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April 27, 1998

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

Dear Secretary McNulty:

Enclosed for filing with the Commission are an original and nine copies of PECO Energy Company's Exceptions to the Recommended Decision in the referenced matter.

Sincerely,

Paul R Bonney

Paul R. Bonney
Mary McFall Hopper

MMH/mtg

enclosures

cc: Facsimile and First Class Mail
Hon. George M. Kashi
Parties of Record

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**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

**DOCKETED
APR 28 1998**

**EXCEPTIONS
OF
PECO ENERGY COMPANY**

**DOCUMENT
FOLDER**

**To The Recommended Decision Of
Administrative Law Judge George M. Kashi**

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Dated: April 27, 1998

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I. INTRODUCTION AND SUMMARY OF ARGUMENT

Ever since its was enacted fourteen months ago, the Electricity Generation Customer Choice and Competition Act (the "Electric Competition Act") has been subjected to intense examination, with parties of diverse interests offering conflicting interpretations of its provisions. On one point, however, all stakeholders seem to agree -- the overriding goal of the Electric Competition Act is to establish a level playing field on which customers can freely choose their generation supplier and generation suppliers can fairly compete for their business without impairing the reliability of existing service.

As an electric distribution company ("EDC") and an electric generation supplier ("EGS"), PECO expects to compete with PP&L in Eastern Pennsylvania and in other retail electric markets. PECO's interest in this proceeding, therefore, is to ensure that its ability to compete is not compromised by factual determinations and/or legal conclusions which are at odds with the treatment it received in its recently concluded restructuring case at Docket No. R-00973953. *Pa. P.U.C. v. PECO Energy Co.*, 181 PUR4th 517 (1997) as amended by Orders entered January 16, 1998; February 5, 1998; and February 27, 1998 ("*PECO Energy*"), and that its shareholders are not treated unfairly vis-a-viz other EDCs. Quite simply, the Commission's resolution of key issues must be consistent.

II. EXCEPTIONS

A. Stranded Cost Calculation Methodology

PECO urges the Commission to be even-handed in its determination of the level of stranded cost recovery. Thus, to ensure consistent treatment and to avoid a situation whereby one utility reaps an unfair advantage (or suffers an unfair disadvantage), stranded costs should be quantified in all restructuring proceedings on the basis of the “asset value” method used in *PECO Energy* and not the “regulatory method” proposed by PP&L and adopted by Judge Kashi (R.D., pp. 82-84).

B. Market Price Of Electricity And Other Assumptions

Not surprisingly, Pennsylvania’s restructuring proceedings have produced a wide range of conflicting and fiercely defended opinions regarding future retail market prices for energy and capacity. And, as has become evident, virtually any scenario can be constructed depending upon the assumptions employed.

In *PECO Energy*, the Commission adopted OCA witness Smith’s market price projections for purposes of quantifying stranded costs.^{1/} PECO submits that the Commission’s findings are not supported by substantial evidence and it has challenged them on appeal. That being said, there is no reason to believe that different wholesale market prices will prevail in

^{1/} At the same time, however, the Commission ignored those market values when it designed PECO’s unbundled tariff rates.

PECO's and PP&L's respective service territories. Indeed, PP&L's definition of the "relevant market for energy," which Judge Kashi accepts (R.D., p. 85), explicitly assumes that the two companies will be competing in the same area. Consequently, the wholesale market prices accepted here should be the same as those utilized in *PECO Energy*.

Notwithstanding the foregoing, Judge Kashi rejects the OCA's analysis and adopts instead the market price projections submitted by Dr. Jones on behalf of PP&L (R.D., p. 112). Because Dr. Jones' future market prices are substantially lower than those proposed by the OCA and utilized in *PECO Energy*, PP&L's generating facilities are found to be less competitive, resulting in much higher stranded costs that if a consistent approach were followed in the two proceedings. In fact, PECO has calculated that its stranded cost claim would have been \$1.3 billion **greater** (\$8.68 billion instead of the \$7.38 billion)^{2/} if it had employed Dr. Jones' estimated market prices.

The inconsistencies between Judge Kashi's recommendation and *PECO Energy* are underscored by the differences in methodology and assumptions used to determine the stranded costs associated with the Keystone and Conemaugh Generating Stations, in which PECO and PP&L are part owners:

^{2/} The total of \$8.68 billion consists of PECO's stranded cost claim (\$6.8 billion) plus the administrative and general costs classified by the Commission as generation-related stranded costs in *PECO Energy* (\$0.58 billion) plus the \$1.3 billion difference that would result from the use of Dr. Jones' estimated market prices, as noted above. The total of \$8.68 billion is 75% greater than the \$4.9 billion of stranded costs the Commission authorized for recovery in *PECO Energy*.

- In *PECO Energy*, the Commission assumed that both stations would be life-extended by fifteen years. In its analysis, PP&L has not reflected any life extensions for these facilities. PECO's proposed life extensions increased the market value of its share of these units by \$250 million and reduced its stranded cost claim by a corresponding amount.
- Dr. Jones used lower fuel price assumptions for Keystone and Conemaugh than were proposed by either PECO or the OCA in *PECO Energy*. For example, by 2010, Dr. Jones' fuel price estimates for Conemaugh are 16% lower than the fuel price assumptions used by PECO and the OCA in *PECO Energy*. If PECO had used PP&L's fuel prices, the market value of Keystone and Conemaugh determined by PECO would have been considerably smaller -- and its stranded costs correspondingly higher -- than the Commission has determined.
- PECO and the OCA modeled on-going capital expenditures in a very conservative manner by treating such expenditures as an operating expense in the year incurred. PP&L, in contrast, actually modeled the future revenue requirements associated with each capital addition. The present value of the revenue requirements calculated by PP&L is greater than the cost that results from "expensing" such expenditures. As a consequence, if PECO had employed the PP&L approach, the market value of its generating units would be smaller -- and its stranded costs correspondingly higher -- than the Commission has determined.

The differences in quantifying stranded costs explained above, if allowed to stand, would unfairly penalize PECO in two respects. First, they would deny PECO's shareholders a commensurate level of stranded cost recovery (even in the case of jointly owned plants), thereby weakening PECO's financial condition in relative terms. Second, if Dr. Jones' proposed market prices are also to be used for purposes of developing "shopping credits" (see discussion, *infra*), PP&L's exposure to market forces during the transition period will be considerably less, and PECO's ability to compete in PP&L's service territory will be severely hampered.

C. Fossil Plant Decommissioning

The Electric Competition Act defines transition or stranded costs to include “retirement costs attributable to the utility’s existing generation plants” (66 Pa. C.S. § 2803).

Notwithstanding this unequivocal language, the Commission, in *PECO Energy*, concluded that it could not approve the recovery of future fossil decommissioning costs because “future or prospective fossil plant decommissioning expenses are not traditionally recognized in rates in Pennsylvania”. 181 PUR4th at 559. PECO believes that the Commission’s treatment of this issue is wrong as a matter of law, rewrites the Electric Competition Act in a way that could not possibly have been intended by the General Assembly and, therefore, will be quickly reversed by the Commonwealth Court. Judge Kashi, in his Recommended Decision (p. 130), rejects the Commission’s analysis in *PECO Energy* and concludes that “fossil decommissioning costs which are incurred to retire existing fossil generating facilities are defined by the Act as allowable “transition or stranded costs” and “must be included” (emphasis added). Even though PECO agrees with PP&L’s position, it must except to Judge Kashi’s finding because there is no legal or equitable basis for treating the two utilities differently.^{3/} This is particularly true in this instance where the same outside consultant (Mr. LaGuardia) conducted the underlying decommissioning studies and testified in support of both companies. Moreover, if adopted,

^{3/} In *Pa. P.U.C. v. Duquesne Light Co.*, Docket No. R-00974104 (Recommended Decision of John H. Corbett, Jr., p. 347) and *Pa. P.U.C. v. West Penn Power Co.*, Docket No. R-00973981 (Recommended Decision of Larry Gesoff, p. 333) the respective ALJs conclude that *PECO Energy* controls this issue. In contrast, Judge Kashi, in *PP&L*, has proposed that PP&L’s fossil decommissioning expense claim be approved, subject to the requirement that all dollars collected for this purpose be segregated in a separate non-qualified trust fund (Recommended Decision, p. 132).

Judge Kashi's recommendation would result in PP&L recovering its decommissioning costs for Keystone and Conemaugh while PECO -- which actually owns a larger share of both plants than PP&L -- being denied recovery of its share of the very same costs.

D. Earnings On Recovered SFAS 106 Costs

In *PECO Energy*, Mr. Kollen, appearing there on behalf of the Philadelphia Area Industrial Energy Users Group, proposed that the Commission recognize, as a regulatory liability, earnings that PECO's actuaries projected its SFAS 106 trust fund would generate on deposits made to the fund prior to the advent of retail competition. Even though PECO pointed out that such future earnings had already been taken into account in calculating its ongoing generating plant costs for market value purposes, the Commission adopted Mr. Kollen's adjustment. 181 PUR4th at 554. PECO has appealed this issue and has asked the Commonwealth Court to correct this obvious error.

In his Recommended Decision (p. 140), Judge Kashi rejects the **identical** adjustment, proposed again by Mr. Kollen, and asserts that the situation is "clearly distinguishable" from that which the Commission faced in *PECO Energy*. In fact, and as a review of the record in the two cases will quickly reveal, the distinction drawn by Judge Kashi is wholly illusory -- both utilities treated future SFAS 106 trust fund earnings in the same manner.^{4/} Consequently, until the

^{4/} Judge Kashi asserts that PECO's "did not credit customers with the earnings on its SFAS 106 trust fund" and that "PECO argued that it should be permitted to retain trust fund earnings in order to account for future inflation and cost escalation" (R.D., p. 140). Neither assertion is correct. Rather, PECO credited the full amount of projected future
(continued...)

Commonwealth Court reverses the Commission in *PECO Energy*, consistency requires that similar offsets to SFAS 106 claims be made in all electric restructuring proceedings.

E. Deferred Energy Cost Underrecovery

In *PECO Energy*, the Commission denied PECO's claim for \$22.0 million per year of deferred energy costs, representing its estimate of the annual underrecovery of expenses to be incurred during the nine-year period following the roll-in to base rates of PECO's Energy Cost Adjustment as of December 31, 1996. In so doing, the Commission concluded that such prospective underrecoveries were not sufficiently "known and measurable" and, therefore, did not qualify as recoverable stranded costs. 181 PUR4th at 552. PECO has appealed this finding.

Confronting an essentially identical claim (\$31.2 million per year versus PECO's \$22.0 million per year), Judge Kashi concludes that the Commission's resolution of this issue in *PECO Energy* "should not be dispositive." He further determines that PP&L's projected underrecovered fuel costs, unlike PECO's, are "'known and measurable' under traditional PUC practice" (R.D., p. 127). Upon closer examination, however, it is clear that PP&L and PECO presented the same kind of evidence to support their respective claims. Both companies calculated a normalized level of future energy costs on the basis of a historic average (a four-year

4/(...continued)

trust fund earnings to customers to offset future increases in SFAS 106 costs, which **reduced** PECO's SFAS 106 expense. By treating future trust earnings as a regulatory liability in *PECO Energy*, the Commission effectively, double-counted the cost-reductive effect of the trust earnings. The treatment of SFAS 106 trust fund earnings as proposed by PECO is the proper way to calculate SFAS 106 costs, and it is the same method that was employed by PP&L.

average in PECO's case and five years in PP&L's) and presented actual energy costs for the first half of 1997 that substantiated their claimed levels of underrecovery^{5/} (R.D., pp. 126-127; PECO St. 3-R, p. 24). Again, PECO respectfully submits that there is absolutely no basis for denying PECO's claim and approving PP&L's -- equity demands that the two companies be treated the same.

F. Unbundled CTCs And "Shopping Credits"

The Commission, in *PECO Energy*, decided that the restructuring process should not simply produce a level, competitive playing field, but rather should put in place real incentives for customers to leave their incumbent utility. It accomplished this objective through a series of interrelated steps:

- The creation of artificial "shopping credits" which far exceed and, indeed, bear no relationship to anyone's projected market prices in the near term.
- The extension of the CTC recovery period to make the inflated "shopping credits" fit under the rate cap.

and

- The requirement that PECO charge default customers the higher "capped" rates and deny them the benefit of lower market prices if they fail to shop.

^{5/} In fact, along with its request for reconsideration of the December 23, 1997 Order, PECO submitted an affidavit verifying the actual level of underrecovery for the full year 1997. Thus, PECO actually presented stronger evidence in support of its claim than PP&L did.

Judge Kashi rejects this approach in his Recommended Decision. Instead, he concludes that PP&L's proposed market prices, which, as noted previously, he endorses for use in calculating PP&L's stranded costs, should also be used for purposes of establishing competitive generation charges or "shopping credits" (R.D., pp. 146-149). Judge Kashi also declines to extend the CTC recovery period to expand the "shopping credits".^{6/}

PECO agrees with Judge Kashi that there needs to be symmetry between the Commission's market price findings and the "shopping credits" that customers will receive if they choose to purchase electricity from an alternative generation supplier. In this regard, PECO does not believe that the General Assembly intended to penalize incumbent utilities or their customers in furtherance of retail competition and has asked the Commonwealth Court to reverse those aspects of the Commission's decision in *PECO Energy* which improperly place it at a competitive disadvantage. Pending the outcome of that case, whatever rules are applied to PECO must be imposed on other utilities as well. Otherwise, the playing field will be anything but "level" and PECO's ability to compete will be severely hampered.

^{6/} Judge Corbett followed the same course as Judge Kashi in his Recommended Decision in *Duquesne* and, as a consequence, Duquesne's "shopping credit", if not revised, will be over 2¢/kWh less than PECO's. In contrast, Judge Gesoff appears to have adopted the *PECO Energy* model in his Recommended Decision in *West Penn* and, as a result, has proposed a "shopping credit" (3.115¢/kWh) that is significantly higher than either Duquesne's or PP&L's -- but still lower than PECO's. This makes no sense.

G. Return On Stranded Costs

PECO makes no specific recommendation regarding PP&L's cost of capital, its appropriate after-tax discount rate or the return it should be allowed to earn on the unamortized balance of its stranded costs. PECO notes, however, that it was granted a **pre-tax** return on stranded costs equivalent to its embedded cost of long-term debt on the grounds that the recovery of CTC revenues is essentially risk-free. In other words, PECO was not allowed to "gross up" the equity portion of its return to recover the income taxes that will fall due. February 5, 1998 Compliance Filing Order, pp. 5-6.

Judge Kashi similarly concludes that PP&L should be granted a return on unamortized CTC balances equivalent to its embedded long-term debt cost rate. However, he properly recognizes that, in order for PP&L to have any opportunity to actually achieve that return level, the tax impact must be taken into account (R.D., pp. 154-55):

[A] substantial portion of PP&L's assets, including stranded assets, are financed with securities on which PP&L pays dividends that are subject to income taxes. For this reason, the portions of the amount to be inflated must be "grossed up" for income taxes.

On this basis, Judge Kashi determined that PP&L's allowed return should equal 10.86% (i.e. to be contrasted with the 7.47% figure imposed on PECO).^{7/}

^{7/} These figures are not directly comparable because PECO's embedded debt cost, which the 7.47% figure was intended to replicate, was adjusted to eliminate losses and premiums on reacquired debt.

PECO agrees with Judge Kashi's reasoning, but notes that his recommendation is entirely inconsistent with the Commission's decision in *PECO Energy*. There is no justification for this disparate treatment.

H. Phase-In Issues

The General Assembly recognized that the restructuring of the electric utility industry and the introduction of retail competition was a daunting and complex task. With that in mind, it adopted a series of provisions which clearly contemplate that customer choice will be phased in gradually over a three-year period (see 66 Pa. C.S. § 2806(b)). However, in *PECO Energy*, the Commission departed from the course plainly marked by the Legislature and effectively accelerated the introduction of customer choice by a year for those customers who, under the statute, would not become eligible to shop until January 1, 2000 and January 1, 2001, respectively. 181 PUR4th at 542. PECO strongly disagrees with this aspect of the Commission's decision and has appealed it to the Commonwealth Court.^{8/}

PECO concurs with Judge Kashi's implicit determination that the Commission in *PECO Energy*, misconstrued the Act's phase-in requirements (R.D., pp. 170-71). PECO therefore urges the Commission, to seek a remand of the record in the appeals taken from *PECO Energy* to correct that error. In the alternative, fairness dictates that similar phase-in schemes be imposed on all of Pennsylvania's electric utilities. Otherwise, the spirit, and arguably the letter, of the

^{8/} Notably, Administrative Law Judges Corbett and Gesoff have also concluded that the Commission's acceleration of the phase-in schedule in *PECO Energy* was in error. See *Duquesne* (R.D., pp. 42-43) and *West Penn* (R.D., p. 39).

Electric Competition Act's reciprocity feature (66 Pa. C.S. § 2805(b)(2)), among other provisions of the Act, would be violated because PECO's service territory would be opened up to competition at an earlier date than those of other jurisdictional companies.

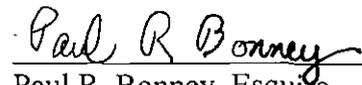
I. Code Of Conduct And Competition Issues

It is absolutely critical that all electric generation suppliers adhere to the same set of competitive safeguards and rules regarding the unbundling of metering and billing services. PECO assumes that such issues will be resolved on a generic basis and that the restrictions imposed on it will also apply to PP&L's and other incumbent utilities. If Judge Kashi's Recommended Decision were read to suggest otherwise, it should be rejected.

III. CONCLUSION

WHEREFORE, PECO Energy Company requests that the Commission adopt the foregoing Exceptions and request a remand of the *PECO Energy* case from the Commonwealth Court or, in the alternative, revise the Recommended Decision to ensure consistency between its final Order in this case and its earlier decisions in *PECO Energy*.

Respectfully submitted,


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Dated: April 27, 1998

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

ORIGINAL

APPLICATION OF PP&L, INC. FOR :
APPROVAL OF ITS RESTRUCTURING PLAN : DOCKET NO. R-00973954
UNDER SECTION 2806 OF THE PUBLIC :
UTILITY CODE :

CERTIFICATION OF SERVICE

I hereby certify that I have this day served a true copy of the foregoing documents upon the participants, listed below, by facsimile and first class mail in accordance with the requirements of §1.54 (relating to service by a participant):

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