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BEFORE THE  
PUBLIC SERVICE COMMISSION

PENNSYLVANIA PUBLIC UTILITY )  
COMMISSION )  
v. )  
PECO ENERGY )

DOCKET NO. R-00973953

DIRECT TESTIMONY OF DR. MARK N. COOPER

IN RESPONSE TO THE

PETITION OF ENRON ENERGY SERVICES POWER, INC. FOR APPROVAL OF  
AN ELECTRIC COMPETITION AND CUSTOMER CHOICE PLAN AND FOR  
AUTHORITY PURSUANT TO SECTION 2801 (E)(3) OF THE PUBLIC UTILITY  
CODE TO SERVE AS THE PROVIDER OF LAST RESORT IN THE SERVICE  
TERRITORY OF PECO ENERGY COMPANY

ON BEHALF OF

THE AMERICAN ASSOCIATION OF RETIRED PERSONS

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1 **I. INTRODUCTION AND OVERVIEW**

2

3 Q. PLEASE STATE YOUR NAME AND ADDRESSES

4 A. Dr. Mark N. Cooper, 504 Highgate Terrace, Silver Spring Maryland.

5

6 Q. ARE YOU THE SAME DR. COOPER WHO PREVIOUSLY FILED  
7 TESTIMONY ON BEHALF OF AARP IN THIS PROCEEDING?

8 A. Yes.

9

10 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

11 A. In my testimony I present a review of the Enron proposal<sup>1</sup> in comparison to the  
12 Settlement to which AARP agreed. Because of the very unorthodox unfolding of events,  
13 with a litigating party attempting to piggy back on a major settlement among many diverse  
14 intervenors late in the process and making a proposal with no substantiation in the record,  
15 I must make a judgement about how my clients are likely to fare under a bizarre set of  
16 regulatory and legal circumstances. These entail highly uncertain projections about future  
17 legal developments and market behavior. Therefore, I respond to the Enron proposal with  
18 a review of the options and an assessment of the possible gains and losses to my clients.

19

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<sup>1</sup>Petition of Enron Energy Services Power, Inc. For Approval of an Electric Competition and Customer Choice Plan and for Authority Pursuant to Section 2801 (e)(3) of the Public Utility Code to Serve as the Provider of Last Resort in the Service Territory of PECO Energy Company, October 7, 1997 (hereafter, Enron).

1 Q. WHAT IS YOUR OVERALL REACTION TO THE ENRON PROPOSAL  
2 COMPARED TO THE SETTLEMENT?

3 A. If my clients have to choose between adhering to the Settlement and litigating the  
4 case (and subsequently a range of issues in court), which I believe is the actual choice  
5 before them, then I recommend sticking with the Settlement. That was my  
6 recommendation when the Settlement was signed.

7 Under no circumstances would I support the Enron proposal because it is based on  
8 a fundamentally incorrect view of stranded costs.

9 To put the matter simply, Enron is reported to have stated when it filed its  
10 Customer Choice Plan that it had "put its money where its mouth is." Unfortunately, as  
11 far as I can tell, it has actually put PECO's money and my client's gains where its mouth  
12 is. Enron does not have one penny at stake in the proposal, whereas the residential  
13 ratepayers of Philadelphia could lose the billions of dollars of gains they made through  
14 negotiations. Under the most likely set of circumstances that will prevail if the  
15 Commission adopts the Enron proposal, they will certainly have to wait much longer to  
16 get rate relief under the Enron proposal. I believe that they will lose many of the gains  
17 that were embodied in the Settlement.

18 There are at least half a dozen reasons why I reach this conclusion. Attachment  
19 MNC-1 summarizes several of the major reasons. I divide the issues into two general  
20 areas which are consistent with the structure of my initial testimony in this proceeding.  
21 The first set of issues deals with consumer prices. This necessarily starts with a discussion  
22 of stranded costs. The second set of issues deals with utility service concerns.

1 II. PRICE CONCERNS

2

3 **A. PUTTING SIGNIFICANT GAINS AT RISK AND ABANDONING**  
4 **IMPORTANT PRINCIPLES FOR A VERY UNCERTAIN OUTCOME**

5

6 Q. WHY DO YOU BELIEVE THE GAINS OF THE SETTLEMENT ARE AT  
7 RISK?

8 A. As an adversarial position, Enron's proposal would impose a great deal more pain  
9 on PECO than the Settlement. Of course, the negotiators who agreed to the Settlement  
10 would also have imposed significantly more pain on PECO in their adversarial positions.  
11 As part of the negotiation process the signatories gained some major concessions and  
12 made some major concessions.

13 Enron asks the commission keep all the concessions that the intervenors won in  
14 negotiations and take back the things that PECO won. Enron then splits the resulting  
15 money taken from PECO between itself and the constituencies of the intervenors. It splits  
16 these gains between consumers and itself by setting a higher price for the generation  
17 credits (i.e. paying itself more for any power it sells) and lowering rates in the early years.

18

19 Q. WOULDN'T THESE RATE CUTS BE A GOOD DEAL FOR CONSUMERS?

20 A. Not necessarily. Settlements do not generally work that way and in this case it  
21 definitely will not work that way. The choice is not simply a choice between the  
22 Settlement and Enron's proposal; the possibilities must also include litigating all the issues

1 in the Enron proposal and and the Settlement, or taking the Settlement.

2 PECO does so badly under the Enron proposal that it will not agree to the same  
3 concessions it made. Since it loses everything under the Enron proposal, PECO will  
4 litigate. Under the structure of the Enron proposal, the rate reductions will be put on hold  
5 until the litigation is finished. Only if PECO fails in its legal challenge, will any rate  
6 reductions be offered.

7 In contrast to this, the Settlement guarantees rate reductions, even if litigation  
8 occurs and regardless of the outcome of the litigation. The Settlement guarantees that  
9 gains will commence immediately; the Enron proposal all but ensures they will not.  
10

11 Q. WHAT PRINCIPLES HAVE BEEN COMPROMISED BY ENRON?

12 A. In order to challenge the Settlement, Enron has attacked it as illegal on several  
13 grounds. I believe that this attack is feeble and will not prevail, but in the process the  
14 Enron proposal gives away some very important principles that we have defended. In  
15 order to launch a legal challenge to the Settlement, Enron has compromised on the most  
16 important principle to protect the consumer interest in electric restructuring -- it has given  
17 away the moral, legal and economic high ground on stranded costs.

18 At the same time, Enron's proposal, which came very late in the process and has  
19 no substantiation in the hearing record, would itself be subject to legal challenge. It asks  
20 the Commission to take actions -- including premature designation of the Provider of Last  
21 Resort, ordering PECO to transfer its securitization bonds, and having PECO agree to  
22 become a contractual subsidiary of Enron -- that have dubious legal grounds. Enron

1 recommends that the Commission hold PECO's stranded cost hostage and demand its  
2 compliance as ransom;<sup>2</sup> but PECO can hold rate cuts hostage through a court case.

3 In short, all of the good things in the Settlement from the consumer point of view  
4 are put back into play. In order to evaluate Enron's offer properly, consumers must  
5 understand what they have to lose through litigation not only what we have to win.

6 Enron's proposal is a high risk gamble for consumers in which real, substantial near term  
7 gains and fundamental principles are put at risk in exchange for higher, but much riskier  
8 rewards in later years.

9

10 Q. WHAT IS YOUR POSITION WITH RESPECT TO THE PRINCIPLE OF  
11 STRANDED COST RECOVERY?

12 A. The current statute takes regulatory assets off the table. That is, the law explicitly  
13 requires payment of regulatory assets. Generation assets are quite a different story. We  
14 believe that the law leaves all generation assets on the table and subject to disallowance.

15 The law leaves in place the current state of affairs with respect to stranded  
16 generation assets. Since Pennsylvania is a "used and useful" state, we believe that all  
17 assets that are found to be uneconomic at any time are subject to disallowance. That was

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<sup>2</sup>Enron, p. 2.

Enron recognizes that consummation and implementation of the Choice Plan requires certain action on the part of PECO, action that are necessary to promote competition in its service territory and provide a legal justification for recovery of stranded costs as set forth in the Partial Settlement. Enron also maintain that since PECO's stranded cost recovery under the Act is conditioned on the creation of a competitive electricity market, PECO's ability to recover these costs should be conditioned on PECO taking the actions called for in the Choice Plan.

1 the adversarial position of just about all of the signatory parties to the Settlement except  
2 for PECO. Based upon that position we negotiated a formal write-off of \$2 billion of  
3 stranded generation costs. This is equal to between 40 and 50 percent of the total  
4 stranded generation assets, depending on how one calculates the base.

5 We maintained our litigative position in the Settlement. Indeed, we believe that we  
6 verify the principles of write-offs by the Settlement. No utility has been forced to take a  
7 larger write-off during the current round of restructuring cases and legislative initiatives.

8

9 Q. WHAT IS THE PROBLEM WITH ENRON'S APPROACH?

10 A. Enron assumes that it can keep the concession in terms of the write-off, but it  
11 gives away something that is absolutely vital to consumer interest in the process. Enron  
12 argues that if the Settlement does not create effective competition, it cannot create  
13 stranded costs. It asserts the illegality of the Settlement, since in the absence of  
14 competition there can be no stranding.

15 Enron wishes to emphasize that the Choice Plan does not assert that PECO  
16 should absorb its stranded costs. The Choice Plan accepts the basic tenet  
17 of the Partial Settlement in permitting full and complete stranded cost  
18 recovery of \$5.462 billion. Unlike the Partial Settlement, however, the  
19 Choice Plan provides a lawful basis for permitting PECO to recover its  
20 stranded costs by creating a structure which allows competition to develop  
21 in PECO's service territory.<sup>3</sup>

22

23 In the process, Enron accepts the utility argument that a regulatory switch is  
24 creating stranded assets.

25 It is clear, therefore, that stranded costs exist solely because of the

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<sup>3</sup>Enron, p. 2.

1 transition from a regulated, monopoly marketplace to a competitive  
2 market. If there is no competition, there are not stranded costs.

3  
4 The Act requires that if the Commission determines that a utility has  
5 lawfully incurred stranded costs, the Commission must approve a CTC and  
6 reconcile the annual revenue received from the CTC with the annual  
7 amortization of the stranded cost allowance.<sup>4</sup>

8  
9 Under this argument, the utility must be allowed 100 percent recovery of stranded  
10 costs, but Enron proposes to preserve the disallowance, which was won by starting from a  
11 completely different legal position. Enron has no legal grounds to ask for the write-off.  
12 In the litigated case, Enron did not challenge PECO's stranded cost claims. If PECO  
13 challenges the Settlement and wins, PECO will recover its full claim to stranded costs. By  
14 accepting the utility argument, Enron has thrown out the baby with the bath water.

15 Fortunately Enron is just as wrong as PECO on the nature of the regulatory  
16 relationship between ratepayers and utilities.

17  
18 Q. WHAT IMPACT DOES ENRON'S STRANDED COST ASSUMPTIONS  
19 HAVE ON ITS PROPOSAL.

20 A. The position is central to and pervades the proposal. Enron repeatedly straddles  
21 the issue. Having accepted the utility argument on stranded costs, it assumes it can get the  
22 disallowance, without a legal basis. This sleight of hand lies at the core of Enron's  
23 proposal.

24 The Choice Plan works for the simple reason that it takes hidden benefits in  
25 the Partial Settlement from PECO and allocates them to the parties to  
26 whom they rightfully belong -- namely, PECO's customers who have for

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<sup>4</sup>Enron, p. 10

1 years paid electric rates that are significantly above the statewide and  
2 national averages. The Choice Plan would permit PECO to obtain full  
3 recovery of its \$5.462 billion in stranded costs.<sup>5</sup>  
4

5 Because the terms of the Partial Settlement force PECO's customers to  
6 overcompensate PECO for its stranded costs and stifle any real opportunity  
7 to have competitive choice, the Partial Settlement stands in clear  
8 opposition to the key provisions of the Act and should not be approved.<sup>6</sup>

9 Enron has ignored or forgotten the record of evidence in the case. It has forgotten  
10 that PECO claims stranded costs of much more than \$5.461 billion. To call \$5.461 full  
11 recovery is a misstatement. It is partial recovery of stranded costs.

12 The only reason Enron thinks the benefits were hidden is because it did not  
13 participate in the stranded cost aspect of the case and it does not see the price risk to  
14 which PECO is exposed. If one recognizes the reality of the case, there are no hidden  
15 benefits. PECO is not overcompensated. There was an exchange of values. Consumers  
16 took near term gains in the form of rate reductions and gave PECO the opportunity to  
17 earn back part of the write off, depending on market conditions.

18  
19 **B. RATE REDUCTIONS**

20  
21 **Q. WHAT ARE THE ISSUES WITH RESPECT TO RATE REDUCTIONS?**

22 **A.** There are really two questions. How much and how certain are the price cuts?

23 The Pennsylvania statute prevents any rate increases as a result of restructuring.

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<sup>5</sup>Enron, p. 3.

<sup>6</sup>Enron, p. 17.

1 PECO's litigated position was to cap rates at current levels. The Settlement produces  
2 secure rate reductions of 10 percent per year for each of the first two years and then  
3 reductions of 5 percent and 2 percent. The total of these rate reductions is \$1 billion.

4 The majority of these reductions are guaranteed. That is, they are not contingent  
5 upon securitization. No matter what happens with securitization, about 70 percent of  
6 these reductions are guaranteed. The full \$1 billion in rate reductions will be made unless  
7 there are specifically defined legal impediments to securitization.

8 At all times, if the market price for energy is below that assumed in the Settlement,  
9 then consumers could reap further benefits by shopping for power. That is, the consumer  
10 gets the additional benefit of lower priced energy in the market. If the market price is  
11 lower than that assumed in the Settlement, PECO bears the burden. Even after the  
12 guaranteed period is over, the consumer will be protected by the legislated cap.  
13 Consumers always get the lower of the Settlement or the market price, with the protection  
14 of the legislated cap.

15 Enron offers to double the rate reductions, but it guarantees none of the price cuts.  
16

17 Q. WHY AREN'T THE RATE CUTS GUARANTEED IN THE ENRON  
18 PROPOSAL?

19 A. I believe that the price cuts would be at serious risk in two respects.

20 First, they are entirely dependent on securitization. If any legal, regulatory, or tax  
21 problems arise with securitization, then the price reductions are put on hold. Enron has  
22 shifted all the risk of securitization to ratepayers because, under its proposal, it would

1 become the ultimate holder of the bonds.

2 Second, if PECO fails to deliver on its part of the bargain, default customers (those  
3 who do not buy competitive power) are at risk for whatever the market price will be.

4 Enron will try to recover excess costs from PECO, but the money comes out of the pocket  
5 of the ratepayer first.

6 If PECO fails to perform under the terms of the Power Purchase  
7 Agreement, Enron will be entitled to obtain alternative energy supplies at  
8 market prices and to collect the cost of such supplies from Default  
9 Customers under the Distribution Tariff for the duration of PECO's non-  
10 performance (subject to a subsequent credit, rebate or other true-up to  
11 reflect the recovery of any cover or other damages from PECO).<sup>7</sup>

12 Enron's promise to provide service at rates reflected in the Distribution  
13 Tariff, which rates reflect the 20% rate reductions for the period September  
14 1, 1998 through December 31, 2000, the 10% rate reduction for calendar  
15 year 2001 and the 4% rate reductions for calendar year 2002, is contingent  
16 on PECO's adherence to the maximum rate caps for transmission and  
17 distribution services as set forth in the Partial Settlement; provided that if  
18 PECO seeks and obtains from the Commission an increase in said charges  
19 so as to increase the rate cap established by the Act or otherwise fails to  
20 perform its obligations under the Choice Plan, Enron reserves the right to  
21 increase the rates charged to Default Customers accordingly.

22  
23 That there arise no legal impediments to the issuance of transition bonds  
24 pursuant to section 2812 of the Act.<sup>8</sup>

25 In fact, under the Settlement ratepayers pay the lower of the stated rate or the  
26 market price for the first five years. They then get the market price for the next seven  
27 years. The signatories to the agreement could have claimed rate cuts up to 40 percent in  
28 the out years. We did not because that depends on the market price and such a claim

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<sup>7</sup>Enron, p. 21.

<sup>8</sup>Enron, p. 29.

1 would mislead consumers. Enron has misled the public and the Commission by comparing  
2 our likely rate ceiling to what is close to its rate floor. In fact, we could get almost all of  
3 the benefits Enron offers without giving up the guarantee.

4  
5 **C. THE RISK OF STRANDED COST RECOVERY AND THE POTENTIAL FOR**  
6 **LARGER RATE REDUCTIONS**

7  
8 Q. HOW DO YOU SEE THE RISK OF STRANDED COST RECOVERY?

9 A. The Settlement imposes a limit on securitization of \$4 billion dollars. This is  
10 substantially less than the amount PECO is allowed to recover. In fact, about one quarter  
11 of the recoverable stranded costs must be recovered in the marketplace and there is no  
12 true-up of the outcome. The signatories believe that with rate cuts guaranteed, a non-  
13 reconcilable CTC is a good idea. If one values a non-reconcilable CTC, then the only  
14 way to achieve it is through negotiations. The Commission lacks the legal authority to  
15 impose one on the company.

16 Enron would securitize \$5.46 billion. Enron complains that because the  
17 Settlement would let PECO get the benefits of load growth and earn its cost of capital on  
18 the entire revenue stream, it may not bear the full two billion dollars in write-offs.

19 The Pennsylvania Electric Competition Coalition's testimony in PECO's  
20 restructuring case demonstrates that the proposed CTC rates in the Partial  
21 Settlement Overstate by approximately \$2 billion the revenues PECO must  
22 collect to recover the \$5.461 billion in stranded investment. This disparity  
23 arises for at least two reasons. First, the CTC revenue recement proposed  
24 by PECO, which is based on an implicit rate or return of approximately  
25 10%, overstates PECO's actual cost to amortize the stranded costs until

1 they are collected from customers because PECO can securitize at least \$4  
2 billion of those stranded costs at an interest rate which is significantly lower  
3 than the overall rate of return. Second, the CTC rate was computed using  
4 PECO's 1996 billing determinants. Excess CTC collections due to load  
5 growth would be retained by PECO because there is no true-up mechanism  
6 in the Partial Settlement, as the Act requires.<sup>9</sup>

7 However, Enron has failed to acknowledge that under the Settlement PECO is at  
8 risk for market price of energy. Enron's complaint that the securitized cost of money is  
9 less than the companies' cost of capital ignores the fact that with a non-reconcilable CTC  
10 the company is at risk of under recovery, if sales volume is below that assumed, so that  
11 there remains marketplace risk that the company faces. If the market clears at a lower  
12 price of generation than assumed in the Settlement, or if the economy goes into a  
13 recession, PECO will recover less of its stranded asset value. If market prices are low,  
14 PECO would not get an over recovery (might get an under recovery of the \$5.461 billion)  
15 and consumers could have lower rates. Once again, Enron's mistaken assertion that  
16 \$5.461 billion represent full stranded cost recovery leads it to misrepresent the nature of  
17 the Settlement.

18 I believe that the risk of stranded cost recovery is shifted to the company with a  
19 non-reconcilable CTC. How one evaluates the risk of recovery, depends on the  
20 assumptions about load growth and price. Enron has not fairly calculated the trade off  
21 because it has ignored the price risk to the company.

22

23 Q. HOW DOES THE SETTLEMENT INCREASE THE CHANCE FOR

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<sup>9</sup>Enron, pp. 15-16.

1 CONSUMERS TO GET LARGER RATE REDUCTIONS?

2 A. The Settlement is structured in such a way as to give consumers the best chance of  
3 increasing their gains because stranded cost recovery is highest when the market is softest  
4 and in the early years when consumers are least likely to be effective shoppers. The high  
5 CTC would be offset by low market prices in the early years. In the later years when  
6 supply and demand are more likely to be in balance in the marketplace, the CTC is  
7 smallest. That is when shopping will be most beneficial and the competitive market  
8 structures best developed (see Attachment MNC-2).

9 Enron reverses this process. It has a low CTC in the near-term and a high CTC in  
10 the long-term (see Attachment MNC-3). Therefore, at a time when the market is likely to  
11 be more in balance, consumers will be carrying a higher CTC. By increasing the  
12 generation credit and decreasing the CTC, Enron has a higher target price and gains easier  
13 market entry in the early years, but consumers are placed at greater risk in the later years.  
14 We believe that generators will enter when the market price allows them and be there in  
15 the later years.

16

17 Q. CAN YOU DESCRIBE THE TIME/MARKET PRICE CHARACTERISTICS OF  
18 THE SETTLEMENT AND THE ENRON PROPOSAL IN GRAPHIC TERMS?

19 A. Yes. Attachment MNC-4, which combines Attachments MNC-2 and MNC-3  
20 shows the CTC and the generation prices under the Settlement and the Enron proposal.  
21 Attachment MNC-5 shows the total price for these two elements (generation plus CTC).

22 Enron starts with a very low CTC which rises rapidly over the period. It assumes

1 a higher generation credit in the early years, but the total KWH charge to customers is  
2 lower in the early years. Over time the Enron price path converges to the Settlement price  
3 path, as the CTC increases and the generation price rises much more slowly than in the  
4 Settlement.

5 Because of the high CTC in the later years, there is much less room for consumer  
6 price savings. While I do not want to get into the battle of price projections, let us take  
7 Enron's assumed marginal cost of new generation as an example. Enron bases its case  
8 against the Settlement on the fact that the generation credit is not high enough to stimulate  
9 the construction of new facilities in the early years. It admits that those facilities would be  
10 built in the later years.

11 Attachments MNC-6 and MNC-7 show the price path under the Settlement and  
12 the Enron proposal assuming that the market clears at the marginal cost of generation as  
13 calculated by Enron. Attachment MNC-8 contrasts the price pattern of the two.

14 Because Enron has back-end loaded the CTC, consumers would end up paying a  
15 much higher price in the later years (see Attachment MNC-8). Enron has jacked up the  
16 generation prices in the early years to get into the market.<sup>10</sup>

17 If we assume that the market clears at Enron's projected marginal cost of new  
18 capacity, we discover an interesting possibility (as in Attachment MNC-6). If the market

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<sup>10</sup>The fundamental problem in Enron's analysis is that it has assumed that the market should clear at the marginal cost of new generation. In a market that has existing capacity, the marginal cost of existing generation might be lower. AARP testified that in competitive situations where markets are in surplus new entry does not occur and market participants do not get their capital out. The take losses, as we have advocated PECO should. Enron seeks to make money in a market that is in surplus. I do not believe that it has any more of a right to do so than PECO does.

1 price prevails, consumers would save approximately \$2 billion more in the later years.  
2 PECO's income stream would be \$2 billion less than estimated in the Settlement. It might  
3 cushion this price risk with load growth or the benefits of interest rate differentials.

4 Attachment MNC-7 shows that because of the reversal of the CTC, the market  
5 price tracks Enron's price closely. There would be potential gains to consumers of  
6 another \$1 billion (in addition to the \$1 billion Enron promises in the early years) if price  
7 of electricity is set at the marginal cost of new generation as assumed by Enron. These are  
8 spread over the period. However, the price difference is always small and, therefore, less  
9 likely to stimulate shopping.

10 In short, under the Settlement, PECO has as much at risk on the downside (\$2  
11 billion) as Enron claims it has potential reward on the upside (\$2 billion). If none of the  
12 good things happen to PECO (strong load growth, low interest rates) and all of the bad  
13 things happen (low market price, no recession), then PECO would recover approximately  
14 \$3.5 billion of stranded costs. If the opposite happens, it would recover approximately  
15 \$7.5, which was its final estimate of stranded costs. Under no circumstances is there likely  
16 to be an over recovery.

17 In essence, consumers could get all of the benefits that Enron promises, if the  
18 market price actually falls to the marginal cost that Enron asserts, without taking the legal  
19 and regulatory risks which Enron creates. Of course, PECO is at much greater risk under  
20 the Enron proposal.

21

22

1 **III. UTILITY CONCERNS**

2

3 **A. THE LIFELINE PROGRAM**

4

5 Q. WHY DO YOU FEEL THAT THE LIFELINE PROGRAM WAS A MAJOR  
6 VICTORY IN THE Settlement?

7 A. Under the new Pennsylvania law, PECO must not diminish its commitment to  
8 universal service in its restructuring plan. It was proposing improvements to a program  
9 with 35,000 households spread across a variety of energy assistance levels. As part of the  
10 negotiations, PECO agreed to triple the size of the program and bring all customers into  
11 the largest benefit program. In essence, PECO agreed to a 65,000 increase in households  
12 and an average benefit level of \$650 per year. If we can get quickly to that level, which  
13 we think we can because PECO also agreed to ease the eligibility requirements (although  
14 we would have preferred even less demanding requirements), the value we would realize  
15 for low income residential ratepayers would be around \$500 million.

16 Enron assumes that this concession will be preserved. It adds nothing to what we  
17 won and it places that at risk, since PECO is likely to return to its litigation position.

18 In fact, Enron goes farther and gives away something that is very vital to  
19 consumer interests. A key point of the negotiation process was the source of the funds to  
20 support what would be one of the largest lifeline programs in the country. The current  
21 moneys come from distribution customers. PECO will fund the increase in participation  
22 from 35,000 to 80,000 households out of current rates. The Settlement states that

1 residential ratepayers are the source, but no provision was made to raise residential rates  
2 to accommodate this. The negotiators agreed to leave open the question of funding the  
3 increment from 80,000 to 100,000 customers.

4 Enron seems to have missed this point.

5 PECO will implement the universals service proposed in the Partial  
6 Settlement, the costs of which are reflected in the distribution rates  
7 established by the Partial Settlement.<sup>11</sup>  
8

9 Regardless of how one views the increment from 35,000 to 80,000 households, the  
10 Settlement did not assign the increment from 80,000 to 100,000 to residential ratepayers.  
11 I believe that all producers should contribute to universal service, since all producers  
12 benefit from universal service. Enron would fund universal service from distribution rates,  
13 which fall predominantly on residential ratepayers. Under Enron's proposal, energy  
14 suppliers make no contribution to universal service whatsoever.

15

16 **B. PRESERVING UTILITY SERVICE**

17 **Q. WHY DO YOU BELIEVE THAT UTILITY SERVICE COULD BE**  
18 **THREATENED?**

19 **A.** The proposed restructuring essentially makes PECO a contractual subsidiary of  
20 Enron. Enron takes over the utility functions of PECO by contract and releases PECO  
21 from its obligation to ratepayers. However, Enron refuses to be a utility. Enron will be the  
22 provider of both wires and energy of last resort, but will not be fully subject to the utility  
23 regulations of the Commission.

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<sup>11</sup>Enron, p. 19.

1 Enron as the PLR under the Choice Plan shall be determined by the  
2 Commission to qualify as an electric generation supplier under 66 Pa.  
3 section 2809 and not as a "public utility" under 66 Pa.C.S. section 102.<sup>12</sup>

4 It is not clear whether this is legal under the Act or good public policy. Without  
5 being a utility, Enron seeks to rely on the forced contractual relationship between itself  
6 and PECO to guarantee utility services.

7 Enron has the ability to fulfill the PLR role. Indeed, the Choice Plan,  
8 including the contracts and service agreements by which Enron will  
9 procure energy and capacity and metering, billing and collections services,  
10 will enable Enron to maintain the level of performance PECO customers  
11 currently receive...

12  
13 Enron recognize that to function as the PLR, it must assume responsibility  
14 for the procurement of electric generation services for a large number of  
15 customers. To fulfill this obligation, Enron and PECO would enter into the  
16 Power Purchase Agreement to secure capacity and energy necessary to  
17 serve this load, thereby assuring that the present level of service delivered  
18 to customers will continue in all respects.

19  
20 Enron also would enter into the MBC Service Agreement with PECO for  
21 metering, billing, collection and other service functions for the PLR  
22 customers. PECO would be compensated for these services at rates  
23 commensurate with the costs that are currently contained in PECO's  
24 existing distribution tariffs. Enron, therefore, would be procuring these  
25 services from PECO, using PECO's facilities and employees.<sup>13</sup>

26 Enron believes that the contractual relations, backed up by a threat of denial of  
27 stranded cost recovery, should calm residential ratepayers fears about the absence of a  
28 utility.

29 The refusal of PECO to enter into the power purchase Agreement or the  
30 MBC Services Agreement with Enron could defeat the Choice plan.  
31 PECO would do so, Enron submits, at the risk of its own stranded cost

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<sup>12</sup>Enron, p. 30.

<sup>13</sup>Enron, p. 25.

1 recovery because the Partial Settlement will not bring about the necessary  
2 predicate of competition that is legally required for stranded cost  
3 recovery.<sup>14</sup>  
4

5 It is true that Enron has proposed a very tough contract on PECO, but contracts  
6 are contracts and they are frequently broken and litigated. They are not utility obligations.  
7 Enron has shifted all of the risks of non-performance by PECO onto the backs of  
8 ratepayers. In what must be seen as the ultimate proof that Enron has brought nothing  
9 real to the table because it failed to specify what it would do to demonstrate the ability to  
10 meet its obligation should its contractual obligations fail.

11 Finally, Enron is prepared to cooperate with the Commission to determine  
12 the appropriate financial support needed from Enron Corp. In order to  
13 demonstrate Enron's financial wherewithal to serve in this role.<sup>15</sup>

14 Enron failed to put any resources at risk in its proposal, but it offers to talk about  
15 putting up some money. It has essentially played the regulatory game with other people's  
16 money.  
17

18 Q. ARE THERE OTHER CONCERNS ABOUT SERVICE QUALITY?

19 A. Yes. Once PECO is removed as the utility and none is put in its place, Enron  
20 throws the relationship between customers and electricity suppliers into a contractual  
21 mode. It is not clear in the proposal which, if any, of the utility protections embodied in  
22 current law and regulation would apply to those who shop for power.  
23

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<sup>14</sup>Enron, p. 25.

<sup>15</sup>Enron, p. 25.

1    **C.    NON-RECONCILABLE CTC, EXTENDED FREEZE ON TRANSMISSION**  
2    **AND DISTRIBUTION RATES, AND CONSERVATION INCENTIVES**

3

4    **Q.    HOW DO THE FIXED KWH CHARGES PROVIDE AN INCENTIVE FOR**  
5    **CONSERVATION?**

6    **A.    The negotiators won a non-reconcilable CTC with an extended freeze on**  
7    **transmission/distribution rates. The dollar value to consumers of the extended freeze on**  
8    **transmission and distribution rates is hard to predict, but could be on the order of \$20**  
9    **million. Enron assumes this will be preserved in the litigated outcome.**

10        The long period of fixed KWH charges (CTC and T&D) creates a strong incentive  
11    for conservation. Every time a consumer saves a kilowatt, the consumer is guaranteed  
12    that there will be no reconciliation of the CTC and no increase in T&D rates to make up  
13    for lost load. The more effective conservation programs are, the more likely PECO is to  
14    have to eat more of its stranded costs.

15        Enron's proposal destroys this feature. A reconcilable CTC means that the  
16    stranded cost part of reduced demand would be made up.

17

1 IV. CONCLUSION

2  
3 Q. WHAT DO YOU CONCLUDE ABOUT THE ENRON PROPOSAL?

4 A. There is remarkably little to gain from the Enron proposal -- \$1 billion of phantom  
5 gains -- compared to the potential loss of all the gains of the negotiations. In fact, all that  
6 the Enron proposal accomplishes is to shift the potential additional benefit of \$1 billion  
7 that were available under the Settlement from the long term, where they were subject to  
8 market risk, to the near term, where they are subject to regulatory and legal risk.

9 Of course, if we were inclined to be opportunistic, as Enron has been, we could  
10 say that what we want the Commission to do is give us the best of both proposals.

11 The Commission should require PECO to guarantee the first 10 percent of rate  
12 reductions and Enron to guarantee the second ten percent. If Enron guaranteed the  
13 second 10 percent, it would have to put \$1 billion on the table.

14 The Commission should require Enron to put up additional resources to ensure the  
15 quality of service as the PLR. As I recommended in my direct testimony, if we must  
16 achieve utility protections in a commodity fashion, we must have very stiff penalties. If  
17 Enron is required to put up another billion, it would have \$2 billion at risk, as PECO does.

18 The Commission should order a kwh charge as the basis for funding of lifeline  
19 programs.

20 This would pretty much get us back to the initial adversarial position -- a 20  
21 percent rate reduction, \$2+ billion write-off of assets and a large expansion of the lifeline  
22 program.

1           To get to that position, however, I do not have to insert Enron as the unregulated,  
2 contractual, semi-utility with no financial risk or utility obligations. I do not have to  
3 abandon the correct principle of disallowance of stranded cost recovery. I can just litigate  
4 the case.

5           At this stage, I prefer the Settlement as a balancing of interests that

- 6           o     produces real consumer benefits immediately,
- 7
- 8           o     gives Philadelphia probably the largest low income program in the  
9           country,
- 10
- 11          o     includes a formal write-off of assets,
- 12
- 13          o     shifts significant risk and rewards to the company, and
- 14
- 15          o     provides consumers the greatest benefit from shopping  
16          when they are more likely to be equipped to shop.
- 17

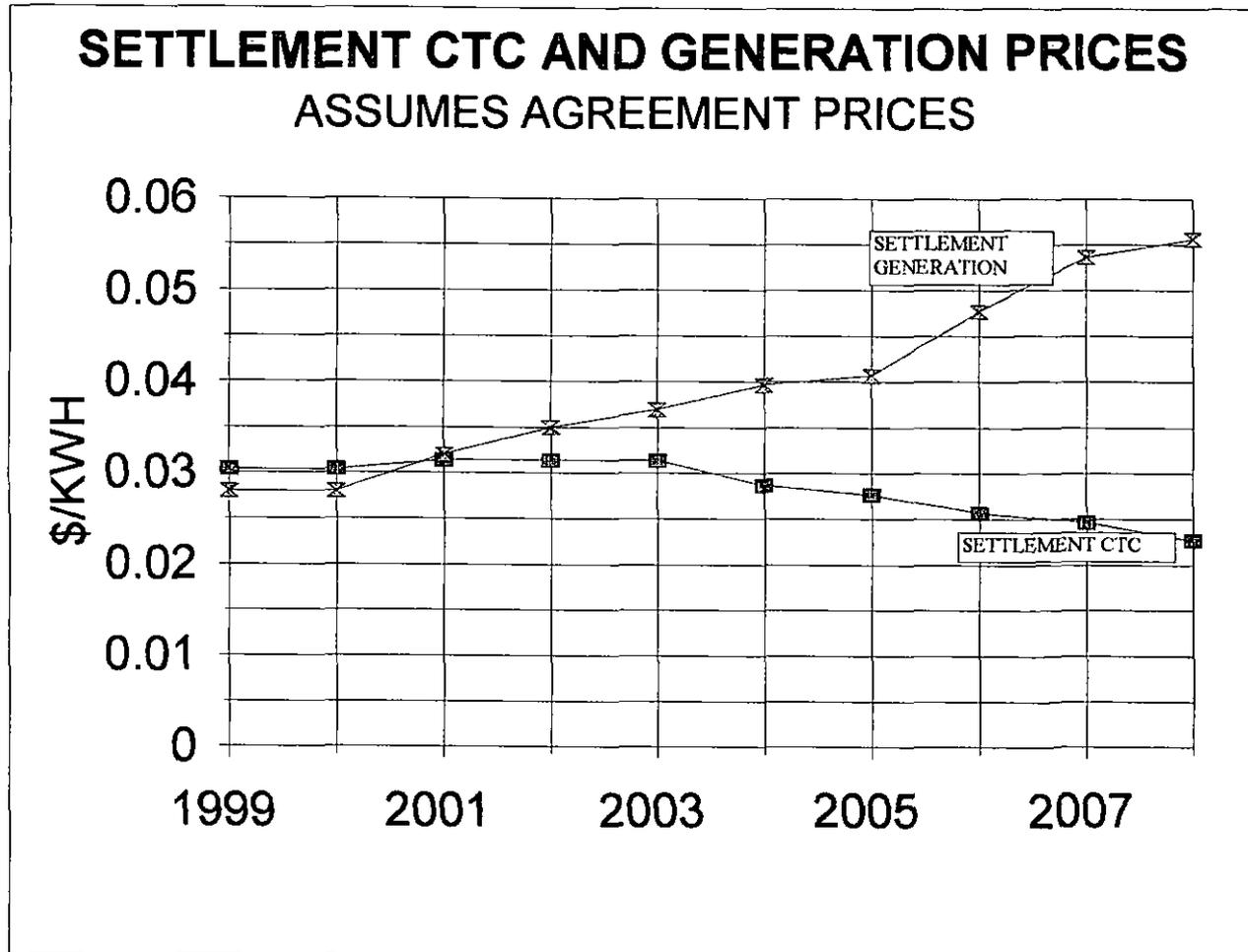
18 Q.     DOES THIS CONCLUDE YOUR TESTIMONY?

19 A.     Yes.

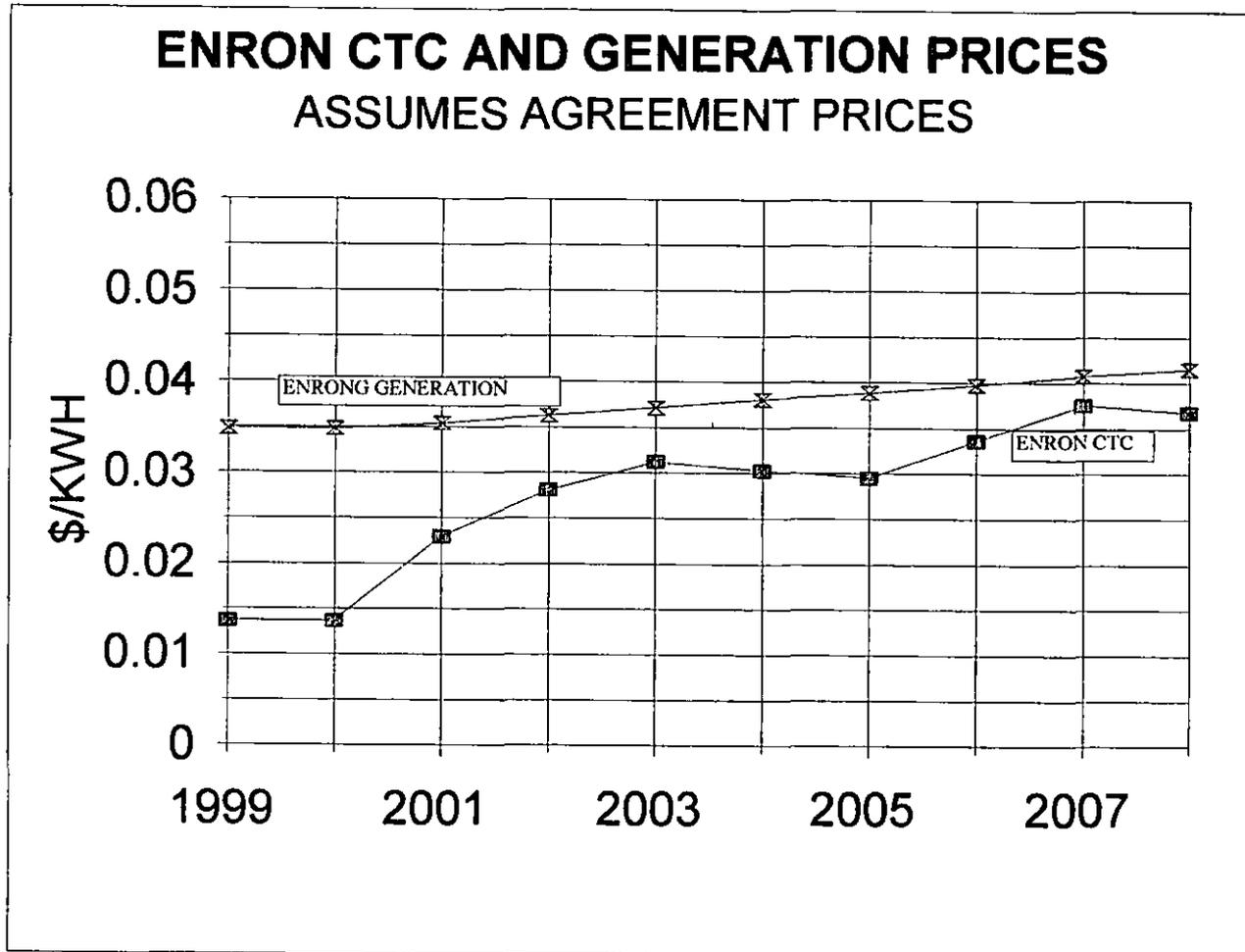
ATTACHMENT MNC-1

**POTENTIAL GAINS AND LOSSES FROM THE ENRON LITIGATION**

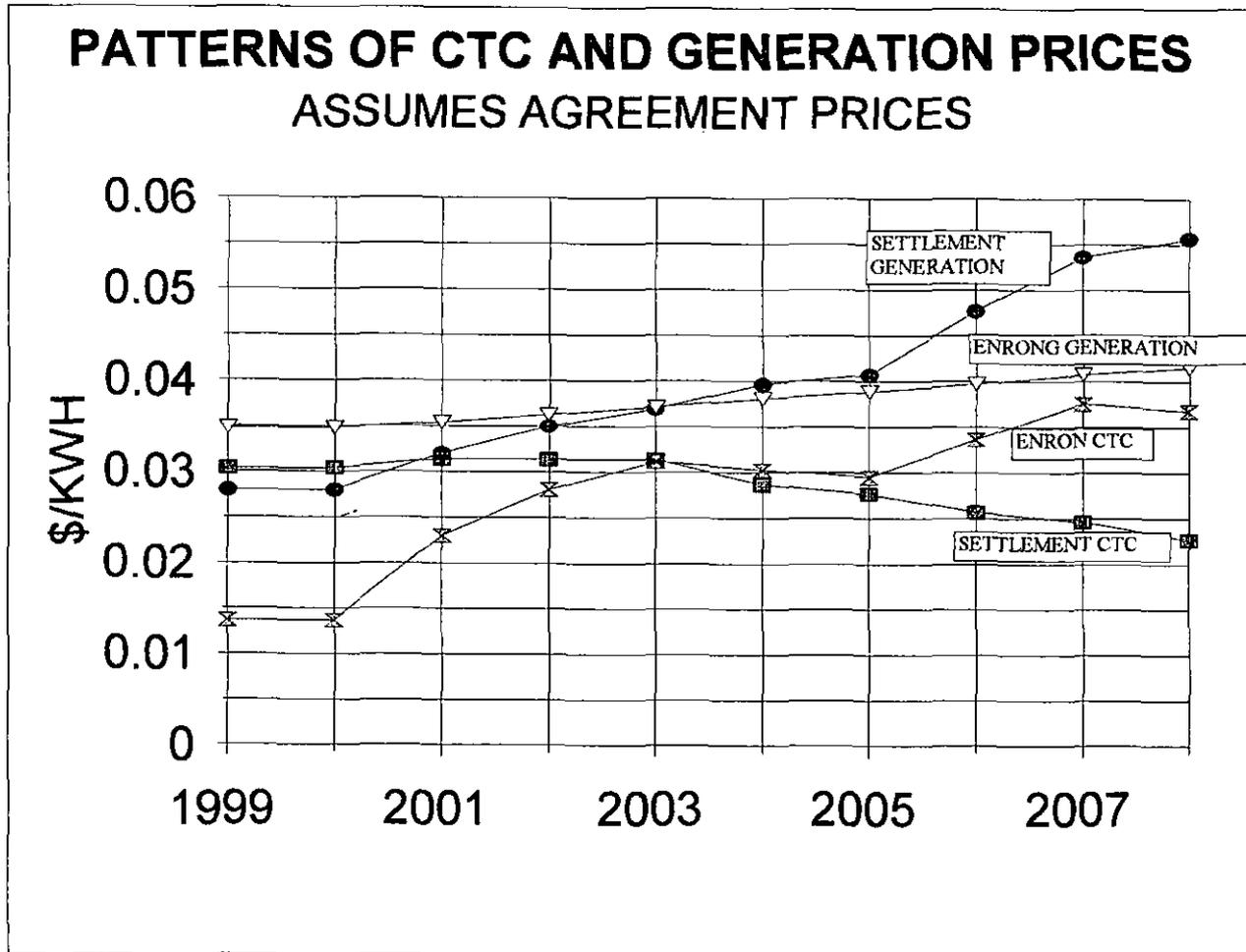
ISSUE	LAW	SETTLEMENT	VALUE TO CONSUMERS (\$ MILLION)	ENRON POTENTIAL GAINS (\$ MILLION)	ENROL LOSSES POTENTIAL
STRANDED GENERATION COSTS	CURRENT LAW PREVAILS, USED AND USEFUL	FORMAL WRITE-OFF OF \$2 BILLION	2000	0	2000, ENRON CONCEDES PECO'S REGULATORY SWITCH CLAIM
RATE REDUCTIONS	NO RATE INCREASE	GUARANTEED 10% REDUCTION FOR FIRST FIVE YEARS	1000 EARLY, POTENTIAL 2000 LATER	1000 EARLY, POTENTIAL 1000 LATER	0-2000, NO GUARANTEE OF RATE REDUCTION
STRANDED COST RECOVERY, STRUCTURE	SECURITIZE PART, RECONCILABLE	\$4 BILLION SECURITIZED, \$1.46 BILLION IN MARKET, NOT RECONCILED	0-1460, NO RISK TO RATEPAYERS. PECO GETS LOAD GROWTH BEARS RISK OF PRICE: PECO AT RISK FOR \$1.46 BILLION	0	SECURITIZE \$5.46 BILLION, RISK OF LITIGATION, RECONCILE, MARKET RISK FOR PECO, NO RISK FOR ENRON
STRANDED COST RECOVERY, TIMING		CTC IS HIGH EARLY, LOW LATE	0 TO 42% RATE REDUCTION, DEPENDS ON MARKET	0	CTC IS LOW EARLY, HIGH LATE
UNIVERSAL SERVICE	CURRENT AS A MINIMUM 35,000 HH	100,000 HH	500	0	500 AT RISK, PRODUCERS ESCAPE UNIVERSAL SERVICE OBLIGATION
CONSERVATION		FIXED CTC AND FROZEN T&D CREATE INCENTIVE			RECONCILABLE UNDERMINES INCENTIVE



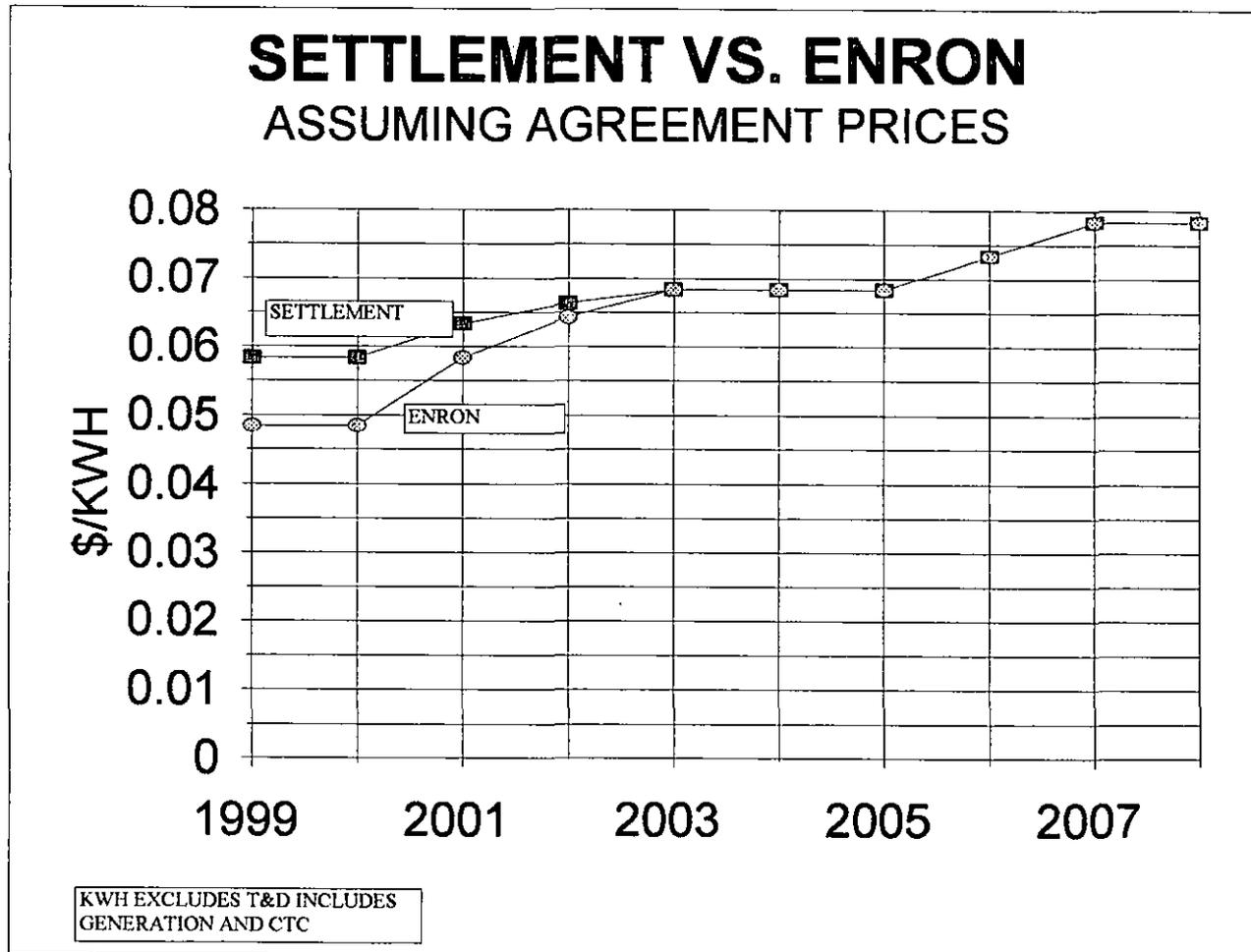
Source: Partial Settlement (p. 8), Customer Choice Plan (pp. 13, 20)



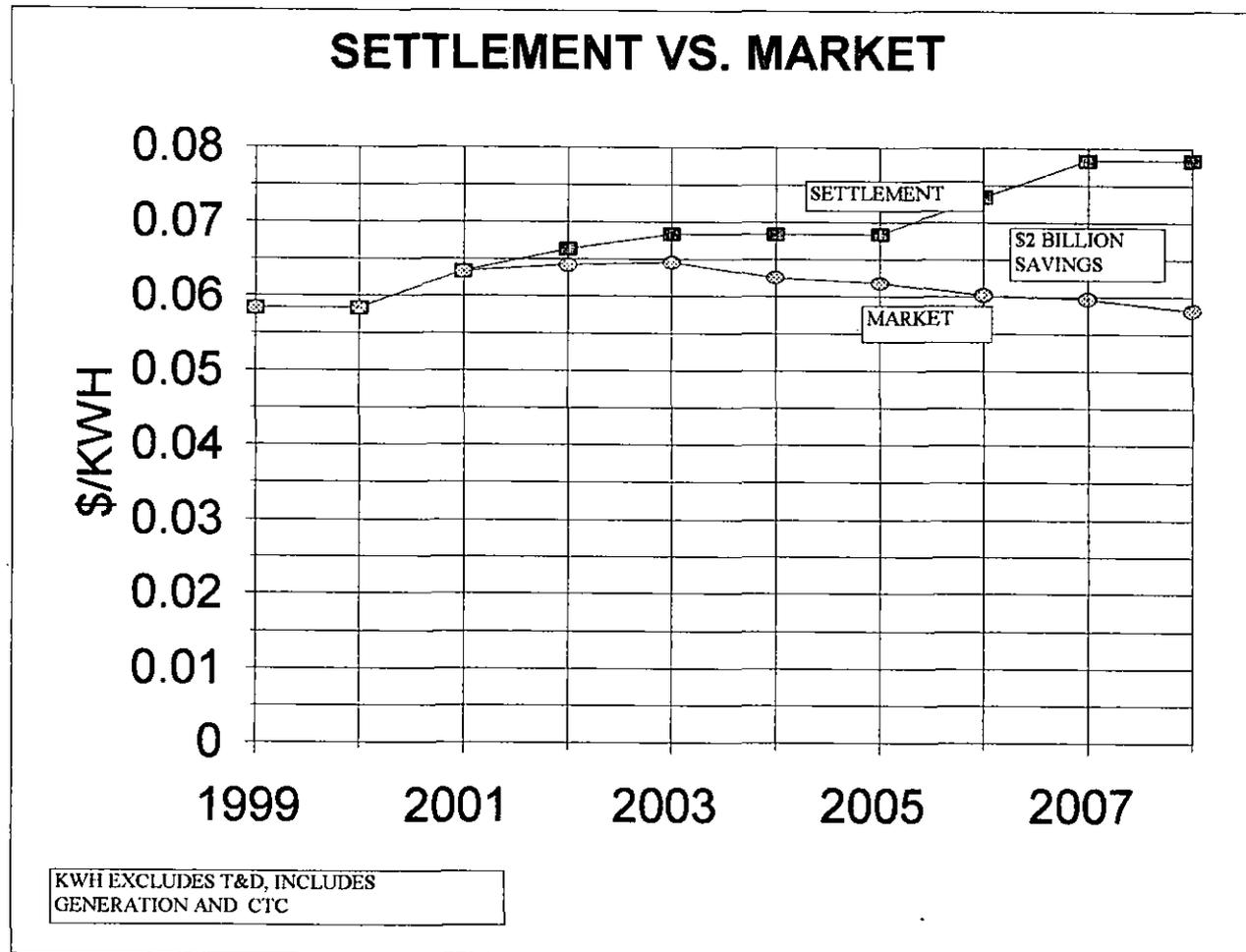
Source: Partial Settlement (p. 8), Customer Choice Plan (pp. 13, 20)



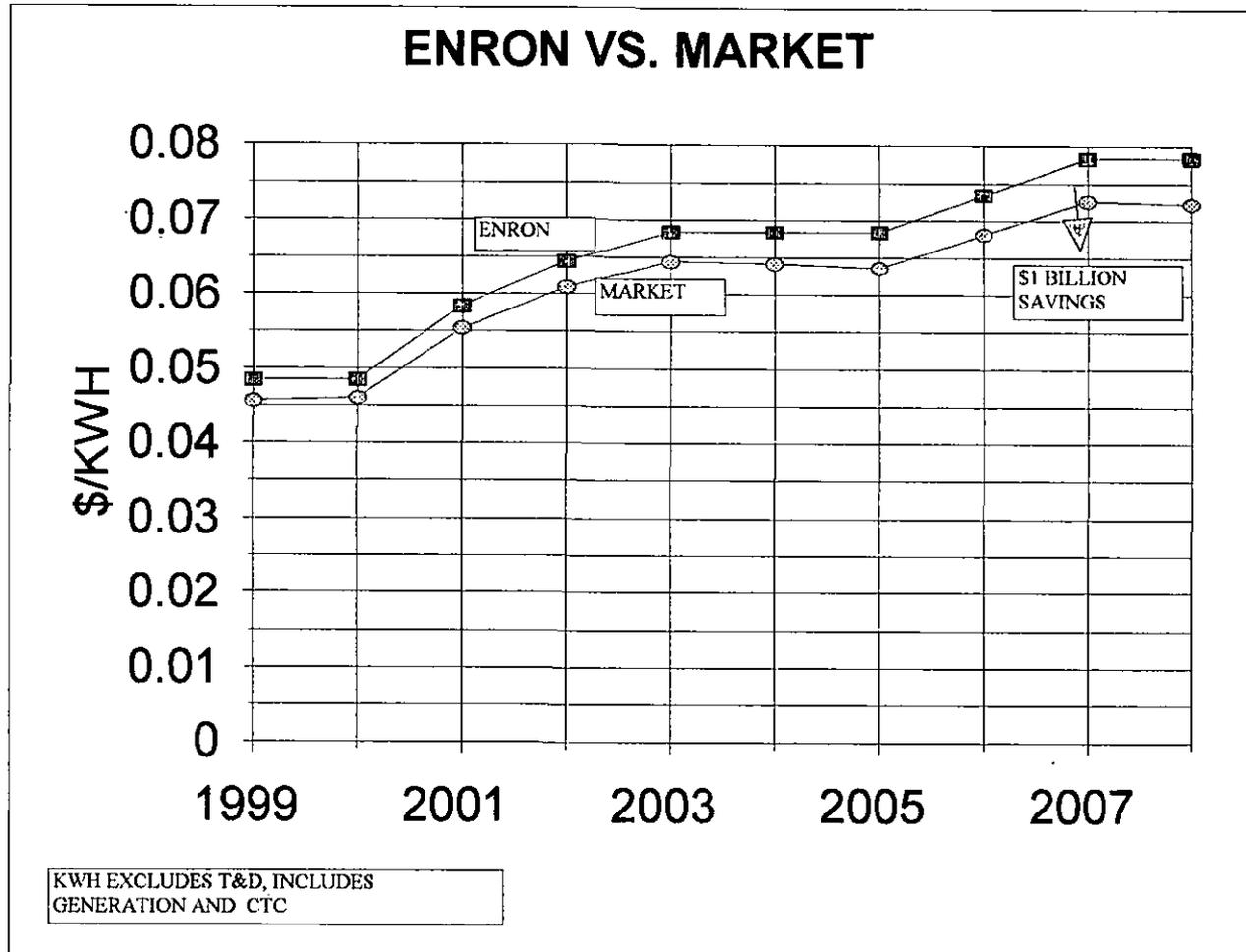
Source: Partial Settlement (p.8), Customer Choice Plan (pp. 13, 20)



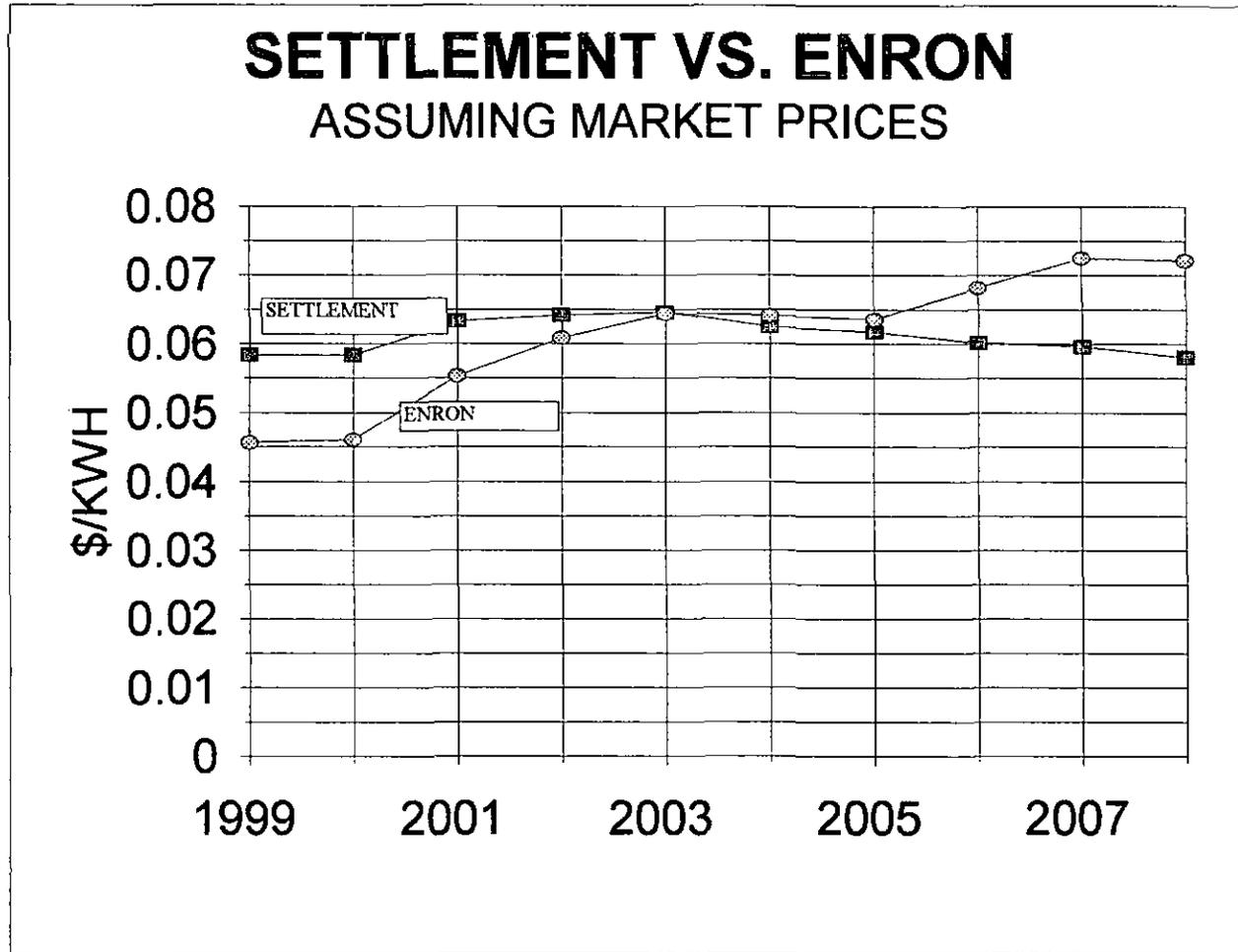
Source: Partial Settlement (p.8), Customer Choice Plan (pp. 13, 20)



Source: Partial Settlement (p. 8), Customer Choice Plan (pp. 13, 20), Testimony of Kenneth Slater (Exhibit 4)



Source: Partial Settlement (p.8), Customer Choice Plan (pp. 13, 20), Testimony of Kenneth Slater (Exhibit 4)



Source: Partial Settlement (p.8), Customer Choice Plan (pp. 13, 20), Testimony of Kenneth Slater (Exhibit 4)