill and meter any customer at any time (Tr. 1634) (all references are to the transcript of 8/26/97). This also was confirmed by Enron witness Bowen, who agreed that PP&L would be required to "maintain a billing, metering and customer service infrastructure sufficient to serve all returning customers." Tr. 1333-1334 (8/22/97). And, in case there was any remaining doubt, Mr. Bowen also confirmed that Enron would oppose any attempt to ***require*** a Marketer to provide billing or metering services to any customer under any conditions. Tr. 1334 (8/22/97).

The Marketers' Proposals are Neither Pro-Consumer Nor Pro-Competition.

The Marketers obviously contend that their proposals would enhance competition and would benefit consumers. In fact, exactly the opposite is true.

IBEW's witness, Mr. Schmitt, testified as follows about the problems that would result if each Marketer could provide its own meter:

> I am very concerned about what would happen if a customer changed electric suppliers with the frequency that some customers change their long-distance telephone supplier or the supplier of other competitive goods and services. If each generation supplier installs its own meter, then a customer could see frequent changes of his or her electric meter. As I mentioned before, an electric meter is not just an appliance that can be unplugged. The work is potentially hazardous, must be done properly, and should not be done frequently to avoid the possibility of wear or damage to the customer's meter base. Further, there can be considerable inconvenience to the customer of having a meter changed.

Depending on the location of the meter, the customer may need to be at home in order to have the meter changed. And in all cases, the customer will suffer a power outage while the meter is being changed. These kinds of outages will be very inconvenient to the customer. ...

Q. Do you agree with the other witnesses that allowing generation suppliers to provide the electric meter will improve the level of competition to customers?

A. Obviously, I am not an economist and I can't point to any studies on this question. But based on some very simple facts and my personal experience, I think that it is more likely that allowing competition for metering will actually result in reducing customer choice for generation supply.

Q. Why do you say that?

A. I am speaking from my experience and the experience of my friends, neighbors, and family. From my experience, many customers do not have a great deal of loyalty to specific suppliers. Many people will go to three or four different stores to buy groceries because of what's on sale. The next week, they'll buy a different set of items and different brands at different stores. Many people will watch the ads and coupons carefully and change their buying habits accordingly. If you get an offer from a long-distance telephone company that looks good, many people will change long distance suppliers, and then change to another supplier when they get a better deal. But customers will not do this if it is expensive or inconvenient to change suppliers. Just imagine how many people would change long-distance telephone suppliers if you had to schedule an appointment, have someone come to your house, lose telephone service for a period of time, and have to pay a substantial charge in order to switch suppliers.

It's also obvious to me that allowing suppliers to provide the electric meter will make it more difficult for smaller suppliers to break into the market. The small wind farm or hydroelectric dam, the factory producing some excess power, and other small power producers would be locked out of the market because they cannot provide metering and billing services.

In other words, it looks to me like having the generation supplier provide the electric meter will result in less customer choice, not more.

IBEW St. 1 at 4-6. *See also* the testimony of Enron witness Jacobson, agreeing that there would be some circumstances where a customer would need to obtain a new meter in order to change electric suppliers. Tr. 1366-1367 (8/22/97).

These problems are serious. Customers will be reluctant to change suppliers if it means having to obtain a different electric meter. Safety can be compromised if the meter is changed

frequently or if several different meter supplies must be contacted before a building can be serviced. Meter installers that are not subject to the supervision and control of a public utility would have to be licensed, and the procedures for such licensing do not exist today (see Enron witness Jacobson's testimony at Tr. 1367 (8/22/97)).

In addition, there would need to be special procedures to ensure that a customer is never without an electric meter. But, as Enron's witness Jacobson testified, "I don't have an answer for you today as to exactly how that will take place." Tr. 1364 (8/22/97).

These concerns were highlighted through the testimony of one of the nation's leading utility consumer experts, Dr. Mark Cooper, who testified on behalf of the American Association of Retired Persons. Dr. Cooper expressed serious concern about the packaging of numerous services, including billing and metering services. As he testified: "[A]s the product gets complex, with an uneducated consumer, people get away with things, consumers end up paying for things they didn't think they were buying, paying more than they would have if they had been given a set of clear and concise choices." Tr. 2053 (8/29/97). Dr. Cooper also noted that it is "critical" to make it easy for customers to change generation suppliers. *Id.* As was noted above, the Marketers' proposals would result in customers also having to change billing and metering suppliers, and on occasion having to arrange for a different meter altogether, greatly increasing the complexity and difficulty of changing suppliers. *See also* IBEW Cross Exh. 3 (8/29/97), where Dr. Cooper addressed the additional complexity that would arise from multiple suppliers of billing and metering services.

The answer to these problems is simple: treat billing and metering as part of the regulated distribution of electricity. PP&L should be solely responsible for providing and maintaining a meter and for billing for the service that it provides. As Enron witness Jacobson

agreed, under such an industry structure, there would be no need "for a customer to change its electric meter if it changed generation suppliers." Tr. 1364-1365 (8/22/97).

The Marketers' Proposals Have Nothing to do With Providing Customer Choice and Everything to do With Trying to Make Money.

What's going on? Why are the Marketers proposing a system that is cumbersome, discriminatory, anti-competitive, and inconvenient? Why do they want to inhibit the entry of small suppliers into the generation market and cause serious concerns about the safety and reliability of electric service (both to the public at large and to utility workers)? The answer is ***money***. Like a breath of fresh air, NEV witness Day provided the real reason that Marketers want to provide billing and metering services. It has nothing to do with customer choice. As she testified:

> Q. Why is distribution service unbundling an essential element of the restructured energy services market?
>
> A. The simple answer is profitability. Without the unbundling and competitive provision of distribution services, new market entrants will eventually be starved out of the market. This will be the inevitable result when the margins on the sale of electricity are too small to support the new market entrant's service delivery overheads.

NEV St. 2 at 2 (Q/A 5).

In other words, it will be hard for Marketers to make money by doing what the law allows them to do – sell electricity. The profit margins will be small; the market will be very competitive. It will be hard to differentiate one marketer from another. It will be hard to compete head-to-head with efficient energy producers. It will be much easier for Marketers to make money if they can also skim off the desirable customers and provide them billing and metering services at less than PP&L's average cost. And, just to make sure that they can make money by cream skimming, the Marketers also want to prevent PP&L from competing by charging anything other than PP&L's average cost for billing and metering services.

To be blunt: It doesn't matter to the Marketers if it's inefficient, inconvenient, unfair, unlawful, or discriminatory. The Marketers will be able to make more money, so it must be a good idea.

The Commission should reject the Marketers' proposals, and do so in no uncertain terms. There is no reason why the Marketers should be allowed to provide billing and metering services. There certainly is no reason why PP&L should be compelled to allow a Marketer to bill a PP&L customer for the distribution services that PP&L provides to that customer.

c. Conclusion

Several provisions of the Public Utility Code would be violated or rendered unenforceable if Marketers are permitted to provide billing and metering services to PP&L's customers. Moreover, even if it were not unlawful for Marketers to provide these services, there are numerous reasons why it would not be in the public interest for them to do so. Simply, the Marketers' proposals would result in discrimination, economic inefficiency, confusion, safety concerns, and other serious problems with the provision of safe, adequate, and reliable electric service.

The Commission, therefore, must reject the Marketers' proposals to provide billing and metering services to PP&L's customers. PP&L, as the public utility charged with providing regulated, electric distribution service, must be responsible for the electric meters that serve its customers and must be permitted to render bills for distribution service to its customers.

E. Further Unbundling of Distribution Rates or Services

1. PP&L Must Be the Exclusive Provider of Metering, Billing and Collection Services for Electric Distribution Service

This issue is addressed in Section X.D.8 of this brief. As IBEW discusses in that section, there is no need to further unbundle the rates for various components of distribution service (such

as billing, metering, and collection), because it is unlawful and against the public interest for anyone other than PP&L to provide these services.

CONCLUSION

For the reasons set forth in this Main Brief, the International Brotherhood of Electrical Workers Local 1600 respectfully requests the Pennsylvania Public Utility Commission to issue an order that prohibits any entity other than Pennsylvania Power and Light Company from providing and maintaining electric meters and from rendering bills for electric distribution service within the service territory of Pennsylvania Power and Light Company.

Respectfully submitted,

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Counsel for:
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Dated: February 12, 1998

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

In the Matter of Pennsylvania Power and Light Company's Restructuring Plan	: : : :	Docket No. R-00973954

ORIGINAL

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a true copy of the Main Brief of the International Brotherhood of Electrical Workers, Local 1600, upon the active participants by United States Postal Service Priority Mail, listed on the following pages, in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a participant).

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February 9, 1998

Via Federal Express

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PA PUBLIC UTILITY COMMISSION
PROTHONOTARY'S OFFICE

James J. McNulty III
Prothonotary
Pennsylvania Public Utility Commission
North Office Building
Commonwealth Ave. And North St.
Harrisburg, PA 17120

Re: Pennsylvania Power & Light Co.
Docket No. R-00973954

Dear Mr. McNulty:

Enclosed for filing please find the original and ten (10) copies of the Post-Hearing Brief of Intervenor NEV East, LLC in the above matter. A copy has been served on all known parties and counsel of record in accordance with the attached Certificate of Service.

Sincerely,

Luke E. Dembosky

LED:pk
Enc.
cc: Honorable George Kashi, ALJ (w/enc.) (two copies via federal express)
Paul Russell, Esq., Pennsylvania Power & Light Co. (w/enc.) (via federal express)
All parties of record (w/enc.) (via first class mail)

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

In the Matter of	)	
Pennsylvania Power & Light Co.	)	**Dkt. No. R-00973954**
Restructuring Plan Filing	)	
	)	

POST-HEARING BRIEF OF INTERVENOR NEV EAST, LLC IN OPPOSITION TO PROPOSED RESTRUCTURING PLAN OF PENNSYLVANIA POWER & LIGHT CO.

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Opinion and Order on Compliance Filing of Pennsylvania Public Utility Commission, entered February 5, 1998, in Application of PECO Energy for Approval of its Restructuring Plan Under Section 2806 of the Public Utility Code and Joint Petition for Partial Settlement and Petition of Enron Energy Services Power, Inc. for Approval of an Electric Competition and Choice Plan and for Authority Pursuant to Section 2807(E)(C) of the Public Utility Code to Serve as the Provider of Last Resort in the Service Territory of PECO Energy Company, Docket Nos. R-00973953 and P-00971265. 3

INTRODUCTION

NEV East, LLC ("NEV")[1], by and through its undersigned counsel, submits this Memorandum of Law in opposition to the proposed restructuring plan (the "Plan") submitted by Pennsylvania Power & Light Company ("PP&L") pursuant to Section 2806 of the Electricity Generation Customer Choice and Competition Act, 66 Pa. C.S.A. §2801 et seq. (the "Act"). The specific aspects of the Plan addressed in this Memorandum are code of conduct and competition issues related to consolidated billing services.[2]

ARGUMENT

X. CODE OF CONDUCT AND COMPETITION ISSUES[3]

A. PP&L Should Be Required To Implement Consolidated Billing For *Multiple Meter Customers In Accordance* With The Commission's Opinion And Order In The PECO Restructuring Proceeding.

Under the current regulatory system, the many customers who receive service on multiple meters throughout an EDU's service territory are discriminated against when compared to customers with similar loads served through a single meter. (Boonin, Direct Testimony, at 17). In particular, a customer with multiple meters who is on the same rate schedule and who places the

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[1] NEV, an intervenor in this proceeding, is a national leader in the formation of retail energy power purchasers groups. NEV negotiates with energy suppliers nationwide to obtain the lowest electricity prices through the collective purchasing strength of its buyers' group members. NEV originally intervened in this proceeding as New Energy Ventures, Inc. Since intervening, due to a corporate restructuring NEV has changed its name to NEV East, LLC.

[2] NEV has joined in the Joint Post-Hearing Brief of the alternative suppliers group, and submits this brief only with respect to these specific issues, in accordance with the letter of Alan Kohler, lead counsel for the Competitive Intervenors Group, to the Hon. George M. Kashi, dated September 3, 1997. Accordingly, NEV has not independently submitted herewith the schedules and tables called for by the Briefing Order.

[3] This section addresses the topics listed in Sections X.B, X.C and X.E.1 of the "Restructuring Plan Case Issues" set forth in the Briefing Order.

same type of non-distribution related load on the system as a single-meter customer is being charged more than that single-meter customer. (Id. at 18).

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

In its Opinion and Order entered December 23, 1997 in the restructuring proceeding involving PECO Energy Company[4], the Commission exercised its authority to remedy the existing discriminatory billing practices affecting multiple meter customers by approving billing consolidation, such that aggregated customers will be billed based on the load that they place on the system. In its restructuring plan, PECO had defined "customer" to include a single point of delivery. In rejecting that definition, the Commission stated:

> In challenging PECO's position, it was asserted that EGSs should be permitted to treat customers with multiple locations as a single service for purposes of billing for transmission and CTC-related charges. In other words, transmission and CTC-related charges would not change with the number of installations or meters,

---

[4] Application of PECO Energy for Approval of its Restructuring Plan Under Section 2806 of the Public Utility Code and Joint Petition for Partial Settlement and Petition of Enron Energy Services Power, Inc. for Approval of an Electric Competition and Choice Plan and for Authority Pursuant to Section 2807(E)(C) of the Public Utility Code to Serve as the Provider of Last Resort in the Service Territory of PECO Energy Company, Docket Nos. R-00973953 and P-00971265.

> as they currently do, but with the amount of load placed on the system.
>
> PECO's restriction is inappropriate in a competitive generation market because it makes it more difficult with multiple sites to aggregate their load with a single EGS. Accordingly, we shall permit billing consolidation. For administrative ease, billing consolidation should only apply to customers who have multiple meters on the same rate tariff. This change shall not apply to distribution charges because customers with multiple meters may impose a cost on the system that is different than a similar load from a single location associated with the distribution of the service.

Order and Opinion, at p. 140 (emphasis added).[5]

The Commission's December 23, 1997 Opinion and Order is entirely consistent with NEV's testimony in this proceeding regarding the need to eliminate the current discriminatory effect on customers with multiple meters by permitting alternative generation providers to treat these customers as a single service for purposes of billing for transmission and CTC-related charges. (Boonin, Direct Testimony, at 17). In particular, when a customer has multiple metering locations, the customer should be permitted to elect to consolidate the bills for any or all of its meters served under the same rate. Transmission and CTC-related charges would not change with the number of installations or meters, as they currently do, but with the amount of load placed on the system. (Id. at 18). As stated by the Commission in its December 23 Opinion and Order, for administrative ease,

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[5] The Commission reaffirmed its intention that billing consolidation be implemented in its subsequent Opinion and Order on Compliance Filing, adopted and entered on February 5, 1998, in the same restructuring proceeding involving PECO Energy Company (at pp. 12 and 14).

this billing consolidation should only be for customers of record who have multiple meters on the same rate tariff. (Boonin, Direct Testimony, at 19).[6]

Elimination of this present discriminatory effect on multiple meter customers is particularly important now that competition -- and the innovation it will inevitably bring -- has been introduced into the system. (Id. at 19). More and more customers will be metered so that hourly loads can be determined, enabling consolidated billing. (Id.). Competition also challenges the necessity of demand-based billing, particularly if customers are paying for the burden they place upon the system virtually on an hourly basis. (Id.). At bottom, competition highlights the importance of electric prices in economic competitiveness, and eliminates any excuse for the type of blatant discrimination which exists under the current system. (Id.).

Accordingly, NEV proposes that the Commission adopt NEV's proposal that alternative generation providers be allowed to consolidate bills for customers with multiple meters within a single tariff, in accordance with the Commission's Opinion and Order entered December 23, 1997 in the PECO Energy Company restructuring proceeding. (Boonin, Direct Testimony, at 19). Only through this modification can the Commission prevent the discrimination that exists under the current system. (Id. at 20). PP&L has not introduced any evidence against the adoption of such

---

[6] The Commission would not need to take action with respect to generation itself because the price of generation is deregulated and the EDU already has the right to issue a customer a bill for its generation services on a consolidated basis. (Id. at 17). Nor would this proposed change apply to distribution charges, as the Commission noted in its December 23, 1997 Order in the PECO proceeding, because customers with multiple meters may impose a cost on the system that is different than a similar load from a single location associated with the distribution of the service. (Id.). Therefore, distribution charges should be billed as they are currently. (Id.).

consolidated billing and so, although its proposal is silent on the issue, PP&L apparently does not contest its adoption by the Commission.

CONCLUSION

For all of the foregoing reasons, NEV East, LLC requests that the Commission reject PP&L's proposed restructuring plan and instead require PP&L to submit a modified restructuring plan which incorporates NEV's proposal of consolidated billing as discussed above.

Respectfully submitted,

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Dated: February 9, 1998

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

In the Matter of	)	
Pennsylvania Power & Light Co.	)	Dkt. No. R-00973954
Restructuring Plan Filing	)	
	)	

CERTIFICATE OF SERVICE

I hereby certify that on February 9, 1998, I caused a true and correct copy of the Post Hearing Brief of Intervenor NEV East, LLC to be served by federal express upon:

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Re: Pennsylvania Power & Light Company
Restructuring Plan - Docket No. R-00973954

Dear Mr. McNulty:

Enclosed for filing in the above-referenced proceeding are an original and nine copies of the Supplemental Initial Post-Hearing Brief of the Pennsylvania Petroleum Association and the Pennsylvania Association of Plumbing, Heating, Cooling Contractors, Inc. Please date stamp our "File Copy" and return in the enclosed self-addressed, postage pre-paid envelope. Also enclosed is a diskette containing said Brief (WordPerfect 6.0).

A Certificate of Service upon all active parties via first class mail is attached.

Very truly yours,

Usher Fogel

Usher Fogel

UF/mac
Enclosures
cc: Hon. George M. Kashi *(by Federal Express - diskette enclosed)*
Active Parties to Docket No. R-00973954 *(by first class mail)*

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ORIGINAL

Before the
Pennsylvania Public Utility Commission

PENNSYLVANIA PUBLIC UTILITY COMMISSION	
v.	Docket No. R-00973954
PENNSYLVANIA POWER & LIGHT COMPANY	
(Application of Pennsylvania Power & Light Company for Approval of its Restructuring Plan Under Section 2806 of the Public Utility Code)	

SUPPLEMENTAL
INITIAL POST-HEARING BRIEF
OF THE
PENNSYLVANIA PETROLEUM ASSOCIATION
and the
PENNSYLVANIA ASSOCIATION OF
PLUMBING, HEATING, COOLING CONTRACTORS, INC.

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Before the
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PENNSYLVANIA PUBLIC UTILITY COMMISSION	:	
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PENNSYLVANIA POWER & LIGHT COMPANY	:	
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SUPPLEMENTAL
INITIAL POST-HEARING BRIEF
OF THE
PENNSYLVANIA PETROLEUM ASSOCIATION
and the
PENNSYLVANIA ASSOCIATION OF
PLUMBING, HEATING, COOLING CONTRACTORS, INC.

I. INTRODUCTION

This supplemental post-hearing brief is filed on behalf of the Pennsylvania Petroleum Association (PPA) and the Pennsylvania Association of Plumbing, Heating and Cooling Contractors, Inc. (PHCC) in accordance with the Order issued by the Hon.

George M. Kashi, Administrative Law Judge on February 2, 1998.

II. PRELIMINARY STATEMENT

This proceeding involves consideration of the restructuring plan submitted by Pennsylvania Power & Light Company ("PP&L" or "Company") in accordance with the Electric Generation Competition and Customer Choice Act, 66 Pa. C.S. §2801 et seq. ("Act"). The underlying goal of the Act is to expose the monopolistic structure which has governed the provision of utility service in the Commonwealth to competitive forces thereby enabling consumers to experience lower rates, greater choice and additional flexibility. This goal can only be achieved if PP&L is prevented from leveraging its monopolistic position in the competitive markets now developing for the provision of electricity and other related competitive services. Additionally, restructuring will only be successful if the rate design, including the competitive transition charge (CTC) is properly designed to provide accurate pricing signals to customers rather than creating a disincentive for customers to purchase electricity from an independent marketer.

This brief will address two issues of primary concern to PPA and PHCC: the application of competitive safeguards to all competitive services and the CTC rate design methodology. It is respectfully proposed that the Commission direct that the competitive standards and code of conduct approved in this proceeding be applied to all

competitive services provided by the utility and reject the Company's proposed CTC rate design and customized rate proposal.

III. THE COMPETITIVE SAFEGUARDS AND CODE OF CONDUCT ESTABLISHED IN THIS PROCEEDING SHOULD BE APPLIED TO ALL COMPETITIVE SERVICES OFFERED BY PP&L AND ITS AFFILIATES

The success of the statutorily mandated restructuring process is contingent upon creation of a market environment in which vendors can compete on a level playing field unencumbered by a competitively advantaged utility. The importance of establishing competitive safeguards and a related code of conduct to maintain an effective balance in the competitive market, was most recently underscored in the Commission's Restructuring Order for PECO Energy Company,[1] wherein the Commission stated:

> "As we enter the era of generation competition, this Commission must ensure that competition can occur on a level playing field without discrimination or inappropriate competitive advantage to any market participant" (PECO Order, p. 123).

With respect to transfers of assets between the utility and its competitive affiliates, the Commission further underscored that it must ensure that such transfers do

[1] Application of PECO Energy Company For Approval Of Its Restructuring Plan Under Section 2806 of the Public Utility Code, R-00973953 (Dec. 23, 1997), Reconsideration Order, (January 16, 1998) (collectively referred to as "PECO Order").

not "provide any inappropriate cross-subsidization of the competitive affiliate, and is accompanied by...safeguards to protect the public interest" (Id., p. 124). Therefore, successful restructuring of the electric utility industry requires the creation of a viable competitive market which is protected by competitive safeguards and codes of conduct governing the relationship between the utility and its competitive affiliates.

The Legislature and the Commission have also noted the importance of assuring a level competitive playing field in connection with all competitive services offered by the utility, not merely the provision of electric generation.

In Section 2806(e) of the Act the Legislature specifically directed each electric utility to file a restructuring plan which includes

> "unbundled prices or rates for generation, jurisdictional transmission, distribution and other services." (emphasis added).

This language requires identification of all types of competitive services offered by a utility associated with the sale of electricity. To assure compliance with this statutory requirement, it is, of course, necessary to elucidate all services the utility offers in connection with the sale of electricity, determine whether they will be performed on a regulated or unregulated basis, and establish competitive safeguards to assure that such services are provided in a manner that maintains a level playing field.

The Commission has also affirmed the relevance and importance of identifying all regulated and non-regulated services each utility will provide.

By its Order adopted on February 13, 1997 in Docket No. M-00960890, F/3, Electric Utility Restructuring Filings Pursuant to 66 Pa. C.S. §2806(e), the Commission ordered each utility restructuring plan to include information and data related to corporate structure issues. Specifically each utility was directed to:

> "Provide a discussion of any contemplated acts of merger, consolidation, acquisition or disposition by the company",
> and
> "Provide a discussion and description of the utility's proposed functional separation between regulated and non-regulated operations."

Docket M-00960890, F/3, Order adopted 2/13/97, Appendix A, p. 31, Items O(2) and O(6).

Through its solicitation of this data, the Commission has recognized that competition will be directly affected by each utility's policy concerning the provision of unregulated services.

Most recently, the Commission in the PECO Order clearly stated in a number of contexts that a regulated utility must be prevented from undermining competitive markets in which they operate, and this concern applied to all competitive services regardless of whether they involve or are directly related to the sale of electric generation.

Initially, the Commission made reference to various sections of the Code which have general applicability to all competitive transactions. Specifically, the Commission noted that Section 2101 of the Public Utility Code which requires that all

contracts or agreements, whether in writing or not, involving a transaction between a utility and its affiliate is not valid unless approved by the Commission. Additionally, the provisions of Section 2101(b) of the Code obligate the Commission to approve an affiliate transaction "only if it shall clearly appear and be established upon investigation that it is reasonable and consistent with the public interest," and Section 2103 requires the Commission to exercise continuing jurisdiction as necessary "to protect the public interest" (PECO Order, p. 125).

After discussing the applicability of these sections of the Code to the restructuring process, the Commission emphasized:

> "Among other issues affecting the public interest, the Commission must insure that affiliate transaction are not inappropriately cross-subsidizing competitive affiliates or divisions." (PECO Order, p. 125).

On the basis of this conclusion, the Commission directed PECO to "review all of its affiliate transactions and submit requests for approval as necessary" (Id., emphasis added).

In connection with the issue of functional separation, the Commission firmly emphasized that anti-competitive cross-subsidies would be prohibited with respect to all goods and services, not merely electric generation:

> "Any transaction between PECO and an affiliate must be approved pursuant to Chapter 21 of the Public Utility Code. In order to ensure a 'level playing field', proposed affiliate contracts for all goods and services, including power, must not involve any anti-competitive cross-subsidy" (PECO

Order, p. 127, emphasis added).

It is evident that both the Commission and the Legislature have recognized that cross-subsidization and other anti-competitive activities by a utility in connection with all competitive services are inappropriate and inconsistent with the public interest. As there is a need to ensure that such unlawful conduct is prescribed and prevented, it is necessary in this proceeding to apply competitive safeguards to all competitive services.

It is also apparent that the development of a competitive generation market - one of the primary goals of the Act - will be directly impacted by the various electric services each utility will offer either on a regulated or unregulated basis through utility personnel or by an affiliate or subsidiary. For example, PP&L could use the sale of appliances or energy management services (activities which are highly competitive) at prices which are subsidized by regulated operations, to leverage its position in the generation market. In essence, as the goal of competition is affected by all services offered by the utility, there is a clear and pressing need to ensure that all such services are governed by appropriate safeguards.

Moreover, establishment of competitive safeguards for all competitive services is especially relevant as we enter the era of utility restructuring. The Commission is now in the process of considering the electric restructuring plans filed by the electric utilities throughout the Commonwealth in response to the directives contained in the Act. As the electricity utility industry as we know it will be

fundamentally changed and each utility will now attempt to compete in a more competitive unregulated environment, implementation of safeguards that ensure a competitive level playing field is extremely vital at this sensitive time.

It is important to underscore that the restructuring process will not only affect the sale of electricity but will be expanded to cover a variety of related products and services associated with the sale of electricity such as appliance sales and repair, energy consulting and many others. The same concerns underlying the need to establish competitive safeguards with respect to the sale of electricity apply equally as well to other related competitive services in which the utility is able to leverage its corporate assets, name and market position to secure an undue competitive edge.

Under these circumstances, application of competitive safeguards to all competitive services is eminently timely, reasonable and prudent.

IV. CTC RATE DESIGN METHODOLOGY

The issues and concerns regarding the customized rate design methodology and the CTC rate design proposal are comprehensively addressed in the testimony and Initial Brief submitted on behalf of MAPSA, and need not be repeated here.

With respect to the CTC rate design, however, there is one aspect that warrants additional comment. As proposed by PP&L (Witness Tierney) half of the projected CTC revenues will be recorded through a fixed monthly charge similar to a

customer charge that is unrelated to the actual level of electricity used by the consumer. This approach fails to properly reflect why these costs were incurred in the first instance and how they were recovered from consumers.

The costs of electric power used by PP&L to render electric service were recovered from consumers through a usage based ¢/Kwh rate. Consumers who used a greater level of electricity would therefore experience a greater charge for power costs. This rate design approach correctly recognized that PP&L acquired generation capacity either through purchase or construction of new facilities, in order to meet the projected level of demand or electric consumption on its system. A reasonable symmetry was established between the basis of incurrence of power costs and the rate mechanisms by which these costs were recovered. As generation was acquired to meet growth in usage, the costs related thereto were recovered from ratepayers through a usage based rate.

The CTC is designed to recover stranded generation costs arising from the introduction of competition. But they still remain electric power costs which, in the first instance, were caused by an increase in usage and were reflected in rates by a Kwh charge. Therefore, the entire CTC related revenues should be recovered through a usage based Kwh rate, and its is inappropriate to recover any portion of these costs by a fixed charge of any kind, as now proposed by the Company. In large measure, the Company's proposal establishing a fixed monthly CTC improperly destroys the nexus between cost incurrence and cost recovery.

V. CONCLUSION

For the foregoing reasons, the Commission should direct that the competitive safeguards adopted in this proceeding be applied to all competitive services, and reject the proposed CTC rate design and customized rate proposal.

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v.
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(Application for Approval of a Restructuring Plan)
Docket No. R-00973954

I hereby certify that I have this day served the foregoing documents upon the participants, listed below, in accordance with the requirements of §1.54 (relating to service by a participant).

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Re: Application of Pennsylvania Power & Light Company for Approval of a Restructuring Plan
Docket No. R-00973954

Dear Prothonotary:

The Anthracite Region Independent Power Producers Association ("ARIPPA") joins in the brief that is being filed under separate cover by two of its members, Schuylkill Energy Resources and Gilberton Power Company. ARIPPA will not be filing a separate brief.

ARIPPA in particular supports the need for a true-up mechanism for payments that are made under contract with independent power producers ("IPPs"). Without such a true-up mechanism, PP&L would have an economic incentive to curtail or eliminate purchases from IPPs through inappropriate means, thereby allowing PP&L to retain projected payments as a windfall to shareholders.

Nine (9) copies of this letter are enclosed with the original for filing.

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Very truly yours,

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BEFORE THE
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Application of Pennsylvania Power & Light Company for Approval of a Restructuring Plan	: : :	Docket No. R-00973954

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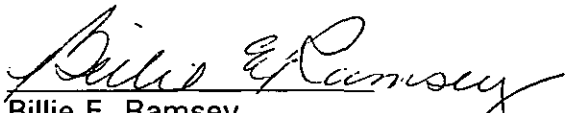

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Re: Application of Pennsylvania Power & Light Company For Approval Of Its Restructuring Plan Under Section 2806 the Public Utility Code Docket No. R-00973954

Dear Prothonotary:

Enclosed for filing are the original and nine (9) copies of the Main Brief on behalf of the Office of Small Business Advocate in the above-docketed proceeding. As evidenced by the enclosed certificate of service, three copies have been served on all active parties in this case.

If you have any questions, please do not hesitate to contact me.

Sincerely,

Bernard A. Ryan, Jr.
Small Business Advocate

Enclosures
cc: Hon. George M. Kashi
Administrative Law Judge

Parties of Record

Mr. Robert D. Knecht

KJR

BEFORE THE

PENNSYLVANIA PUBLIC UTILITY COMMISSION

Application of Pennsylvania Power & Light Company For Approval Of Its Restructuring Plan Under Section 2806 Of The Public Utility Code	:	Docket No. R-00973954

MAIN BRIEF
OF THE
OFFICE OF SMALL BUSINESS ADVOCATE

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Dated: February 10, 1998

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INTRODUCTION

On April 1, 1997, Pennsylvania Power & Light Company ("PP&L" or "Company") filed its Restructuring Plan pursuant to the Electricity Generation Customer Choice and Competition Act, 66 Pa.C.S. §§2801-2813. As modified during this proceeding, PP&L's Restructuring Plan projects stranded costs in the amount of $4.5 billion. Within the constraints of the statutory rate caps and the limited time period over which it may recover stranded costs, PP&L proposes to collect about $4.0 billion from its ratepayers through a competitive transition charge.

The Office of Small Business Advocate ("OSBA") filed a Notice of Intervention on April 17, 1997 and actively participated in this proceeding. In accordance with the procedural schedule, the OSBA submitted the Direct Testimony, Rebuttal Testimony, Surrebuttal Testimony and Exhibits of Robert D. Knecht. These pre-filed documents were admitted into the record during the evidentiary hearing on August 19, 1997, when Mr. Knecht appeared for cross-examination.

By this Main Brief, the OSBA does not recommend an overall level of stranded costs to be recovered by PP&L. Rather, this Main Brief sets forth the OSBA's primary concerns regarding the validity of key assumptions relied upon by PP&L in projecting its stranded costs and submits a recommendation pertaining to the use of PP&L's electricity market price forecasts as a basis for calculating stranded costs. Further, the OSBA focuses on the propriety of the specific recovery mechanism by which PP&L proposes to recover stranded costs from its small business customers. Finally, by this Main Brief, the OSBA addresses several other aspects of PP&L's Restructuring Plan that significantly impact the small business community, proposing that certain safeguards be implemented to ensure that PP&L's small business consumers are treated fairly during the transition to a competitive generation environment.

This brief was ready to be served and filed when the procedural schedule for this case was delayed to accommodate additional efforts to reach a settlement among the active parties.[1] Despite diligent efforts on the part of all parties to reach such a settlement, none was achieved. While those settlement efforts were underway, the Commission entered two Orders in the restructuring proceeding involving PECO Energy Company[2] that provide some guidance to the parties on a number of the issues discussed here; appropriate references to those two Orders have now been added to this Main Brief of the OSBA.

[1]The Small Business Advocate acknowledges the lead role played by Karen Oill Moury, then serving as Deputy Small Business Advocate, in the presentation of the OSBA's case and the preparation of this Main Brief. The small business customers of PP&L have been well served by Ms. Moury's diligent efforts and forceful advocacy on their behalf in this proceeding.

[2]The Opinion and Order that was entered by the Commission on December 23, 1997 (hereafter called the "PECO Restructuring Order") and the Opinion and Order (Restructuring Reconsideration Order) that was entered by the Commission on January 16, 1998 (hereafter called the "PECO Reconsideration Order").

SUMMARY OF ARGUMENT

The cornerstone of this proceeding rests on the reliability of PP&L's electricity market price forecasts. Especially in view of PP&L's residual method for calculating stranded costs, the accuracy of those estimates hinges upon the validity of the underlying forecasts of market prices. In fact, however, the price forecasts utilized by PP&L in calculating its stranded costs are unreasonably low and are not reliable for use in this proceeding.

By any comparison, PP&L's market price forecasts are conservative, producing understated projections of the future economic value of its generating facilities. Particularly since the evidence in this proceeding demonstrates that PP&L's projections are insufficient to attract the new capacity that it assumes will be needed early in the next decade, the Commission should not rely on the Company's market price estimates. Rather, the Commission's analysis should incorporate more realistic projections of future market value, such as those advanced by intervenors in this proceeding, including the Office of Consumer Advocate and the PP&L Industrial Consumers Alliance. Through the utilization of market price forecasts that more closely track investors' needs and expectations, the Commission would ensure that the resulting level of estimated stranded costs is more reliable.

It is also important for the Commission to carefully examine the Competitive Transition Charge ("CTC") proposed by PP&L. While the residual approach to calculating CTC revenues has certain benefits, it is necessary to determine a method for assigning any excess CTC revenues if the Commission authorizes the recovery of a level of stranded costs that is below the residual CTC revenues. Depending upon the ultimate level of stranded cost recovery in this case, the Commission should consider whether it would be feasible to direct that stranded costs be allocated among customers in a way that is consistent with PP&L's last cost allocation study. Through such an allocation approach, the

Commission would ensure that PP&L's small businesses are not required to shoulder more than an appropriate share of the stranded cost recovery. Moreover, the Commission should reject any rate design proposals advanced by PP&L or other intervenors in this proceeding that would have the effect of shifting cost responsibility among customers within the same class or among customers in different classes.

Finally, the Commission should direct PP&L to develop phase-in procedures that address the needs of the small business classes. In particular, the Commission should seek to afford all small businesses a fair and timely opportunity to obtain direct access to a competitive generation market.

ARGUMENT

I. Overview of Competition Act

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

Through this amendment to the Public Utility Code, the legislature established some basic standards and procedures designed to provide for direct access by retail customers to the competitive market for the generation of electricity, while maintaining the safety and reliability of the electric system for all parties. In particular, the Competition Act requires "electric utilities to unbundle their rates and services and to provide open access over their transmission and distribution systems to allow competitive suppliers to generate and sell electricity directly to consumers in this Commonwealth." 66 Pa.C.S. §2802(14). As to the resolution of many of the specific issues required to fully implement the directives of the Competition Act, the legislature delegated extensive responsibility to the Commission. See, e.g., 66 Pa.C.S. §§2804, 2806 and 2808.

Recognizing that electric utilities have incurred certain costs as a result of long-term investments in generation facilities and long-term power supply

agreements which "may not be recoverable in a competitive market," the legislature empowered the Commission "to determine the level of transition or stranded costs for each electric utility and to provide a mechanism...for the recovery of an appropriate amount of such costs in accordance with the standards established" in Chapter 28. 66 Pa.C.S. §2802(15). (Emphasis supplied). "[T]ransition or stranded costs" are defined as an "electric utility's known and measurable net electric generation-related costs...which traditionally would be recoverable under a regulated environment but which may not be recoverable in a competitive electric generation market and which...will remain following mitigation by the electric utility." 66 Pa.C.S. §2803 (Definitions).

The extent to which the Commission may authorize the recovery of stranded costs by electric utilities is specifically limited by the Competition Act to those costs that are determined to be just and reasonable. 66 Pa.C.S. §2804(13)-(14); 66 Pa.C.S. §2808(c); 66 Pa.C.S. §2812(a)(2)(iii). In particular, while Section 2808(c) requires the Commission to authorize the recovery of certain costs associated with regulatory assets, nuclear generating plant decommissioning obligations and non-utility generation projects, it expressly imposes an obligation upon the Commission to determine what level of an electric utility's stranded cost claim attributable to generation plants may appropriately be recovered. 66 Pa.C.S. §2808(c)(1)-(3). Also, this provision of the Act requires the Commission to "consider the extent to which the electric utility has undertaken efforts to mitigate" its stranded costs, as well as any measures employed by the electric utility to reduce or moderate customer rate levels prior to the enactment of the Competition Act. 66 Pa.C.S. §2808(c)(4)-(5).

In establishing the general parameters for the non-bypassable stranded cost recovery mechanism referred to as the Competitive Transition Charge ("CTC"), Section 2808(a) of the Act provides that electric utilities will be afforded an opportunity to recover their transition or stranded costs, so long as the

recovery of those costs is accomplished in a manner that "maintains consistency with the allocation methodology for utility production plant accepted by the commission in the electric utility's most recent base rate proceeding" and does not "shift inter-class or intra-class costs." 66 Pa.C.S. §2808(a). As to the time period over which electric utilities may collect the CTC from their transmission and distribution ("T&D") customers, Section 2808(b) authorizes such recovery through December 31, 2005, nine years after the effective date of the Competition Act. 66 Pa.C.S. §2808(b).

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

A final provision of the Act that is particularly important to small business customers is Section 2806, which provides for the implementation of direct access through a three-year phase-in period beginning on January 1, 1999. Under this section, one-third of the peak load of each customer class must have the opportunity for direct access as of January 1, 1999, while two-thirds of the peak load must be eligible for direct access as of January 1, 2000. All

customers of electric distribution companies must have direct access to a competitive generation supply by January 1, 2001. 66 Pa.C.S.§2806(b).

Although the Competition Act suggests that customers be selected on a first-come-first-served basis to attain direct access during the first two years, it affords the Commission the discretion to choose a different approach. In particular, this provision recognizes the need to examine other phase-in methods so as "to prevent competitive disadvantages among similarly situated customers within a customer class." 66 Pa.C.S. §2806(b)(4).

II. PP&L's Stranded Cost Calculations

Through the testimony of Joseph R. Schadt, PP&L presented its calculation of stranded costs, segregated into four categories: nuclear generation plants, fossil generation plants, non-utility generation projects and generation-related regulatory assets. PP&L Stmt. No. 8 at 4. According to Mr. Schadt's testimony, PP&L's total stranded costs, after mitigation, amount to $4.6 billion on a net present value basis. PP&L Ex. JRS 8. This estimate was eventually lowered by PP&L to $4.5 billion as a result of a change in the estimated market-clearing energy prices. PP&L Ex. STJ 7 (revised); Tr. 2327 (9/9/97).

Mr. Schadt explained that in order to calculate its stranded generation plant costs, PP&L compared the annual revenue requirements for each nuclear and fossil plant to the projected annual revenue each plant would receive from the sale of output using market-based prices from January 1, 1999 to the end of the remaining service life of each plant. After applying a PUC jurisdictional percentage and discounting the resulting figures to present value, PP&L's stranded generation plant is estimated at approximately $3.6 billion. Of that amount, PP&L designated nearly $2.9 billion as stranded nuclear generation plant, while attributing the remainder to stranded fossil generation plant. PP&L Stmt. No. 8 at 4; PP&L Ex. JRS 1A; PP&L Ex. JRS 8.

For non-utility generation ("NUG") projects, Mr. Schadt compared the expected annual cost of the output that PP&L is contractually required to purchase from these projects to the annual revenues from the sale of such output using market-based prices. Also, he added the annual payments for the buy-out of two NUG projects. PP&L Stmt. No. 8 at 5. Again, applying the jurisdictional percentages and discounting to present value, he concluded that PP&L's stranded costs associated with NUG obligations is about $657 million. PP&L Ex. JRS 8.

Mr. Schadt computed the stranded costs for generation-related regulatory assets by determining the annual amortization that would be charged to expense under traditional cost-based regulation, applying jurisdictional percentages to the amortization and discounting the resulting stream of annual amortizations to present value. PP&L Stmt. No. 8 at 5. According to these calculations, Mr. Schadt estimated PP&L's stranded regulatory assets at roughly $354 million. PP&L Ex. JRS 8.

III. Electricity Market Price Forecasts

A. The electricity market price forecasts, which impact the calculation of PP&L's stranded costs and the development of an alternative generation market, are critical and need to be thoroughly examined.

The key component affecting PP&L's calculation of stranded costs is its electricity market price forecast. In particular, the accuracy of PP&L's projections of the future economic value of its generating facilities hinges upon the reliability of its underlying market price forecasts.

Indeed, Scott T. Jones, presenting the market price forecasts that he developed for PP&L, emphasized the significance of electricity generation market prices in this proceeding. Specifically focusing on the underlying fuel price forecasts and the resulting market-clearing energy prices, Dr. Jones indicated that these factors will "have the single largest impact on the utility's estimated stranded cost." PP&L Stmt. No. 7-R at 5.

In addition to highlighting the substantial impact that market price forecasts have on the overall magnitude of PP&L's stranded cost claim, the OSBA's expert witness, Robert D. Knecht, also stressed the use of reliable electricity price forecasts because of the effect on the meaningful development of a competitive generation market. OSBA Stmt. No. 1 at 8-10. Commenting that "under-forecasted market prices give rise to below-market rates for utility generation service, under PP&L's residual CTC methodology," Mr. Knecht opined that the market price forecasts will determine "how competitive the industry will be during the transition period." OSBA Stmt. No. 1 at 8 and 10. Given the fundamental importance of reliable market price forecasts underlying PP&L's stranded cost calculations, it is critical that the assumptions relied upon by Dr. Jones be carefully scrutinized. OSBA Stmt. No. 1 at 10.

Aside from the significant impact that PP&L's market price forecasts have on its calculation of anticipated stranded costs, Mr. Knecht set forth another particularly compelling reason for thoroughly examining the market price forecasts developed by Dr. Jones. In particular, he noted the natural incentive that PP&L has "to utilize a 'conservative' market price forecast for electricity." OSBA Stmt. No. 1 at 9. As Mr. Knecht explained:

> First, in the transition period (1999-2005), a low forecast of market prices improves the competitive position of PP&L vis-a-vis other generation suppliers. (Note that in the transition period, if PP&L's market price forecast were adjusted upward, both its stranded cost claim and its CTC revenues would decline relative to the existing proposal.) After the transition period, a low market price forecast increases PP&L's stranded cost claim.

OSBA Stmt. No. 1 at 9. On the other hand, the use of "[h]igher forecast market prices in the transition period would reduce CTC charges and make alternative generation suppliers more competitive," while "higher post-transition period price forecasts will reduce the stranded cost claim." Id.

B. Dr. Jones described the development of his market price forecasts for energy and capacity.

Dr. Jones explained that electricity prices are based on prices in both the energy and capacity markets, which "satisfy two different forms of demand for electricity: the capacity requirements of producers and the demand for power supplied by the energy market." PP&L Stmt. No. 7 at 6. As to the energy component of market prices for electricity, Dr. Jones indicated that the energy or kilowatt-hour price for electricity "is driven mainly by the incremental cost of fuel required to generate electricity." PP&L Stmt. No. 7 at 11. To arrive at projected market energy prices, Dr. Jones relied on the results of the Company's EGEAS (Economic Generation Expansion Analysis System) model. PP&L Stmt. No. 7 at 8, 25.

Although Dr. Jones eventually utilized the market energy price forecasts produced by the EGEAS model to project hourly market clearing prices for PJM, he separately developed the capacity component of market prices for electricity. PP&L Stmt. No. 7 at 45; Tr. 1416 (8/25/97). On the subject of capacity, Dr. Jones testified that the factors affecting these prices "include the short-term costs associated with the last capacity-holder that succeeds in making its capacity available to the system." PP&L Stmt. No. 7 at 7. Specifically, Dr. Jones explained as follows:

> In an excess capacity situation, those costs tend to be the incremental fixed costs of keeping a plant available for operation (e.g., a single year's fixed O&M costs, any necessary investment, and taxes). In a capacity deficit period, the marginal cost of capacity would tend toward the cost of adding new capacity.

PP&L Stmt. No. 7 at 7. Despite Dr. Jones' articulation of these sound economic principles, he actually did not adhere to these theories in forecasting capacity prices. Rather, in developing his capacity forecasts, he relied almost exclusively "on PP&L's energy marketers' experience negotiating with buyers of the Company's capacity." PP&L Stmt. No. 7 at 45; OSBA Stmt. No. 1 at 31-32.

The results of Dr. Jones' PJM market price analyses are shown on Exhibits STJ 7 (revised) and STJ 8. According to those exhibits, Dr. Jones' projections of the average market clearing electricity prices for the years 1999 through 2016 range from $22/mWh to $37/mWh, while the forecast capacity prices begin at $22/kW/year in 1999 and rise to a level of $61/kW/year in 2016. As shown by Michael J. Gruber, an expert witness for the Office of Trial Staff ("OTS"), Dr. Jones' estimates produce average projected market prices paid to PP&L over that period of 2.63¢/kWh to 4.51¢/kWh. OTS Ex. No. 1, Schedule 3.

C. A comparison of Dr. Jones' projected market prices with forecasts developed by other expert witnesses demonstrates that Dr. Jones' projections are conservative.

When Dr. Jones' projected market prices are compared with forecasts developed by other expert witnesses in this proceeding, as well as in other restructuring cases, the conservative nature of his projections, particularly in the later years of the transition period, becomes clear. To illustrate, focusing on the year 2005, we note that compared to Dr. Jones' projected market price of 3.47¢/kWh,[3] Douglas Smith, an expert witness sponsored by the Office of Consumer Advocate ("OCA"), estimated a PJM market price (all-hours baseload) in that year of 3.72¢/kWh.[4] Similarly, Randall Falkenberg, an expert witness presented by PP&L Industrial Consumers Alliance ("PPLICA"), projected a PJM market price of 3.74¢/kWh in 2005.[5]

By way of further comparison, Mr. Smith showed that the three estimates of PJM market prices in 2005 that were submitted by PECO Energy Company in its restructuring proceeding range from 3.61¢/kWh to 3.76¢/kWh, and thus center

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[3] See OTS Exhibit No. 1, Schedule 3.

[4] OCA Exhibit DCS-7. Note that Mr. Smith's PP&L weighted generation price for that year is 4.156¢/kWh, as shown on OCA Exhibit DCS-8.

[5] PPLICA Exhibit RJF-5.

around his own figure of 3.74¢/kWh.[6] Obviously, the strong correlation among the figures furnished by the OCA, PPLICA and PECO witnesses establishes the conservative nature of Dr. Jones' projections for 2005.

Additionally, testifying for the OTS, Mr. Gruber referred to the market price estimates supplied by Metropolitan Edison Company and Pennsylvania Electric Company in their restructuring proceedings of 3.53¢/kWh and 3.54¢/kWh in 2005.[7] OTS Stmt. No. 1 at 12. Clearly, even though those figures are somewhat lower than the PJM market price estimates supplied by Mr. Smith and Mr. Falkenberg in this case, they were provided by electric utilities who have the same incentives as PP&L does to produce conservative market price forecasts. As such, they clearly lend a measure of additional support for the proposition that Dr. Jones' market price forecasts are simply too low to be afforded any credibility or weight in this proceeding.

Moreover, Mr. Gruber's exhibit illustrates the disparity between PP&L's market price projections and the average of the forecasts presented by PP&L, PECO and the GPU Companies. Specifically, we note that again referring to 2005, the average forecast of these companies is 3.83¢/kWh, compared to PP&L's projection of 3.47¢/kWh. See OTS Exhibit No. 1, Schedule 3.

D. Conservative assumptions regarding key factors driving electricity market price forecasts cause Dr. Jones' low projections of market value.

Several witnesses have offered testimony challenging many of the critical assumptions underlying Dr. Jones' low market price forecast. In particular, Mr. Knecht and other experts testifying for the intervenors identified numerous conservative or flawed assumptions that Dr. Jones has incorporated into his

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[6] OCA Exhibit DCS-9. Note that PECO's weighted market price estimates for 2005, as shown on OTS Exhibit No. 1, Schedule 3, range from 3.93¢/kWh to 4.17¢/kWh.

[7] OTS Exhibit No. 1, Schedule 3.

analyses, which have had the combined effect of producing much lower than average projections of market value during the transition period.

1. Rather than relying on independent fuel price forecasts, Dr. Jones' developed his own outlook which contain projections that are in the lower end of the range of independent forecasts.

A key factor driving Dr. Jones' low market price forecast is his fuel price outlook. As Dr. Jones recognized, "[i]n the PJM region, the single most important driver of electricity price in a competitive generation market...is fuel prices." PP&L Stmt. No. 7-R at 4-5. He further observed that whatever "fuel price forecast the Commission implicitly or explicitly adopts in this proceeding will have the single largest impact on the resulting market-clearing energy price, no matter what model is used to produce the forecasted competitive price for energy." Id.

a. Dr. Jones' method

In his direct testimony, Dr. Jones indicated that he had reviewed several independent fuel price forecasts, such as those prepared by Data Resources, Inc. ("DRI") and the Energy Information Administration ("EIA"). Also, he "examined the recent historical record for price behavior in assessing the short-to-intermediate term forecasts of others." PP&L Stmt. No. 7 at 39. Then, applying his judgment to that data, he produced his own outlook for delivered prices of oil, natural gas and coal, as set forth in PP&L Exhibit STJ 3. Dr. Jones described that exhibit as representing "a reasonable consensus forecast of fuel prices." PP&L Stmt. No. 7 at 40.

In rebuttal testimony, Dr. Jones offered a different explanation of his methodology for forecasting fuel prices. Criticizing the various independent sources that he had discussed and apparently relied upon in his direct testimony, Dr. Jones seemed to abandon his previous description of his forecast as reflecting a consensus of those independent forecasts. Rather, on rebuttal, he

declared that his forecast was "guided mainly by actual changes in oil and gas prices during this century." PP&L Stmt. No. 7-R at 47.

b. Comparison of Dr. Jones' fuel price forecasts with those produced by independent sources

A review of various independent forecasts of natural gas, coal and oil prices, as reported by the Energy Information Administration in 1997, reveals that Dr. Jones' fuel price outlook is hardly representative of a "consensus" view. Rather, based upon a comparison of Dr. Jones' fuel price forecasts with other independent forecasts of fuel costs, Mr. Knecht found that Dr. Jones' projections are consistently in the lower end of the range of independent forecasts. OSBA Stmt. No. 1 at 27-30.

Mr. Knecht's observations tracked those of Mr. Falkenberg, who also examined various independent sources of fuel price outlooks and described Dr. Jones' fuel price forecast as a consensus of "low" forecasts. PPLICA Stmt. No. 2 at 30. Moreover, testifying for the OCA, Mr. Smith reached similar conclusions, particularly when he compared Dr. Jones' fuel price estimates to the DRI price escalation rates for each fuel relied upon by PECO expert witnesses in its restructuring proceeding. OCA Stmt. No. 2 at 10.

c. Review of oil price trends

Attempting to justify his fuel price forecast on the basis of historical trends in oil prices, Dr. Jones reviewed oil prices over the last one hundred years and concluded that they have tracked a flat real price trend. As Mr. Knecht observed, however, it would be more accurate to say that Dr. Jones analyzed "selective historical changes in oil prices." OSBA Stmt. No. S1 at 19. Specifically, "by eliminating the price spike caused by the Iranian Revolution, Dr. Jones effectively assigns a zero percent likelihood to similar price spike in the next twenty years" without providing any analysis to support his decision to exclude certain data observations. OSBA Stmt. No. S1 at 19.

Further, Mr. Knecht demonstrated that Dr. Jones' claim that oil prices have exhibited a flat real trend over the last one-hundred years is unfounded. Specifically, Mr. Knecht explained that if "oil prices have exhibited a flat real trend over long periods of time, then the average real price over time should remain reasonably constant." OSBA Stmt. No. S1 at 19. Yet, as Mr. Knecht noted, Dr. Jones performed no such analysis of the trends in the average price of oil. Rather, he simply performed a static computation, calculating the average price over a single period of time (1900-1996), which provided no information about whether the average real prices are increasing, decreasing or remaining constant. Id.

In view of that deficiency in Dr. Jones' presentation, Mr. Knecht analyzed the trend in average oil prices over time and presents those results both graphically and statistically. A review of OSBA Exhibit RDK-S2 shows that "even ignoring the Iran price spike, real crude oil prices have trended upwards, at an average annual rate of 0.8 percent." OSBA Stmt. No. S1 at 19.

Mr. Knecht also raised concerns about Dr. Jones' analysis of the historical correspondence between real gas, oil and coal prices. Specifically, he refuted Dr. Jones' claim that the use of a correlation coefficient measure indicates that "there is no real-world precedent for a sustained and growing gap between competing fuels." OSBA Stmt. No. S1 at 28. Through OSBA Exhibit RDK-S3, Mr. Knecht demonstrated that Dr. Jones' conclusion is unsupported because "[h]igh correlation coefficients can be associated with an increasing, constant, or decreasing gap between variables." OSBA Stmt. No. S1 at 21.

d. Reliance on independent fuel price forecasts

In addition to raising serious questions about the validity of Dr. Jones' fuel price forecasts, Mr. Falkenberg also appropriately emphasized the lack of independence between these forecasts and Dr. Jones' estimates of market prices and stranded costs. PPLICA Stmt. No. 2-S at 34. Recommending that "the

Commission consider recognized forecasts prepared by independent organizations" in lieu of Dr. Jones' own assumptions about the direction of fuel prices, Mr. Falkenberg warned the Commission to be "skeptical of forecasts of fuel prices prepared by witnesses, such as Dr. Jones, who also are presenting market electric price forecasts." PPLICA Stmt. No. 2 at 28-29.

As Mr. Falkenberg observed, it is "impossible to separate the end result (the electric market prices) from the judgmental fuel price inputs." PPLICA Stmt. No. 2 at 29. As a result, the Commission should "insist that the fuel price forecasts that are used be developed independently from the consideration of any impacts on market prices or stranded costs." Id. In surrebuttal testimony, Mr. Falkenberg reiterated his concern relating to Dr. Jones' fuel price forecasts, stressing that it is this lack of independence between these forecasts and his estimates of market prices and stranded costs that is critical, even more than the actual validity of his forecast values. PPLICA Stmt. No. 2-S at 34.

2. Besides relying on his own conservative fuel price forecasts, Dr. Jones made other conservative assumptions about future market conditions.

Another flaw in Dr. Jones' market price forecast identified by Mr. Knecht is that "it is based on optimal capacity configuration and perfect foresight for demand." OSBA Stmt. No. 1 at 30. As Mr. Knecht explained, this assumption "precludes periods of tight capacity and high demand-based pricing...and periods of excess capacity and marginal cost pricing." Id.

Mr. Knecht also criticized Dr. Jones' expectations for plant closures, again observing that while these assumptions are not unreasonable, they are quite conservative. He noted, that in modeling PJM plant availability, "PP&L has conducted no economic tests to determine whether existing plants will close before the end of their engineering lives." OSBA Stmt. No. 1 at 30. Recognizing that generation plant owners may evaluate plant shutdowns on an incremental cash flow basis, Mr. Knecht opined that plants may be closed before the end of their

useful lives if they "require significant ongoing capital expenditures and have high 'fixed' O&M costs" or if generators with numerous plants find "that shutting some of their facilities...will have a favorable impact on market prices earned at other facilities." OSBA Stmt. No. 1 at 30-31.

3. Dr. Jones incorporated two significant conservative assumptions into the EGEAS model.

Mr. Knecht also identified two conservative assumptions that PP&L incorporated into its EGEAS model. First, "by using a probalistic approach to capacity availability in its EGEAS model, PP&L appears to effectively" assume that there is no correlation in the forced outages among plants. Mr. Knecht noted that "[t]o the extent forced outages are correlated, due to extreme weather conditions for example, PP&L's forecast understates periods of capacity shortages and demand-driven prices." OSBA Stmt. No. 1 at 32.

Also incorporated into the EGEAS model was an assumption relating to the modeling of non-utility generators as must-run facilities with zero cost. Since "[i]t is likely that at least *some* of these facilities have marginal costs in excess of the PJM system spot price at certain times" and "would purchase spot market power to meet their contractual obligations, rather than generate," the effect of modeling these facilities as having zero cost was to lower the supply curve and reduce forecast market prices. OSBA Stmt. No. 1 at 32.

4. Dr. Jones' approach to developing future capacity values is flawed.

Further, Mr. Knecht challenged the validity of Dr. Jones' approach to developing capacity values. Although Mr. Knecht agreed with Dr. Jones' testimony as to the proper method for estimating capacity prices, he noted that Dr. Jones did not adhere to that approach when he actually developed those forecasted prices. In particular, Mr. Knecht observed that in his testimony, Dr. Jones recognized that capacity prices in the near term must reflect the going forward incremental costs of existing capacity and that in the longer term, the

combination of capacity and energy prices must be sufficient to induce new plant construction. Despite his articulation of those principles that Mr. Knecht described as "well-grounded in economic theory," Dr. Jones apparently relied on information provided to him by PP&L personnel, along with his understanding of the market, for developing near-term capacity price forecasts rather than adhering to that sound economic theory. OSBA Stmt. No. 1 at 31. See also OCA Stmt. No. 2 at 14-15.

Moreover, as Mr. Falkenberg highlighted, the actual data relied upon by Dr. Jones considered only the period prior to restructuring, which is "largely meaningless because it only reflects market prices for the next few years." PPLICA Stmt. No. 2-S at 15. Noting that PJM has excess capacity now and will continue in that status for the next few years, Mr. Falkenberg observed that these pre-restructuring transactions do not reflect market-equilibrium values and apparently only incorporate data relating to wholesale transactions. PPLICA Stmt. No. 2-S at 15. On the basis of Dr. Jones' "totally judgmental" computation of capacity values, Mr. Falkenberg analogized these projections to Dr. Jones' forecast of fuel prices, noting that both analyses suffer "from the same problems related to lack of independence." PPLICA Stmt. No. 2-S at 16. Emphasizing that "[t]he Commission simply has no way to determine whether Dr. Jones' forecast of fuel prices and capacity prices is a result-oriented effort," Mr. Falkenberg opined that "PP&L's claim for $4.6 billion of stranded costs rests on little more than the judgment of a single witness without substantial quantitative evidentiary support." PPLICA Stmt. No. 2-S at 16.

E. PP&L's Electricity Market Price Forecasts Are Insufficient To Induce The Construction Of Capacity That Will Be Needed Early In The Next Decade.

The conservative, or possibly result-oriented, biases that are inherent in Dr. Jones' market price forecasts have resulted in very low projections of the future economic value of PP&L' generating facilities. This point can perhaps

best be illustrated through an analysis of whether those forecasts are sufficient to induce the construction of capacity that will be needed early in the next decade.

1. The OSBA's analysis establishes the insufficiency of PP&L's market price forecast.

Mr. Knecht has conducted and presented the results of such an analysis, demonstrating that, in fact, Dr. Jones' market price forecasts are not sufficient to justify the addition of new capacity early in the next decade. OSBA Stmt. No. 1 at 32. In particular, Mr. Knecht presented two cash flow analyses of new gas-fired combined cycle generating units that would begin operation in 2005, with both scenarios using Dr. Jones' assumptions for costs and revenues, as best as Mr. Knecht could determine from various interrogatory responses. As he explained, an analysis of the equity return that an investor would expect from investing in a natural gas fired combined cycle plant in PJM, using Dr. Jones' forecasts and replacement cost assumptions, is "the critical test of a forecast's reasonableness." OSBA Stmt. No. S1 at 22. Specifically, he offered the following rationale:

> The analysis looks at the problem from the point of view of a potential investor, and therefore addresses the entire economic life of a facility. If the forecast is reasonable, the returns to equity holders should approximate the cost of equity capital. When investors consider new projects, and market price expectations produce a return that is well in excess of the cost of equity capital, these investors will construct capacity and these economic rents will disappear. If, however, market expectations produce an inadequate return, no capacity will be added until price expectations firm.

OSBA Stmt. No. S1 at 22 (footnotes omitted).

The first version of Mr. Knecht's analysis, which is set forth in Schedule 5 of OSBA Exhibit RDK-2, utilized extremely favorable assumptions regarding costs, including no gas transmission costs, no maintenance capital expenditures, no working capital requirements, and no decommissioning costs. As Mr. Knecht concluded, such a project "produces only an internal rate of return below

Dr. Jones' assumed cost of equity (i.e., a negative NPV at Dr. Jones' reported cost of equity)." OSBA Stmt. No. 1 at 33. In the second version, which incorporated very modest provisions for the excluded costs and is shown in Schedule 6 of OSBA Exhibit RDK-2, "the project will not come close to providing an adequate return." OSBA Stmt. No. 1 at 33.

In rebuttal testimony, Dr. Jones attempted to discredit Mr. Knecht's conclusions about the insufficiency of PP&L's market prices to attract investment in new capacity early in the next century. As part of that effort, Dr. Jones produced an exhibit to support his claim that his capacity forecast is adequate to induce investors to construct combined cycle units. PP&L Ex. STJ 28.

In response, Mr. Knecht noted that the primary reason for the difference in their conclusions is that in rebuttal testimony, Dr. Jones changed many of his key assumptions. OSBA Stmt. No. S1 at 23. Nevertheless, in an effort to incorporate those changes of Dr. Jones that appeared reasonable, Mr. Knecht re-examined this issue and presented the results of his revised analysis. Again, Mr. Knecht concluded that "Dr. Jones' price forecast is too conservative and is insufficient to induce sufficient capacity additions to meet demand plus the PJM reserve margin requirement." OSBA Stmt. No. S1 at 23; OSBA Ex. RDK-S4.

While we will not attempt to reiterate here all of the differences in the assumptions that Dr. Jones either changed or corrected during his rebuttal testimony, Mr. Knecht has set forth a detailed discussion in his surrebuttal testimony of each of those factors. Also, Mr. Knecht's surrebuttal testimony described how Dr. Jones' revisions should be treated for purposes of comparing the conflicting analyses. See OSBA Stmt. No. S1 at 23-26. In any event, the studies presented by Mr. Knecht thoroughly address and adequately consider all factors that are relevant to a determination of whether Dr. Jones' price forecast is sufficient to provide an adequate return to an independent power plant investor. As Mr. Knecht found on his second pass at this issue, using

assumptions that are generally optimistic for adopting the project, "the present value of the project based on Dr. Jones' price forecast is negative $89 million on an equity investment of $207 million." OSBA Stmt. No. S1 at 26.

2. The OSBA's witness determined what level of long-term prices would be sufficient to induce investment in new capacity.

In an effort to determine the level of long-term market prices that would be necessary to induce investment in a combined cycle facility in 2005, Mr. Knecht attempted to ascertain what escalation rates would be necessary for each price forecast to produce a zero NPV project. He noted that a zero NPV project provides an equity return equal to the equity cost of capital, 12.5%, and produces prices that are just high enough to induce an entrant with a required return on equity of 12.5%. OSBA Stmt. No. S1 at 26.

In particular, Mr. Knecht's exercise was designed to determine the level of market prices that would be necessary in 2016 to justify the construction of a combined cycle facility in 2005. Another way of stating his goal was to ascertain the energy and capacity values in 2016 that would indicate a break-even project commenced in 2005. The results of his analysis are set forth in OSBA Ex. RDK-S5, which demonstrate that escalating Dr. Jones' 2002 energy forecast at nominal rates of 4.6% per year and his capacity forecast at 2.8% per year would produce a zero net present value project. OSBA Stmt. No. S1 at 26-27.

In the year 2016, Mr. Knecht's "break-even capacity price forecast is $74 per kW per year and the energy forecast is $45 per mWh, with both values being a little more than 20% above Dr. Jones' forecast." OSBA Stmt. S1 at 27. Overall, Mr. Knecht's analysis demonstrates that for a new combined cycle facility to be economic, the average market price received in 2016 should be $56.9/mWh.[8] We note that the capacity and energy values shown on Mr. Knecht's

[8] Using PP&L's average capacity factor forecast for new CC facilities of 73 percent, a capacity price of $74/kW/year produces an average capacity cost of $11.6/mWh. When that figure is added to the energy price forecast of $45.3/mWh, the resulting average market price is

exhibit for the year 2016 are significantly higher than PP&L's market price forecasts for that year, but actually compare very favorably to the other projections furnished in this proceeding. Since 2015 data is more readily available, a comparison of the various 2015 energy and capacity projections with the values calculated by Mr. Knecht, is set forth in the table below:

	Energy $/mWh	Capacity $/kW/year	Total $/mWh
OSBA[9]	43.3	72.0	54.5
PP&L[10]	36.0	60.0	44.2
PPLICA[11]	42.3	80.0	55.2
OCA-I[12]	52.8	66.7	60.4
OCA-II[13]	50.8	66.7	58.4
OCA-III[14]	47.4	66.8	55.0

As the above table illustrates, the market estimates produced through Mr. Knecht's break-even analysis are far above PP&L's projections and very

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$56.9/mWh.

[9] See OSBA Exhibit RDK-S5. Although these capacity and energy values for 2015 appear on the exhibit, the average market price of $54.5/mWh is derived by dividing the revenues of $178.55 million by 3,274 gWh, both of which are included on that exhibit.

[10] PP&L Exhibit STJ-7 (revised); PP&L Exhibit STJ-8. The $44.2/mWh shown in the last column does not appear in either of these PP&L exhibits, but is set forth in OTS Exhibit No. 1, Schedule 3.

[11] See PPLICA Exhibit RJF-8. Although the capacity value of $80.04/kW/year for 2015 is clearly shown on RJF-8b, it is necessary to calculate Mr. Falkenberg's energy value for that year from the data set forth in RJF-8c. Specifically, the energy estimate of $42.3/mWh can be derived by starting with the total market energy revenues shown on page 3 of RJF-8c, of $1,186,521 ($1,000), and dividing that by the generation figure shown on page 1, of 28048 gWh (under the heading "Large Unit Output Report"). Also, the figure of $55.2/mWh shown in the last column can be derived by first multiplying Mr. Falkenberg's assumed capacity price of $80.04/kW/year by his assumed large unit capacity of 4516 mW that appears on page 1 of RJF-8c, which produces $361,460 ($1,000) in projected capacity revenues. To that amount, it is necessary to add the projected energy revenues of $1,186,251. That sum should then be divided by 28048 gWh (generation for large units). The implicit capacity factor in this analysis is 71%.

[12] OCA Exhibit DCS-7.

[13] OCA Exhibit DCS-10.

[14] OCA Exhibit DCS-13.

closely track the long-term market price estimates submitted by Mr. Falkenberg and Mr. Smith.[15]

In fact, the comparison between Mr. Knecht's and Mr. Falkenberg's combined energy and capacity values ($54.5/mWh and $55.2/mWh), assuming very similar capacity factors, provides extremely compelling evidence of the reasonableness of relying on market price projections such as those advanced by Mr. Falkenberg, rather than those presented by Dr. Jones. Simply stated, as Mr. Knecht's analysis demonstrates, Mr. Falkenberg's market price projections closely match the long-term prices that would be sufficient to induce the capital necessary to construct capacity early in the next century.

3. Other intervenors raised similar concerns about the sufficiency of PP&L's market price forecast to justify the construction of new capacity.

It is noteworthy that Mr. Smith, testifying for the OCA, also raised questions about the adequacy of Dr. Jones' capacity price assumptions to support the introduction of new combustion turbines at the time he has assumed they will be needed. As. Mr. Smith observed, "[b]ased on a reasonable carrying charge rate (to reflect recovery of and return on the capital investment), the annual carrying charges associated with this new combustion turbine would be higher than Dr. Jones' estimated market capacity price when he assumes the addition." OCA Stmt. No. 2 at 15.

Moreover, Mr. Falkenberg found that the "capacity credits" utilized by Dr. Jones "will not provide sufficient revenues to justify the addition of combined cycle or combustion turbine generators in PJM anytime over the period 1999 to 2015 as modeled in EGEAS." PPLICA Stmt. No. 2-S at 16. To support his findings, Mr. Falkenberg "performed an economic analysis of new combustion turbines based on Dr. Jones' estimated capacity values, and the EGEAS fuel costs

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[15] Further, a review of Mr. Gruber's exhibit reveals that the market price estimates of PECO and the GPU Companies range from $51.4 to $62.2/mWh in 2015. OTS Exhibit No. 1, Schedule 3.

and energy revenues for new units," the results of which he has set forth in PPLICA Exhibit RJF-11a. Since it would be uneconomic to build new CT capacity in 1999, as they would fail to recover their cost every year from 1999 to 2015, Mr. Falkenberg opined that "no reasonable developer would add any type of new generation under these circumstances." PPLICA Stmt. No. 2-S at 17.

F. The use of more optimistic market price forecasts is further justified when the stranded cost issue is viewed from the perspective of potential buyers.

Besides the fact that the market price forecasts presented by Mr. Falkenberg and Mr. Smith closely mirror the level of capacity and energy prices that would be needed to induce the capital necessary to construct capacity in the years ahead, Mr. Knecht highlighted another basis for the Commission to "lean" a little toward reliance on more optimistic forecasts of market value. OSBA Stmt. No. 1 at 33-34.

In particular, noting that the regulatory approach is not the only way to evaluate stranded costs, Mr. Knecht testified that the asset method, which defines stranded costs as the difference between the market value of a utility's assets and its book value, also has merit. As he observed, "[i]f a utility can sell its assets at book value, it has no stranded costs." Suggesting that stranded costs could "be valued by requiring divestiture of generating plant," he explained that the stranded costs would simply be those reflecting the difference between the market sale price of the assets and the book value. OSBA Stmt. No. 1 at 33. While Mr. Knecht did not advocate divestiture by PP&L, he appropriately concluded that if stranded costs were determined in that manner, the enormous number of assumptions that necessarily go into the development of market value would reflect the "market's expectations for all of these factors...and not those of the parties with vested interests in a regulatory proceeding (utilities, customers and competitors)." OSBA Stmt. No. 1 at 34.

Mr. Knecht's realistic approach to the dilemma facing the Commission in determining a proper level of stranded costs is to "try to incorporate assumptions that would reflect those of potential buyers." OSBA Stmt. No. 1 at 34. He pointed out that if PP&L "... were to offer some of its generation assets for public sale, it can safely be assumed that they would sell to the bidder with the highest offer price." Id. Obviously, the successful buyer would likely be the one with the most optimistic economic prospects for the facility, which supports the utilization of market price forecasts that "reflect assumptions on the optimistic side of reasonable, rather than the pessimistic side." OSBA Stmt. No. 1 at 34.

G. The Commission should not rely on the low market price forecasts submitted by PP&L and should instead utilize the more realistic and more optimistic projections offered by the witnesses for PPLICA and OCA.

Based upon the foregoing, the OSBA supports reliance by the Commission on more optimistic (and more realistic) market price forecasts than those that have been tendered by PP&L. With PP&L's market price forecast for 2015 being far below the necessary level for an investor to break-even on a combined cycle unit, especially as compared to other estimates of market value, it is clear that PP&L's market price projections are substantially understated. Since PP&L's estimates are not reliable, they should be afforded no weight for purposes of determining stranded costs in this proceeding.

The Commission can and should, however, rely on the forecasts provided by both PPLICA and OCA, both of which appear to meet the important objective of ensuring that the prices support the construction of needed additional capacity.[16] Moreover, those market price estimates more closely reflect assumptions that would be made by successful purchasers of generation facilities.

[16] The OSBA notes that the Commission specifically endorsed the market price forecast of OCA witness Smith in the PECO Restructuring Order (at p. 88). Those market prices should certainly be equally applicable to PP&L which, like PECO, is a member of the PJM power pool.

As such, they provide a solid and credible basis upon which to calculate PP&L's stranded costs.

IV. Competitive Transition Charge

A. The Company's Competitive Transition Charge is designed to collect $4.0 billion in stranded costs.

Although PP&L projected that its stranded costs will total about $4.5 billion, it does not expect to recover that amount due to the rate caps in the Act and the limited statutory time period for recovering stranded costs. Rather, according to PP&L witness Douglas Krall, the Company's CTC would collect stranded costs over the transition period of about $4.0 billion. PP&L Stmt. No. 10 at 10.

As Mr. Krall explained generally, PP&L's proposed CTC is the difference between the Company's current bundled rates and the sum of the transmission and distribution costs and the projected market price of generation. In other words, after subtracting its transmission and distribution costs and the projected generation market price from its existing bundled rates, PP&L designated the residual amount as the CTC. PP&L Stmt. No. 10 at 8.

Since the market price of generation is expected to rise during the transition period, PP&L's proposed CTC would decline in order to avoid exceeding the statutory generation rate cap. PP&L Stmt. No. 10 at 10; PP&L Stmt. No. 9 at 26; PP&L Ex. SFT 10. The CTC charges for each of the seven years are shown on the rate schedules provided in PP&L's proposed tariff. See PP&L Ex. OGK 2. Testifying for PP&L, Joseph Kleha explained that if actual sales during the transition period would differ from the sales levels projected by PP&L, the Company would track any over/under collections and then either reduce or extend the term of the CTC to reflect these differences. PP&L Stmt. No. 3 at 17.

PP&L witness, Susan Tierney, provided further explanation of the Company's unbundling method, describing it as a "bottom-up" approach, as compared to "top-

down" unbundling approach. As Dr. Tierney indicated, a "top-down" approach would have begun with the Company's stranded cost estimate and then allocated responsibility for those costs among the various customer classes. PP&L Stmt. No. 9 at 23-24. By contrast, following a bottom-up approach, "PP&L started with the individual rate structure for each customer class and unbundled that rate first in order to separate delivery costs from generation-related costs, and then to separate the latter into supply costs (priced at prevailing market rates) and competitive transition charges." PP&L Stmt. No. 9 at 24.

Thus, although the Company relied on the cost allocations from its last base rate case to identify that portion of the rate related to delivery versus generation charges, it did not actually employ allocation factors from its last cost of service study to assign CTC responsibility among the classes. Rather, for each class, the amount that was left, after subtracting transmission, distribution and market generation charges from existing rate levels, was designated as that class' CTC, or its share of the stranded costs. Noting that PP&L estimated its total stranded costs as exceeding the amount it would be able to collect under the rate cap during the course of the transition period, Dr. Tierney concluded that "PP&L must use all of the remaining room under the cap -- after delivery and supply charges are backed out -- in order to recover those stranded costs that can be recovered under the rate cap." PP&L Stmt. No. 9 at 24.

B. Although the OSBA's witness found the Company's overall unbundling approach to be reasonable, he addressed the issue of assigning excess CTC revenues.

As to the Company's overall unbundling approach, OSBA witness Mr. Knecht testified that in his opinion, "the PP&L approach is reasonable." OSBA Stmt. No. 1 at 7. He explained, that through calculating the CTC as the residual, PP&L's "method puts all classes on an equal basis with respect to the attractiveness of purchasing generation services from non-PP&L suppliers." OSBA Stmt. No. 1 at 7.

Recognizing the possibility, however, that the Commission could determine that PP&L has a lower level of stranded costs than it has projected, Mr. Knecht discussed the need for the Commission to determine how to assign any excess CTC revenues. In other words, if the Commission authorizes stranded cost recovery in an amount that allows PP&L to collect all of those costs and still have room under the rate cap, it is necessary to consider how those excess revenues should be handled. Specifically, existing rates should be reduced in order to prevent PP&L's shareholders from receiving those excess revenues. OSBA Stmt. No. 1 at 11.

1. A proportional reduction of CTC charges would be appropriate if PP&L's stranded costs are somewhat lower than its residual CTC revenues.

In his direct testimony, Mr. Knecht recommended a method for handling a situation where PP&L's stranded costs are lower than its residual CTC revenues. Under Mr. Knecht's suggested approach, every CTC charge proposed by PP&L would be reduced "by the ratio of approved stranded costs to base case stranded revenues." OSBA Stmt. No. 1 at 12. Describing this approach, Mr. Knecht observed that it would "provide immediate and tangible benefits to existing ratepayers from deregulation, in the form of lower fully bundled rates." OSBA Stmt. No. 1 at 12. The OSBA notes that this proposal was eventually endorsed by PP&L, through Dr. Tierney, who indicated agreement with a pro rata reduction of CTC revenues if reliance on the residual calculation contained in PP&L's original proposal is not feasible. Tr 827.

2. An allocation of stranded costs among customer classes is a fairer way of recovering stranded costs.

In offering his scale-back recommendation, Mr. Knecht recognized that small business customers served by Rate Schedules GS-1 and GS-3 would actually be treated more fairly if stranded costs were allocated among the customer classes. Specifically, because customers on those rate schedules currently exhibit rates

of return that are far above system average returns,[17] a pro rata reduction of residual CTC revenues simply perpetuates the existing inequities associated with over-recovery from those customer classes. Stated differently, since those small business classes currently pay rates that exceed cost-of-service indications, they effectively have more room under their rate caps to accommodate the assignment of CTC revenues under the Company's residual approach. See OSBA Stmt. No. 1R at 3-4, 8.

a. Applicability of simplicity criterion

Although agreeing with the concept of the residual CTC approach, Mr. Knecht also realized that the allocation of stranded costs that are near the residual CTC revenues would be unduly complicated. In particular, an allocation of stranded costs in that situation could easily cause rate cap problems. Therefore, he concluded that a scaleback approach "makes sense if estimated stranded costs are at or near residual CTC revenues." OSBA Stmt. No. 1R at 8.

In rebuttal testimony, Mr. Knecht further refined his recommendation on this issue. Noting that when he filed his direct testimony, he "had not considered the possibility that the approved stranded costs might be significantly less than residual CTC revenues," Mr. Knecht emphasized that his original scaleback proposal was "designed for simplicity." OSBA Stmt. No. 1R at 8. Specifically, Mr. Knecht had opted for simplicity so as to avoid causing rate cap violations that might have occurred via an allocation of stranded costs at or near the residual CTC calculation. In view of some of the intervenors' proposals, however, for stranded cost recovery at a level that is significantly below the CTC revenues proposed by PP&L, Mr. Knecht determined that it was necessary to revisit this issue especially since rate cap violations would no

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[17] Mr. Kleha's cost allocation study shows rates of return for the GS-1 and GS-3 classes of 15.7 percent and 11.4 percent respectively, as compared to system average returns of 9.5 percent. See OSBA Stmt. No. 1 at 40-41.

longer be a concern. OSBA Stmt. No. 1R at 2-5. As he explained, "if estimated stranded costs fall substantively below residual CTC revenues (say more than 10 or 20 percent below residual CTC revenues), fairness should override simplicity as the key criterion." OSBA Stmt. No. 1R at 8.

b. Applicability of fairness criterion

Relying on the fairness criterion, Mr. Knecht urged the Commission to avail itself, under these circumstances, of an opportunity to minimize the inequities resulting from PP&L's residual approach to calculating stranded costs. Indeed, an examination of Section 2808(a) of the Competition Act expressly supports the allocation of stranded costs among customer classes "in a manner that...maintains consistency with the allocation methodology for utility production plant accepted by the Commission in the electric utility's most recent base rate proceeding." 66 Pa.C.S. §2808(a). See OSBA Stmt. No. 1R at 6-8.

Specifically, Mr. Knecht recommended that a "broad-based, unbiased total generation cost allocator be developed" so that the "allocator for stranded costs would then be each class' share of total allocated generation costs." OSBA Stmt. No. 1R at 7. While Mr. Knecht generally agreed with the approach proposed by Ms. Lee Smith, testifying for the OCA,[18] he believed that it would be necessary for PP&L to develop a broad-based, unbiased generation allocator so as recognize past treatment of interruptible service classes by the Commission. OSBA Stmt. No. 1R at 7-8.

3. PPLICA'S proposal for assigning stranded costs to individual rate classes unfairly penalizes small business classes who currently pay rates that are above cost of service indications.

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[18] Ms. Smith, in proposing that stranded costs be amortized on a levelized basis over the transition period, had recommended that these costs be allocated among the customer classes on the basis of the 12 CP production plant allocator used by PP&L in the cost study performed in the last base rate proceeding at Docket No. R-943271.

Further, in rebuttal testimony, Mr. Knecht responded to the alternative method for assigning stranded costs to individual rate classes that had been proffered by PPLICA witness, Mr. Stephen Baron. Describing Mr. Baron's proposal to impose the residual CTC only until stranded costs are recovered, Mr. Knecht explained that under "PPLICA's calculation of stranded costs...residual CTC revenues are sufficient to recover [PPLICA's much lower level of] stranded costs within the first year of the transition period." OSBA Stmt. No. 1R at 3.

Since Mr. Baron's approach effectively allocated stranded costs to customer classes on the basis of how much room exists under the rate cap, Mr. Knecht found that "[c]lasses such as GS-1 and GS-3 which have historically over-recovered costs are therefore assigned a greater share of stranded costs." OSBA Stmt. No. 1R at 6. Noting that "Mr. Baron's approach serves to extend and exacerbate a historical inequity," Mr. Knecht relied on the criterion of fairness as a basis for recommending its rejection. Id.

The unfairness of Mr. Baron's proposal for assigning CTC revenue responsibility to the customer classes can perhaps best be illustrated through an analogy of existing class rates to empty pitchers. Rather than viewing the customer classes as have varying levels of existing rates, this analogy recognizes that they have different sizes of pitchers. Through PP&L's "bottom-up" approach to unbundling, it "pours" transmission and distribution charges into each pitcher and then adds the market generation prices into each pitcher. The total remaining space in the pitchers is available for CTC revenues. Under PP&L's proposal, all of the pitchers would be filled to the brim each year and then after seven years, the Company would have collected $4 billion, which is about $500 million less than the amount of stranded costs that it anticipates.

Under Mr. Baron's approach, however, each class' pitcher would be filled to the brim with CTC revenues until a much lower level of authorized stranded cost recovery is achieved. Thus, while an allocated share of that significantly

lower level of stranded costs might only fill the small business "pitchers" one-half or two-thirds full, his approach would not stop there. Rather, he would continue filling those larger pitchers with CTC revenues that are properly allocable to other customer classes and should be poured into their pitchers over a longer period of time. It is this feature of Mr. Baron's proposal that raises serious fairness concerns from the standpoint of small businesses.

An additional factor of which the Commission should be aware in reviewing Mr. Baron's proposal to shorten the CTC recovery period, is the language in Section 2804(4) of the Competition Act relating to rate cap protections for distribution and generation charges. In particular, although the statutory rate cap protections extend until June 30, 2001 for distribution charges and until December 31, 2005 for generation charges, those protections automatically terminate earlier if an electric distribution utility ceases to recover stranded costs from its customers and all of its customers have direct access. Since adoption of Mr. Baron's proposal would result in a significantly earlier termination of rate cap protections than is envisioned by the statute, it would *adversely impact any small business customers who are unable to obtain or* otherwise avail themselves of lower generation prices via the competitive market.

4. To summarize, the OSBA recommends that the Commission exercise its discretion, depending on the level of stranded cost recovery authorized for PP&L, to arrive at an appropriate sharing of these costs among customer classes.

If the Commission determines that PP&L's stranded costs are greater than the residual CTC revenues, small businesses on Rate Schedules GS-1 and GS-3 would have paid a larger portion of their allocable share of the CTC revenues than other classes whose current rates do not cover costs. Because that would occur simply because of the combined effects of the existing rate levels, the rate caps and the limited time period over which stranded costs may be recovered, the OSBA has not challenged that result. See OSBA Stmt. No. 1 at 6-7.

If PP&L's authorized stranded cost recovery is only moderately lower than the residual CTC revenues, a proportional reduction in each class' CTC revenue responsibility does not address the existing inequities but also does not exacerbate them. In other words, while small business classes would still pay a greater than allocable share of their CTC revenue responsibility than other classes, they would not be called upon to shoulder the CTC responsibility of any other classes. In the interests of simplicity, the OSBA has also not challenged that result. See OSBA Stmt. No. 1-R at 8.

To the extent, however, that the Commission concludes that PP&L's stranded costs are likely to fall far below the residual CTC revenues, the OSBA advocates greater reliance on the criterion of fairness than on simplicity. Specifically, under this scenario where there is significant room under the rate caps, the Commission should seek to minimize the economic distortions caused by stranded cost recovery. OSBA Stmt. No. 1-R at 5-8. Accordingly, in that situation, the Commission should require PP&L to allocate CTC revenues in a manner that is consistent with each class' share of total allocated generation costs. Alternatively, if the Commission is not persuaded by the fairness of this approach, a proportional reduction in CTC revenues would be clearly superior to the method advanced by Mr. Baron. In any event, the Commission must avoid any method that would result in an assignment of CTC revenues that effectively shifts responsibility for stranded generation-related costs to classes that simply have more room under their existing rate caps as a result of historically having been required to pay rates that are above their cost-of-service indications.

V. Rate Design

A. PP&L proposes the use of a Customized Rate Design for implementing its CTC.

1. The Company would calculate customer-specific CTCs.

The Company's proposal for implementing the CTC is described by Dr. Tierney. Referring to PP&L's proposal as offering a Customized Rate Design ("CRD") to all customers, Dr. Tierney explained that the Company would calculate a CTC for each customer, based upon historical usage. Half of that CTC would be collected through a monthly fixed charge known as a "CTC customer charge", while the remaining portion would be recovered through a variable (kWh) charge. Dr. Tierney indicated that "this new customized CTC customer charge would be retained for the rest of the transition period, although the level of the cents-per-kilowatt-hour charge would decline over time consistent with the established schedule for CTC charges." PP&L Stmt. No. 9 at 29.

2. The Company's rationale for the CRD is economic efficiency.

In support of the CRD, Dr. Tierney suggested that this approach "establishes rates for incremental use of electricity that are more efficient than today's rates." PP&L Stmt. No. 9 at 6. By better reflecting the "marginal cost of providing service to customers, Dr. Tierney contended that the CRD enables customers "to make better informed consumption decisions." PP&L Stmt. No. 9 at 6. She further described the CRD as "providing effective rate relief by reducing the marginal rate for electric energy." PP&L Stmt. No. 9 at 20.

3. While the CRD would be optional for residential customers, it would be mandatory for commercial and industrial customers.

Noting that the CRD would be optional for residential customers, who could choose to remain with a traditional rate design where the CTC charges would be collected on the basis of kilowatt-hour consumption, Dr. Tierney testified that all other customers would be required to take service under the CRD. PP&L Stmt. No. 9 at 32. In an effort to justify a mandatory CRD for commercial and

industrial customers, she testified that "these other customer groups are generally more price sensitive." PP&L Stmt. No. 9 at 33. Echoing Dr. Tierney's comments, Mr. Krall added that "customers in these classes are...more familiar with economic issues than the average residential customer." PP&L Stmt. No. 10 at 15.

Through oral rejoinder testimony provided by Mr. Krall, PP&L expressed its willingness to offer the CRD on an optional basis to all customers, provided that a customer's election of a particular rate design would be in effect for a period of twelve months and that PP&L would reconcile its CTC collections on the basis of revenues rather than sales. Tr. 734 (8/19/97). The effect of this reconciliation on the basis of revenues is set forth in OSBA Cross-Examination Exhibit 1, which was admitted into the record on September 9, 1997. The OSBA considers those conditions reasonable, given PP&L's explanation of the need to avoid a revenue shortfall resulting from customers choosing the best option for them.[19]

The OSBA is uncertain, however, as to just what PP&L's final position will be with regard to making its CRD proposal mandatory for commercial and industrial customers. On cross-examination after saying that the CRD could be optional for all customers, Mr. Krall appeared to revert to PP&L's initial preference for mandatory CRDs for the commercial and industrial classes. TR. 760, 774 (8/19/97). To avoid having to argue here over what we hope is a non-issue at this juncture, the OSBA simply lists its objections to the mandatory CRD in the following summary manner:

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[19] Mr. Knecht had actually suggested this solution as a way of addressing the self-selection problem expressed by PP&L. OSBA Stmt. No. 1 at 43; OSBA Stmt. No. S1 at 10. Further, Dr. Tierney recognized that some small business customers would not choose the rate design that makes the most economic sense. Tr. 891 (8/19/97).

- The impacts of a mandatory CRD can be seriously adverse to a small business customer whose consumption of electricity in the future is significantly different than that customer's 1996 consumption.
- A CRD that is optional for residential customers but mandatory for commercial and industrial customers is inherently discriminatory and unfair.
- PP&L's justification for the mandatory CRD for commercial and industrial customers apparently is based on its views about (a) price elasticity, and (b) business customers greater familiarity with economic issues, contentions that are both unpersuasive and unsupported on the record in this case.

If PP&L in its Main Brief goes back to its initial proposal and asks that the CRD be mandatory for all of its commercial and industrial customers, the OSBA may more fully develop these objections to that proposal in its Reply Brief.

B. PP&L has included other features in its proposed rate design that have an unfair impact on small businesses.

Mr. Knecht identified two particular aspects of PP&L's rate unbundling proposal that inappropriately impact small business customers. Both features resulted from certain tariff design decisions made by PP&L in the process of backing out the transmission/distribution costs and the forecast market prices to arrive at a residual CTC. OSBA Stmt. No. 1 at 43-47.

1. PP&L's proposed treatment of the demand charge in GS-1 tariff adversely affects some small business customers.

The first relates to PP&L's proposed treatment of the demand charge in the GS-1 tariff. When PP&L backed out the transmission and distribution costs for the GS classes, it opted to assign customer charge and unblocked energy charge revenues to the transmission/distribution costs, which left a blocked energy charge and a demand charge. Further, in backing out the market price, PP&L

deducted market energy rates from the residual energy charges and deducted market capacity charges from the demand charge, which left a blocked energy structure and demand charge for the CTC tariff. OSBA Stmt. No. 1 at 44.

The problem with this approach is that the demand charge on the GS-1 tariff applies only to billing demand above 5 kW. Thus, as Mr. Knecht discovered, "[c]ustomers who are not demand-metered, or who have billing demand of less than 5 kW, will see no reduction in their transmission/distribution service bill associated with the market rate demand credit, because they now pay no demand charge." OSBA Stmt. No. 1 at 45. Moreover, Mr. Knecht found that since the market rate credit will apply only to demand over 5 kW, "smaller GS-1 customers will effectively face rates for utility generation service that are below the market rates forecasted by Dr. Jones." OSBA Stmt. No. 1 at 45.

To resolve this problem, Mr. Knecht recommended that PP&L simply leave the existing demand charge in the component of the rates designated for transmission and distribution. He explained that "[m]arket demand charge revenues should then be backed out of the first block energy rate, and if necessary, the second block." OSBA Stmt. No. 1 at 45. Mr. Knecht provided a detailed proof of revenues for 1999 tariff levels that would result from implementing only this change. See OSBA Ex. RDK-2, Schedule 9.

During oral rejoinder testimony, the Company's rate design witness, Oliver Kasper, agreed to implement Mr. Knecht's suggestion. Tr. 1051-1052; 1099 (8/20/97). Therefore, the OSBA urges the Commission to include this directive in any order approving PP&L's Restructuring Plan.

2. PP&L's proposal to recover delivery charges through a flat energy tariff and a modest customer charge also adversely affects some small business customers.

The second rate design concern raised by Mr. Knecht affects both the GS-1 and GS-3 tariffs. It occurs as a result of PP&L's proposal to recover all transmission and distribution costs, which are essentially fixed, with a flat

energy tariff and a modest customer charge. This contrasts with PP&L's current tariffs which impose transmission and distribution costs through a customer charge and a declining block energy charge. As Mr. Knecht noted, this proposal raises serious questions relating to the "accuracy of intra-class cost recovery and intra-class equity." OSBA Stmt. No. S1 at 12.

Although Mr. Knecht recognized the simplicity of PP&L's approach, he observed that PP&L's proposed rate design changes may not actually reflect the load patterns within the GS-1 and GS-3 classes. In the absence of load research data to justify the elimination of the declining block tariff for delivery, Mr. Knecht simply recommended that further examination of this issue await the rate proceedings that PP&L initiates after the end of the transmission/distribution rate cap in mid-2001. OSBA Stmt. No. 1 at 46.

The problem with eliminating the declining block structure for delivery, in the context of this proceeding, is the potential for larger customers within those classes who have higher load factors to subsidize the very small consumers, such as billboards, detached garages, etc., in those classes. OSBA Stmt. No. 1 at 46-47; OSBA Stmt. No. S1 at 12-13. As Mr. Knecht explained, "[e]ach of these very small customers attracts customer costs in the cost allocation study. Under PP&L's proposal to phase out the declining block structure, these customers will provide less in revenue that their allocated costs. Larger, small business customers will be obliged to pick up the difference." OSBA Stmt. No. S1 at 13.

Concluding that sound economic reasons exist for retaining PP&L's current declining block tariff for delivery service, Mr. Knecht recommended that it should be maintained in each area of the GS-1 and GS-3 tariffs. OSBA Stmt. No. 1 at 46-47; OSBA Stmt. No. S1 at 13. To that end, he provided the details of such tariffs in OSBA Exhibit RDK-2, Schedules 10 and 11. The OSBA urges the Commission to direct PP&L to retain its current declining block charges for delivery, as set forth in those schedules.

C. Universal Service Fund costs should be allocated on the basis proposed by PP&L.

Using an unweighted customer allocator, PP&L proposes to assign approximately $6 million of Universal Service Fund ("USF") costs to the residential and general service classes. This allocation method results in the imposition of a USF costs of $731,914 on the General Service classes, which amounts to a USF charge of 0.008¢/kWh on the bills of commercial customers. See OTS Stmt. No. 2 at 4-8; OTS Ex. No. 2, Schedule 1. Since that proposal is consistent with the approach approved in PP&L's last base rate proceeding, the OSBA submits that it is the appropriate method to follow here. OSBA Stmt. No. 1-R at 10.

Testifying for the OCA and the OTS, however, Ms. Brockway and Mr. Reed proposed in their respective pieces of direct testimony that universal service costs be allocated and recovered in rates on an energy consumption basis. OCA Stmt. No. 6 at 44; OTS Stmt. No. 2 at 6. Specifically, under Mr. Reed's approach, the General Service classes would be responsible for $1.7 million of the USF costs, which amounts to a USF charge for those customers of .019¢/kWh. OTS Stmt. No. 2 at 6. Moreover, despite Mr. Reed's concern that PP&L's proposal places "a significant burden on the Residential and General Service customer groups,"[20] his recommendation would actually increase the General Service responsibility for USF costs by about $1 million over the Company's method.[21]

As Mr. Knecht testified, PP&L's approach complies with the allocation method approved in the last base rate case. Further, since universal service costs benefit only residential class customers, there is no justification for a

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[20] OTS Stmt. No. 2 at 5.

[21] Under Mr. Reed's method, it is necessary to multiply his proposed .019¢/kWh USF charge by the General Service total kWh sales level (8,973,654,000) to arrive at his proposed USF cost responsibility for the General Service classes of approximately $1.7 million. OTS Stmt. No. 2 at 6-7; OTS Ex. No. 2, Schedule 1.

change in the allocation scheme that would shift cost responsibility to general service, or small business, customers. OSBA Stmt. No. 1R at 10.

Moreover, the Commission has expressly interpreted Section 2804(7) of the Competition Act, which precludes unreasonable discrimination, as prohibiting interclass and intraclass cost shifting in the context of allocating universal service costs. See Commission Order entered on July 11, 1997 at Docket No. M-00960890F0010. In that Order, the Commission specifically rejected a kWh assessment of universal service costs on all customer classes, noting that "it places a disproportionate responsibility for funding universal service...programs on high kWh (high volume) users in violation of Section 1301." Order at 20. As the Commission found, the prohibition against cost shifting requires the use of a funding mechanism that is consistent with "rate treatments for these programs *in recent base rate cases.*" *Id.*

For that reason, the Commission again stated in its two PECO decisions that it would retain the principle of allocating universal service costs in an electric restructuring case in the same manner by which those costs were previously allocated for that particular utility. See PECO Restructuring Order, at p. 146, and PECO Reconsideration Order, at p. 16.

Accordingly, the Commission should approve PP&L's proposal to adhere to the method used in its last base rate proceeding of allocating USF costs on the basis of an unweighted customer allocator. Any changes in cost allocation methods or inter-class rate design should clearly await the filing of proceedings that follow the termination of the statutory caps on distribution rates. OSBA Stmt. No. 1R at 12.

VI. Phase-In Issues

A. The Company proposes to utilize a random selection process if customer classes are over-subscribed.

The OSBA has also raised concerns about PP&L's proposals for the phase-in of its customers to retail choice. In particular, if customer classes are over-subscribed during the enrollment periods for the first and second phases of direct access, the Company intends to select participants on a random basis. PP&L Stmt. No. 14 at 4. Although PP&L's original filing was not clear as to how the statutory percentage requirements would be applied, the Company's witness, Henry Baumann, subsequently clarified that the one-third and two-thirds portions would be determined for each rate class. For example, rather than simply including one-third of the load of the commercial class during the first phase, PP&L intends to phase-in one-third of the available load for the each of the commercial (GS-1 and GS-3) rate classes. Tr. 1251 (8/21/97).

Further, Mr. Baumann indicated that "[t]he Company is sensitive to the fact that the selection process may result in a customer being eligible for retail access in a later group than its competitors." PP&L Stmt. No. 14 at 5. Mr. Baumann's proposed solution to that dilemma is to have the Company review such situations on "a case-by-case basis and attempt to resolve it to the satisfaction of the affected customers." PP&L Stmt. No. 14 at 5.

B. PP&L's proposal fails to adequately address the potential for competitive concerns within customer classes.

Mr. Knecht raised two primary concerns with PP&L's proposed phase-in plan. First, PP&L has not adequately addressed the need to resolve competitive distortions within the small business classes. OSBA Stmt. No. 1 at 51-52.

In particular, Mr. Baumann's suggestion that the Company simply review these situations on an individual basis is deficient. As Mr. Baumann conceded, PP&L has developed no procedures for reviewing individual requests and has established no guidelines for determining how to resolve such requests. Tr.

1244-1245; Tr. 1251 (8/21/97). Further, he acknowledged that he was unaware how extensive such requests might be and whether PP&L would even be willing or able to accommodate all of them. Tr. 1247-1249 (8/21/97). See OSBA Stmt. No. 1 at 52.

Mr. Baumann also attempted to downplay the significance of the competitive disadvantages that might be created during the phase-in period. Specifically, he indicated that "any problem will exist for a maximum of two years and since customers only are allowed to shop for generation service, it will not affect the majority of the total bill." PP&L Stmt. No. 14-R at 6. Despite those general observations, however, he admitted that he has not surveyed small businesses to determine how seriously they might be affected by their competitors having access to lower electricity prices. Tr. 1252 (8/21/97). Additionally, he eventually recognized that for businesses operating on thin profit margins, any break on electricity costs could afford one business a competitive advantage over its competitors. Tr. 1250 (8/21/97). Moreover, he conceded that a business which is enrolled in the pilot program and then grandfathered into the first phase would have an advantage over its competitors for a period exceeding three years. Tr. 1253 (8/21/97).

As Mr. Knecht recommended, PP&L needs to establish procedures and guidelines to address competitive concerns among small business customers who are adversely affected by exclusion from an early phase of direct access. It is simply not sufficient for PP&L to suggest that special requests will be resolved. Given the potential for a large number of small businesses to be competitively disadvantaged during the phase-in period, it is critical "that PP&L develop specific details about the information that will be required from a customer who appeals for competitive relief, and also details for the appeal process." OSBA Stmt. No. 1 at 52. We note that PP&L has not objected to this recommendation and also has not set forth any particular reason for rejecting this approach.

Further, as both Mr. Baumann and Ms. Lennon agreed, PP&L should include information in its consumer education materials to notify small businesses of their ability, as well as the procedure they should follow, to request eligibility for direct access on the basis of competitive disadvantages. Tr. 1251 (8/21/97); Tr. 2000 (8/29/97).

C. PP&L's proposal fails to address the possibility of a few large customers dominating the entire load that is eligible for direct access in a particular phase.

A second major concern expressed by Mr. Knecht relating to PP&L's phase-in proposal is the potential for a few large customers within the GS-1 and GS-3 classes to dominate the available load. He noted that:

> In the GS-1 class, the top 5.7 percent of customer bills account for 33 percent of kWh consumed, based on the 1996 bill frequency analysis shown in Exhibit OGK-5. For the GS-3 class, the top 3.8 percent of customer bills constitute 33 percent of kWh consumption.

OSBA Stmt. No. 1 at 53. Therefore, as Mr. Knecht concluded, "even with random sampling, large customers could potentially dominate the competitive access within both classes." OSBA Stmt. No. 1 at 53.

As a way of addressing this problem, Mr. Knecht suggested that minimum levels of customer participation be set for the GS classes for each of the two phase-in years. While it would not be feasible to expect one-third of the GS customers to be represented in one-third of the load available for direct access in the first phase, it would be reasonable to establish some guidelines to prevent the entire eligible load from being dominated by a very small percentage of GS customers. In particular, during the first phase, Mr. Knecht recommended that at least 20% of the GS-1 and GS-3 customers be permitted to obtain direct access, and that in the second phase, a minimum of 40% of the GS customers be afforded direct access. In that manner, if the random drawing process produces too few customers, the large customers could be limited in the amount of their load that is available for competition. This approach would ensure that more

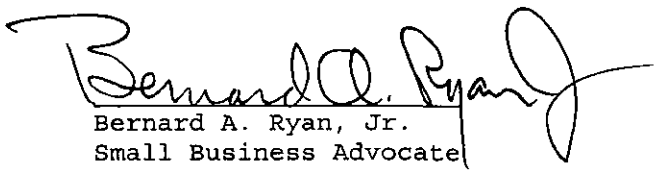
customers in these diverse business classes have access to competitive suppliers in the first two phases. OSBA Stmt. No. 1 at 53-54.

The OSBA notes that the Commission directed an accelerated phase-in of customer choice in the PECO Restructuring Order (at pp. 47-49). Under that Order, up to 33% of all customer classes will be eligible to shop on January 1, 1999 and another 33% become eligible to do so the next day. By January 2, 2000 all PECO customers will be able to shop for electric generation service. That more rapid phase-in of customer choice effectively makes the potential for competitive disadvantages to small business customers a one year rather than a two year problem. The OSBA agrees that speeding up the phase-in to customer choice in that manner is another way to address and minimize the potential competitive problems that Mr. Knecht discussed in his direct testimony. OSBA Stmt. No. 1, at 53-54.

CONCLUSION

On the basis of the foregoing, the Office of Small Business Advocate respectfully requests that the Commission (1) utilize market price forecasts such as those presented by the Office of Consumer Advocate or the PP&L Industrial Consumers Alliance, in lieu of the unreasonably low projections of future market value utilized by PP&L, for determining an authorized level of stranded cost recovery, (2) select the fairest possible method for assigning stranded cost revenue responsibility among customer classes, (3) allow PP&L to implement its proposed "customized rate design" only if it is optional for small business classes, (4) require PP&L to revise its proposed rate design to eliminate certain provisions that alter existing rate structures to the detriment of some small business customers, (5) approve PP&L's method for allocating universal service costs among customers, (6) direct that either PP&L establish specific procedures for handling competitive distortions within the small business classes during the phase-in to direct access, while also defining specific targets for the percentage of commercial customers who are eligible for direct access during the early phases, or implement the accelerated phase-in ordered by the Commission in the PECO Restructuring Order, and (7) mandate that PP&L modify its consumer education materials to reflect information about the effect of the customized rate design on small businesses, if it is approved on an optional basis for those customers, and also revise its customer education materials to inform small businesses of the ability and the method to request eligibility for direct access during the early phases if they would otherwise be competitively disadvantaged.

Respectfully submitted,



Bernard A. Ryan, Jr.
Small Business Advocate

Date: February 10, 1998

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Application of Pennsylvania	:	
Power & Light Company For	:	
Approval Of Its Restructuring	:	
Plan Under Section 2806 Of	:	Docket No. R-00973954
The Public Utility Code	:	

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