



OFFICE OF CONSUMER ADVOCATE
1425 Strawberry Square
Harrisburg, Pennsylvania 17120

IRWIN A. POPOWSKY
Consumer Advocate

April 27, 1998

(717) 783-5048

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

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

Dear Secretary McNulty:

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

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

DOCUMENT
FOLDER

Sincerely,

James A. Mullins

James A. Mullins
Assistant Consumer Advocate

Enclosure

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

46289

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I. INTRODUCTION

The Office of Consumer Advocate ("OCA") files the following Exceptions to the Recommended Decision of Administrative Law Judge George M. Kashi issued on April 7, 1998 in the above-captioned proceeding. ALJ Kashi essentially adopted the case presented by PP&L, Inc. ("PP&L") with limited exceptions. Given the magnitude of this proceeding combined with the page limitation on Exceptions, the OCA will only be able to highlight key elements of its presentation here. However, the OCA refers the Commission to its Main and Reply Briefs in this case for a complete exposition of the OCA's positions on the issues presented in this case.

It is necessary in this Introduction to discuss what the OCA believes are the shortcomings in the ALJ's almost total adoption of PP&L's position in this restructuring case which, by the OCA's calculation, results in the ability to collect from ratepayers approximately \$4 billion in generation-related stranded costs through the competitive transition charge ("CTC").¹

These shortcomings are the adoption of a proposed level of stranded costs that is facially unreasonable, and the approval of market prices and other adjustments for PP&L that are directly opposite to treatments adopted by the Commission for PP&L's neighboring utility, PECO Energy, in PECO's restructuring case. See Application of PECO Energy Company for Approval of its Restructuring Under Section 2806 of the Public Utility Code and Joint Petition for Partial Settlement, R-00973953 (December 23, 1997) ("PECO Energy Restructuring Order" or "PECO"). These shortcomings only lead to the conclusion that the ALJ's decision is unreasonable and cannot be adopted.

The OCA documented at pages 11-14 of its Main Brief that the combination of PP&L's revenue requirements methodology and PP&L witness Jones's market price assumptions for the Pennsylvania-New Jersey-Maryland ("PJM") Interconnection market area lead to the facially unreasonable result of a stranded cost claim that exceeds its appropriately calculated jurisdictional

¹ The ALJ's result is roughly equivalent to the entire \$4 billion that PP&L postulated could be recovered under the rate cap through the CTC over a seven year period.

rate base. This result is wholly implausible given the relative economics of PP&L's existing plants. OCA M.B. at 14-15.

In addition, the Commission's orders in the PECO Energy restructuring case further demonstrate the prima facie unreasonableness of PP&L's generation related stranded cost claim. As the Commission noted in its initial order in that case, PECO Energy's generating assets had a total book value of approximately \$6.77 billion (PECO at 80) and, in its reconsideration order, the Commission established a level of owned generation related stranded cost of \$2.679 billion. Application of PECO Energy Company For Approval of its Restructuring Plan Under Section 2806 of the Public Utility Code, R-00973953, Appendix (January 16, 1998 Restructuring Order) ("PECO Energy Reconsideration Order"). Yet, even with PP&L's lower rates and lower book value, the ALJ adopted a \$3.49 billion stranded cost level for PP&L's owned generation assets even though its appropriate Pennsylvania jurisdictional rate base is \$3.25 billion.

The acceptance of PP&L witness Jones market prices, combined with the level of CTC collection requested by PP&L and recommended by the ALJ, essentially creates the result of no rate savings for PP&L's ratepayers, little room for competition until the year 2006, and the ability of PP&L to receive windfall profits. OCA M.B. at 1. This result directly contradicts the purpose and goals of the Electricity Generation Customer Choice and Competition Act ("Customer Choice Act" or "Act") and the Commission's decision in PECO. Principally, the ALJ's result violates the direction of the General Assembly in Section 2802(8) of the Act, 66 Pa.C.S. §2802(8), that transitional issues must be resolved in a manner that is fair to all stakeholders, including customers, electric utilities, investors, and competitors.

As the OCA noted in its Main Brief, the subjection of the generation portion of the electricity industry to competition affects the balancing of interests in this case. The risks associated with the operation of generation assets, and the potential gains from the operation of those assets in the new competitive market will shift to the unregulated operations of the electric utility. The results of

restructuring, therefore, fundamentally affect the balancing of ratepayer and Company interests. OCA M.B. at 2.

Since the ALJ's decision leads to the anomalous result of the recovery of a level of owned generation related stranded costs that exceeds the jurisdictional net book value of that generation, at January 1, 1999, the Company will recover more than the entire jurisdictional net book value of the plant from ratepayers over the next seven years, and then essentially have capital-overhead free assets to use in the new competitive market.

The impact of this recommendation also is that ratepayers essentially receive no rate savings. Thus, the balancing effect created by PP&L's restructuring proposal and the ALJ's decision equates to the following. PP&L's financial posture is protected through the transition period as if it continued under traditional regulation while customers have little, if any, room to benefit from a competitive generation market and see no rate savings. PP&L's risk in the competitive market place is, in the best light, mitigated through regulatory fiat. In the worst light, PP&L's proposal leads to a massive windfall if market prices approach the level that the Commission just determined were appropriate in PJM in the PECO restructuring order. Id. at 3.

The danger with this proposal is that the recovery of 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. Each market price 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. See PP&L Initial Brief at 55. Also, every witness agreed that capacity additions in the PJM market area will be required beginning around the year 2000. Thus, the provision of capital-overhead free assets to PP&L, especially under the PJM market price assumptions adopted by the Commission in the PECO Energy restructuring proceeding, means that 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 will 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 noted that capacity additions will be necessary in the PJM system due to the expected elimination of the excess capacity currently in existence. PP&L Initial Brief at 56. 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, and the ALJ's decision, requires no such recovery and, hence, windfall profits for PP&L. OCA R.B. at 1-2.

The OCA's proposal, on the other hand, as outlined in its Main and Reply Briefs, recommends stranded cost recovery levels consistent with the Act, based upon market price analyses incorporating publicly available fuel price forecasts, and consistent with the Commission's comprehensive analysis in the PECO Energy restructuring case. These recommendations appropriately balance the interests of the stakeholders by providing for reasonable stranded cost recovery and by appropriately recognizing that PP&L's profits for generation related activity will come from the competitive market in the future, as dictated by the Act, and not from regulatory fiat as a result of restructuring. The ALJ's decision, to the contrary, permits PP&L to retain its generation assets for its own future competitive benefit, but expects PP&L's ratepayers to finance that competition through payment of stranded costs that are billions of dollars in excess of the amount needed to make the company whole.

The Commission in the PECO Energy restructuring case adopted the asset valuation methodology and OCA witness Smith's market prices as appropriate for PJM. Even though PP&L and PECO Energy are neighboring utilities and will both compete in the PJM market area, the ALJ adopted a different market line for PP&L. This failure to apply uniform treatment of PJM member companies does not correctly prevent the award of windfall subsidies, which, as pointed out by Schuylkill Energy Resources, Inc. and Gilberton Power Company, will skew the competitive market during its most formative years. Schuylkill Energy M.B. 26.

ALJ Kashi determined that Dr. Jones' market prices were reasonable based upon the conclusion that this was a different case from PECO. See R.D. at 84-99 as examples. He also

relies on the argument that this is an independent case in recommending other treatments directly contrary to the Commission's determinations in PECO Energy. In fact, the OCA has counted twelve decisions by the ALJ that were contrary to the PECO case. These issues will all be discussed later in individual exceptions.

The issue is not whether this is a different case than the PECO case. This fact standing alone evidences nothing. The issue is the consistency of market price recommendations for all companies within the PJM market territory and fair treatment of all utilities and consumers within the Commonwealth. As PECO Energy noted in its Main Brief, there is no reason to believe that different wholesale market prices will prevail in PECO's and PP&L's respective service territories. PECO Energy M.B. at 2. The ALJ simply never dealt with this question and, in approving Dr. Jones market line, he established inconsistent market prices for PP&L versus PECO Energy, as well as excessive levels of stranded costs.

As the OCA noted in its Main Brief in this case, the same OCA witnesses, including witness Smith, applied the identical model, methodology and fuel price forecast endorsed by the Commission in the PECO Energy restructuring case. Those witnesses concluded that PP&L's stranded cost on its owned generation plant is \$138 million and that PP&L's total stranded cost recovery should not exceed \$1.08 billion. That recommendation should be adopted.

II. EXCEPTIONS

A. Legal And Policy Foundations

Exception No. 1 Neither Pennsylvania Law, The Constitution, Nor A "Regulatory Compact" Requires Recovery Of And Return On One Hundred Percent Of Stranded Costs.

The ALJ mistakenly determined that a regulatory compact exists which mandates complete recovery of stranded costs by PP&L. The OCA excepts to the decision.

The ALJ approvingly cites testimony supporting the view that a regulatory compact exists (R.D. at 58), and adopts PP&L's argued position that there can be no doubt that the Commonwealth

and its regulated utilities have operated for decades under a regulatory compact. R.D. at 65. The ALJ opines that Section 2802(15) of the Act, 66 Pa.C.S. §2802(15), expressly recognizes this bargain, and cites with approval the concept that any application of the Act in a manner that denies recovery of stranded costs is a violation of the Fifth and Fourteenth Amendments to the United States Constitution. R.D. at 66. The OCA submits that there has never been a regulatory promise in Pennsylvania, nor a constitutional requirement, that guarantees utilities the return on and recovery of every dollar of prudent investment in generating assets. Nor does the Customer Choice Act itself provide for such a result. If there ever was a promise in Pennsylvania, it was to Pennsylvania ratepayers ensuring them that they would not have to pay for plant that is not used and useful.

The Customer Choice Act does not provide for the automatic recovery of stranded costs associated with investment in facilities used to meet past obligations to serve all customers. Section 2802(15) of the Act, 66 Pa.C.S. §2802(15), provides that the Commission is empowered to determine the level of stranded costs for each utility and to provide a CTC for the recovery of an appropriate amount of such costs. Indeed, Section 2804(13) of the Act, 66 Pa.C.S. §2804(13), states that the Commission must approve such a charge for the recovery of stranded costs it determines to be just and reasonable. Thus, the Commission is responsible for determining a just and reasonable allocation of these costs.

Moreover, with respect to utility owned generation, the Act does not mandate full recovery. While Section 2808(c)(1) and (2) of the Act, 66 Pa.C.S. §2808(c)(1) and (2), notes that the Commission, in determining a CTC, shall allow recovery of regulatory assets, nuclear decommissioning costs and NUG costs that meet certain standards, along with prudently incurred NUG buyout costs, Subsection (3) of that section provides a different standard for owned generation assets. It states:

(3) The Commission shall determine the level of other generation-related transition or stranded costs that may be recovered through the competitive transition charge.

66 Pa.C.S. §2808(c)(3). Emphasis added. As this Commission well knows, the members of the Pennsylvania General Assembly explicitly recognized that this statute did not mandate 100% recovery of and return on utility owned stranded generating plant. See Senator Brightbill's explanation at 180 Legislative Journal of the Senate of Pennsylvania 2692 (November 29, 1996), and Representative Tulli's statement at 180 Legislative Journal of the House of Representatives 2567 (November 25, 1996).

Similarly, as stated at pages 75-77 of OCA's Main Brief, there is no constitutional requirement mandating the recovery of one hundred percent of stranded generation costs. The Pennsylvania courts have long recognized that, even where an investment is prudent when made, such an investment may be excluded from rates where it is not used and useful. OCA M.B. at 75. If there was ever any doubt that utilities do not have a right under Pennsylvania law or a constitutionally guaranteed right to a return on all prudent investment, that doubt was dispelled by the United States Supreme Court's decision in Duquesne Light Co. v. Barasch, 488 U.S. 299 (1989) ("Barasch"). In that case, the Court upheld a ruling that the utility could be denied any return on or recovery of canceled plant costs, even where prudently incurred. 488 U.S. at 314. Other states have correctly applied Barasch in considering stranded electric generation costs. OCA M.B. at 75-76.

The ALJ's legal conclusions are incorrect and should not be adopted.

Exception No. 2: The ALJ Incorrectly Interprets The Just And Reasonable Standard.

The ALJ determined that any proposals to share stranded costs between ratepayers and shareholders are based upon the misapplication of the just and reasonable standard. R.D. at 77-78. The OCA submits that the ALJ is in error.

The ALJ does recognize Section 2804(13) of the Act, 66 Pa.C.S. §2804(13), which, as noted earlier, vests the Commission with the power and duty to approve a CTC for the recovery from ratepayers of stranded costs it determines to be just and reasonable. The ALJ's view of sharing

proposals and other adjustments as being misapplications of this standard, however, rests upon inappropriate conclusions.²

First, the ALJ opines that, since plant investments have been prudently incurred and placed in rate base as just and reasonable, all stranded costs associated with those investments must also be just and reasonable. R.D. at 78. This simple assumption, of course, ignores the case law cited earlier and is little more than a further exposition of the incorrect legal conclusion that all stranded costs associated with generation assets must be recovered.

Second, the ALJ opines that PP&L's past mitigation efforts have led to moderate current rate levels and, because of the rate cap, these rate levels prevent PP&L from recovering up to \$500 million in stranded costs.³ This rationale has been removed by the ALJ's own decision. The ALJ's recommended decision reduces PP&L's stranded cost allowance to slightly in excess of \$4 billion. Thus, under the ALJ's decision, there is no existent sharing through the operation of the rate cap.

Third, the ALJ accepted PP&L's incorrect legal analysis based upon two Commonwealth Court cases that dealt with the Commission's short lived policy of sharing rate case expense between shareholders and ratepayers. R.D. at 78-79. In the principal case, the Commonwealth Court did not reject sharing per se, but instead disagreed with the Commission's evidentiary basis for its conclusion. Butler Township Water Company v. Pa. PUC, 81 Pa. Cmwlth 40, 473 A.2d 219, 221-222 (1984).

Fourth, the ALJ incorrectly adopted PP&L's circular argument relative to the Public Utility Code. He held that, since the General Assembly knows how to mandate sharing mechanisms, if it does not do so expressly then none can be applied. R.D. 39. This argument is belied by the fact that the Act itself, based upon the continuation of regulatory principles founded in prior Commission

² The OCA in this case recommended as a sharing relative to stranded costs the denial of a return on the owned generation portion of any stranded costs for PP&L.

³ PP&L's stranded cost claim in this case is \$4.5 billion. It opines that under the rate cap it could collect \$4 billion of this amount.

action and legal precedent, permits the Commission to employ sharing concepts.

The OCA submits that sharing of stranded costs is not prohibited under either the Act or the Constitution.

B. Stranded Cost Methodology

Exception No. 3 The ALJ Erred In Adopting PP&L's Method As Appropriate For Calculating Stranded Costs.

The ALJ in his Recommended Decision adopted PP&L's revenue requirements stranded cost methodology as opposed to the asset valuation methodology as employed by OCA witness LaCapra and PPLICA witness Falkenberg. The OCA submits that the ALJ's adoption of the PP&L methodology is inconsistent with the PECO Energy restructuring case and is based upon faulty support.

The ALJ lists several reasons in support of PP&L's methodology at pages 82-83 of his Recommended Decision. However, as the OCA noted, PP&L's method is flawed as it applies to generation assets because it calculates stranded costs based upon assumed perfect ratemaking for every year considered in the future. The PP&L method equates to assuming that PP&L had a full rate case every year for the next twenty five years, that it was successful in every issue, that there was no regulatory lag, and that the Company actually earned every penny that it was allowed in that year. The method then combines all of these results, returns them to present value, and then replicates the difference between those revenues and assumed market based revenues in the CTC. OCA M.B. at 20.

The OCA submits that the asset valuation methodology used by the OCA and PPLICA witnesses in this case is preferable since it is a more direct way of reflecting that the market value today is the discounted present value of the expected future stream of revenues, but that the future stream of revenues should be based on rational economic principles, rather than presumed perfect ratemaking for the next twenty five years. 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. 1-5 at 9.

The Commission in PECO's restructuring case agreed. It held that the amount of utility generation plant investment that will be stranded is equal to "the net difference between the depreciated value of the investment on the Company's books as of December 31, 1998 and the future market value of these assets." PECO Energy Restructuring Order at 80. The Commission also stated:

We agree with PAIEUG witness Falkenberg that a "lost revenues" approach to stranded cost recovery is inappropriate. He notes that even under traditional regulation, a utility never had the expectation of guaranteed future revenues. Instead, traditional regulation sought to provide a reasonable opportunity to earn a just and reasonable return on investment. While future revenues are an important component of the future value of utility generation assets, they do not directly determine the amount of recoverable stranded utility plant.

Id. The ALJ erred in not adopting the asset valuation methodology proposed by the OCA and PPLICA for the Commission's stranded cost calculations in this case.

The ALJ's belief that the asset valuation approach presents numerous problems and complexities is in error and fails to reflect record evidence. First, the ALJ's view that the asset valuation approach is a hybrid approach is not on point. As the OCA noted at page 20 of its Reply Brief, PP&L's argument that the revenue requirements methodology is somehow superior because it applies to owned generation assets as well as regulatory assets, versus the use of the asset valuation methodology for owned generation assets and a regulatory approach for regulatory assets, is a distinction without a difference. 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.

Second, the ALJ relies on unspecified "serious" errors in the OCA's application of the asset valuation methodology. R.D. at 83. While he does give one example of such an error, there is no discussion of the record in this case.

The ALJ apparently founds his view on the position of PP&L that, when properly applied, both the revenue requirements and the asset valuation methodology should produce comparable results. Id. The upshot of PP&L's argument, of course, was that the asset valuation method should result in stranded cost levels similar to PP&L's revenue requirements result. PP&L M.B. at 46. PP&L's logic, as incorrectly adopted by the ALJ, therefore is that only the OCA's and PPLICA's inconsistent application of that method leads to a contrary conclusion.

The record completely refutes this view. PP&L through its revenue requirements methodology inflates its owned generation related stranded costs by incorrectly applying the discount rate used for net present value purposes. As the OCA noted at pages 21-23 of its Main Brief, PP&L in calculating the annual revenue requirements for its generation included a return on investment for each year beginning January 1, 1999 to the end of the generating units lives, including an 11.5% cost of equity, and then grossed up the revenue requirement for federal and state income taxes payable on the return. PP&L's revenue requirement streams were, therefore, performed utilizing a pre-tax rate of return.

However, for net present value purposes, PP&L discounted the stream of revenue differences using a proposed after-tax cost of capital at December 31, 1996. The fallacy in using different discount rates rests in the fact that the use of the after-tax rate of return as a discount rate leads to the collection of costs greater than the net book value of the assets. If PP&L uses pre-tax revenue requirements streams, it should not present value with the after-tax rate of return. It is only in this fashion, i.e., discounting consistently, that PP&L can achieve correct book value.

As correctly noted by PPLICA witness Kollen, PP&L's revenue requirements methodology inappropriately recovers the present value of income taxes due to equity financing in future years. The utility will never incur these future years income taxes due to equity financing because of the accelerated recovery of its stranded generation costs through the CTC. It is entitled only to the income taxes associated with the equity financing of the stranded generation costs during the CTC

period, which is properly incorporated in the asset valuation methodology employed by OCA witness LaCapra. OCA M.B. at 22-23.

Faced with the need to force the asset valuation methodology to give the results of its flawed revenue requirements methodology, PP&L advanced numerous changing justifications in attempting to justify its results. First, it focused on the determination of market price within the various stranded cost models employed in this proceeding. OCA R.B. at 4. Next, it argued, through its witnesses Schadt and Guth that the methods, if properly applied, should produce comparable results. The only significant difference in the two methods was argued by PP&L to be in the treatment of income taxes. Id. The record evidences that PP&L's assumptions were incorrect. Id.

The record amply supports that the asset valuation method consistently treats current income taxes and taxes recoverable under SFAS 109. OCA R.B. at 21-22. In addition, the record demonstrates that PP&L is incorrect in its assertion that the asset valuation method improperly fails to reduce the market value of assets to reflect Accumulated Deferred Income Tax ("ADIT") that would be payable upon sale of an asset. Id. at 23.

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 million for the book balance of deferred taxes representing ADIT. OCA R.B. at 23-24. This treatment precisely mirrors PECO's and OCA's methods that were adopted by the Commission in the PECO restructuring order. Id. at 24. Thus, contrary to PP&L's hypothesis, OCA 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.

Finally, PP&L presented for the first time in its Initial Brief a further analysis to "reconcile" the asset valuation methodology to its revenue requirements stranded cost result that belied its earlier position on the reconcilability of methods. This analysis consisted not only of tax treatments, but twenty two separate adjustments. Id. at 4-5. Since PP&L could not demonstrate the

reasonableness of its methodological application and its results, it tried to force the asset valuation methodology to fit its revenue requirements result. This exercise, as with its other exercises, simply failed to obviate the failings of PP&L's revenue requirements methodology.

The ALJ failed to consider the evidence in this proceeding, particularly the evidence that continually refutes PP&L's claims of serious errors in the OCA's application of the asset valuation methodology. That evidence, contrary to the ALJ's view, clearly supported the asset valuation method and catalogued the excessive stranded cost results obtained by PP&L through the use of its revenue requirement method.⁴

The OCA must also discuss PP&L's presentation in its brief for the first time of the above-mentioned adjustments to the asset valuation method, the calculations of which are not in the record in this proceeding. This presentation is highly prejudicial to all parties and should not be relied upon. OCA R.B. at 5.

The inappropriateness of PP&L's purported asset valuation method calculations in its brief is set forth at pages 24-26 of the OCA's Reply Brief. However, it must be noted that it is not clear, since these calculations were not presented during the case, whether PP&L's new calculations are stand alone numbers or additive numbers. The problem created is clear. If PP&L's asset valuation presentation is indeed interactive, then the calculated numbers are useless on a stand-alone basis. If the adjustments are not incremental, then it is useless to sum them as a "reconciliation." PP&L itself in its brief is not certain of its own presentation. OCA R.B. at 25-26.

The problems 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

⁴ The ALJ also mentioned approvingly PP&L's argument that the asset valuation method should not be employed because it was not in the record. R.D. at 83. This aspect of the ALJ's opinion is truly baffling. OCA witness LaCapra explained the method in testimony as well as enumerating the inputs and the results of that method, just as PP&L witness Schadt did with the revenue requirements method.

unacceptable. Thus, the OCA submits that PP&L's alternative adjustment allegedly presented on an asset valuation method approach should not be relied upon in this proceeding.

The OCA submits that the asset valuation method presented by OCA witness LaCapra is appropriate in this proceeding. As noted earlier, the OCA in this case presented the same OCA witnesses, including OCA witness LaCapra, that appeared in the PECO case, and those witnesses applied the identical model, methodology and fuel price forecasts that were adopted in PECO's restructuring case. The enumeration of witness LaCapra's methodology and the inputs to that methodology, are set forth at pages 25-32 of the OCA's Main Brief. The record amply supports the adoption of OCA witness LaCapra's recommended level of stranded cost of PP&L of \$1.08 billion.

C. Market Price of Electricity

Exception No. 4 The OCA Excepts To The ALJ's Adoption Of PP&L Witness Jones' Market Prices For The PJM Area In Calculating Revenues Under Competition.

The ALJ in this proceeding accepted the market prices calculated by PP&L witness Jones in this proceeding. The OCA submits that the ALJ erred in this determination. The market prices advanced by OCA witness Doug Smith are the appropriate prices to be adopted in this proceeding. The OCA will respond later to the reasons given for the action by the ALJ. However, at this point, it is necessary to discuss the major flaw in the ALJ's decision.

As the OCA noted at page 1 of its Main Brief, the Commission is not deciding this case on a blank slate. It has already decided the restructuring case of PP&L's neighboring PJM utility, PECO Energy. In that proceeding, the Commission adopted the exact same market price and stranded cost analysis by the same witnesses that the OCA presented in this case. At the same time, the Commission flatly rejected three separate market price analyses presented by PECO witnesses, all of which in the OCA's view, were less favorable to the utility than the PP&L methodology presented in this case.

The Commission adopted the testimony of OCA witness Smith as the most reasonable determination of future market value. OCA M.B. at 24. The Commission found witness Smith's

testimony to be the most credible, and an objective analysis of the issues in the proceeding. It also approved the use of the ENPRO model used by witness Smith, and those aspects of the model dealing with unit commitment, NUG operations, fuel prices, imports and exports, and heat rates. OCA M.B. at 33. The Commission also agreed with witness Smith's approach to fuel use by dual fuel units, the cost of new generation and the use of average heat rates. Id. Of perhaps equal, or even greater importance, the Commission specifically commented on the credibility and balanced nature of the OCA presentation in the PECO case, including witness Smith's presentation. Id. at 134.

As noted, OCA witness Smith's presentation in this case tracks those elements approved by the Commission in the PECO restructuring case. OCA witness Smith's generation market analysis in the present case is based upon publicly available generating load and fuel price data. Id. His analysis reflects fuel price escalation rates from the DRI Spring 1997 World Energy Services U.S. Outlook. Witness Smith's analysis was performed to assist the Commission by providing a balanced, non-utility perspective on generation market issues. His approach was not, however, to develop a high bound or counter to the Company's analysis. Id. at 34-35. As noted at pages 35-42 of OCA's Main Brief, OCA witness Smith employed the ENPRO dispatch simulation model with the same inputs approved by the Commission in PECO.

The most problematic aspect of the ALJ's determination to inappropriately accept PP&L's market prices is that both PECO Energy and PP&L are PJM companies. While the ALJ notes that the Commission must make a determination of the market price projections presented in this case, as noted earlier he never addresses with the central issue of the efficacy of entirely different market assumptions for two companies competing in the same market. As the OCA noted at page 16 of its Main Brief, it would be unfair and inherently discriminatory for the Commission to adopt wholly inconsistent PJM market prices for two adjacent PJM companies that both intend to remain in the generation business. The OCA submits that principles of reasoned decision-making do not allow

such arbitrary discrimination between utilities operating in the same market. The ALJ's approval of PP&L's requested market prices is inappropriate.

Exception No. 5 The ALJ Incorrectly Adopted PP&L Witness Jones' Estimated Future Capacity Prices.

The ALJ in this decision adopted the estimated future capacity prices advanced by PP&L witness Jones. He found that witness Jones' proposed capacity prices are sufficient to produce returns that support the installation of new capacity. R.D. at 86-87. He opines that PP&L's capacity prices are the only capacity prices that are justified by the record in this proceeding. *Id.* at 87. The OCA submits that the record evidences exactly the contrary and that the ALJ is in error.

The OCA at pages 14-15 of its Reply Brief set forth the record evidence indicating that PP&L witness Jones never demonstrated the efficacy of his capacity price assumptions. He presented a series of exhibits with different assumptions and different start dates that had only one constant, a much lower capital cost assumption for new units than the assumption he used in his analysis. Thus, while witness Jones may have evidenced that combined cycle units at lower capital costs may lead to adequate returns, he never demonstrated that his assumptions led to that result.

The OCA submits that witness Smith's capacity prices are appropriate, as the Commission noted in the PECO Energy restructuring case. PECO Energy Restructuring Order at 10.

In addition, the ALJ in determining this issue relies upon an argument raised by PP&L that pervades other portions of his market line determinations. This argument is that PP&L's market line must be appropriate since it is low, which one would expect since deregulation and competition produce lower prices. R.D. at 84, 86 for example. This simplistic assumption is incorrect. In this case, all market price assumptions, including Dr. Jones', increase on a nominal basis. In fact, this is expected as PJM's need for capacity drives increased capacity prices. Also, fuel prices, a central component of market energy prices, are all predicted to increase. Thus, as noted at pages 16-17 of OCA's Reply Brief, PP&L's simplistic reliance on economic theory as a predicate to support its market line is unproven. In fact, PP&L is inconsistent with its own theory since it argues against

OCA witness LaCapra's application of a productivity offset to future plant O&M costs because of a competitive environment. OCA R.B at 16.

PP&L never presented an analysis evidencing that the market lines presented by other parties lead to unacceptable real, versus nominal growth in prices, nor that such market lines would be suspect under competition in comparison to the industry's real growth in prices in the past under regulation. The ALJ's reliance on this simplistic argument is misplaced.

Exception No. 6 The ALJ Erred In Rejecting OCA Witness Doug Smith's Use Of The ENPRO Model.

The ALJ in his discussion rejected the ENPRO model employed by OCA witness Doug Smith and determined that the EGEAS model employed by PP&L witness Jones produced the most realistic and reliable results. R.D. at 88-94. The OCA submits that the ALJ is incorrect.

As noted earlier, the Commission in the PECO Energy restructuring cases adopted OCA witness Doug Smith's market prices using the ENPRO model. In fact, the Commission noted that it was familiar with the ENPRO model and perceived it to be quite suitable to the task of estimating the generation market revenues for PECO. In addition, it found that witness Smith's model fairly represented the inputs listed previously. PECO Energy Restructuring Order at 89-90. Witness Smith used the same model and assumptions here, and his results, including the use of the ENPRO model, should be adopted.

The ALJ's dismissal of the ENPRO model is based upon perceived errors that are not supported by the record. These errors include the ability to model "only" 200 units in PJM, the treatment of dual fired units, and the treatment of imports from outside of PJM after 2005. R.D. at 90. As the OCA noted at pages 26-29 of its Reply Brief, the record fails to support the ALJ's conclusions. The ALJ failed to discuss these facts.

The record evidences that the aggregation employed with ENPRO was comprised of the smallest and most expensive units in PJM, including a number of 20 MW combustion turbines that are not efficient. Tr. 1511. The aggregation had a minimal affect on Mr. Smith's analysis. Tr. 1502.

The record supports the Commission's finding in PECO that OCA witness Smith's model fairly represents such important matters as unit commitment. PECO Energy Restructuring Order at 89.

The record evidences that 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. The representation of multi-fuel units is a minor source of difference between OCA witness Smith's market prices and Dr. Jones' prices. Tr. 1502. The record, therefore, supports the Commission's agreement with OCA witness Smith's approach to fuel use by dual fuel units. PECO Energy Restructuring Order at 90.

PP&L's argument that witness Smith inappropriately reduced the availability of imports from outside PJM after 2005 without justification is specious. As the OCA stated at page 28 of its Reply Brief, PP&L's only possible rationale for such a hypothesis must be an assumption that capacity in the East-Central Area Reliability Council, the assumed source of imports, will remain at levels supporting sales to PJM indefinitely into the future. What is unexplained is why ECAR will differ from PJM, whose capacity reserve requirement of eighteen percent will dissipate and will require capacity additions after the year 2000. PP&L failed to demonstrate why ECAR will continue, over the long term, to have economic capacity available for sale to PJM. The record does not impugn the Commission's finding in PECO that OCA witness Smith fairly represented imports and exports in the ENPRO model. PECO Energy Restructuring Order at 89.

The OCA submits that the ENPRO model, which is an operational dispatch model and commercially available (R.D. at 90), is appropriate for use here just as it was in PECO.⁵ As the ALJ acknowledged, the ENPRO model can be used to forecast energy prices. R.D. at 94.

⁵ In addition, Dr. Jones' use of the EGEAS model inappropriately employs an incremental heat rate versus an as-operated average heat rate. OCA M.B. at 35-36.

Exception No. 7 The ALJ Incorrectly Adopted PP&L Witness Jones' Inputs And Assumptions In Fashioning His Market Prices.

The ALJ, in pages 94-112 of his Recommended Decision, adopted the inputs of PP&L witness Jones in his market price analysis. The key portions of the ALJ's decision are his adoption of PP&L witness Jones' personal fuel price forecast versus the use of independent professional forecasts by OCA witness Smith (DRI Spring 1997 forecast) and PPLICA witness Falkenberg (EIA forecast), and PP&L witness Jones' postulation that today's low inflation rate will prevail for the next twenty years based upon current federal monetary policy. The ALJ's conclusions are incorrect.

The OCA refers the Commission to pages 36-42 of its Main Brief for an explanation of the reasonableness of OCA witness Smith's market price inputs. Contrary to the ALJ's postulation, the record demonstrates that PP&L witness Jones' assumptions inappropriately lead to unacceptably low market price results.

Dr. Jones' price assumptions systematically ignore historic price volatility and lead to counter intuitive owned generation related stranded cost results for a company in PP&L's overall price position. His 1996 starting point base fuel price assumptions are understated based upon actual prices. OCA St. 2 at 9-10. See also OCA R.B. at 6-7. Dr. Jones rejected fuel price forecasts advanced by DRI and the EIA and simply used his own judgment to select fuel price escalation rates. Similarly, Dr. Jones used judgment and an unrepresentative view of historical data to arrive at a 2.5 percent annual inflation rate. Indeed, PP&L witness Moul disagreed with Dr. Jones on the likelihood of flat inflation for the next twenty years at today's inflation levels. OCA R.B. at 10-12. The OCA provided a critique of Dr. Jones assumptions at pages 6-14 of its Reply Brief.

The ALJ also inappropriately accepted other inputs into the determination of market prices by PP&L. For example, the ALJ adopted PP&L's assumed 78% forecasted nuclear capacity factor despite the use by OCA witness Smith of the 75% nuclear capacity factor adopted by the Commission in the PECO Energy restructuring case. R.D. at 105-106. As the OCA noted at page 29 of its Reply Brief, the adoption of the industry average nuclear capacity factor by the Commission

in PECO was sound. PECO Energy Restructuring Order at 89. This is especially true in comparison to PP&L witness Jones' employed capacity factor, which is a forecasted capacity factor based upon future supposition. OCA witness Smith's use of a 75% capacity factor is appropriate.

The ALJ also approved the NUG capacity factors employed by PP&L in its market price analysis. R.D. at 109. The ALJ incorrectly determined that OCA witness LaCapra provided no reasonable basis upon which to employ in the asset valuation method reduced NUG capacity factors. The ALJ is in error. The OCA demonstrated at pages 55-58 of its Main Brief that the record evidenced that PP&L's use of 1994-1996 NUG experience led to an unreasonably high forecast of future NUG production for the balance of the contract terms. Indeed, as the OCA noted at page 50 of its Reply Brief, the OCA's position was supported in the brief of the non-utility generators in this case, Schuylkill Energy Resources, Inc. and Gilberton Power Company. PP&L's NUG estimates should be rejected.

Finally, the ALJ adopted PP&L's argument that OCA witness Smith improperly ignored PP&L's projected plant retirement data in his analysis. R.D. at 111. As noted by the ALJ, PP&L postulated that the correction of this assumption would increase stranded costs. *Id.* The ALJ is in error. Again, as the OCA explained at page 30 of its Reply Brief, PP&L's assertion is incorrect.

Exception No. 8 The ALJ Incorrectly Adopted PP&L's Revenue Requirements Analysis Which Inappropriately Included The Stranded Cost Effect Of Wholesale Contract Assets Which PP&L Included In Jurisdictional Rate Base As Those Contracts Expired In The Future.

The ALJ, with no discussion, accepted that portion of PP&L's stranded cost claim based upon owned generation assets that included the automatic future inclusion in jurisdictional rate base of capacity associated with expiring FERC wholesale contracts. R.D. at 112. The OCA submits that this determination is in error.

As the OCA noted at pages 26-29 of its Main Brief, OCA witness LaCapra in his application of the asset valuation method appropriately determined PP&L's PUC jurisdictional book value to be \$3.25 billion. This figure properly excluded capacity associated with expiring wholesale contracts in the future which PP&L included within its analysis based upon the assumption that it is a known

and measurable change and that the capacity would be used and useful in serving its jurisdictional customers.

The record indicates that the automatic inclusion of this capacity into jurisdictional rate base under PP&L's revenue requirements methodology is not consistent with traditional regulation, and PP&L's inclusion thereof violates Section 2803 of the Act, 66 Pa.C.S. §2803. Indeed, in PP&L's last rate case in 1994, PP&L sought similar regulatory treatment for capacity associated with these contracts in the future through automatic ECR treatment versus base rate treatment. The Commission properly rejected this request noting that since the wholesale contracts were in existence based upon PP&L's excess capacity, the Company's request was simply a continuation of the excess capacity question and declined to prematurely judge whether this capacity would be used and useful. Pennsylvania Public Utility Commission v. Pennsylvania Power & Light Company, R-00943271 (Order entered September 27, 1995), Slip op. at 255.

Thus, the inclusion of the capacity is inappropriate since it is not traditionally recovered under a regulated environment without a showing of its being used and useful, and this capacity has already received a regulatory denial of an advanced treatment through rates. The treatment of this capacity by PP&L in this case is the same as its prior attempt to receive advance approval of recovery of the capacity through the ECR and is in violation of the Commission's regulatory treatment excluding the recovery of non-used and useful property.

Finally, PP&L's only justification for its treatment was PP&L witness Krall's presentation of PP&L's fixed resource plans in PP&L Exhs. DAK3 and DAK4. These plans were presented to indicate the Pennsylvania jurisdictional need for this returning capacity. However, these resource plans were not compiled with competition in mind and do not justify capacity needs for remaining retail customers.

D. Revenue Under Regulation

Exception No. 9 The ALJ Erred In Not Setting PP&L's Cost Of Capital Reflecting A 10% Opportunity Cost Of Common Equity.

The ALJ in this proceeding adopted an opportunity equity cost rate of 11.5%. R.D. at 125. The OCA, as documented at pages 59-60 of its Main Brief, submits that the Commission should establish the cost rate of common equity to be used for discount rate purposes at 10%, which the Commission initially adopted in the PECO Energy securitization case.

Exception No. 10 The ALJ Improperly Granted PP&L's Request For Unrecovered Energy Costs As a Regulatory Asset.

The ALJ approved PP&L's request for stranded cost treatment for a regulatory asset associated with going forward unrecovered energy costs. He not only agreed with stranded cost recovery for actual unrecovered energy costs as of December 31, 1996, but also a projected level of going forward unrecovered energy costs. R.D. at 126-128. While the OCA did not oppose PP&L's \$17.2 million regulatory asset for actual undercollected energy costs at December 31, 1996, it did oppose PP&L's \$62.94 million claim representing a two year total of a normalized annual level of approximately \$31.5 million in on-going energy costs above the level included in base rates. OCA M.B. at 53. The OCA submits that the ALJ erred.

Despite the ALJ's conclusion that the projected unrecovered energy costs are known and measurable (R.D. at 128), the record demonstrates that they are not. The Commission so held in the PECO case, noting that it had no statutory basis for allowing recovery of unknown, future fuel costs. PECO Energy Restructuring Order at 71. In addition, the Commission reaffirmed that portion of its decision in the PECO Energy reconsideration order, also citing OCA witness Catlin's testimony that recovery of 1997 and 1998 fuel costs would be inappropriate while PECO remained under traditional regulation without a demonstration that its existing rates are inadequate. PECO Energy Reconsideration Order at 8-11.

The identical principles apply in this case and the record amply demonstrates the Company's failure to justify its deferred fuel cost regulatory asset claim for the post-1996 time frame. OCA St. 1 at 8; OCA St. 2-5 at 4; PPUCA St. 3 at 20-21; and PPUCA St. 3-5 at 21-22.⁶

Exception No. 11 The ALJ Inappropriately Approved Stranded Cost Treatment As a Regulatory Asset Of Employee Transition Costs And Pension Plan Costs.

The ALJ approved PP&L's claimed stranded costs for additional severance and pension costs. R.D. at 128. The OCA submits that this is in error. In making his determination, the ALJ without discussion simply noted that the OCA and PPLICA adjustments to PP&L's claim were inappropriate. *Id.* at 129.

The OCA has set forth the rationale and support for its position that \$3.4834 million is appropriate as a regulatory asset associated with employee transition costs at pages 49-52 of its Main Brief. Stated briefly, the Company in calculating its stranded cost claim included an additional \$7.7 million for on-going employee transition costs in addition to its \$13.132 million amortization from the 1994 base rate case. Its claim for additional transition costs during the years 1997 to 2001 must be modified to exclude 1997 and 1998 employee transition costs since the net costs in those years are less than the additional \$7.7 million annual expense already reflected in the base year. In addition, the incremental pension benefits for employee transition costs must be excluded since, due to overfunding of the pension plan, these benefits will not result in any additional out-of-pocket cost to PP&L.

Exception No. 12 The ALJ Incorrectly Allowed Fossil Plant Decommissioning.

The ALJ in this case recommended the approval of PP&L's stranded cost claim of \$315.867 million attributable to fossil plant decommissioning. R.D. at 129-132. The OCA submits that the ALJ

⁶ As in PECO, OCA witness Catlin testified that PP&L's pro forma return was not so low as to warrant the prejudgment that PP&L's rates will be inadequate to recover its total energy costs. OCA St. 3 at 6. PP&L misinterpreted this testimony as alleging that PP&L was earning more than its required return on common equity as a means of shifting the issue. R.D. at 127. The ALJ cited PP&L's argument even though it missed the point. PP&L, like PECO, could not demonstrate that its rates were inadequate, nor did it try.

erred. The OCA refers the Commission to pages 46 and 47 of its Main Brief for a complete discussion of this issue. In summary, however, it is inappropriate to grant stranded costs for future fossil decommissioning costs because that treatment contradicts the Act's requirement that costs be recoverable under traditional regulation. The Company's proposed treatment is opposed to the Commission's standard ratemaking treatment for these costs. OCA M.B. at 46.

In addition, the inclusion of these costs violates the Act's requirement that assets be stranded under the most reasonable future market scenario. There is no distinction between a regulatory and a competitive environment that would prevent these costs from being recovered in a competitive environment. As OCA witness LaCapra noted, unit owners, as well as PP&L, will have to dismantle their units. Thus, fossil decommissioning will be a cost of production for all owners to be reflected in market price. Id. Indeed, PP&L's proposal equates to the situation where, if a competitor dismantles a unit, it bears the cost, but if PP&L dismantles a unit, it will have been funded in advance by current ratepayers. OCA St. 1 at 18.

The Commission in PECO Energy's restructuring case appropriately rejected fossil decommissioning expense as a stranded cost. PECO Energy Restructuring Order at 91-92. It should do so here.

The ALJ failed to deal with the issue of the creation of a competitive advantage in allowing fossil decommissioning to PP&L even though the Commission denied it to PECO. As noted above, all utilities must be treated similarly, ie. as competitors will be treated, if a level playing field is to be created for competition. They must also be treated similarly as utilities or the unreasonable result created by the ALJ's decision, if adopted, will prevail. That result is that one neighboring utility competing in the same market with the other will have the competitive advantage of fossil plant decommissioning recovery from its ratepayers while the other will not. This result is untenable.

Exception No. 13 The ALJ, While Adopting PP&L's Investment Tax Credit Regulatory Liability, Did Not Evidence The Amount Of That Offset To Stranded Costs. If PP&L's Recommendations Are Adopted, That Offset Should Be \$111.052 Million. If The OCA's Recommendation Is Adopted, The Offset Should Be \$91.563 Million.

The ALJ adopted PP&L's investment tax credit regulatory liability. R.D. at 140-141. However, the ALJ did not evidence the monetary value of that offset. While the OCA does not except to the principle of the ITC reduction, PP&L in calculating the ITC regulatory liability understated the necessary reduction to its stranded cost. OCA M.B. at 45. It calculated an offset of \$102.272 million whereas the correct amount is \$111.052 million. *Id.* Under the OCA's recommended PUC jurisdictional allocation factors, that amount is \$91.563 million. The OCA submits that the Commission should employ the correct amount in its order.

Exception No. 14 The ALJ Incorrectly Failed To Adopt The Life Extension Of The Keystone And Conemaugh Generating Units.

The ALJ adopted PP&L's treatment of the service lives of the Keystone and Conemaugh units in the calculation of stranded costs. The OCA submits that the ALJ erred.

As with numerous other issues in this case, the ALJ failed to adopt issues already decided by the Commission in the PECO Energy restructuring case. PECO correctly identified that these two units added net revenue potential by extending their book lives through cost effective life extension measures. OCA M.B. at 31-32. OCA witness LaCapra included these life extensions in his analysis of PP&L's stranded costs as appropriate and employed the life extension option based upon information from the PECO proceeding.

The Commission in the PECO Energy restructuring case adopted the OCA market value analysis that incorporated the life extension for Keystone and Conemaugh. PP&L's suggested treatment of retaining the currently expected lives of Keystone and Conemaugh in this case creates the nonsensical result of having different portions of Keystone and Conemaugh with longer lives than other portions of those units. The ALJ's decision is inappropriate.

Exception No. 15 The ALJ Incorrectly Approved PP&L's Proposed Swap Of Depreciation Between The Susquehanna Station And Transmission And Distribution.

At pages 74-76 of his decision, the ALJ approved PP&L's proposed transfer of a portion of the depreciation reserve applicable to its transmission and distribution facilities to nuclear generation facilities as an appropriate mitigation effort in reducing stranded costs. The ALJ erred.

The OCA fully briefed this issue at pages 60-62 of its Main Brief. Briefly, the transfer of \$205 million of accumulated depreciation from the transmission and distribution function to the production function is not supportable as a mitigation measure. Section 2808(c)(4) of the Customer Choice Act, 66 Pa.C.S. §2808(c)(4), requires the Commission to consider mitigation efforts of generation-related transition or stranded costs by appropriate means in a manner that is reasonable under all of the circumstances. The transfer of \$205 million in depreciation reserve mitigates no cost and in this case it increases cost responsibility given the different jurisdictional allocation factors of the production and T&D functions. OCA M.B. at 61. The stranded cost allocation to Pennsylvania jurisdictional customers is reduced by less than the transmission and distribution rate base is increased. Distribution customers have already contributed through rates the full amount of the accumulated depreciation reserve booked as distribution.

The Commission in the PECO case correctly determined that a depreciation swap between distribution plant and generation plant is inappropriate and anti-competitive. PECO Energy Restructuring Order at 97. The OCA submits that the same result is dictated here.

E. **Determination Of Present Value**

Exception No. 16 The ALJ Incorrectly Adopted PP&L's Discount Rate.

As noted earlier, the OCA submits that the correct cost of equity for PP&L is 10%. OCA witness LaCapra employed this same equity value in deriving his recommended discount rate to be used for stranded cost purposes in this case. Accepting the capital structure and long term debt and preferred stock cost rates of PP&L, the appropriate discount rate is 7.24%.

F. Recovery Of Stranded Costs

Exception No. 17 The ALJ Incorrectly Rejected The OCA's Recommended CTC Charges.

The ALJ at pages 147-149 of his decision correctly approved the "bottoms up" general design of PP&L's CTC. However, he incorrectly rejected the OCA's proposed CTC levels assuming reduced levels of overall stranded cost recovery. He opined that the CTC recovery in that situation should not be spread over the full transition period (R.D. at 149), and that a leveling of CTC recovery adversely impacts PP&L's financial position. Id. at 149-152. The OCA submits that the ALJ erred.

The OCA set forth its proposed CTC calculation at pages 69-72 of its Main Brief. The OCA proposed a CTC that is a blend of the levelized CTC method and the levelized percentage rate reduction method. The levelized amortization of recoverable stranded costs over the CTC period tracks the Commission's preferred approach in the PECO case. PECO Energy Restructuring Order at 112. However, the OCA recommended a blended levelized approach to take into consideration the ALJ's concern, namely, the timing impact created by the Act's requirement of the recovery of stranded costs on a net present value basis on PP&L's short-term financial posture. OCA M.B. at 71. The blended levelized method provides for a declining CTC over time but moderates any overall increases as much as possible. Id. The OCA submits that its recommended CTC level should be adopted along with its determination of stranded cost.

Exception No. 18 The ALJ Incorrectly Rejected The OCA's Proposal That The CTC Must Be Reconciled On A Class Specific Basis.

The ALJ rejected the OCA's recommendation that the CTC reconciliation must be accomplished on a class specific basis. R.D. at 152-153. The ALJ erred.

As noted at pages 72 and 73 of its Main Brief, the OCA did not object to PP&L's CTC reconciliation proposal as a general matter, but recommended that the reconciliation be done on a class specific basis to avoid cost shifting. This is particularly important if the Company retains the ability to award discounted economic development rates in the future, or if sales to large customers

decline. Id. The recommendation is appropriate and was ordered by the Commission in the PECO restructuring case. PECO Energy Restructuring Order at 112.

Exception No. 19 The ALJ Improperly Rejected Any Sharing Of Stranded Cost Responsibility

The ALJ refused to allow any sharing of stranded cost responsibility based upon his legal view that any such sharing would amount to an unlawful taking of PP&L's property without just compensation. R.D. at 155. The ALJ also found that the Barasch decision mandates a return on unamortized CTC balances. Id. at 155-156. As noted earlier, that case stands for exactly the opposite proposition. As also noted earlier, the ALJ's legal views are incorrect.

The OCA's recommended CTC in this case contains stranded costs associated with NUG's and stranded costs associated with regulatory assets. The OCA's CTC design includes a return on the unamortized balance associated with the recovery of those stranded costs. OCA M.B. at 73. However, the OCA reflected a sharing between ratepayers and shareholders by not reflecting a return on the unamortized balance of stranded costs associated with owned generation assets.

The OCA's recommendation is reasonable. As noted earlier, the Commission has the duty to approve a CTC for the recovery of stranded costs it determines to be just and reasonable. The OCA's recommendation is consistent with past ratemaking policy in Pennsylvania, which has not allowed a return on plant which was not used and useful. By definition, stranded generating plant is uneconomic and was not used and useful. Since it provides no benefit to ratepayers, stockholders must share in the cost of stranded owned investment. OCA M.B. at 74.

G. Rate Design And Tariffs

Exception No. 20 The ALJ Failed To Address The OCA's Concerns Regarding PP&L's Residential Rate, RTS.

In his discussion of PP&L incentive rates at pp. 165-167 of the Recommended Decision, the ALJ accepts the Company's proposal to treat as "new" those customers who leave the Company to obtain supplies from electric generation suppliers and then return to PP&L's BUSS (Basic Utility

Supply Service). Due to this "new" designation, rates that these customers were served under before they left the Company will be unavailable to these customers upon their return to BUSS.

As set forth in the OCA's Main Brief, treating customers served under residential rate RTS as "new" customers should they leave the Company and return to BUSS creates a special problem. OCA M.B. at 105. In its Main Brief, the OCA addresses this unique situation in detail, but in a nutshell, rate RTS is available according to location, i.e., physical abodes, rather than the resident's status as a "new" or current customer. The ALJ failed to address this argument. Therefore, the OCA submits that the Commission determine the rights inherent to RTS customers in a competitive market. As previously explained, the OCA asserts that an RTS customer should not be denied this rate unless he or she is no longer associated with the original RTS location.

H. Code Of Conduct And Competition Issues

Exception No. 21 The ALJ Erred In Recommending Adoption Of The Company's Code Of Conduct.

The ALJ recommended adoption of the Company's proposed Code of Conduct which is to remain in effect until the Commission adopts regulations establishing permanent standards of conduct. R.D. at 178. PP&L's Code of Conduct is designed to govern the relationship between the Company and its Electric Delivery Group. Therefore, the Code provisions must be certain to reasonably prevent anti-competitive behavior between the two entities. However, as explained in the testimony and briefs of the OCA, PP&L's proposed Code of Conduct contains certain "loopholes" which may enable the two entities to engage in behavior deemed detrimental to electric generation suppliers or a competitive environment in general. See OCA St. 5 at 51-52; OCA M.B. at 107.

In recommending adoption of the Company's Code of Conduct, it is quite unclear whether the ALJ acknowledged the concerns raised by the OCA in its testimony and briefs. Consequently, the OCA submits that the Commission refrain from accepting PP&L's Code of Conduct until the Commission is satisfied that the Code contains provisions which will ensure an equitable and

unbiased relationship between the Company and its Electric Delivery Group. The most pressing issues identified by the OCA are outlined in the Main Brief of the OCA at page 107.

Exception No. 22 The ALJ Erred In Recommending Adoption Of The Company's Customer Switching Provisions Without Clarifying That Such Provisions Must Comply With Recently Issued Final Rulemakings.

In his Recommended Decision, ALJ Kashi recommends adoption of PP&L's proposal regarding the changing of a customer's energy supplier and the protocol to effectuate such. R.D. at 190-191. Although the OCA suggested additional provisions in its Main Brief which would have provided further consumer protections while fostering competition, on February 27, 1998, the Commission issued a Rulemaking Order which dealt with this issue in its entirety. See Rulemaking Order Establishing Standards for Changing a Customer's Electric Supplier, Docket No. L-00970121 (Order entered February 27, 1998). This Order and these regulations now govern the procedure for a customer's change of suppliers. Because this Order had not been issued when the parties filed briefs in this case, the parties were unable to include a discussion of these regulations prior to this point in time. For that reason, the OCA notes that the Commission should mandate that the Company revise its proposal, if necessary, so that it will comply with the above cited Order. Consequently, the ALJ's recommendation that the Company's proposal be accepted irrespective of this Order is in error; PP&L's proposal should only be accepted to the extent which it complies with the Final Rulemaking Order cited above.

I. **Universal Service And Customer Assistance Programs**

Exception No. 23 The ALJ Erred In Finding That PP&L's Proposed Funding Levels For Its CAP And LIURP Programs Are Sufficient To Meet The Needs Of The Company's Customers.

In this proceeding, PP&L has proposed to fund its Customer Assistance Program ("CAP") and Low-Income Usage Reduction Programs ("LIURP") at the following annual levels: WRAP--\$3 million, Keep Warm--\$1 million and OnTrack--\$9.1 million. PP&L St. 16 at 18. WRAP and Keep Warm are LIURP programs while OnTrack is the Company's CAP program.

As set forth in the Main Brief of the OCA, these proposed funding levels are commendable; however, moderate increases are necessary to ensure that the program funding levels enable the Company to serve those customers in its service territory who are most in need of assistance. See OCA M.B. at 114 and 118-119. While ALJ Kashi recognized the need to ensure adequate funding of CAP and LIURP programs, he accepted the Company's proposed funding levels. Consequently, he has recommended acceptance of PP&L's proposed funding levels for WRAP, Keep Warm and OnTrack without modification. As will be explained below, the ALJ's rejection of the OCA's proposed funding levels is in error and should not be accepted by the Commission.

As set forth in OCA's Main Brief, the OnTrack funding level proposed by OCA is only \$2.7 million more than PP&L's proposed funding level. OCA M.B. at 114. OCA's proposed funding level of \$11.7 million is well below the dollar value of uncollectibles associated with low-income customers and represents 0.5% of the Company's revenues. Id. The ALJ's characterization of this amount as "unreasonable and unwarranted" is unfounded. As the OCA noted in its Main Brief, the median income household in the PP&L service area spends about 2.3% of its income on baseload electricity and 4.5% on space heating electricity. OCA M.B. at 112. Conversely, low-income families spend 20% and 46%, respectively. Id.

Along similar lines, the ALJ's acceptance of the Company's proposed LIURP funding levels is in error as well. ALJ Kashi recommends adoption of PP&L's proposed \$4 million funding level rather than OCA's proposed \$4.7 million level, calling this \$700,000 increase unreasonable. R.D. at 197-198. However, as set forth in OCA's Main Brief, a LIURP funding level of \$4.7 million rather than \$4 million will ensure that the Keep Warm and WRAP programs are adequately funded while also allowing the Company to explore baseload usage reduction and a renewable energies pilot program with the additional \$700,000. OCA M.B. at 119. The Company has provided no evidence that this increase is unreasonable.

Moreover, the ALJ's recommendation that the Company focus its efforts on electric space heating customers rather than baseload customers should not be adopted. R.D. at 199. As

explained in the OCA's Main Brief, baseload 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. OCA M.B. at 116. The unreasonableness of such a proposal to increase the exploration of baseload usage reduction is unsubstantiated.

In light of the above, the OCA submits that it was error for the ALJ to find that the Company's proposed funding levels for WRAP, Keep Warm and OnTrack are adequate to serve PP&L's customers. The OCA's proposed funding levels represent moderate increases to the Company's proposed levels and will ensure that PP&L's CAP and LIURP programs are able to provide meaningful assistance to those customers in need of such assistance.

Exception No. 24 The ALJ Erred In Rejecting OCA's Proposal To Target More Customers For Participation In OnTrack.

The Company has proposed to "ramp-up" its OnTrack level of enrollment to about 10,000 customers by the year 2001. PP&L St. 16 at 18. Enrollment would be maintained at this annual level by adding enrollees whenever needed. Id. The OCA has proposed to "ramp-up" OnTrack to an 18,500 customer level with an emphasis on payment-troubled customers. OCA St. 6-S at 4.

The ALJ, in recommending adoption of the Company's proposed enrollment level, reasoned that the OCA's proposal would present two significant problems: 1) it would be impractical to effectively identify, interview, and enroll tens of thousands of customers, and 2) the costs would be prohibitive. R.D. at 198. However, as previously explained, these reasons are unsubstantiated by the Company and without merit.

As set forth in OCA's Main Brief, an expansion in eligibility is vital due to affordability constraints faced by low-income families within the Company's service territory. As set forth by witness Brockway:

Today, the median income household in the PP&L service area spends about 2.3% of its income on electricity in the case of a general use customer, and 4.5% in the case of a customer who heats with electricity. By contrast, low-income families without electric space heat spend as much as 20% of their income on electricity, and those with space heat can spend over 46% of their income for electricity alone.

These extremely high burdens are a function of the level of income and the typical bills of such customers.

OCA St. No. 6 at 18.

Furthermore, the OCA continues to submit that ramping the program up to 18,500 customers should not pose significant problems for PP&L. As OCA witness Brockway explained:

[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. No. 6-S at 4-5. As to cost, as explained above, the OCA is only recommending a \$2.7 million increase in the Company's budget. OCA St. No. 6-S at 5. Consequently, expansion of OnTrack from 10,000 to 18,500 participants is reasonable and will not pose significant problems for the Company. As a result, the Commission should reject the ALJ's recommendation that the Company's proposed enrollment level be accepted.

Exception No. 25 The ALJ Erred In Recommending That The Level Of Write-Offs Associated With Low-Income Customer Uncollectibles Be Ignored When Analyzing The Potential Benefits Of An Adequate Funding Level For OnTrack.

The OCA has continued to assert that the level of write-offs associated with low-income customer uncollectibles should be considered when determining an appropriate level of funding for OnTrack. See OCA St. 6 at 26; OCA St. 6-S at 5-6; OCA M.B. at 113; OCA R.B. at 43 (n.10). As OCA witness Brockway stated:

[T]o get a full picture of the amounts PP&L might cost-effectively expend on low-income customer bill affordability, we also need to consider the \$23 million in write-offs the Company estimates it makes on accounts of low-income customers (citation omitted). If such funds were directed towards bill reductions *before the fact*, rather than write-offs *after-the-fact*, the customers would be able to pay the resulting lower bills with greater timeliness and completeness, the Company would save credit and collection costs, and customers would also enjoy the sense of self-respect and responsibility that comes with the ability to pay bills on time and in full.

OCA St. 6 at 26-27 (emphasis in original). However, the ALJ recommends rejection of consideration of uncollectibles associated with low-income customers when determining an appropriate OnTrack funding level. R.D. at 200.

Rather than recognize the advantages associated with low-income customers' transfer from a delinquent debt posture to one of a reasonable opportunity to make complete payments, the ALJ focuses on the fact that low-income customers do pay some portion of their electric bills. Id. For instance, the ALJ cites a PP&L evaluation of 1,000 very low-income customers which illustrated that these particular customers pay some amount to the Company roughly half of the time in a given year. Id. Apparently, these figures are provided to illustrate that, based on this data, low-income customers do make efforts to pay their bills regardless of the billed amount. However, contrary to the ALJ's assertion, OCA's proposal that such uncollectibles be considered when establishing OnTrack funding amounts is not based on the "key false assumption" that low-income customers do not pay any portion of their bills. The OCA is well aware of low-income customers' efforts to pay a portion of their bills, however, the OCA submits that it is equally important to take into account the sacrifices that some of these households make in order to pay these bills. As previously set forth, focusing on a customer's lack of payment delinquency fails to acknowledge the burden of high bills on customers who go without food, clothing, medical care or other necessities to pay for essential electricity. OCA St. 6 at 23. The ALJ's apparent rationale that customers who pay their bills roughly half of the time would not benefit from increased OnTrack benefits, i.e., lower bills on a monthly basis, is unsound and without merit. Consequently, the ALJ's recommendation that low-income customer uncollectibles be ignored when determining OnTrack funding should be rejected.

Exception No. 26 The ALJ Erred In Recommending That The Company's Universal Service Costs Be Allocated To Customer Classes On A Per Customer Basis.

In order to recover the costs associated with administration of its universal service programs, PP&L has proposed to allocate these costs to its customer classes on a per customer basis. PP&L St. 3-R at 36. As previously explained, such an allocation allows disproportionately more recovery

of these costs from classes with greater numbers of customers, such as the residential class. OCA M.B. at 122. The ALJ implicitly recommends adoption of the Company's proposed allocation method. However, as explained below, this recommendation should be rejected.

As explained in the Main Brief of the OCA, a per customer allocation effectively allows large industrial customers to bypass the universal service charge. OCA M.B. at 122. For instance, even though primary and subtransmission customers account for over one third of PP&L's sales, a per customer allocation based on \$6-7 million in universal expenditures would only compel these customer classes to pay \$5,000 of the total expenditures. *Id.* Based on §§2802(17) and 2804(9) of the Customer Choice Act, such a de minimis contribution would allow these classes to bypass universal service costs in contravention to the goals of the Act. *Id.*

The ALJ recommends implementation of a per customer allocation based on the Commission's Final Guidelines for Universal Service. R.D. at 199. In these Final Guidelines, the Commission refrained from adopting kilowatt-hour allocation. See Final Order Re: Guidelines for Universal Service And Energy Conservation Programs Made Pursuant to 66 Pa.C.S. §§2803, 2802(17), 2804(8) and 2804(9), Docket No. M-00960890F0010 (Order entered July 11, 1997). However, these guidelines also make it clear that recovery of universal service costs is to be achieved via a nonbypassable mechanism, i.e., all classes are to contribute to these programs.

In light of these guidelines, the OCA still supports kilowatt-hour allocation, but continues to assert that a non-production revenue allocation is an appropriate alternative to kilowatt-hour allocation if the Commission determines that it will not adopt a kilowatt-hour allocation. A non-production revenue allocator would be based on each class's relative combined transmission and distribution revenue requirement, but would exclude that portion of the revenue requirement which has been functionalized as production related, i.e., generation. OCA M.B. at 124. Consequently, this allocation would only include those costs which remain subject to price regulation as the basis for the allocation. *Id.* As illustrated in OCA Exhibit NB-Surrebuttal-1, use of a non-production revenue allocator would require a larger contribution from the residential class than a kilowatt-hour

allocator, but would provide for a smaller contribution from the other classes. Id. at 125. The ALJ did not address implementation of a non-production revenue allocator, therefore, the OCA submits that the Commission consider adoption of this alternative allocator should it reject implementation of a kilowatt-hour allocator.

J. Environmental Issues

Exception No. 27 The ALJ's Recommendation That The Company Refrain From Funding A Renewable Energies Pilot Should Be Rejected.

In its testimony and briefs, the OCA has proposed that the Company fund a renewable energies pilot for low income customers in an effort to determine what future methods can be used to make energy usage more efficient. See OCA St. 6 at 34-35; OCA M.B. at 117-118. In its Final Guidelines for Universal Service, the Commission also recognized that renewable technologies are a part of universal service and energy conservation service, even though it did not mandate inclusion of any particular renewables program. See Final Order Re: Guidelines for Universal Service And Energy Conservation Programs Made Pursuant to 66 Pa.C.S. §§2803, 2802(17), 2804(8) and 2804(9) at 6, Docket No. M-00960890F0010 (Order entered July 11, 1997). The ALJ relied on the Commission's decision not to mandate renewables pilot programs in its Final Guidelines as a basis for rejecting the OCA's proposed renewables pilot. The OCA submits, however, that the PUC made clear in PECO its interest in the implementation of such pilots (the Commission adopted OCA witness Brockway's proposal for a renewables pilot in PECO-- See PECO at 147). Consequently, the ALJ's recommendation that PP&L refrain from implementing a renewable energies pilot should be rejected by the Commission. As witness Brockway suggested, it would be best to pool the photovoltaic purchases of all the electric utilities and run a single statewide pilot. OCA St. 6 at 37-38. However, in the alternative, separate pilots could be run while still pooling photovoltaic purchases. Id.

III. ADDITIONAL ISSUES

The OCA notes that there are several issues raised by the OCA that are not covered in the ALJ's decision since he essentially adopted almost all of the Company's proposals. The OCA would simply call the Commission's attention to these areas.

First, at the OCA's recommended \$1.08 billion level of stranded costs for PP&L, the OCA recommends that rate reductions are appropriate and necessary to provide benefits to those customers ineligible to shop under the phase-in of competition. OCA M.B. at 81-83; OCA R.B. at 32-34.

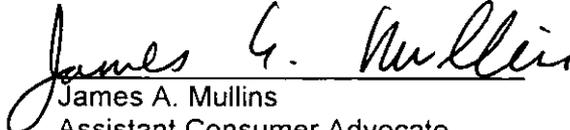
Second, the OCA has set forth the appropriate rates to be charged customers under its proposal. These rates are detailed at pages 79-81 of its Main Brief.

Third, the ALJ approved PP&L's preferred alternative of receiving its nuclear decommissioning costs over the remaining life of its nuclear generating facilities through distribution charges on a per kWh basis. R.d. at 132-135. The OCA does not except to this decision so long as the Commission is satisfied that PP&L's proposal is sufficient to meet the criteria the Commission found appropriate in the PECO restructuring case, and so long as there is no double recovery of nuclear decommissioning expenses.

IV. CONCLUSION

For the foregoing reasons, the OCA recommends that the Commission adopt the OCA's exceptions to the ALJ's decision and adopt the OCA's recommendations in this case.

Respectfully submitted,


James A. Mullins
Assistant Consumer Advocate


Craig R. Burgraff
Senior Assistant Consumer Advocate

Counsel for:
Irwin A. Popowsky
Consumer Advocate

Office of Consumer Advocate
1425 Strawberry Square
Harrisburg, PA 17120
(717) 783-5048

Dated: April 27, 1998

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 documents,
OCA's Exceptions, 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:

Dated this 24th day of April, 1998.

SERVICE IN PERSON 4/27/98

Johnnie E. Simms, Esq.
Scott DeBroff, Esq.
Office of Trial Staff
PA Public Utility Commission
P. O. Box 3265
Harrisburg, PA 17105-3265

Bernard A. Ryan, Jr., Esq.
Office of Small Business Advocate
Suite 1102, Commerce Bldg.
300 North Second Street
Harrisburg, PA 17101

David M. Kleppinger, Esq.
Robert A. Mills, Esq.
McNees, Wallace & Nurick
100 Pine Street
P. O. Box 1166
Harrisburg, PA 17108-1166

Robert J. Longwell, Esq.
Wolf, Block, Schorr & Solis-Cohen
Suite 300, Locust Court Bldg.
212 Locust Street
Harrisburg, PA 17101

William T. Hawke, Esq.
Malatesta, Hawke & McKeon
Harrisburg Energy Center
100 North Tenth Street
Harrisburg, PA 17101

Craig A. Doll, Esq.
214 State Street
Harrisburg, PA 17101

Terrance J. Fitzpatrick, Esq.
David M. DeSalle, Esq.
Ryan, Russell, Ogden & Seltzer, LLP
Suite 101
800 North Third Street
Harrisburg, PA 17102-2025

Patricia Armstrong, Esq.
Regina L. Matz, Esq.
Thomas, Thomas, Armstrong & Niesen
Suite 500
212 Locust Street
P. O. Box 9500
Harrisburg, PA 17108-9500

Linda C. Smith, Esq.
Dilworth, Paxson, Kalish & Kauffman
Suite 403
305 North Front Street
Harrisburg, PA 17101-1236

David W. Francis, Esq.
Powell, Trachtman, Logan, Carrle
Bowman & Lombardo
114 North Second Street
Harrisburg, PA 17101

Harry S. Geller, Esq.
PA Utility Law Project
118 Locust Street
Harrisburg, PA 17101

Robert F. Young, Esq.
Anthony C. Adonizio, Esq.
Allegheny Electric Cooperative, inc.
212 Locust Street
P. O. Box 1266
Harrisburg, PA 17108-1266

Susan M. Shananman, Esq.
Suite 203
212 North third Street
Harrisburg, PA 17101-1505

SERVICE BY FIRST CLASS MAIL, POSTAGE PREPAID

Eric Epstein
2308 Brandywine Drive
Harrisburg, PA 17110

Billie E. Ramsey, Esq.
ARIPPA
Suite 7
1300 Market Street
Lemoyne, PA 17043

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Paul E. Russell, Esq.
Pennsylvania Power & Light Company
Two North Ninth Street
Allentown, PA 18101-1179

Mid-Atlantic Power Supply Assoc.
Suite 200
620 Herndon Parkway
Herndon, VA 20170

Stephen J. Baron
J. Kennedy & Associates, Inc.
Suite 475
35 Glenlake Parkway
Atlanta, GA 30328

Jerry Mendl
MSB Energy Associates
Suite 200
7507 Hubbard Avenue
Middleton, WI 53562

Richard L. Caplan, Esq.
Caplan & Lubner, LLP
The Caplan & Lubner Building
40 Darby Road
Paoli, PA 19301-1461

Fred Zalcman, Esq.
Pace University School of Law
78 North Broadway
White Plains, NY 10603

Donald A. Kaplan, Esq.
Lisa M. Helpert, Esq.
Preston, Gates, Ellis & Rouvelas
Meeds, LP
Suite 500
1735 New York Avenue, N.W.
Washington, DC 20006

Bruce Biewald
Synapse Energy Economics, Inc.
101 Chilton Street
Cambridge, MA 02138

John R. Orr, Esq.
Duke Energy Trading & Marketing
Suite 650
One Westchase Center, 10777 Westeimer
Houston, TX 77042

Mr. Robert D. Knecht
Industrial Economics Incorporated
2067 Massachusetts Avenue
Cambridge, MA 02140

Scott J. Rubin, Esq.
Public Utility Consulting
3 Lost Creek Drive
Selinsgrove, PA 17870-9357

William Schmitt
IBEW Local 1600
540 Grange Road
P.O. Box 470
Trexertown, PA 18087

Mary McFall Hopper, Esq.
PECO Energy
2301 Market Street
P. O. Box 8699
Philadelphia, PA 19101-8699

Randall V. Griffin, Esq.
Delmarva Power & Light Company
800 King Street
P. O. Box 231
Wilmington, DE 19899

James D. Steffes
Enron Corporation
1400 Smith Street
P. O. Box 4428
Houston, TX 77002

David A. McCormick, Esq.
Department of the Army
United States Army Legal Services
901 North Stuart Street
Arlington, VA 22203-1837

Joel D. Newton, Esq.
Verner Liipfert Bernhard McPherson
& Hand
901-15th Street, N.W.
Washington, DC 20005-2301

John L. Munsch, Esq.
Allegheny Power Company
800 Cabin Hill Drive
Greensburg, PA 15601

Michael L. Kessler, Esq.
American Energy Solutions, Inc.
111 South Alfred Street
Alexandria, VA 22314

Michael A. Stosser, Esq.
Adelia S. Borrasca, Esq.
Heller, Ehrman, White & McAuliffe
Suite 200
815 Connecticut Avenue, N.W.
Washington, DC 20006

Michael T. Vough, Esq.
Vough & Mecadon
Greater Pittston Professional Center
126 South Main Street
Pittston, PA 18640

Joan O. Brandeis, Esq.
Schnader, Harrison, Segal & Lewis
Suite 3600
1600 Market Street
Philadelphia, PA 19103

Usher Fogel, Esq.
Roland, Fogel, Koblenz & Carr, LLP
1 Columbia Place
Albany, NY 12207

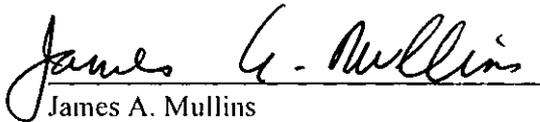
David M. Boonin
New Energy Ventures, Inc.
Suite 800
200 South Broad Street
Philadelphia, PA 19102

Andrew Altman, Deputy Director
Clean Air Council
Suite 300
135 South 19th Street
Philadelphia, PA 19103

Gordon J. Smith, Esq.
John & Hengerer
Suite 600
1200 17th Street, N.W.
Washington, DC 20036-3006

Roger E. Clark
Environmental Energy Project
905 Denston Drive
Ambler, PA 19002

Joseph A. Dworetzky, Esq.
Hangley, Aronchick, Segal & Pudlin
Twelfth Floor
One Logan Square
Philadelphia, PA 19103-6933



James A. Mullins
Assistant Consumer Advocate

Counsel For
Office of Consumer Advocate
1425 Strawberry Square
Harrisburg, PA 17120
(717) 783-5048

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