

ORIGINAL



OFFICE OF SMALL BUSINESS ADVOCATE

Suite 1102, Commerce Building
300 North Second Street
Harrisburg, Pennsylvania 17101

Bernard A. Ryan, Jr.
Small Business Advocate

April 27, 1998

(717) 783-2525
(717) 783-2831 (FAX)

HAND DELIVERED

Office of the Prothonotary
Pa. Public Utility Commission
North Office Building
P. O. Box 3265
Harrisburg, PA 17105

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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 Exceptions on behalf of the Office of Small Business Advocate in the above-docketed proceeding. As evidenced by the enclosed certificate of service, two 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.
Bernard A. Ryan, Jr.
Small Business Advocate

Enclosures

cc: Cheryl Walker Davis, Director
Office of Special Assistants

Hon. George M. Kashi
Administrative Law Judge

Parties of Record

Mr. Robert D. Knecht

DOCUMENT
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JK

ORIGINAL

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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 P.A.P.U.C.
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EXCEPTIONS
 OF THE
 OFFICE OF SMALL BUSINESS ADVOCATE

DOCKETED
 APR 28 1998

Bernard A. Ryan, Jr.
 Small Business Advocate

Office of Small Business Advocate
 Suite 1102, Commerce Building
 300 North Second Street
 Harrisburg, PA 17101
 (717) 783-2525

DOCUMENT
 FOLDER

Dated: April 27, 1998

TABLE OF CONTENTS

INTRODUCTION	1
EXCEPTIONS	4
1. The Electricity Market Price Forecasts Submitted by PP&L and Accepted in the Recommended Decision Can Not Be Relied Upon Because They Are Based on a Number of Unrealistic and Very Conservative Assumptions	4
A. Price sufficiency to support additions of new capacity	5
B. Fuel price projections	7
C. Capacity displacements	9
2. The Recommended Decision Improperly Approves PP&L's Proposal to Revise Its Rate Design for the GS-1 and GS-3 Rate Classes by Eliminating the Present Declining Block Structure of those Rates	11
3. The Recommended Decision's Phase-in Recommendations Fail to Address Serious Potential Competitive Disadvantages to Small Business Customers	13
CONCLUSION	16

Pursuant to the schedule established by the Commission, the Office of Small Business Advocate ("OSBA") files these Exceptions to the Recommended Decision dated April 1, 1998 of Administrative Law Judge George M. Kashi (the "Recommended Decision" or the "R.D.") in this restructuring proceeding for Pennsylvania Power & Light Company ("PP&L" or "Company").

INTRODUCTION

Along with 16 other complainants or intervenors, the OSBA actively participated in the development of the record in this proceeding. In response to the testimony introduced by PP&L, the OSBA offered the testimony of its expert witness, Robert D. Knecht (OSBA Stmts. No. 1, 1R and 1S). In his testimony Mr. Knecht raised and discussed a number of serious concerns about the reliability of a number of the assumptions upon which the PP&L stranded cost claim of \$4.0 billion rests.¹ Expert witnesses for other complainants

¹Because the OSBA did not undertake a complete review of all aspects of the total PP&L stranded cost claim, no recommendation was made by the OSBA as to an overall level of stranded costs that PP&L should be allowed to recover through a competitive transition charge ("CTC"). The OSBA did, however, support the more realistic market price forecasts that were provided by the Office of Consumer Advocate ("OCA") and the PP&L Industrial Customer Alliance ("PPLICA"). The OSBA argued that the OCA and PPLICA forecasts, not PP&L's projections, are the appropriate basis on which to project future market prices for electricity, an essential component in any effort to determine a utility's stranded costs. OSBA Main Brief, pp. 3, 26-27.

and intervenors similarly testified about the defects they found in the PP&L claim for stranded costs. Additionally, Mr. Knecht recommended revisions to or the rejection of several of PP&L's proposals regarding the Company's rate structure and design as the restructuring of the electric industry moves forward in Pennsylvania.

After only brief recitations of the concerns raised by the various intervenors, the Recommended Decision essentially accepts *in toto* the PP&L contentions regarding the stranded costs it should be allowed to collect from its customers. The Recommended Decision calls for only minor adjustments to some of the individual elements of PP&L's alleged stranded costs. The OSBA now urges the Commission to review the very substantial stranded cost claims presented by PP&L with a much more critical eye, taking into account the persuasive objections that have been advanced by a number of the intervening parties.

Because the OSBA did not suggest a specific stranded cost figure in its Main Brief, the OSBA will not do so now.² Those parties who did will certainly note in their own Exceptions how the Recommended Decision fails to reflect the numerous well-founded

²The OSBA has not been able to calculate the amount of stranded costs actually recommended in the R.D. for recovery by PP&L, although it is clear that only modest changes were recommended in the PP&L claim. For that reason, the OSBA can not accept the invitation (in the transmittal letter for the Recommended Decision) to provide tables with these Exceptions that would incorporate the adjustments contained in the Recommended Decision.

adjustments to the PP&L claim that were advanced in this proceeding. To avoid redundancy, the OSBA will only note its objections to the Recommended Decision's conclusions in summary fashion, with cross-references to the more complete discussion of the point that will be found in the OSBA's Main Brief or the testimony of its expert witness.

A few additional introductory comments on the general matter of the stranded cost calculations in this proceeding are appropriate. The PP&L stranded cost claim was calculated using the "regulatory method." The OCA and PPLICA alternatives, on the other hand, were calculated using the "asset value method," the approach that the Commission accepted for calculating stranded costs in the restructuring proceedings for PECO Energy Company at Docket No. R-00973953. The OSBA chose not to enter the debate over which method for calculating stranded costs is the superior one, primarily because it agrees with the Recommended Decision's conclusion (at page 83 of the R.D.) that "... when properly applied, both the regulatory and asset value methods should produce comparable results since they are measuring the same costs."

As noted by OSBA witness Knecht, the regulatory approach favored by PP&L and accepted by the presiding officer in his Recommended Decision makes the market price forecast for electricity a critical issue in determining just how competitive

the industry will become during the transition period leading to full competition for generation service. PP&L's very low projected market prices that are relied upon in the Recommended Decision almost guarantee that a vigorous competitive market will not develop for years in the PP&L territory if the Recommended Decision is allowed to stand. OSBA Stmt. No. 1, pp. 7-8.

In addition to its major concerns about the excessive stranded cost allowance called for in the Recommended Decision, the OSBA takes exception to certain other aspects of the Recommended Decision. Exceptions are also noted in the general areas of rate structure and design and the schedule for the phase-in to competition for PP&L's customers

EXCEPTIONS

- 1. The Electricity Market Price Forecasts Submitted by PP&L and Accepted in the Recommended Decision Can Not Be Relied Upon Because They Are Based on a Number of Unrealistic and Very Conservative Assumptions**

Relying on the testimony of PP&L witness Dr. Jones and giving no credence to the very different views expressed by OCA witness D. Smith, PPLICA witness Falkenberg and OSBA witness Knecht, the Recommended Decision concludes that the advent of generation competition will insure low market prices for electric energy and capacity well into the future. That conclusion in turn means, and

the Recommended Decision approves, significantly higher stranded cost recovery for PP&L than was recommended by either the OCA or the PPLICA witnesses who testified about an appropriate total stranded cost amount for PP&L. R.D. 84-85. But Dr. Jones' electricity price forecasts rest on inappropriately conservative and uncertain foundations. Those questionable forecasts will cost all of PP&L's customers very dearly indeed if the Commission accepts them in the same uncritical fashion that the Recommended Decision does.

A. Price sufficiency to support additions of new capacity [See OSBA Main Brief, pp. 19-25].

The OSBA respectfully disagrees with the Recommended Decision's conclusion (at p. 86) that the OCA, PPLICA and OSBA experts, all of whom agreed that Dr. Jones' forecast of market capacity costs are insufficient to support the addition of new capacity, were simply creating a "tempest in a teapot." To the contrary, the issue of price sufficiency to spur investments in new generating facilities goes to the crux of the price forecasting debate.

The Recommended Decision rejects the intervenors' arguments that Dr. Jones' market prices will not sustain new capacity additions, finding that PP&L's analysis demonstrates how Dr. Jones' forecasted prices will support such additions at today's costs and

heat rates. R.D. pp. 86-87. It is clear, however, that Dr. Jones actually used different assumptions for replacement capacity costs in his price sufficiency analysis than he did in his price forecasting analysis.

The discussion on this issue in the Recommended Decision relies upon an analysis that was presented by Dr. Jones in his rejoinder testimony at the conclusion of the evidentiary hearings, specifically his Exhibit STJ-28R. In that Exhibit, Dr. Jones presents a range of capacity cost and heat rate assumptions for new natural gas-fired combined cycle capacity. Taking simple averages, however, it is obvious that on rejoinder Dr. Jones radically changed his position on this point from what is reflected in the direct testimony he filed earlier in this case.

On average, the heat rate of new capacity drops from Dr. Jones' direct testimony value of 7,000 BTU/kWh (Exhibit STJ-5) to a value of only 6,163 BTU/kWh in Exhibit STJ-28R that he introduced just before the end of the hearings. In effect, Dr. Jones reduced the fuel costs of the new unit by 12 percent between the time he prepared his direct testimony and his oral rejoinder testimony late in the hearings. Similarly, Dr. Jones' replacement capital cost assumption drops from \$595 per kW in his direct testimony (Exhibit STJ-5) to \$537 per kW in Exhibit STJ-28R, a reduction of nearly 10 percent. Considered in the light of those

last-minute and very radical changes in his underlying assumptions, it is not at all surprising that Dr. Jones could conclude at the end of the day that his low price forecasts for electricity are nevertheless high enough to support the addition of new capacity.

Unless electricity price expectations are sufficient to provide a reasonable return on a contemplated capacity addition, that new capacity simply will not be built, and the reliability of electric supply for PP&L's customers in future years will be jeopardized. For that reason alone, the issue of price sufficiency to support capacity additions is certainly not a "tempest in a teapot." To the contrary, it is the only reasonable and appropriate test of a long term price forecast for electricity, and the PP&L price projections fail to satisfy that test.

B. Fuel price projections [See OSBA Main Brief, pp. 14-16].

The Recommended Decision correctly notes that the cost of the fuel used by an electric generating facility is a critical input to any model used to forecast prices for electricity in the future, and the primary component of the variable cost of generation at the facility. R.D. 94. Given that recognition, the willingness of Dr. Jones (and the Recommended Decision) to ignore completely the fuel price forecasts issued by such well-recognized authorities as Data Resources, Inc. ("DRI") and the Energy Information

Administration ("EIA") is distressing. Unlike PP&L, both of those organizations project both real and inflation-related increases in fuel prices throughout the transition period to full competition for electric generation services.

Dr. Jones developed his own projections concerning future fuel prices. His forecasts, prepared at PP&L's request for use in this proceeding, have fuel prices remaining flat until 1999 and increasing only with inflation thereafter. R.D. 95. By contrast, both the EIA and DRI price projections show rising fuel prices throughout the forecast period. If these independently-prepared forecasts prove to be more accurate than those prepared by PP&L's own expert witness expressly for this case, the PP&L customers will be required to pay for a significant amount of "stranded costs" that never will materialize.

The Commission should not confine its review to just one forecast of fuel prices as did the Recommended Decision. Instead it should take into account the EIA and DRI forecasts calling for increasing fuel prices (just as it did in the PECO restructuring proceeding) when it projects what the prices for electric energy and capacity will be as Pennsylvania moves from regulation to competition over the next ten years or so.

C. **Capacity displacements** [See OSBA Stmt. No. 1, pp. 30-31].

Quoting Dr. Jones, the Recommended Decision assumes that new combined cycle gas-fired units will displace older PJM fossil fuel units that are retired in the near future. If that were to happen, the result would be lower generation costs (and prices) because of the more efficient operation of the combined cycle units. R.D. 111. But there is no discussion at all (or even any mention) in the Recommended Decision of the testimony of OSBA witness Knecht that specifically addressed the question of which kinds of PJM generating facilities are most likely to be retired first. Contrary to Dr. Jones' assumption, Mr. Knecht concluded that a nuclear unit rather than a fossil fuel plant is likely to be the kind of generating facility replaced by a new combined cycle plant during the transition period.

Any plant retirement choice will undoubtedly be made on the basis of an incremental cash flow analysis of the older generating facilities. The higher fixed O&M costs for aging nuclear plants will be made very obvious in any such analysis, making them more likely candidates for early retirement when compared to existing fossil fuel plants. While the nuclear facilities do have lower short-run marginal costs, the higher incremental capital costs that are required to keep them in operation most likely will point the

decision makers in the direction of first closing a nuclear generating facility, not a fossil fuel plant. Projecting the replacement of a nuclear generating station's low variable costs with the higher costs of a new gas-fired combined cycle plant thus will cause forecasts of electric prices to rise, not fall as Dr. Jones and the Recommended Decision both assert. OSBA Stmt. No. 1, pp. 30-31.

In summary, PP&L's projections of depressed market prices for electricity over the next decade are based on extremely conservative assumptions about fuel prices, the need for new generating capacity and the costs of replacing older generation facilities. Moreover, the market prices that PP&L projects (and the Recommended Decision accepts) are completely inconsistent with the market line for energy and capacity prices in the PJM region that the Commission itself used in its restructuring decisions for PECO Energy Company.³ While certainly PECO and PP&L have different cost structures, they both operate and will sell their power in the PJM territory. The market prices for that power surely will not be

³The market prices the Commission accepted in the PECO proceeding were those prepared by OCA witness D. Smith, the same witness who testified here on those issues. While noting that no one pricing proposal presented in the PECO proceeding was completely convincing in every detail, the Commission stated that "... Witness Smith's [market line] is the most credible ... and produces a result approximately midway between the other two most credible models." PECO Order (R-00973953) at p. 88.

lower for PP&L than they will be for PECO, but that is the incongruous result the Recommended Decision suggests will occur.

2. The Recommended Decision Improperly Approves PP&L's Proposal to Revise Its Rate Design for the GS-1 and GS-3 Rate Classes by Eliminating the Present Declining Block Structure of those Rates [See OSBA Main Brief, pp. 37-39].

The Recommended Decision approves PP&L's proposal to recover its transmission and distribution costs through a flat energy charge and a fixed customer charge for Rate Schedules GS-1 and GS-3. R.D. pp. 158-159. Perhaps such a revision to PP&L's existing rate structure would result in a highly simplified rate structure as the Recommended Decision states, but that simplification (or over-simplification) would come at a significant price for the GS-1 and GS-3 customers. The proposed elimination of the blocking structure now incorporated into those rate schedules raises the spectre of significant cost shifting within those two classes of commercial customers.

Changes in cost responsibilities within a rate class should not be made in the context of an electric utility's restructuring proceeding. The kinds of detailed cost-of-service analyses that are used to justify such intra-class rate realignments are not available in this proceeding. The Commission-approved blocked rate design under which PP&L presently recovers the wires service costs

allocated to the GS-1 and GS-3 classes should be continued until such time as PP&L can justify a revised rate design in a future T&D rate proceeding (after the current statutory rate cap on such charges has expired).

Moreover, the Recommended Decision's approval of PP&L's proposal to eliminate the declining block structure rests on an incorrect understanding of the significance of these wire service charges to the GS-1 and GS-3 classes. In endorsing PP&L's proposal to redesign Rate GS-1 and GS-3 in this fashion, the Recommended Decision states that there is no evidence suggesting "... that delivery charges are such a significant component of the current blocked rate structure for the GS-1 and GS-3 rates that the shifting of this structure from delivery service rates to the CTC will have the detrimental affect which the OSBA alleges." R.D. p. 159. Actually there is precisely such evidence in this record. Schedules 10 and 11 of Exhibit RDK-2 (attached to OSBA Stmt. No. 1) calculate the revenue effects of PP&L's proposed rates for its GS-1 and GS-3 customers. For GS-1, the delivery (or wires) service charges represent more than 22% of total class revenues. The corresponding figure for the GS-1 class is about 18%. The OSBA submits that delivery charges in the range of 20% are indeed a significant part of a GS-1 or GS-3 customer's total electric service charges, particularly when one recognizes that those

percentages will increase significantly after the CTC no longer applies.

The rates charged to those GS-1 and GS-3 customers should not so quickly be redesigned in a proceeding intended to address other precedent-setting issues. If PP&L wishes to simplify its existing rate design for these two classes, it should do so in a future T&D rates proceeding in which the utility produces whatever evidence it has to support such a redesign of its commercial rates. No such evidence has been offered by PP&L here. This proceeding is quite properly focused on a very different set of issues related to the introduction of competition into the sale of electric generation services. This is not the time nor is this the proceeding in which to consider such an alteration in PP&L's rate structure as the Recommended Decision would allow.

3. The Recommended Decision's Phase-in Recommendations Fail to Address Serious Potential Competitive Disadvantages to Small Business Customers [See OSBA Main Brief, pp. 42-45].

Stating that the phase-in schedule set forth in Section 2804(11) of the Electric Generation Customer Choice and Competition Act, 66 Pa. C.S. §2804(11) (the "Act"), is mandatory, the Recommended Decision rejects all proposals for modifications to the schedule proposed for that purpose by PP&L. R.D. pp. 171-173.

Neither the PP&L proposal nor the Recommended Decision take into account the very considerable discretion the Act gives to the Commission to prevent the kinds of competitive disadvantages that almost certainly will result from such a mechanical interpretation of Section 2804. Surprisingly, the Recommended Decision makes no mention at all of the Commission's recent use of that discretion in formulating the phase-in plan it directed for the customers of PECO Energy Company.

The Act recognizes the need to examine other approaches for the phase-in to generation competition so as "to prevent competitive disadvantages among similarly situated customers within a customer class." 66 Pa. C.S. §2806(b) (4). That kind of competitive disadvantage could very easily occur in the PP&L service territory if one business enterprise is included in the first one-third for phase-in purposes while a competing business finds its access to competitive generation service delayed to a later date.

At pages 47 through 49 of the PECO restructuring order⁴ the Commission directed an accelerated phase-in of customer choice. Under that Order, up to 33% of all customer classes will be eligible to shop for competitively-priced generation on January 1,

⁴Order entered December 23, 1997 at Dockets No. R-00973953 and P-00971265, pp. 47-49.

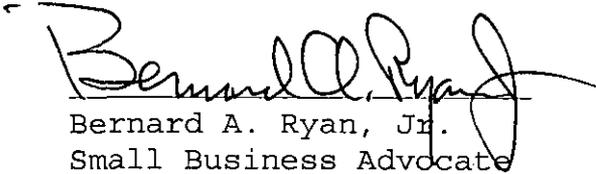
1999, and another 33% become eligible to do so the very next day. By January 2, 2000, all of PECO's customers will be able to shop for electric generation service. This more rapid phase-in of customer choice effectively makes the potential for competitive disadvantages to business customers a one year rather than a two year problem.

Accelerating the phase-in to customer choice in the manner directed by the Commission in the PECO restructuring case is an effective way to address the statutory mandates of Section 2806(b) and minimize potential competitive problems for small business customers. The schedule ordered for PECO should, for those same reasons, be directed for PP&L as well.

CONCLUSION

The Office of Small Business Advocate respectfully requests the Public Utility Commission to grant these exceptions and reject those portions of the Recommended Decision that guarantee excessive stranded cost recovery for PP&L, improperly restructure PP&L rates for its GS-1 and GS-3 rate classes and increase the likelihood of competitive disadvantages for PP&L's business customers whose access to competitive generation services is delayed beyond January 1, 1999.

Respectfully submitted,


Bernard A. Ryan, Jr.
Small Business Advocate

Dated: April 27, 1998

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The Public Utility Code :

CERTIFICATE OF SERVICE

I certify that I am serving two copies of the Exceptions on behalf of the Office of Small Business Advocate in the manner indicated upon the persons addressed below:

Cheryl Walker Davis, Director
Office of Special Assistants
Pa. Public Utility Commission
P.O. Box 3265
Harrisburg, PA 17105-3265
(hand delivered 4/27)

Hon. George M. Kashi
Administrative Law Judge
Pa. Public Utility Commission
P.O. Box 3265
Harrisburg, PA 17120
(hand delivered 4/27)

Paul E. Russell, Esquire
Pennsylvania Power & Light Co.
Two North Ninth Street
Allentown, PA 18101-1179
(PP&L)
(610) 774-4254
(610) 774-6726 (fax)
(overnight mail 4/24)

Donald A. Kaplan, Esquire
Lisa M. Helpert, Esquire
Preston Gates Ellis & Rouvelas Meeds
Suite 500
1735 New York Avenue, N.W.
Washington, DC 20006-4759
(PP&L)
(202) 628-1700
(202) 331-1024 (fax)
(overnight mail 4/24)

Johnnie E. Simms, Esquire
Scott DeBroff, Esquire
Office of Trial Staff
Pa. Public Utility Commission
P.O. Box 3265
Harrisburg, PA 17105
(Office of Trial Staff)
(717) 787-1976
(717) 772-2677 (fax)
(hand delivered 4/27)

Craig R. Burgraff, Esquire
Barrett C. Sheridan, Esquire
James A. Mullins, Esquire
Office of Consumer Advocate
1425 Strawberry Square
Harrisburg, PA 17120
(Office of Consumer Advocate)
(717) 783-5048
(717) 783-7152 (fax)
(hand delivered 4/27)

David Kleppinger, Esquire
Pamela C. Polacek, Esquire
McNees, Wallace & Nurick
100 Pine Street
P.O. Box 1166
Harrisburg, PA 17108-1166
(PPLICA)
(717) 232-8000
(717) 237-5300 (fax)
(hand delivered 4/27)

Joan O. Brandeis, Esquire
Schnader, Harrison, Segal and Lewis
1600 Market Street, Suite 3600
Philadelphia, PA 19103
(Bethlehem Steel Corporation)
(215) 751-2000
(215) 751-2205 (fax)
(overnight mail 4/24)

Craig A. Doll, Esquire
214 State Street
Harrisburg, PA 17101
(Delmarva Power & Light Company)
(717) 230-9555
(717) 230-9750 (fax)
(hand delivered 4/27)

Environmental Energy Project
Attorney of Record
3700 Vartan Way
Harrisburg, PA 17110
(Environmentalists)
(first class mail)

Roger E. Clark, Esquire
905 Denston Drive
Ambler, PA 19002
(Environmentalists)
(215) 643-2364
(215) 628-2630 (fax)
(overnight mail 4/24)

William T. Hawke, Esquire
Janet L. Miller, Esquire
Todd S. Stewart, Esquire
Malatesta, Hawke & McKeon
100 North Tenth Street
P. O. Box 1778
Harrisburg, PA 17105.
(MAPSA)
(717) 236-1300
(717) 236-4841 (fax)
(hand delivered 4/27)

Mr. Eric Joseph Epstein
2308 Brandywine Drive
Harrisburg, PA 17110
(717) 541-1101
(717) 541-5487 (fax)
(first class mail)

Clinton A. Vince, Esquire
Paul E. Nordstrom, Esquire
Deborah A. Swanstrom, Esquire
Joel E. Newton, Esquire
Verner, Liipfert, Bernhard,
McPherson & Hand
901 15th Street, N.W.
Washington, DC 20005-2301
(Allegheny Power)
(202) 371-6000
(202) 371-6279 (fax)
(first class mail)

Richard L. Caplan, Esquire
Mary Huwaldt, Esquire
Caplan & Luber, LLP
The Caplan & Luber Building
40 Darby Road
Paoli, PA 19301-1461
(Schuylkill Energy Resources)
(Gilberton Power Company)
(610) 640-1200
(610) 640-9865 (fax)
(overnight mail 4/24)

Daniel Clearfield, Esquire
Robert J. Longwell, Esquire
Alan Kohler, Esquire
Wolf, Block, Schorr & Solis-Cohen
Locust Court Building, Suite 300
212 Locust Street
Harrisburg, PA 17101
(Enron Corp.)
(717) 237-7160
(717) 237-7161 (fax)
(hand delivered 4/27)

Billie E. Ramsey, Esquire
Executive Director - ARIPPA
1300 Market Street, Suite 7
Lemoyne, PA 17043
(Anthracite Region Independent Power
Producers Association)
(717) 763-7635
(717) 763-7455 (fax)
(first class mail)

John L. Munsch, Esquire
Allegheny Power
800 Cabin Hill Drive
Greensburg, PA 15601
(Allegheny Power)
(412) 837-3000
(412) 838-6177 (fax)
(overnight mail 4/24)

David A. McCormick, Esquire
Regulatory Law Office -U 3949
US Army Legal Services Agency
901 North Stuart Street
Arlington, VA 22203-1837
(Dept. of the Army)
(703) 696-1646
(703) 696-2960
(overnight mail 4/24)

Mary McFall Hopper, Esquire
Assistant General Counsel
PECO Energy Company
2301 Market Street, S23-1
Philadelphia, PA 19103
(PECO Energy)
(215) 841-4917
(215) 568-3389 (fax)
(overnight mail 4/24)

Scott J. Rubin, Esquire
3 Lost Creek Drive
Selinsgrove, PA 17870
(Electrical Workers, Local 1600)
(717) 743-2233
(717) 743-8145 (fax)
(overnight mail 4/24)

Robert F. Young, Esquire
Deputy General Counsel
212 Locust Street
P.O. Box 1266
Harrisburg, PA 17108-1266
(Allegheny Electric Cooperative)
(717) 233-5704
(717) 236-0248 (fax)
(hand delivered 4/27)

Patricia Armstrong, Esquire
Thomas, Thomas, Armstrong & Niesen
212 Locust Street
P. O. Box 9500
Harrisburg, PA 17108-9500
(Allegheny Electric Cooperative)
(717) 255-7600
(717) 236-8278 (fax)
(hand delivered 4/27)

Bruce A. Connell, Esquire
General Counsel
600 N. Dairy Ashford, ML-1034
Houston, TX 77079
(Dupont Power Marketing, Inc.)
(overnight mail 4/24)

Terence Fitzpatrick, Esquire
David Desalle, Esquire
Ryan, Russell, Ogden & Seltzer
800 North Third Street
Suite 101
Harrisburg, PA 17102-2025
(GPU Energy)
(717) 236-7714
(717) 236-7816 (fax)
(hand delivered 4/27)

Michael T. Vough, Esquire
Vough & Mecadon
Greater Pittston Prof. Center
126 South Main Street
Pittston, PA 18640-1793
(Commission on Economic Opportunity)
(717) 654-6499
(717) 654-6509 (fax)
(overnight mail 4/24)

Harry S. Geller, Esquire
118 Locust Street
Harrisburg, PA 17108
(Pa. Utility Law Project)
(hand delivered 4/27)

Michael A. Stosser, Esquire
Heller Ehrman White & McAuliffe
815 Connecticut Avenue, N.W.
Suite 200
Washington, DC 20006-4004
(Kraft Foods, Inc.)
(overnight mail 4/24)

Mr. Stephen J. Baron
J. Kennedy and Associates, Inc.
35 Glenlake Parkway, Suite 475
Atlanta, GA 30328
(770) 395-1288
(770) 396-0151 (fax)
(first class mail)

Michael L. Kessler, Esquire
Vice President/General Counsel
American Energy Solutions, Inc.
111 South Alfred Street
Alexandria, VA 22314
(American Energy Solutions, Inc.)
(703) 684-1006
(703) 683-3256
(overnight mail 4/24)

Mr. Bruce Biewald
Synapse Energy Economics, Inc
101 Chilton Street
Cambridge, MA 02138
(Witness for environmentalists)
(617) 661-3248
(617) 661-0599 (fax)
(first class mail)

Usher Fogel, Esquire
Roland, Fogel, Koblenz & Carr, LLP
1 Columbia Place
Albany, NY 12207
(Pa. Petroleum Assoc.)
(Plumbing, Heating, Cooling
Contractors, Inc.)
(518) 434-8112
(518) 462-4242 (fax)
(overnight mail 4/24)

Gary A. Jeffries, Esquire
CNG Energy Services Corp.
One Park Ridge Center
P.O. Box 15746
Pittsburgh, PA 15244-0746
(For CNG Energy Services)
(412) 787-4268
(412) 787-4464 (fax)
(first class mail)

Susan M. Shanaman, Esquire
212 North Third Street
Suite 203
Harrisburg, PA 17101-1505
(For Center for Energy/Econ Dev)
(717) 236-2055
(717) 236-2070 (fax)
(hand delivered 4/27)

Joseph A. Dworetzky, Esquire
Hangley Aronchick Segal & Pudlin
One Logan Square, Twelfth Floor
Philadelphia, PA 19103-6933
(New Energy Ventures)
(215) 496-7014
(215) 568-0300 (fax)
(overnight mail 4/24)

Mr. David M. Boonin
New Energy Ventures, Inc.
1845 Walnut Street, Suite 2525
Philadelphia, PA 19103
(New Energy Ventures)
(215) 563-9290
(215) 563-9292 (fax)
(first class mail)

Gordon Smith, Esquire
John & Hengerer
1200 17th Street, N.W., Suite 600
Washington, DC 20036-3006
(Duke Energy Trading/Marketing)
(Electric Clearinghouse, Inc.)
(Vastar Power Marketing, Inc.)
(NorAm Energy Management, Inc.)
(202) 429-8809
(202) 429-8805 (fax)
(overnight mail 4/24)

John R. Orr, Esquire
Duke Energy Trading/Marketing
One Westchase Center
10777 Westheimer, Suite 650
Houston, TX 77042
(Duke Energy Trading/Marketing)
(713) 260-1800
(713) 260-6511 (fax)
(first class mail)

John P. Zinkand
Executive Vice President
Pennsylvania Petroleum Association
Suite 121, Building 2
2001 N. Front Street
Harrisburg, PA 17102
(Pennsylvania Petroleum Association)
(717) 233-5838
(717) 233-4578 (fax)
(hand delivered 4/27)

Linda C. Smith, Esquire
Dilworth, Paxson, Kalish & Kauffman LLP
305 N. Front Street, Suite 403
Harrisburg, PA 17101-1236
(AARP)
(717) 236-4812
(717) 236-7811 (fax)
(hand delivered 4/27)

Mr. Scott T. Jones
The Economic Resource Group
One Mifflin Place
Cambridge MA 02138
(first class mail)

Brian A. Rider, President
Pennsylvania Retailers' Assoc.
224 Pine Street
Harrisburg, PA 17101-1325
(717) 233-7976
(hand delivered 4/27)

David W. Francis, Esquire
Powell, Trachtman, Logan, Carrle,
Bowman & Lombardo
114 North Second Street
Harrisburg, PA 17101
(Quaker Oats Company)
(Mount Joy Wire Corporation)
(717) 238-9300
(717) 238-9325 (fax)
(hand delivered 4/27)

Robert A. Mills, Esquire
McNees, Wallace & Nurick
100 Pine Street
P.O. Box 1166
Harrisburg, PA 17108-1166
(717) 232-8000
(717) 237-5300 (fax)
(hand delivered 4/27)

Gene Stilp, Coordinator
1550 FCVR
Harrisburg, PA 17112-9240
(PP&L Ratepayers Association)
(first class mail)

Mr. David L. Cruthirds
Electric Clearinghouse, Inc.
1000 Louisiana, Suite 5800
Houston, TX 77002-5050
(Electric Clearinghouse, Inc.)
(713) 507-3761
(first class mail)

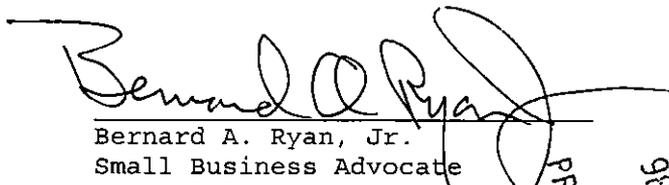
Keith M. Sappenfield, II
Director of Marketing Support
NorAm Energy Management, Inc.
P.O. Box 2628
Houston, TX 77252-2628
(NorAm Energy Management, Inc.)
(713) 654-5864
(first class mail)

Stephanie A. Sugrue, Esquire
Duane, Morris & Heckscher
1667 K Street, N.W., Suite 700
Washington, DC 20006-1608
(QST Energy, Inc.)
(202) 776-7800
(202) 776-7801 (fax)
(overnight mail 4/24)

John J. Gallagher, Esquire
Leboeuf, Lamb, Greene & MacRae
200 North Third Street, Suite 300
P.O. Box 12105
Harrisburg, PA 17108-2105
(Duquesne Light Company)
(717) 232-8199
(717) 232-8720 (fax)
(hand delivered 4/27)

Norma J. Rosner, Esquire
Vastar Power Marketing, Inc.
200 Westlake Park Boulevard
Houston, TX 77079
(Vastar Power Marketing, Inc.)
(713) 584-3980
(first class mail)

Mr. Richard LaCapra
LaCapra Associates
The Province Building
333 Washington Street
Boston, MA 02108
(Witness for OCA)
(617) 367-6500
(617) 951-0528
(first class mail)


Bernard A. Ryan, Jr.
Small Business Advocate

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