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ORIGINAL

February 27, 1998

James J. McNulty, Secretary
Pennsylvania Public Utility Commission
Room B-20, North Office Building
Harrisburg, PA 17120

VIA HAND DELIVERY

**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 for filing are the original and nine (9) copies of the Reply Brief of the PP&L Industrial Customer Alliance in the above-referenced proceeding.

As evidenced by the attached Certificate of Service, all parties are being duly served with the reply brief. Please date stamp the extra copy of this letter and return it for our filing purposes.

Very truly yours,

MCNEES, WALLACE & NURICK

By *Pamela C. Polacek*
Pamela C. Polacek

Counsel to the PP&L Industrial Customer Alliance

PCP/clc

Enclosures

c: Honorable George M. Kashi(w/ diskettes) (via hand delivery)
Certificate of Service

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INTRODUCTION AND COUNTER STATEMENT OF POSITION

A. INTRODUCTION

PP&L's Restructuring Plan and its Main Brief are dangerously contrary to both the letter and the spirit of the Electricity Generation Customer Choice and Competition Act, 66 Pa. C.S. § 2801, *et seq.* ("Chapter 28" or "Act"). The PPLICA Main Brief submitted in this proceeding addressed the multiple ways in which the PP&L Restructuring Plan must be modified in order to comply with the Act and to enable the development of a robust competitive environment. This Reply Brief does not reiterate those criticisms and only addresses: (1) the major and pervasive flaws and failures in PP&L's Restructuring Plan and Main Brief;¹ and (2) proposals by the Electric Distributors, the Office of Consumer Advocate ("OCA"), the Office of Small Business Advocate ("OSBA") and the Competitive Intervenors.

B. COUNTER STATEMENT OF POSITION

PP&L claims to be a "low-price, highly efficient provider of electric service." PP&L M.B., p. 1. Despite this status, PP&L quantifies its gross stranded cost under the Act at \$5.5 billion. Id. at 5. Ironically, this litigation claim is higher than the Commission's stranded cost award for PECO Energy Company, which has long been derided as a high price, inefficient provider of electric service. See PECO Restructuring Order, 181 PUR 4th, 517, 564 slip op. at 101-02. Attempts by PPLICA and the OCA to accurately and fairly determine the appropriate amount of stranded cost recovery for PP&L are met with alarmist assertions about a decrease in system reliability (PP&L M.B., p. 6) and financial disaster for PP&L (PP&L M.B., p. 41). PP&L even makes an absurd

¹PPLICA is not addressing specific PP&L proposed findings of fact and conclusions of law. The PP&L proposals are clearly argumentative and inappropriate. See, e.g., #87, 88, 90, 91, 191 & 341. To the extent that PP&L's proposed findings of fact and conclusions of law conflict with positions advanced in PPLICA's testimony, Main Brief or Reply Brief, the Commission should reject those PP&L proposals.

"relativity" argument that because the Commission awarded PECO approximately 70% of its stranded cost litigation claim, PP&L's claimed net stranded costs should be fully accepted. Id. at 7. These PP&L arguments imply that the Commission's determination of stranded cost recovery is an arbitrary decision, rather than the measured, deliberative approach mandated by the Act. These emotional PP&L arguments do not assist the Commission's decision making process based on the evidentiary record.

PP&L selectively applies the Commission's PECO precedent only when it supports the PP&L claim. 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 & Petition of Enron Energy Services Power, Inc. for Approval of an Electric Competition and Choice Plan and for Authority Pursuant to Section 2807(E)(c) of the Public Utility Code to Serve as the Provider of Last Resort in the Service Territory of PECO Energy Company, Docket Nos. R-00973953 & P-00971265, Opinion and Order entered on December 23, 1997, 181 PUR 4th 517 ("PECO Restructuring Order"), Opinion and Order on Reconsideration entered on January 16, 1998 ("PECO Restructuring Reconsideration Order"). In two consecutive paragraphs, PP&L first states that the OCA market price projection for PJM accepted for PECO should not be used for another PJM participant (PP&L) and states the Commission's total stranded cost recommendation in PECO supports PP&L's litigation position to recover 70% of its gross stranded cost claim and 90% of its net stranded costs claim. PP&L M.B., p. 7. PP&L cannot selectively apply this precedent. The PJM issues in the PECO proceeding are appropriately extended to all PJM member utilities and critical issues effecting customers' right to direct access and effective participation in the competitive market must be consistently decided. PECO, as a participant in this proceeding, emphasizes a need for consistency

in order to ensure that its ability to compete is not harmed. See PECO M.B., pp. 1-5. Only through consistent decisions can the Commission fulfill the Act's goal of creating a level playing field for all market participants in the PJM region.

PP&L also claims that the most controversial rate design issue in this proceeding was its Customized Rate Design ("CRD"). PP&L M.B., p. 8. PP&L nearly ignores the very serious concerns raised by its interruptible service customers with respect to inappropriate tariff changes proposed in this proceeding. See PPLICCA M.B., pp. 71-77 & 82-89. PP&L proposed substantial, unjustified and anti-competitive tariff changes clearly intended to punish interruptible customers and prevent them from exercising their statutory right to access competitive supply. Id. Given PP&L's omission of direct testimony supporting the reasonableness of proposed changes, which severely and adversely impact the interruptibility, availability, and pricing of buy through for interruptible service, PP&L's omission of material discussion of these issues in its Main Brief is not surprising.

PP&L's Main Brief includes a plethora of calculations and positions not supported by record evidence. The most egregious incidence is the "restatement" of PP&L's litigation stranded cost claim purportedly based on the Asset Value Methodology. See PP&L M.B., Tables C & D. In addition, PP&L submits completely unsupported calculations (and changes its position from testimony) regarding deferred taxes and taxes recoverable. See id. at 127-131. These calculations must be completely ignored. The Commission and the parties cannot verify the derivation of these figures. In addition, acceptance by Commission of the PP&L "revised" claims would raise significant due process concerns for the parties. The calculations must be disregarded.

II. LEGAL AND POLICY FOUNDATIONS OF STRANDED COST RECOVERY

A. THE ACT CLEARLY PROSCRIBES A THREE-STEP APPROACH TO THE DETERMINATION OF RECOVERABLE STRANDED COSTS

PPLICA fully addressed the legal standard for recovery of stranded cost in its Main Brief.

PPLICA M.B., pp. 6-20. The Act provides a three-step process for the Commission's determination of PP&L's recoverable stranded costs.

1. The Commission must determine whether specific items are properly claimable under the Act (i.e., generation related; known and measurable; netted against all other generation-related costs; traditionally recoverable in a regulated environment but not recoverable in a competitive market; and, remaining after mitigation). 66 Pa. C.S. § 2803.
2. The Commission must properly quantify the properly claimed stranded costs (i.e., known and measurable; net present value basis at 12/31/98). Id.
3. The Commission must determine the just and reasonable amount of properly claimed and quantified stranded costs to be recovered from ratepayers through the CTC.² Id. §§ 2808(a), 2808(c), 2804(15), & 2804(14).

The Commission adopted this process in the PECO QRO and restructuring proceeding. PECO Restructuring Order, slip op. at 63-68; Application of PECO Energy Company for Issuance of a Qualified Rate Order Under Sections 2808 and 2812 of the Public Utility Code, Docket No. R-00973877 Opinion and Qualified Rate Order entered on May 22, 1997, 177 PUR 4th 417, 427 ("PECO QRO Order"). The same three-step process must be used in this proceeding.

Other aspects of the Commission's orders in PECO and on generic issues provide further guidance on the burden of proof, allocation of universal service costs, recovery of future fossil decommissioning costs, regulatory asset claims and the market price for the PJM supply region.

²Because the Act clearly allows for less than 100% recovery of PP&L's properly claimed and quantified stranded costs, this represents another exception to the principle that prudently-incurred stranded costs are recoverable. See PP&L M.B., p. 21 n. 8.

PPLICA M.B., pp. 13-20. These decisions must be applied consistently to ensure the development of the level competitive playing field envisioned by the Act.

B. PP&L'S CLAIM THAT IT IS ENTITLED TO FULL STRANDED COST RECOVERY IS CONTRARY TO THE ACT AND ESTABLISHED COMMISSION PRECEDENT

PP&L objects to proposals by PPLICA, the OCA, and the OTS to share stranded costs between ratepayers and shareholders. PP&L M.B., pp. 38-42. PP&L's arguments against equitable sharing of stranded costs are misguided and must be rejected. The Act does not entitle utilities to, nor otherwise mandate, 100% recovery from ratepayers of stranded costs. PPLICA M.B., pp. 6-20.

All statutes must be interpreted according to the rules in the Statutory Construction Act. 1 Pa. C.S. §§ 1501-1911. "Words and phrases shall be construed according to rules of grammar and according to their common and approved usage..." Id. at § 1903(a). The Supreme Court of Pennsylvania has stated that a statute must be interpreted according to the plain, unambiguous meaning of the statutory language. Markle v. Workmen's Compensation Appeal Board, 541 Pa. 148, 157, 661 A.2d 1355, 1360 (1995), reargument denied Aug. 10, 1995.

The Act does not require or mandate 100% recovery of stranded cost; rather, the Commission must exercise discretion to determine an appropriate or just and reasonable level of stranded cost that are recoverable from ratepayers. 66 Pa. C.S. §§ 2802(15), 2804(13) & 2804(14); PPLICA M.B., pp. 10-11 & 14-16. In PECO, the Commission recognized that this just and reasonable determination *involves consideration of the utility's mitigation efforts and separate consideration of whether the Commission should "exercise [its] discretion under Sections 2804(13) and (14) to disallow recovery of a portion of accurately quantified 2808(c)(3) stranded costs."* PECO Restructuring Order, 181

PUR 4th at 563, slip op. at 100. This interpretation by the administrative agency charged with execution of the statute is clearly reasonable.

PP&L states that PPLICA and others “misconstrue and misapply the term ‘just and reasonable’” to support the sharing proposals. PP&L M.B., p. 38. What is clear, however, is that PP&L uses its past actions as a regulated utility to bootstrap its attempt to gain excessive stranded cost recovery at the expense of ratepayers and to the detriment of the development of the competitive market. PP&L construes the “just and reasonable” mandate in the Act as requiring a retroactive look at its present rates. PP&L M. B., p. 38. This position clearly contradicts relevant precedent regarding the Commission’s duty to examine and ensure that every rate charged by a utility is just and reasonable. The Commonwealth Court described this ongoing duty as follows:

Prudence on the part of a utility in incurring certain expenses is no guarantee that it will recover those expenses dollar for dollar from its customers. Utility rates must be just and reasonable when charged, a standard temporarily and therefore often actually quite removed from the prudence of the original arrangements for the products needed to supply the services for which the rates are later charged.

Duquesne Light Co. v. Pennsylvania Pub. Util. Comm’n, 96 Pa. Commw. 398, 405, 507 A.2d 1274 (1986). Clearly, even if the Act required a retroactive determination of the reasonableness of PP&L’s rates, Section 1301 of the Public Utility Code, 66 Pa. C.S. § 1301, requires a prospective and ongoing duty by the Commission in this regard.

PP&L actually claims that “all of the stranded costs identified by PP&L in this case are reflected in PP&L’s current retail rates.” PP&L M.B., p. 4. Many stranded cost claims by PP&L are not reflected on current rates — nuclear decommissioning, regulatory assets, future NUG contract liability, to name a few. Thus, when viewed in conjunction with the statutory rate cap, the application of a “just and reasonable” test to stranded cost recovery is critical. See Popowsky v.

Pennsylvania Pub. Util. Comm'n, 683 A.2d 958 (Pa. Commw. 1996); Cup v. Pennsylvania Pub. Util. Comm'n, 124 Pa. Commw. 291, 556 A.2d 470 (1989). To limit the Commission's inquiry in this proceeding to a retroactive examination of rates would render the numerous references to a "just and reasonable" level of recoverable stranded costs surplusage and ineffective. See 1 Pa. C.S. § 1922(2). This construction consequently violates the principles of statutory construction and must be rejected.

PPLICA satisfies the "just and reasonable" standard through an equity return disallowance of stranded generation costs. PPLICA M.B., p. 11. PP&L's assertion that the PPLICA equity return disallowance is "artificial" or "arbitrary" is erroneous. PP&L M.B., p. 38. The equity return disallowance shares stranded costs between ratepayers and shareholders based on the PP&L debt structure. PPLICA M.B., p. 11. Clearly the utility's own debt structure is not an arbitrary manner to effect the equitable sharing mandated under the Act. Moreover, the equity return disallowance has been used with assets that are similarly no longer used and useful. Id.

PP&L also claims that appellate precedent "uniformly" rejects the sharing of costs based on "policy grounds similar to contentions received by various parties in this proceeding." PP&L M.B., p. 39. This assertion is misleading and factually inaccurate. PP&L's cited cases in support of this assertion deal with the very narrow issue of whether a past Commission policy to share rate case expenses between ratepayers and shareholders was appropriate. Butler Township Water Co. v. Pennsylvania Pub. Util. Comm'n, 81 Pa. Commw. 40, 473 A. 2d 219, 221-22 (1984); T.W. Phillips Gas & Oil Co. v. Pennsylvania Pub. Util. Comm'n, 81 Pa. Commw. 205, 474 A.2d 355, 366-67 (1984). The cases were very limited as to scope — the policy at issue was a Commission policy dealing only with rate case expenses; not a statutory directive that stranded costs may be shared between ratepayers and shareholders. Id. The proposed sharing in this proceeding is clearly

permitted by the Act's repeated recitation that only a just and reasonable amount of properly quantified stranded costs are recoverable from ratepayers. See 66 Pa. C.S. §§ 2804(13) & 2804(14). The Commission is not unilaterally instituting the sharing policy. The Commission is applying the unambiguous language of Chapter 28, which gives it the power (and duty) to ensure only an appropriate and just and reasonable amount of stranded costs are recovered from ratepayers.

In an unrelated and wandering passage, PP&L discusses how the OCA's stranded cost proposal "will have a devastating impact on PP&L." PP&L M.B., pp. 39-42.³ PP&L's alarmist arguments are inaccurate. PP&L's financial analysis used PP&L's flawed projection of market prices, not the OCA's recommended market prices. PP&L M.B., p. 41. By comparing the effect on the Company of the OCA recommendation to the effect of the PP&L recommendation (which inflates stranded cost through use of the inappropriate Regulatory Method and Dr. Jones' biased market price forecast), the Company produced a meaningless analysis based on a flawed baseline scenario (i.e., the PP&L stranded cost recommendation). Furthermore, PP&L's claim that the rate cap protects customers if its market price calculation is accepted by the Commission (and the correlating stranded cost) and market prices turn out to be higher, is wrong. Ratepayers will be harmed by providing PP&L with excessive stranded cost recovery.

The Act and case law clearly establish that the rates charged to ratepayers, including a rate collecting PP&L's proper stranded costs, must be just and reasonable. This gives the Commission discretion to order a sharing of PP&L's properly claimed and quantified stranded costs between

³PPLICA notes that no similar assertion is made regarding the PPLICA equity return disallowance.

shareholders and ratepayers. The Commission must exercise this discretion via the equity return disallowance.

C. PP&L'S CLAIM THAT A "REGULATORY COMPACT" OR CONSTITUTIONAL DOCTRINES REQUIRE FULL RECOVERY OF ITS LITIGATION STRANDED COST CLAIM IS UNSUPPORTED BY THE LAW

PP&L asserts that purported "regulatory compact" and Federal Constitutional doctrines require the recovery of stranded costs. PP&L M.B., pp. 22-25. The clear implication is that PP&L believes these items support its entitlement to full recovery of its litigation stranded cost claim. PP&L relies on the testimony of its witnesses and a handful of cases but its arguments are without basis and must be rejected.

First and foremost, neither the Act nor case law entitles PP&L to full recovery of its properly claimed and quantified stranded costs. See PPLICA M.B., pp. 6-20 & Section II.B, supra. The Act mandates that only an "appropriate" and "just and reasonable" level of stranded costs can be recovered from ratepayers. 66 Pa. C.S. §§ 2802(15), 2804(13) & 2804(14); PPLICA M.B., pp. 6-20. This "just and reasonable" amount is determined after the proper quantification of stranded costs.

Second, the Commission must follow the General Assembly's instructions; the Commission cannot stray beyond those instructions to determine whether Chapter 28 is an "unconstitutional taking" because of its potential for less than full recovery of all properly claimed and quantified stranded costs. Borough of Green Tree v. Board of Property Assessments, 459 Pa. 268, 328 A.2d 819 (1974); Philadelphia Life Ins. Co. v. Commonwealth of Pennsylvania, 410 Pa. 571, 190 A.2d 111 (1963). As stated by the Supreme Court of Pennsylvania in Green Tree:

[T]he determination of the constitutionality of enabling legislation is not a function of the administrative agencies thus enabled.

459 Pa. at 281, 328 A.2d at 825. Thus, PP&L's claim that "[i]f the Act did not provide recovery of stranded costs, or if the Act were applied in a manner that denied recovery of stranded costs, the change in regulatory policy would violate the Fifth and Fourteenth Amendments to the United States Constitution" is irrelevant to the Commission's determination. PP&L M.B., p. 24. The Commission must only be concerned with interpreting the Act according to the rules contained in the Statutory Construction Act, 1 Pa. C.S. §§ 1501-1911.

Third, no "regulatory compact" (under any name) exists. The Commonwealth of Pennsylvania did not enter into an express contractual arrangement with any electric utility. This key fact eviscerates any attempt by PP&L to rely on United States v. Winstar Corp., ___ U.S. ___, 116 S. Ct. 2432 (1996), to mandate full recovery of its litigation claim for stranded costs. See PP&L M.B., p. 24. The Supreme Court's plurality decision in Winstar held that an express contract existed between the government and Winstar, the government breached that contract by a change in the regulatory treatment of "supervisory goodwill," and no special defenses relieved the government of its obligation to indemnify Winstar. See id. at 2448-2472. Contrary to PP&L's assertion, Winstar is not a constitutional takings case; Winstar is a government contracts case.⁴ PP&L M.B., p. 24.

⁴Interestingly, the Court noted in Winstar that express contracts "are especially appropriate in the world of regulated industries, where the risk that legal change will prevent the bargained for performance is always lurking in the shadows." 116 S.Ct. at 2452. The Court recognized the very real possibility of regulatory change and endorsed the use of express contracts to minimize the impact of regulatory change on businesses in the industry. No express contract exists between PP&L and the Commonwealth. Consequently, investor and utility claims of a regulatory compact should be viewed with suspicion. See PP&L M.B., pp. 25-26.

Winstar clearly does not apply to electric restructuring stranded cost recovery. Pennsylvania courts have repeatedly held that a certificate of public convenience authorizing an electric utility to operate, does not constitute a contract. See e.g., Pennsylvania Pub. Util. Comm'n v. Zanella Transit, Inc., 53 Pa. Commw. 359, 362, 417 A.2d 860, 861 (1980) ("a certificate of public convenience is a privilege, not a contract or a property interest"). Thus, PP&L cannot reasonably argue that an implied contract exists between it and the Commonwealth, let alone an express contract as was present in Winstar. One Pennsylvania court characterized the legal relationship between a utility and the PUC as follows:

We [the court] agree with the PUC's observation that a certificate of public convenience is neither a contract nor a property interest under which its holder acquires vested rights. All of these cases indicate that a utility holding a certificate of public convenience accepts it subject to the statutory provisions which permit the certificate to be modified or rescinded for legal cause.

Western Pennsylvania Water Co. v. Pennsylvania Pub. Util. Comm'n, 10 Pa. Commw. 533, 543-44, 311 A.2d 370, 375-76 (1973) (citations omitted). These decisions clearly demonstrate that the existence and operation of a public utility are based upon a privilege, which may be revoked or modified by the Commonwealth or the PUC. In Pennsylvania, the financial risk associated with regulatory change falls squarely on the public utility. Id. Under these circumstances, the "regulatory compact" is nonexistent.

In addition, in Winstar the government promise regarding regulatory treatment of "supervisory goodwill" was absolutely necessary to induce the actions by the plaintiffs. Winstar, 116 S.Ct. at 2437. In contrast, the decision to make capital investments is uniquely within the managerial discretion of the utility — the PUC generally cannot supersede these decisions. See, e.g., Pennsylvania Pub. Util. Comm'n v. Philadelphia Elec. Co., 501 Pa. 153, 159, 460 A.2d 734, 737

(1983). Consequently, unlike the government in Winstar, the Commonwealth and the PUC did not induce electric utilities to make particular investments in electric generation facilities that the utilities would not otherwise have made. Electric utilities had the prerogative to decide where, when, and how to invest. The PUC merely acted in response to the utility's initiative. This critical fact distinguishes electric utilities from the plaintiffs in Winstar.

Fourth, PP&L's attempted reliance on Duquesne Light Co. v. Barasch, 488 U.S. 299, 109 S.Ct. 609 (1989), is severely misplaced. PP&L cannot reasonably assert that any decisions made by the Commonwealth or the PUC regarding stranded cost recovery equate with a decision to "arbitrarily switch back and forth between [rate] methodologies." Id. at 315. To the contrary, the decision by the Commonwealth and the PUC to deregulate electricity generation supply and to provide some measure of stranded cost recovery to utilities is anything but arbitrary.

Rather than supporting PP&L's position, Barasch actually validates the allowance of a return of, but not a return on, investments. Id. Thus, Barasch supports both PPLICA's use of the Asset Value Method (which returns the investment in plant but not the anticipated return on the investment) and PPLICA's recommended equity return disallowance (which accomplishes the Act's permitted sharing of stranded costs by providing PP&L a return of, but not an equity return on, its stranded generation cost during the transition period). See PPLICA M.B., pp. 9-11 & 23-28.

Barasch specifically mandates that the entire rate decision be viewed as a whole to determine the impact. 488 U.S. at 314 (citing FPC v. Hope Natural Gas Co., 320 U.S. 591, 602 64 S.Ct. 281 (1944)). Thus, the relevant consideration is not whether PP&L would be financially better off if its litigation position was adopted. The actual decision must be examined as a whole to determine whether it properly balances utility and ratepayer interests.

Moreover, Barasch specifically recognizes that no single ratemaking methodology rises to constitutional levels and acknowledges that the advent of competition may impact methodology choice.

The adoption of a single theory of valuation as a constitutional requirement would be inconsistent with the view of the Constitution this Court has taken since *Hope Natural Gas, supra*. As demonstrated in *Wisconsin v. FPC*, circumstances may favor the use of one ratemaking procedure over another. The designation of a single theory of ratemaking as a constitutional requirement would unnecessarily foreclose alternatives which could benefit both consumers and investors.¹⁰ The Constitution within broad limits leaves the States free to decide what ratesetting methodology best meets their needs in balancing the interests of the utility and the public.

¹⁰*For example, rigid requirement of the prudent investment rule would foreclose hybrid systems such as the one Pennsylvania used before the effective date of Act 335 and now uses again. See n.4, supra. It would also foreclose a return to some form of the fair value rule just as its practical problems may be diminishing. The emergent market for wholesale electric energy could provide a readily available objective basis for determining the value of utility assets.*

Id. at 316 (emphasis added). PP&L reliance on Barasch to support its litigation claimed stranded costs based on the Regulatory Method is clearly misplaced. If anything, the Barasch decision foreshadowed the appropriateness of the Asset Value Method advocated by PPLICA.

Fifth, PP&L's categorization of Columbia Gas of Pa., Inc., v. Pennsylvania Pub. Util. Comm'n, 149 Pa. Commw. 247, 613 A.2d 74 (1992), aff'd, 535 Pa. 517, 636 A.2d 627 (1994), is inaccurate. See PP&L M.B., p. 23 n. 9. In Columbia Gas, the Commonwealth Court did reverse the Commission's denial of recovery of arrearages associated with bad debt, but the disallowance was based on the general prohibition against retroactive ratemaking. Columbia Gas, 613 A.2d at 79-80. In contrast, the Commission allowed recovery for prospective or ongoing uncollectible expense related to the arrearages. Id. at 79-80. On appeal, Columbia challenged the denial of retroactive expenses and the court agreed. Id. The delay in seeking recovery of the expenses was not based on

a change in regulatory requirements (as PP&L claims); rather, outside auditors informed Columbia that generally accepted accounting principles required that retroactive arrearages for accounts of the most payment troubled ratepayers be written off as bad debt. Id. at 79. Moreover, the court specifically cited the “peculiar circumstances” of the case. Id. at 80. In other words, the court limited its holding and it does not support PP&L’s claim that a regulatory compact or constitutional principles somehow entitle it to full recovery of its litigation claim.

In summary, no regulatory compact or constitutional doctrines mandate that PP&L be permitted to recover 100% of its claimed stranded costs or 100% of the portion of the litigation claim determined to be properly claimed and quantified under the Act. Regardless, the Commission must not concern itself with the constitutionality of Chapter 28; the Commission must concern itself only with applying the requirements of Chapter 28, which clearly permit an accurate quantification of properly claimed stranded cost and an equitable sharing of those costs between shareholders and ratepayers.

D. ALLEGHENY POWER’S ARGUMENTS REGARDING THE NEED TO SHIELD INVESTORS FROM AN EQUITABLE SHARING OF STRANDED COSTS MUST BE REJECTED

Allegheny Power categorizes the PPLICA and OCA stranded cost recommendations as attempts to “penalize utility investors.” See Allegheny Power M.B., p. 8. This purported “penalty” takes two forms: (1) lower stranded cost calculations; and, (2) sharing of stranded costs between ratepayers and shareholders. Id. at 6-15. Allegheny Power’s arguments ignore the fundamental balancing of interests necessary under the Act and must be rejected. See 66 Pa. C.S. § 2804(14).

PP&L’s request for stranded cost recovery is drastically overstated. See PPLICA M.B., pp. 22-50. PP&L’s investors cannot be “penalized” by denying them undeserved stranded cost recovery.

In addition, the appropriateness of the PPLICA equity return disallowance is evident. See Id. at 10-11. The Act clearly requires only a just and reasonable recovery of stranded costs from ratepayers. 66 Pa. C.S. §§ 1301, 2804(13) & 2804(15). As explained fully in Section II.B, supra, the Commission has the discretion, after considering a utility's mitigation efforts, to mandate a sharing of stranded costs between ratepayers and shareholders. PPLICA's request for the Commission to invoke that discretion is not punitive.

The PPLICA stranded cost recommendations are intended to provide a reasonable calculation of PP&L's properly recoverable stranded costs under the Act. The PPLICA recommendations are not intended to (nor do they) penalize PP&L's shareholders. The PPLICA stranded cost calculations are reasonable and should be adopted by the Commission.

E. PP&L IS CLEARLY NOT ENTITLED TO CLAIM ITS FOREGONE RECOVERY OF STRANDED COSTS NECESSITATED BY THE RATE CAP AS A TYPE OF MITIGATION

PP&L claimed that its anticipated "foregone recovery" of \$500 million necessitated by the operation of the rate cap should be considered mitigation under the Act. PP&L M.B., p. 33. This foregone recovery is not properly claimed as mitigation under the Act. PPLICA M.B., p. 20. The Act clearly contemplates that the recovery of stranded cost is constrained both in time and in amount. Id. PP&L's attempt to claim its statutory obligation to charge only capped rates as a form of mitigation is clearly inappropriate.

III. STRANDED COST CALCULATION METHODOLOGY

A. THE ASSET VALUE METHODOLOGY IS THE ONLY APPROPRIATE MEASURE OF PP&L'S STRANDED GENERATION COST

What is a "stranded cost"? This question stands at the heart of the major dispute in this proceeding — the appropriate level of stranded cost recovery by PP&L. The answer turns on what

level of recovery is appropriate to make PP&L and its shareholders whole for any diminution in asset value due to the advent of competition. See 66 Pa. C.S. § 2803. The Commission is presented with two vastly divergent theories of the appropriate level of compensation — the “Regulatory Methodology” and the “Asset Value Methodology.” The Asset Value Methodology is the only appropriate means to determine the just and reasonable amount of stranded cost compensation for PP&L. See PPLICA M.B., pp. 26-28. PP&L and its shareholders are satisfactorily compensated for their investment in generating plant. This compensation occurs either through expected market revenues or through stranded cost recovery. After stranded cost recovery is terminated, PP&L is free to use its plants to maximize its return in the competitive market. In essence, the Asset Value Methodology provides PP&L with the compensation necessary to permit PP&L to enter the competitive marketplace on equal footing with all other suppliers. The Asset Value Methodology embraces the reality that PP&L should have the opportunity to enter the competitive market unencumbered by the investments the Company made to serve customers as a regulated entity. In contrast, the Regulatory Method unfairly and inequitably subsidizes PP&L’s position in the competitive market by providing the Company with revenue levels as if regulation continued indefinitely.

PP&L argues that the Regulatory Methodology is “fully consistent with the Act.” PP&L M.B., p. 44. PP&L cites (and misquotes) the definition of “stranded cost” in Section 2803 to support this claim. Id. The Act does not define stranded cost as those “traditionally . . . recoverable under a regulated generation market.”⁵ Rather, the Act focuses on what is “traditionally . . . recoverable

⁵Nor does the Act define stranded cost as those “which traditionally would be recoverable in a competitive generation market” as PP&L claims. PP&L M.B., p. 44. Ironically, it could be
(continued...)

under a regulated environment." 66 Pa. C.S. § 2803. In the regulated environment, utilities (and utility investors) are guaranteed a return of their investment and the opportunity to earn a return on the investment. PPLICA M.B., pp. 26-27. The Asset Value Methodology fulfills this purpose — PP&L is compensated for any diminution in the value of its investment and PP&L retains the opportunity to maximize profits from its generating units in the competitive market. Only the Asset Value Methodology properly compensates PP&L and its shareholders for their stranded costs that "traditionally would be recoverable under a regulated environment but which may not be recoverable in a competitive electric generation market." 66 Pa. C.S. § 2803.

PP&L argues that the Asset Value Methodology is inappropriate because it "presents numerous problems and complexities." PP&L M.B., p. 45. Apparently these purported "problems and complexities" were not significant to prevent the Commission from accurately using the Asset Value Methodology in the PECO proceeding. PECO Restructuring Order, slip op. at 80. The Commission's adoption of the Asset Value Methodology for computing PECO's stranded costs is clearly relevant. See PP&L M.B., pp. 46-47. The Commission must consistently apply its decision on this issue in order to ensure that restructuring is accomplished in a manner fair to all ratepayers, utilities and competitors. See PPLICA M.B., pp. 23 & 27-28. In addition, the Commission did more than use the Asset Value Method in the PECO proceeding; it specifically rejected the Regulatory Method.

We agree with PAIEUG witness Falkenberg that a "lost revenues" approach to stranded a cost recovery is inappropriate. He notes that even under traditional regulation, utility never had the expectation of guaranteed future revenues. Instead,

⁵(...continued)

argued that nothing is traditionally recoverable in a competitive market; thus, PP&L is entitled to no stranded costs.

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.

PECO Restructuring Order, 181 PUR 4th at 555 n. 71, slip op. at 80 n. 71.

B. THE COMMISSION MUST DISREGARD PP&L'S PURPORTED "RESTATEMENT" OF ITS STRANDED COST CLAIM BECAUSE IT IS NOT SUPPORTED BY RECORD EVIDENCE AND IS OTHERWISE FLAWED

PP&L presented its stranded cost request based on the Regulatory Methodology. See PP&L Statement No. 1, p. 17; PP&L Statement No. 8, pp. 4-5. PPLICA witnesses Baron and Falkenberg submitted extensive direct testimony regarding the inappropriateness of the Regulatory Methodology. See PPLICA Statement No. 1, pp. 20-22; PPLICA Statement No. 2, pp. 9-11. PP&L postulated in rebuttal testimony that the two methodologies should produce equivalent results if employed consistently. See PP&L Statement No. 8R, pp. 8-18; PP&L Statement No. 19R, pp. 8-14. PP&L provided a hypothetical illustration purportedly reflecting this concept. PPLICA provided extensive testimony regarding the fallacy that the methods produce equivalent results and illustrating the gimmicks that PP&L employed in its flawed comparison of the methodologies. PPLICA Statement No. 3S, pp. 6-14.

In its Main Brief, PP&L for the first time recalculated its stranded cost claim allegedly using the Asset Value Methodology. See PP&L M.B., Tables C & D. The Commission must completely disregard these calculations (if not strike them entirely from the brief). PP&L had the opportunity to introduce this restated (albeit grossly incorrect) claim in rebuttal testimony. It chose not to do so. The calculations in Tables C & D attached to the PP&L Main Brief are not record evidence in this proceeding and were never tested by discovery or cross-examination. Amazingly, PP&L readily admits this defect (PP&L Main Brief, p. 47) yet claims these tables were derived from record

evidence. How did PP&L perform the "derivation?" What assurance does the Commission have as to the accuracy of the derivation calculations or the propriety of the calculations? PPLICA submits the PUC can have absolutely no confidence in these Tables and must completely disregard them.

Furthermore, the PP&L calculation obviously misapplies the principles of the Asset Value Methodology. Specifically, PP&L treats future income taxes inappropriately. PP&L attempted a similar "mathematical proof" to show the equivalence of the two methodologies in its rebuttal testimony. See PP&L Statement No. 8R, pp. 8-18; PP&L Statement No. 19R, pp. 8-14 & Exhibit LAG-3. In order to produce equivalent results, however, both witnesses had to restate either the Regulatory Methodology and/or the Asset Value Methodology. PPLICA Statement 3S, p. 7. PPLICA witness Kollen explained the situation as follows:

Q: Both Mr. Guth and Mr. Schadt assert that the two methodologies result in equivalent quantifications of stranded generation costs. Please respond.

A. Both Mr. Guth and Mr. Schadt claim to provide mathematical proof that equivalent quantifications are obtained. However, to obtain the "equivalent" results, both resort to restating the [Asset Value] and/or PP&L methodologies. For example, Mr. Guth found it necessary, in his "mathematical proof" based upon data provided by Mr. Schadt, to restate the PP&L methodology on an after tax basis.

However, the two methodologies do not provide equivalent results and it is precisely because the treatment of income taxes differs between the two methodologies. The income tax treatment differs in two respects. First, the PP&L methodology projects income taxes in the future years traditional cost of service revenue requirements due to returns on equity. These future years income taxes are then discounted and included in the net present value of the stranded generation costs.

The PP&L methodology includes future years income taxes (for more than 40 years) due to equity returns under traditional cost of service regulation in contrast to [the Asset Value Methodology] inclusion of income taxes due to equity returns only for the CTC recovery period. Thus, the PP&L methodology results in a significantly higher stranded generation cost than

the [Asset Value] methodology on this difference alone. Again, the two methodologies provide equivalent results only if there are no income taxes, which is not the case.

Second, the PP&L methodology uses an after tax rate of return to discount its future years before tax revenue requirement projections. In contrast, the [Asset Value] methodology utilizes an after tax rate of return to discount the future years after tax market based contribution margins. Thus, the PP&L methodology results in a significantly higher stranded generation cost than the [Asset Value] methodology on this difference as well. Again, the two methodologies provide equivalent results only if there are no income taxes, which is not the case.

Id. at 7-8 (emphasis added). Mr. Kollen proceeded to provide a concrete illustration of why this critical issue, the treatment of income taxes, leads to a drastic overstatement of PP&L's stranded costs. See id. at 8-11 & Surrebuttal Exhibit LK-1. The PP&L application of the Asset Value Methodology in its Main Brief predictably produces equivalent stranded cost because PP&L misapplies the Asset Value Methodology.

C. THE PPLICA METHODOLOGY IS NOT A "HYBRID" APPROACH, IT IS THE CORRECT APPROACH

PP&L categorizes the PPLICA (and OCA) approaches as a "hybrid" between the Asset Value Methodology and the Regulatory Methodology. PP&L M.B., pp. 45-46. This misguided criticism is based on an alleged inconsistency between PPLICA's treatment of generating stranded costs and of stranded regulatory assets. Id. Regulatory assets are conceptually different from stranded generation costs. Regulatory assets have a definitive value today that the Company should be compensated for if the Company's claim satisfies the other requirements of the Act. PPLICA has selected the fair and appropriate manner to accurately quantify each type of stranded cost. In the PECO proceeding the Commission also recognized the need to compute regulatory assets in a different manner than stranded generation costs. See PECO Restructuring Order, 181 PUR 4th at

548-559, slip op. at 63-91. The PPLICA approach is not a "hybrid;" the PPLICA approach is the correct approach. PPLICA Statement No. 3S, p. 12.

D. PP&L'S CLAIM THAT THE PPLICA METHODOLOGY IS NOT IN THE RECORD BELIES REALITY

PP&L cryptically states that the Commission cannot adopt the PPLICA or OCA stranded cost recommendation because "the OCA and PPLICA stranded cost models are not in the record of this case." PP&L M.B., p. 47. This assertion is ridiculous and absurd. The OCA and PPLICA recommendations are fully developed in the evidentiary record. See PPLICA Statement No. 1, pp. 9-22; PPLICA Statement No. 1S, pp. 2-5; PPLICA Statement No. 2, pp. 9-11 & 50-71; PPLICA Statement No. 2S, pp. 2-66; PPLICA Statement No. 3, pp. 4-40; PPLICA Statement No. 3S, pp. 5-34. PP&L saw fit to file substantial, even if ineffective, rebuttal to these positions, so the "model" must have been sufficiently in the record for PP&L to respond in such detail. The only recommendation not in the record in this proceeding is PP&L's belated and flawed attempt to recast its stranded cost claim based on the Asset Value Methodology.

E. THE ENVIRONMENTALISTS' PLAN TO DELAY STRANDED COST VALUATION IS UNLAWFUL, INAPPROPRIATE AND WILL DELAY DEVELOPMENT OF A COMPETITIVE MARKET

The Environmentalists propose the sale of PP&L's generating assets, or in the alternative, they request the Commission to "create a mechanism for calculating the value of its stranded generating assets that allows for adjustments as the values become known." Public Interest Parties M.B., pp. 24-26. These two alternative methods are inappropriate. First, the Commission cannot order PP&L to sell its generating assets. PPLICA M.B., p. 28; 66 Pa. C.S. § 2804(5). Second, as addressed fully in Section II.F, infra, it is inappropriate under the Act to delay the determination of

a definitive level of stranded cost recovery for PP&L. Consequently, both Environmentalists proposals must be rejected.

F. ALLEGHENY POWER'S CRITICISMS OF THE USE OF MARKET PRICE FORECASTS TO ESTABLISH A DEFINITIVE LEVEL OF STRANDED COSTS AND A YEARLY CTC ARE MISGUIDED

Allegheny Power criticizes all stranded cost calculations submitted in this proceeding that are based on long-term forecasts of future market prices. Allegheny Power M.B., pp. 15-17. Allegheny Power also objects to setting CTCs based on market-price projections. Id. at 17-19. Both arguments are misguided and must be rejected.

Allegheny Power does not endorse any methodology for calculating PP&L's stranded generating costs. Id. at 15-19. Allegheny Power notes, however, that West Penn submitted an alternative methodology in its restructuring filing that purportedly values stranded costs based on "actual market prices." Id. at 15. What Allegheny Power does not state, however, is that this alternative methodology involves delaying the stranded cost determination until a point during the transition period (as opposed to determining it in the litigation of the restructuring filing), and that method has no evidentiary support in this record.

Allegheny Power's attempt to interject this subject into this proceeding is inappropriate and must be ignored. The Act clearly requires computation of a definitive level of stranded cost recovery as part of PP&L's (and every utility's) restructuring proceeding. The following features of the Act support this conclusion:

- The definition of stranded cost requires generation-related costs to be netted in determining stranded costs. 66 Pa. C.S. § 2803. It is impossible to net a utility's potential stranded costs if one component of stranded cost is not quantified.

- The definition of stranded cost states that such costs are to be determined “as part of the restructuring plan.” Id. The Commission will not be reviewing a utility’s restructuring plan during the transition period.
- The definition of stranded cost requires that such cost be mitigated. Id. The Commission is required to look at both retrospective and prospective mitigation by the Company. Id. §§ 2808(4) & (5). The Commission cannot fulfill its duty to ensure that such costs are mitigated in order to produce a just and reasonable level to recover from ratepayers unless a definitive level of stranded cost is determined as part of this proceeding.
- The Commission cannot perform its duty to ensure that stranded cost recovery is “just and reasonable” unless a definitive determination of total stranded costs is made as part of the restructuring proceeding. See id. §§ 1301, 2802(15), 2804(13), 2804(14) & 2808(c)(3).
- The Commission cannot fulfill its duty under the Act to perform a yearly reconciliation of the CTC revenues (id. § 2808(f)) unless a definitive level of stranded cost is established as part of this proceeding.
- Delaying determination of stranded costs does not adequately balance the interests of ratepayers and the Company, in violation of Section 2802(8). Id. § 2802(8).
- Delaying determination of a definitive level of stranded cost is unfair and equitable to a utility’s ratepayers because other ratepayers in the Commonwealth have been granted such certainty as to stranded cost responsibility. Id. § 2802(8).
- Delaying determination of a utility’s stranded cost will hinder the development of the competitive market, in contravention of the goals of the Act. Id. §§ 2802(4)-(7).

A definitive level of stranded costs must be determined in this proceeding. Despite any uncertainty, the best evidence to establish that level (absent voluntary sale of the assets) is reliance on a market price forecast. Allegheny Power’s arguments contradict the clear dictates of the Act.

Allegheny Power also objects to establishing fixed CTCs based on market price forecasts. Allegheny Power M.B., pp. 18-19. PPLICA addressed the appropriateness and necessity of establishing fixed CTCs in its Main Brief. See PPLICA M.B., pp. 65-68. Allegheny Power raised no arguments that were not fully addressed (and refuted) in the PPLICA Main Brief.

IV. MARKET PRICE OF ELECTRICITY

PPLICA presented a market price forecast prepared by Mr. Randall J. Falkenberg. PPLICA M.B., pp. 28-49. This forecast was performed using a model developed by Mr. Falkenberg to simulate a competitive market ("KPC Model"). Contrary to PP&L's assertion, Mr. Falkenberg has extensive experience in the energy industry projecting energy prices. See PP&L M.B., p. 49 n. 22. Mr. Falkenberg submitted an explanation of his substantial qualifications as Exhibit RJF-1. PPLICA Statement No. 2, Exhibit RJF-1. In addition, this Commission relied on Mr. Falkenberg's market price recommendations in the PECO QRO proceeding. See PECO QRO Order, 177 PUR 4th at 434-35. Finally, in preparing his market price forecast, Mr. Falkenberg relied on the extensive experience of the Energy Information Administration ("EIA") for projecting fuel price and inflation escalation, and publicly available sources for other inputs. See PPLICA M.B., pp. 30-32 & 39-49. Mr. Falkenberg's forecast is reasonable and should be accepted.

PP&L submitted a market price forecast performed by Dr. Scott Jones. PP&L M.B., pp. 48-87. Despite Dr. Jones' "extensive experience," his analysis contains three critical errors that completely invalidate the forecast:

1. Dr. Jones inappropriately treats start-up and no load costs in his application of the EGEAS model.
2. Dr. Jones used no model to project capacity prices; rather, Dr. Jones relied on current contract negotiations (in a wholesale, regulated market) and a judgmental escalation of those prices. As a result, Dr. Jones fails to project prices sufficient to support the addition of the new generating capacity that his EGEAS modeling predicts must be added to the PJM region.

3. Dr. Jones used his judgment to determine many of the input variables to his energy price forecast. The Commission cannot be assured that Dr. Jones' desired market price result did not taint his judgment on key input variables such as fuel prices.

See PPLICA M.B., pp. 30-33 & 36-50. These three major flaws, and a myriad of less substantial flaws detailed in the PPLICA Main Brief and testimony, render the Jones forecast invalid.

A. RELEVANT MARKET FOR ENERGY

All parties, including PP&L, appear to agree that PJM is the relevant energy market for this analysis. PP&L M.B., p. 50; PPLICA M.B., p. 28-29. If PJM is the relevant market, then the Commission cannot adopt a different price forecast for that market in this proceeding than it adopted in the PECO proceeding (another PJM member utility). The OCA's market price forecast must be used to determine both PECO and PP&L's stranded costs.

B. PRICE OF CAPACITY

PP&L refers to the PPLICA criticism of Dr. Jones' capacity price forecast as a "tempest in a teapot." PP&L M.B., p. 51. Not surprisingly, PP&L attempts to minimize the importance of this issue. PP&L's capacity prices are understated because Dr. Jones does not base those prices on the EGEAS model that he used to forecast energy prices (and anticipated capacity additions). PPLICA M.B., pp. 32-34. This understatement of capacity price makes it uneconomic to build the new generation capacity that the EGEAS model predicts is necessary to meet demand in the PJM region. Id. The inability of a price forecast to support new capacity additions raises significant reliability concerns that the Commission must consider. See 66 Pa. C.S. § 2804(1). This issue deals with an area more significant than a teapot; this issue deals with the continued reliability of the PJM system.

Contrary to PP&L's assertion, the inadequacy of Dr. Jones' capacity prices to support addition of new capacity is clearly supported by the record. See PP&L M.B., p. 54. PPLICA

Exhibits RJF-11A-R and RJF-11B-R, which were submitted after PP&L submitted its final EGEAS run necessitated by its inappropriate O&M figure (PP&L Exhibit No. STJ-7 (revised 9/4/97)), clearly show that in 1999, the year when Jones' EGEAS modeling predicts capacity additions will be necessary, the Jones capacity price is insufficient to support the addition of new capacity. See PPLICA Exhibit Nos. RJF-11A-R & RJF-11B-R.

In addition, PP&L's attempt to rely on Dr. Jones' revised rejoinder exhibits is reckless. See PP&L M.B., 51-52. Mr. Falkenberg thoroughly discredited Dr. Jones' original exhibits in surrebuttal testimony. See PPLICA Statement No. 2-S, pp. 18-33. The obvious flaws included the following:

- Confusion of the LHV and HHV heat rates for new combined cycle plants.
- Dr. Jones did not use the standard industry practice of using summer ratings to report unit capacities. More significantly, it is during the summer when PJM has its peak, and when the value of capacity will be the highest. It stands to reason that most of the capacity revenues will be paid out in the summer season when capacity ratings are lower. PP&L assumed this in applying Dr. Jones' capacity prices to its own units when Mr. Schadt computed market capacity revenues.
- Incorrect assumption that the figures reported in the Gas Turbine World 1996 Handbook were in 1997 dollars. The publication itself states the figures are in 1996 dollars. Thus, Dr. Jones understated all capacity costs by an additional 2.5% (his assumed rate of inflation).
- Assumption that debt is retired evenly over 30 years (the life of the plant). However, he actually computed the debt interest based on the 20-year tax life of the plant. Thus, he has excluded debt interest for the last ten years of the study.
- Dr. Jones did not included any "hard costs" for land, gas pipelines, and etc., in STJ-28. While he does include a 15% allowance for "soft costs" (such as interest during construction, overheads, etc.), there is no allowance for many of the costs actually required for equipment needed to allow these units to run.

Id. at 19-23. Mr. Falkenberg testified that Dr. Jones' corrections made in rejoinder testimony did not change his conclusion.

Q. Does the revised exhibit change any of the conclusions and other criticisms that you included in your surrebuttal testimony with respect to this exhibit?

A. There's nothing that changes in the way of conclusions because of this exhibit. Dr. Jones did adjust the capacity factors; he took the capacity factors out of the EGEAS run, from what I can tell. I believe he still has improperly applied these capacity factors, because the EGEAS runs are based on the summer ratings of the units, are what's shown in EGEAS, so the capacity factors that are computed based on that are based on the summer rating. So to the extent that he hasn't used the summer rating, but he's used a 59 degree rating, I believe that his estimates of generation for these units would be overstated.

Second of all, Dr. Jones did increase his revenue. His explanation of it was that the units would have lower capacity factors, I guess, than he thought previously, and that he wasn't any longer utilizing Mr. Knecht's calculation, he now had a different calculation. To my knowledge there is no evidence in the record as to support those figures. Having said that, I believe that if I were to have had this information at the time that I filed my surrebuttal testimony, it wouldn't have changed any of my conclusions; I still would have made the other adjustments that I made. I might or might not have accepted all of the higher revenue that Dr. Jones shows here.

Furthermore, this exhibit really only corresponds — this exhibit deals with the question of whether or not Dr. Jones' market prices are sufficient to pay for the cost of new capacity. I had two sets of exhibits that dealt with that question, my Exhibits 11a and b, and my Exhibits 13a and b. These modifications that Dr. Jones made here to the revenues would only be applicable to my Exhibit 13a and b. If Dr. Jones is right, then that would mean that I would have somewhat higher revenue; however, I don't believe that that effect would be enough to change the conclusions in my exhibits. It wouldn't affect my Exhibit Nos. 11 a and b because I used a different revenue forecast for those anyway based on a higher cost unit than even Dr. Jones uses here. So had I had this exhibit earlier, I obviously wouldn't have made the criticisms about the heat rate inputs; I don't believe it would have changed my calculations or my end results.

Tr. at 1717-1719 (Aug. 26, 1997). PP&L's arguments to the contrary are baseless.

PP&L criticizes Mr. Falkenberg for failing to support the increased rate of return for new investors indicated by PPLICA's higher capacity prices. PP&L M.B., p. 54. PP&L's own witness

admitted, however, that the cost of capital of a firm operating in a competitive generating market will likely be higher than that of a regulated electric utility. PP&L Statement No. 19R, p. 33. Clearly this is a reasonable result. Returns sufficient to support PP&L's capacity contracts in a regulated environment will not be sufficient to induce new builders of capacity in the competitive environment. See PP&L M.B., p. 54. Regulation reduces the risk associated with capacity construction. This lower risk results in lower return expectations. In the competitive market, risk is higher and, correspondingly, the return demanded by investors will be higher. PP&L unreasonably understates the return necessary for new capacity (and consequently overstates stranded cost) by relying on the returns sufficient in the regulated environment.

PPLICA clearly presented a reasonable capacity price forecast. PP&L's arguments raised in its Main Brief do not alter the validity of the PPLICA forecast. In addition, PPLICA clearly demonstrated that: (1) PP&L's projected capacity prices fail to support the construction of new capacity in PJM at the times and prices assumed by PP&L's EGEAS modeling; and (2) PP&L's Dr. Jones arbitrarily established the forecast based on current capacity contracts in a wholesale, regulated market. Clearly, the PP&L forecast must be rejected.

C. PRICE OF ENERGY

1. PP&L's Analysis is Flawed and Must be Rejected.

PP&L's forecast of energy market prices is severely flawed and must be rejected. See PPLICA M.B., p. 36-50. PP&L attempts to confront two key criticisms in its Main Brief: (1) the treatment of start-up or no load costs; and, (2) the inappropriateness of Dr. Jones' inputs. PP&L M.B., pp. 55-87.

First, PP&L cannot rebut PPLICA's valid criticism that Dr. Jones's modeling does not sufficiently deal with start-up and no load costs. In the competitive market (in which there are no captive baseload customers to shoulder start-up and no load costs), generator bids must cover all variable costs of running a unit in a given hour, including start-up and no-load costs. PPLICA M.B., pp. 42-44. PP&L argues that no-load costs will not be included in the bid, but will rather be *recovered over the long-term each time a unit is compensated for more than its variable cost because of the operation of the market.* PP&L M.B., p. 56. In the event that the costs cannot be recovered, PP&L claims those fixed costs are "stranded investments in generation." Id. Obviously, "stranded investments" are not recoverable in a competitive market and the generators will financially fail. Generators will not operate in a given hour unless these costs can be recovered. PP&L's arguments to the contrary evince a clear ignorance to the operation of a competitive market and must be rejected.

Second, PP&L cannot rebut the lack of independence between the market price forecast and Dr. Jones' judgmental inputs. PP&L discusses the many inputs to the forecast that Dr. Jones used his infinite (and uncorroborated) wisdom to determine. PP&L M.B., 64-87. PPLICA submitted extensive criticism of Dr. Jones' analysis. PPLICA M.B., pp. 39-50. The main thrust of the PPLICA criticism was that Dr. Jones used his judgment to determine many key input variables that have a substantial impact on the resulting market price forecast. The Commission cannot rely on the forecast because PP&L cannot demonstrate the independence of those variables. PP&L's brief actually supports PPLICA's argument in this regard by detailing how Dr. Jones used his judgment to determine most of the inputs to his forecast (as opposed to relying on independent sources). The

Commission simply cannot be confident that Dr. Jones' desired market price result did not taint his judgmental application to those inputs.

The most egregious example of this lack of independence is Dr. Jones' fuel price forecast. PP&L admits that: "The effect of the different fuel price forecasts pervades the market price analysis and is difficult to isolate." PP&L M.B., p. 74. PPLICA agrees. Given the pervasive effect of the fuel price forecast, and the obvious differences between Dr. Jones' fuel price forecast and those performed by nationally recognized, independent organizations (EIA and DRI), the Commission cannot rely on the Jones market price forecast. As PPLICA witness Falkenberg explained:

Dr. Jones places his own personal opinion and judgment above the detailed modeling and analysis of these legitimate, disinterested sources. Dr. Jones and PP&L expect ratepayers to place a \$4.6 billion bet on his personal fuel price forecast. Given a total lack of mathematical analysis supporting his forecast, I believe it would be imprudent for the Commission to accept Dr. Jones forecast over that of the credible, independent and disinterested source advocated by PPLICA.

PPLICA Statement No. 2S, p. 37. The Commission must insist on absolute independence. Dr. Jones' forecast fails to meet this standard and must be rejected.

In addition, PP&L has not justified why the Commission should adopt a different fuel price forecast in this proceeding than it used in the PECO proceeding. The Company simply asserts that each proceeding must be judged by its own record. PP&L M.B., p. 71. However, the Commission must also be guided by its prior decisions. Both PP&L and PECO are members of PJM. The fuel prices for generators in PJM cannot differ based on which utility's stranded cost claim is being considered. The "divergence issue" and the attempt by PP&L to have the Commission alter the DRI forecast to reflect less divergence between the escalation of coal prices and the escalation of oil and natural gas prices is simply a self-interested ploy designed to unreasonably increase PP&L's stranded

cost claim. See PP&L M.B., pp.71-74. The Jones fuel price forecast (including the lack of divergence between coal prices and oil and natural gas prices) must be rejected.

2. PPLICA's Modeling of Future Energy Prices is Appropriate.

PP&L criticized the PPLICA market price forecast on two topics: (1) the use of the KPC model; and (2) Mr. Falkenberg's reliance on independent, publicly available sources for inputs to the forecast. PP&L M.B., pp. 57-58 & 64-87. Both arguments are baseless.

PP&L criticized the KPC model as "theoretical" and not tested in the real world environment. PP&L M.B., p. 57. PP&L is wrong. The KPC model has been successfully benchmarked and shown to be valid. PPLICA Statement No. 2S, pp. 48-50, Exhibit No. RJF-14. The KPC Model has been used (and relied on) in various regulatory proceedings. Id. at 43-45 & 47-48. Mr. Falkenberg authored similar models for Ebasco Services. Id. at 46. The KPC Model has been sufficiently "tested" to prove its adequacy for the task at hand.

PP&L also criticized the KPC Model as being proprietary to Mr. Falkenberg's firm and not provided to PP&L until after the filing of rebuttal testimony. PP&L M.B., p. 58. Of course the KPC Model is proprietary; after all, PP&L's Mr. Falk testified that his company's (NERA) model is only available if the user pays a fee of \$150,000. Tr. at 1694 (Aug. 26, 1997). Moreover, unlike the other models in the proceeding, the KPC Model was provided to PP&L to run; in contrast, the entire EGEAS model used by PP&L was not made available to the other parties in this proceeding. PPLICA Statement No. 2S, p. 45. Only PP&L can run the EGEAS model. Frankly, even if the EGEAS model were available, neither the other parties nor the Commission could replicate Dr. Jones' analysis because of the extensive ad hoc adjustments made by Dr. Jones to produce a result that conveniently awards PP&L excessive stranded cost recovery. See PPLICA M.B., pp. 37-41.

PP&L also criticizes Mr. Falkenberg's inputs to the market price forecast. The overarching theme of this criticism is that Mr. Falkenberg inappropriately relies on objective independent sources for his inputs. PP&L M.B., pp. 64-87. The most criticized (and most critical) input to the market price forecast is the fuel price forecast. Mr. Falkenberg relied on the EIA forecast. PP&L categorizes the EIA forecast and the DRI forecast used by the OCA as "unreliable inputs to any model." Id. at 74. In other words, throughout the country, the forecasts performed by these independent organizations are incorrect and cannot be relied upon; however, according to PP&L, Dr. Jones' forecast, performed solely for this proceeding and conveniently producing results that maximize stranded cost recovery for PP&L, is absolutely correct. Moreover, Dr. Jones' inflation estimate is the only correct figure. PP&L M.B., pp. 74-77. One wonders why Dr. Jones is not relied upon more extensively by the Federal Reserve Board and other government agencies if he is so clairvoyant compared to EIA and DRI.

Finally, PP&L claims that Mr. Falk addresses, "in detail," multiple flaws with the KPC model. PP&L M.B., p. 58. Noticeably, PP&L provides no citation to this "detailed" discussion. Id. A review of Mr. Falk's testimony shows no valid criticisms of the KPC model. Furthermore, Mr. Falkenberg specifically addressed and rebutted Mr. Falk's insignificant comments in his surrebuttal testimony. See PPLICA Statement No. 2S, pp. 39-40, 43-51 & 60-65. Importantly, Mr. Falk never quantified the impact of his purported criticisms. This omission is probably caused by Mr. Falk's inability to accurately assess the logical impact of changes in inputs on predicted market prices. After all, on cross-examination Mr. Falk testified that PP&L's overstatement of O&M in its market price forecast would probably increase stranded costs when corrected (Tr. at 1703 (Aug. 26, 1997));

in reality, when PP&L corrected the error the Company had to revise its stranded cost claim downward. See PP&L Exhibit STJ-7 (Revised 9/4/97).

V. REVENUE UNDER REGULATION

C. REGULATORY ASSETS AND LIABILITIES

1. PP&L's Regulatory Asset Claim For Unrecovered Energy Costs Is Overstated And Partially Inappropriate For Recovery Under The Act

PP&L proposed a regulatory asset of \$76.815 million in unrecovered energy costs, consisting of \$17.2 million in actual under-recoveries at December 31, 1998, and an estimated \$31.2 million annual under-collection in 1997 and 1998. PP&L M.B., pp. 98-101. PP&L claims that the Commission's Tentative Order in Docket Nos. P-00961131 and R-00963842 created both regulatory assets. Id. at 99. PP&L incorrectly calculated actual unrecovered energy cost at December 31, 1996. PPLICA M.B., p. 52. The correct calculation is \$16.2 million. Id.; PPLICA Statement No. 3S, p. 19.

The Company's claim for 1997 and 1998 anticipated under-recovered fuel costs lacks a legal and factual basis. PPLICA M.B., pp. 51-54. The Act permits PP&L to roll its ECR into base rates once. 66 Pa. C.S. § 2804(4)(v). Permitting recovery for fuel costs incurred after that ECR roll-in circumvents the rate cap. PECO Restructuring Reconsideration Order, slip op. at 11. The PP&L proposal is clearly inappropriate because it violates the rate cap in Section 2804(4)(i), 66 Pa. C.S. § 2804(4)(i).

In addition, the anticipated under-recoveries do not automatically qualify as a regulatory asset. Contrary to PP&L's assertion, the Commission did not create a regulatory asset regarding this claim. PP&L M.B., p. 99. PPLICA specifically petitioned for modification of PP&L's Tentative

Order at Docket Nos. R-00963842 and P-00961131 regarding this issue. In response, the Commission stated:

We agree with the Petitioners. Although there is no question that PP&L has our approval to defer and seek to recover the differential, we will not, in the context of this action, decide that the differential is an appropriate component of PP&L's transition or stranded cost. Both recovery and the amount of this item should be addressed in PP&L's restructuring proceeding, with an opportunity for all participants there to review PP&L's proposal and be heard on the issue. The limited nature of the proceeding before us is such that these issues are better left to restructuring in which full complete consideration of PP&L's transition or stranded cost will be given.

Petition for Amendment of the Pennsylvania Power & Light Company Industrial Customer Alliance, Docket Nos. P-00961131 & R-00963842, Opinion and Order entered on May 22, 1997, slip op. at 9-10. The Company failed to show these anticipated under-recoveries qualify as a regulatory asset. PPLICA M.B., pp. 52-54. First, anticipated under-recovered fuel costs are not "known and measurable." See 66 Pa. C.S. § 2803. An "expectation" of under-recovery does not establish a known and measurable cost. See PP&L M.B., pp. 99-100. In fact, PPLICA shows that the amount may be inflated. See PPLICA M.B., pp. 53-54; PPLICA Statement No. 3, p. 21. Second, unrecovered energy costs are not recoverable in the regulated environment until actually incurred. Id. at 53. Consequently, the costs do not qualify as "traditionally . . . recoverable under a regulated environment." See 66 Pa. C.S. § 2803. The claim must be rejected.

2. PP&L's Claim For Employee Transition Costs Does Not Meet The Known And Measurable Standard

PP&L claimed a \$17.106 million stranded regulatory asset for employee transition costs related to severance and incremental pension costs. PP&L M.B., pp. 101-103. This claim should be denied because the costs are highly speculative (i.e., not known and measurable) and because PP&L failed to account for normal employee attrition in its calculation (i.e., these costs would be

incurred regardless of the transition to a competitive environment). PPLICA M.B., pp. 54-55. PP&L admits it has been pursuing an employee reduction strategy (now claimed as one of its mitigation efforts) since 1985. See PP&L M.B., pp. 29-30. PP&L has not sufficiently established the basis for or amount of this claim.

3. Historic Evidence Contradicts PP&L's Attempt To Collect Escalating Taxes Other Than Income

PP&L included taxes, other than income, in its calculation of stranded costs. PP&L M.B., pp. 104. To reflect these taxes in future years, PP&L escalated the 1996 capital stock taxes and Public Utility Realty Tax ("PURTA") for each generating unit by 2.5% each year over the life of the generating asset. Id.

Among many other criticisms, PPLICA objected to the inappropriate overstatement of taxes at the rate of inflation. PPLICA Statement No. 2, pp. 50-51. The record evidence clearly illustrates that these tax-related costs have declined over the past five years. Id. at 51. PP&L's arguments of the need for revenue neutrality for the Commonwealth do not change this evidence. See PP&L M.B., pp. 104-105. Section 2810 authorizes the Commonwealth to impose an additional tax to recoup any revenue shortfall caused by restructuring. 66 Pa. C.S. § 2810. Section 2810 does not authorize a utility to unjustifiably attempt to increase its stranded cost recovery based on forecasts for tax rate increases. The PP&L proposal to include increasing taxes other than income as part of its stranded generation cost calculation must be rejected.

4. PP&L's Anticipated Fossil Decommissioning Costs Are Not Recoverable Under The Act And Applicable Precedent

PP&L inappropriately included \$315.867 million in future fossil decommission expense as a part of its stranded cost claim. PPLICA M.B., pp. 56-60. These costs are neither "known and

measurable” nor typically recoverable in the regulated environment. Id. Consequently, the costs do not qualify as stranded costs under the definition in the Act. 66 Pa. C.S. § 2803. The Commission properly rejected a similar claim by PECO. PECO Restructuring Order, slip op. at 91-92.

PP&L’s attempt to subvert the PECO precedent is misguided. See PP&L M.B., pp. 105-109. PP&L raised no arguments to overcome the reality that future fossil decommission costs are not known and measurable and are not typically recoverable under applicable precedent.

In addition, the Electric Distributors’ argument that the definition of stranded cost specifically recognizes the recoverability of fossil decommission cost is spurious. See Electric Distributors M.B., pp. 4-5. The General Assembly specifically stated that nuclear decommissioning costs were recoverable but did not assure recoverability of fossil decommission costs. 66 Pa. C.S. § 2803. Moreover, it is reasonable to assume that the Legislature was cognizant of the long line of Commission and court precedent denying recovery for future fossil decommissioning costs. A vague reference to “retirement costs” is not sufficient to overcome the presumption that the General Assembly intended to continue this principle. See 1 Pa. C.S. § 1921(c)(5). Arguments to the contrary must be rejected.

6. PP&L’s Request To Recover Its DOE Assessment As Both A Regulatory Asset And A Stranded Generation Cost Must Be Denied

PP&L claimed a stranded regulatory asset for its obligations related to decontamination and decommissioning of the Department of Energy’s (“DOE”) uranium enrichment facilities. PP&L M.B., pp. 113-114. This claim must be denied because identical costs are included in the PP&L stranded generation cost claim. PPLICA M.B., p. 62. Recovery as both a regulatory asset and a stranded generation cost is inappropriate under the Act, which allows recovery only for the “net” stranded costs. 66 Pa. C.S. § 2803.

7. PP&L's Request To Recover Deferred Susquehanna Refueling Costs Must Be Denied

PP&L inappropriately claimed a stranded regulatory asset for deferred expenses associated with an accounting change for refueling costs. PP&L M.B., pp. 114-116. The Commission did not authorize deferral of these costs, which were associated with a unilateral accounting change. PPLICA M.B., pp. 62-63. Consequently, the deferred costs are not properly treated as a regulatory asset. Commission approval is required to create a regulatory asset, and no approval was sought by PP&L.

8. PP&L Must Recognize A Regulatory Liability For SFAS 106

PPLICA recommended that PP&L be required to recognize a regulatory liability relating the excessive revenues received by PP&L from ratepayers related to SFAS 106 (post-retirement benefits). PPLICA M.B., pp. 63-65. The Company recognized the PECO precedent on a similar regulatory liability, but attempted to distinguish the PECO decision by claiming the Company credits the SFAS 106 earnings to customers as part of a reduction to its stranded generation costs. PP&L M.B., pp. 116-118. This attempt is factually inaccurate and must be rejected.

PPLICA responded to the identical assertion in surrebuttal testimony. PP&L failed to: (1) reduce the O&M expense in the stranded cost quantification for the interest income at issue; and (2) reflect additional interest income from full funding of ratepayer's cumulative prepayments. PPLICA Statement No. 3S, pp. 28-29. PP&L clearly must compensate ratepayers for this expense through recognition of a regulatory liability offsetting the other components of its stranded cost claim.

10. PP&L's Attempt To Use Inappropriate Retirement Dates For Generating Plant Must Be Rejected

PPLICCA addressed the retirement of generating plant in its market price analysis and fossil decommissioning discussion. PPLICCA M.B., pp. 49 & 59. The retirement assumptions for these plants should be consistent with those adopted by the Commission to project market prices and stranded costs in the PECO proceeding. Id. PP&L used earlier retirement dates for several plants, which decreases the revenue the plant can recover in the competitive market and increases stranded cost.

PP&L advanced various arguments attempting to illustrate that its proposed retirement dates are appropriate and should be accepted. PP&L M.B., pp. 119-121. The Commission must reject those arguments because of the need for fairness and consistency in deciding the restructuring plans for the various PJM utilities. See 66 Pa. C.S. § 2802(8). It is simply illogical for the Commission to agree in one proceeding that a plant will be retired in one year and yet in another proceeding agree that the same plant will be retired in a different year. The past practice of the PUC regarding the use of differing retirement dates is irrelevant to the Commission's determination in this proceeding. See PP&L M.B., p. 120. Clearly this issue impacting the critical stranded cost determination under the Act deserves better support than blind adherence to past practice. The PP&L retirement dates should be adjusted to coincide with those used to determine PECO's stranded cost to avoid unnecessary competitive differences between the two companies.

D. OTHER REVENUE ISSUES

1. PP&L Changed Its Position On Taxes Recoverable In The Main Brief, Included Calculations Not In The Evidentiary Record And Manufactured A Dispute With PPLICA

The Company has changed substantially its litigated position on taxes recoverable. The Company originally claimed as a regulatory asset taxes recoverable of \$231,708,000 on a net present value basis at December 31, 1998. See PP&L Statement No. 8, Exhibit JRS 1A (revised). PPLICA accepted this claim. PPLICA Statement No. 3, pp. 9-13. For the first time, the Company now strongly disagrees with its own methodology and increases its claim for this regulatory asset by extraordinary amounts without citation to any record evidence. See PP&L M.B., pp. 127-28 & Tables C & D. The Commission must ignore the extra-record argument and quantifications.

To the extent the Commission considers the Company's extra-record arguments and increased claim for taxes recoverable, they are incorrect. The Competition Act requires that regulatory assets be stated at net present value, computed in accordance with traditional cost of service regulation. 66 Pa. C.S. § 2803; PPLICA M.B., pp. 11-12. For taxes recoverable, the net present value should be computed over the remaining life of the asset. PPLICA Statement No. 3, p. 11. The Company, PPLICA, and the OCA all agreed on this point and agreed with the Company's claim quantified on this basis.

The Company now argues entitlement to the nominal amount of taxes recoverable, which it then quantifies on a "gross" and "net" basis, neither of which quantifications are supported in the record. See PP&L M.B., Table C, p. 5. The Company's argument assumes that it will not retain its generation assets and that it will have to accelerate its payment to the government of the taxes recoverable, which would normally occur over the remaining lives of the underlying assets. This

argument, based upon immediate divestiture of its generation assets, is contrary to reality and the Company's representations in the record.

Because the Company intends to continue to own and operate its generation assets, there will be a time value benefit of delaying the payment of the taxes recoverable, consistent with the recognition and recovery of these taxes under traditional cost of service regulation, that will redound either to the Company or to the ratepayers as a reduction to stranded cost. The Competition Act unequivocally assigns that time value benefit to the ratepayers, not the Company. It cannot be assumed away in complete contradiction to reality.

The future taxes represented by the taxes recoverable balance represent taxes that will be payable in future years due to tax/book basis differences such as AFUDC and pension expense. The net difference, assuming the book basis is greater than the tax basis, will result in higher tax expense and higher future revenue requirements to recover the higher tax expense. These future and higher taxes are backloaded (i.e., they increase in future years). Thus, the net present value of payments required from ratepayers are significantly less than the nominal sum of these future payments. There simply is no justification for ignoring this reality in order to provide the Company with a windfall on this regulatory asset.

Finally, the Company's newly increased claim produces a further compounding of excessive stranded costs and CTC recovery because the Company includes a levelized rate of return on this taxes recoverable regulatory asset stranded cost. Such a claim would be valid only if the taxes recoverable regulatory asset stranded cost is first properly stated on a net present value basis, which it no longer is.

2. The Company Inappropriately Changed Its Position On Deferred Taxes In The Main Brief

The Company has changed substantially its litigated position on accumulated deferred taxes. The Company originally claimed a reduction to its stranded generation cost claim for the net present value at December 31, 1998 of the carrying charge effects of the accumulated deferred taxes over the remaining lives of its underlying generation assets. See PP&L Statement No. 8, pp. 8 & 13-14. The Company now claims, under the same false hypothesis advanced to support its upwardly revised claim for taxes recoverable, that there will be no carrying charge benefit to the ratepayers under the theory that its stranded cost claim must be based upon the assumed immediate divestiture of its generating assets. See PP&L M.B., pp. 129-131. Of course, this is a false hypothesis because it stands in stark contrast to the Company's intent to continue to own and operate its generation assets.

Given the reality of the Company continuing to own and operate its generating assets, there will be carrying charge benefits associated with the accumulated deferred taxes. There simply is no question that under the provisions of the Competition Act that the ratepayers, not the Company, are entitled to the net present value of those benefits as a reduction to generation stranded cost. The Company's attempt to reject through brief its own litigated position and to improperly "correct" the stranded generation cost quantifications of PPLICA and OCA without any evidentiary support must be rejected.

VI. DETERMINATION OF PRESENT VALUE

A. CONTRARY TO PP&L'S CLAIM, THE PPLICA STRANDED COST CALCULATION FULLY INCLUDES INCOME TAXES

PP&L claims that the PPLICA stranded cost calculation is understated because of its treatment of income taxes. PP&L M.B., pp. 133-34. Specifically, PP&L claims that Mr. Falkenberg

“reflect[s] income taxes in calculating the value of PP&L’s generating assets, but fail[s] to adjust stranded costs upward to account for the taxability of CTC revenues.” Id. at 133.

PP&L’s claim is baseless. PPLICA fully addressed its treatment of income taxes in its surrebuttal testimony. For stranded generation costs, PPLICA witness Mr. Falkenberg subtracted the net present value of the future years after tax contribution margins discounted at an after tax rate of return from the net book value of the Company’s assets. Various adjustments were made by Mr. Falkenberg to market value for tax benefits. For net stranded regulatory assets, PPLICA witness Kollen quantified these costs as the net present value of the future years required recovery under traditional cost of service regulation discounted at an after tax rate of return. PPLICA witness Baron then applied a before tax return to the aggregate unamortized balances of these stranded costs until the costs were fully recovered under the PPLICA CTC recovery methodology. PPLICA Statement No. 3S, pp. 5-6. PP&L must pay income tax only on the portion of the CTC that represents the equity financing of the stranded generation costs during the CTC recovery period; the CTC revenue that represents the return of the Company’s investment is not taxable. PPLICA Statement No. 3S, pp. 10-11 & 13. The PPLICA proposal properly accounts for those income taxes in its CTC methodology. Id. at 5-6. Thus, no additional amount for income taxes needs to be included in PPLICA’s recommendation. PP&L’s claim must be rejected.

VII. RECOVERY OF STRANDED COSTS

A. THE OSBA’S CRITICISM OF PPLICA’S CTC METHODOLOGY, IS FLAWED AND MUST BE REJECTED

PPLICA proposed a CTC design methodology based on a CTC residual approach, with the yearly CTC fixed based on projected market price. PPLICA M.B., pp. 65-68. OSBA objects to the PPLICA methodology and proposes a system that creates the problem specifically avoided by the

PPLICCA proposal (i.e., the allocation of stranded cost to rate classes). See OSBA M.B., pp. 29-34. OSBA offers a vague recommendation that the allocation could be based on a “broad-based, unbiased generation allocator” to be developed by PP&L. Id. at 31. The OSBA’s vague and unspecific proposal must be rejected.

In addition, the OSBA’s criticisms of the PPLICCA methodology are unfounded. The OSBA claims that it is “unfair” for rate classes with higher current rates to bear a fair portion of stranded cost recovery until PP&L fully recovers its allowed level of stranded costs. Id. at 31-34. OSBA would rather provide those customers with an immediate rate reduction by shifting stranded costs to customer classes with lower current rates. The OSBA is misguided.

By permitting customers to access the competitive market, PP&L will not collect the difference between the generation component in each customer class’s current bundled rate and the actual market price that it receives for the electricity that would have been sold to the customer. See PPLICCA M.B., pp. 67-68. The PPLICCA methodology assures collection of that differential.

In addition, it is appropriate to accelerate stranded cost recovery rather than produce immediate artificial rate reductions because acceleration expedites the emergence of the fully competitive market. When that market emerges all customers will have the opportunity to eliminate any rates allegedly above the customer’s cost of service indications.

The PPLICCA CTC methodology appropriately assigns stranded cost responsibility based on how those costs are embedded in current rates. No unfairness exists.

B. PP&L MISCATEGORIZES THE PPLICA OBJECTION TO AUTOMATIC EXTENSION OF CTC RECOVERY

PP&L proposed to track yearly over- or under- collections of CTC revenues and to, near the end of the transition period, reconcile the yearly figures to determine whether an automatic extension or early termination of the recovery period is warranted. PP&L M.B., pp. 138-139.

PPLICA objected to the automatic extension of the recovery period and the extension of CTC recovery without a correlating extension of the rate cap. PPLICA M.B., pp. 68-70. In addition, PPLICA proposed a monthly tracking mechanism for PP&L's CTC revenues. Id. at 69.

PP&L misconstrues the PPLICA arguments on this topic to mean that the total stranded cost quantification could be relitigated if and when PP&L applies for the CTC recovery extension. PP&L M.B., p. 140-141. This assertion is false. PPLICA specifically states that the stranded cost determination would not be revisited at that point. PPLICA M.B., p. 70; PPLICA Statement No. 1S, pp. 8-9. PPLICA's proposal is designed solely to ensure that PP&L does not over-recover its allowed stranded costs and to ensure that the recovery period is not needlessly extended. PPLICA M.B., pp. 69-70. The PPLICA argument to delay this extension until the Company can substantiate the under-recovery (if any) of its allowed stranded costs is reasonable and should be accepted.

C. NO SUPPORT EXISTS IN THE RECORD OR THE PECO DECISION FOR AN INCOME TAX GROSS-UP ON STRANDED COSTS

PP&L proposes to set the return on its unamortized CTC balances at its long-term debt cost of 7.89%. PP&L M.B., p. 143. This is the same measure (long term debt cost) as the Commission used in the PECO proceeding. PECO Restructuring Order, 181 PUR 4th at 567, slip op. at 108. PP&L also proposes to "gross up" portions of its stranded cost claim for income taxes. PP&L M.B., p. 143-144. This is inappropriate and must be rejected.

First, the Commission did not permit a gross-up for income taxes on any portion of PECO's stranded cost claim. See PECO Restructuring Order, 181 PUR 4th at 567, slip op. at 108. Consequently, it is not appropriate to permit PP&L to receive excessive compensation by a gross-up.

Second, PP&L submitted no evidence regarding this issue. The Company cites only to the explanation of its capital structure and cost rates. PP&L M.B., p. 143. The attempt to gross-up certain portions of the return on unamortized CTC balances must be rejected as contrary to the PECO precedent and unsupported by record evidence.

D. PP&L'S PROPOSAL TO CHANGE AN INTERRUPTIBLE CUSTOMER'S CTC RESPONSIBILITY FOR ACCESSING COMPETITIVE SUPPLY IS UNLAWFUL AND ANTI-COMPETITIVE

PP&L proposed to limit the availability of interruptible service under Rate Schedules IS-1, IS-P and IS-T to customers taking full requirements service from PP&L. PP&L M.B., pp. 144-46. Consequently, if a current interruptible obtained generation supply from an alternative supplier, the customer would become a firm rate schedule customer with substantially greater CTC payments. As explained by PPLICA in its Main Brief, this limitation and forced migration to a firm rate schedule (and CTC) violates the rate cap and anti-cost shifting provisions of the Act (66 Pa. C.S. §§ 2808(a) & 2804(7)) and is clearly anti-competitive. PPLICA M.B., pp. 71-77. In addition, the PP&L proposal effectively thwarts the ability of current interruptible customers to exercise the right to direct access guaranteed by the Act. Id. at 75-77.

PP&L attempts to justify this tariff change on three bases: (1) it is "simply unfair" for customers to have the right to continue to pay the CTC applicable to the rate they were taking service under on January 1, 1997, if those customers access the competitive market; (2) the discount reflected in the interruptible rate schedules is generation related; and, (3) the Commission's decision

in the PECO proceeding supports the forced migration of these customers to firm rate schedules. PP&L M.B., pp. 144-46. All three arguments are baseless and must be rejected.

First, contrary to PP&L's asserted "unfairness" to allow shopping interruptible customers to remain on the interruptible tariffs, true unfairness will occur only if the PP&L proposal is accepted. As PPLICA explained fully in its Main Brief, the PP&L proposal violates the Act's rate cap, anti-cost shifting provisions, pro-competition goals, and business developmental goals. PPLICA M.B., pp. 72-77. Consider the absurdity of PP&L's position:

Under an Act designed and intended to provide customers with direct access to competitive supply, one class of customers will face a drastic increase in responsibility for stranded costs based solely on the exercise of the statutory right to direct access.

See PP&L M.B., pp. 144-47. The PP&L position is clearly contrary to fundamental fairness and in no manner comports with the dictates and goals of Chapter 28. The proposal must be rejected.

Second, PP&L's claim that the discounts in interruptible rate schedules are "clearly generation-related" is false. PP&L M.B., p. 144. The Commission recognized that interruptible service has a transmission and distribution system benefit. PECO Restructuring Order, 181 PUR 4th at 570-71, slip op. at 118. PP&L itself admits that its proposed unbundled tariffs attribute a portion of the total interruptible discount to transmission and distribution. See PP&L M.B., p. 145 ("Under these circumstances, the interruptible customers would continue to receive from PP&L the benefit of a deeply discounted rate for interruptible delivery service while providing no reciprocal benefits to PP&L or its customers." (emphasis added)). This prior transmission and distribution benefit must be accorded to current interruptible customers throughout the transition period or the Act's rate caps will be violated.

Third, PP&L's position is not "substantially similar" to the Commission's conclusion in the PECO proceeding. See PP&L M.B., p. 146. In fact, PP&L's position is diametrically opposed to the Commission's conclusion in the PECO proceeding. The Commission's Order clearly states:

As a general rule, our approach to these special classes of customers is to treat them the same as all other customers concerning all regulated rates and services including transmission, distribution and generation services provided by PECO as an EDC, including CTC obligations. . . . Our goal is to permit customers to continue to receive the economic benefit of these tariffs to the extent that such benefits can be applied to the regulated portion of the bill.

PECO Restructuring Order, 181 PUR 4th 570, slip op. at 117. The "regulated portion of the bill" includes the transmission, distribution, and CTC components of the bill, so the interruptible customers' CTC should not change when the customer accesses alternative suppliers. PP&L must continue to provide service at those tariffed rates (including the assigned CTC) to current interruptible customers for the duration of the transition period.

E. PP&L'S PROPOSAL TO ELIMINATE LIMITATIONS ON THE FREQUENCY AND DURATION OF ECONOMIC INTERRUPTIONS MUST BE REJECTED

PP&L also proposed to change its interruptible tariffs regarding the duration and frequency of economic interruptions. PP&L M.B., pp. 146-147. The proposed change constitutes a violation of the Act's rate cap, is anti-competitive, and is not supported by any record evidence. PPLICA M.B., pp. 84-85. The proposed change must therefore be rejected.

Noticeably absent from PP&L's brief is any citation to testimony or record evidence beyond a citation to the proposed tariff page containing the change. PP&L M.B., pp. 146-147. PP&L has not shown, as it claims, that the provision "is appropriate to protect PP&L's other customers" or that the current provision "is simply not sufficient to protect the interest of other PP&L customers receiving BUS service." See id. Furthermore, even PP&L's purported justifications for the tariff

change support PPLICA's argument that the elimination of the current limitations on the frequency and duration of economic interruptions is a prohibited cost shift between customer classes that will violate the Act's rate cap. See id. at 147. PP&L's eleventh hour attempt to justify this obviously unlawful and anti-competitive tariff change must be rejected.

The assertion that customers can make an economic decision to buy through an economic interruption is irrelevant. PP&L M.B., p. 147. The Act clearly requires that the quality level of service be maintained throughout the transition period while the utility collects stranded costs. Increased interruption decreases the value of interruptible service from that received by customers on January 1, 1997. PPLICA M.B., pp. 84-85. Furthermore, PP&L proposed a change to the buy through price (again unsupported by testimony or record evidence) that results in violations of the rate cap, is unlawful, and provides customers no certainty of the actual cost of buying through the interruption. Id. at 86-87. The possibility of buy through does not compensate for this unlawful and unsupported tariff change.

VIII. RATE DESIGN AND TARIFFS

A. PP&L'S OPTIONAL CUSTOMIZED RATE DESIGN IS ACCEPTABLE

PP&L noted in its Main Brief that it proposed during hearings to make its Customized Rate Design optional for all customers. PP&L M.B., p. 148 n. 72. PPLICA accepts the Company's proposal to make the Customized Rate Design optional. PPLICA M.B., pp. 77-80.

B. THE ENVIRONMENTALISTS' PROPOSAL TO REQUIRE ALL CTC REVENUES AND TRANSMISSION AND DISTRIBUTION COSTS ON A PER KWH BASIS MUST BE REJECTED⁶

The Environmentalists propose that the entire CTC and all transmission and distribution costs be collected on a per kWh basis. Public Interest Parties M.B., p. 45.⁷

The Environmentalists' proposal clearly violates the Act's rate cap and anti-cost shifting provisions. 66 Pa. C.S. §§ 2804(4)(i) & (ii) & 2804(7). The Environmentalists propose to eliminate the declining block structure for collection of the CTC and transmission and distribution costs. This will result in transmission and distribution rates rising above January 1, 1997, levels. This proposal will disproportionately impact large volume users. The proposal is unlawful under the Act and must be rejected.

C. PP&L APPARENTLY CONCEDED THE INAPPROPRIATENESS OF THE TERMS AND CONDITIONS MODIFICATIONS TO THE PRICE RESPONSE AND INTERRUPTIBLE TARIFFS

In its Main Brief, PPLICA discussed three significant and inappropriate terms and conditions modifications to PP&L's tariff. PPLICA M.B., pp. 82-89. Specifically, PPLICA discussed the following:

1. PP&L's proposed change in the ISA, ISP, IST, PRS-1 and PRS-2 rates that limits availability of those rates to customers taking full load from PP&L. PPLICA M.B., pp. 82-83.

⁶The criticisms in this section apply equally to the proposal by the Pennsylvania Petroleum Association and the Pennsylvania Association of Plumbing, Heating, Cooling Contractors, Inc., to collect all CTC revenue on a per kWh basis. See Pennsylvania Petroleum Association and Pennsylvania Association of Plumbing, Heating, Cooling Contractors, Inc. M.B., p. 9.

⁷It is unclear whether this is a joint position of the Public Interest Parties or solely an Environmentalists' position.

2. PP&L's proposed change in the interruptible tariff rates removing limitations on the frequency and duration of economic interruptions. PPLICA M.B., pp. 84-85.
3. PP&L's proposed changes to the calculation of the interruption buy through price for interruptible customers. PPLICA M.B., pp. 86-87.

Each proposed change individually and in the aggregate has stark anti-competitive and anti-development implications that will hinder the competitive market. See PPLICA M.B., pp. 87-89.

PP&L failed to address its proposed modification to the interruption buy through price in Main Brief. In addition, PP&L did not discuss the full load requirement for the interruptible and price response rates. Apparently PP&L recognized unreasonableness and unsubstantiation of the proposed changes and decided to concede the issues.

G. THE COMPETITIVE INTERVENORS' ASSERTION THAT THE COMMISSION'S ORDER IN THE PECO PROCEEDING REQUIRED ELIMINATION OF COMPETITIVELY PRICED TARIFF OFFERINGS IS INACCURATE

The Competitive Intervenors claim that the Commission in the PECO decision ordered the elimination of competitively priced tariff offerings. Competitive Intervenors M.B., p. 57. This interpretation of the PECO precedent is inaccurate. The PECO decision requires a utility to continue to offer regulated competitively priced services such as interruptible service and economic development rates throughout the transition period. PECO Restructuring Order, 181 PUR 4th at 570, slip op. at 118. Furthermore, the utility must honor all special contracts (another competitively priced alternative) throughout the transition period. Id. at 571, slip op. at 119-120. Clearly the PECO decision does not require elimination of these alternatives; rather, it requires maintenance of all tariff offerings and options in effect as of January 1, 1999, throughout the transition period. The Competitive Intervenors' interpretation is clearly erroneous and must be rejected.

IX. PHASE-IN ISSUES

A. THE PPLICA PHASE-IN PROPOSALS ARE CONSISTENT WITH THE LETTER AND GOALS OF THE ACT

PPLICA's proposed phase-in procedures are identical to those adopted by the Commission in the PECO proceeding. PPLICA M.B., pp. 93-95. Subscription for the commercial and industrial classes for each phase will be on a first-come, first-served basis unless a class is oversubscribed. If oversubscribed, each customer requesting to participate in that phase will experience a pro-rata reduction in their nominated load. Id. at 93-94. In addition, the stages of phase-in will be accelerated such that 33% of each customer class's peak load has the opportunity for direct access on January 1, 1999, 66% has the opportunity on January 2, 1999, and 100% has the opportunity on January 2, 2000. Id. at 94-95.

The PPLICA approach eliminates competitive distortions caused by one customer having the opportunity for access when a competitor does not and maximizes the number of participants in the first two stages of phase-in. Id. at 94. The Commission specifically endorsed both concepts in the PECO proceeding. PECO Restructuring Order, 181 PUR 4th at 541-42, slip op. at 48; PECO Restructuring Reconsideration Order, slip op. at 22.

PP&L offered no valid justification for the Commission to stray from the PECO precedent. PP&L M.B., pp. 159-161. The PPLICA proposals comply with the plain language of the Act and will provide for an orderly transition to the competitive environment. Unlike PP&L's Dr. Tierney, PPLICA has confidence that the Commission, PP&L, customers and suppliers will be able to implement and understand this system. See PP&L M.B., p. 161.

The Electric Distributors argue that the Competition Act mandates an inflexible schedule that affords one-third of the peak load of each customer class the opportunity for direct access as of

January 1, 1999, January 1, 2000, and January 1, 2000, respectively. Electric Distributors M.B., p. 7-12. The Distributors' argument is based on its interpretation of the term "as of" (as it appears in 66 Pa. C.S. § 2806(b)) to mean "beginning on." Id.

Arguments presented by the Electric Distributors that an accelerated phase-in is not contemplated by the Act are incorrect. As noted by the Distributors, Section 2806(b) states that the milestones for phase-in of customer choice shall be 33% "as of January 1, 1999," 66% "as of January 1, 2000," and 100% "as of January 1, 2001." 66 Pa. C.S. § 2806(b) (emphasis added). However, contrary to the arguments presented by the Distributors, the term "as of" does not render itself to an interpretation that each stage of the transition must "begin on" the date specified. Rather, the words "as of" can, and should be, interpreted to mean that each stage of the phase-in must be completed by the stated date. That is, the milestone dates set forth the minimal requirements of the Act with respect to phase-in percentages.

When a word or phrase is ambiguous, Pennsylvania courts must look beyond the statutory language and attempt to determine the intention of the legislature by reference to various statutory factors, including the occasion and necessity for the statute; the circumstances under which it was enacted; the mischief to be remedied; and the object to be attained. 1 Pa. C.S. § 1921(c); Grom v. Burgoon, 448 Pa. Super. 616, 672 A.2d 823 (1996). Thus, to the extent that there is any ambiguity with respect to specific language contained in Section 2806, the Commission must look to the intent of the legislation at hand.

Accelerating customer access to a retail generation market facilitates the development of a robust electricity generation market, which is the core purpose of enacting the Competition Act. 66 Pa. C.S. §§ 2804 & 2806; see PPLICA M.B., pp. 93-95. Increased participation in retail access

encourages competitive forces that promote efficient generation and lower electricity prices. In addition, accelerating the phase-in schedule “remedies the mischief” of competitive disadvantages developing during phase-in among similarly situated customers within and outside PP&L’s service territory. Applying the rules of statutory construction leaves no doubt that the General Assembly acknowledged the vast benefits of transitioning to a competitive market, that reasonable acceleration of that transition is in the public interest, and that the Commission has the statutory discretion to implement that accelerated transition.

The PPLICA proposals are clearly supported by the Act and by the record. The Commission must consistently apply the PECO precedent on this issue. Nothing could be more inequitable than to offer customers a different timetable for participation in direct access based on where the customer lives.

XII. UNIVERSAL SERVICE AND CUSTOMER ASSISTANCE PROGRAMS

A. THE ENVIRONMENTALISTS’ PROPOSAL TO ALLOCATE UNIVERSAL SERVICE COSTS BASED ON A FIXED PER KWH BASIS IS UNREASONABLE AND MUST BE REJECTED

The Environmentalists’ “adopt” the OCA position that universal service costs should be assessed on a fixed per kWh basis on all end users. Public Interest Parties M.B., p. 67. Application of a per kWh allocation is clearly unreasonable and has already been rejected by the Commission as producing unjust and unreasonable rates under Section 1301, 66 Pa. C.S. § 1301. PPLICA M.B., pp. 16-17 & 89-91. Even the OCA recognized the Commission’s rejection of a per kWh allocation and abandoned its proposal (replacing it, of course, with the equally unlawful non-production revenue allocator). OCA M.B., p. 124.

B. THE OCA'S ATTEMPT TO SHIFT UNIVERSAL SERVICE COST ALLOCATION THROUGH USE OF A "NON-PRODUCTION REVENUE ALLOCATION" VIOLATES THE ACT AND MUST BE REJECTED

PP&L's current universal service program costs are recovered as a component of each customer's rates. In unbundling rates for this proceeding, PP&L proposed to continue the responsibility level embedded in those rates. PP&L Statement No. 9R, pp. 38-39. PPLICA agrees with this approach because it does not shift costs between classes and because it ensures compliance with the rate caps in Section 2804(4)(i), 66 Pa. C.S. § 2804(4)(i). PPLICA M.B., pp. 16-17 & 89-91.

The OCA argues that this methodology is unfair and results in a disproportionate allocation of universal service costs to the residential class. OCA M.B., pp. 122-23. In addition, the OCA argues that PP&L's proposed universal service charge is "bypassable" because of the "de minimus" contribution required by large customers. Id. The OCA proposes to allocate universal service costs based on a "non-production revenue allocation." Id. at 124-126.

The OCA's attempt to shift cost responsibility is unlawful under the Act and must be rejected. PPLICA M.B., pp. 90-91. It is not "unfair" to unbundle universal service costs from each customer class rates in the same manner that all other components of those rates are unbundled. Contrary to the OCA's assertion, Section 2808(a) is not the only provision of the Act that governs this decision. See OCA M.B., p. 125 n. 30. As recognized by the Commission in its Universal Service Order, Section 2804(7) prohibits interclass and intraclass cost shifting. 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(a), Docket No. M-960890F00010, Order entered on July 11, 1997, slip op. at 20. As explained by PPLICA in its Main Brief, the rate cap in Section 2804(4) and the prohibition against cost shifting mandate a cap on individual rate components at their

January 1, 1997, levels. PPLICA M.B., p. 17 n. 4. The OCA's recitation of how responsibility will be modified under its proposal only highlights the proposal's lack of conformity with the Act. Fairness requires that universal service costs be recovered consistent with the allocation of similar costs (uncollectibles) in PP&L's last base rate proceeding. PPLICA M.B., pp. 16-17 & 89-91. The "non-production revenue allocator" was not used in PP&L's last base rate proceeding and is consequently inappropriate for application here.

The OCA's claim that PP&L's proposed allocation is bypassable because of the small contribution required from industrial and large commercial customers is misguided. See OCA M.B., pp. 122-23. The OCA's calculations in its brief show that some level contribution to universal service costs by commercial and industrial customers. Id. The Act does not place a threshold level on the costs of any type that must be allocated to customer classes; rather, the Act requires that the costs be unbundled from current rates in a way that does not shift cost responsibility or violate the rate caps. 66 Pa. C.S. §§ 2804(3), 2804(4), 2804(7) & 2808(a). The PP&L proposal complies with these requirements concerning its allocation of universal service costs.

Finally, the OCA's attempt to distinguish the PECO precedent must fail. OCA M.B., p. 123. The Commission's concern in PECO with cost shifting is clearly present here (as illustrated by the OCA's calculations). Furthermore, even the costs of new or expanded programs must be recovered, if at all, in accordance with the Act's rate caps. 66 Pa. C.S. § 2804(4)(i). The rate cap and anti-cost shifting provisions of the Act require that the allocations in the last base rate case be continued. The PECO precedent is unequivocal on this issue. PECO Restructuring Order, 181 PUR 4th at 582, slip op. at 146.

CONCLUSION

As explained by PPLICA in its Main and Reply Briefs, the PP&L Restructuring Plan has pervasive flaws that, if not corrected, will hinder, if not irreparably harm, the development of a competitive market. PP&L attempts to gain excessive stranded cost recovery to subsidize its position in the competitive market. In addition, PP&L proposes tariff changes that can only be construed as intending to penalize customers that exercise their statutory right to access competitive supply. Finally, instead of submitting a Main Brief that clarifies the PP&L positions to aid the Commission in making a reasoned decision, PP&L submitted countless new calculations and litigation positions that are unsupported by record evidence and simply cannot be verified or relied upon.

In Main Brief, PPLICA highlighted the modifications necessary to bring the PP&L Restructuring Plan into compliance with the dictates and goals of the Act. See PPLICA M.B., "Proposed Findings of Fact and Conclusions of Law." PPLICA respectfully requests the Commission endorse and accept those proposed modifications.

Respectfully submitted,

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