COMMONWEALTH OF PENNSYLVANIA

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February 27, 1998

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PROTHONOTARY'S OFFICE

James J. McNulty, Secretary
Secretary's Bureau
Pennsylvania Public Utility Commission
Room B-20, North Office Building
P. O. Box 3265
Harrisburg, PA 17105-3265

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

Dear Secretary McNulty:

KJR

Enclosed please find for filing an original and nine (9) copies of the Office of Consumer Advocate's Reply Brief in the above-captioned proceeding.

Copies have been served upon all parties of record as shown on the attached Certificate of Service.

Sincerely,

James A. Mullins

James A. Mullins
Assistant Consumer Advocate

Enclosures
cc: All parties of record
Hon. George M. Kashi, ALJ

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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

REPLY BRIEF
OF THE OFFICE OF CONSUMER ADVOCATE

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DATED: February 27, 1998

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I. INTRODUCTION

There is little question that PP&L, Inc.'s ("PP&L") primary focus in this case has been to protect throughout the transition period its earnings level derived from the past regulatory environment. As the OCA noted at page 1 of its Main Brief, PP&L's extraordinarily high level of claimed stranded cost recovery, combined with its unbundling of rates and market price assumptions, essentially leads to no rate savings for customers and little room for competition until the year 2006. Thus, the result of PP&L's restructuring presentation is to protect the status quo under regulation through the transition period.

The goals of the Customer Choice Act, of course, provide for the creation of a competitive generation market and includes a framework to accomplish the goal of providing reduced electricity prices to consumers. As the OCA noted at pages 66-69 of its Main Brief, the Act itself, through the requirement that owned generation stranded costs be determined on a net present value basis over the life of the asset or liability, produces lower returns in the short-term but higher returns in the future. Stated differently, rates during the transition period reflect the present value of future earnings streams, which as market prices increase, will exceed revenue requirements on a traditional ratemaking basis.

The danger with PP&L's focus in this proceeding is that recovering excessive levels of stranded costs from ratepayers now to protect short-term regulatory returns leaves PP&L with the concomitant ability to inappropriately garner windfall profits in the future competitive market as market price and revenues rise. PP&L itself demonstrates this in its own brief.

For those accustomed to monopoly ratemaking, at first blush it is hard to understand how a utility whose rates are reduced today can benefit in the future. However, as noted by PP&L, each witness agreed in this proceeding that a marginal price model should be designed to determine the market cost of the last generating unit dispatched to PJM each hour. PP&L Initial Brief at 55. PP&L correctly noted:

> It is to be noted that every generating unit operating in a given hour will receive the price paid for energy from the marginal or highest cost unit dispatched. In this way, all units which run in a given hour and have costs less than the marginal cost unit will receive a price which exceeds the variable cost of running such units. Accordingly, these units will recover a portion of their fixed costs.

Id. at 56. The combination of PP&L's exceedingly low market price assumptions which result in PP&L's ratepayers paying more than the net book value of its owned generation assets over a seven year period means that, especially under the PJM market price assumptions adopted by the Commission in the PECO Energy restructuring proceeding, PP&L will not have to dedicate any of the competitive price received above its variable costs to the recovery of fixed assets. These assets would have already been paid for by ratepayers. The price differential becomes immediate profit.

PP&L's competitors, of course, will not have that option. PP&L in its brief correctly notes that capacity additions will be necessary on the PJM system due to the expected elimination of the excess capacity currently in existence. Id. Thus, competitors will be adding capacity and will have to recover fixed costs through the competitive market differential between their own variable costs and the highest cost unit dispatched. PP&L's proposal requires no such recovery and, hence, windfall profits.

PP&L goes to great lengths in its brief to attempt to justify its restructuring proposal, and even injects a host of new "adjustments" to the asset valuation methodology, the calculation of which are not on the record in this proceeding. This last effort by PP&L to "reconcile" the asset valuation methodology to the results of its flawed revenue requirements method is without merit and inappropriate. Indeed, as will be discussed later, the submittal of undocumented calculations is highly prejudicial to ratepayers. As such, it cannot be relied upon by the Administrative Law Judge.

The OCA submits that its stranded cost proposals in this proceeding are reasonable and should be adopted.

II. STRANDED COSTS.

A. PP&L's Argument That Its Present Rate Levels Justify High Stranded Costs Is Irrational.

PP&L recites its current level of rates in comparison to electric rates both nationally and in Pennsylvania. PP&L Initial Brief at 4-5. It opines that one of the goals of the Act is to spur high cost utilities to cut costs and reduce rates, and that PP&L's past efforts must be considered by the Commission in determining the reasonableness of the Company's stranded cost claim. Id. at 5. That consideration is the allowance of PP&L's stranded cost claim of $4.5 billion. Id. at 6.

PP&L's argument is without merit. As noted at pages 14-16 of the OCA's Main Brief, PP&L's own witness testified correctly that lower rates equate to lower stranded costs. Given the market prices presented by OCA witness Smith and adopted by the Commission for PJM in the PECO Energy case, there is no question that this is true. PP&L's argument that lower rates equate to higher stranded costs is little more than an unsubstantiated request that ratepayers must give back benefits attained in the past because PP&L now faces a competitive generation market. The Act countenances no such result.

B. PP&L's Stranded Cost Claim Is Not Effectively $2.25 Billion

PP&L, in this case, claimed $4.5 billion of stranded cost and posited that, under a competitive transition charge ("CTC"), it would recover $4.026 billion of stranded costs. At page 5 of its Initial Brief, it apparently attempts to make this claim more palatable by alleging that it will actually recover "only" $2.25 billion in stranded costs on an after-tax basis since it must pay income taxes on the CTC revenue. It also presents Table E which demonstrates its calculation of the alleged after-tax recoverable stranded costs.

As will be noted later, PP&L's postulation of a current income tax requirement on CTC revenues is just another in a series of alleged tax effects in this proceeding that are misplaced. The OCA submits that PP&L is mistaken and that its claim is not somehow made more acceptable by inappropriate income tax treatments.

PP&L witness Schadt first raised the contention that CTC recovery would be subject to income tax in rebuttal testimony and on oral rejoinder. Tr. 1547 (August 25, 1997). His contention was based upon the simple assumption that "revenue is revenue", and since CTC recovery represents revenue, it is subject to income tax. Tr. 1548. (August 26, 1997). Thus, he proposed treating revenues from the CTC as income. Id.

Witness Schadt's contention is incorrect. He inappropriately ignores tax depreciation that will occur and the accelerated tax depreciation that already has occurred. His contention rests upon no tax write offs in the future associated with the investment in the plant or deductibility associated with the billions of dollars invested in the plant.

The OCA submits that PP&L's current income tax treatment is unjustified.

C. PP&L's Attempted Justifications For The Stranded Cost Results Of Its Revenue Requirements Methodology Are Meritless.

PP&L in this case has attempted several justifications for the difference between its stranded cost claim and OCA's and PPLICA's stranded cost claim, especially with regard to owned generation assets. First, it focused on the determination of the market price within the various stranded cost models employed in this proceeding. The market price results are driven primarily by fuel cost assumptions. PP&L noted at page 65 of its Initial Brief that the most critical and significant input to the models is the cost of fuel to operate each unit generating electricity because fuel price is the primary component of variable cost.

In addition, PP&L through its witnesses Schadt and Guth, argued that, if properly applied, both the regulatory requirements and asset valuation methods should produce comparable results because they theoretically measure the same costs. PP&L Initial Brief at 46. The only significant difference in the two methods was argued by PP&L to be in the treatment of income taxes. Tr. 1540. (August 26, 1997).

Now, in its brief, PP&L for the first time has presented an analysis to "reconcile" the asset valuation methodology to its revenue requirements stranded cost result that consists of not only tax

adjustments, but twenty two separate adjustments. Also included are regulatory assets, NUG contract adjustments and nuclear decommissioning adjustments. Even though it makes the blanket assertion that its asset valuation adjustments as summarized in Table D of its brief were prepared from data in the record, a review of its brief evidences that in no instance was there a citation to any place in the record supporting the calculations. See, for example, PP&L brief at 7, 55, 59, 60, 74, 75, 77, 79, 84, 86, 89, 123, 127, 128 and 129. The OCA will discuss this new "analysis" later in this brief, but the presentation of non-record calculations in brief is inappropriate and highly prejudicial. As such, it should be ignored by the Commission. PP&L had ample opportunity to quantify recommended adjustments throughout this proceeding and failed to avail itself of this opportunity. In the process, it failed to give other parties the ability to respond to these quantifications.

The problem with PP&L's numerous presentations is that they are propounded for the purpose of reconciling the results of other parties recommendations to PP&L's results from employing the revenue requirements methodology. As PP&L noted in its brief, PP&L's reflection of unsubstantiated dollar adjustments for application to the asset valuation methodology is for the purpose of not only providing an alleged consistent application of the asset valuation model, but also a "full reconciliation" of the model with PP&L's preferred revenue requirements model. PP&L Initial Brief at 47. Not surprisingly, PP&L's purported adjustments to the asset valuation methodology result in the exact amount of its stranded cost claim based upon the revenue requirements methodology. See PP&L Brief at Table B, page 1 and Table D, page 1. As the OCA noted in its Main Brief, the stranded cost results of the revenue requirement methodology in this case are inappropriate. Since PP&L cannot demonstrate the reasonableness of its methodological application and its results, it tries to force the asset valuation methodology to fit its revenue requirements results. This exercise does not obviate the failings of PP&L's revenue requirements methodology.

The OCA in the balance of this section will evidence the failings of Dr. Jones' market price assumptions, the incorrect suppositions by PP&L's witnesses of the tax treatments that allegedly make the methods consistent, and the inability of the Commission to rely on the unsupported asset

valuation calculations advanced by PP&L in its brief for the first time, either collectively or individually.

1. PP&L's Market Price Assumptions Employed In Its Determination Of Generation Related Stranded Costs Are Unreasonabe.

The OCA submits that Dr. Jones market price analysis is unacceptable and should not be adopted by the Commission. This analysis has seriously contributed to the unreasonable and counterintuitive stranded cost result of PP&L's analyses.

As the OCA noted at page 23 of its Main Brief, the significant problems with Dr. Jones' recommendations center upon his projection of fuel prices. Witness Jones, through circular reasoning, arrives at a fuel price forecast that ignores *any* real fuel price increases in the future through the normalizing away of past non-stable real fuel prices, and applying today's low inflation rate for eighteen years into the future based upon the long-term surety of today's federal monetary policy.

Dr. Jones' results are also impacted by two other facts. First, concerning future market energy prices, he fails to use actual 1996 fuel prices as a starting point for his analysis even though he purports to do so. By failing to reflect December, 1996 actual prices, witness Jones continues his disregard for price increases, in this case gas price increases. Second, his capacity price assumptions do not lead to the economic viability of combined cycle (CC) or combustion turbine (CT) construction in the future.

a. PP&L Witness Jones' 1996 Starting Fuel Prices Are Understated.

Dr. Jones testified in his original testimony that he began his analysis by using plant specific fuel costs for PJM generating facilities for the year 1996. He stated the following:

> I used data and information provided to me by PP&L personnel. For the most part, these data are reported to PJM and made available to member companies. For example, the fuel related information can be found in 1996 "Allocation of Forecast Requirements" reports that each company files with the PJM Interconnection Association. This information was updated for PP&L facilities as late at (sic) November of last year. For non-PP&L facilities, fuel price data have been reviewed and, when necessary, updated by the Company's fuel department.

PP&L St. 7 at 28. Dr. Jones in his rebuttal testimony also testified that he used actual 1996 fuel prices for PJM's generating facilities in his fuel price forecast. PP&L St. 7-R at 41.

The record establishes that PP&L witness Jones did not use actual 1996 fuel costs at PJM's generating stations as a starting point for his analysis. On cross-examination, Dr. Jones acknowledged that he utilized actuals and estimates, including estimates for December 1996 natural gas prices. Tr. 1462-1463. He also noted that the data he used did not include the natural gas price spike in that month and, as noted by OCA witness Smith, Dr. Jones' proposed escalation path is not applied to actual 1996 prices which most forecasters believe were exceptionally high.[1] Id.

The OCA submits that Dr. Jones' failure to reflect actual 1996 prices leads to a consistent annual under-estimation of market prices throughout the years forecasted by Dr. Jones. As such, his results are not reliable and should not be utilized.

b. PP&L Witness Jones' Future Fuel Price Forecast Is Also Inappropriate.

Witness Jones stated that he forecasted a number of variables including the key input variables of fuel prices and variable operation and maintenance expense, in arriving at his estimated market clearing prices in PJM rather than assume that the 1996 values for these variables would prevail into the future. PP&L St. 7 at 35. He noted that market forces are "dynamic, not static" (Id. at 35) and that attempts to forecast prices by forecasting the key variables that contribute to price information is an improvement on simply assuming that variables do not change over the forecast horizon, or that "all variables change in similar ways in the future." Id. at 36-37. However, Dr. Jones' forecast did not meet his stated goals. Despite his acknowledgment of the dynamic nature of market

[1]Based upon FERC Form 1 data, Dr. Jones assumed a 1996 fuel price 10 to 15 percent lower over the actual fuel prices included at most gas-fired generators in PJM, and lower than the gas prices assumed by PECO for new combined cycle generating units in its restructuring cost. OCA St. 2 at 10. In comparison to 1996 actual oil and gas fuel prices for the same units reported in the Energy Information Administration's ("GIA") Form 423, Dr. Jones assumed 1996 base prices are 20 percent lower. OCA St. 2-S at 8.

forces, Dr. Jones essentially negates dynamic forces to arrive at a postulated constant historic real dollar level of fuel prices, to which he applies a constant 2.5% inflation factor after 1999.

Dr. Jones also testified that he looked at the variables underlying the forecasting firms estimates, including predictions about economic growth, OPEC production, regulatory trends, reserve additions, and transportation. Id. at 39.

However, despite his review of the variables attendant to forecasting, witness Jones essentially removed the effect of any of those variables by removing inflation and real price spikes from his review of historical patterns in fuel prices. This allows him to rely on a pattern of stable real prices in the past. Since fuel prices in the past have been deemed to be stable, Dr. Jones then applies a stable 2.5% inflation factor through 2016 in reliance on past behavior. The inappropriate circularity in Dr. Jones approach is clear.

Dr. Jones' use of historic trends in oil prices is central to his view of past fuel prices. As PP&L notes at page 66 of its brief, witness Jones' fuel price forecast revolved solely around his treatment of historic real oil prices. Dr. Jones' analysis of historical oil price numbers and trends is based upon PP&L's Exhibit STJ-16. As his testimony and that exhibit demonstrate, historical oil price trends only behave in the fashion perceived by Dr. Jones if not only inflation is excluded, but if price spikes are removed. As Dr. Jones noted, his reasonably narrow range of oil prices around a flat real price trend of $15.50/Bbl (1996 $) is contingent upon his removal of prior price spikes. Id. at 47.

As PP&L Exhibit STS-16 notes, the six year period of 1979-1985 is excluded from the derived $15.50 average price at 1996 dollars. See PP&L Initial Brief at page 66. Prices during this period ranged from $20/Bbl to over $50/Bbl according to PP&L Exhibit STJ-16. Thus, rather than consider variables, Dr. Jones simply, as he did with natural gas price spikes in December of 1996, removes variables from consideration in order to arrive at his flat real price assumptions.

More telling is the fact that, even at 1996 dollars, PP&L Exhibit STJ-16 evidences that actual oil prices have exceeded Dr. Jones' cited average price of $15.50 a barrel for virtually all of the past twenty years. OCA St. 2-S at 6-7.

Thus, Dr. Jones fuel price assumptions are clearly inappropriate. They are not fuel price forecasts at all, but instead consist of an historic review of oil prices that are first adjusted for inflation and are then interpreted to essentially exclude the "anomaly" of price spikes in oil prices. This analysis is then used to conceptually apply to gas and coal prices based upon Dr. Jones' views of comparable price movement between fuels. Dr. Jones then uses his analysis, which not surprisingly results in a flat real-oil price trend after all non-flat oil prices have been excised, to postulate through circular reasoning that future real fuel price escalation will be flat as well. This analysis contributes greatly to the conclusion that PP&L has a stranded cost level for owned generation assets which exceeds the net book value of these assets.

The OCA submits that PP&L witness Jones market energy price assumptions are inappropriate for use in this proceeding and should be rejected.

c. The Efficacy Of PP&L Witness Jones Real Oil Price Analysis Is Also Undermined By The Lack Of Record Support For The Historic Real Oil Price That He Relied Upon.

PP&L posits in its brief that Dr. Jones' real oil price employed in his analysis was $18/Bbl. PP&L Initial Brief at 66. Its only citation for this proposition is PP&L Exh. STJ-16. However, PP&L Exh. STJ-16 only evidences a 1996 national average wellhead price for oil in dollars per barrel. In actuality, as noted by OCA witness Smith, Dr. Jones' base year oil and gas fuel prices for 1996 were provided by PP&L staff for all PJM facilities and were substantially lower for the units provided than the 1996 actual prices. OCA St. 2-S at 8. See also OCA St. 2 at 9, Tr. 1461-1462. (August 25, 1997).

Thus, the OCA submits that PP&L's assumed national average 1996 oil price per barrel is undemonstrated as the actual fuel price for 1996 employed by Dr. Jones. The record not only does not support a figure of $18 per barrel, but also does not demonstrate that $15.50 per barrel was the equivalent oil price used by PP&L witness Jones.

d. PP&L's Inflation Assumptions Are Optimistic Over The Long-Term.

Once PP&L witness Jones determines real fuel prices, he applies an inflation factor. In this case, he chose to apply a steady 2.5% inflation rate for the economy after 1999 to his miscategorized actual 1996 fuel prices. PP&L St. 7 at 40. This decision comes down to his economic view that the viability of current federal monetary policy will continue unabated through the life of his fuel price forecast, or through 2016. Id. [2]

The efficacy of Dr. Jones inflation forecast of a flat 2.5 percent per year essentially becomes one of symmetry. In other words, the decision is whether or not it is reasonable to conclude that inflation in the future will exceed Dr. Jones' assumed inflation level, or whether it will be less than Dr. Jones' level. Dr. Jones himself notes that in making this determination the Commission should be influenced by the past and historical trends. PP&L St. 7-R at 7. A look at Dr. Jones' own presentation indicates that the past contains little comfort with regard to inflation in the future being at or below his assumed flat 2.5 percent inflation rate.

Dr. Jones has presented information concerning the difference between fuel price forecasts and actual prices for DRI and EIA. However, he nowhere provides historical inflation levels, except to note that since the early 1980's, the correlation between inflation measured as the change in GNP deflation and real oil prices has been 0.8. Id. at 30. He did imply, however, that inflation levels in the 1980's were greater than at present. PP&L St. 7 at 40.

The OCA submits that the Commission, in order to accept Dr. Jones, must also essentially ignore past inflation tendencies and believe that the current federal monetary policy will prevail and keep inflation rates at today's low levels for the next 18 years. Tr. 1400 (August 25, 1997). Dr. Jones categorically denied that there was any other parameter besides federal monetary policy that could impact inflation. He noted:

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[2] As noted earlier, Dr. Jones' proposed escalation rates for natural gas and oil are constant nominal prices through 1999 followed by increases of 2.5 percent annually thereafter.

Q. Dr. Jones, would you agree that there will be other parameters besides the monetary or economic policy of the United States that will enter into the ultimate level of inflation applicable to oil, gas and coal prices in the future?

A. No.

Tr. 1457. (August 25, 1997).[3]

The OCA submits that historical experience and the potential in the future suggests that there is a more reasoned chance that this will not happen. The assumed inflation rates of DRI and EIA, which are 3.2% and 3.1% respectively, reflect symmetry since they fall within the range of an expected future level of inflation.

It is interesting to note that the analysis presented by PP&L's cost of capital witness, Mr. Moul, is inconsistent with the basic inflation assumptions relied upon by PP&L witness Jones. Mr. Moul inherently believes that symmetry does not support the assumption of a flat 2.5% inflation rate over the next 18 years. PP&L witness Moul testified that the use of 1996 as a base period to establish a long-term rate of return on common equity is likely to result in an understatement of the cost of equity for the next thirty years. PP&L St. 8 at 4. His proposition is directly tied to the fact that interest rates in 1996 were relatively low by recent historical standards. Id. His graph at PP&L Exh. PRM-3 shows the monthly yields for Moody's A-rated utility bonds from January 1986 through December 1996. He noted that the 1996 data is from a period of relatively low interest rates by historical standards. He stated:

> Essentially, the yield on public utility bonds at the beginning of 1996 was near the trough of interest rates which occurred in October 1993. Although interest rates rose from the beginning of 1996, the average yield for the year was 7.75% for A-rated public utility bonds.

Id.

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[3] Dr. Jones did note that the economic policy of the United States will affect the nominal price of oil, gas and coal but not their real price. Tr. 1455. (August 1997). Those prices are driven by supply/demand fundamentals in those markets. Tr. 1456. (August 1997). However, as noted earlier, Dr. Jones effectively removed any real price gains from his analysis by focusing on oil prices and then ignoring any non-inflation related oil price increases.

PP&L witness Moul addressed his view of symmetry as it applies to interest rates as follows:

> Although it is always possible that interest rates could move lower, this possibility is outweighed by the prospect of higher future interest rates. That is to say, there is more potential for higher rather than lower interest rates when the beginning point in the process contains relatively low interest rates. Indeed, the average yield for Moody's index of A rated public utility bonds was 9.03% for the monthly yields from 1986 to 1996, shown on Exhibit PRM 3, when this average yield is compared to the average yield for 1996 of 7.75% noted above.

Id. at 5.

Given the tie of bond yields to levels of inflation, it is clear that PP&L witness Moul's testimony supports the view that the plausible assumption is that inflation will be greater in the future than PP&L witness Jones' incorporated levels. Indeed, OTS witness Deardorff notes the parallel between interest rates and inflation (OTS St. 3 at 15-16), and OTS Exh. 3, Sch. 4 notes that forecasting professionals are expecting treasury bills to be in the range of 4.8 to 5.2 percent over the next ten years while inflation is expected to be in a range of 2.8 to 3.1 percent. Id. [4]

e. PP&L's Assumed Relationship Of Coal Prices To Oil And Gas Prices Is Misplaced.

At page 71 of its Brief, PP&L criticizes a perceived problem with the use of the DRI and EIA fuel price forecasts. That problem is categorized as the projection of a divergence between the real prices of oil and gas versus coal. PP&L asserts that the divergence of gas and oil prices from coal and uranium prices is both illogical and unprecedented for competing fuels. Since the marginal cost units operating on PJM will normally be gas and oil fired units, and PP&L coal fired generating plants account for 38% of its generation, PP&L asserts that the divergence of coal prices predicted by DRI and EIA have a disparate effect on PP&L's stranded costs. Id. at 71-72.

To remedy this alleged problem, PP&L recalculates its stranded costs using coal prices that escalate consistent with DRI's escalation of gas prices and adjusts Table D for this adjustment as

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[4] Witness Deardorff's Sch. 4 behind his surrebuttal testimony (OTS St. SR-3) shows ten years inflation projections of 2.6% to 2.9%.

ostensibly applied to an asset valuation methodology. Id. at 74. This undocumented adjustment equals $230.157 million. Id.

The OCA submits that the coal divergence question is little more than an extension of witness Jones' inappropriate flat real price scenario for oil and gas prices. The OCA submits that witness Jones' escalation assumptions between fuel types are not supported by the record.

In his initial testimony in this case, Dr. Jones submitted no empirical evidence supporting any precedent suggesting a distinct correlation between the price of oil, gas and coal. He simply submitted PP&L Exh. STJ-3 which set forth his fuel price escalation assumptions. In his rebuttal testimony, witness Jones set forth the proposition that oil, gas and coal prices are formed in highly competitive fuels markets where inter-fuel competition plays a role in the way prices move over time. PP&L St. 7-R at 47. His supposition was that consumers can expect fuel prices that tend to move together and fluctuate in response to market conditions. Id. Witness Jones proffered PP&L Exh. STJ-16a to show correlation coefficients based on historical real price movements for oil, coal and natural gas. He testified that the coefficiency he found evidences a strong tendency to move together over time. Id. at 48. Thus, Exhibit STJ-16a is witness Jones' support for his proposition.

Exhibit STJ-16a is limited to the time frame of 1981-1995. However, it is unexplained by witness Jones whether, in applying his real historical fuel price correlations for this time period, he compared coal and gas prices to real historical oil prices including the effect of the period of 1979 to 1985 discussed earlier, or if he compared gas and coal prices to his determined real historic oil prices excluding this period. See PP&L Brief at 66. Since his real fuel price forecast is based upon real historic oil prices excluding real price spikes in this period, it has to be assumed that he consistently excluded those real oil prices for the 1981-1985 period from his fuel correlation calculations. If so, it is hardly surprising that a price comparison of flat oil and gas prices to coal prices would give witness Jones these correlation coefficients.

The OCA submits that a presumptive argument that oil, gas and coal prices move in unison over time simply because of general inter-fuel competition is insufficient without distinct support.

Witness Jones' schedule does not meet the Company's burden of proof since it does not establish that the correlation is appropriate for real historic price comparisons in the absence of price exclusions. The record does not establish any precedent as argued by PP&L in its brief at page 71 and in fact, Dr. Jones' argument appears to be simply a continuation of his flat oil price postulations. The forecasts of DRI and EIA are not debunked by witness Jones' alteration of history.

f. Witness Jones Has Never Demonstrated The Efficacy Of His Capacity Price Inputs

Several witnesses in this case have concluded that PP&L witness Jones' capacity price analysis is inappropriate since his market prices are insufficient to support additions of new capacity. See, for example, OCA St. 2 at 12-19; OCA St. 2-S at 10-20. PP&L witness Jones has never demonstrated the efficacy of his capacity price inputs.

In attempting to demonstrate the financial viability of his capacity assumptions, Dr. Jones employed a worksheet from OSBA witness Knecht to attempt to demonstrate the long-term profitability of his capacity addition assumptions. PP&L Exhibit STJ-28, STJ-28a and STJ-28b attempt to show that, with adjustments, the net present value is positive for a variety of different combined cycle units. PP&L St. 7-R at 83. However, Exhibits STJ-28a and 28b employ a capacity capital cost of $489/kw versus the assumed capital cost of $595/kw employed by witness Jones in his analysis. OCA St. 2 at 13. As OCA witness Smith cogently noted, this assumed capital cost is unrealistically low and inexplicably differs from witness Jones' market price analysis. OCA St. 2-S at 11. This fact, combined with the future to include property taxes and project insurance and a lower heat rate than the rate used by Dr. Jones' in his own analysis, leads to the proper conclusion that Dr. Jones' market price projections would not be sufficient to support the additions of combined cycle capacity that he assumed will be built in PJM. Id. at 10-11. This is because each of the factors noted above understate the cost of power from a new combined cycle plant. Id. at 12.

Dr. Jones then returned to this topic on oral rejoinder and introduced PP&L Exhibits STJ-28R, 28aR, 28bR. Witness Jones corrected PP&L Exhibits STJ-28, STJ-28a and STJ-26b to account for

two additional corrections relative to market price assumptions and heat rate values. As opposed to a start date of 2005 assumed in PP&L Exhibit STJ-28a and 28b, witness Jones time frame employed a start date of 2002. However, Dr. Jones' analysis in Exhibit STJ-28aR and STJ-28bR still assumes a lower $489/kw capital cost for combined cycle units versus the level employed in his market price capacity projection. Thus, Dr. Jones has never demonstrated the appropriate profitability of his assumed capacity addition.

The OCA submits that Dr. Jones has never demonstrated the efficacy of his capacity price assumptions in his market price analysis. He presented a series of exhibits with different assumptions and different start dates that are only heightened by the fact that he used a much lower capital cost figure constantly. Witness Jones demonstrated that combined cycle units at lower capital cost may be positive. This isn't the issue, however.

PP&L has computed an undocumented capacity price adjustment of $38.446 million based upon OCA witness Smith's capacity price assumptions. PP&L Initial Brief at 54-55; Table D at 2. The OCA submits that witness Smith's capacity prices are appropriate, as the Commission noted in the PECO Energy restructuring case. Application of PECO Energy Company for Approval of its Restructuring Plan Under Section 2806 of the Public Utility Code and Joint Petition for Partial Settlement, R-00973953 (December 23, 1997), Slip Op. at 90. ("PECO Energy Restructuring Order" or "PECO").

2. PP&L's Non-Methodological Justifications For The Facially Unreasonable Level Of Its Stranded Cost Claims Are Faulty.

PP&L raises two non-methodological arguments concerning the validity of its stranded cost recommendation and, parenthetically, the desirability of adopting its stranded cost recommendation based upon risk considerations. Both arguments are faulty.

a. Competition In And Of Itself Is No Justification For PP&L Witness Jones' Market Prices.

PP&L argues at page 49 of its Initial Brief that the OCA and PPLICA market price projections are flawed because "sharply" increasing market prices are contrary to the assumption that deregulation and competition produce lower prices. Witness Jones' postulation is that the market price assumptions relied upon by OCA witness Smith and PP&L's witness Falkenberg must be in error since they do not recognize these results as propounded by economic theory.[5] PP&L witness Kahn mirrors similar views. PP&L St. 18-R at 26-27.

While economic theory dictates that competition should certainly tend toward reducing costs and prices versus continued regulation, it is certainly a long stretch to the conclusion that general economic theory directly supports the low market price estimates of Dr. Jones and debunks the market price estimates of Mr. Smith and Mr. Falkenberg. In fact, the record demonstrates that this is not the case and the Company has failed to demonstrate that its simplistic reliance on economic theory as a predicate indeed proves the alleged result.

The assumption that the OCA's market price assumptions contradict historical forces and the expectations of major benefits to consumers is belied by those assumptions themselves. Dr. Kahn admitted that he was not asked to, nor had he, studied the basis for the OCA's market estimates. PP&L St. 18-R at 29. If he had done such a study, he would discover that the OCA's market price forecast is not contradictory to his expectations. Witness Kahn opined that utilities on the East and West coasts possess average generating costs in the range of 6¢ to 10¢ per kWh and, because of their excess capacity, possess short-run marginal costs of 1¢ to 2¢ per kWh. PP&L St.

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[5]It is interesting to note that these rules apparently don't apply to PP&L. PP&L witness Schadt argues against OCA witness LaCapra's application of a productivity offset to future plant O&M costs because of a competitive environment. He also escalates numerous costs in his revenue requirement analysis at his assumed rate of inflation recognizing no future efficiencies beyond 2001. PP&L St. 8 at 7, 11, 14 and 16. PP&L witness Jones study escalated variable O&M costs by 1.5% through 2000, and 2.5% annually thereafter. PP&L St. 7 at 42. Similarly, for emission allowance prices for SO_2, Dr. Jones assigned to EGEAS model an initial SO_2 allowance cost with the 2.5% annual inflation factor. Id. at 43. Thus, both PP&L witnesses include cost increases.

18-R at 22. The OCA's recommended market prices do not exceed 4¢ per kWh through 2006 and never reach 6¢ per kWh. OCA Exh. DCS-12. As OCA witness LaCapra testified in reference to Dr. Kahn:

> For example, he cites average generating costs in the range of 6-10 cents and contrasts that with new combined cycle costs in the range of 4 cents. Our market price forecast is below 4 cents through 2006 and does not reach 6 cents. In all years, our prices are well below the current average cost cited by Kahn, even including consideration of inflation. While our forecast is high relative to PP&L's very low forecast, it is very consistent with general expectations that generation costs in the future will be significantly lower than have been experienced in the past.

OCA St. 1-S at 4-5.

The OCA submits that general economic theory does not evidence any excessiveness in the OCA's market price assumption.

b. The OCA's Recommendation Does Not Asymmetrically Penalize The Company.

PP&L at pages 41-42 of its Initial Brief argues that the OCA's recommended stranded cost level does not represent any reasonable even-handed sharing of risks associated with stranded costs. It based its conclusion on PP&L witness Kahn's testimony. Dr. Kahn on behalf of PP&L also testified that the necessary symmetry of risks between shareholders and ratepayers required when a single point estimate of stranded costs is determined is lacking as a result of the OCA's recommended market prices. PP&L St. 18-R at 29-30. Witness Kahn notes that the rate cap under the Customer Choice Act acts to cap PP&L's regulated rates at their present levels for nine years in nominal dollars. Thus, according to Dr. Kahn, if the Commission adopts the OCA's recommendation and the stranded cost estimate turns out to be too low due to market prices below those proposed by the OCA, then PP&L would be deprived of the opportunity to recover its stranded costs. Id. at 32. Conversely, Dr. Kahn opines that if the stranded cost estimate turns out to be excessive because future market prices are underestimated, the ceilings on PP&L's rates will deny the Company the symmetrically offsetting opportunity to fully recover these overestimated sunk costs after 2005. Id. at 30-31. Dr. Kahn's hypothesis essentially means that PP&L can overrecover, but

not as much as it should. Dr. Kahn determines, therefore, that the risk to the Company of stranded cost estimates being too high or low are not symmetrical. He stated:

> But if the Commission accepts the OCA estimates, the Company will be permanently denied the recovery of its sunk or strandable costs to the extent those projections are too low, whereas it will overrecover, if the projections are too high, only under a very particular scenario of the relationship, *before and* after 2006, between competitive rates and the price ceiling imposed by the Act.

Id. at 32.

Dr. Kahn's analysis is skewed. He essentially incorrectly treats the operation of the rate cap as creating a disallowance of stranded costs. The OCA submits that a disagreement about the level of stranded costs is not the same as a disallowance of stranded costs. Obviously, the OCA contends that the market value of PP&L's plant is greater than PP&L claims. Much of the benefit from the plant, i.e. the excess of market value over costs occurs after the CTC period. Thus, that value will be retained by PP&L and the way to reflect it for ratepayers is to do a present value analysis (as required by the statute) and set the CTC at a level that reflects those benefits. Contrary to Dr. Kahn's view, there is no attempt to penalize the Company in the early years and then get the benefit in later years.

In addition, Dr. Kahn's perception of symmetry of risk as arguing for not erring on adopting low-side market price and stranded costs estimates is incorrect since the Act provides *outlets* for Dr. Kahns perceived problems. Section 2804 of the Customer Choice Act allows the Company to seek remedies from the Commission in the instance where fuel prices increase to the point where the Company can not earn a fair return. 66 Pa. C.S. §2804(4)(iii)(D). Thus, the basis of Dr. Kahn's symmetry argument, namely that PP&L bears all the risk of low projections because it will be permanently denied the recovery of costs, is simply incorrect. As OCA witness LaCapra noted:

> First, Mr. Kahn assumes that PP&L has no recourse if the Commission sets stranded costs too low. In fact, the legislation maintains specific provisions which allows the Company to seek relief if this is, in fact, the case.

OCA St. 1-S at 5.

The OCA submits that the second prong of Dr. Kahn's argument is also without merit. Again, Dr. Kahn contends that the rate cap limits the Company's opportunity if stranded costs are set too high. As noted above, this argument fails to take into account the Company's ability to use generating assets obtained at little cost to reap profits in the market. OCA witness LaCapra explained:

> Second, Mr. Kahn contends that the rate cap limits the Company's opportunity if stranded costs are set too high. This ignores the fact that, while there may be some delay in the Company's collection of the overstated stranded costs, the Company also obtains substantial generating assets for virtually no cost to operate in a market that has market prices much higher than those used as a basis for establishing stranded costs. While Mr. Kahn may believe PP&L is harmed in this scenario, the Company, in fact, could end up with a significant windfall if stranded cost recovery is set too high. In contrast, the consumers pay higher stranded costs in the transition period and higher market prices in the ensuing competitive market.

Id. at 5-6.

Contrary to Dr. Kahn's arguments, the symmetry of impacts makes it extremely important for consumers that the Commission take care to set stranded costs at reasonable projected values. PP&L's assumptions and stranded cost claim are unsupported by risk symmetry considerations since their adoption would force huge stranded cost requirements on ratepayers, while giving PP&L no cost generating assets with which to make windfall profits when market prices exceed those assumed by the Company.

3. PP&L's Methodological Justifications For Its Recommended Level Of Stranded Costs Are Without Merit.

PP&L has devoted a substantial effort to attempt to rationalize why its stranded cost recommendations, and particularly its owned generation related stranded cost recommendations, are acceptable despite their counterintuitive results.

As noted earlier, PP&L presented testimony alleging that the difference is not based upon fuel price assumptions, but rather is due to the application of stranded cost methodologies. It attempted to explain why, if calculated correctly, the use of a revenue requirements methodology and an asset valuation methodology should give comparable results. Since they do not give

comparable results, in this case, PP&L argues that OCA and PPLICA must have misapplied the asset valuation method. In essence, PP&L's position equates to little more than a manipulation of the asset valuation method to equate to the unreasonable results of its revenue requirements method. As the OCA will demonstrate, either PP&L misapplies its changes to the asset valuation methodology or it simply does not understand that methodology. As OCA witness LaCapra cogently testified, there is no need for an artificial and unnecessary constraint to bend the regulatory model to describe competition. Rather, begin with a competitive model. OCA St. 1-S at 9. In either case, the OCA submits that the record demonstrates that PP&L is in error. The record amply identifies that it is PP&L's misapplication of the revenue requirements methodology that is the problem.[6]

PP&L argued at page 46 of its Initial Brief that, when properly applied, both the revenue requirements and asset valuation methodologies should produce comparable results. The upshot of PP&L's argument is that the asset valuation method should result in stranded cost levels similar to PP&L's revenue requirements methodology results. PP&L argues that only the OCA and PPLICA's inconsistent application of that method leads to a contrary conclusion. Id.

On oral rejoinder, PP&L witness Schadt noted the following with regard to stranded cost methodologies:

> ...I want to emphasize that, correctly applied, both methods produce the same result. Both methods must project generating plant revenues, operating costs, and capital expenditures over the remaining life of the generating plants. The only significant difference in the two methods is in their treatment of income taxes.

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[6]PP&L also argues that the revenue requirements method is superior because it applies to both owned generation assets and regulatory assets. PP&L Initial Brief at 4. PP&L even argues that the use of the asset valuation methodology for owned generation asset stranded cost purposes and the revenue requirements methodology for regulatory assets results in a hybrid approach which causes serious errors in the OCA and PPLICA applications. Id. at 45-46. These arguments are specious. Generation plant represents amounts already spent which, pursuant to the statute, may be recovered on a going-forward basis. Regulatory assets are not current expenditures. They represent a future obligation that recovery is being provided for at the present time. Hence, no inconsistency exists between employing an asset valuation methodology for owned generation related stranded costs, and normal ratemaking treatment for regulatory assets. The Commission in the PECO Energy restructuring case rejected this argument by employing an asset valuation methodology for owned generation related stranded costs and a regulatory based approach for regulatory assets.

Tr. 1540 (August 26, 1997). Witness Schadt's quarrel with the income tax treatments in the asset valuation methodology is that current income taxes and taxes recoverable are not calculated "over a consistent time frame." Tr. 1541 (August 26, 1997). He notes that PP&L's methodology calculates each of these tax items over the remaining life of relevant generating assets, roughly thirty years. Id. He then opines that the OCA and PPLICA methods calculate current income taxes related to return on plant assets over seven years, the CTC period, and calculates taxes recoverable over 30 years. This perceived inconsistency leads witness Schadt to opine that this treatment results in a significant understatement of stranded costs. Id. PP&L at pages 127 and 128 of its Initial Brief presents for the first time an alleged $419 million adjustment to recognize that stranded cost related to unfunded deferred taxes will reverse over a seven year period under the asset valuation methodology.

Witness Schadt's perceptions are in error. First, it is necessary to reflect current income taxes related to return on plant assets over seven years, the CTC period. As noted in OCA's Main Brief at pages 22 and 23 PPLICA witness Kollen is correct that it is inappropriate, as the revenue requirements methodology does, to recover the present value of income taxes due to equity financing in future years beyond the CTC period when the utility will never incur these taxes because of the CTC recovery of stranded costs.

The OCA submits that there also is no inconsistency with calculating SFAS 109 deferred taxes for regulatory asset purposes over the life of the assets since the useful life of the asset will not change. In fact, PP&L does not plan to give up ownership of its generating facilities. The balance of recoverable taxes under SFAS 109 represents the future tax obligation associated with tax book timing differences for which the benefits have been flowed through to ratepayers rather than normalized. Under the actual taxes paid doctrine, these taxes would be recovered from ratepayers in the future when the timing differences reverse.

It is appropriate to recognize as a stranded cost the net present value of the revenue stream which PP&L would have received for the recovery of SFAS 109 taxes under traditional regulation,

or over the remaining life of the assets. This is because the useful lives of PP&L's generating assets are not changed as a result of the Customer Choice Act or the fact that recovery of the stranded portion of the cost of those assets would be reduced from thirty years to seven years. Indeed, witness Schadt inherently recognized that the useful lives of the Company's generating assets are unchanged since he did not also suggest that the CTC recovery period be employed for determining the net present value of the investment tax credit benefits, or regulatory liability, owed to ratepayers.[7] PP&L also recognizes that the lives of its generating assets were not changed in calculating the benefits to ratepayers of the future tax depreciation deductions associated with those assets.

The result of such an alleged "inconsistency" related to SFAS 109 taxes is that ratepayers would pay more in net present value terms than they would have paid under traditional regulation where the balance would have been recovered over thirty years. Thus, this suggested treatment violates the dictates of the Customer Choice Act. Section 2803 of the Act, 66 Pa. C.S. § 2803, defines transition or stranded costs as an electric utility's known and measurable net electric generation related costs, determined on a net present value basis over the life of the asset or liability, which would be recoverable under a regulated environment but which may not be recoverable in a competitive generation market and which remain after mitigation. This term includes regulatory assets typically recoverable under current regulatory practice.

Thus, witness Schadt's posited inconsistency with treatment of taxes is incorrect. The treatment of SFAS 109 costs in the same fashion as the Company treated them in this case is entirely appropriate.[8]

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[7]Witness Schadt calculated the annual amortization of the generation-related portion of this regulatory liability applicable to PUC jurisdictional customers beginning January 1, 1999 that would apply under traditional regulation to the end of its remaining service life, and reduced the stranded cost calculation by the present value of the annual amortization. PP&L St. 8 at 5, 28-29. See also PP&L Initial Brief at 118.

[8]The OCA would note in this regard that the OCA and PPLICA arguments on this point were not accepted by the Commission in the PECO restructuring case. PECO Energy Restructuring Order at 68-70. The OCA would, therefore, acknowledge that if the Commission is consistent with the PECO Energy decision concerning SFAS 109, the PP&L claim on this issue would have to be

Finally, witness Schadt makes the assertion in oral rejoinder testimony that, since the asset valuation method determines the price that a willing buyer would pay for PP&L's generating plant today (Tr. 1541 (August 26, 1997)), the employment of that model in this case is improper by failing to reduce the market value of assets to reflect Accumulated Deferred Income Tax (ADIT) that would be payable upon sale. Witness Schadt stated:

> Well, it occurs primarily because of the mishandling of deferred taxes. If the Company were to sell its generating assets on January 1, 1999, for the market value estimated by either the OCA or PPLICA, the associated deferred taxes would immediately reverse and become payable in 1999.
>
> However, the OCA/PPLICA method ignores this fact and treats deferred taxes as if they will not reverse upon the sale of related assets. As a result, they have significantly understate (sic) the Company's actual stranded costs.

Tr. 1542 (August 26, 1997).

PP&L in its Initial Brief at pages 129-131 argues that the OCA's asset valuation methodology fails to account for deferred taxes and shortchanges the Company by failing to reflect the fact that deferred taxes must be paid when the plant is sold. PP&L argues that, by failing to reflect these tax payments, the OCA overstates the value of PP&L's assets. PP&L "corrects" this error by reflecting an undemonstrated stranded cost allowance of $281.671 million in Table D.

The OCA submits that witness Schadt's postulation and PP&L's argument is incorrect and that his testimony evidences a misunderstanding of the asset valuation model. It is instructive to differentiate between the two types of deferred taxes. The first element is SFAS 109 deferred taxes which represent tax benefits flowed through to ratepayers that will be paid in the future. As just noted, these deferred taxes are treated for stranded cost purposes as a regulatory asset. The second element is ADIT which represents future tax benefits that the Company has retained for itself but will also be payable in the future.

OCA witness LaCapra, as clearly delineated on OCA Exh. RLC-6, reflected for purposes of his initial recommendation in his net present value contribution to margin a calculation of $794.699

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increased.

million for the book balance of deferred taxes representing ADIT. PP&L witness Schadt may be confused by his perception of the asset valuation methodology. He testified that the asset based model calculates the present value of the market-based revenues less cash expenses from generation and compares this with the sum of the book value of generation assets and regulatory assets. PP&L St. 8-R at 7. Witness LaCapra's method, of course, must not only calculate the net present values of operating margins, but also adds the net present value of deferred income taxes. OCA St. 1; Exh. RLC-6. This treatment adjusts the net present value of operating margins to account for the fact that a buyer will acquire a tax basis with the plant. This treatment precisely mirrors PECO's and OCA's methods that were adopted by the Commission in the PECO restructuring order.

Thus, contrary to witness Schadt's hypothesis, witness LaCapra's asset valuation model provides the Company not only with the net present value of operating margins associated with its assets but also with the ADIT deferred taxes payable associated with the assets. Thus, the treatment of deferred taxes under the asset valuation methodology is not an example of the "mix and match" approach alleged by PP&L. PP&L Initial Brief at 130-131. In reality, Witness Schadt's testimony simply evidences a misunderstanding of the model.

4. PP&L's Asset Valuation Methodology Reconciliation Can Not Be Relied Upon.

As noted earlier, PP&L has, for the first time in its brief, presented a plethora of unsubstantiated "adjustments" to reconcile the asset valuation methodology to exactly equal its inappropriate revenue requirements stranded cost results. PP&L even had to include unexplained miscellaneous adjustments to allow its reconciliation to exactly balance. PP&L Initial Brief at Table D. These adjustments cannot be relied upon by the Commission.

First, the calculation of the adjustments has no record support. PP&L had the opportunity to present these calculations, and indeed its new presentation, during the trial of this case. It did not do so.

Second, the preferred dollar adjustments simply aren't plausible as presented. For example, it is unclear how PP&L's discrete monetary adjustments treat the heat rate question. While PP&L at pages 61-63 of its brief argues for the use of Dr. Jones' incremental approach versus OCA witness Smith's average approach which was adopted by the Commission in the PECO Energy restructuring case, it does so in support of its revenue requirements methodology. It is unclear whether PP&L in its "reconciliation" assumed the proper treatment of this issue in its view of the asset valuation methodology.[9]

Also, PP&L now argues for a coal price adjustment that is not tied to either OCA witness Smith's or PP&L witness Jones' treatment of coal versus gas and oil prices in this case. It is based upon the calculation of coal prices at the same rate as gas prices after 2000 in the OCA's recommendation. PP&L Initial Brief at 71-74.

The impact of the treatment of these two parameters impact on other results, as do other assumptions. If a change is made to a fuel price and an import assumption, the net result would be impacted. PP&L has done both in its calculations but there is no way of telling if it properly dealt with the interaction. See also PP&L Initial Brief at 60. It is not at all clear, therefore, since these calculations were not presented during the case, whether PP&L's new calculations are stand alone numbers or are additive numbers.

This creates problems with any use of these numbers. If PP&L's presentation indeed is interactive, then the calculated adjustments are useless on a stand-alone basis. If the calculated adjustments are not incremental, then it is useless to sum them as a "reconciliation." PP&L itself appears to not be certain of its own presentation. At page 48 of its brief, it states that Table D should be used to derive the value of any adjustments. This suggests that the numbers are appropriate to be used on a stand-alone basis. It then goes on to state that changing one item will likely have

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[9]While the Company noted that the use of the average heat rate assumption in its EGEAS model has a $37 million impact (PP&L Brief at 63), there is no mention of the heat rate treatment under its "reconciliation".

secondary effects on other figures which would have to be reconciled in the Company's compliance filing. Id. This suggests that the numbers are interactive and thus, correctly totalled and not subject to stand-alone use.

The problems created by PP&L's new presentation are obvious. The invitation to allow the Commission to accept individual adjustments that may or may not be appropriate on a stand-alone basis, and then allow PP&L in a compliance filing to determine whether or not the numbers were really stand-alone or not, is unacceptable. PP&L should have placed these numbers in the record so that other parties could deal with these questions. Allowing the use of calculations that only PP&L has any knowledge of, which will continue through the compliance filing process, is highly prejudicial, completely unacceptable, and threatens the viability of a very important process.

5. Several Additional Adjustments Advanced By PP&L In Its Brief Are Inappropriate.

PP&L in its alleged "reconciliation" of the asset value methodology raised numerous adjustments that not only have calculated values, but are based upon references to no testimonial citation. The OCA will respond to several of these adjustments.

a. The ENPRO Model Is Not Deficient Based Upon The Number Of Units Modeled.

PP&L argues that the ENPRO model is deficient since it can model "only" 200 units. Thus, OCA witness Smith must aggregate certain units. PP&L Initial Brief at 59. PP&L then states, without any record support at all, that the problem with aggregating units is that it raises energy prices by using the average cost of the aggregate group rather than the lowest cost at all times. Id.

PP&L's argument is specious. The record evidences exactly the opposite. When questioned about his aggregation, OCA witness Smith noted that the aggregation was comprised of the smallest and most expensive units in the system, including a number of 20 MW combustion turbines located remotely that are not efficient. Tr. 1511 (August 25, 1997). More importantly, the aggregation had a minimal effect on witness Smith's analysis. He stated: "We grouped a lot of these so that their

impact of aggregation versus not, if you will, for those units is minimal." Id. See also Tr. 1502 (August 25, 1997).

As noted in the OCA's Main Brief, the Commission in the PECO restructuring case adopted the ENPRO model. It perceived it to be quite suitable to the task of estimating market price and resulting generation market revenues. PECO Energy Restructuring Order at 89. It also expressly found that OCA witness Smith's model fairly represents such important matters as unit commitment. Id.

PP&L's argument is meritless and should be disregarded.

b. OCA Witness Smith's Dual Fuel Unit Treatment Is Appropriate.

PP&L alleges that OCA witness Smith's assumption that units which can be fired with either oil or gas will use oil one half of the time and gas one half of the time is unrealistic and biases electricity prices upward since fuel units can be presumed to use the lower fuel price. PP&L Initial Brief at 59. It calculates an adjustment of $159.298 million for this presumed problem. Id.

PP&L's argument is incorrect. Dual fuel units within PJM are peakers and have no impact on average market price. Over time, the long-term market price is constrained by the all-in costs of combined cycle units. Indeed, PP&L's calculation is highly questionable given the small number of dual fuel units on the entire PJM system. OCA witness Smith testified that the representation of multi-fuel generating units is a minor source of difference between his market prices and Dr. Jone's prices. Tr. 1502 (August 25, 1997). Once again, the Commission expressly agreed with OCA witness Smith's approach to fuel use by dual fuel units. PECO Energy Restructuring Order at 90. PP&L's argument and, in particular, its calculation of any impact, is incorrect and must be rejected.

c. OCA Witness Smith's Import Assumptions Are Appropriate.

PP&L argues that OCA witness Smith significantly reduces the availability of imports from outside PJM after 2005 without explanation or justification. Because imports from the west are generally at lower costs, PP&L argues that this increases the price of electricity in PJM. PP&L Initial

Brief at 60. PP&L derives an unexplained adjustment based upon alleged overstated market value of $226.296 million. Again, PP&L's argument is specious.

In fact, OCA witness Smith did adjust his methodology to consider the import concerns of PP&L. He adjusted the way purchases from outside PJM were represented in the ENPRO dispatch simulation model by increasing the hourly flexibility of energy imports from the East-Central Area Reliability Council ("ECAR"). This change increased the amount of PJM energy imports and lowered the projected PJM market energy price modestly in the near term, with the price effect declining over time. OCA St. 2-S at 2-3. Witness Smith also replaced the sharp drop in imports assumed in his initial analysis with a smoother decline over a six-year period. The effect of the change was minimal. Id. at 3.

PP&L's only possible rationale for arriving at a figure for overstated market value, although not argued, must be an assumption that capacity on ECAR will remain at levels supporting sales to PJM indefinitely into the future. What is unexplained is why ECAR will differ from PJM. As noted by OCA witness Smith, PJM's capacity reserve requirement of eighteen percent will dissipate and PJM will require additional capacity after the year 2000. OCA St. 2 at 18. PP&L has failed to demonstrate why ECAR will continue, over the long term, to have capacity available. The basis for its adjustment is unreasonable.

PP&L also references PP&L Exh. STJ-33 to evidence the "correction" of the alleged inconsistencies in witness Smith's use of the ENPRO model. PP&L Initial Brief at 60. Apparently unheeding of witness Smith's revisions for imports, PP&L witness Jones kept imports constant from 2005 forward. Tr. 1459 (August 25, 1997). He thus reversed the decline in ECAR imports into PJM and assumed constant imports into the pool over time. Tr. 1502 (August 25, 1997). However, as noted by OCA witness Smith, Mr. Jones did not take the next logical step of re-evaluating the expansion plan for new generating units. Tr. 1502-1503 (August 25, 1997). Any reevaluation of new base load would have resulted in a higher market price than determined by witness Jones in PP&L

Exh. STJ-33. Tr. 1503 (August 25, 1997). Thus, witness Jones' exhibit does not represent what it is purported to show.

The OCA submits that PP&L's arguments relative to imports are without merit. While price may be lower, PP&L has never demonstrated the continued availability of the imports. As before, the Commission in the PECO case found that OCA witness Smith fairly represented imports and exports. PECO Energy Restructuring Order at 89.

d. OCA Witness Smith's Nuclear Capacity Factor Is Reasonable.

PP&L witness Jones employed a forecasted 78% nuclear capacity factor in his analysis. PP&L argues for use of that capacity factor versus the 75% nuclear capacity factor employed by OCA witness Smith. PP&L Initial Brief at 78-79. Once again, PP&L advanced an unsupported calculation evidencing a $46.679 million difference that would increase the asset valuation methodology result. Id. Such a result, however, is counterintuitive. An increased capacity factor for low cost nuclear units would tend to reduce stranded costs as the units earned more market revenue from increased operation.

As PP&L observed, the Commission in the PECO case adopted witness Smith's analysis which reflected a 75% nuclear capacity factor. Id. at 79. This capacity factor was consistent with industry averages. PECO Energy Restructuring Order at 89. The OCA submits that consistency demands that this capacity factor based upon historic industry averages be employed for PP&L as well since the PJM market price is the measurement ultimately at issue.

In addition, PP&L argues that the adoption of a 75% capacity factor would somehow penalize PP&L. PP&L Initial Brief at 79. While PP&L did not demonstrate why that statement is correct, the argument even if demonstrated is not controlling. The important point is striking a consistent PJM market price.

e. OCA Witness LaCapra's NUG Capacity Factor Is Reasonable.

PP&L argues at pages 83 and 84 of its brief that OCA witness LaCapra's capacity factors for NUG costs are inappropriate. PP&L again calculates an undemonstrated increase in stranded costs of $56.911 million associated with that treatment within an asset valuation methodology.

The OCA demonstrated at pages 55-58 of its Main Brief the unreasonable nature of relying on 1994-1996 historical experience for NUGS, as PP&L did. The OCA's position has been supported in the brief of Schuylkill Energy Resources, Inc. and Gilberton Power Company at pages 29-30. These entities, of course, are non-utility generators who certainly are well aware of the generation characteristics of NUG projects. PP&L's NUG estimates should be rejected.

f. The OCA's Application Of Generating Unit Retirements In Its Calculation Of Stranded Cost Is Appropriate.

PP&L, at pages 86 and 87 of its brief, notes that OCA witness Smith's application of ENPRO assumes that all plants will remain in service throughout the projection period. It also noted that OCA witness LaCapra accepted PP&L's book retirements, with the exception of extending the lives of Keystone and Conemaugh, in calculating stranded costs. PP&L then asserts that, if PP&L's retirement lives were employed in OCA witness Smith's market price analysis, stranded costs would be increased by an undocumented $144.181 million. Id. at 87.

PP&L's assertion is incorrect. Going out in time in the market price analysis, the market price of energy and capacity is determined by the cost of new combined cycle units. OCA St. 2 at 14. The all-hours market price never exceeds that amount. Thus, any "adjustment" based upon retirements to OCA witness Smith's market analysis is in error. OCA witness LaCapra appropriately dealt with retirements in his calculation of stranded costs, and he accepted PP&L's book retirements with one appropriate exception.

g. In Determining The Market Value Of PP&L's Generating Assets, OCA Witness LaCapra's Treatment Of Capital Additions Is Appropriate.

PP&L correctly notes that, in determining the market value of PP&L's generating assets for stranded cost calculation purposes, OCA witness LaCapra treats capital additions as expenses in

the year in which they are incurred. PP&L Initial Brief at 126. PP&L also correctly notes that witness LaCapra reflects the full associated tax deductions in the year in which the underlying capital expenditure is incurred. Id. PP&L then argues that, with no record cite, the treatment is incorrect since tax laws require that a deduction equal to the nominal value of the expenditure be spread over the life of the investment utilizing IRS tax depreciation guidelines. Id. at 127. PP&L then advances yet another undocumented calculation of $165.318 million for the alleged understatement of PP&L's stranded costs due to an alleged understatement by the OCA of the actual cost of capital additions and the overstatement of net market revenue through the tax reducing effect of that expenditure. Id.

PP&L's postulation is yet another example of its attempt to force an asset valuation methodology to match the revenue requirements approach. While the income statement and balance sheet approach to capital additions referenced by PP&L is preferred by it from a regulatory requirements methodology perspective, there is nothing that indicates that it must be employed for plant valuation in a stranded cost methodology.

Under the asset valuation methodology, the market value of the generating assets is an estimate of the amount a willing buyer would pay for the assets. OCA witness LaCapra's capital additions application essentially is a discounted cash flow method that recognizes the concern of a potential investor for cash flow. Under either an annual approach or a balance sheet approach, there is still the same capital investment level and the same level of tax.

III. RECOVERY OF STRANDED COST

A. PP&L's Claim That An Equity Allowance On Unamortized CTC Balances Set At A Long-Term Debt Cost Rate Must Be Grossed Up For Income Taxes Has Been Rejected By The Commission.

The OCA at pages 73-79 of its Main Brief recommended a CTC rate design that allowed a return on the unamortized balance associated with the recovery of stranded costs associated with

NUG's and regulatory assets, but no return on the unamortized balance of owned generation related stranded costs.

The Commission in the PECO Energy restructuring case determined that a return should apply to the unamortized recovery of all stranded costs recovered through the CTC at the level of PECO's long-term debt. The Commission noted:

> We have concluded that PECO should receive a rate of return on the unamortized balance of its authorized recoverable stranded costs at a rate consistent with PECO's receipt of payment and the risk of non-recovery. The duration and risk associated with long-term debt is commensurate with that associated with the CTC recovery during the transition period.

PECO Energy Restructuring Order at 107. PP&L at page 143 of its brief opines that, if that treatment is to be followed, its 7.89% long-term debt cost must be grossed up for income taxes since a substantial portion of PP&L's assets are financed with securities on which PP&L pays dividends that are subject to income taxes.

The Commission has rejected this income tax treatment. Application of PECO Energy Company For Approval of its Restructuring Plan Under Section 2806 of the Public Utility Code and Joint Petition for Partial Settlement, R-00973953 (February 5, 1998), *Slip op.* at 5-7. ("PECO Energy Compliance Order"). Competitive Intervenors Brief at 20.

IV. RATE DESIGN

A. The Benefits Of The Act Must Be Extended To All Customers During The Phase-In.

In this case, both the Competitive Intervenors and Schuylkill Energy Resources, Inc. and Gilberton Power Company argued against PP&L's Basic Utility Supply Service ("BUSS") proposal to serve customers who have not yet been offered the legal right to choose, customers who choose not to choose, customers whose suppliers fail to deliver and customers who return to PP&L BUSS service after choosing an alternative supplier. The main problem that these parties have with PP&L's proposed BUSS service is that electricity will be provided by a PP&L competitive generation

division and will be priced at prevailing wholesale market levels. See Schuylkill Energy Resources Brief at 6-10; Competitive Intervenor Brief at 13-23.

The Competitive Intervenors request the determination of a "shopping credit" similar to the PECO restructuring decision. That credit would be established as the difference between current rates and the combination of the T&D and CTC components. Competitive Intervenors Brief at 12-13. Thus, in arguing against BUSS, the Competitive Intervenors request that default customers served under BUSS must be served at current regulated tariff rates until the Commission reduces those rates pursuant to Chapter 13 or promulgates regulations pursuant to Section 2807(e)(2) and (3) of the Act. 66 Pa. C.S. § 2807(e)(2) and (3).

The arguments of these parties highlight the necessity to reflect rate reductions to customers as a result of this proceeding. As the OCA noted at page 81 of its Main Brief, the reflection of the entire difference between the Company's capped rates and the combination of the T&D charge and the levelized CTC as a "shopping credit", even if it exceeds the established prevailing market price; means that customers who remain PP&L customers for whatever reason must pay a generation rate that is higher than the applicable market rate. As the OCA argued, all customers should have the opportunity to receive the rate savings proposed in OCA's testimony, not just customers who leave PP&L. This is especially important during the phase-in period when many customers will be ineligible to choose an alternative supplier.

Further, the Competitive Intervenors argument that any rate reductions for POLR customers must be pursuant to a Chapter 13 case filed by ratepayers is untenable and inconsistent with the Act's direction to move away from the regulation of generation. 66 Pa.C.S. §2802(14). Further, as the OCA has demonstrated in this proceeding, rate reductions are necessary for all customers to prevent PP&L from overrecovering stranded cost and receiving future windfall profits.

Next, Section 2807(e)(3) of the Act makes clear that, after the phase-in period, customers who have not chosen an alternative supplier are to be served by the utility or a Commission-approved provider of last resort at "prevailing market prices" and all reasonable costs, subject to the

rate caps established in Section 2804 of the Act. 66 Pa. C.S. § 2807(e)(3). At that point, PP&L's BUSS proposal and alternative market-based default rate proposals may be considered.

Thus, the OCA submits that the generation rates charged by PP&L for customers who continue to purchase generation from PP&L should not exceed prevailing market rates, including reasonable costs. In order to achieve that result, PP&L's rates must be initially reduced by the amounts set forth in the OCA's testimony. At the completion of the phase-in, PP&L's default generation rates will be set at prevailing market prices (including reasonable costs) as determined by the Commission's regulations to be established under Section 2807(e)(2) and (3) of the Act.

B. OCA's Reflection Of Certain Of The Generation Related A&G Costs In The Competitive Market Price Is Appropriate.

As the OCA noted at pages 78-79 of its Main Brief, OCA witness Lee Smith included within the avoidable generation component of her recommended rates certain administrative and general costs required to market, aggregate load, reconcile load and supply, deal with PJM, write contracts, etc. OCA St. 4 at 13; Exh. LS-5 at 3. It is appropriate to recover these costs through the adjusted market price of power since these are costs attendant to service that either PP&L or alternative suppliers will provide to customers purchasing generation. Id.

PP&L argues that the Commission's decision in the PECO Energy restructuring case mandates that $402.7 million, representing this portion of generation related A&G costs, must either continue to be recovered as generation related stranded costs or through regulated transmission and distribution rates. PP&L Initial Brief at 123. The OCA submits that the PECO restructuring decision is distinguishable from this case and that PP&L's argument is without merit.

As the OCA noted at page 79 of its Main Brief, PECO had not allocated any A&G costs to the production function. Thus, the costs were contained within the transmission and distribution function. Thus, its stranded cost claim contained no stranded costs associated with A&G. The Commission determined that the reallocation of A&G costs from transmission and distribution to the production function increased PECO's stranded costs. PECO Energy Restructuring Order at 60-62.

Here, PP&L already allocated certain A&G costs to the generation function. Thus, its stranded cost claim already included A&G costs. And, the OCA has not removed all generation related A&G costs from stranded costs. It has reflected appropriately in market price that portion of generation related A&G costs that are a function of the competitive generation market and will be recovered in the competitive market.

Thus, the issue becomes whether OCA's treatment of generation related A&G costs between stranded generation costs and avoidable generation costs which are collected in the competitive market price is reasonable. PP&L argues that the OCA's treatment of these costs effectively eliminates these A&G expenses and precludes their recovery. PP&L Initial Brief at 123. This hypothesis is based upon the assertion that these costs are necessary for PP&L to continue to provide service to its customers and, thus, will not disappear following the transition to competition. Id.

PP&L mischaracterizes the issue. The OCA's treatment does not suggest that the costs are not necessary or that the costs will disappear. The issue is which of these costs are appropriately within the generation production function and subject to stranded cost treatment, and which are appropriately collected through the avoidable generation component or market price, in the competitive market. PP&L's position essentially assumes that all generation related assets are subject to the non-competitive production function. The OCA's proposal recognizes that certain of these costs relate to the provision of power in the competitive market and are subject to collection through that market. OCA St. 4 at 13. A review of the type of A&G differentiated by the OCA can lead to no other conclusion than these costs appropriately rest with the competitive generation function. Id. PP&L does not argue to the contrary.

Thus, the OCA's reflection of certain of the generation related A&G costs as part of its market price is reasonable and is not precluded by the Commission's PECO Energy decision.

V. UNBUNDLING OF METERING AND BILLING SERVICES

A. Future Unbundling Of Metering And Billing Services Is A Possibility Which The Company Should Begin To Prepare For At The Present Time.

1. Introduction

PP&L asserts that, based on PECO, metering and billing services are to be solely provided by EDCs. PP&L M.B. at 177. Consequently, the Company supports the use of Commission-approved "qualified meters" and adherence to open architecture standards for all metering services hardware and software. Id. at 178-179. However, the Company is not inclined to allow alternative suppliers to bill on its behalf (alternate supplier single billing) or provide metering services to customers. Id. at 178.

As set forth in the Main Brief of the OCA, the OCA submits that many of the Company's proposed metering and billing proposals "do not reflect the current trends in exploring competitive metering and billing and could foreclose future developments in this area." OCA M.B. at 99. Consequently, such proposals by the Company should be rejected. Id. Instead, the Company should adhere to provisions which are more oriented towards possible future competition in the areas of metering and billing service. Id.

Although the Commission refrained from unbundling metering and billing services in PECO, the Company should still make an effort to ensure that its operations and systems are compatible with future competition in these areas. As set forth in PECO, the Commission simply refrained from unbundling metering and billing at the present time. PECO at 139-140. However, the possibility of future unbundling of these services has been left open. PP&L's present efforts should take into account this possibility.

In a similar fashion, because the Company proposes to implement a new billing system in 1999, the OCA submits that in establishing this system the Company should "incorporate the ability of alternate supplier billing, i.e., an alternate supplier's ability to bill on behalf of PP&L, into the framework of its new system." OCA M.B. at 100. Consequently, for the reasons set forth above and

in the OCA's Main Brief, the Company should adhere to the provisions previously recommended. See OCA M.B. at 99-100.

VI. CONSUMER EDUCATION AND PROTECTION

A. PP&L's Consumer Education Plan Should Be Modified In Several Respects Prior To Its Implementation.

1. Introduction

Although the Company intends to support a consumer education initiative comprised of a statewide effort coupled with a local EDC effort, PP&L's proposed consumer education plan remains inadequate at this time. In its Main Brief, the Company states its willingness to support and participate in a statewide consumer education effort while also recognizing the need for a local effort spearheaded by PP&L to better educate customers within its service territory. PP&L M.B. at 183. Although this two-pronged approach is supported by the OCA, the OCA submits that the Company's proposed consumer education plan for its local efforts should be modified.

2. PP&L's Customer Choice Handbook Is Excessively Narrow In Scope And Fails To Provide A Neutral, Unbiased and Informative View Of Pending Retail Competition.

The Company's Customer Choice Handbook will be the "centerpiece" of its consumer education plan. PP&L M.B. at 182. PP&L asserts that the Handbook will "include an overview of the restructuring of the electric utility industry, an explanation of customer choice and how it works, consumer protection tips, worksheets for determining the customer's choice of suppliers and answers to important questions about the retail access market place." Id. Although the OCA applauds the Company's efforts in seeking to educate consumers within its service territory, as will be explained below, PP&L's currently proposed consumer education plan requires modification.

As set forth in the Main Brief of OCA, PP&L's consumer education plan is a "top down" plan which teaches consumers about the basics of retail competition while failing to identify specific underlying themes associated with the transition from regulation to competition. OCA M.B. at 91.

Since the Handbook will be the centerpiece of PP&L's education plan, this reference document must be as unbiased and informative as possible. However, it fails in both respects.

As set forth fully in OCA's Main Brief at 91-92, the Handbook, as it currently exists, has many shortcomings. For example, the "Consumer Protection Checklist" emphasizes risk rather than opportunity and the "Shopper's Worksheet" fails to address consumer concerns regarding supply mix. OCA M.B. at 91-92. Furthermore, the Handbook in general fails to motivate customers to take part in the pending competitive market. Id. Consequently, the Company's proposed consumer education plan must be modified to reflect a more neutral, unbiased and informative plan. PP&L's eventual consumer education plan should be broader in scope while also seeking to motivate consumers to become interested in the pending retail access market. OCA St. 5-S at 3.

3. Adequate Funding And More Efficient Resource Allocation Are Needed Prior To Implementation Of The Company's Proposed Consumer Education Budget.

PP&L's proposed consumer education budget is set forth at PP&L Exhibit DGL-2. The Company submits that this preliminary budget will enable it to meet its consumer education goals for the next five years. PP&L M.B. at 184. However, as set forth in the Main Brief of OCA, the amount of funding needs to be increased in addition to a more efficient resource allocation.

In its Main Brief at 92-93, the OCA documented a series of shortcomings inherent in the Company's proposed consumer education budget. Among these are 1) the inadequate level of funding, 2) failure to provide adequate funding for community-based organizations, and 3) failure to allocate funds for multi-media techniques. OCA M.B. at 92-93. Consequently, based on its budget and intended initiatives, the OCA submits that PP&L needs to increase the level of funding while allocating resources in a more efficient manner if its consumer education plan is to be as successful as it can possibly be. Id. at 93.

B. PP&L's Proposal To Phase-Out Or Deny Access To Rate RTS To Those Customers Who Enter The Competitive Market And Then Return To The Company's Basic Utility Supply Service Should Be Rejected.

The Company proposes that RTS customers who shop and then return to Provider of Last Resort Service be treated as "new" customers, thus foreclosing their return to the RTS rate which has been closed to new customers. PP&L M.B. at 152. However, as explained in the Main Brief of the OCA, those customers currently served under the Company's RTS schedule should be allowed to return to PP&L's provider of last resort service at their previous rates. To deny these customers this ability would violate the rate caps set forth in the Act and the Commission's previous Order regarding this service. See OCA M.B. at 104-106.

Under the Company's Rate RTS (a special thermal storage heat rate), customers who previously installed certain electric thermal storage systems are served under this specific tariff rather than the Company's other residential tariff, Rate RS. See Pennsylvania Public Utility Commission v. Pennsylvania Power & Light Company, R-00943271 (Order entered September 27, 1995). In PP&L, the Company proposed to continue "providing service to existing RTS locations throughout the life of the existing thermal storage units", but to close the rate to new customers. The Commission accepted the Company's proposal as it was modified during the proceeding. Id. at 216, 219.

PP&L's proposal to treat current RTS customers as "new" customers should they leave the RTS rate for competition and then return to BUSS must be rejected. As OCA witness Alexander explained:

> [t]he Commission approved PP&L's proposal to close the rate to new customers. However, the Commission also found that service to the existing RTS locations be provided at the RTS rate throughout the life of the existing thermal storage unit and adopted the OCA position that the rate differential not be cut off on a date certain as PP&L had proposed [citation omitted]. I understand this to mean that even a new customer who purchased a home with an existing thermal storage unit would qualify for the RTS rates. Thus, RTS customers who return to service with PP&L at the existing thermal storage unit location must also be permitted to return to service on the RTS rate for the length of the rate cap period. To not allow RTS customers to return to the RTS rate during the rate cap period may constitute a violation of the rate cap for these customers if the total charges to the customers upon return to the

regulated BUSS service are higher than the total charges to the customer as of the effective date of the rate.

OCA St. No. 5 at 48-49.

As witness Alexander recognized, in the PP&L order, the Commission directed that the rate must continue for service to locations. Consequently, if an RTS customer decides to enter the competitive market and then return to the Company's BUSS at the same location, that customer must be entitled to the RTS rate in effect at the customer's location. Otherwise, the rate cap provisions of the Act would be violated. Based on PP&L and Section 2804(4), the Company must be precluded from denying an RTS customer access to the rate when the customer returns to PP&L's BUSS.

VII. CODE OF CONDUCT AND COMPETITION ISSUES

A. Joint Marketing Between PP&L And Its Generation Supply Division Should Be Prohibited.

1. Introduction.

PP&L sets forth its proposed Code of Conduct at Exhibit RMG-4. This Code is intended to govern the relationship between PP&L and alternate suppliers (including PP&L's generation supply division). PP&L M.B. at 163. Although the OCA has no reason to believe that the Company will engage in anti-competitive behavior which will advantage its supply division while disadvantaging other alternate suppliers, certain provisions must be followed to prevent the likelihood of such occurring.

In its Main Brief, the OCA outlined those provisions which should supplement the Company's proposed Code of Conduct. See OCA M.B. at 107. Among these is a prohibition on joint marketing which, as explained below, will lessen the likelihood of PP&L's supply division benefitting when alternate suppliers may not.

2. Joint Marketing

The Company proposes to engage in joint marketing activities with its supply division so long as "comparable opportunities" for joint marketing are afforded to alternate suppliers. PP&L M.B. at 173-174. Although the Company attempts to level the playing field, the ultimate determination of a "comparable" opportunity is vague and may rest with the Company. Consequently, this determination becomes subjective and can be abused to the detriment of alternate suppliers. A prohibition on joint marketing between the two entities similar to provisions adopted in Massachusetts and recommended in Vermont is a more appropriate solution.

Additionally, the dangers of joint marketing between the two entities raise consumer education concerns. As previously stated, the OCA is concerned with the ability of the Company to separate its educational efforts from its marketing efforts. OCA St. 5 at 15. It will be extremely difficult for PP&L to distinguish its consumer education efforts from information and/or marketing. As evidence of such, even though the Company's pilot programs are not yet fully functional, PP&L has already been compelled to re-determine what actually constitutes consumer education. See OCA St. 5 at 16; PP&L St. 17-R at 14. By jointly marketing with its supply division, the Company merely increases the chances of customer confusion regarding education and corporate cross-subsidies to the possible detriment of a fully competitive market. A prohibition on joint marketing would lessen the possibility of either of these events occurring with unplanned regularity. Consequently, the OCA continues to assert that joint marketing between PP&L and its supply division be prohibited. OCA M.B. at 107.

C. PP&L Customers Should Only Be Required To Place A Single Call To Establish Service.

Due to "slamming"concerns, i.e., the unauthorized switching of a customer's energy supplier without his or her knowledge, the Company proposes that a customer provide PP&L with direct confirmation whenever he or she switches energy suppliers. PP&L St. 14 at 6; PP&L M.B. at 181. As set forth fully in the OCA's Main Brief at 97, to avoid unnecessary restrictions on changing

suppliers, when a customer initiates service with an alternate supplier, no further written notification or documentation should be required. The OCA submits that the Company should be directed to conform its procedures to those set forth in the Main Brief of OCA at 97.

VIII. UNIVERSAL SERVICE AND CUSTOMER ASSISTANCE PROGRAMS

A. Although The Company Proposes To "Ramp Up" Spending In Its Universal Service and Customer Assistance Initiatives, More Must Be Done To Ensure That These Efforts Reach Their Intended Beneficiaries.

1. Introduction

The Company's universal service program consists of, among other initiatives, WRAP (Winter Relief Assistance Program) and OnTrack. These programs serve as PP&L's LIURP (Low-Income Usage Reduction Program) and CAP (Customer Assistance Program) initiatives, respectively. PP&L does propose to increase spending for these programs while establishing less stringent eligibility criteria, however, as will be explained below, additional modifications are needed to ensure the effectiveness of these programs.

2. The OnTrack Funding Level Should Be Increased To $11.7 Million Per Year On An Ongoing Basis.

PP&L proposes to increase OnTrack spending to $9 million per year by 2002. PP&L M.B. at 188. This funding level would continue on an ongoing basis beyond 2002. OCA M.B. at 114. Although the OCA only recommends a funding level of $2.7 million more than the Company's proposal, PP&L adamantly opposes any increase beyond its proposed amount. PP&L M.B. at 189. The Company argues that OCA's proposed funding level was not envisioned by the Act and should therefore be rejected. Id. at 190. However, as set forth by OCA witness Brockway:

> The OCA's proposed annual funding level of $11.7 million for OnTrack is only $2.7 million more than PP&L's proposal. OCA St. 6-S at 5. Furthermore, $11.7 million is well below the dollar value of uncollectibles associated with low-income customers and also represents a modest portion of the Company's present revenues. Id. Consequently, establishing a funding level of $11.7 million rather than $9.1 million is

> a reasonable and desirable solution. The $11.7 million represents 0.5% of PP&L's revenues.[10]

OCA St.6 at 22. As such, the OCA submits that its proposed funding level should be adopted.

3. PP&L Should Target 18,500 Customers For Enrollment In OnTrack.

PP&L opposes the expansion of its OnTrack eligibility requirements noting two problems: 1) impracticality in effectively identifying, interviewing, and enrolling tens of thousands of customers and 2) prohibitive costs. PP&L M.B. at 191. However, as set forth by OCA witness Brockway:

> [t]he Company is proposing a major ramp-up of its program on its own initiative. Thus, the Company expects that the infrastructure for program delivery services either exists, or can be brought into existence in a timely fashion, to multiply its program size 5 to 6 fold from today's levels. Once a program is at this significantly larger size, the Company will have already addressed and solved the practical problems of managing a full-scale program.
>
> I am proposing an expansion of the Company's goals, and do not propose that the Company serve "tens of thousands" of CAP customers (although presumably it would be feasible to expand the program to accommodate as many customers as are deemed eligible, especially if the Company follows a prudent ramp-up path).

OCA St. 6-S at 4-5.

Furthermore, in its Main Brief, the OCA documented the need for expansion of eligibility for OnTrack particularly noting that low-income families tend to spend a greater percentage of their income on electricity than median income households do. OCA M.B. at 112. Specifically, the OCA noted that low-income families without electric space heat spend as much as 20% of their income on electricity and those with space heat spend over 46% of their income on electricity. OCA St. 6 at 18. Consequently, the OCA continues to submit that such affordability constraints facing low-income families warrant expansion of OnTrack eligibility.

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[10]The OCA also recommended that the level of write-offs associated with low-income customers be considered when analyzing the potential benefits of an adequate funding level for OnTrack. OCA St. 6 at 26. In its Main Brief, the Company asserted that the level of write-offs should not be considered because low-income customers do in fact pay portions of their bills. PP&L M.B. at 192. However, the OCA submits that the purpose of considering the level of write-offs is to illustrate a level of uncollectibles which, if applied to bill reductions after the fact, rather than write-offs after the fact, would save the Company credit and collection costs while allowing customers to pay their bills on time and in full. OCA M.B. at 27.

4. Increased Funding Levels For WRAP Are Needed To Further Baseload Initiatives.

Inclusion of baseload usage reduction as a component of WRAP is a vital conservation measure which would assist many of the Company's low-income customers. OCA M.B. at 116. As set forth by OCA witness Brockway:

> Although PP&L focuses its conservation efforts towards the 31% of its customers who utilize electric space heating, non-space heating, low-income customers can also benefit from conservation efforts. These non-space heating customers comprise two-thirds of the Company's low-income customers, therefore, cost-effective, baseload usage reduction would assist in making bills for these customers more affordable, thereby saving credit and collection costs.

OCA St. 6 at 33. Furthermore, as set forth in OCA's Main Brief, resource costs which are borne by the entire system could be saved. OCA M.B. at 116.

Nevertheless, despite the fact that two-thirds of its low-income customers are non-space heating customers, PP&L continues to propose that its conservation efforts be directed solely towards electric heat customers. PP&L M.B. at 191. The Company's rationale is that PP&L has the highest electric heat saturation rate of the eight major Pennsylvania utilities. Id. However, such a phenomenon does not address the fact that 66% of the Company's low-income customers do not utilize electric space heat. As previously set forth by OCA witness Brockway:

> There are thousands of baseload electricity users in the PP&L service territory, then, who use needlessly high levels of electricity because they cannot install the measures needed to use electricity more efficiently.

OCA St. 6-S at 13. The OCA recommends that an increase in WRAP funding will enable the Company to target these baseload customers with vital and beneficial conservation measures.

B. OnTrack Participants Should Not Be Restricted In Their Ability To Participate In The Competitive Supply Market.

PP&L supports the OCA's recommendation that OnTrack participants be afforded the opportunity to choose alternate suppliers. PP&L M.B. at 192. However, the Company places three restrictions on such participation: 1) OnTrack participants who select an alternate supplier must receive a single bill from PP&L, 2) alternate suppliers serving OnTrack customers must be required

to discount the energy portion of the bill by a percentage equal to the overall percentage reduction established pursuant to OnTrack, and 3) alternate suppliers must agree to absorb the supply portion of the revenue shortfall that is written off monthly for OnTrack customers. Id. at 192-193.

OCA witness Brockway previously addressed the portability of OnTrack benefits and the requirement that recovery of these costs be nonbypassable. See OCA St. 6 at 46-47. According to witness Brockway, insurmountable problems to such portability are unlikely and the only vital determinations are the eventual amount of the bill and how the reduction is applied. Id. Consequently, consideration of the restrictions suggested by the Company are premature at the present time. The OCA submits that issues regarding the efficient portability of OnTrack benefits must be established prior to any significant restrictions in this area. As a result, the restrictions proposed by the Company should not be adopted at this time.

C. The Company Should Fund A Renewables Pilot.

The Company argues that a renewables pilot is not mandatory and the benefits are low compared to the costs and time commitments that would be involved. PP&L M.B. at 197. As a result, PP&L asserts that implementation of a renewables pilot is inappropriate. However, as explained in OCA's Main Brief, support for such a pilot is contained within the Act as well as in PECO. See § 2803; PECO at 147. For the reasons set forth in the Main Brief, as well as the testimony, of the OCA, the Company's argument must be rejected. See OCA M.B. at 118; OCA St. 6 at 34-38; OCA St. 6-S at 9-12.

D. Universal Service Program Costs Should Be Allocated To All Customer Classes On A Kilowatt-hour Basis Or, In The Alternative, Non-Production Revenue Basis.

1. Introduction

The OCA has continued to recommend that universal service program costs be allocated to all customer classes on a kilowatt-hour (kWh) basis.[11] See OCA St. 6 at 44; OCA M.B. at 124. Such

[11]The Company erroneously asserts that the OCA recommends that universal service charges be a separate line item on customers' bills (PP&L M.B. at 158). However, the OCA's recommendation is that this charge be separately identified in the Company' tariff (OCA St. 6 at 45),

an allocation will ensure that all customers share responsibility for universal service costs in a nonbypassable fashion. OCA St. 6 at 44. However, due to the Commission's final guidelines on universal service and energy conservation, the OCA has alternatively proposed a non-production revenue allocation. See OCA St. 6-S at 20-21; OCA M.B. at 124-125. Although a non-production revenue allocation would result in the residential classes paying a larger percentage of universal service costs than a kWh allocation, the OCA submits that this allocator is a reasonable alternative to a kWh allocation.

Despite the fact that a per customer allocation, i.e., allocation of universal service costs based on the number of customers in a class, would compel the residential classes to pay the vast majority of universal service costs, the Company recommends implementation of this allocator. PP&L M.B. at 191. The Office of Small Business Advocate ("OSBA") and the PP&L Industrial Customer Alliance ("PPLICA") also recommend implementation of this allocator. OSBA M.B. at 40; PPLICA M.B. at 17. However, as will be explained, implementation of such an allocator contradicts the Customer Choice Act and would result in cost recovery unintended by the Act.

2. Implementation Of A Per Customer Allocator Would Result In An Inequitable And Unreasonable Allocation To The Company's Residential Classes.

Despite the reasonableness of a non-production revenue allocator, the Company and PPLICA reject implementation of this allocator. See PP&L M.B. at 155; PPLICA M.B. at 91. Both parties argue that the use of the non-production revenue allocator is inconsistent with cost causation principles and will result in improper cost shifting.

To begin with, cost causation principles are premised on the notion that costs should follow benefits. Yet, taken to its logical conclusion, this would result in low-income customers paying all universal service costs and eliminating the benefit. OCA St. 6-S at 18-19. Nevertheless, PP&L, PPLICA and OSBA seek to assign the majority of universal service costs to the entire residential

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not on the customer's bill.

class even though there are members of these classes which, like members of other customer classes, receive no direct benefit from the existence of universal service programs. As set forth by OCA witness Brockway, this approach is not supported. Witness Brockway characterized the approach as follows:

> there is again no more reason to allocate costs to non-low-income residential customers under this reasoning than there is to allocate them to non-residential customers. Non-low-income residential customers benefit, as they do, exactly and only in the ways and to the extent that non-residential customers benefit.

Id.

Furthermore, the Act does not require that all allocation schedules used in the Company's last rate proceeding be used in the current proceeding. OCA St. 6 at 17. As previously set forth, "so long as rates for each class (broken out separately into generation and non-generation) do not exceed the [rate] cap, the Commission is free to apply sound ratemaking principles, and to follow the statutory mandate that all classes contribute to a non-bypassable universal service cost recovery." Id. at 18. Consequently, the arguments of the Company and PPLICA must fail.

3. The Allocation Issue In The PECO Proceeding Differs From The Allocation Issue Present In The Current Proceedings.

Both PP&L and PPLICA assert that the Commission should allocate PP&L's universal service costs to the residential class because this was done in PECO. PP&L M.B. at 155; PPLICA M.B. at 90. However, as explained below, the allocation issues in the two proceedings are not identical.

As explained at length in OCA's Main Brief, the allocation issue presented to the Commission in the present proceeding differs from that addressed by the PUC in PECO. OCA M.B. at 123. In PECO, the Commission did assign universal service costs to the residential class. However, in PECO, the Commission's concern was with substantial cost-shifting and since PECO's previous universal service costs had been allocated to the residential classes, the Commission reasoned that such an allocation should be continued. Of critical importance is the fact that the Commission addressed substantial existing costs for existing programs in PECO while in the present proceeding

it must address new costs for expanded programs. As a result, PP&L and PPLICA are incorrect in relying on PECO for an allocation determination in the present proceeding.

IX. CONCLUSION

WHEREFORE, The Office of Consumer Advocate respectfully submits that its recommended modifications to PP&L's restructuring plan should be adopted. Those recommendations are reasonable and consistent with the Customer Choice Act. PP&L's restructuring plan, particularly its stranded cost recommendations, are not reasonable. This is especially true of its alternative recommendations raised in its brief which can not be relied upon in this proceeding.

Respectfully submitted,

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Dated: February 27, 1998
46015

CERTIFICATE OF SERVICE

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

I hereby certify that I have this day served a true copy of the foregoing document, OCA's Reply Brief, upon parties of record in this proceeding in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a participant), in the manner and upon the persons listed below:

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