COMMONWEALTH OF PENNSYLVANIA

ORIGINAL

OFFICE OF CONSUMER ADVOCATE
1425 Strawberry Square
Harrisburg, Pennsylvania 17120

IRWIN A. POPOWSKY
Consumer Advocate

(717) 783-5048

February 12, 1998

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

KJR

RECEIVED
98 FEB 12 PM 3:31
PA.P.U.C.
PROTHONOTARY'S OFFICE

DOCUMENT FOLDER

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

Dear Secretary McNulty:

Enclosed please find for filing an original and nine (9) copies of the Office of Consumer Advocate's Main Brief in the above-captioned proceeding. The Administrative Law Judge extended the page limit for the Office of Consumer Advocate to 130 pages.

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

Sincerely,

James A. Mullins

James A. Mullins
Assistant Consumer Advocate

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

57

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

ORIGINAL

APPLICATION OF PENNSYLVANIA POWER & LIGHT COMPANY FOR APPROVAL OF ITS RESTRUCTURING PLAN UNDER SECTION 2806 OF THE PUBLIC UTILITY CODE	:	Docket No. R-00973954

MAIN BRIEF
OF THE OFFICE OF CONSUMER ADVOCATE

Craig R. Burgraff
Senior Assistant Consumer Advocate

James A. Mullins
Assistant Consumer Advocate

For:

Irwin A. Popowsky
Consumer Advocate

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

DATED: February 12, 1998

TABLE OF CONTENTS

TABLE OF CITATIONS

CASES:

ADMINISTRATIVE DECISIONS:

STATUTES AND REGULATIONS:

MISCELLANEOUS:

I. INTRODUCTION

This case presents two distinct approaches to the Commission that will affect how it interprets and applies the Electricity Generation Customer Choice and Competition Act ("Customer Choice Act" or "Act"), 66 Pa.C.S. §2801 et seq.

PP&L, Inc.'s ("PP&L") response to the Act has been to request an extraordinarily high level of stranded cost recovery that, combined with its unbundling of rates and market price assumptions, essentially leads to no rate savings and little room for competition until the year 2006. See OCA St. 4-S; Exh. LS-11-R. In contrast, the Office of Consumer Advocate's ("OCA") recommendation provides for rate savings for all consumers while providing a reasonable and appropriate level of stranded cost recovery for PP&L. The OCA submits that its recommendations better meet the Customer Choice Act which calls for a careful balancing of all interests as the Commission seeks to implement the Act in a manner that best achieves the purpose of the Act--bringing the benefits of electric restructuring to Pennsylvania's consumers in a timely manner.

It is important to recognize that the Commission is not deciding this case on a blank slate. The Commission already has decided the restructuring case of PP&L's neighboring PJM utility, PECO Energy. Application of PECO Energy Company for Approval of its Restructuring Under Section 2806 of the Public Utility Code and Joint Petition for Partial Settlement, R-00973953 (December 23, 1997) ("PECO Energy Restructuring Order" or "PECO") and Application of PECO Energy Company for Approval of its Restructuring Plan under Section 2806 of the Public Utility Code, R-00973953 (January 16, 1998 Restructuring Order) (("PECO Energy Reconsideration Order"). In that proceeding, the Commission adopted the exact same market price and stranded cost analysis by the same witnesses that the OCA presented in this case. At the same time, the Commission flatly rejected three separate market price analyses presented by PECO witnesses, all of

which in OCA's view, were less favorable to the utility than the PP&L methodology presented in this case.

In determining how it will apply the Customer Choice Act, the OCA submits that the Commission must recognize one salient principle. That principle is that this case does not represent traditional regulation. The generation portion of the electric industry will now be subject to competition. The risks associated with the operation of generation assets, and the potential gains from the operation of those assets in the new competitive market will shift to the unregulated operations of the electric utility. As OCA witness LaCapra correctly noted, the result of restructuring will have the same effect as an outright sale of the generating assets on PP&L's franchise ratepayers. OCA St. 1 at 4. This change fundamentally alters certain rights and obligations, and fundamentally affects the balancing of ratepayer and Company interests.

For example, under traditional regulation a gain on a depreciable asset was generally considered as a cost item in ratemaking. If a utility sold a depreciable asset at a price above its net book value, the gain after taxes was recognized as a reduction to its electric revenue requirements. After restructuring is complete, the utility is the owner of each generation-related asset and is the beneficiary of any subsequent gain or loss. Id. Thus, the balancing of interests in this case must be centered on the reasonable and rational sharing of the costs and benefits of restructuring between the customers and investors of the Company.

The OCA submits that this balancing of interests is especially important since the recommendations in this case, primarily concerning market price studies and owned generation related stranded costs, offer a clear disparity on the question of a proper balancing of interests in the age of competition. On the one hand, PP&L's market price analysis leads to the anomalous result of a level of owned generation related stranded costs that exceeds the jurisdictional net book value of that

generation at January 1, 1999. Even with a non-specific $1 billion reduction in its total stranded cost claim for mitigation, the Company's owned generation related stranded cost claim still exceeds the OCA's estimate of the jurisdictional net book value of the generation assets. The Company's proposal results in the Company recovering more than the entire jurisdictional net book value of the plant from ratepayers over the next seven years, and then essentially having capital-overhead free assets to use in the new competitive market. This result is accomplished through future market price assumptions that are below any results offered by three witnesses for PECO Energy in its restructuring case, and PPLICA witness Falkenberg and OCA witness Doug Smith in this case, even though the market reviewed is the same, the Pennsylvania-New Jersey-Maryland ("PJM") interconnection.

The flip side of this recommendation, of course, is that ratepayers essentially receive no rate savings under PP&L's results. Thus, the balancing effect created by PP&L's restructuring proposal equates to the following. The Company's risk in the competitive market place is, in the best light, mitigated through regulatory fiat. In the worst light, PP&L's proposal leads to a massive windfall if market prices approach the level that the Commission just determined were appropriate in the PECO restructuring order. The balancing proposed by the Company to mitigate all competitive risk for the Company is to shift that risk to ratepayers through the payment of excessive stranded cost charges.

On the other hand, the OCA and PPLICA have recommended stranded cost recovery levels consistent with the Act, based upon market price analyses incorporating publicly available fuel price forecasts, and consistent with the Commission's comprehensive analysis in the PECO Energy restructuring case. These recommendations provide for reasonable stranded cost recovery and appropriately recognize that PP&L's profits for generation related activity will come from the

competitive market in the future, as dictated by the Act, and not from regulatory fiat as a result of restructuring. If PP&L is not satisfied with this approach, it is free to divest any or all of its generation assets, as some other utilities in Pennsylvania and around the Nation have proposed. What PP&L should not be permitted to do is to retain these assets for its own future competitive benefit, but expect its ratepayers to finance that competition through payment of stranded costs that are billions of dollars in excess of the amount needed to make the Company whole.

Applying the identical model, methodology, and fuel price forecast endorsed by the Commission in the PECO Energy restructuring case, the same OCA witnesses concluded that PP&L's stranded costs on its owned generation plant is only $138 million. OCA St. No. 1-S, Exh. RLC-8, or more than $3 billion less than the comparable estimate of PP&L. Id.[1] It is this vast difference between the stranded generation plant projection of PP&L versus that of OCA (and PPLICA) that lies at the heart of the controversy in this case. If the Commission adopts the PP&L stranded cost estimate, the OCA submits that the result would be to force ratepayers to pay the full costs of PP&L's generating plant as stranded costs and then let PP&L earn windfall profits from deregulated market revenues achieved by these plants over the rest of their useful lives.

While the most fundamental disagreement between PP&L and OCA in this proceeding relates to the calculation of stranded costs, it should be noted that the OCA also has presented comprehensive proposals regarding the full panoply of issues raised by the Customer Choice Act. In this Brief, the OCA will set forth its position on these issues including, most importantly, unbundling, universal service, consumer education, consumer protection, and competitive safeguards. Each of these issues is, of course, critical to the success of Pennsylvania's transition to a competitive

[1]When non-utility generation stranded costs and regulatory assets are considered, the OCA's total stranded cost estimate is $1.08 billion. Id.

retail generation market and the impact of that transition on consumers.

In addition, the OCA would note at the outset one disagreement with the Commission's PECO decision that OCA would ask the Commission to reexamine in this proceeding. Specifically, as a result of the unbundling method in PECO, only customers who shop and leave the PECO generation service receive any rate savings. The OCA submits that this is unfair to customers who cannot or do not choose to obtain an alternative provider. As set forth in this Brief, the OCA submits that all customers should be able to share in any rate savings achieved in this restructuring proceeding, even if they remain as PP&L generation customers.

II. THE CUSTOMER CHOICE ACT

The instant proceeding is occasioned by the passage of the Customer Choice Act. In that Act, the General Assembly declared it to be in the public interest to permit retail customers to obtain direct access to a competitive generation market. 66 Pa.C.S. § 2802(3). The General Assembly realized that, in moving toward greater competition in the electricity generation market, it was necessary to resolve certain transitional issues in a manner fair to all stakeholders, including customers, incumbent electric utilities, investors, utility employees, local communities, nonutility generators of electricity, and other affected parties. 66 Pa.C.S. § 2802(8).

The transition envisioned by the legislature to a structure where retail customers have direct access to a competitive electric generation market encompasses several components. The Act recognizes that the transmission and distribution of electricity continues to be a regulated natural monopoly provided by the electric utility, and that electric utility distribution companies will continue to be the service provider of last resort unless another provider is approved by the Commission. 66 Pa.C.S. §2802(16). The Act expressly mandates the continuance of universal service and energy conservation policies, protections and services at least at their existing levels, with the recovery of

attendant costs for these programs through a nonbypassable rate mechanism. 66 Pa. C.S. §2802(17).

In order to preserve the monopoly functions of transmission and distribution while at the same time creating a competitive generation market, the Act requires incumbent electric utilities to unbundle their rates and services and to provide open access over their transmission and distribution systems to allow competitive suppliers to generate and sell electricity directly to consumers. 66 Pa. C. S. § 2802(14). Hence, the generation of electricity will no longer be regulated except as noted in the Act. Id.

Finally, the Act recognizes that the transition to competition in the generation and sale of electricity may result in transition or stranded costs for the incumbent utilities. The General Assembly, therefore, empowered the Commission to determine the level of transition or stranded costs for each electric utility and to provide a mechanism, the competitive transition charge ("CTC"), for recovery of an appropriate amount of such costs in accordance with the standards established in the Act. 66 Pa. C.S. § 2802(15).

The Act delineates additional requirements in establishing the general transition framework just discussed. These requirements are:

- The competitive transition charge is designed to recover transition or stranded costs, and is a nonbypassable charge applied to the bill of every customer accessing the transmission or distribution network. 66 Pa. C.S. § 2803.

- Transition or stranded costs are an incumbent electric utility's known and measurable net electric generation-related costs, determined on a net present value basis over the life of the asset or liability as part of its restructuring plan, which traditionally would be recoverable under a regulated environment but which may not be recoverable in a competitive electric generation market and which the Commission determines will remain following mitigation by the electric utility. Id.

- Transition or stranded costs may include regulatory assets and other qualifying deferred charges, the unfunded portion of the incumbent utility's projected nuclear generating plant decommissioning costs, cost obligations under contracts with nonutility generating projects ("NUGs") which have

received a Commission order, prudently incurred costs related to the cancellation, buyout, buydown or renegotiation of NUG projects consistent with Section 527 of the Public Utility Code, net plant investments and costs attributable to existing generation plants and facilities, the disposal of spent nuclear fuel, long-term non-NUG purchase power commitments, other plant retirement costs, and other transition costs. Id.

- In order to allow recovery of transition or stranded costs through a competitive transition charge, the Commission must apply certain principles. Regulatory assets and other deferred charges must be typically recoverable under current regulatory practice. Costs related to the cancellation, buyout, buydown or renegotiation of NUG projects must be prudently incurred consistent with Section 527 of the Code. Other generation-related transition or stranded costs are subject to the Commission's discretion. 66 Pa. C.S. § 2808(c)(1)(2) and (3).

- In determining transition or stranded costs, the Commission shall consider the extent to which the electric utility has undertaken efforts to mitigate generation-related costs. During the transition period, electric utilities have the duty to mitigate generation-related transition or stranded costs to the extent practicable. 66 Pa. C.S. § 2808(c).

- Consistent with Section 2808, transition or stranded costs must be just and reasonable. 66 Pa. C.S. § 2804(13).

- The costs to be recovered through a competitive transition charge shall be allocated to customer classes in a manner that does not shift interclass or intraclass costs and maintains consistency with the allocation methodology for utility production plant accepted by the Commission in the utility's most recent base rate proceeding. 66 Pa. C.S. § 2808(a).

- The Act mandates caps on the electric utility company's rates. To any customer who purchases generation from the utility, the total charges for service shall not exceed the total charges approved by the Commission for such service as of the effective date of the Act. This cap applies for the shorter of 54 months from the Act's effective date or until an electric distribution company is no longer recovering its transition or stranded costs through a competitive transition charge or intangible transition charge and all the distribution utility's customers can choose an alternative provider of electric generation. For any customer purchasing generation from an alternative supplier, the charges of the utility for non-generation services regulated as of the Act's effective date, exclusive of the competitive or intangible transition charge, shall not exceed the non-generation charges that have been approved by the Commission as of the Act's effective date. 66 Pa. C.S. § 2804(4)(i).

- In addition to these rate caps, for a period of the shorter of nine years from the Act's effective date or until an electric distribution company is no longer recovering its transition or stranded costs through a competitive or intangible transition charge and all customers can choose an alternative provider of electric generation, the generation component of a utility's charge to customers who purchase from the utility, including the CTC or ITC, shall not exceed the generation component charged to customers as of the Act's effective date. 66 Pa. C.S. § 2804(e)(iii).

- The restructuring of the electric utility industry shall be implemented in a manner that does not unreasonably discriminate against one customer class to the benefit of another. 66 Pa. C.S. § 2804(7).

Incumbent electric utilities were directed to file restructuring plans with the Commission to implement direct access to a competitive market for the generation of electricity. 66 Pa. C.S. § 2806(d). These plans are to include unbundled rates for generation, distribution and jurisdictional transmission and other services, a proposed CTC, a proposed universal service and energy conservation cost recovery mechanism, procedures for ensuring direct access to all licensed generation suppliers, a discussion of the impact of the proposed plan on the utility's employees, and revised tariffs and rate schedules implementing the above. 66 Pa. C.S. § 2806(e).

The purpose of this proceeding is to determine an appropriate restructuring plan for PP&L. The OCA recommends that the Commission reject PP&L's plan and direct the Company to file an alternative plan incorporating the recommendations advanced by the OCA.

III. STRANDED COSTS

A. Introduction

OCA witness LaCapra succinctly reviewed the Act's criteria relating to the determination of stranded costs as well as considerations of the public interest:

> I believe that the Act and the public interest requires that the amount of stranded cost allowed should satisfy several general criteria:
>
> - The assets would be stranded in the most reasonable future market scenario in which competition replaces regulation in

the generation service function;

- The assessment of stranded costs must be made on a 'net' basis (in which assets with positive value are netted against those which are negative);
- The costs must be non-mitigable, meaning that they are net of reasonable opportunities to be reduced;
- The amounts would have been recovered under traditional regulation and are known and measurable;
- With respect to utility-owned generation related assets, even if costs are found to be stranded under the above criteria, the Commission must determine what level of recovery of such costs is just and reasonable.

OCA St. 1 at 2-3.

As noted earlier, the statutory definition of stranded costs sets forth three general categories of stranded cost recovery. The first category consists of regulatory assets, deferred charges, unfunded portions of projected nuclear decommissioning costs, and cost obligations with non-utility generating projects that have received a Commission order. For this category of costs, recovery is pursuant to Section 2808(c)(1) which provides that the Commission shall allow recovery of such costs once it is determined that they have met the requirements of the definition.

The second category of costs are associated with prudently incurred costs related to the buyout, buydown, cancellation, or renegotiation of non-utility generation ("NUG") contracts. The recovery of costs in this category is governed by Section 2808(c)(2) which provides that the Commission shall allow recovery of such costs once it is determined that they have met the requirements of the statute.

The third category of costs are those associated with a utility's own generating assets, recovery of which is governed by Section 2808(c)(3). For a utility's own generating assets, the Act requires that any recovery from ratepayers be just and reasonable. Even if a utility's own prudently

incurred generating asset costs are found to be stranded, it still must be demonstrated that recovery from ratepayers of any or all of these costs is just and reasonable.

The OCA submits that generation-related assets should be truly stranded, on a net non-mitigable basis, after the introduction of retail competition and under the most reasonable future scenario. If the assets in question are able to earn sufficient returns in a competitive environment under the most reasonable future assumptions, there is no reason for special stranded cost recovery. In fact, as noted by OCA witness LaCapra, allowing stranded cost recovery over a seven year time frame in this situation would result in ratepayers subsidizing shareholder profits. That recovery could also eliminate an important incentive for incumbent electric companies to efficiently reduce going-forward costs in order to mitigate stranded asset values. OCA St. 1 at 4.

Under restructuring, the effective ownership of generation assets, risks of operations and potential gains from the competitive market will shift to the unregulated operations of the Company. This leads to potential results quite different from traditional regulation. Using the sale of a depreciable asset as an example, under traditional regulation a gain on such an asset was generally considered as a cost item in ratemaking. If a utility sold a depreciable asset at a price above its net book value, the gain after taxes was recognized as a reduction to its electric revenue requirement. After restructuring is complete, however, the utility is the owner of each generation-related asset and is the recipient of any subsequent gain or loss.

In this context, as noted by OCA witness LaCapra, it is important to view the most reasonable future scenario under a competitive regime, and that scenario is one that is reasonably centered within the range of possible future outcomes. Id. at 4.

B. PP&L's Proposed Level of Stranded Costs Is Facially Unreasonable.

The results of the application of PP&L's stranded cost methodology for generation related

assets, particularly for its own generation assets, leads to a level of stranded costs that is unreasonable on its face and incapable of adoption by the Commission.

1. PP&L's Stranded Cost Request Inexplicably Results In The Collection Of A Level of Owned Generation Related Stranded Costs Exceeding The Net Book Value Of The Assets

In this case, the Company calculated stranded costs pursuant to a regulatory requirements methodology including that portion of its claim related to generation assets. As set forth more fully below, the OCA and the PP&L Industrial Customer Alliance ("PPLICA") calculated owned generation related stranded costs pursuant to the asset valuation methodology that was recently adopted by the Commission in the PECO Energy restructuring order. PP&L's revenue requirements methodology as applied to generation assets is a lost revenues approach. It compares the annual revenue requirements for each generating plant to the projected annual revenues each plant would receive from the sale of its output using market based prices for each year beginning January 1, 1999 to the end of its remaining life. PP&L applied a PUC jurisdictional percentage to the annual excess or deficiency in revenues, and discounted the resulting stream of annual excesses or deficiencies to present value. PP&L St. 8 at 4. The asset valuation methodology calculates the differences between the PUC jurisdictional net book value of the generation related assets as of January 1, 1999 and the estimated market value of those assets as of the date. The primary component of the market value is the difference between the revenues that a buyer could expect for electric production at market based prices less the going-forward costs of operating the unit, including fuel, O&M, ongoing capital investments, taxes, and administrative and general expenses. Other factors will also influence the value that a buyer will place on an asset. OCA St.1 at 14-15.

Concerning generation related assets, PP&L witness Schadt agreed that the goal of both the revenue requirements method and the asset valuation method should be to permit the utility to

recover the book value of its investment in generation assets. Tr. 1541 (August 26, 1997). PP&L's application of the revenue requirements methodology, however, utterly fails this central test. PP&L's methodology results in a greater level of stranded costs than appropriate and, combined with the market price assumptions employed by PP&L witness Jones, results in a level of owned generation stranded costs greater than the jurisdictional net book value of the generating assets themselves at January 1, 1999, the date when competition will begin on PP&L's system.

PP&L witness Schadt lists the components of PP&L's stranded cost claim on page 1 of PP&L Exhibit JRS 1A. The owned generation related portion of the stranded cost claim is $2.873 billion for nuclear generation, and $756 million for fossil generation. Thus, out of a total net present value based claim of $4.641 billion, PP&L's owned generation related stranded costs represent $3.63 billion.

The entire original stranded cost claim made by PP&L was as follows:

Net Present Value (thousands of $)	
Nuclear	(2,873,041)
Fossil	(756,502)
NUG's	(656,870)
Regulatory Assets	(354,326)
NPV Total	(4,670,739)[2]

However, this claim did not represent the results of PP&L's revenue requirements stranded cost methodology. PP&L witness Schadt testified that the full application of the Company's methodology would have resulted in stranded costs at January 1, 1999 of $5.6 billion. PP&L St. 8 at 3. The way that PP&L arrived at its initial claim of $4.641 billion for stranded costs was to apply a reduction of $1 billion for future mitigation. Of that $1 billion, $907 million was related to its own

[2]PP&L subsequently reduced that claim to $4.5 billion in order to correct an acknowledged error in its market price analysis. Tr. 2327 (September 9, 1997).

generation assets. Id. at 31. Nearly one-third of this claimed mitigation is represented by PP&L's inappropriate reallocation of transmission and distribution depreciation reserve to generation. OCA St. 1 at 23.

The total net book value of PP&L's generation assets at January 1, 1999, with no jurisdictional separation, is $4.08 billion according to the Company.[3] PP&L's revenue requirements methodology, therefore, produces the result of having ratepayers be subject to not only reimbursing the Company for the entire net book value of its plant, including the non-Pennsylvania jurisdictional portion, but also a premium of $500 million. This result is inappropriate on its face and demonstrates the unacceptability of PP&L's revenue requirements methodology result.

Even with PP&L's $1 billion reduction in the stranded cost results of its methodology for unspecified future mitigation, the Company's $3.63 billion claim for stranded costs related to owned generation assets still exceeds its net book value if that book value properly reflects appropriate PUC jurisdictional allocation factors.

The PUC portion of the Company's net book value of generation related assets as of January 1, 1999 based upon correct jurisdictional allocations is $3.25 billion. OCA St. 1 at 14. As OCA witness LaCapra stated:

> My estimate of the net book values for total plant, including production plant, general and intangible plant, and land for each of PP&L's generating stations as of January 1, 1999 were based on values presented in PP&L's Exhibit JRS-1. I adjusted these values with appropriate PUC jurisdictional allocation factors to obtain my estimate

---

[3]This figure can be determined by adding the $2.807 billion net book value at year end 1998 in the "total nuclear" line on PP&L Exhibit JRS 1A (Revised), page 16, and the $1.273 billion net book value at year end 1998 in the "total fossil plant including general plant" line on page 24 of the same exhibit. Witness Schadt testified that the net book value was $4.3 billion (Tr. 1542), which includes inventories and prepayments from the same pages of those exhibits. PP&L witness Schadt testified that this amount was not reduced to a Pennsylvania jurisdictional basis. Tr. 1583-1584 (August 26, 1997).

of PUC jurisdictional net book value.[4]

Id. With nuclear decommissioning costs separated out of the $3.63 billion generation related stranded cost claim of the Company, which will be discussed later in this brief, the resultant generation related stranded cost claim of $3.5 billion still exceeds the appropriate net book value of $3.25 billion for these assets. As OCA witness LaCapra noted, it is PP&L's position that its generating plants are essentially worthless. He stated:

> As I pointed out in my original testimony, PP&L's estimate of stranded costs, particularly its estimate of generation related stranded costs, is grossly out of line with the Company's total book value and current price level. For example, PP&L has asked for $3.45 billion in generation stranded costs which is more than the entire $3.25 billion January 1999 book value of the Company's generating assets. The implication is that its generation currently has negative value in the market, a proposition that I find very hard to believe, indeed, shocking.

OCA St. 1-S at 9.

The OCA submits that PP&L's stranded cost claim for generation related assets is facially unreasonable.

2. PP&L's Stranded Cost Claim Is Belied By Its Own Witnesses And Is Totally Inconsistent With The Recent PECO Restructuring Decision.

PP&L witness Hill noted that PP&L has below average rates in comparison to all of Pennsylvania's electric utilities and has about average rates for electric utilities nation-wide. PP&L witness Hill makes the common sense statement in his direct testimony that lower rates equate to lower stranded costs. PP&L St. 2 at 15. On cross-examination he enumerated further on this common sense belief:

. . .

[4]As will be discussed later in this brief, PP&L in its stranded cost analysis uses unreasonable PUC jurisdictional percentage allocations to calculate the portion of its total estimated stranded costs that it believes to be subject to the Commission's jurisdiction and thereby eligible for recovery.

> So lower rates generally mean lower costs today. Lower rates mean that over the life of facilities, you would require less revenue in a regulated environment than if in fact our rates were higher. So the result of that, if your rates are lower today, the projected revenue would be lower than what they would be for higher rates today, and therefore the stranded costs would be lower.

Tr. 992-993 (August 20, 1997). OCA witness LaCapra noted:

> First, PP&L's rate level suggests that stranded costs should not be high. Mr. Ronald Hill, the Company's mitigation witness, asserts that PP&L's comparatively low rates are a demonstration of PP&L's past mitigation record. He also asserts that "lower rates mean lower stranded costs". While the Company makes the case for its low rates, this did not translate to a low stranded cost forecast by the Company.

OCA St. 1 at 20.

The Company has never attempted to explain this disparity. As OCA witness LaCapra correctly observed:

> If Mr. Hill's contention that lower rates (relative to the national average retail rate), mean lower stranded costs, these numbers would suggest that PP&L's stranded cost would be significantly less than PECO's stranded cost, given that the two companies have nearly identical sales levels. However, PP&L's requested $4.2 billion is more than 60% of PECO's stranded cost request of $6.8 billion.

Id.[5]

The OCA submits that the Commission's order in the PECO Energy restructuring case further demonstrates the prima facie unreasonableness of PP&L's generation related stranded cost claim. As the Commission noted in its PECO restructuring order, PECO Energy's generating assets had a total book value of approximately $6.77 billion and it claimed that $3.825 billion of those assets would be stranded. PECO Energy Restructuring Order at 80. In that order, the Commission adopted the OCA conclusion that PECO's generating plant had a market value of $3.96 billion, and, therefore,

---

[5]The $4.2 billion figure represented the amount initially assumed by PP&L that it would be able to recover under a rate cap. This level was reduced by PP&L witness Hill to $4 billion. Tr. 964. (August 20, 1997).

found that PECO Energy had $2.679 billion of owned generation related stranded costs. On reconsideration, the Commission revised that finding to $2.813 billion due to two adjustments increasing PECO Energy's book value. PECO Energy Reconsideration Order, Appendix.

As noted above, applying the identical model, methodology and fuel price forecasts that were adopted in the PECO case, the same OCA witnesses concluded that PP&L's stranded costs on its own generating plant is $138 million, OCA St. 1-S, Exh. RLC-8, or more than $3 billion less than the comparable estimate of PP&L. While the Company complains that the OCA (and PPLICA) stranded cost analyses are inadequate, it is the PP&L analysis that is essentially off the charts. The OCA submits that the Company's methodology leads to absurd results and that its claim does not even pass a common sense test.

The OCA submits that the problem lies with the results of the Company's methodology and the application of market price calculations that are even less reasonable than the PECO market price calculations that were flatly rejected by the Commission just one month ago in the PECO Energy restructuring case. It would be unfair and inherently discriminatory for the Commission to adopt wholly inconsistent PJM market prices for two adjacent PJM companies that both intend to remain in the generation business. The OCA submits that principles of reasoned and rational decision-making do not allow such arbitrary discrimination between utilities operating in the same market. PP&L's requested stranded cost recovery level and in particular its owned generation related stranded cost claim, simply fails to pass the test of common sense reasonableness.

3. Appropriate Stranded Cost Results Are Necessary To Balance The Interest Of Parties In This Proceeding.

The importance of the results of a determination of stranded costs in this case is that, once generation related stranded costs are determined, the Company will be able to use these assets in the

competitive market. Essentially PP&L's proposal asks ratepayers to pay the entire $3.25 billion net book value of its owned generating assets along with a premium of $250 million in order to position itself for competition. It then will have these assets at essentially no capital cost to employ to earn windfall profits by selling the output of these plants at higher market prices over their remaining lives. When asked to confirm this result, PP&L witness Hill did not agree with the characterization but he had no other characterization to offer. Tr. 990-991 (August 20, 1997). The OCA submits that this completely one-sided result violates PP&L witness Hill's view of the intent of the Customer Choice Act as well as that Act's just and reasonable standard. 66 Pa.C.S. §2804(13). As witness Hill noted:

> In my opinion, the Act contemplated a fair balancing of costs and benefits among all stakeholders as Pennsylvania moves toward a competitive electric generation market.

PP&L St. 2-R at 4.

Under PP&L's proposal, all of the costs would be borne by ratepayers and retail customers would see no material benefits from the Act for seven years during the transition period. All of the benefits would be reaped by PP&L in the form of windfall market generation profits in later years. OCA St. 1 at 21. The OCA submits that no one can argue that this was the General Assembly's intent in bringing electric competition to Pennsylvania.

4. The Company's Stranded Cost Claim Is Inconsistent With Recent Generation Plant Sales And The Company's Ability To Divest Its Generating Assets.

PP&L's estimates are not only incredible on their face but also stand in stark contrast to actual market data that has begun to accumulate around the Nation, where utilities have been able to sell plants at prices well above zero and, indeed, well above book value. As noted by OCA witness LaCapra in response to PP&L witness Guth:

> While Mr. Guth asserts that my market price and stranded costs estimates are not grounded in the market, there is recent and directly relevant experience in New England. My recent work on market price forecasting in New England has been

> criticized by experts such as Mr. Guth for being too high. However, New England Power Company just recently completed the sale of nearly 4,000 MW of generating assets to U.S. Generating Company for almost $1.6 billion; a price that well exceeded estimates made by myself and others, and exceeded the book value of their assets by almost 50 percent. New England attracted serious interest from more than 25 bidders for their assets. Also in two recent solicitations by large consumers for suppliers under retail access in Rhode Island and Massachusetts, the price bid received exceeded the customer's options for standard offer prices that were established. In addition, in 1996 Duquesne Light Company sold its interest in the Fort Martin Power Station Unit 1 at a price of $169 million, over 4.5 times its book value of $37 million.

OCA St. 1-S at 10-11. Thus, Mr. LaCapra concluded:

> In light of PP&L's stranded cost estimate that places negative value on their generating assets, I suggest that they take Mr. Guth's advice and entertain offers for their generation assets about which he states "PP&L would be very happy to receive and review offers of this magnitude". He does, however, avoid opining that the Company would accept, or that he would recommend that the Company accept "offers of this magnitude." There is very tangible and recent market experience that suggests the Company could find investors that will view their assets as much more valuable than the Company's current estimates.
>
> The unavoidable conclusion is that the electricity market is changing rapidly and the new entities are transforming the notions of ongoing value of the business. The theoretic dicta which Mr. Guth espouses is already being contradicted by the marketplace.

Id. at 11.

PP&L can't have it both ways. It cannot hold on to its plants for its future unregulated generation business, and then avoid a reasonable present value life-cycle valuation of its generating assets. If PP&L cannot accept the OCA's valuation which is consistent with the Commission's Order in the PECO case, PP&L is free to exit the generation business as Met-Ed and Penelec are doing. But, if PP&L wants to play in the future unregulated generation market, it should do so with its own money, not with several billion dollars of what amount to pre-paid ratepayer subsidies.

PP&L should not be permitted to recover the full book value of its plants as stranded cost charges over the next seven years, and then earn massive windfall profits by selling the output of these plants at higher market prices over their remaining lives. Again, in response to PP&L witnesses

claims that OCA's stranded cost recovery was too low, OCA witness LaCapra noted:

> This ignores the fact that, while there may be some delay in the Company's collection of the overstated stranded costs, the Company also obtains substantial generating assets for virtually no cost to operate in a market that has market prices much higher than those used as a basis for establishing stranded costs. While Mr. Kahn may believe PP&L is harmed in this scenario, the Company, in fact, could end up with a significant windfall if stranded cost recovery is set too high. In contrast, the consumers pay higher stranded costs in the transition period and higher market prices in the ensuing competitive market.
>
> This asymmetry of impacts make it very important for consumers that the commission take care to set stranded costs at reasonable projected values.

OCA St. 15 at 5-6.

C. The Unreasonable Request Of The Company Is Grounded In Its Improper Application Of The Revenue Requirements Methodology As Well As The Inappropriate Assumptions Of Its Market Price Analysis.

The counter-intuitive results of the Company's analysis are grounded in three principal areas. First, the Company's revenue requirements methodology overstates stranded costs. Second, PP&L's net present value discounting under that methodology is inappropriate. Third, PP&L witness Jones' market price forecast, which is central in determining market revenues for owned generation related stranded cost purposes, seriously underestimates market prices. All three combine to raise PP&L's results to the level of unbelievability.

1. PP&L's Revenue Requirements Methodology Itself Is Inconsistent With The Determination Of The Amount Of Recoverable Stranded Utility Plant.

PP&L's revenue requirements method as it applies to generation assets calculates stranded costs by comparing, on a present value basis, revenues from generation that could be received under traditional regulation and revenues from generation that could be received in a market environment. PP&L St. 8-R at 4. Distilled to its basic character, PP&L's revenue requirements methodology as it is applied to generation assets essentially assumes perfect ratemaking for every year considered in

the future. The PP&L method equates to assuming that PP&L had a full rate case every year for the next twenty five years, that it was successful in every issue, that there was no regulatory lag, and that the Company actually earned every penny that it was allowed in that year. The method then combines all of these results, returns them to present value (albeit at an incorrect discount rate), and then replicates the difference between those revenues and assumed market based revenues in the CTC.

The OCA submits that the asset valuation methodology is preferable since it is a more direct way of reflecting that the market value today is the discounted present value of the expected future stream of revenues, but that the future stream of revenues should be based on rational economic principles, rather than the assumption of perfect ratemaking for the next twenty five years.

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

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

Id.

Applying the holding of the PECO restructuring case here, the OCA submits that the asset valuation methodologies proposed by OCA and PPLICA should form the basis for the Commission's stranded cost calculations in this case.

2. In Applying The Revenue Requirements Methodology, PP&L Incorrectly Applies The Discount Rate Used For Net Present Value Purposes.

PP&L's central mistake in applying its revenue requirements methodology was in its net present value assumptions. In calculating the annual revenue requirements for both nuclear and fossil generation, witness Schadt included a return on investment. PP&L St. 8 at 6, 12. This return on investment for each year beginning January 1, 1999 to the end of the generating units' lives employed the Company's weighted cost of capital at December 31, 1996 and included the 11.5% cost of equity allowance in PP&L's last base rate case at Pa. PUC v. Pennsylvania Power & Light Co., R-00943271 (September 27, 1995), Slip op. at 7, 12-13. ("PP&L"). This included grossing up the revenue requirement for federal and state income taxes payable on the return. PP&L St. 8 at 9, 14. Thus, witness Schadt's revenue requirement streams were performed utilizing a pre-tax rate of return.

However, for net present value purposes, witness Schadt discounted the stream of revenue differences using a discount rate of 7.92%. PP&L St. 8 at 30. This discount rate is the Company's proposed after-tax cost of capital as of December 31, 1996.

The Company's application of the revenue requirements methodology thus overstates the net present value of stranded costs because its discounting is inconsistent with its revenue requirements forecast. This error alone causes the company's stranded cost estimate to be overestimated by $880 million. OCA St. 1 at 13.

The fallacy in using different discount rates rests in the fact that the use of the after-tax rate of return as a discount rate leads to the collection of costs greater than the net book value of the assets. If it uses pre-tax revenue requirement streams, it should net present value with the pre-tax rate of return. It is only in this fashion, i.e. discounting consistently, that PP&L can achieve the

correct book value.[6]

PPLICA witness Kollen agrees. As he testified, the revenue requirements methodology employed by PP&L and the asset valuation methodology employed by the OCA and PPLICA (and by PECO in the PECO case) can only produce equivalent results if appropriate and consistent income tax and discount rate assumptions are used. PPLICA St. 3-S at 6. He noted that the PECO asset valuation methodology results in a quantification of the after tax lost income associated with the generation assets. He also noted that the PP&L methodology ostensibly results in a quantification of the before tax lost revenues, assuming PP&L had computed the net present value of those amounts properly, which it did not. Id. at 6-7. He further testified:

> 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 PECO's 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 PECO methodology on this difference alone.
>
> . . .
>
> Second, the PP&L methodology utilizes an after tax rate of return to discount its future years before tax revenue requirement projections. In contrast, the PECO 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 PECO methodology on this difference as well.

Id. at 8. Thus, as noted by witness Kollen, PP&L's revenue requirements methodology inappropriately recovers the present value of income taxes due to equity financing in future years. The utility will never incur these future years income taxes due to equity financing because of the

---

[6] The revenue requirements methodology utilitized by the Company also incorporates assumptions that are more appropriately considered in the design of the CTC. For example, it builds in return on investment over the entire forecast period, ignoring that the CTC period will be a much shorter period for recovery of stranded costs authorized by the Commission. OCA St. 1 at 13.

accelerated recovery of its stranded generation costs through the CTC. It is entitled only to the income taxes associated with the equity financing of the stranded generation costs during the CTC recovery period, which is properly incorporated in the asset valuation methodology employed by OCA witness LaCapra.

3. PP&L's Market Price Assumptions Employed In Its Determination Of Owned Generation Related Stranded Costs Unreasonably Affects These Costs.

A key element of PP&L's proposed stranded cost claim is the market price forecast of PP&L witness Jones used in determining owned generation related stranded costs. Dr. Jones first provided estimates for the future price of electricity in a competitive market and then computed the expected revenue generated by each PP&L generating facility over its remaining plant life.[7] These price estimates and generating plant revenue estimates were then used as inputs to the Company's calculation of its claimed $4.6 billion in stranded costs.

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

The significant problems with Dr. Jones' recommendations center upon his projection of fuel prices. While much can be said of Dr. Jones' independent and judgmental derivation of fuel prices, mainly through the exercise of circular reasoning, his "forecast" distills itself into little more than ignoring any real fuel price increases in the future through the normalizing away of past non-stable fuel prices, and applying today's low inflation rate for eighteen years into the future based upon the long-term surety of today's federal monetary policy.

---

[7]The price of electricity derived by witness Jones are the hourly market clearing prices in the PJM power pool inclusive of imports and exports. These prices include estimated capacity prices and estimated energy prices. PP&L St. 7 at 3.

The Commission in PECO's restructuring case has already determined that OCA witness Smith's approach, which includes the Spring 1997 DRI fuel price forecast, is appropriate for establishing market prices to be used in determinations of asset market value within PJM. PECO Energy Restructuring Order at 88.

D. Based Upon Appropriate Methodologies, The Company's Level Of Stranded Costs Is $1.08 Billion.

The facts presented in the record establish that the OCA's total stranded cost recommendation of $1.08 billion is clearly reasonable. The OCA's recommendation avoids PP&L's unreasonable result of having its owned generation related stranded costs exceed the net book value of the plant. In short, the OCA's recommendation passes the test of common sense whereas PP&L's does not.

Moreover, the OCA's recommendations here are entirely consistent with the stranded cost calculations that were adopted by the Commission in the recent PECO Energy restructuring order. For this reason, the clear affirmative rulings in the PECO restructuring order are of paramount importance here. As stated by the Commission in that order:

> We have reviewed the record concerning this issue in extraordinary detail in order to make a factual finding of the future market value of PECO's generating assets that is supported by the evidence.

PECO Energy Restructuring Order at 87. After completing that "extraordinary" analysis, the Commission concluded:

> Though there is no single proposal that we find completely convincing on every component of its analysis, we adopt the testimony of OCA witness Smith as the most reasonable determination of future market value in the record and therefore determine a market value of PECO's stranded generation plants of $3.96 billion as of 12/31/98. Witness Smith's testimony is the most credible, and least criticized of any of the other market value witnesses, and produces a result approximately midway between the other two most credible models. We are also convinced that witness Smith performed an objective analysis of the issues in this proceeding, a task that the Commission believes no other party truly performed.

Id. at 88.

PP&L should be allowed to recover $1.08 billion in net stranded costs through a competitive transition charge. It should not be allowed to recover its requested $4.6 billion of stranded costs.

1. PP&L's Level Of Owned Generation Related Stranded Costs Is $138 Million.

PP&L's owned generation related stranded cost, based upon an application of an asset valuation methodology, is $138 million. OCA St. 1-S at 7; OCA Exh. RLC-8. OCA witness LaCapra's methodology correctly balances the stranded cost determination by calculating the difference between the net book value of the generation related assets as of January 1, 1999 and the estimated market value of those assets as of that date. The stranded investment as of January 1, 1999 resulting from this calculation is then used as the basis for the determination of the competitive transition charge. As noted above, this method was adopted by the Commission in the PECO Energy case, and employed by PPLICA witness Falkenberg in this case. The net book value of owned generation related assets as of January 1, 1999 was determined by OCA witness LaCapra to be $3.25 billion. OCA St. 1 at 14; RLC-5. This determination of the net book value of total plant, including production plant, general and intangible plant, and land for each of PP&L's generating stations was based upon values presented in PP&L's Exh. JRS1 adjusted for the appropriate PUC jurisdictional allocation factors discussed infra.

The market value of the generating assets is an estimate of the amount a willing buyer would pay for the assets. As OCA witness LaCapra noted, the primary component of the market value is the difference between the revenues that a buyer could expect for electric production at market based prices less the going forward costs of operating the unit, including fuel, operation and maintenance expense, ongoing capital investment, taxes, and administrative and general expenses. OCA St. 1 at 14-15. OCA witness LaCapra developed projections of both the going forward costs associated with

the assets and the market based revenues for electric production.

The estimate of the market based revenues for PP&L's generation is based upon OCA witness Doug Smith's forecast of market prices for the PJM system in combination with forecasts of production from each of the Company's generating units. This results in estimated revenues that each unit will realize. The results of witness Smith's analysis will be discussed later in this brief.

OCA witness LaCapra's approach is appropriate and should be adopted in this proceeding.

a. The $3.25 Billion Book Value Of PP&L's PUC Jurisdictional Generation Assets As Of January 1, 1999 Is Appropriate.

PP&L in its stranded cost analysis uses PUC jurisdictional percentage allocations to calculate the portion of its total estimated stranded costs that it believes to be subject to the Commission's jurisdiction and therefore eligible for recovery. As OCA witness LaCapra noted:

> As shown in Exhibit JRS-1, the Company projects that these percentages will increase over the next several years, adjusting the applicable ratios for known future changes to the Company's existing wholesale contracts (OCA-XI-6).

OCA St. 1 at 9. This trend of increasing PUC jurisdictional allocators is evidenced also at PP&L Exhibit JRS 1A (Revised) at pages 2-4 for the Susquehanna station, and at pages 5-8 of the same exhibit for the fossil units.

These expanding PUC jurisdictional percentages were based upon the assumption by PP&L witness Kleha that capacity associated with expiring current wholesale contracts will automatically revert to Pennsylvania jurisdictional service. Even though witness Kleha presented a fully distributed allocation of the Pennsylvania jurisdictional costs of providing electric service to PP&L's various retail classes based upon the future test year in PP&L's last rate case, he adjusted the PUC jurisdictional ratios for future changes to the Company's existing wholesale bulk power contracts, the contract with UGI Utilities, Inc-Electric Division, and PP&L's full requirements wholesale municipal customers, including Citizens Electric Company and Allegheny Electric Cooperative, Inc.

These changes included expiration of the existing bulk power contracts with Jersey Central (ratable expiration over a five year period ending December 31, 1999), Atlantic City (March 20, 1998 expiration), and Baltimore Gas and Electric (May 31, 2001 expiration). PP&L St. 3-R at 9. Thus, PP&L included the capital and operating costs associated with these expiring wholesale power contracts in the calculation of PP&L's retail level of stranded costs.

Currently, of course, the resources associated with all wholesale contracts, including those that may be modified in the future, are excluded from rate base. The Company argues, however, that these resources should be eligible for retail stranded cost recovery because these are known and measurable changes (PP&L St. 3-R at 8-9) and, therefore, under traditional regulation would be assimilated into PUC jurisdictional revenue requirements and corresponding retail customer rates in future rate proceedings as those contracts expire. OCA St. 1 at 9.

The OCA submits that the automatic inclusion of this capacity into jurisdictional rate base under the revenue requirements methodology is not consistent with the regulatory principles of the Commission, and that retail consumers should not be required to pay for these alleged wholesale stranded costs. Therefore, OCA witness LaCapra's use of appropriately adjusted PUC jurisdictional allocation factors is reasonable. OCA St. 1 at 14.

Section 2803 of the Act, 66 Pa. C.S. §2803, requires stranded costs to be those which traditionally would be recoverable under a regulated environment. PP&L essentially makes the undemonstrated assumption in its revenues requirements approach that the capacity associated with all of the wholesale contracts in question would be necessary in the future and thus used and useful in service to retail consumers. This leap of faith is nowhere evidenced in the record nor, the OCA submits, can it be. In fact, in its last rate case in 1994, PP&L sought similar regulatory treatment for the capacity associated with these contracts in the future through automatic ECR treatment versus

base rate treatment. The Commission rejected this proposal, which parallels the Company's request in this case to consider that capacity jurisdictional for stranded cost calculation purposes. The OCA submits that the capacity at issue is not traditionally recovered under a regulated environment without a showing of it being used and useful, and this capacity has already received a regulatory denial of an advanced treatment through rates.

In its last case, PP&L proposed a modification to its ECR to reflect the expected return of capacity costs and revenues attributable to off-system capacity sales that will terminate in the future. Included in that proposal was the return of the 945 MW slice of system capacity and energy sold to Jersey Central Power & Light Company. This sale was associated with the Commission's determination in PP&L's 1982 rate case that PP&L had excess generating capacity, and that a disallowance of the recovery of all return on a 945 MW slice of the system was necessary. In the Company's 1984 rate case, all of the costs and revenues associated with the 945 MW were allocated out of PUC jurisdictional rates. On January 1, 1996, this sale began to reverse on a one-fifth basis over a five year period. PP&L at 244.

PP&L requested that it be allowed ratemaking treatment of this capacity, as well as the capacity and energy sold to Atlantic City Electric (125 MW slice of all coal-fired plants) and Baltimore Gas & Electric (125 MW slice of the Susquehanna plant), not through base rates but through the ECR. Under its proposal, PP&L desired to reflect the full costs of each slice of returning capacity in the ECR, as well as a credit of all revenues from off-system sales.

The Commission rejected this proposal to allow ratemaking recognition in advance of the return of the capacity associated with wholesale contracts. It correctly viewed this request as a continuation of the excess capacity question and declined to prematurely judge whether this capacity would be used and useful in the future. Id. at 255.

The OCA submits that PP&L's treatment of the capacity associated with expiring wholesale contracts in the future for stranded cost purposes, i.e., assuming the capacity automatically as Pennsylvania jurisdictional capacity, is the same as its prior attempt to receive advance approval of recovery of the capacity through the ECR. The Commission's traditional regulatory treatment properly excludes the recovery of non-used and useful property from rates, and it has excluded from rates the recovery of costs associated with the future expiration of PP&L's wholesale contracts.

PP&L's further attempt to include this capacity within Pennsylvania jurisdictional allocators for stranded cost calculation purposes fails to meet the requirements of the Customer Choice Act.

b. OCA Witness LaCapra's Assumptions Concerning The Going-Forward Costs Are Reasonable.

The estimate of the going forward costs for the PUC jurisdictional portion of the Company's generating units were estimated by OCA witness LaCapra on an annual basis. These costs are:

- Fuel costs - The annual fuel costs for the generating units were provided by OCA witness Doug Smith and are consistent with the assumptions used in his market price analysis.

- Operation and maintenance expenses - Witness LaCapra employed the Company's estimated annual O&M costs for each unit with four adjustments. First, the Company's 2.5 percent inflation assumptions were replaced by the inflation assumptions employed by OCA witness Smith in his market price analysis. Second, the annual variable O&M costs were adjusted to reflect any differences between OCA witness Smith's and PP&L witness Schadt's projected generation quantities. Third, it was necessary to adjust the escalation of annual O&M costs after 1997 to account for annual productivity. While PP&L's forecast began with its current budget and plans for the next five years followed by escalation at inflation, it did not include any productivity gains due to competition. PP&L witness Jones testified on the reductions in O&M that have been observed in other industries as they became subject to competition. PP&L St. 7 at 41-42. Based on PP&L witness Jones' observations, OCA witness LaCapra incorporated an annual productivity factor after 1997 of 0.2 percent. Fourth, witness LaCapra corrected an error of the Company which incorrectly reallocated some of PP&L's A&G costs to other plants in the future as plants retire, rather than discontinuing that A&G expense. In addition, it was necessary to exclude certain A&G expense that PP&L incorrectly allocated to generation plants.

- Plant additions - The estimated annual plant additions were those provided by PP&L adjusted to reflect OCA witness Smith's inflation assumptions.

- Taxes Other Than Income - OCA witness LaCapra reflected the estimated annual taxes other than income for each unit provided by PP&L for 1997, and held them constant in the future.

- Generating unit life - PP&L did not include life extensions for any of its units in its analysis. OCA witness LaCapra used the same useful life as assumed by PP&L for each unit except for the Keystone and Conemaugh generating stations. He included life-extension costs and continued operating lives for those units consistent with those estimated by PECO Energy in its restructuring filing, adjusted to reflect PP&L's ownership share.

- Fossil Decommissioning Costs - As will be discussed infra, OCA witness LaCapra excluded all fossil decommissioning costs proposed by PP&L.

OCA St. 1 at 15-16.

As has been noted, the fuel cost assumptions, O&M inflation assumptions, unit generation levels, and inflation associated with annual plant additions were adopted by OCA witness LaCapra from OCA witness Smith. The record demonstrates that the other parameters employed by witness LaCapra in determining the going-forward costs for the PUC jurisdictional portion of the Company's generating units are reasonable.

i. Witness LaCapra's Productivity Assumptions Are Conservative.

The Customer Choice Act establishes clear expectations that utilities will take reasonable steps to mitigate their stranded costs. For example, Section 2803 of the Act, 66 Pa. C.S. §2803, notes that, even if all stranded cost conditions are met, those costs to be recoverable under the Act still must be determined by the Commission to remain following mitigation by the electric utility. Thus, the Act requires the Commission to consider past and prospective mitigation efforts by the Company in determining the level of stranded costs to be recovered through the CTC.

Given this situation, OCA witness LaCapra adjusted the escalation of annual O&M costs after 1997 by an annual productivity factor of 0.2 percent. PP&L, as noted by the testimony of witness

Schadt, forecasted O&M for generation based upon its current budget and plans for the next five years. While it did hold those forecasts constant through 2001, it then escalated generation O&M costs for both nuclear and fossil generation at 2.5 percent per annum. PP&L St. 8 at 11, 16.

OCA witness LaCapra noted correctly that the Company's reflection of productivity over only a short period assumes that the Company is unable to find any further efficiencies in a competitive environment. OCA St. 1 at 24. The OCA submits that this assumption of no further improvements beyond 2001 due to competition is inconsistent with the testimony of PP&L witness Hill who testified that the Company certainly has significant O&M reduction plans for the Susquehanna unit. As OCA witness LaCapra testified:

> The Company conducted a strategic assessment of cost control and performance improvement for Susquehanna in 1994 entitled Strategy 2000: Positioning Susquehanna SES For A Competitive Environment. This proprietary document presents an excellent example of an aggressive mitigation plan for the facility. Unfortunately, its recommendations are not reflected in Mr. Hill's proposal, in Mr. Schadt's stranded costs, nor Mr. Jones' market price analysis.

Id. at 25.[8]

The OCA submits that OCA witness LaCapra's productivity offset is reasonable in a long-term competitive environment and is, indeed, conservative.

ii. The Life Extension Of Keystone and Conemaugh Is Reasonable.

As noted, OCA witness LaCapra also assumed life extensions for the Keystone and Conemaugh generating stations in determining the market value of each plant. The primary measure of a generating facility's market value is the net present value of net revenues that can be expected from the facility. PECO Energy in its restructuring case correctly identified that these two units

[8]PP&L witness Hill testified that of the Company's $3.6 billion claim for generation related stranded costs, $2.9 billion was related to Susquehanna. Tr. 982. Thus, O&M reductive efforts at Susquehanna have the greatest mitigation potential.

added net revenue potential by extending the life beyond their book lives through cost effective life extension measures. OCA St. 1 at 17. OCA witness LaCapra included these life extensions in his analysis of PP&L's stranded costs as appropriate and, since the units in question are jointly owned units, employed the life extension option based upon information from the PECO proceeding. Id.

The Commission in the PECO Energy restructuring case adopted the OCA market value analysis that incorporated the life extension for Keystone and Conemaugh. PP&L's suggested treatment of retaining the currently expected lives of Keystone and Conemaugh in this case creates the nonsensical result of leaving different portions of Keystone and Conemaugh with longer lives than other portions of those units. The Commission's order in the PECO restructuring case is directly on point, and the recommended life extension is appropriate for this proceeding.

c. OCA Witness Smith's Market Analysis Is Reasonable.

Based upon OCA witness Doug Smith's forecast of market prices for the PJM system consistent with the Spring 1997 DRI fuel price forecast, OCA witness LaCapra deducted the going forward costs of the generation from the market based revenues and discounted that net margin back to January 1, 1999. The resulting market value for the Company's jurisdictional generation is $3.110 billion. OCA St. 1-S; Exh. RLC-8. Compared to the net generating plant book value of $3.25 billion, PP&L's owned generation related stranded cost is $138 million. Id. Thus, not surprisingly, the OCA (as well as PPLICA) conclude that PP&L's own generating plant has a market value which is quite close to its book value.

i. The OCA's Market Value Input Into Its Owned Generation Related Stranded Cost Analysis Has Been Approved By The Commission In The PECO Energy Restructuring Case And Should Be Applied In This Case As Well.

As noted earlier, the estimation of market electricity prices in the PJM area is one of the components in evaluating the generation market revenues for PP&L. The OCA submits that OCA

witness Doug Smith presented an analysis of market electricity prices for PJM, based on a detailed simulation of the PJM system, which provides an internally consistent basis for evaluating the generation market revenue of PJM utilities.

Before reviewing OCA witness Smith's presentation in this case, it is important to review the specific findings in the recent PECO restructuring order. The Commission in the PECO case explicitly adopted the OCA stranded cost estimate and methodology as well as the use of the ENPRO model -- all of which are utilized in an identical manner by OCA witness Smith in the present case. Thus, the Commission found:

> The general "contribution margin" methodology used by witness Smith has not been challenged by any party, and no party opposes the model used by witness Smith. PAIEUG witness Falkenberg did not object to witness Smith's use of the ENPRO model, and PECO Witness Bustard testified that "the ENPRO model appears to be an adequate model for projecting market value." The Commission is familiar with the ENPRO model and perceives it to be quite suitable to the task of estimating the generation market revenues for PECO.
>
> We find that witness Smith's model fairly represents several other important matters such as unit commitment, NUG operations, fuel prices, imports and exports, and heat rates. The rebuttal testimony of PECO witness Hieronymus and Bustard and the surrebuttal testimony of witness Smith and PAIEUG witness Falkenberg leads us to conclude that witness Smith's testimony is the most reasonable presented in the record of this proceeding. PECO witness Bustard indicates that witness Smith's capacity value projection "is relatively consistent with the projections of the three PECO models." Witness Bustard indicates that witness Smith's all hours market value for energy is 9% higher than the three PECO projections when levelized over the period 1999 through 2015. We accept witness Smith's explanation that most of the difference is due to "differences in our input assumptions such as capital costs, O&M costs, and energy price." In addition, we agree with witness Smith's approach to fuel use by dual fuel units, the cost of new generation, and the use of average heat rates. Lastly, we accept witness Smith's discount rate of 7.6% for this purpose as the most reasonable in the record. It is approximately the same as the 7.53% adopted by the Commission in our May, 1997 QRO decision and was also recommended by PAIEUG Witnesses Kollen and Falkenberg in this proceeding.
>
> In adopting witness Smith's proposals, we emphasize that we are not adopting each and every assumption and input, however. We find substantial merit in several

of the specific considerations utilized by witnesses Venkashwatara and Falkenberg and find that witness Smith's result best balances all of our considerations.

PECO Energy Restructuring Order at 89-90.

Of perhaps equal, or even greater importance, the Commission specifically commented on the credibility and balanced nature of the OCA presentation in the PECO case. The Commission recognized that the OCA calculation was not a "low-ball" estimate intended to produce the most favorable result, but rather included adjustments that served to increase stranded costs as well. Thus, the Commission noted:

> Witness Smith provided further evidence of the reasonableness of his recommendations and his overall credibility by not adjusting PECO's treatment of nuclear capacity factors and reserve requirements in a way that increases stranded cost recovery. Witness Smith did not recommend any adjustments to PECO's proposals even though adjustments would have reduced PECO's stranded cost recovery significantly and would have been consistent with his credible testimony in the May 22, 1997 QRO proceeding.
>
> In this proceeding, PECO assumed a reserve requirement of 18% and nuclear capacity factors consistent with industry averages, just as it did in the QRO proceeding. In the QRO proceeding, the OCA argued that there was no factual basis for an 18% reserve requirement based either on PJM's historic or announced future requirements. In the QRO proceeding, the OCA calculated that use of PECO's own actual nuclear performance factors instead of industry averages would reduce stranded cost recovery by $643 million. We conclude that this discussion reaffirms our view that witness Smith recommended the most broadly reasonable result rather than advocating in every case an approach that would minimize stranded cost recovery by PECO.

PECO Energy Restructuring Order at 88-89.

OCA witness Smith's presentation in this case tracks those elements approved by the Commission in the PECO restructuring case. OCA witness Smith's generation market analysis in the present case is based upon publicly available generation, load and fuel price data. His analysis reflects fuel price escalation rates from the DRI Spring 1997 World Energy Service U.S. Outlook. OCA witness Smith's analysis was performed to assist the Commission by providing a balanced, non-

utility perspective on generation market issues. OCA witness Smith's approach in developing assumptions and methods used in the analysis was not, however, to develop a high bound or counter to the Company's analysis. As will be demonstrated, witness Smith has sought and achieved reasonable expected value outcomes in the areas encompassing a market value study. OCA witness Smith testified that he chose assumptions that have the equivalent likelihood of being above or below the actual outcome. OCA St. 2 at 19-20.

To approximate the PJM energy market, OCA witness Smith conducted a dispatch analysis of the PJM system once again using the ENPRO dispatch simulation model. Id. at 20.

The most important methodological difference between OCA witness Smith's and PP&L witness Jones' analysis is in the derivation of the energy market clearing price. OCA witness Smith represented the energy market in terms of bids for delivered energy from each PJM generating unit in which the energy market price is defined by the highest selected bidder, and each bidder is assumed to bid based on its total variable cost. OCA St. 2 at 20. This is superior to Dr. Jones' approach, which systematically understates the market clearing price by not reflecting a unit's average variable costs in each hour but rather a unit's incremental cost.

The marginal generating units in PJM are typically coal, oil or gas fired units with a declining incremental heat rate curve. Id. at 4. Production at low output levels is typically less efficient and more costly than production at maximum output or full load. As output levels increase, the incremental rate of fuel input required per incremental kwh output is less than the average rate of fuel input required to produce that output level. Id. Therefore, if the energy market clearing price is based upon the incremental heat rate of the marginal generating units in the market, that price will be systematically lower than the actual variable costs incurred by these marginal units. As OCA witness Smith correctly noted, energy bids priced on this basis would therefore often be inadequate

to recover the actual variable costs of the marginal generators. Id. While Dr. Jones acknowledged this outcome, he never altered his market price analysis to make a correct adjustment for unrecovered variable costs. Id.

Despite Dr. Jones' failure to include start up costs, witness Smith testified that they should be included in any analysis since the costs are unavoidable generating costs for thermal generating units. OCA St. 2 at 7. Because some of PP&L's generating units do not incur start-up costs or start infrequently, the net effect of including start-up costs would be to increase the collective value of PP&L's generation.

Based upon the impact of incremental heat rates and start-up costs, OCA witness Smith correctly determined that, to properly forecast PJM energy market prices, it is appropriate to represent the energy bid of each thermal generating unit based on the units' "as-operated" average heat rate. Id. at 8. This treatment appropriately reflects the unit's actual operating condition and costs. He testified:

> For units that are operated strictly at full load, the "as operated" heat rate will tend to approximate the unit's full load average heat rate. For units that are operated regularly at less efficient partial output levels, the as-operated heat rate will tend to exceed the full load average heat rate. The as-operated heat rate reflects the realistic efficiencies incurred by thermal generating units during generation (including low load and cycling conditions), and includes the fuel consumed during startups.

Id.

Finally OCA witness Smith's methodology assumes over time that the market price for capacity will approximate the carrying costs of the combustion turbine option, the least costly type of additional generating capacity. Unlike Dr. Jones' analysis, however, witness Smith's analysis supports the introduction of new capacity in the time frames used.

ii. OCA Witness Smith's Inputs Are Reasonable.

The fundamental inputs in OCA witness Smith's analysis are generally based on publicly

available data or are based upon witness Smith's assumptions. As will be described, those assumptions are superior to the assumptions relied upon by Dr. Jones. These primary assumptions are as follows:

- PJM generating units and their maximum capacities were identified from Energy Information Agency Form 860. OCA St. 2 at 21.

- Variable O&M costs of PJM generating units were based upon assumptions presented by PECO Energy in its restructuring case at Docket No. R-00973877. These values, which include only direct O&M costs and not emission adders, are in general lower than those utilized by Dr. Jones. Id. See also, OCA St. 2 at 11.

- As discussed earlier, the energy bid of each thermal generating unit is represented based upon its average as-operated heat rate for 1996. OCA witness Smith obtained this data from FERC Form 1.[9]

- Generating unit availabilities were developed for major classes of generating units based upon NERC records of 1990-1994 actual generating unit availabilities with the following exceptions. The output of PJM hydro units was based upon the estimated long term average output. The nuclear generating units in PJM were assumed to produce at a 75 percent annual capacity factor in each year of the analysis. Finally, the non-utility generating capacity was projected in accordance with the North American Electric Reliability Council's 1996 Electric Supply and Demand Database. Id. at 21-22.

- The projected peak load and energy requirements for PJM were based upon data obtained from MAAC Form ERI-411. Id. at 22.

- Fuel price assumptions represent the most critical aspect of the inputs. OCA witness Smith utilized the Spring 1997 DRI forecast that he utilized in the final market price analysis that the Commission adopted in the PECO Energy restructuring case. OCA St. 2-S at 4-5.

The energy market prices that PP&L will receive for the output of its generating units will depend significantly on fuel prices faced by the "marginal" generating units in the PJM electricity

---

[9]OCA witness Smith on surrebuttal also adjusted the way purchases from outside PJM were represented in the ENPRO dispatch simulation model. He increased the hourly flexibility of energy imports from ECAR which increased the amount of PJM energy imports and lowered modestly the projected PJM market energy price in the near term. This price effect declined over time. Witness Smith also assumed a smooth decline in imports over a six year period which had a minimal effect on market price. These revisions, along with revised base year fuel prices, resulted in a levelized market price roughly 2 percent lower than his initial analysis. OCA St. 2-S at 2-3.

market. These are units that tend to operate during high demand periods, but not on an around-the-clock basis. In PJM, the margin is defined primarily by coal, oil and gas-fired sources. Nuclear and hydroelectric sources will rarely (if ever) define the market price. OCA St. 2 at 9.

As OCA witness Smith correctly noted, PP&L's nuclear, coal and hydro units are rarely, if ever, at the margin. Id. Energy clearing prices are most often set by more expensive coal, oil and gas units elsewhere in PJM. Thus, if gas and oil prices increase, the energy revenues realized by PP&L could be much greater than expected. This would substantially lower the Company's actual stranded generation costs.

Dr. Jones' final price assumptions systematically ignore historic price volatility and lead to counter-intuitive owned generation related stranded cost results for a Company in PP&L's overall price position. Dr. Jones' 1996 base fuel price assumptions are understated based upon actual prices. OCA St. 2 at 9-10.[10] Dr. Jones rejected fuel price forecasts advanced by DRI (as utilized by the OCA) and by the Department of Energy's Energy Information Administration (as used by PPLICA)[11] and simply used his own judgment to select price escalation rates for each major fuel type. Similarly, Dr. Jones used judgment and an unrepresentative view of historical data to arrive at a 2.5 percent annual inflation rate for the study period. OCA witness Smith succinctly summarized the results of Dr. Jones' judgment in real terms:

Specifically, taking inflation into account, Dr. Jones assumes that oil and gas prices

---

[10]Dr. Jones' testimony leaves the impression that his proposed fuel price escalation path is applied to actual 1996 prices, which most forecasters believe were exceptionally high. OCA St. 2-S at 8. However, Dr. Jones did not apply his escalation forecast to the actual 1996 prices experienced by PJM generating units but to an understated level of 1996 costs. Id. at 8-9.

[11]PPLICA witness Falkenberg reflected the fuel price assumptions method in the U.S. Energy Information Administration's 1997 "Annual Energy Outlook." OCA St. 2-S at 6.

> will remain constant through 1999 and will increase at 2.5 percent per year thereafter, for a decline of about 7 percent in real terms by 2015. Dr. Jones assumes that coal prices will increase at 1.5 percent through 2000 and at 1.7 percent per year thereafter, for a decline of about 14.5 percent in real terms by 2015.

Id. at 10.

As OCA witness Smith noted, Dr. Jones' analysis assumed lower inflation as well as lower fossil fuel price escalation in real terms than either of the two escalation forecasts for PJM utilized by PECO in its restructuring filing. OCA Exhibit DCS-4 compares Dr. Jones' fuel price escalation rates for natural gas, coal and residual oil to the DRI escalation rates used by two of PECO's market price witnesses. The exhibit also compares the price escalation rates for each fuel to the general inflation rates assumed by DRI and Dr. Jones. Id. OCA Exhibit DCS-4 illustrates that, over the planning horizon, Dr. Jones' cumulative escalations for oil and gas prices are lower than his assumed rate of general inflation, and much lower than the DRI projection of price escalation used by PECO's witnesses. Id. at 11.[12] OCA witness Smith used the DRI forecast that was also used by PECO's witnesses in its restructuring case. OCA witness Smith testified that he employed DRI forecasts because DRI is a well-known forecasting firm that has been used in numerous electric industry

---

[12]Dr. Jones attempts to explain his incredible results by raising arguments based upon statistical behavior. In his rebuttal testimony, Dr. Jones raises the concern that the DRI and EIA fuel price forecasts predict a widening of the existing spread between oil, gas and coal prices. He states that just ten years into the forecast the odds that the gap between oil and gas prices predicted by DRI could materialize are roughly 33,000 to 1. PP&L St. 7-R at 31. This allows him to postulate that there is essentially no chance that final prices will behave as forecasting firms predict. Id. While Dr. Jones offered no background for his statistical analysis, OCA witness Smith correctly testified that Dr. Jones' statistical foray could only be an extension of his historical review of oil price behavior discussed earlier. OCA St. 2-S at 6-7. And as witness Smith accurately noted, Dr. Jones' Exhibit STJ-16 contains sustained periods when actual prices deviated significantly from Dr. Jones' professed trend in price spreads. In fact, that exhibit shows that actual oil prices have exceeded Dr. Jones' actual "average" price of $15.50/barrel for virtually all of the past twenty years. Id. at 7. In fact, historic fuel prices have varied substantially over time and the variations have often lasted for sustained periods, as Dr. Jones' Exhibit STJ-16 illustrates for oil. Id. at 9.

analyses, and because the future described by the DRI escalation rates is reasonable. OCA St. 2 at 22. The OCA submits that the use of this independent professional forecast is preferable to Dr. Jones' judgmental individual forecast.

The OCA submits that it is vitally important to employ an independent fuel price forecast by reputable forecasting firms. As correctly noted by PPLICA witness Falkenberg, PP&L witness Jones is the only market valuation witness in either the PECO Energy case, or this case, to not employ independent fuel price forecasts and advance a fuel price forecast based solely on his own judgment. Witness Falkenberg testified:

> ...PECO presented three independent market price studies supported by three experts. GPU has also presented an independent market price forecast study. Further, the OCA presented Mr. Smith and PPLICA has presented my testimony. Of the seven market price studies presented to the Commission there is only one case where the market price expert also presented his own fuel price forecast.

PPLICA St. 2-S at 35.

As witness Falkenberg noted, the danger in a forecast such as Dr. Jones is that the witness' own personal judgment and opinion are placed above the detailed modeling and analysis of independent sources with no parochial interest in the outcome of any particular case. Id. at 37. Witness Falkenberg correctly noted that Dr. Jones and PP&L expect ratepayers to place a $4.6 billion bet on his personal fuel price forecast. Id. And, as noted earlier, the counter-intuitive results of PP&L's owned generation related stranded cost claim, driven significantly by Dr. Jones' fuel price assumptions, demonstrates the concern with employing a forecast from a non-disinterested source. The Commission should not adopt any result based upon Dr. Jones' fuel price analysis.

OCA witness Smith's fuel price assumptions began with actual annual fuel prices for PJM generating units obtained on a station basis for calendar year 1996 from FERC Form 1. OCA St. 2 at 21. In his surrebuttal testimony, OCA witness Smith revised the base year fuel price based upon

data from FERC Form 423. OCA St. 2-S at 1-2. Witness Smith explained the update as follows:

> My revised analysis reflects actual base year fuel prices for each major fuel type, for each major utility in PJM. While the change was made to address certain concerns raised by PECO in Docket No. 00973953 regarding the basis of FERC Form 1 data, the net effect of this change on market prices was not large.

Id. at 2.

From 1997 forward, OCA witness Smith initially escalated fuel prices according to major fuel type based upon escalation rates from the Fall 1996/Winter 1997 DRI price forecasts. OCA St. 2 at 21. Specifically, coal prices were assumed to decline steadily in real terms over 20 years. Oil and gas prices were assumed to initially decline by about 10 percent in real terms, and to increase moderately thereafter. Over 20 years, oil and gas prices were assumed to increase by between 15 and 20 percent in real terms. Uranium prices were assumed to remain constant over the planning horizon in real terms. OCA St. 2 at 22.

OCA witness Smith later presented a revised analysis based upon DRI's Spring, 1997 revision to its forecast of fuel prices in the mid-Atlantic region. The Spring 1997 revision featured lower prices for natural gas (the fuel assumed by PP&L to be burned at most new generating units in PJM) and oil. All else being equal, this change would tend to decrease projected PJM generation market prices relative to the Fall 1996/Winter 1997 version, and increase projected stranded generation costs. At the same time, coal is the predominant fuel burned by PP&L and will therefore affect the Company's costs. The Spring 1997 DRI forecast featured an increase in coal prices relative to the Fall 1996 version. This change would also tend to increase projected stranded generation costs for PP&L. Id. at 4.

The results of the market analysis for the DRI Spring 1997 fuel price forecast is evidenced at OCA St. 2-S; Exhs. DCS-12 and DCS-13. From 1999 to 2015, the levelized market price of power is three percent lower than witness Smith's revised analysis based on the prior Fall 1996/Winter

1997 forecast. The OCA submits that the results of OCA witness Smith's analysis employing the DRI Spring 1997 revisions should be employed in this case.[13]

OCA St. 2; Exh. DCS-9, with witness Smith's updated PJM market price estimates from OCA Exh. DCS-12 substituted for the OCA column in DCS-9, evidences that witness Smith's analysis shows significantly higher market prices than those projected by Dr. Jones. The OCA submits that witness Smith's alternative analysis provides a practical way for the Commission to implement consistent market price assumptions in its determination of stranded generation costs. It yields more appropriate generation market prices and yields generation related stranded costs much more in line with PP&L's pricing position in the industry.

d. Conclusion

In fulfilling the Act's mandate to replace price regulation of a generation monopoly with an effective competitive generation market discussed earlier, the Commission in the PECO restructuring order adopted the asset valuation approach to generation related stranded costs similar to that employed by OCA witness LaCapra (PECO Energy Restructuring Order at 80), and as part of that analysis adopted the testimony of OCA witness Smith as the most reasonable determination of future market value in the record. Id. at 88.

The OCA submits that the Commission's adoption of witness Smith's methodology and results is equally applicable in this proceeding. First, the record amply demonstrates that witness Smith's market valuation results are much more reasonable than PP&L's. Second, consistency and reasoned regulation requires that the market price and market valuation approaches be the same for PECO Energy and PP&L. All of the market value assessments performed by all parties in both the

---

[13]It should be noted that, by updating his final price forecast (as he did in the PECO restructuring case as well), Mr. Smith increased the OCA's stranded cost recommendation by $548 million. See OCA St. 1-S at 6-7.

PECO Energy and PP&L cases model PJM. This is appropriate since both PECO Energy and PP&L are members of PJM. It is simply inappropriate, and indeed unjustifiable, to adopt market valuations for PP&L and PECO based upon different approaches and, particularly, different market prices. PJM will constitute a single market, and market price assumptions should be the same for both PJM companies if the generation related stranded cost results are to have any proper symmetry or consistency.

Thus, the OCA submits that consistent with the PECO decision, the Commission must recognize that PP&L's stranded costs of its owned generation plant is no more than $138 million.

2. The Company's Claim For Stranded Regulatory Assets Should Be Reduced From $354.326 Million to $259 Million.

a. Introduction

The Company seeks recovery of numerous regulatory assets as stranded costs based upon treatments contrary to past Commission decisions, and thus contrary to Section 2803 of the Act which requires that regulatory assets be typically recoverable under current regulatory practice. 66 Pa. C.S. §2803. As such, the Company's claims must be denied stranded cost treatment or modified as recommended by the OCA. The proper allowance of stranded costs for regulatory assets is $259.249 million. OCA St. 1-S; Exh. RLC-8.

b. The Company's Reflection Of Unamortized Rate Case Expense As A Stranded Regulatory Asset Is Inappropriate.

The Company has requested $184,000 as a stranded regulatory asset for unamortized rate case expense. The OCA submits that this claim should be eliminated in its entirety. OCA St. 3 at 12. In PP&L's last base rate case the Commission adopted a four-year normalization of PP&L's rate case expense. In fact, PP&L in that case recognized the Commission's long-standing application of normalization to rate case expense, and did not argue against normalization of the expense. Instead,

it argued for a shorter normalization period. PP&L at 65-67. In arriving at its decision, the Commission applied a ratemaking treatment that it has used consistently since 1980. In that year, the Commission stated:

> In the Philadelphia Suburban case [R-79040824, Feb. 1, 1980], the Commission stated that at the present time rate case expenses are more appropriately characterized as normal operating expenses and that they should be accorded the same ratemaking treatment as any other normalized expense.

Pa. PUC v. Apollo Gas Co. 54 Pa. PUC 358, 373(1980). The Commission has not deviated from this treatment since. PP&L however elected to defer the costs of its rate case on its books and to amortize those costs, for accounting purposes, over four years. OCA St. 3 at 12. PP&L has included the unamortized balance of those costs that are applicable to the generation function which will remain as of December 31, 1998, as a regulatory asset in this case.

PP&L attempts to justify its proposed recovery of this regulatory asset through accounting conventions that it chose to adopt. Having created a deferral, PP&L then relies on the Act for its collection as a regulatory asset. PP&L St. 8-R at 39-40. The Customer Choice Act, however, keys the recovery of regulatory assets and other deferred charges to those typically recoverable under current regulatory practice. As OCA witness Catlin noted, the Commission's practice has been to normalize rate case expenses in determining revenue requirement rather than to approve the deferral and amortization of those costs. OCA St. 3 at 12. He noted:

> If a subsequent case is filed prior to the end of the interval over which rate case expenses were normalized, the Commission has not allowed recovery of amounts related to the prior case. Consistent with this practice, the Commission approved the normalization of rate case expenses for PP&L in Docket No. R-00943271. It did not authorize PP&L to defer and amortize rate case expenses.

Id.

The OCA submits that the Company's claimed balance of unamortized rate case expense does not qualify as a regulatory asset.

c. The Proper Offset To PP&L's Stranded Costs Under The OCA's Recommendation For The Investment Tax Credit Regulatory Liability Is $91.563 Million.

PP&L, in the past, took advantage of investment tax credits under federal tax law. The Company deferred immediate recognition of these credits as income by recording a regulatory liability for accumulated deferred investment tax credits. As noted by PP&L witness Schadt, the amortization of accumulated investment tax credits, including the associated income tax effect, reduces the cost of service over the lives of the assets that generated the credits and reduces customer rates. PP&L St. 8 at 28. As OCA witness Catlin noted, the term regulatory liability refers to the fact that this is an amount owed to ratepayers by PP&L as opposed to a regulatory asset which is recoverable from ratepayers. OCA St. 3 at 13.

PP&L calculated the annual amortization of the generation-related portion of the regulatory liability applicable to PUC jurisdictional customers beginning January 1, 1999 that would apply under traditional regulation and reduced the stranded cost calculation by the present value of the annual amortization. The OCA submits that, even though PP&L followed an appropriate regulatory treatment in this case, it understated the necessary reduction to PP&L's stranded costs. The balance of the ITC regulatory liability which the Company allocated to its generation assets is too low.

PP&L, in calculating the ITC regulatory liability, understates the necessary reductions to its stranded costs. OCA St. 3 at 14. However, even though the correct calculation under PP&L's recommendation results in an annual amortization allowable as an offset to stranded costs of $111.052 million versus the $102.278 million recognized by PP&L, the PUC jurisdictional balance of the ITC regulatory liability under OCA's recommended PUC jurisdictional allocation factors is $91.563 million. OCA St. 3 at 15. The OCA has reduced the Company's stranded costs by this amount. OCA St. 3 at 14, 15; Sch. TSC-1.

d. PP&L Inappropriately Requested Stranded Costs Associated With Fossil Plant Decommissioning

In calculating its proposed stranded costs for fossil generation plants, PP&L witness Schadt included $643.298 million in projected costs for decommissioning for each coal-fired and oil-fired generating plant beginning in the last year of the plant's remaining life. OCA St. 3; Sch. TSC-5. The Company escalated the current decommissioning costs contained in current studies performed for the fossil units, either by PP&L for its wholly owned units or by the plant operator for plants not totally owned by PP&L, to the projected price levels at the time those costs are expected to be incurred. OCA St. 3 at 16. The costs for each unit were assumed to be incurred 40 percent in the year of retirement, and then 40 percent and 20 percent in the two succeeding years. Id., see also PP&L St. 8 at 17. These costs were then discounted back to a net present value as of January 1, 1999 to obtain the stranded cost to be recovered from ratepayers.

The OCA submits that fossil plant decommissioning costs must be properly excluded from any determination of stranded costs. This proposed treatment contradicts the Act's requirement that these costs would have received the requested recognition under traditional regulation. As noted by OCA witness LaCapra, the Company's proposed treatment is opposed to the Commission's standard ratemaking treatment for these costs. OCA St. 1 at 18.

In addition, the inclusion of these costs violates the Act's requirement that assets would be stranded under the most reasonable future market scenario. There is no distinction between a regulatory and a competitive environment that would prevent these costs from being recovered in a competitive environment. As OCA witness LaCapra noted, unit owners as well as PP&L will have to dismantle their units. Thus, fossil decommissioning will be a cost of production for all to be reflected in market price. Id.

Indeed, the Commission has determined in its first electric restructuring order that it will not

allow recovery of fossil decommissioning as a stranded cost. In PECO Energy's restructuring case, the Commission rejected the inclusion in stranded costs of fossil fuel decommissioning expense. It found that PECO Energy's claim for separate recovery of the future costs related to fossil plant decommissioning expenses cannot be approved because future or prospective fossil plant decommissioning expenses are not traditionally recognized in rates in Pennsylvania, because they are not known and reasonable without a specific plan to decommission a particular plant at a particular time. PECO Energy Restructuring Order at 91-92.[14]

There is absolutely no basis upon which this Commission can grant PP&L the recognition of fossil fuel decommissioning that it just denied to PECO Energy. PP&L's entire reflection of $643.298 million in fossil decommissioning costs must be rejected.

e. The Record Demonstrates That PP&L's Claim For Deferred Susquehanna Refueling Costs Is Unnecessary.

PP&L witness Schadt reflected in PP&L's stranded cost calculation a regulatory asset for deferred Susquehanna refueling costs of $8.343 million. Witness Schadt testified that the regulatory asset represents incremental maintenance costs incurred during refueling and inspection outages which are deferred and amortized from the end of the outage until the next scheduled refueling and

---

[14]In the event that the Commission inappropriately grants the Company's requested stranded cost treatment of any prospective fossil decommissioning costs, the OCA submits that it is necessary to exclude certain of those costs based upon contingency factors built into the Company's estimation. As OCA witness Catlin noted, PP&L's decommissioning cost estimates for its wholly owned fossil generating units include contingency factors in the range of 16.5 to 18.7 percent. In addition, the cost estimates provided by the operator of the Keystone and Conemaugh units of which PP&L is a part owner include contingency factors of 15 percent. OCA St. 3 at 16.

The OCA submits that the fossil decommissioning cost estimates included within the determination of stranded costs must exclude these contingency factors for the same reasons that the Commission has excluded contingencies built into PP&L's nuclear decommissioning cost estimates. It is nonsensical to pancake completely speculative contingency factors upon cost estimates which are already speculative. Excluding the contingencies reduces the fossil decommissioning costs by $97,854,000 in nominal dollars. OCA St. 3 at 17; Sch. TSC-5.

inspection outage is completed. PP&L St. 8 at 25. The Company calculated the annual recovery that would occur through existing rates and included in the stranded cost calculation the present value of the PUC jurisdictional portion of these costs. Id. As explained by OCA witness Catlin, PP&L included the projected balance of deferred Susquehanna refueling outage costs as of December 31, 1998. This balance consists of the estimated unamortized balance of the projected costs of the 1997 refueling outage at Susquehanna Unit 2 and the 1998 refueling outage of Susquehanna Unit 1. OCA St. 3 at 8. The total projected balance claimed by PP&L is $9,552,000 of which $8,343,000 is Pennsylvania jurisdictional.

The OCA submits that it is inappropriate to include the projected balance of deferred Susquehanna refueling outage as a regulatory asset since a sufficient normalized level of refueling outage costs is already recognized as an annual expense in PP&L's rates.

As explained by OCA witness Catlin, PP&L established the accounting procedure of deferring and amortizing refueling outage costs in order to normalize the amount of such costs reflected as an expense in any given year. This was necessary because refueling outages have historically occurred at an interval of once every eighteen months at each unit, or at a rate of four outages every three years for the two units combined. Thus, even though from an accounting perspective the costs of the outage were amortized and recovered over the interval from the end of that outage to the end of the next outage to account for the fact that the costs are recovered after the outage has taken place, the Commission has allowed normalized ratemaking to provide the necessary funds on an annual basis to provide for the deferral.

The Commission in PP&L's last rate case reflected the normalized level of refueling outage costs to account for the interval between outages. PP&L at 58-61. Thus, a normalized level of refueling outage costs is already recovered in rates and recognized as an annual expense. No further

recovery for any additional refueling outage costs is necessary as a regulatory asset. PP&L, as it did with regard to rate case expense, has confused accounting conventions with regulatory rate recovery.

This lack of a need for any regulatory asset recognition is further evidenced by PP&L's change in refueling outage scheduling in the future. OCA witness Catlin testified that, beginning with the 1997 refueling outage at Susquehanna Unit 1 and the 1998 refueling outage at Susquehanna Unit 2, refueling outages will now occur every twenty four months at each unit, or at the rate of one outage per year for the two units combined. OCA St. 3 at 9; PP&L St. 8-R at 47-48.

Thus, there is no longer any need to defer and amortize refueling outage costs in order to include a normalized level of such costs as an expense. In fact, PP&L has indicated that it intends to make this accounting change, but will not do so until after 1999. Id. Thus, on a going-forward basis, the Company's projected O&M costs for 1999 which were used to calculate stranded costs include an annual expense equal to the cost of one outage per year. The Company's stranded regulatory asset claim must be reduced by $8.343 million. OCA St. 3; Sch. TSC-1.

f. PP&L's Claim For Employee Transition Costs Is Overstated

The Commission, in its order in PP&L's 1994 base rate case, approved PP&L's requested inclusion in rates of a five year amortization of $65,660,119 in costs associated with the Pennsylvania jurisdictional portion of its voluntary early retirement program. This resulted in an annual amortization amount of $13.132 million. OCA St. 3 at 10, footnote 2. The Commission's allowance of this amortization was predicated upon the fact that the early retirement program efforts resulted in a net savings to ratepayers. The savings to ratepayers were included in the Company's base rate case.

In this proceeding, PP&L in calculating its stranded cost claim included not only the $13.132 million amortization from the 1994 base rate case, but also an additional $7.7 million for employee

transition costs incurred during 1996. Id. at 10. PP&L, therefore, reflects voluntary early retirement costs of $20.845 million in its base case and recognizes those levels as representative of on-going annual cost levels for ratemaking purposes in this case.

PP&L has additionally included as a regulatory asset further alleged incremental employee transition costs which it projects it will incur during the years 1997 to 2001 in conjunction with its efforts to reduce the Company's work force in preparation for competition. OCA St. 3 at 9. These costs are comprised of severance payments and incremental pension benefits to be paid to employees accepting early retirement offers. PP&L assumed that the transition costs incurred in each year would be amortized over the ensuing five years. The Company then established the amount of its claimed regulatory asset based on the net present value of the amortization allowance in 1999 and subsequent years. Id.; See also PP&L St. 8 at 25-26.

The OCA submits that two adjustments to PP&L's claim for employee transition costs are necessary. First, the portion of the Company's claimed regulatory asset related to 1997 and 1998 employee transition costs should be eliminated. Second, the costs per employee to exclude the incremental pension benefits must be adjusted to include only the cost of severance payments to departing employees.

The elimination of the regulatory asset for 1997 and 1998 employee transition costs is necessary first, because only a small portion of the 1997 and 1998 transition costs is incremental to the $7.7 million annual expense for 1996 already reflected in the base year for employee transition costs. The projected employee transition costs in 1997 and 1998 are $7.585 million and $10.20 million, respectively. Only a small portion of the 1997 and 1998 transition cost is incremental to the level already recognized as an ongoing cost by PP&L. OCA St. 3 at 10.

Second, the cost savings associated with the projected employee reductions are $71,400 per

employee per year, compared to the one time costs of $97,000 per employee. Thus, employee reductions in 1997 and 1998 will in large part pay for themselves in those years. Id. As OCA witness Catlin noted, assuming the employee reductions projected for each year occur more or less evenly in each year, the cost savings realized by PP&L in 1997 and 1998 will be $12.745 million compared to costs of $17.845 million. Id. Therefore, the net costs to PP&L in 1997 and 1998 will total only $5.1 million for the two years, less than the $7.7 million annual expense already reflected in the base year. Id. Thus, the claim to recover alleged 1997 and 1998 employee transition costs is unnecessary and should be excluded as a regulatory asset.

The OCA also submits that it is also necessary to exclude the incremental pension benefits from the employee transition costs included in the determination of the regulatory asset. The funded percentage of PP&L's pension plan is currently 170.8 percent of the accumulated benefit obligation and 133.9 percent of the projected benefit obligation. OCA St. 3 at 11. Because of this overfunding, the incremental pension benefits will not result in any additional out-of-pocket cost to the Company. OCA witness Catlin testified:

> The effect of the increase in the ABO and PBO attributable to the incremental benefits for all 300 employees which PP&L has projected to participate will be to advance the date at which pension contributions are required by one year, all else being equal. However, there is no requirement for such contributions for at least the next ten years.

Id.

The exclusion of employee transition costs projected to be incurred in 1997-1998 reduces the nominal balance of the regulatory asset associated with employee transition costs allocated to generation by $10.793 million. The recognition of only the lump sum severance benefits and the exclusion of the incremental pension benefits further reduces the nominal balance of the regulatory asset by $8.003 million.

Therefore, the proper recognition associated with employee transition costs as a regulatory

asset is $3.483 million. The annual amortization amounts for these costs are shown at OCA St. 3, Schedule TSC-1. This is a reduction in the Company's stranded cost claim of $18.796 million. Id.

g. PP&L Has Failed To Justify It's Claim For Projected Unrecovered Energy Costs.

On December 13, 1996, PP&L filed with the Commission to roll into base rates its Energy Cost Rate and its State Tax Adjustment Surcharge. PP&L made this filing in response to Section 2804(4) of the Customer Choice Act. PP&L St. 3 at 9-10. In that filing, PP&L also requested that two categories of costs be recognized as regulatory assets or other deferred charges. These categories were the ECR undercollection as of December 31, 1996 and a normalized level of estimated future on-going energy costs. PP&L estimated that its normalized level of on-going energy costs would be approximately $31.5 million greater than the level of energy costs rolled into base rates. This amount was calculated by taking an average of actual energy costs for a five year period from 1992 through 1996 and subtracting the jurisdictional level of energy costs in base rates after the ECR roll-in. Id. at 10.

The Commission approved the roll-in in a tentative order issued at Pennsylvania Power & Light Company's Application for Approval of the Roll-In of the Energy Cost Adjustment and State Tax Adjustment Surcharge effective January 1, 1997, P-00961131 and R-00963842 (December 19, 1996). The Commission noted:

> When granting this declaration the Commission notes that it believes the appropriate forum to address the prudence and reasonableness of these undercollections is in conjunction with a filing submitted by the Company in response to Section 2806 of the Electricity Generation Customer Choice and Competition Act (Act). It would not be proper for the Commission to rule, with finality, on the prudence and reasonableness of these undercollections, and the length of the amortization period until such time as the matter can be thoroughly reviewed by all interested parties.

Slip op. at 4. In its final May 22, 1997 order in that docket, the Commission emphasized that PP&L had approval to seek to recover any differential, but that both the recovery and the amount should

be addressed in the restructuring proceeding. Id. ,Slip op. at 9.

In this proceeding, the Company has requested as a regulatory asset for stranded cost purposes a $17.2 million level of actual undercollected energy costs at December 31, 1996, and $62.940 million representing a two year total of a normalized annual level of approximately $31.5 million in ongoing energy costs above the level included in base rates.[15] See OCA St. 3 at 5.

The OCA does not dispute the Company's claim for the inclusion of the unrecovered energy costs through the end of 1996 as a regulatory asset. However, as the Commission found in the recent PECO Energy restructuring proceeding, the claimed deferrals for the years 1997 and 1998 are inappropriate and should be excluded as regulatory assets in this case.

First, it must be noted that the requested $31.5 million per year request is not an undercollection. As OCA witness LaCapra noted, a more accurate description is that the Company will collect $31.5 million less in base rates, assuming no change in sales, than it would have if a higher amount of fuel costs was rolled-in. A future undercollection is not known. OCA St. 1 at 7.

Second, the OCA submits that PP&L's presentation fails to demonstrate that it will actually underrecover its energy costs. Thus, PP&L's request for stranded costs beyond 1996 in this case fails the Act's requirement that net electric generation-related stranded costs must be known and measurable, and that regulatory assets and other deferred charges must be typically recoverable under current regulatory practice.

In PECO's restructuring case, the Commission approved PECO's claimed regulatory asset related to deferred fuel cost through December 31, 1996, but denied PECO's claimed regulatory asset for annual deferred fuel expense for 1997 and 1998. The Commission stated the following:

---

[15]As noted by PP&L witness Kleha, the approximate $31.5 million normalized level of on-going energy costs is reflected in 1997 and 1998 prior to the beginning of the CTC period. Id. at 11-12.

> At this point in time, there is no "known and measurable" fuel cost since the expenses have not yet been incurred. As under traditional ratemaking, PECO cannot claim that it would have collected any specific amount of increased fuel costs in the future. Thus, undetermined future expenses cannot qualify as recoverable stranded costs under the Act. We agree with these arguments that the Commission has no statutory basis for allowing recovery of unknown, future fuel costs, and the claim must be denied.

PECO Energy Restructuring Order at 71.

The Commission specifically reaffirmed that portion of its decision in the PECO Energy reconsideration order. PECO Energy Reconsideration Order at 8-11. The Commission reiterated its reasoning from its prior order and also cited OCA witness Catlin's testimony "that recovery of 1997 and 1998 fuel costs would be inappropriate while PECO remained under traditional regulation without a demonstration that its existing rates are inadequate." Id. at 11.

The OCA submits that the identical principles apply in the PP&L case and the record amply demonstrates the Company's failure to justify its deferred fuel cost regulatory asset claim for the post-1996 time frame. OCA St. 1 at 8; OCA St. 2-S at 4; PPLICA St. 3 at 20-21; and PPLICA St. 3-S at 21-22.

In addition, as the PUC correctly noted in its PECO restructuring order, PP&L is also protected by the Act from loss due to future increases in fuel costs to serve its regulated customers. Section 2804(4)(iii)(D) provides an exception to the rate cap for customers purchasing generation from PP&L if there are significant increases in the unit rate of fuel outside of the utility's control that would not allow the utility to earn a fair rate of return. PECO Energy Restructuring Order at 72.

As the Commission cogently stated, the existence of these statutory protections supports its conclusion that unknown, future fuel costs are not recoverable stranded costs. Id. Consistent with the recent PECO restructuring order, the Company's stranded cost claim must be reduced by $62.946 million to reflect the elimination of the Company's deferred fuel expense claim for 1997-1998. OCA

St. 3 at 5; Sch. TSC-1.

h. The DOE Assessment Must Be Removed From Stranded Costs Associated With Regulatory Assets Since The OCA Includes It Within Nuclear Fuel Costs.

PP&L in its filing included the present value of the annual federal Department of Energy ("DOE") assessments applicable to the years 1999 through 2007 as a regulatory asset. Utilities with nuclear power plants are required to pay an assessment to fund the decommissioning of the DOE's uranium enrichment facilities. The amount of PP&L's claim was $22.923 million.

The OCA submits that it is unnecessary to include the DOE assessment as a regulatory asset since PP&L has admitted that projected fuel expenses for the years 1999-2007 already include the DOE assessment. OCA St. 3 at 7. Thus, in order to avoid a double count, the OCA recommends that PP&L's claimed regulatory assets must exclude the present value of the projected DOE annual assessments. The nominal amount of such adjustment is $24.306 million on a total company basis, of which $22.923 million is allocable to the Pennsylvania jurisdiction. Id.

In his surrebuttal testimony, OCA witness Catlin noted that PP&L, in its rebuttal case, removed the DOE assessment from its nuclear fuel costs in order to eliminate the double count. OCA St. 3-S at 2. However, because the DOE assessment has not been removed from the OCA's nuclear fuel costs, the OCA continues to exclude the DOE assessment from its quantification of regulatory assets. Id. This is reflected as a reduction of $22.923 million in OCA's stranded cost calculation. OCA St. 3-S; Sch. TSC-1.

In any case, the OCA submits that the Commission must ensure that there is no double count of this expense item.

3. The Company's Claim For Stranded Non-Utility Generation Costs Should Be Reduced From $696.870 Million to $574.708 Million.

In the calculation of its stranded cost claim in this restructuring proceeding, PP&L has included $656.870 million associated with non-utility generating ("NUG") project contract costs. PP&L Exh. JRS 1A (Revised) at 1. PP&L's claim for stranded costs associated with NUG contracts was calculated by comparing the difference between the contract cost of output purchased from NUG's, beginning on January 1, 1999 and extending through the end of the contract terms, to the market value of that output. This difference was adjusted for the Pennsylvania jurisdictional portion and discounted to determine the present value at January 1, 1999. PP&L St. 8 at 18. In addition, PP&L witness Schadt included the present value of payments occurring after December 31, 1998 for buyout costs associated with two NUG contracts. One of these buyouts has been approved by the Commission and the second buyout is awaiting Commission approval. Id. at 19-20.

The contract cost of output purchased from the NUGs in most cases was derived by multiplying the estimated output purchases from the NUG by the contract price. Annual output purchased was estimated to equal the average annual generation during the three years 1994-1996, and was assumed to continue at this level through the life of the contracts. Id. at 18-19. For three of the contracts, however, PP&L witness Schadt made different assumptions. Id. at 19.

The market value of the purchased output was calculated by multiplying the output purchased by the projected market clearing price of generation supplied by PP&L witness Jones. For all NUGs but one, the market clearing price of generation was the weighted average market price that applies to base load units. For one dispatchable NUG, the market price was the peak market clearing price of generation. Id.

The OCA submits that PP&L's claim for stranded NUG costs is overstated in two respects. First, the future cost of power purchases is based upon an unreasonably high forecast of future NUG production. Second, the claimed above market costs of these contracts are overstated based upon

PP&L's use of a low estimate of future market prices. The OCA has already discussed the market price forecast of PP&L witness Jones in this brief. This section of the brief will detail the unreasonable assumptions employed by PP&L concerning future NUG output.

The general use by the Company of NUG production levels equal to the 1994-1996 output levels throughout the balance of the contract terms produces a high NUG output forecast. As OCA witness LaCapra noted, the 1994-1996 period capacity factors were very high for most of the NUG projects, reflecting the fact that these projects were new, but beyond the start-up phase of their life cycle. OCA St. 1 at 11. The significance of the selection of this period was noted by Mr. LaCapra as follows:

> This approach produces a forecast that has very little likelihood or possibility to be exceeded by actual performance and has a significant possibility to exceed annual performance. This approach excludes any consideration of the potential for degradation of performance with age or the possibility of extended outages due to technical or other factors.

Id.

The record contains several examples of the unreasonably high forecast of future NUG production produced by PP&L's methodology. The Company assumed that it will be required to purchase 659,688 Mwh annually from Gilberton Power, one of the largest projects under contract. This is equivalent to an annual capacity factor of more than 95 percent for this 79 Mw facility. Id. However, as noted by OCA witness LaCapra, PP&L has purchased this amount in only one of the nine years that it has been purchasing power from Gilberton Power. Id.

Similarly, PP&L assumed in its analysis that it will purchase 605,228 Mwh annually from Schuykill Energy Resources. The Company, however, has recently initiated a proceeding at the Federal Energy Regulatory Commission to revoke Schuylkill's status as a qualifying facility which could reduce the price and/or the volume of purchases the Company is required to make under the current contract. Id. at 11-12.

Based upon the necessity to reflect a reasonable forecast of production for these projects for stranded cost analysis purposes, OCA witness LaCapra arrived at an 80% annual capacity factor for the balance of the contract lives. The use of this annual capacity factor for NUG output, along with the market price forecast of OCA witness Smith, results in stranded costs associated with the future costs of NUG contracts of $574.7 million. OCA Exh. RLC-8.

4. PP&L's Stranded Cost Claim For Nuclear Decommissioning Must Be Modified And Collected Consistent With The OCA's Recommendations.

OCA witness Catlin reviewed the Company's request for unfunded nuclear decommissioning costs and recommended no changes to the Company's estimate. OCA witness LaCapra used those values in his stranded cost analysis, but applies his recommended discount rate and appropriate PUC jurisdictional percentages to those values. With these changes, OCA witness LaCapra estimates the net present value of these costs at January 1, 1999 to be $108 million, or $15 million lower than the Company's estimate. OCA St. 1 at 10.

In determining generation related stranded costs, PP&L witness Schadt included nuclear decommissioning costs within the nuclear generation portion of the Company's claim. PP&L St. 8 at 6. In arriving at annual revenue requirements for the Company's nuclear generation, he included in annual decommissioning expense the amount that the Company is recovering in its existing retail and wholesale rates, and then adjusted revenue requirements to the applicable PUC jurisdictional portion. Id. at 11.

Even though PP&L's nuclear decommissioning costs are embedded within the owned generation related portion of its stranded cost claim, it has proposed that the CTC period be extended solely to permit recovery of its nuclear decommissioning costs over the remaining life of the Susquehanna generating plant. PP&L St. 3 at 14.

The OCA submits that it is unnecessary to spread the collection of these costs over the life of the nuclear units for PP&L. As OCA witness Lee Smith noted, the OCA's stranded cost estimate for nuclear decommissioning was calculated by taking the net present value of the annual decommissioning fund contributions to be made by PUC jurisdictional customers over the life of each plant. OCA St. 4 at 11. However, the established reasonable level of nuclear decommissioning costs should be recovered over the CTC period established by the Commission. Taking into account the projected earnings rate for the decommissioning trust funds that were used by PP&L, the equivalent annual decommissioning fund contribution over the seven year CTC period for PUC jurisdictional customers is $19.959 million. OCA St. 4 at 11. The OCA has determined a CTC that will allow these costs to be recovered over a seven year period. Id.

The OCA submits that there is no reason to spread these costs over an extended CTC period since the OCA's recommended CTC accomplishes the recovery of these costs. Therefore, the OCA has delineated the costs as a separate stranded cost item with inclusion in the normal CTC period.[16]

5. The Proper Discount Rate Is 7.24%

PP&L in its filing employed a discount rate incorporating a return on common equity value of 11.5%. OCA St. 1 at 8. This value was authorized by the Commission for PP&L in its last base rate case in 1995. Id. See also PP&L St. 6 at 2. The OCA submits that the Commission should employ the return on common equity value of 10% which the Commission initially adopted for PECO Energy in its May 22, 1997 Qualified Rate Order at Pa. P.U.C. vs. PECO Energy Company, R-

[16]In the PECO case, the Commission approved PECO's proposal to establish a nuclear decommissioning clause as part of its regulated rates with mechanisms for continuing Commission review. PECO Evenery Restructuring Order at 78-80. Here, however, PP&L has made a proposal to extend its CTC over the remaining life of the units with no specificity as to how these costs will be reviewed, reconciled, or adjusted in the future. Since the OCA's analysis shows that the Company will not require such an extension to collect its nuclear decommissioning costs, the Company's proposal should be rejected.

00973877 (May 22, 1997), Slip. op. at 59.

In the subsequent PECO Energy restructuring case, the Commission for discounting purposes adopted OCA witness Smith's discount rate of 7.6% for the purpose of calculating stranded costs. PECO Energy Restucturing Order at 90. This figure contained a 10% equity return. OCA witness LaCapra employed this same equity value in deriving his recommended discount rate to be used for stranded cost purposes in this case. That discount rate is 7.24%. In making that calculation, OCA witness LaCapra accepted the capital structure and long term debt and preferred stock cost rates of the Company.

6. The Company's Proposed Transfer of $205 Million From Transmission and Distribution Depreciation Reserve To Generation Depreciation Reserve Should Be Rejected

PP&L witness Hill notes that the Company proposes to transfer $205 million of accumulated depreciation from the transmission and distribution functions to the production function in order to reduce stranded costs. This transfer reduces the net book value of the Susquehanna station by $205 million by transferring accumulated T&D depreciation reserves to Susquehanna. The Company proposes this transfer as a stranded cost mitigation measure which it claims reduces stranded costs by $317 million. PP&L St. 2 at 16-17.

The OCA submits that this transfer is not supportable as a stranded cost mitigation measure. It not only inappropriately shifts cost recovery from generation to the fully regulated transmission and distribution component, it increases the cost responsibility of the Pennsylvania jurisdictional customers. This proposal was flatly rejected by the Commission in the PECO restructuring case on the ground that it is "anti-competitive". PECO Energy Restructuring Order at 97. It should be rejected here as well.

Section 2808(c)(4) of the Customer Choice Act, 66 Pa. C.S. §2808(c)(4) requires the

Commission to consider the extent to which the electric utility has undertaken efforts to mitigate generation-related transition or stranded costs by appropriate means in a manner that is reasonable under all of the circumstances. Even though reallocation of depreciation reserves is listed in the Act as a potential mitigation effort, it is still subject to the test of reasonableness under all of the circumstances. The record demonstrates that this transfer of $205 million in depreciation reserve mitigates no cost. In fact, it not only reallocates costs from competitive generation to the regulated transmission and distribution function, it increases cost responsibility. The OCA submits that the record demonstrates that PP&L's proposed depreciation reserve swap is unreasonable.

The effect of the swap shifts cost recovery from generation to the fully regulated T&D component. In addition, the shifting of cost from the generation revenue requirement to the regulated T&D revenue requirement is exacerbated by the different jurisdictional allocation of the two functions. As OCA witness Lee Smith correctly noted:

> Since 97 percent of the T&D depreciation reserve is allocated to the Pennsylvania jurisdiction, whereas only 81 percent of the production depreciation is allocated to Pennsylvania, the result of this shift of depreciation reserve is a shifting of cost responsibility into the Pennsylvania jurisdiction (see Exhibit LS-2). Although the Company has not made this calculation, a reduction to generation plant of $205 million is only a reduction to the retail jurisdiction of $165 million (80.7 percent of $205 million), but the retail T&D rate base was increased by $198 million (96.7 percent of $205 million).

OCA St. 4 at 5-6. In other words, as noted by OCA witness Smith, the stranded cost allocation to Pennsylvania is reduced by less than the transmission and distribution rate base is increased. Thus, the shift in the depreciation reserve does not mitigate costs at all, but instead increases costs that Pennsylvania ratepayers are responsible for.

The OCA submits that there is no justification for this result. The unbundled rates of PP&L should reflect the existing rates of the Company. Distribution customers have already contributed through rates the full amount of the accumulated depreciation reserve booked as distribution. To

shift this reserve to the generation function results in distribution customers paying again for the same plant. This also creates a potential for cost shifting between classes. OCA St. 4 at 6. This is not what the General Assembly intended.

The Commission in the PECO restructuring order correctly determined that a depreciation swap between distribution plant and generation plant is inappropriate. The Commission stated:

> While Section 2808(c)(4)(iii) of the Act identifies the reallocation of depreciation reserves as an example of mitigation, PECO's proposed reallocation is not a mitigation benefit to consumers. The proposed reallocation would increase future distribution expense, inappropriately shifting distribution revenues to subsidize generation costs. It is therefore anti-competitive, and is not approved.

PECO Energy Restructing Order at 97. The OCA submits that the same result is dictated here.

OCA witness Smith, in order to reverse the depreciation reserve shift made by the Company, calculated an annual revenue requirement associated with the reduction in T&D depreciation reserve resulting in an annual reduction of $18 million in 1999 for the T&D delivery revenue requirement for the Pennsylvania jurisdiction. See OCA St. 4, Exhibit LS-2. OCA witness LaCapra appropriately excluded the reallocation from his stranded cost analysis. OCA St. 1 at 23.

7. PP&L's Financial Arguments Are Misplaced.

Despite the clear dictates of the Customer Choice Act concerning stranded costs, PP&L attempts to use financial analyses to not only argue that the OCA's recommended stranded cost level is unreasonable but to also argue that the reasonableness of stranded cost levels should be determined through financial analyses. The OCA submits that these arguments are fallacious, contradict the Act, and evidence precisely how PP&L's claimed level of generation related stranded costs leads to potential windfall gains.

PP&L witness Schadt testified as follows concerning the reasonableness of stranded cost recommendations in this proceeding:

> In order to determine whether any of the above estimates pass the reasonableness test, I reviewed the results of the estimates provided by the Company and the OCA within the accounting model, using the most positive scenario reasonably possible during the transition period.

PP&L St. 8-R at 19. The "accounting model" used by witness Schadt was a financial analysis employing an income statement representative of 1999 adjusted for the acceleration, during the period 1999-2005, of the expense amortization of generation-related regulatory assets and the accrual for above-market power purchases from non-utility generators by the amount of the amortizations and above-market payments that would have occurred after 2005. Id. at 19-21. Witness Schadt's financial analysis offset the increased expenses over the transition period with the scheduled reduction of the Susquehanna station's depreciation due to a switch to the straightline method of depreciation. Id. at 21. Witness Schadt did not recognize during the transition period any incremental expense to accelerate the recovery of the $3.6 billion of stranded costs associated with generation assets. Id. This exercise resulted in an after-tax decline of about $20 million in earnings, which witness Schadt attributed to the Company's inability to recover all of its stranded costs during the transition period due to the rate cap. Id. at 22-23. The return results from this financial analysis were a 9.02% overall return and a 10.52% equity return. Id.

Witness Schadt then compares the original OCA recommended total stranded cost level applying the same assumptions. In performing this analysis, witness Schadt derives a -.10% overall return and a -9.65% equity return. Id. at 25. However, in applying this analysis, witness Schadt included not only the generation related regulatory asset and NUG purchase portion of the OCA's original recommendation, but also that portion of the recommendation for stranded costs associated with generation assets. Id. at 24-25. Mr. Schadt then proceeds with a litany of the financial impacts of such a scenario. Id. at 25-29.

In summary, the accounting-based financial analysis presented by witness Schadt purportedly

buttresses his and the Company's view that the purpose of the transition period is designed to enable incumbent utilities to have the opportunity to prepare for competition (Id. at 27), and that the Act inherently requires that PP&L's "prosperity" must be maintained through the transition period. Id. Thus, except for expenses not captured because of the rate cap, PP&L posits through an accounting analysis that the Act defines as reasonable only a level of stranded cost recovery that essentially leaves the incumbent utility whole from its prior position under traditional regulation, with no consideration of revenues or gains from its competitive activities in the future.

The OCA submits that the Company's accounting analysis distorts the Act and leads to results inimical to the purpose of that statute.

a. PP&L's Short-Term Financial Comparisons Are Incorrectly Applied

First, PP&L witness Schadt noted that his chart at PP&L St. 8-R at 23, based upon the 1999 pro forma income statement analysis, is based upon PP&L's assumptions and PP&L's assumed market price. Tr. 1558 (August 26, 1997). This column is transposed in the chart at PP&L St. 8-R at 25 as the 1999 Pro Forma column. Under the OCA 1999 Pro Forma Column on that chart, witness Schadt applies the OCA's originally determined initial year rate reduction of 32% and the OCA's recommended market price for that year. Tr. 1558-1559 (August 26, 1997). The gravamen of witness Schadt's presentation is that, if PP&L's market prices turn out to be correct, then the adoption of the OCA's stranded cost recommendations would lead to negative returns in 1999. This analysis truly begs the question since it assumes that PP&L's own market evaluation result is appropriate and, hence, it will forfeit generation revenues.

In fact, witness Schadt's problem is not due to the OCA recommendation of the level of stranded cost recovery at all, but rather is due to the revenue and expense timing difference in the

competitive generation function.[17] The same result applies to PP&L's recommendation if witness Schadt had consistently applied his analysis. As noted earlier, witness Schadt in his charts neglected to reflect the accelerated amortization of the $3.6 billion in stranded costs associated with owned generating plant included in PP&L's recommendation. Witness Schadt did reflect, however, the financial impact of the OCA's entire original stranded cost recommendation. This inconsistent application is incorrect.

It is a basic accounting standard that expenses be matched as closely as possible with revenues, particularly in a regulatory environment where revenues are set to equal expense. The result of witness Schadt's inconsistent application was explained by witness LaCapra:

> If the Company does not reflect the amortization of above-market generating plant associated with the recovery of stranded costs, the CTC revenues under the Company's proposal would produce after-tax returns on rate base of about 15 percent during the transition period and small or negative returns on rate base after the transition period.

OCA St. 1-S at 12. If the Company had correctly and consistently reflected these amortization expenses for both its proposal and the OCA's proposal, the "income available for return" under the Company's proposal would be similar to the OCA's. As OCA St. 1-S; Exh. RLC-9 (Revised) evidences, including the OCA's updated 16% rate decrease in 1999 recommendation, PP&L's return and OCA's return are very similar.

In oral rejoinder, witness Schadt refused to acknowledge his inconsistent financial analysis. He attempted to avoid the issue by stating that OCA Exh. RLC-9 (Revised) compares apples and oranges because it includes OCA's assumed market price versus PP&L's assumed market price. Tr. 1543 (August 26, 1997). However, OCA witness LaCapra simply inserted OCA's updated

---

[17]The OCA, as will be discussed later, has recommended a restructuring of its recommended CTC charge to ameliorate some of that timing difference.

recommendation for OCA's original recommendation in witness Schadt's analysis. Witness Schadt did not worry about the different market price assumptions in his analysis. Indeed, witness Schadt testified on cross-examination that for the year 1999, none of the three market prices employed in this case were significantly different. Tr. 1558 (August 26, 1997).. Thus, witness Schadt's response is a red herring and he nowhere refutes the necessity to reflect the amortization of stranded costs in the PP&L results. In addition, witness Schadt offered the results of four new calculations without providing any back-up support for these conclusions. These calculation are of common equity returns based upon combinations of PP&L's stranded cost proposal, PP&L's market price assumptions, OCA's stranded cost proposal and OCA's market price assumptions. Tr. 1544-1545 (August 26, 1997). Witness Schadt did not offer the result on a total return basis, as he did in his rebuttal. Based upon his original analysis of the OCA's original recommendation, it is a fair conclusion that witness Schadt has continued to fail to apply the analyses correctly. See PP&L St. 8-R at 25. It appears that on its face witness Schadt's new undocumented calculations suffer from the same deficiencies as his original analysis.

b. The Reason For Return Differentials Are A Logical Outcome Of The Customer Choice Act.

The real reason the overall rate of return is, and should be expected to be, lower for the year 1999 is the difference in the timing of revenues and expenses in the competitive generation market. OCA St. 1-S at 13. As OCA witness LaCapra noted, unlike traditional revenue requirements, which are designed to be front-loaded, competition will produce a level of market prices that remove this tendency. Id. In fact, Section 2803 of the Act defines "transition or stranded costs" as follows:

> An electric utility's known and measurable net electric generation-related costs, determined on a net present value basis over the life of the asset or liability as part of its restructuring plan, which traditionally would be recoverable under a regulated environment but which may not be recoverable in a competitive electric generation market and which the Commission determines will remain following mitigation by the

electric utility.

66 Pa. C.S. § 2803. PP&L witness Schadt's quarrel, then, is not with the recommendations of other parties but with the nature of competition and the Act's requirement that stranded costs be determined on a net present value basis over the life of the asset or liability, with recovery of those costs over a seven year period. The result of this process is by definition lower returns in the short-term traded for higher returns in the future. Stated differently, rates during the transition period reflect the present value of future earnings streams, which when the market reverses, will exceed revenue requirements on a traditional ratemaking basis.

Given the results created by the timing of revenues and expenses, the result of competition is understandable. One cannot, as PP&L argues, simply focus on the short-term results while ignoring the future implications of the Act and thereby falsely interpret the Act through the use of traditional financial barometers for incumbent utilities during the transition period. This argument and interpretation not only violates the Act, but also provides the groundwork for the recovery of windfall profits. The Act nowhere states, nor can it be interpreted to mean, that incumbent utilities must be maintained in the same financial condition as under regulation during the transition period.

OCA witness LaCapra evidenced the competitive result. The cost curve for the generation assets heading into competition begins at a high level and decreases as those assets are depreciated. On the market revenue side, however, the revenues begin low and increase over time. Everyone's market analysis in this case, including PP&L witness Jones', includes increasing market price projections while costs are decreasing over time. Essentially, then, ratepayers are being given today the benefits they would have received in the future but won't receive then because of the unregulated status of generation. Once again, the Act requires the passing back of the present value of future revenue requirements.

As witness LaCapra explained:

> Which brings us to the real reason why the overall return is, and should be expected to be, as low as these examples show for the year 1999- the timing of revenues and expenses in the competitive generation market. Unlike traditional revenue requirements, which are designed to be front-loaded, competition will produce a level of market prices that remove this tendency.
>
> . . .
>
> Furthermore, projected market prices for PJM will be somewhat lower than system long-run marginal costs in the early years of the analysis due to the temporary projection of surplus capacity and energy in the PJM pool.

OCA St. 1-S at 13.

OCA St. 1-S, Exh. RLC-10 evidences the revenue curve encompassing these principles to those that would be included in rates under the revenue requirements approach for the Susquehanna station. As can be seen from that exhibit, the revenues available for return under competition significantly exceed those under a revenue requirements analysis after the transition period.

The result, as noted by witness LaCapra, is that PP&L and any other electric utility which chooses to participate in the competitive generation market should expect returns to be somewhat lower than normal in the early years of the transition period, with profits increasing over time as the pool's capacity and energy become more in balance. OCA St. 1-S at 13. This is entirely consistent with the Act and its delineated transition to a competitive generation market.

The danger with PP&L's interpretation of the Act is that excessive levels of stranded costs will be recovered from ratepayers with a utility then being able to garner windfall profits in the future as market price and revenues rise. The OCA submits that this view not only contradicts the Act, but is inimical to its purpose.

As noted earlier, if PP&L does not wish to operate under the conditions of the Act, and the establishment of PJM market prices by the Commission as in the PECO restructuring case, it has

the option that the GPU companies are adopting of selling its generation assets and earning a regulated rate of return on its transmission and distribution assets subject to the rate cap provisions of the Act, and the CTC revenues. Remarkably, however, PP&L witness Hill, even though he agreed that PP&L's claim for stranded costs associated with its generating assets exceeds the net book value of those assets as of January 1, 1999 (Tr. 988 August 20, 1997), testified that PP&L would not divest itself of those assets because of financial reasons. Tr. 991 (August 20, 1997). In fact, he opined that over their life its generating assets will ultimately prove to be economical. Id.

The OCA submits that PP&L cannot have it both ways. If it truly believes it has generating assets with a negative value, it is free to divest those assets. Tr. 990 (August 20, 1997). If its assets are economical over time, however, then its stranded cost claim is unfounded.

The result of PP&L's view, and its proposal is to inappropriately allow recovery from ratepayers of stranded costs exceeding the net book value of its assets to protect its monopoly earnings levels during the transition period, thereby dampening competition and allowing PP&L to unreasonably position itself for windfall profits in the future. This violation of the Act cannot be countenanced.

IV. RECOVERY OF STRANDED COST

A. The OCA Recommends A CTC That Is A Blend Of The Levelized CTC Method And The Levelized Percentage Rate Reduction Method.

OCA witness Lee Smith initially testified for and proposed a CTC calculated as a levelized amount over the seven year recovery period from 1999 to 2005. OCA St. 4 at 9-12. Witness Smith developed both a levelized annual CTC revenue requirement to collect each component of the cost, namely regulatory assets, above-market NUG purchases, nuclear decommissioning, and owned generating plant and a CTC that produced a levelized percentage rate reduction.

The stranded cost associated with regulatory assets, as developed by OCA witness Catlin, is

$259.2 million. In order to design a CTC revenue requirement that allows the Company to recover this stranded cost over the seven year CTC recovery period, the net present value of the CTC revenue requirement must equal $259.2 million when discounted at 7.24 percent, the OCA's recommended discount rate. OCA witness Smith computed this requirement at approximately $48.5 million per year over the CTC recovery period. Id. at 10.

The stranded cost estimate for NUG purchases was developed using the same method. The net present value of the CTC revenue requirement associated with the above-market NUG contracts must equal the estimated cost of $550.95 million when discounted at 7.24 percent. The resulting levelized annual CTC revenue requirement is $103.088 million. Id.

The stranded cost estimate for nuclear decommissioning was calculated by taking the net present value of the annual decommissioning fund contributions to be made by PUC jurisdictional customers over the life of each plant. As opposed to PP&L, OCA witness Smith determined a CTC that will allow these costs to be recovered over a seven year period. Using the projected earnings rate for the decommissioning trust funds used by PP&L, the equivalent annual decommissioning fund contribution over the seven year period for PUC jurisdictional customers would be $19.959 million. Id. at 11.

Based on the final market price of OCA witness Doug Smith, and after adjusting the CTC for the gross receipts tax, OCA witness LaCapra's recommended stranded cost estimate results in a levelized CTC of $205 million per year in each year of the CTC recovery period. OCA St. 4-S at 1-2. As will be noted infra, it is inappropriate to allow a return on the unamortized balance of the owned generation related stranded cost component of the CTC. OCA witness Smith reflected no return at OCA St. 4-S; Exh. LS-8 at 2. A levelized CTC at the OCA's recommended stranded cost level creates rate decreases on average of 28% in 1999, declining to 5% in 2005 compared to current rates.

OCA St. 4-S; Exh. LS-10-R.

The Commission in the PECO Energy restructuring case determined that it preferred a levelized amortization of recoverable stranded costs over the CTC period. PECO Energy Restructuring Order at 112. However, in order to address the timing impact created by the Act's requirement of the recovery of stranded costs on a net present value basis discussed earlier, OCA witness Smith reviewed additional methodologies along with the levelized CTC. OCA St. 4-S; Exh. LS-10-R.

The second alternative strategy shows a method in which a declining CTC produces a levelized percentage rate reduction from current rates in all years of the CTC recovery period. Under this method, customers would experience a savings of 17% for each year of the recovery period. This would result in an initial CTC of $485.6 million which would decrease to a negative $98.6 million in the last year. This is because the market rates increase during the CTC recovery period. Id. OCA witness Smith rejected this method as an impractical alternative for PP&L since a large negative CTC rate component in the later years could cause customer confusion. Id.

The third alternative shows a blend of the first two methods in which each method is weighted so that the CTC decreases but does not become negative. This results in an initial overall decrease in rates of 20% in 1999 followed by increases of 1% to 2% in the remaining years. OCA St. 4-S; Exh. LS-10-R. The rate savings in 2005 is 13% in comparison to current rates. Id.

OCA witness Smith recommended the blended approach. OCA St. 4-S at 3. This method, which blends the levelized CTC method with the levelized percentage rate reduction method, provides for a declining CTC over time but moderates any overall increases as much as possible. Thus, the OCA recommends a blended CTC approach that produces rate reductions of 20% in 1999 that decrease to 13% in 2005. As will be noted infra, the OCA believes that rate reductions are

appropriate in this case.

B. The CTC Reconciliation Must Be Accomplished On A Class Specific Basis.

Section 2808(f) of the Act, 66 Pa. C.S. §2808(f), requires that the Commission perform an annual review and reconciliation of the competitive transition change. As PP&L witness Kleha noted, the Act appears to be limited to a true-up for changes in sales from the level of sales used initially to establish the CTC. PP&L St. 3 at 16.

PP&L rejected a reconciliation procedure similar to the annual ECR (Energy Cost Rate) reconciliation procedure for the reason that, if a utility's rates including the CTC were at the rate cap level, any undercollection of CTC in a year would be foregone by the utility so long as its rates remained at the rate cap level. Id. at 17. PP&L, therefore, proposed to track its annual collections under the CTC and compare those collections with the Commission-authorized CTC collection levels. The CTC under or overcollection would be tracked by the Company through the life of the CTC with no change in the CTC rate. PP&L near the end of the CTC period would calculate the net amount of over or undercollections for the entire CTC term and adjust the term of the CTC to provide for a full refund of overcollections or a full recovery of undercollections. If PP&L had a net undercollection, it would extend the CTC recovery period. If it had a net overcollection, it would terminate the CTC sooner. Id. at 17-18.

The OCA does not object to the CTC reconciliation proposal advanced by PP&L as a general matter as long as the rate cap is extended if the CTC period is extended. However, the OCA believes that the reconciliation must be done on a class specific basis, as directed in the PECO case, to avoid cost shifting. This is particularly important if the Company retains the ability to award discounted economic development rates in the future, or if sales to large customers decline. OCA St. 4-S at 17. As such, any reconciliation must be done on a class basis. This is precisely what the Commission

ordered in the PECO restructuring case. PECO Energy Restructuring Order at 112.

C. The Company Should Not Be Permitted To Charge Consumers A Return On Utility Owned Generation Related Stranded Costs.

OCA witness LaCapra appropriately recommended that, if a reasonable balance between PP&L and its customers is to be attained, the Company should not be permitted to charge a return on the recovery of the unamortized balance of its owned generation related stranded costs. OCA St. 1-S at 4. Stockholders who have been in a position to influence the Company's past investments and who have benefitted from profitable investments, should bear some of the cost of these stranded investments. OCA St. 1 at 30. The OCA submits that the Commission should institute a sharing between ratepayers and shareholders in this case by permitting the recovery of its stranded owned generation related costs over the seven year period, but should not permit PP&L to charge ratepayers a return on the unamortized balance of these costs. The OCA's CTC designed to collect the OCA's recommended $138 million level of owned generation related stranded costs allows recovery of, but no return on such costs during the transition period. OCA St. 1-S at 7. Parenthetically, it should be noted that the OCA's CTC design does include a return on the unamortized balance associated with the recovery of stranded costs associated with NUG's and regulatory assets.

The Customer Choice Act contemplates that the Commission will determine the level of stranded costs that the Company can collect from ratepayers through a CTC. With respect to utility owned generation, the Act does not mandate full recovery of stranded costs. The Commission has the power and duty to approve a competitive transition charge for the recovery of transition or stranded costs it determines to be just and reasonable to recover from ratepayers. Thus, a just and reasonable sharing of these costs must be determined by the Commission.[18]

---

[18]It should be noted that the Commission in the PECO retructuring case determined that all stranded costs should receive a return on the unamortized recovery of its stranded costs through the

The OCA submits that its approach is consistent with past ratemaking policy in Pennsylvania, which has not allowed a return on plant which was not used and useful. By definition, stranded generating plant is uneconomic and is not used and useful. It provides no benefits to ratepayers. OCA St. 1 at 30. Stockholders must share in the cost of stranded owned investment.

The OCA stresses that the denial of a guaranteed return on the unamortized balance of owned stranded generating assets through a CTC does not deny the Company a return. As OCA witness LaCapra correctly noted, the Company still has the ability to earn a return through its future actions. It can improve margins from the plant, sell plant to buyers with a higher projection of future market prices, sell sites, or use existing sites to build additional generation. Id.

Also, PP&L has the ability to use its expertise in the generation business, garnered with the support of ratepayers, in the unregulated market. It currently markets power in other regions through two unregulated subdivisions which market energy related services and products and invests in energy products worldwide. Id. at 31. The existence of these sources of income because of expertise required while functioning as a regulated utility, supported by ratepayer contributions, also suggests the appropriateness of the proposed balancing of risk and rewards through no return on owned stranded plant. The Commission expressly agreed with these principles in the PECO restructuring case. See, PECO Energy Restructuring Order at 99.

The OCA also submits that neither Pennsylvania law, the Constitution, nor a "regulatory

---

CTC pegged at the level of its long-term debt. The Commission stated:

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

PECO Energy Restructuring Order at 107.

compact" requires recovery of one hundred percent of stranded generation costs. The OCA submits that there has never been a regulatory promise in Pennsylvania, nor a constitutional requirement, that guarantees utilities the return on, and recovery of, every dollar of prudent investment in generating plant.

The Pennsylvania Courts have long recognized that, even where an investment was prudent when made, such an investment may be excluded from rates where it is not used and useful in serving ratepayers. See, e.g., Philadelphia Electric Company v. Pennsylvania Public Utility Commission, 61 Pa. Cmwlth. 325, 433 A.2d 620 (1980) and Pennsylvania Electric Company v. Pennsylvania Public Utility Commission, 509 Pa. 324, 502 A.2d 130 (1985), appeal dismissed sub nom., Metropolitan Edison Co. v. Pennsylvania Public Utility Commission, 476 U.S. 1137 (1986). Additionally, Section 1315 of the Pennsylvania Public Utility Code codified the long-standing principle that electric utility assets which are not "used and useful" in providing service to the public should not be included in rates. 66 Pa.C.S. §1315.

If there was ever any doubt that utilities do not have a right under Pennsylvania Law or a constitutionally guaranteed right to a return on all prudent investment, that doubt was dispelled by the United States Supreme Court's decision in Duquesne Light Co. v. Barasch, 488 U.S. 299 (1989). In that case, the United States Supreme Court upheld a ruling that a utility could be denied any return on or recovery of canceled plant costs, even though these costs were admitted by all parties to be prudently incurred. 488 U.S. at 314. The New Hampshire Commission, in considering this very point as it relates to stranded cost recovery, concluded:

> The fact that costs were prudent does not make their recovery constitutionally guaranteed either. Disallowances have been found to be consistent with the Constitution even where the disallowed costs had been explicitly found to be prudent. Indeed, the U.S. Supreme Court in Duquesne Light v. Barasch explicitly rejected the notion that if an investment was prudent, its recovery is mandated by the Constitution.

Re Restructuring New Hampshire's Electric Utility Industry, 175 PUR4th 193, 276 (1997).[19]

The application of the constitutional principles regarding confiscation to the stranded cost issue were, perhaps, best summarized recently by the Vermont Public Service Board in Re Restructuring of the Electric Utility Industry in Vermont, 174 PUR4th 409 (1996). In that Order, the Vermont PSB stated:

> The Supreme Court's decisions on the limits the Takings Clause imposes on utility regulation reveal several clear principles upon which the Court's decisions are consistently anchored. The overarching principle is that under the Takings Clause, it is the end result of regulation that matters rather than the specific methodology by which the result is obtained; the end result must represent a balancing of ratepayer and shareholder interests, and fall within a range of reasonableness. Subsumed under this overarching principle are several subsidiary principles: the Constitution does not require states to protect utilities from the effects of competition; and the Constitution does not require rates that guarantee the financial viability of the utility.

Id. at 443, 444.

The case law is clear, as is the Customer Choice Act, that the Commission must balance the interests of both ratepayers and investors, even in a move to a more competitive market. This balancing does not require that the Commission award PP&L a return of and a return on each and every dollar of its prudent investment. This balancing does, however, require the Commission to consider the interests of the consumers, particularly in light of the goals of the Customer Choice Act which seeks to bring the benefits of competitive generation markets to consumers. 66 Pa.C.S. §2802. The OCA submits that the Commission must effectuate a sharing of owned generation stranded costs if such recovery is to be just and reasonable under the Act. PP&L should be permitted to recover stranded owned generation costs over the CTC period with no return provided on those costs. OCA witness Lee Smith, in her calculation of the annual CTC, has appropriately provided for no return for

---

[19]It should be noted that the New Hampshire Commission Order is currently being challenged on a number of grounds in the federal courts. Public Service Company of New Hampshire, et al v. Patch, et al., Civil Action Nos. 97-97-JD, 97-121L.

stranded owned generating plant. OCA St. 4-S; Exh. LS-8 at 2. In like fashion, that exhibit at pages 3 and 4 evidences, for annual CTC revenue requirement purposes, the application of a return to regulatory assets and NUG purchases and buyouts. OCA Exhibit LS-8 at 5 shows the collection through the CTC. OCA St. 1 at 10.

V. RATE DESIGN AND TARIFFS

A. With Modifications, The OCA Agrees With The Company's Unbundling Methodology.

OCA witness Lee Smith quantified the rate recommendations of the OCA concerning unbundled transmission and distribution rates, the appropriate CTC and the avoidable generation price. As a general matter, the OCA agrees with the Company's fundamental approach in unbundling its rates. The Company began by functionalizing its most recent cost allocation study which forms the basis for the current rates of the Company, and appropriately allocated administrative and general expenses. OCA St. 4 at 2.

PP&L then designed its delivery rates for transmission and distribution services in order to recover the revenue requirement it defined as associated with the transmission, distribution and customer function. Where applicable, the Company included the existing fixed monthly charges in the delivery rates. In the residential Rate RS, the remainder of the revenue requirements were collected in a flat cost per kilowatt hour rate.

The Company then proceeded to develop market-based generation charges based upon the capacity and energy prices derived by PP&L witness Jones. The generation charge, of course, is optional for customers desiring to purchase their electric requirements from alternative suppliers. The generation charges increase with the market prices during the transition period.

Finally, the Company set the competitive transition charge in each year as the residual of the current rates so that the sum of all three components, namely delivery, generation, and CTC, is equal

to the current set of rates. PP&L witness Krall testified that the proposed CTC will not collect all of the Company's estimated stranded costs over the seven year CTC period. PP&L witness Hill opined that PP&L would collect $4.08 billion under its proposal. PP&L St. 2 at 18.

As noted by OCA witness Lee Smith, if calculated correctly, this approach is an appropriate method for unbundling rates. OCA St. 4 at 4. It will ensure that the unbundling is accomplished without shifting costs between the current class allocations, or between customers in the same class. This approach will foster competition in generation, since the optional, avoidable component of rates is set at the market price of power.

In order to determine the correct level of unbundled elements, however, it is necessary to reflect certain modifications. As noted earlier in this Brief, the OCA disagrees with the jurisdictional allocators applied by PP&L in its determination of stranded costs. OCA witness Smith, therefore, employed the Pennsylvania jurisdictional allocations recommended by OCA witness LaCapra in her retail stranded cost calculation. OCA St. 4 at 3.

As also discussed earlier, OCA witness Smith reversed the Company's depreciation reserve transfer from transmission and distribution to production. That reversal resulted in an annual reduction of $18 million in 1999 for the T&D delivery revenue requirements for the Pennsylvania jurisdiction. Id. at 6; OCA Exh. LS-2.

OCA witness Smith also included within the avoidable generation component of her recommended rates certain administrative and general costs that will be required to market, aggregate load, reconcile load and supply, deal with PJM, write contracts, etc. OCA St 4 at 13; Exh. LS-5 at 3. OCA witness Smith noted that either PP&L or alternative suppliers will provide the service those costs represent to customers purchasing generation. Id. Thus, this type of A&G cost should be included and recovered in the adjusted market price of power so that that price does not understate

the cost of getting generation to customers. Id.[20]

Finally, OCA witness Smith in her recommended rate design incorporated the market price projections arrived at by OCA witness Doug Smith in the development of market-based generation charges, and the stranded cost analysis of OCA witness LaCapra in establishing the CTC. Id. at 9. With these adjustments and with the establishment of an appropriate CTC, the OCA submits that an appropriate unbundling does in fact occur. Indeed, as set forth below, when the appropriate unbundled T&D, CTC, and market price generation rates are added together, there is room for a significant rate reduction which the OCA submits should be ordered in this case.

1. T&D Rate

OCA witness Smith started with the Company's estimate of total transmission and distribution revenue requirement and total revenues under the existing rates as proposed by the Company. OCA St. 4-S; Exh. LS-11-R. The revenue requirement was adjusted to reverse the depreciation reserve transfer discussed above. Witness Smith then calculated transmission and distribution rates for the revised functional revenue requirements. OCA St. 4 at 9. The resultant unbundled average T&D delivery rate is 1.7 ¢ per kwh in 1999. OCA St. 4-S; Exh. LS-11-R.

2. The CTC

As noted above, OCA witness Smith's adopted CTC methodology results in a CTC of 1.19 cents per kwh in 1999. This CTC decreases to 0 in 2005, the expiration of the CTC period.

---

[20]In the PECO restructuring case, the Commission determined that the reallocation of A&G costs from transmission and distribution to the production function increased PECO's stranded cost. PECO Energy Restructuring Order at 60-62. Here, A&G costs were allocated by PP&L to generation, but OCA witness Smith determined that certain of these costs should be included in the determination of the avoidable generation price.

3. Avoidable Generation Price

In initially developing the avoidable generation price, OCA witness Lee Smith began with OCA witness Doug Smith's market price projections at the generation level for capacity and energy. It was necessary to adjust the market prices to determine rates at the customer level since these rates will be higher due to line losses and differences in class load shapes. OCA St. 4 at 13. Witness Smith did this by assuming the same relationship PP&L used to proceed from market prices to customer level prices, namely the ratios of estimated customer-level prices to generation-level energy and capacity prices. OCA St. 4; Exh. LS-2. Witness Smith also adjusted, again using PP&L ratios, for the difference between residential and average retail market prices.

As noted earlier, since the adjusted market price of power will understate the cost of getting generation to customers by the amount of administrative and general costs that will be required to get power to customers, OCA witness Smith estimated these costs from PP&L's cost of service study and included them in the avoidable generation price. Id. at 13-14; OCA Exh. LS-5 at 3.

Using the Spring 1997 DRI forecast, Ms. Smith calculated an unbundled average market rate of 3.13 cents per kwh in 1999. OCA St.4-S; Exh. LS-11-R. This rate increases to 4.86 cents per kwh in 2005. Id.

4. Residential Rates

OCA witness Smith also calculated rates for residential customers. She adjusted the Company's proposed delivery rates in a fashion similar to the total retail rate analysis. The CTC amount was allocated to the residential class on the basis of the generation capacity allocator and the rate design followed the process described for the system as a whole. This resulted in a rate decrease of 16 percent in 1999. OCA St. 4-S; Exh. LS-12-R.

B. The OCA Submits That Rate Reductions Are Appropriate.

The OCA recognizes that the Commission in the PECO restructuring case determined that it preferred to reflect the entire difference between the Company's capped rates and the combination of the T&D charge and the levelized CTC as a "shopping credit." Thus, the Commission required PECO to offer a shopping credit greater than the projected market generation price. This meant that customers who remain PECO customers--either because they do not yet have choice under the phase-in, or because they are unable to find an alternative supplier to serve them, or they simply choose to remain with PECO--must pay a generation rate that is higher than the applicable market rate.

The OCA respectfully urges the Commission to reexamine that approach in this case. The OCA submits that PP&L's generation customers should only be charged a market based generation rate and that all PP&L customers should have an opportunity to receive the rate savings proposed in OCA's testimony, not just the customers who leave PP&L.

This is the primary difference between the Commission's approach in the PECO restructuring case and that recommended by OCA in this proceeding. In the PECO restructuring case, customers can receive rate savings only if they select an alternate supplier and that supplier's charges are less than the shopping credit provided by PECO. In contrast, under OCA's proposal in this case, all customers will receive rate savings, and alternate suppliers will have to compete based upon their ability to provide favorably priced electric generation when compared to the market-based retail generation price reflected in the Company's rates. Additional savings are possible for customers who are able to obtain electricity for less than the avoidable generation component of the OCA's rate which starts at 3.13¢/kwh in 1999 on a total Company basis and goes up to 4.86¢/kwh by 2005.

OCA respectfully submits that this aspect of the approach taken in the PECO case should not be applied in this case. There are a number of reasons that it should not be applied. First, and

perhaps most important, is that only customers who are able to and who choose to "shop" will see any of the rate benefits resulting from restructuring. The customers will only see benefits, if and to the extent that, these benefits are flowed through to them, which unquestionably will depend on the level of competition in the market.

Second, the OCA submits that the effect of a shopping credit which is significantly higher than the price of generation results in customers who must remain with the utility unreasonably subsidizing the collection of stranded cost. In other words, the Company, by being required to charge more than the market price upon which the stranded cost amount was determined, will overcollect its costs.

Finally, the OCA submits that while the Commission may be concerned about the development of a competitive market, it should not provide artifical incentives to customers to participate in the marketplace. Indeed, Section 2807(e)(3) of the Act makes clear that, after the phase-in period ending on January 1, 2001, customers who have not chosen an alternative supplier are to be served by the utility or a Commission-approved provider of last resort at "prevailing market prices" and all reasonable costs, subject to the rate caps established in § 2804. 66 Pa.C.S. § 2807(e)(3).

The OCA submits that the generation rates charged by PP&L for customers who continue to purchase generation from PP&L should not exceed prevailing market rates, including any reasonable costs. In order to achieve that result, PP&L's rates must be initially reduced by the amounts set forth in the OCA's testimony. At the completion of the phase-in in 2001, PP&L's generation rates will be set at prevailing market prices (including reasonable costs) as determined by the Commission's regulations to be established under Section 2807(e)(3) of the Act.[21]

---

[21]In this regard, PP&L has proposed a Purchase Generation Cost Rate ("PGCR") cost recovery mechanism for Basic Utility Supply Service customers. PP&L St. 3-R at 39; PP&L Exh. JMK 7. BUSS customers are those customers served under PP&L's supplier of last resort obligation.

OCA St. 4-S; Exh. LS-11-R evidences that the difference between PP&L's unbundled average rates and the OCA's unbundled average rates creates rate reductions of 20% in 1999 which decline to 13% in 2005.[22]

C. PP&L's Proposed Customized Rate Design Should Be Rejected.

PP&L proposed in this case a customized rate design in which one half of its CTC charges are collected through customer charges based upon individual customer usage in calendar year 1996. The Company is proposing that the customized rate design be mandatory for all classes except for residential customers, who would have the choice of two rate designs. PP&L refers to the residential option as the traditional rate design, and this rate in total is the same as the current Rate RS in each rate component. Thus, many of the Company's customers would have a uniquely determined customer charge, which would remain fixed, under the customized rate design. The OCA submits that PP&L has failed to justify the efficacy of its proposed customized rate design and that the Company should be ordered to design all of its rates in the traditional format.

There are several reasons to reject PP&L's proposal. First, the Company has failed to demonstrate the efficiency of such a rate design. PP&L witness Tierney has presented testimony stating that a customized rate design is more efficient since there are no marginal costs associated

---

Id. at 37. The PGCR is designed to reflect and recover the actual costs of obtaining electricity from the market place for last resort customers, including the "prevailing market price" and the costs of administering the procurement program. The PGCR acts as a mini-ECR within the Company's rate cap. Id. at 40-41. While the OCA objects to certain features of this proposal, the OCA submits more importantly that the pricing elements of this proposal are premature at this time. The pricing of this type of service is the issue to be addressed in the Comission's regulations to be adopted pursuant to Section 2807(e)(2) of the Act.

[22]While the OCA's schedules go out to 2005, the OCA recognizes that the market generation rates in effect after the end of the phase-in in 2001 cannot actually be established in this case, but must in fact be established in accordance with the prevailing market price regulations under Section 2807(e)(2).

with stranded costs. However, neither she nor the Company have provided a full marginal cost study, including the transmission and distribution function, to demonstrate this claim. As OCA witness Lee Smith noted, without such a study it cannot be determined whether a partially fixed CTC is actually consistent with an efficient total rate design. OCA St. 4 at 15. As she noted, the marginal cost of transmission and distribution may be higher than the embedded revenue requirement. In that case, a flat transmission and distribution charge and a fixed CTC may not signal to customers the full cost of marginal usage. Id.

Even though Dr. Tierney acknowledged that no marginal cost study was presented, she posited that it is possible to conclude that the total non-bypassable usage charges exceed the Company's marginal costs. She stated that most of the variable costs of energy use are attributable to the production function and that embedded transmission and distribution costs are largely fixed costs which do not vary with energy use. PP&L St. 9-R at 34.

However, as OCA witness Lee Smith testified, witness Tierney is incorrect. In fact, the opposite is true. Witness Smith noted that, in her experience, the marginal cost of transmission and distribution is greater than the embedded cost of transmission and distribution. OCA St. 4-S at 4. This is based on the fact that the cost of transmission and distribution facilities has been increasing over time so that the cost of new facilities is greater than existing facilities, which can remain in service over many decades. Also, as noted by witness Smith, there have not been radical new technologies which result in decreasing costs. Id. Increases in peak demands will necessitate the building of upgraded or new facilities to serve higher loads. System planners must size transmission and distribution facilities to serve the expected peak load on the system and are constantly monitoring the performance of transmission and distribution equipment to ensure that adequate capacity is in place. Id.

In contrast, as noted by witness Smith, the marginal cost of generation is often less than the embedded cost of supply. This is due to the ability of new facilities to come on line at lesser cost than existing facilities, particularly for those utilities with expensive nuclear generation. Id.

Second, the proposed customized rate design shifts stranded cost responsibility away from customers who increase their usage, thereby resulting in a promotional rate design. This is due to the fact that a portion of the stranded cost recovery is fixed rather than usage dependent. As OCA witness Smith noted, if usage remains the same there is no effective difference in the two rate designs. However, if customers increase their usage, the customized rate design produces a decrease in the total bill compared to the standard rate design. OCA St. 4 at 15-16. OCA witness Smith demonstrated this result at OCA Exh. LS-6.

While PP&L may prefer to favor customer growth, the OCA submits that this result should not be permitted in this case. The customized rate design inappropriately shifts stranded cost responsibility from customers who increase their usage and discourages usage reduction options.

Inexplicibly, both PP&L witness Tierney and PP&L witness Krall deny there is a shifting of CTC responsibility under the customized rate design. The incorrectness of this view, as noted by OCA witness Smith, is shown on witness Tierney's own Exhibit SFT-14. This exhibit shows that a customer who reduces consumption from 9,000 kwh to 6,000 kwh would pay $123.58 in CTC charges under the traditional rate, but $153.58 on the customized rate. Likewise, the exhibit evidences that a customer who increases consumption from 9,000 kwh to 12,000 kwh would pay $243.58 on the traditional rate, but only $213.58 on the customized rate. Thus, the customer who increases usage pays less and the customer who decreases usage pays more on the customized rate. OCA St. 4-S at 5.

The OCA submits that the Commission should disapprove the proposed customized rate

design. The radical change proposed by the Company in which the tail blocks are reduced is clearly promotional and shifts CTC responsibility from customers who increase usage to customers who conserve energy. The proposal should be rejected.

D. The Continuation Of PP&L's Current Competitive Rate Rider Should Not Be Approved.

PP&L has proposed the continuation of its current Competitive Rate Rider (CRR). In 1994, PP&L filed the CRR as a competitively priced rate option for new and existing customers with monthly demands greater than 5000 KW and served under Rate Schedule LP-5. In 1995, this option was expanded to include customers on Rate Schedules LP-6 and IS-T. The CRR was a three-year experimental rate rider which is scheduled to terminate December 31, 1997. PP&L St. 11 at 11. PP&L witness Kasper described the rider as follows:

> The rate rider was designed to enable PP&L to compete for load in the electric utility marketplace. To be eligible for the CRR, a customer must first demonstrate that it has a verifiable competitive alternative to service under the applicable rate schedule and that the customer intends to select that alternative. Once these conditions are met, PP&L, at its discretion, can develop an alternative rate to meet competition, as long as the competitive rate recovers all of the Company's short-run marginal costs of providing service and provides a contribution to fixed costs.

Id. at 11-12. As of December 31, 1996, PP&L had signed CRR contracts with two customers.

PP&L proposes to continue the experimental CRR tariff through 1998, and Tariff No. 201 extends the CRR through December 31, 2005 but it is applicable to delivery charges and the CTC only.

The OCA submits that the ability to discount the CTC through the CRR tariff in the future cannot be countenanced. OCA witness Smith testified:

> It is inappropriate to allow the Company to retain or acquire generation customers by discounting the CTC. This would suggest that if an alternative supplier offered generation service below the market level

> offered by the Company, the Company could retain load by discounting the CTC. The new competitive structure should be one in which customers search for the service of generation that they prefer, and the Company cannot influence that choice by discounting the CTC.

OCA St. 4 at 8.

Indeed, the CTC must be nonbypassable as required by the Act. 66 Pa C.S. § 2803. PP&L's proposal to discount the CTC as part of its requested extension of the CRR is contrary to the Act and could result in the shifting of CTC costs to other customers through the reconciliation mechanism.

Section 2803 of the Act, 66 Pa.C.S. §2803, defines the competitive transition charge as a nonbypassable charge applied to the bill of every customer accessing the transmission or distribution network. Thus, Section 2808(a) of the Act's requirement that every customer accessing the transmission or distribution network of an electric utility shall pay a competitive transition charge means that it must pay a nonbypassable charge. While PP&L may be of the view that a discounted CTC charge is still a nonbypassable charge, albeit at a lower level, the Act contradicts this approach. The discounting of the CTC would, with reconciliation, violate Section 2808(a)'s prescription against the allocation of CTC costs to customer classes in a manner that does not shift interclass or intraclass costs. The Act stands for the proposition that the payment of a nonbypassable CTC means just that, that no part of the CTC charge may be bypassed through discounting.

Further, the discounting of the CTC is a violation of Section 2804(7) of the Code. 66 Pa.C.S. §2804(7). That Section states: "The commission shall require that restructuring of the electric utility industry be implemented in a manner that does not unreasonably discriminate against one customer class to the benefit of another." The violation of the requirement that the CTC be nonbypassable is unreasonable discrimination.

The OCA submits that PP&L's CRR proposal must be denied to the extent that it would permit discounting of the CTC component of rates.

VI. CONSUMER EDUCATION AND PROTECTION

A. The Company's Proposed Consumer Education Plan Is Inadequate And Should Not Be Implemented In Its Current State; Instead PP&L Should Participate In A Commission-Led Statewide Education Effort Which Can Then Be Locally Supplemented By The Company.

1. Introduction

The Act requires all Pennsylvania electric utilities to implement a proposed consumer education program. See 66 Pa.C.S. §2807(d)(3). In accord with §2807(d)(3) and the Commission's filing requirements, PP&L's restructuring filing included its proposed consumer education plan. However, as will be explained below, the Company's consumer education plan is inadequate in many respects and, in its present state, will not accomplish the educational goals of the General Assembly or the Commission. In order to ensure that the Company's customers are adequately educated, PP&L should be directed to participate in a statewide consumer education effort which can then be supplemented by the Company in a more localized fashion. This notion of a statewide plan coupled with a local EDC (electric distribution company) effort was recently adopted by the Commission in PECO Energy Company's Restructuring proceeding and, as explained below, such a dual educational effort is the preferred approach to better educating consumers within PP&L's service territory. See 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, Docket No. R-00973953 (Order entered December, 23, 1997).

2. Statewide Campaign

As noted above, the Commission has recognized the importance of a statewide consumer education program under the direction of the Commission. In its PECO order, the Commission established a Consumer Education Committee to develop and coordinate this statewide approach. PECO at 152-154. The OCA fully supports this statewide consumer education effort and submits

that PP&L should be directed to participate in and help fund this effort. As OCA witness Barbara Alexander[23] testified, a statewide consumer education plan could occur in two phases. OCA St. 5-S at 6-8. The initial phase can be aimed at all customers statewide and make use of uniform themes and messages. OCA St. 5 at 21. This phase could build on the ongoing pilot programs to educate consumers about the meaning of the changes taking place in the electric industry and prepare customers for retail access beginning in 1999. Id. Development of this phase could be delegated to a professional (experienced in community and public policy education as well as public relations techniques), with advice and input from EDCs, consumer representatives, independent power producers, alternative suppliers and educators. Id. It should then be ensured that this phase identifies key themes and messages to unify the statewide campaign while also making use of specific vehicles for educating consumers. Id. Furthermore, the roles to be played by stakeholders could be clarified.

This initial phase can be used to educate consumers about the new competitive market and stimulate public awareness of the impending changes to electric service. OCA St. 5 at 6. As set forth in PECO, the use of multi-media techniques would be necessary in this phase. PECO at 152. In essence, this initial phase would prepare consumers for the educational materials they will later receive from their respective EDCs.

The second phase should present customers with the tools they need to make decisions regarding their electricity supplier. As set forth by OCA witness Alexander:

> Phase II should focus on educating customers about the tools they need to evaluate their own electricity needs and make informed decisions about their electric supplier...During this phase consumers will receive more fact-oriented brochures and bill inserts. As a result of Phase I, they will

---

[23]Witness Alexander is a consultant on consumer protection and customer service issues associated with utility regulation. She has over ten years of experience including a Division directorship within the Maine Public Utilities Commission. Ms. Alexander's qualifications are presented in OCA St. No. 5 at Exh. BA-1.

> be ready to read these materials and hopefully interested in learning how to shop for electricity.

OCA St. No. 5-S at 7.

This Commission-led statewide consumer education plan (contrary to the Company's concerns) is not intended to promote switching of suppliers, but merely ensures that consumers are motivated to review the educational materials that they will receive. A significant Commission role in the educational process is preferable and necessary to balance these interests. As can be seen, use of a two-phase, Commission-led statewide education effort will ensure that PP&L's customers receive unbiased and extremely useful information as they prepare to participate in a competitive environment.

The OCA submits that the Company should participate in the funding of this statewide effort. As in PECO, an allocation of the Company's education budget between a statewide and a local initiative will ensure that customers within PP&L's service territory receive neutral and unbiased information. The OCA would also encourage that funding--either directly or indirectly, from governmental, educational, non-profit organizations and other key stakeholders be pursued. OCA St. No. 5 at 23.

Regarding the role of PP&L as the local EDC, the Company's primary function will be to:

> provide customers with the utility-specific information such as the specific nature of the pilot programs in their service territory, prices for distribution services, format of the distribution company bill, how to select a supplier, and how and where to contact the utility for further information (get copies of brochures, handbooks, etc.).

Id. at 20. However, Commission oversight will be necessary to ensure separate marketing from education through the enforcement of the Company's forthcoming Code of Conduct and the orders that will flow from the Competitive Safeguards Working Group. Id.

3. The Company's Proposed Consumer Education Plan Is A "Top Down" Plan Which Fails To Elicit Consumer Interest In The Pending Competitive Market.

OCA witness Barbara Alexander reviewed PP&L's proposed consumer education plan and noted several concerns about the plan. To begin with, PP&L's proposed consumer education plan is a "top down" plan which teaches consumers about the basics of the impending competitive electric arena, yet fails to identify specific underlying themes associated with the transition from regulation to competition. OCA St. 5 at 9. Additionally, the plan, to date, has not involved the local community in development or implementation. Id. As such, the Company's plan is inadequate. Id.

The Company's primary tool intended to educate consumers about electric competition is its Customer Choice Handbook ("Handbook"). PP&L St. 17 at 5. The Handbook, along with a website, workshops, audio tapes and related initiatives, is "designed to ensure that customers have the information and references they need to develop a sound basis of knowledge about customer choice." PP&L St. 17-R at 2. Although PP&L's education campaign provides valuable and useful information, the OCA submits that the plan is too narrow in scope and fails to motivate customers to participate in the market. Id. at 9-11.

Additionally, the "Consumer Protection Checklist" in the PP&L Handbook emphasizes risk rather than assisting customers in finding opportunity and the "Shopper's Worksheet" fails to address consumer concerns regarding supply mix and environmental impacts. Id. This failure to identify supply mix and environmental concerns as areas of possible consumer interest is particularly concerning since PP&L acknowledges that it is aware of the focus group research in other states which clearly documents consumers' concerns with such disclosures. Tr. at 2020-2021 (August 29, 1997). Although the Handbook has not been finalized as of yet, the Company's failure to prepare and motivate consumers to take part in the competitive market warrants modification of its plan. A

consumer education plan which only seeks to provide consumers with a "sound basis of knowledge" is inadequate to prepare these consumers for the monumental and historical transition from regulation to competition.

4. PP&L's Proposed Budget For Its Consumer Education Plan Is Inadequate And Should Be Rejected.

PP&L has proposed a budget for its consumer education plan for the 1997-2002 time period. See PP&L Exhibit DGL 2. In 1998, the proposed budget totals $467,500 and then decreases to $125,500 in 2001.[24] Id. Although the OCA submits that this proposed budget is a step in the right direction, the specified amounts are still inadequate. Consequently, PP&L's consumer education budget needs to be increased in order to ensure that adequate funds are available to properly educate the customers in its service territory. As will be explained below, an increase in the Company's budget would allow for contribution to the statewide education effort as well as PP&L's focused educational efforts.

In 1997, the Company has budgeted $242,000 for its consumer education program. See PP&L Exhibit DGL 2. Since PP&L's customer choice pilot program is offered in this year, the budgeted amount is only allocated between the Handbook and evaluation of the pilot. Id. However, in all subsequent years, i.e., 1998-2001, more than 50% of the annual budget is allocated for publication and promotion of the Handbook. OCA St. 5-S at 4. This allocation in favor of the Handbook is of concern because of the limitations of the Handbook.

Further examples of the inadequacy of the budget as a whole are

- in 1998, the largest annual budget between the years 1997 through 2001, the proposed expenditures represent less than 0.002% of PP&L's revenues (OCA St. No. 5-S at 4);

[24]A budgeted amount for 2002 has not been determined at this time.

- between 1999-2001, expenditures for community workshops/adult education are 8% or less of the annual budget even though PP&L asserts that its desire is to empower the representatives of community-based organizations so that these leaders can better educate the community (Tr. at 2023--August 29, 1997);
- between 1999 and 2001, proposed expenditures for PC-based/Internet self-study and shoppers tools are greater than or equal to expenditures for community workshops even though hard-to-reach, low income or disadvantaged residents may not have ready access to such tools; and
- the Company's budget fails to allocate funds for multi-media techniques which, as explained above, would provide the impetus for increased customer receptiveness to consumer education materials.

Consequently, the Company's proposed consumer education budget is inadequate at this time.

PP&L should first be required to contribute to the statewide educational plan. Then, PP&L should modify its proposed consumer education budget by increasing the funding and allocating resources in a more efficient manner. For instance, funding for community workshops and adult education needs to be significantly increased. The OCA submits that this Commission-led statewide education effort, supplemented by PP&L's focused consumer education effort, is more beneficial than mere implementation of the Company's proposed consumer education plan.

5. PP&L's Focus Group Research Provides Support For A Commission-Led Consumer Education Plan.

On June 30, 1997, the Social Research Corporation issued its *Focus Group Report: Awareness of Electric Utility Deregulation And Feedback on PP&L's Educational Handbook ("Report")*. See PP&L Exhibit DGL 1. According to the *Report*, Social Research Corp. conducted four focus groups "to obtain a baseline assessment of customer knowledge about electric utility deregulation and to solicit feedback on an educational handbook prepared by PP&L." Id. at 1. The groups consisted of two residential focus groups in Wilkes-Barre and one residential and one commercial focus group in Whitehall. Id. The stated goal of this research was to "better understand how PP&L customers think about customer choice and how they respond to PP&L's educational

handbook." Id. The OCA submits that the results of these focus groups, like results obtained in other states, emphasize the need for a Commission-led statewide consumer education plan. OCA St. 5-S at 9. Consequently, PP&L's reliance on the results of these focus groups to bolster implementation of its proposed education plan is misplaced.

To be successful, a consumer education effort must effectively communicate the information which is intended to reach the desired group. PP&L's focus group research, however, showed that customers do not routinely read bill inserts and few participants had learned anything about electric restructuring from the PP&L bill insert. OCA St. No. 5-S at 9. Although the results of the focus group suggest that the Handbook provided enough information to make an informed choice, of critical concern is what must be done to ensure that most people *actually read* the eventual Handbook. As evidenced in the *Report*, the majority of participants could not recall where they had first heard about deregulation. PP&L Exhibit DGL 1 at 5-6. Consequently, this raises the concern that many of the residential and commercial customers may not even read a PP&L distributed Handbook. Id. at 13. As set forth by OCA witness Alexander, in order to remedy this:

> [b]oth utilities and the Commission must develop a highly visible multi-media campaign using TV, radio and newspaper advertisements just to get customer attention on this issue.

OCA St. 5-S at 10. As previously suggested, a two-step Commission-led statewide education plan would accomplish this. Phase I would "call" attention to the impending competitive market so that customers will be "ready" and receptive to subsequent Phase II information. As evidenced by the focus group results, without the initial impetus provided by Phase I, the possibility of consumers actually reading EDC consumer education materials, e.g., handbooks, is extremely low. Consequently, the results from the focus group research clearly establish the need for a Commission-led statewide plan which would be supplemented by individual EDC educational efforts.

B. The Company's Consumer Protection Measures Should Be Modified Significantly; Certain Measures Are Unnecessarily Stringent While Others Are Inadequate To Serve Their Intended Purposes.

1. Introduction

PP&L's restructuring filing raises a number of consumer protection and service quality issues. These include Company customer service, PP&L's interactions with alternate generation suppliers, interaction between PP&L's regulated distribution service and its generation supply division, the Company's "supplier of last resort" service and changes required in the Company's current tariff to reflect the separate functions of delivery and sale of electricity. OCA St. 5 at 26. Numerous issues have arisen due to some of the Company's proposals and these issues will be addressed below. As will be seen, certain proposals by the Company should be rejected while others need only be modified in order to conform with the intent of the Act.

2. The Company's Billing Format Should Contain A Number Of Components In Order To Provide Consumers With The Information Needed To Understand Their Bills And Comparison Shop If They So Desire.

PP&L presented two bill formats with its filing--one for both delivery and generation service and one for delivery alone. OCA St. No. 5 at 28. The OCA submits that if PP&L bills contain charges for generation services provided by the Company's generation supply division or from alternate suppliers who have contracted with PP&L for billing services, the billing format should incorporate certain provisions. The most crucial of these are:

- separate identification of generation services which allow the customer to easily distinguish between the EDC's bill for its regulated services and the price for unregulated generation supply (as well as other services provided by the EDC's generation supply division or the alternate provider);
- a uniform method of disclosing the price for the sale of electricity to the customer;
- disclosure of the supplier's fuel supply mix; and
- use of plain language on the customer's bill.

OCA St. 5 at 28-30.

The OCA would note in particular that a uniform method of disclosing the price for the sale of electricity to the customer is necessary. For instance, the price disclosure format for residential customers should include a calculation of the customer's cents per kilowatt hour ("kWh") price paid for usage that month. OCA St. 5 at 29. Fixed and variable charges should be factored into this calculation. Id. Such a calculation should be disclosed for the regulated transmission and distribution portion of the bill and the supply portion (regardless of the supplier). Id. Finally, documentation of a customer's historical kWh usage should be provided so that the customer can reference this information when evaluating any electricity offers he or she may become aware of. Id.

The Company intends to comply with Commission plain language requirements and will make its proposed bill design open to review by the Commission and other concerned parties. PP&L St. 15R at 20. The OCA agrees with this approach and will work with the Company and the Commission in the compliance phase to ensure that its plain language requirements are complied with as the Commonwealth enters into this new competitive market.

3. In Order For Meaningful Competition To Develop, PP&L Must Establish Communication Protocols With Alternate Suppliers Regarding Customer Applications For Service.

To begin with, it is very likely that current PP&L customers will contact the Company with an interest in participating in the competitive market for generation services. Consequently, it is extremely important that competition not be inhibited at this critical juncture. The Company is currently in the process of developing communication protocols with suppliers and this is a step in the right direction. Nevertheless, the OCA submits that certain provisions must be established to ensure that alternate suppliers (when dealing with PP&L as a regulated EDC) are able to reach potential customer pools as easily and frequently as PP&L's generation supply division.

First, the OCA submits that a customer should not have to make more than one call to initiate services. OCA St. 5 at 32. It is understood that a customer may have to contact both a supplier and an EDC regarding credit-worthiness if the customer has not dealt with either. For instance, the OCA submits that if a PP&L customer desires to enter into a contract with an alternate generation supplier, that customer need only do one of the following: 1) directly inform PP&L of the identity of the alternate supplier, or 2) directly contact a supplier and establish service. Id. at 35. Under the first scenario, PP&L would merely need to notify the supplier who would then contact the customer and issue the required contract or agreement disclosure. Under the second scenario, as long as the process is documented with valid records (verbal, written, etc.), the customer is able to initiate service in much the same way as he or she would initiate new or additional service at an existing location with his or her present provider. Consequently, the OCA submits that either of these alternatives is acceptable. The requirement that the customer agree to a change of supplier in writing should only apply if the initial customer contact was made by a marketer, agent or supplier instead of the customer. Id.

Second, PP&L's tariffs should establish that the Company will not evaluate a customer's credit worthiness based on the customer's payment history with alternate suppliers when the customer is only initially seeking regulated distribution services from PP&L. Id. at 34. Although the Company argues that it should be able to consider payment histories with alternate suppliers, the OCA asserts that a customer's payment history with regard to the receipt of prior regulated services is more relevant.

Third, it is incumbent upon the Company to educate consumers about their rights to choose generation suppliers. OCA St. 5 at 33. In furtherance of such, PP&L should also provide consumers with a complete or randomly generated list of these suppliers. Id. The supplier of last resort service

should be explained upon request, however, the Company may not use this opportunity to market any of PP&L's competitive business products. Id. The Company agrees with all of these premises and intends to implement the appropriate provisions. Although the OCA submits that the Company's proposed consumer education plan is inadequate and must be modified, PP&L's commitment to implement these provisions will suffice at this time.

Finally, there are certain practices that must be completely prohibited by the Commission. As set forth by witness Alexander:

- PP&L should not offer to transfer customers to PP&L's retail sales office without offering this same service to other suppliers (who would of course pay a fee, including PP&L's sales division, for such "hot" transferred calls);
- PP&L should be prohibited from selling generation services to customers with the same employees whose primary duty is to provide the customer service function for the monopoly utility;
- PP&L's utility customer service function should not share facilities or employees with its competitive generation affiliate; and
- PP&L's provision of services should be subject to audit and monitored to assure that initiation of service is provided promptly and without undue procedural delay for customers who choose PP&L as their generation supplier or who choose another supplier. PP&L should be required to explore the use of prorated bills between two energy suppliers during one billing cycle.

OCA St. No. 5 at 34. Implementation of these provisions will ensure that the Company's regulated and generation supply divisions are adequately separated, thereby avoiding any bias in favor of PP&L to the detriment of alternative suppliers.

4. The Company's Proposals For Metering And Meter Reading Services Are Too Restrictive And Should Be Modified.

In its restructuring plan, the Company included proposals for future metering and meter reading services. While the Company acknowledges that under the Act, customers can obtain alternative meters, PP&L witness Bujnowski asserts that the Company will perform the upgrades and continue to own and maintain meters while billing the customer directly for the additional costs

associated with the alternative meters. PP&L St. 15 at 4. The Company also intends to prohibit other parties from providing meters or meter reading services and does not intend to unbundle any part of its current metering costs even when a customer seeks the installation of a new meter. Id. Such restrictive proposals by the Company do not reflect the current trends in exploring competitive metering and billing and could foreclose future developments in this area. Consequently, many of the metering proposals as currently set forth by the Company should be rejected. Instead, adherence to the following provisions is appropriate:

- The Company's current short-term policies should at least be compatible with the possibility of competition in the provision of metering services in the future;
- Regarding open architecture standards, these standards should be developed by stakeholders, including developers of new metering technology. Furthermore, approval by the Commission of such standards will be necessary as well;
- The Company should be prepared to unbundle the current cost of some features associated with metering;
- The Company should be prepared for installation and billing for alternative meters;
- If PP&L uses load profiles for customers with standard mechanical meters, it would be appropriate to update these load profiles frequently and with approval by the Commission;
- The Company's customers should be able to obtain their historical usage history over the past twelve months without charge by merely calling PP&L.

OCA St. 5 at 37-40.

5. The Company's Proposed Billing Procedures Are Inadequate And Should Be Modified In Order To Comply With The Expectations Of The Act.

PP&L has proposed a number of billing procedures which it intends to implement under its restructuring plan. See PP&L Exhibit BJB 1. As will be explained below, there are numerous shortcomings regarding the Company's proposed billing procedures and these shortcomings must be rectified prior to implementation of PP&L's restructuring plan.

Initially, the Company currently has plans to replace its current information system with a "new, state-of-the-art" information system which will result in "improved levels of customer

satisfaction regarding billing accuracy, timely resolution of customer inquiries, and increased billing options consistent with customer choice." PP&L St. 15 at 5. Implementation of this system is set for 1999. While it is able to, the OCA submits that the Company should incorporate the ability of alternate supplier billing, i.e., an alternate supplier's ability to bill on behalf of PP&L, into the framework of its new system.

Furthermore, the Company should develop "multiple balance billing". OCA St. 4 at 42. This type of billing will ensure that customers are not threatened with disconnection of their regulated service due to payment disputes concerning their unregulated service. Multiple balance billing will ensure an accurate and efficient allocation of payments should any dispute arise regarding a customer's generation supply payments, or lack thereof.

6. The Company's Complaint Resolution Procedures Need To Be Clarified To Ensure That Customer Concerns Are Adequately Addressed.

Once retail access becomes available, there will inevitably be disputes between a customer and its regulated or competitive service provider. Resolution of these complaints to the satisfaction of all parties may be a difficult task, therefore, procedures must be established to ensure that complaints are properly resolved. At present, the Company has asserted its responsibility to handle customer billing concerns. PP&L St. 15R at 24. If a customer receives a single bill from PP&L including regulated and competitive charges, the Company will verify the meter reading and issue a new bill if warranted. However, if a customer receives a separate bill from its alternate supplier, the Company will advise the customer to seek assistance from the alternate supplier.[25] Id. The OCA submits,

[25]Under the PP&L-issued single bill option, the Company will also advise the customer to seek assistance from the alternate supplier if the Company has entered a rate schedule on behalf of the alternate supplier which was not in error according to the alternate supplier, yet is disputed by the customer.

however, that to the extent the complaint depends on an accurate meter reading, PP&L should "own" these complaints in the near term. OCA St. No. 5 at 43.

7. PP&L Must Clarify Intended Procedures To Be Followed Regarding Deposits, Discontinuation Of Service And Reconnection Of Service.

PP&L has yet to propose provisions concerning a number of service oriented issues. To begin with, the Company's filing fails to address the procedures to be followed when a customer requests that service be discontinued. OCA St. 5 at 44. Consequently, the OCA submits that procedures be established which differentiate between customers who request discontinuation of distribution services and those who seek to merely terminate a contract with an alternative supplier. Id. Furthermore, provisions should be made for those customers which seek to discontinue any service, i.e., regulated or competitive, by calling an alternative supplier. Id. These procedures should be submitted at the time of the compliance filing for review by all parties and the Commission.

Along similar lines, the Company's policies regarding termination and payment agreements must be clarified. As explained by OCA witness Alexander:

> The Commission adopted the OCA's recommendation on this matter in its Final Order regarding Licensing Requirements for Electric Generation Suppliers [citation omitted] which prohibits a distribution company from disconnecting a customer for the failure to pay supplier charges and allows disconnection to occur only for the failure to pay regulated distribution company charges or those associated with the supplier of last resort. The Commission confirmed this approach in its Tentative Order on Maintaining Customer Service Quality [citation omitted] and clarified that this policy applied as well to the purchase of accounts receivable by an distribution company from a supplier.

OCA St. No. 5 at 45. Although there is no indication that PP&L disagrees with this policy, the Company's tariffs are unclear on this issue. The Company's tariffs should be amended to clearly state that a customer's failure to pay only distribution charges or energy charges billed the provider of last resort will result in termination of all electric service. Id.

The Company also fails to clarify what policies will be in place regarding restoration of service. Id. at 49. The OCA's concern in this respect is that restoration of service not be conditioned on a customer's unpaid charges to an alternative supplier for service other than provider of last resort.

Finally, the OCA submits that the Company's tariffs should clarify that deposit amounts for a distribution portion of a bill will be based on estimated distribution charges while deposits requested for the supply portion of a bill will be based on estimated supply charges. Id. at 36. Implementation of these provisions will certainly be of use as the Company deals with more customers, alternative suppliers and service-oriented issues in the competitive market.

C. The Company's Proposed Provisions Regarding Its Basic Utility Supply Service, Or Provider Of Last Resort Service, Must Be Addressed In The Future To Ensure Fairness To Its Customers While Providing The Company With Adequate Protections In The Competitive Market.

1. Introduction

Under § 2807(e) of the Act, EDCs are required to provide electric service to those customers within their territory. § 2807(e)(1) reads:

> While an electric distribution company collects either a competitive transition charge or an intangible transition charge or until 100% of its customers have choice, whichever is longer, the electric distribution company shall continue to have the full obligation to serve, including the connection of customers, the delivery of electric energy and the production or acquisition of electric energy for customers.

Subparagraph (2) of § 2807(e) requires the Commission to establish regulations which will govern the provider of last resort service after the end of the phase-in period and subparagraphs (3) and (4) provide guidance to the Commission regarding the future regulations referenced in subparagraph (2).

In accord with § 2807(e), the Company proposed its Basic Utility Supply Service ("BUSS"). The BUSS is intended to satisfy the Company's "provider of last resort service" obligation. As noted in Section IV, B above, the OCA submits that it is premature at this time to rule on the overall pricing of the BUSS plan because regulations have not yet been issued under Section 2807(e)(2). The OCA also submits, however, that certain element of PP&L's proposal raise questions that will have to be addressed by the Commission.

2. PP&L's Proposal To Treat Returning Customers Of BUSS As "New" Customers Should Be Clarified.

At present, the Company proposes to treat returning BUSS customers as "new" customers under its tariffs. PP&L St. 14 at 7. For PP&L, which has certain rate tariffs closed to new customers, this would prohibit a customer from competitively shopping for electricity and then

returning to PP&L at the same tariffed rate under which the customer was previously served if that rate has been closed to new customers. Id. As discussed below, this is a particular problem for residential customers on the RTS rate schedule.

PP&L has also proposed to require a customer returning to BUSS enter into a one year contract for service with PP&L. Id. PP&L does propose an exemption for residential customers to test the competitive market and return to BUSS at their previously tariffed rate if this is done within six months of the customer's initial departure. PP&L St. No. 14 at 7. Nevertheless, as will be explained below, many provisions of this service must be modified.

PP&L has argued that its proposal to require a 12 month contract is necessary to avoid what it perceives to be "gaming" of the system. However, as OCA witness Alexander explained, customers who move into and out of a competitive system may do so for a variety of reasons that have nothing to do with "gaming". OCA St. No. 5 at 47. Regardless of the ultimate reasons, PP&L will not be in a position to ascertain the impetus for a customer's moving into and out of the competitive market. The Company's concern with customers "gaming" the system, i.e., returning to PP&L when competitive prices are unfavorable, can be alleviated in other ways, such as using a market-based price subject to the rate caps or charging a modest fee to those customers who return to BUSS more than twice in any 12 month period. OCA St. No. 5 at 47; OCA St. No. 5-S at 15-16. The OCA submits, however, that the Company's requirement of a 12 month contract may unnecessarily impede customers' ability to choose and should be rejected.

3. The Company's Proposal To Phase-Out Or Deny Access To Rate RTS Once A Customer Enters The Competitive Market And Then Returns To PP&L's BUSS Should Be Rejected.

Under PP&L's proposal to treat returning customers as "new", a special problem arises for

certain residential customers under Rate RTS. Under the Company's Rate RTS (a special thermal storage heat rate), customers who previously installed certain electric thermal storage systems are served under this specific tariff rather than the Company's other residential tariff, Rate RS. See Pennsylvania Public Utility Commission v. Pennsylvania Power & Light Company, R-00943271 (Order entered September 27, 1995). These systems are equipped with timing devices which permit PP&L to pre-set the time during which electric heat and/or hot water heating occurs. Id. at 215. In PP&L, the Company proposed to continue "providing service to existing RTS locations throughout the life of the existing thermal storage units", but to close the rate to new customers. The Commission accepted the Company's proposal as it was modified during the proceeding. Id. at 216, 219.

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

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

OCA St. No. 5 at 48-49.

As witness Alexander recognized, in the PP&L order, the Commission directed that the rate

must continue for service to locations. Consequently, if an RTS customer decides to enter the competitive market and then return to the Company's BUSS at the same location, that customer must be entitled to the RTS rate in effect at the customer's location. Otherwise, the rate cap provisions of the Act would be violated. Section 2804 (4) mandates that rates to a customer be no higher than rates to that customer on January 1, 1997 for the specified period. In light of such, a customer's rate in effect as of January 1, 1997 cannot be exceeded until July 1, 2001 at the earliest. Consequently, an RTS customer cannot be denied access to the RTS rate upon return to service if that would cause that customer's total charges to exceed the charges which were being assessed on January 1, 1997. Based on PP&L and Section 2804(4), the Company must be precluded from denying an RTS customer access to the rate when the customer returns to PP&L's BUSS.

D. To Ensure That Customers And Alternative Suppliers Are Not Disadvantaged, The Company's Proposed Code Of Conduct Must Be Modified In Many Respects.

1. Introduction

Because the Company intends to take part in the competitive market as an alternative supplier, it was necessary for PP&L to propose a set of guidelines and provisions to ensure that the two corporate functions remain appropriately separated. Towards this end, the Company proposed implementation of its Code of Conduct ("Code"). See PP&L Exhibit RMG 4. This Code is intended to functionally separate PP&L's electric delivery activities and its generation supply and marketing activities. PP&L St. 13 at 4. The Company also extended its Code of Conduct adopted pursuant to FERC Order Nos. 888 and 889 to govern the relationship between its delivery and supply functions at the retail level. Id. As, as will be explained below, the Company's proposed Code of Conduct has numerous shortcomings and requires significant modification prior to its implementation.

2. The Company's Intention To Conduct Its Distribution And Generation/Sales Businesses Within The Same Corporate Structure Is Inherently Troublesome.

By proposing that its distribution and generation/sales businesses operate within the same corporate structure, the Company is setting the stage for potential cross-subsidies and unfair trade practices. OCA St. 5 at 50. Although the OCA has no reason to doubt PP&L's intent to operate these entities in a non-discriminatory and equitable fashion, certain provisions are needed to supplement the Company's Code of Conduct to ensure that the rules and procedures are clear. These supplemental provisions will diminish the possibility of cross-subsidies and unfair trade practices which are inherent in the Company's proposal. The following provisions are the most vital at this juncture:

- There should be no shared employees, expenses or assets between the two entities other than costs billed back to corporate support functions. These costs should be priced at prevailing market rates;
- Transactions between the divisions or between either division and the corporate support function should be limited to the purchase of tariffed items generally available to other similarly situated generation suppliers, with the exception of general and administrative support services. The Company agrees with this recommendation, however, these policies should be set forth in written form and subject to Commission review;
- Each entity should maintain its own books of accounts, office facilities and personnel, computer systems and other equipment needed to conduct daily business;
- If there are employee transfers between the entities, they should be tracked and annually reported to the Commission;
- Joint marketing between the entities should not be allowed. Specifically, the delivery group should refrain from promoting the competitive services offered by any portion of PP&L, including those competitive services currently offered by the Company;
- Dispute resolution regarding alleged violations of the Code should include a procedure to designate a person to conduct an investigation of the complaint. Results of this investigation should be provided to the complainant within 30 days after the complaint is received and should document any action taken in response to the complaint while also apprising the complainant of the ability to seek Commission involvement if such is desired.

OCA St. No. 5 at 51-52.

In conclusion, the OCA recommends that PP&L be directed to incorporate these modifications into its Code of Conduct, so that its Code of Conduct provides appropriate safeguards until such time as the Commission completes its Rulemaking on Competitive Safeguards and issues

a Final Code of Conduct.

E. The Company's Phase-In Proposal Is Acceptable And Only In Need Of Two Minor Additional Provisions.

Section 2806(b) of the Act requires that a maximum of 33% of the peak load of each customer class have the opportunity for direct access as of January 1, 1999. See 66 Pa.C.S. §2806(b). As explained by OCA witness Alexander, the Company's proposal is appropriate for residential customers since PP&L will publicize the enrollment procedures to all of its customers and accept enrollment on a first-come/first-served basis. OCA St. No. 6 at 53. Witness Alexander's only additional suggestions were that 1) "the Company provide a prepaid postcard to all customers so that they can easily respond by mail" and 2) the Company "automatically enroll those residential customers who are participating in the pilot program into Phase I to avoid the need for those customers to communicate their desire to participate again." Id.

VII. UNIVERSAL SERVICE AND CUSTOMER ASSISTANCE PROGRAMS

A. PP&L's Proposed Universal Service Program Should Be Modified To Ensure That The Funding Level Is Adequate, Associated Costs Are Equitably Allocated And Participation Is Possible For Those Customers Who Need Assistance.

1. Introduction

Universal service is an effort to make electricity service available on affordable terms to all households in a particular service area, regardless of income. OCA St. 6 at 3. There are two aspects to the concept of universal service: the extent to which households have affordable access to service, and the level of service to which households have affordable access. Id. The Consumer Choice Act has specifically recognized the importance of universal service, particularly for low-income customers. For example, at §2802 of the Act ("Declaration of policy"), the Pennsylvania General Assembly sets forth its findings and declarations regarding electric restructuring in the Commonwealth. See 66 Pa.C.S. § 2802. Paragraph (9) of this section reads:

> Electric service is essential to the health and well-being of residents, to public safety and to orderly economic development, and electric service should be available to all customers on reasonable terms and conditions.

Paragraph (10) goes on to state that:

> The Commonwealth must, at a minimum, continue the protections, policies and services that now assist customers who are low-income to afford electric service.

Furthermore, the Act empowers the Commission to ensure that universal service is available and properly funded in Pennsylvania. §2804(9) reads:

> The Commission shall ensure that universal service and energy conservation policies, activities and services are appropriately funded and available in each electric distribution territory. Policies, activities and services under this paragraph shall be funded in each electric distribution territory by nonbypassable, competitively neutral cost-recovery mechanisms that fully recover the costs of universal service and energy conservation services.

66 Pa.C.S. §2804(9). In light of these requirements, PP&L presented testimony regarding its proposed universal service program in this proceeding. Included in the Company's universal service program are: CARES, Operation HELP, WRAP, the Keep Warm Plan and the OnTrack Payment Program Pilot. PP&L St. 16 at 7.

OCA witness Nancy Brockway[26] reviewed the Company's proposal and found it deficient in several respects. To begin with, certain provisions within the Company's proposed universal service program design are unacceptable. Second, certain eligibility criteria proposed by the Company are unnecessarily stringent or unwarranted. Third, PP&L's proposed level of funding is deficient. Finally, the proposed allocation of universal service costs, i.e., the source of the funding is

---

[26]Witness Brockway, an attorney and utility analyst at the National Consumer Law Center with more than 20 years of experience, presented Direct and Surrebuttal Testimony on behalf of the OCA in this proceeding. Witness Brockway specializes in the fields of poverty issues, public utility regulation, low-income affordability programs, and low-income conservation. Ms. Brockway's qualifications are presented in OCA St. No. 6 at Exh. NB-1.

unacceptable.

As discussed below, the OCA has recommended modifications to PP&L's universal service program in order to achieve the goals of the Act. As set forth below, OCA urges adoption of these modifications in this proceeding.

2. The Design Of The Company's Universal Service Program Should Be Modified.

a. Introduction

The purpose of a Customer Assistance Program ("CAP") is to lower the bills of income-limited residential households so that electric bills do not unnecessarily strain the budgets of these households. OCA St. 6 at 10. A Low Income Usage Reduction Program ("LIURP") program also seeks to make electric service more affordable by reducing usage which, in turn, lowers bills, improves payment patterns and saves electricity resource costs. Id. at 30. The Company's CAP and LIURP programs, OnTrack and WRAP, respectively, seek to ensure that the legislature's goals set forth at §2802 are adequately met, namely, the availability of electric service and continuous efforts to ensure that low-income customers are not deprived of this necessity. However, as explained below, certain modifications to the Company's CAP and LIURP programs are necessary to ensure that these programs reach their intended recipients and are as equitable as possible.

b. The Company's CAP Program, OnTrack, Must Be Expanded To Ensure That Adequate Measures Are Taken To Accommodate Those Customers Who Are Eligible To Participate.

i. Introduction

CAP programs are intended to lower the bills of income-limited residential households so that the burden an electric bill places on these households is affordable. OCA St. 6 at 10. CAP programs also enable credit and collection costs to be reduced or reprogrammed into more productive uses.

Id. Due to such benefits, it is extremely important that CAP programs remain available to those citizens who need them--even after the implementation of retail access. The General Assembly recognized the need for the continuation of such programs[27] and PP&L's existing CAP program is one of the more sophisticated among Pennsylvania electric utilities. PP&L has even proposed to expand its programs and broaden its eligibility criteria. As discussed below, however, additional measures should be taken to ensure that the Company's CAP program adequately addresses the needs of PP&L's low-income customers.

ii. CAP Program Expansion

Even though broadening its eligibility criteria, PP&L initially proposed to focus its OnTrack program on those customers with delinquent accounts. The OCA submits, however, that even though focusing on customers who have demonstrated an inability to pay their electric bills in a timely fashion is desirable, customers should not be denied affordability assistance solely because they have not been delinquent in their bill payments.

In response to the OCA's stated concerns, the Company proposed in its Rebuttal case that eligibility criteria for OnTrack be expanded to include certain customers who may not have a delinquent account but may be in need of assistance. PP&L proposed to evaluate the circumstances of such cases on a case-by-case basis provided that the household has an income at or below 150% of the federal poverty guidelines and meets one or more of the following criteria: 1) injury or illness of the primary wage earner, 2) high medical bills, 3) loss of job or other reduction in income, 4) abandoned spouse with young children, or 5) very low income elderly. PP&L St. 16-R at 22. The OCA supports these additional considerations and, as set forth by witness Brockway, would only add that "very low-income households with children under school-age and very low-income households

[27]See § 2802(9) of the Act.

with a permanently disabled person residing in the house in need of personal care for daily living" be considered as well. OCA St. 6-S at 8. Inclusion of these additional considerations, coupled with those set forth by PP&L, will ensure that a broader range of customers in need are reached by PP&L's programs.

Additionally, OnTrack should be expanded to include a larger percentage of at-risk, eligible customers. OCA St. 6 at 22. The Company proposes to increase the level of enrollment from 1,040 customers to 10,000 customers by 2001. This would result in an increase of 3,000 customers per year. PP&L St. 16 at 18. However, as OCA witness Brockway testified, a more appropriate measure would be for the Company to expand its OnTrack program more quickly to a modestly higher resulting level of approximately 18,500 participants. OCA St. 6-S at 4. At this participation level, low-income customers who are behind on their bill payments would still be the focus of the program. Id.

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

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

OCA St. No. 6 at 18.

PP&L generally has opposed expanding its CAP eligibility level beyond 10,000 customers. The Company argues that expansion presents some significant problems, e.g., impracticality in effectively identifying, interviewing and enrolling tens of thousands of customers and prohibitive costs. PP&L St. 16-R at 10. However, the OCA submits that ramping the program up to 18,500

customers should not pose significant problems for PP&L. As OCA witness Brockway explained:

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

OCA St. No. 6-S at 4-5. As to cost, as will be discussed in detail below, the OCA is only recommending a $2.7 million increase in the Company's budget. OCA St. No. 6-S at 5. OCA witness Brockway testified:

> I propose a CAP (OnTrack) budget for PP&L of $11.7 million. This is only $2.7 million above the Company's proposed budget. My proposal is well below the dollar value of uncollectibles associated with low-income customers. It represents a modest portion of today's revenues. It is targeted to low-income customers whose payment-trouble gives concrete evidence of their struggle to afford their bills.

Id. Consequently, expansion of OnTrack from 10,000 to 18,500 participants is doable and will not pose significant problems for the Company.

The OCA recognizes that the costs of the OnTrack program will increase by extending affordability to a larger portion of the at-risk, low-income customers, but the benefits of the program will increase as well. For instance, savings in credit and collection costs will result, as well as PP&L's ability to re-target previously uncollectible dollars from write-offs to affordability subsidies. Id. at 25. According to a 1994 impact evaluation of OnTrack, the gross billing deficiency (the amount of dollars of revenue that would have been billed at the regular residential rate, but are not billed to OnTrack participants) was nearly offset by the savings in credit and collection costs produced by the

OnTrack rate. Id. Consequently, despite the gross billing deficiency, the net costs of the Company's OnTrack program can be quite low due to the associated savings. Id.

iii. Funding Level for CAP

The Company has proposed a $9.1 million ongoing level of funding for its CAP programs by 2002. PP&L proposes to gradually increase the funding level for its OnTrack program from $2 million to $9 million over a three-year period beginning in 1999. PP&L St. 16 at 18. In 2002, the funding level would be $9.1 million per year and would continue at this level on an ongoing basis. Id. Although the OCA supports the Company's efforts to "ramp-up" the funding level of OnTrack, the annual level must be somewhat higher to ensure that the proper amount of funding exists to ensure that the program is run as efficiently as possible and that the targeted expansion of the program can be accomplished. The OCA asserts that an annual funding level of $11.7 million will ensure that PP&L's OnTrack program has sufficient funding to support those eligible customers who avail themselves of the program benefits. This amount, rather than the Company's proposed amount, is a more appropriate annual funding level.

The OCA's proposed annual funding level of $11.7 million for OnTrack is only $2.7 million more than PP&L's proposal. OCA St. 6-S at 5. Furthermore, $11.7 million is well below the dollar value of uncollectibles associated with low-income customers and also represents a modest portion of the Company's present revenues. Id. Consequently, establishing a funding level of $11.7 million rather than $9.1 million is a reasonable and desirable solution. The $11.7 million represents 0.5% of PP&L's revenues. OCA St. 6 at 22.

c. PP&L's LIURP Program, WRAP, Needs To Be Expanded To Ensure That Meaningful Usage Reduction Is Achieved By Those Customers Who Would Benefit The Most From Decreased Or More Efficient Energy Usage.

i. Introduction

PP&L's low-income, usage reduction program, WRAP, was implemented in 1985. PP&L St. 16 at 10. Through WRAP, the Company is able to offer weatherization services for eligible customers as well as individualized energy conservation counseling. Id. Although the Company has made a commitment to continue the WRAP program, the OCA submits that there are additional measures which, if taken, would further enhance the effectiveness of the program. These measures will be explored in detail below.

Initially, the OCA would note that LIURP programs such as WRAP play a critical role in ensuring universal service. OCA witness Brockway explained that:

> [u]sage reduction is an integral component of the efforts of the distribution utility and other market participants to assist low-income customers to achieve the same level of service as non-low-income customers. Usage reduction is particularly valuable because it not only helps lower bills, and thereby improve payment patterns, it also saves electricity resource costs, such as fuel and capacity costs. In addition, it has environmental benefits. Thus, low-income usage reduction is a beneficial proposition to all concerned (affordable bills, lower credit and collection costs to the utility, lower credit and collection costs passed on to other customers, lower electricity resource costs, and lower environmental costs).

OCA St. No. 6 at 30.

Recognizing the importance of usage reduction, OCA witness Brockway recommended six measures which, if implemented, will improve the effectiveness of the WRAP program. The measures recommended by witness Brockway are:

- Establishment of a baseload usage reduction component of WRAP which would assist non-space heat and non-water heat customers in reducing their usage
- Issuance of a request for proposals (RFPs) in order to receive bids for implementation of a low-income, renewables pilot
- Devotion of a higher proportion of overall LIURP funding to lower income customers and others with incomes below 150% and 100% of the federal poverty guidelines
- Piloting the use of special copayment procedures to lower attrition, engage customers to "buy-in" to conservation benefits and spread scarce program dollars

- Increasing the overall level of spending from $4 million to $4.7 million per year;
- Creation of an Advisory Committee of stakeholders and interested parties which can provide PP&L with feedback on its LIURP activities on an ongoing basis.

OCA St. 6 at 32.

As will be seen, each of the above-listed measures will further energy conservation measures among the Company's customers and should therefore, contribute to the overall effectiveness of the Company's LIURP efforts.

ii. Baseload Usage Reduction

The inclusion of a baseload usage reduction component within WRAP is an extremely important measure.[28] Although PP&L focuses its conservation efforts towards the 31% of its customers who utilize electric space heating, non-space heating, low-income customers can also benefit from conservation efforts. OCA St. 6 at 33. These non-space heating customers comprise two-thirds of the Company's low-income customers, therefore, cost-effective, baseload usage reduction would assist in making bills for these customers more affordable, thereby saving credit and collection costs. Id. Additionally, resource costs which are borne by the entire system could be saved. As such, it is appropriate to devote LIURP costs to non-space heating customers.

The Company argues that its level of effort on LIURP programs is satisfactory. However, the OCA submits that thousands of baseload electricity users within the Company's service territory needlessly use high levels of electricity because measures which would allow more effective electricity usage have not been installed within or around their residences. OCA St. 6-S at 13. For example, of the 122,000 low-income households with baseload or water heat only, PP&L has only 1,700 baseload installations. Id. Thus, while PP&L has undertaken some initiatives, it should expand these

[28]Baseload usage, or non-space heating, customers utilize electricity for lighting and household appliances. However, these customers do not utilize electricity for residential heating purposes.

programs more rapidly. For example, the Company's refrigerator replacement pilot can be ramped-up to full scale implementation. As set forth by witness Brockway:

> Refrigerator replacement is technologically straightforward, and the program issues have been worked out by numerous utilities, including a number in Pennsylvania. It should not be necessary to pilot such a program, although a ramp-up period might be appropriate. Refrigerators are often the highest single electricity end-use in a non-electric water-heat household, and models in use in low-income households are disproportionately the older, less efficient models. Replacement would save large amounts of energy, and help participating WRAP baseload customers manage their energy bills.

Id.

iii. Renewables Pilot

The second measure recommended by the OCA that the Company take in an effort to improve its WRAP service is implementation of a renewables pilot. At 66 Pa.C.S. §2803, the Act specifies the application of renewable resources as a worthwhile method to be utilized in the areas of universal service and energy conservation. Towards that end, the OCA submits that PP&L should implement a pilot renewables program as recommended by OCA witness Brockway which can ultimately become part of a larger, more statewide effort. The Company should establish its pilot by:

- Issuing an RFP to solicit proposals of contractors to install 35 units of photovoltaic ("PV") electricity panels at 1 kW in 1999, and 75 units of PV in 2000, on the dwellings of low-income PP&L customers
- Seeking bids in a price range of $5.00 per watt
- Seeking proposals to install up to $150,000 worth of passive or active solar hot water heating on low-income customers' dwellings
- Requiring a diversity of building types, locations, land tenancies, sizes and metering arrangements
- Conducting a process and impact evaluation of the installations, capturing such features as customer acceptance of the measures, landlord acceptance in the case where the customer is a renter, cost per unit, payback per unit, Total Resource Cost on a present value basis per unit, and the like
- Involving the LIURP Advisory Committee at all stages of the pilot development and evaluation
- Submitting a report to the Commission in 1999 and 2000 concerning the status of the pilot and the findings of any evaluations, together with recommendations as to

whether to renew or extend the pilot.

OCA St. 6 at 34-35.

It is important for the Company to undertake a renewables pilot for a number of reasons. To begin with, the Act specifically recognizes renewable energy as a worthwhile method to be utilized for energy conservation and highlighted the importance of testing the viability for renewable generation in universal service programs. The OCA submits that renewables programs hold the promise of addressing both affordability concerns and environmental concerns. OCA St. 6 at 36.

In PECO, the Commission adopted OCA witness Brockway's proposal for a renewables pilot program while championing the continuation of LIURP programs. See PECO at 147. Consequently, the Company's assertion that installation and maintenance of PV units warrants its reluctance to implement a renewables pilot should be disregarded.

iv. Increased Funding For Lower-Income Customers

PP&L has a budget for its WRAP program of $3 million and its Keep Warm program of $1 million. The Keep Warm program is for customers with incomes between 151% and 200% of federal poverty guidelines. OCA St. 6 at 30-31. OCA witness Brockway has recommended that the Company, although retaining flexibility to serve customers with incomes above 150% of federal poverty guidelines, should stress usage reduction among lower income customers. Id. at 40. By devoting a higher proportion of its overall LIURP funding to lower income customers and others with incomes below 150% and 100% of the federal poverty guidelines, the Company can better serve those customers at greater risk of losing electric service.

OCA witness Brockway states that in order to better target these lowest-income customers, the Company should 1) increase its overall budget from $4 million to a target 0.2% of revenues, or $4.7 million, thereby enabling more funds to be targeted to baseload customers and 2) reconsider its

proposed increase in the Keep Warm Plan portion of the LIURP budget. Id. at 41. PP&L currently spends about $534,000 on Keep Warm and proposes to increase this amount to $1 million by 1999. Id. However, the OCA submits that rather than expanding the Keep Warm program using LIURP dollars, the Company should institute the lease-fee (copayment) approach discussed below to expand Keep Warm. The Company should direct the proposed funding increase to a baseload component of WRAP to serve non-space heat, non-hot water customers with incomes at or below 150% of the federal poverty level. Priority should be given to the lowest income customers from this group. For higher-income customers, such as Keep Warm program customers, a lease-fee can be used to expand the number of participants without expanding the budget beyond acceptable limits.

v. Overall Budget

The OCA recommends that the Company increase the overall level of spending to $4.7 million per year for its LIURP programs (WRAP and Keep Warm) which brings its spending to 0.2% of revenues. PP&L currently has a budget of $4 million per year for its LIURP programs. This represents spending at a rate of 0.17% of gross operating revenues. OCA St. 6 at 31, PP&L St. No. 16 at 18. The OCA submits that in order to better target its baseload customers, an increase from $4 million to $4.7 million is required. In PECO, the Commission adopted OCA witness Alexander's recommendation that additional funding be provided for LIURP programs. PECO at 147. Consequently, it is not unreasonable to direct PP&L to moderately increase its LIURP funding level in this proceeding. The additional funding of $700,000 could be utilized for baseload usage reduction and PP&L's renewables pilot program. OCA St. 6 at 42.

vi. Keep Warm Copayment

OCA witness Brockway recommended that customers participating in the Company's Keep Warm program (a program directed at customers with incomes between 150% and 200% of federal

poverty guidelines) make a modest copayment.[29] OCA St. No. 6 at 38; OCA St. No. 6-S at 15. As OCA witness Brockway testified, the single most important benefit of a copayment is its ability to engage the customer more fully in the conservation effort. OCA St. 6 at 39. Rather than receiving a free service, the customer who takes the measure has made a greater commitment to the success of the savings. Id. at 39-40.

To be effective, a copayment should: 1) be collected on the bill and 2) provide an immediate positive payback. OCA St. 6 at 38. Collection on the bill limits the number of transactions which the customer must engage in to receive the program benefits. Additionally, to provide immediate positive payback, the monthly charge for the copayment must be less than the savings each month from the usage and corresponding bill reduction. Id. at 38-39. Once all required payments have been made, the customer will have sole ownership of the conservation measure whether it be fluorescent bulbs, ceiling fans or weatherization measures. Id. at 39. The OCA submits that even though a copayment approach is not a typical approach to low-income energy efficiency, it has been utilized elsewhere with positive results and should be tried in this case. The copayment approach could assist in expanding PP&L's Keep Warm Program without significant additional cost.

vii. Advisory Committee

Finally, the OCA recommends that PP&L create an Advisory Committee for its LIURP activities. Creation of an Advisory Committee (comprised of stakeholders and interested parties) would provide the Company with invaluable feedback as to the benefits and shortcomings of its LIURP activities.

d. The Benefits Of PP&L's CAP And LIURP Programs Should Be Portable, That Is, Available To A Program Participant Regardless Of

[29]The OCA realizes that for very low-income customers, even a small copayment may preclude participation in conservation efforts. OCA St. 6 at 40.

His/Her Generation Supply Provider.

PP&L has stated that its goal is to make CAP and LIURP programs available in some form to customers who purchase generation from alternative suppliers. PP&L St. No. 16 at 21. In PECO, the Commission approved of such "portability" and the OCA agrees that it is important that universal service benefits be portable so as not to hinder customer's ability to participate in a competitive market. See PECO at 147. As OCA witness Brockway testified, there are no insurmountable problems in making OnTrack and WRAP benefits available to customers which receive their generation supply from a provider other than PP&L. OCA St. 6 at 46. The portability of these benefits will ensure that OnTrack and WRAP participants are able to take part in the competitive market despite any financial constraints which these customers may be subject to.

With respect to OnTrack, the major issue to be determined is the actual bill of the customer. OCA St. 6 at 46. Since a portion of the bill, namely, the generation supply portion, will be independent of PP&L, it will be important to segregate this information. The OCA recognizes that various approaches can be utilized to ensure that the benefit is then provided to the customer. The OCA is willing to work with the Company and other parties to devise an appropriate solution. Regarding WRAP services, these would merely continue to be provided to the customer directly. Id. at 47.

e. PP&L's Universal Service Costs Should Be Shared By All Customer Classes Through A Non-Bypassable Charge.

i. Introduction

Initially, the OCA would note that universal service programs are beneficial to all customer classes. For example, some benefits that accrue to all consumers within the Company's service territory when electric service is made available to all at affordable rates are: 1) economic stability, 2) secure and stable neighborhoods and 3) better public health and safety. OCA St. 6-S at 20. Thus,

these programs provide broad-based public benefits, not just benefits to the residential class.

However, the Company has proposed to recover the costs associated with the universal service programs on a per customer basis. This method allocates the vast majority of these costs to the residential class. However, the OCA submits that PP&L's proposal to recover the costs of these vital programs almost solely from the residential class fails to recognize the benefits of these programs to the PP&L system as a whole and is inconsistent with the goals and requirements of the Customer Choice Act. While the OCA recognizes that the Commission in PECO allocated all universal service costs to residential consumers, the OCA respectfully submits that such a determination would not be appropriate in this case.

ii. Per Customer Allocation

An allocation of universal service costs to rate classes on a per customer basis allows more recovery of these costs from classes with greater numbers of customers, such as the residential class. The Company, as well as the PP&L Industrial Customer Alliance ("PPLICA") support this allocation of universal service costs. PPLICA St. 1R at 3. The OCA submits, however, that allocating universal service costs to classes with the largest number of customers effectively allows large industrial customers to bypass this cost. This was not the General Assembly's intent and should be avoided.

A per customer allocation of universal service costs results in a disproportionate allocation of universal service costs to the residential class. OCA St. 6-S at 15. For instance, a per customer allocation effectively allows primary and subtransmission customers to bypass contribution. OCA St. 6 at 43; Id at 16. These two classes, however, account for over one third of PP&L's sales. Yet, a per customer allocation based on $6-$7 million in universal service expenditures would only compel these major customer classes to pay $5,000 of the total expenditures. The OCA submits that as the

term "non-bypassable" is used in §§2802(17) and 2804(9), such a de minimis contribution allows these classes to bypass the universal service charge in contravention to the goals of the Act. OCA St. 6 at 43.

The OCA recommends that the Commission adopt an allocation of universal service costs which ensures that all customer classes contribute to universal service program funding in an equitable fashion. The OCA recognizes that the Commission, in PECO, directed that PECO's universal service costs be allocated to the residential class. The OCA submits, however, that the Commission's concern in PECO was with substantial cost shifting--that is, the Commission believed that since PECO's previous universal service costs had been allocated to residential customers, such an allocation should be continued. Although the OCA disagrees with the Commission's decision on several grounds, the OCA would note that in PECO, the Commission was largely addressing existing costs for existing programs that had been previously allocated to residential customers. Here, however, the OCA submits that the costs of PP&L's expanded programs--i.e., new costs, present a different issue for the Commission's consideration. The OCA submits that the allocation of all universal service costs to only one class under these circumstances violates the Act's requirements that universal service costs be fully collected through a non-bypassable mechanism. As OCA witness Brockway explained:

> The General Assembly requires that universal service program costs be recovered via a non-bypassable charge in the distribution utility's rates (§2804). The common understanding of the bypass problem is the risk that some customers will leave the distribution utility's facilities entirely, and leave their share of system costs behind. Thus, in choosing the word "non-bypassable", the General Assembly was incorporating the concept that all customers should cover the Universal Service costs.

OCA St. No. 6 at 43-44. As such, the OCA submits that PP&L's universal service costs should be recovered from all customers on an equitable basis.

iii. Kilowatt-Hour And Non-Production Revenue Allocation

In light of the Act's direction, the OCA initially proposed that a kWh allocation, i.e., allocation based on kWh usage, would be the most appropriate allocator. The OCA recognizes, however, that the Commission's final guidelines regarding universal service determined that such an allocation is not acceptable at this time. Final Order Re: Guidelines for Universal Service And Energy Conservation Programs Made Pursuant to 66 Pa.C.S. §§2803, 2802(17), 2804(8) and 2804(9) at 20, Docket No. M-00960890F0010 (Order entered July 11, 1997). Consequently, the OCA submits that while the kWh allocator would be a sound basis for allocation, a non-production revenue allocation could also be used to meet the intent of the Act. As will be explained below, a non-production revenue allocation will more effectively ensure that all customer classes equitably contribute to universal service funding. The non-production revenue allocation allocates a larger share of universal service costs to the residential class than the kWh allocator, but it is far superior to a per customer allocation recommended by the Company. Moreover, the non-production revenue allocator should satisfy the goals of the Act, as well as the concerns of the Commission.

A non-production revenue allocation would be based on each class' relative non-production revenues. OCA St. 6-S at 20. In other words, it would be based on each class' relative combined transmission and distribution revenue requirement, but would exclude the portion of the revenue requirement which has been functionalized as production related, i.e., generation. Id. at 21. Consequently, this allocation would only include those costs which remain subject to price regulation as the basis for the allocation. OCA Exhibit NB-Surrebuttal-1 utilizes pro forma revenue requirements and illustrates how a non-production revenue allocation would impact the Company's customer classes. Although a kWh allocation would allocate about one-third of universal service costs to the residential class, the non-production revenue allocation set forth in Exhibit NB-

Surrebuttal-1 would allocate over half of these costs to the residential class. Id. at 22. As can be seen, use of a non-production revenue allocator would require a larger contribution from the residential class, but would provide for a smaller contribution from the other classes than would a kWh allocator. Consequently, the OCA submits that a non-production revenue allocation is a viable and preferred alternative to the Company's per customer allocation should the Commission elect to refrain from utilizing a kWh allocation to recover universal service costs.

The Company and PPLICA have argued that the utilization of a per customer allocator to recover universal service costs is the only equitable and lawful result. PP&L and PPLICA assert that utilization of any allocator besides a per customer allocator will result in intra- and inter-class cost shifting. PP&L St. No 3-R at 36; PPLICA St. 1R at 5. However, as explained above, neither a kWh allocator nor a non-production revenue allocator would result in inter- or intra-class cost shifting. Furthermore, neither allocator would result in an inequitable or unlawful outcome under the Act.

Mr. Baron also argues that implementation of any allocator other than a per customer allocator would violate the rate cap provisions set forth in the Act. PPLICA St. 1R at 5-6. However, although witness Baron submits that utilizing an allocator other than a per customer allocator would violate one or both of the rate caps, this assertion is completely without merit. Contrary to witness Baron's interpretation, Section 2804(4), does not require that all allocation schedules used in the last rate case be followed in this case or even throughout the rate cap period. OCA St. 6-S at 17[30]. Rather, the OCA submits that as long as allocation of universal service costs does not result in a customer's rates exceeding either of the rate caps, the first of which is on total charges, the Commission may use any individual cost allocator which it deems appropriate. Id. at 17-18. The

[30]The only costs which must be allocated in the same way as they were allocated in prior rate cases are stranded costs. See 66 Pa.C.S. §2808(a).

OCA submits that a kWh allocation or a non-production revenue allocation would satisfy the goals of the Act.[31]

Finally, PP&L witness Kleha and PPLICA witness Baron argue that traditional cost causation principles require that these costs be allocated primarily to the residential class. PP&L St. No. 3-R at 35-36; PPLICA St. No. 1R at 5-6. Cost causation principles are premised on the notion that costs should be recovered from those responsible for the costs. Following this logic, however, would assign the cost of all universal service programs to the universal service recipients themselves, thus eliminating any bill reductions or benefits. OCA St. 6-S at 18-19. Nevertheless, witness Baron continues to argue that the residential class should bear the responsibility for universal service funding because only residential customers benefit. Notwithstanding the overall benefits of universal service outlined above, Mr. Baron ignores the fact that the residential class is comprised of low-income, middle-income and high-income customers. OCA witness Brockway explained this flaw in Mr. Baron's argument as follows:

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

Id. Consequently, PP&L's and PPLICA's arguments must fail.

VIII. CONCLUSION

---

[31]PPLICA witness Baron also asserts that the General Assembly's direction for use of a non-bypassable charge to collect these costs is to be permitted, though not required, by the Act. Witness Baron submits that § 2802(17) is intended to permit implementation of a non-bypassable charge to recover universal service costs, but does not require implementation of such a charge. PPLICA St. 1R at 7. However, this assertion is unsupported by a plain reading of §2802(17) of the Act. A plain reading of the statute reveals that it is intended to establish that EDCs be permitted full recovery of these costs. Contrary to witness Baron's assertion, the word "permitted" is intended to modify cost recovery not non-bypassibility. OCA St. 6-S at 16.

WHEREFORE, the Office of Consumer Advocate respectfully submits that OCA's recommended modifications to PP&L's restructuring plan should be adopted.

Respectfully submitted,

James A. Mullins
Assistant Consumer Advocate

Craig R. Burgraff
Senior Assistant Consumer Advocate

Counsel for:
Irwin A. Popowsky
Consumer Advocate

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

Dated: February 11, 1998
45470

STRANDED COSTS ($000)

	Company Claim	OCA Adjustments	OCA Adjusted Amount
Nuclear	(2,851,961)	1,799,646	(1,052,315)
Fossil	(718,219)	1,566,323	848,104
Land value	0	66,089	66,089
NUG	(856,870)	282,162	(574,708)
Regulatory Assets	(383,911)	124,662	(259,249)
Nuclear Decommissioning	(123,657)	15,532	(108,125)
Total NPV in 1999 $	(4,934,618)	3,854,414	(1,080,203)

STRANDED COST CALCULATION -
REGULATORY ASSETS
($000)

	Company Claim	OCA Adjustments	OCA Adjusted Amount
Unrecovered Energy Costs	$80,150	$(62,946)	$17,204
Post-Retirement Benefits	14,496	0	14,496
Susquehanna Operating Costs	12,836	0	12,836
Common Plant			
Nuclear	17,896	0	17,896
Other Production	324	0	324
Retired Miners' Healthcare Costs	6,582	0	6,582
DOE Assessment	22,923	(22,923)	0
Deferred Refueling Costs	8,343	(8,343)	0
Voluntary Early Retirement Costs	15,190	0	15,190
Employee Transition Costs	22,279	(18,796)	3,483
Rate Case Expenses	184	(184)	0
Taxes Recoverable			
Nuclear	570,145	(104,660)	465,485
Other Production	157,299	(23,703)	133,596
Regulatory Liabilities			
Nuclear	(73,425)	7,820	(65,605)
Other Production	(27,853)	1,895	(25,958)
Total PUC Amortizations (1999-2024)	$827,369	$(231,840)	$595,529
Net Present Value (NPV) in 1999 $	$383,911	$(124,662)	$259,249
	@ 7.92%		@ 7.24%

STRANDED COST CALCULATION -
NON-UTILITY GENERATION (NUG)

	Company Claim	OCA Adjustments	OCA Adjusted Amount
Cost of Purchase (1999)	168,576		n.a.
Market Value (1999)	63,901		n.a.
Cost in Excess of Market Value (1999)	(104,675)		n.a.
Less: Buy-out Payments (1999)	(20,732)		n.a.
Total (Deficiency) /Excess (1999)	(125,408)		n.a.
PUC Jurisdictional Percent (1999)	96.76%	0.7880%	95.97%
PUC (Deficiency) /Excess (1999)	(121,345)		n.a.
Summation of (Deficiency) /Excess Amounts	(924,321)		n.a.
Discount Rate	7.92%	0.6800%	7.24%
Net Percent Value (NPV) in 1999 $	(856,870)	282,162	(574,708)

STRANDED COST
CALCULATION - FOSSIL + NUCLEAR

	Company Claim	OCA Adjustments	OCA Adjusted Amount
Revenue Required (1999)	1,585,384		n.a.
Market Revenue (1999)	984,922		n.a.
Total (Deficiency) /Excess (1999)	(600,462)		n.a.
PUC Jurisdictional Percent (1999)	87.34%	7.71%	79.63%
PUC (Deficiency) /Excess(1999)	(538,493)		n.a.
Summation of (Deficiency) /Excess Amounts	(6,620,317)		n.a.
Discount Rate	7.92%	0.68%	7.24%
Net Percent Value (NPV) in 1999 $	(3,570,180)	3,365,969	(204,211)
Land Value	0	66,089	66,089
Total generation stranded cost	(3,570,180)	3,432,058	(138,122)

STRANDED COST
CALCULATION - FOSSIL

	Company Claim	OCA Adjustments	OCA Adjusted Amount
Revenue Required (1999)	864,533		n.a.
Market Revenue (1999)	658,221		n.a.
Total (Deficiency) /Excess (1999)	(206,312)		n.a.
PUC Jurisdictional Percent (1999)	94.15%	-11.94%	82.21%
PUC (Deficiency) /Excess(1999)	(194,243)		n.a.
Summation of (Deficiency) /Excess Amounts	(950,483)		n.a.
Discount Rate	7.92%	-0.68%	7.24%
Net Percent Value (NPV) in 1999 S	(718,219)	1,566,323	848,104

STRANDED COST
CALCULATION - NUCLEAR

	Company Claim	OCA Adjustments	OCA Adjusted Amount
Revenue Required (1999)	720,851		n.a.
Market Revenue (1999)	326,701		n.a.
Total (Deficiency) /Excess (1999)	(394,150)		n.a.
PUC Jurisdictional Percent (1999)	87.34%	8.88%	78.46%
PUC (Deficiency) /Excess(1999)	(344,251)		n.a.
Summation of (Deficiency) /Excess Amounts	(5,669,834)		n.a.
Discount Rate	7.92%	0.68%	7.24%
Net Percent Value (NPV) in 1999 $	(2,851,961)	1,799,646	(1,052,315)

CERTIFICATE OF SERVICE

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

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

Dated this 12th day of February, 1998.

SERVICE IN PERSON 2/12/97

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

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

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

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

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

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

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

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

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

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

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

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

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

SERVICE BY FIRST CLASS MAIL, POSTAGE PREPAID 2/12/98

Eric Epstein
2308 Brandywine Drive
Harrisburg, PA 17110

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

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

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

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

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

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

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

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

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

SERVICE BY FEDERAL EXPRESS 2/11/98

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

James A. Mullins
Assistant Consumer Advocate

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

41338

APPENDIX A

PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17105-3265

Public Meeting held December 11, 1997

Commissioners Present:

John M. Quain, Chairman, Joint Statement and Dissent attached
Robert Bloom, Vice Chairman , Joint Statement and Dissent attached
John Hanger
David W. Rolka, Statement attached
Nora Mead Brownell, Statement attached

Application of PECO Energy Company for Approval of its Restructuring Plan Under Section 2806 of the Public Utility Code and Joint Petition for Partial Settlement	R-00973953
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	P-00971265

OPINION AND ORDER

If we can assume that the figure of 2.60 cents per kWh referenced by Mr. Cohn includes the award in PECO's base rate case determined in 1990[50] then that figure would represent the Commission's approved rate in effect on January 1, 1997, after considering any adjustments which have been approved since our order in 1990. Those adjustments would not increase the T&D rate to the level of 3.11 cents. However, after adjusting general and overhead expenses with a proper allocation method, the OCA figure on surrebuttal of 2.93 cents[51] is closer to the statutorily required rate than that proposed by PECO.

The OCA methodology was generally described in its direct testimony as follows:

> A substantial percentage of these costs [A&G] should be allocated to the production function as well. Costs in these accounts are not easily identifiable with particular operating functions. They include salaries and office supplies for personnel in administrative functions such as human resources, legal, or accounting. These activities contribute to the generation function as well as distribution and transmission. Generation planners and marketers make use of these administrative functions and expenses. An appropriate functionalization of these accounts is one based on the total labor costs in each utility function.

OCA St. No. 4, pp. 4-5.

The OCA adopted a labor allocation approach to A&G functions. In 1996, 66% of all directly functionalized labor was in the generation function. Accordingly, the

---

[50] We are aware that PECO filed and was awarded an increase in base rates as a result of a single issue filing since 1990. See Order at Docket No. R-00922479 entered December 1, 1994. However, that proceeding did not result in a T&D rate of 3.11 cents. The 2.60 cent rate alluded to by Mr. Cohn is closer to the latest Commission approved T&D rate than 3.11.

[51] OCA Exh. LS-12.

OCA used a 66% allocation factor of A&G expense to generation. OCA St. No. 4, p. 6; OCA St. No. 4S, pp. 2-3.

In determining to adopt the OCA position on surrebuttal, we are mindful that we have not modified PECO's proposed allocations for uncollectibles, customer accounts, customer service and sales. Although several witnesses, notably Mr. Reising and Mr. Mitnik, make strong arguments for unbundling the customer accounts and customer services charges at this time, we will not do so. We also will not alter PECO's treatment of its sales expense. In this context we note that PECO's T&D rates continue to be subject to Chapter 13 of the Public Utility Code and, subject to the Act's rate caps, parties may challenge existing rates. Also, we would expect that as functions continue to be unbundled, PECO's rates may be reexamined to determine if they provide for charges which encompass generation or other unbundled services.

It is equally important to note that PECO's revised proposal has provided for the funding, in part, of its Universal Service program through its uncollectible expense. PECO St. No. 12-R, pp. 11-13; PECO St. No. 14-R. Although we are cognizant that consistent application of the methodology directed herein could also require allocation of a significant portion of the uncollectible expense, we believe that a careful balancing of the interests of the parties and the record in this case permit us to allow PECO's and the OCA's treatment of this expense. However, it is possible that a different result could occur if the balance were altered. At this time, however, we will accept PECO's treatment of the uncollectible expense given its role in the funding of the Universal Service program and the substantial public interest in that program. We are also mindful that Section 2804(9) of the Act, 66 Pa. C.S. §2804(9), requires appropriate funding of Universal Service mechanisms.

Our adoption of the OCA methodology and adjustments results in a reduction of the T&D rate from the PECO revised number of 3.11 cents/kWh, to the OCA adjusted figure of 2.93 cents/kWh. Exh. LS-12. Several parties assert that this reallocation of expense to generation does not increase PECO's stranded costs or should not be recovered. We disagree. See PECO St. No. 12-R, p. 9; PECO St. No. 1-R. Subject to receipt and review of PECO's compliance filing, we conclude that this will result in an increase to PECO's stranded costs of approximately $460,691,000.[52] This amount is to be included as part of PECO's stranded cost recovery.[53]

The compliance filing must include one final adjustment to the T&D rate resulting from the OCA methodology. Further below in this Opinion and Order, we discuss our adoption of PECO's proposed alternative for funding nuclear decommissioning costs. In that discussion, we provide for an annuity approach which will be collected through regulated rates.

5. Conclusion

In this Section, we have described why PECO's proposed plan must be modified regarding the treatment of Transmission and Distribution rates. We have also provided specific direction to PECO on its allocation methodology to assist PECO in addressing our modification. Accordingly, PECO's compliance tariff is expected to incorporate these modifications.

---

[52] In its compliance filing, PECO is directed to remove all return dollars from the A&G expense allocated to production in this Order. OCA Stmt. 4S, Exhibit LS-8, contains items to be presented in PECO's compliance filing on an expense or capitalized basis.

[53] This adjustment of approximately $460,691,000 is included into the stated total of $5.024 billion recoverable stranded costs, but not in the subtotal of $2.679 for stranded generation assets. The accepted compliance filing will establish final numbers.

PECO claims as a regulatory asset $69.7 million of deferred fuel costs and $22.3 million for its nuclear performance incentive actually recognized on the company's books for the period ending 12/31/96 when the ECA was rolled into base rates. No party disputes PECO's right to recover this claimed stranded cost that previously was approved by the Commission in the May 22, 1997 QRO Order. In the QRO Order, the Commission granted interest to the net present value date of 12/31/98. Since the QRO Order is irrevocable, the same amount should be granted in this proceeding.

PECO also claims recovery of $22.0 million for annual deferred fuel expense through 12/31/98 when competition begins and of $22.7 million annually through December 31, 2005. This claim is to recover "the amount by which the Company's average energy costs rolled into base rates from its ECA understated its projected energy costs for the 9-year period from January 1, 1997 to December 31, 2005."

PAIEUG witness Kollen and OCA witness Catlin and La Capra agree with PECO that fuel expenses through December 31, 1998 reflect a potentially unrecovered cost because there no longer will be an ECA adjustment in which to reconcile PECO's actual fuel costs thereafter. However, both witnesses Kollen and La Capra conclude that the ECA permits recovery only based on actual experience and documentation of such costs. Under traditional ratemaking, the ECA cannot grant with finality any future anticipated fuel cost. At this point in time, there is no "known and measurable" fuel cost since the expenses have not yet been incurred. As under traditional ratemaking, PECO cannot claim that it would have collected any specific amount of increased fuel costs in the future. Thus, undetermined future expenses cannot qualify as recoverable stranded costs under the Act. We agree with these arguments that the Commission has no statutory basis for allowing recovery of unknown, future fuel costs, and the claim must be denied.

In addition, PECO's claim for recovery of fuel costs from January 1, 1999 through December 31, 2005 must be denied because it is the market that will determine the amount of generation costs, including fuel costs, that will be recovered during this period. Fuel costs are an important component of the future value of generating plants and have been considered in determining the amount of PECO's generation plant that will be stranded.

Lastly, it is appropriate to recognize that Section 2804(4)(iii)(D) provides an exception to the rate cap for customers purchasing generation from PECO if there are significant increases in fuel costs outside of the utility's control that would not allow the utility to earn a fair rate of return. In addition, Section 2804(4)(v) provides that when a utility rolls its ECA into base rates in compliance with the rate cap, and then experiences excess earnings within its capped rates, the utility may retain such excess earnings rather than being subject to a rate reduction if the Commission determines that the excess earnings are being used to either mitigate transition costs or cover known and measurable cost increases not included within the capped rates. Certainly, neither of these contingencies are applicable at this time, but the existence of these options protects PECO from loss due to future increases in fuel costs to serve its regulated customers. The existence of these statutory protections for PECO further supports our conclusion that unknown, future fuel costs are not recoverable stranded costs.

iii. SFAS 106 Deferred Costs.

PECO claims recovery of two SFAS 106 regulatory assets. The first claim is for $32.615 million for the unamortized balance of certain 1993 and 1994 deferrals. The Commission granted deferred recovery of this regulatory asset pursuant to a

PAIEUG witness Kollen also has identified a regulatory liability for SFAS 106 trust fund earnings.[62] These earnings represent amounts recovered from ratepayers prior to the Company's associated cash expense. According to witness Kollen, PECO continued to overcollect from ratepayers even after the overfunding became apparent and contributions to the fund were reduced. Under traditional ratemaking, consumers would receive credit against future expenses for these earnings. As such, they should be treated as a regulatory liability at this time. Since generation will no longer be under traditional cost-based regulation, customers would lose these credits if we did not allow them in this proceeding. Mr. Kollen calculated this amount as $150.861 million, and we adopt his adjustment.

b. Non-Utility Generation Contracts

PECO does not claim any stranded costs related to non-utility generation contracts or existing Purchased Power Contracts because its contracts generally require market pricing. PECO asserts, and no party introduced any evidence in the record to the contrary, that PECO's existing purchased power commitments are not above projected market prices and therefore do not expose the company to any related stranded costs. Thus, the Commission finds that PECO incurs no stranded costs related to NUG or other Purchased Power contracts.

We note that OCA witness La Capra testified that some of PECO's existing Power Purchase contracts may in fact be below-market prices, yielding PECO with a negative stranded cost that could and should be "netted" against other generation related stranded costs incurred by PECO. There is not, however, any evidence in the record concerning the actual contract prices, so no adjustment is appropriate.

---

[62] PAIEUG Stmt. No. 3, pp.31-34.

c. Nuclear Decommissioning Expense.

Under traditional regulation, consumers contribute to a nuclear decommissioning trust fund to ensure that the full amount necessary to decommission a nuclear plant is available. PECO claims $233.8 million for underrecovery through 12/31/98 for the nuclear decommissioning expense, reflecting PECO's ownership in Limerick 1 and 2, Peach Bottom 1, 2 and 3, and Salem 1 and 2. We agree with PECO's basic proposal that consumers should be responsible to fund that portion of nuclear decommissioning expense associated with the period in which the plants were in service to the public, through January 1, 1999.[63] Similarly, we agree with PECO's proposal that it, or its affiliate or future owners of each plant, should be responsible for that portion of the decommissioning cost related to its remaining useful life. Post-1998 decommissioning expenses are properly reflected as a future operating expense that affects the market value of the plants.

PECO bases its claim for underrecovery of nuclear decommissioning costs on its most recent projection of the timing and expense of decommissioning the plants and the contributions made by consumers to the decommissioning trust fund to date, based on the testimony of witness LaGuardia, although PECO proposes several modifications that are reasonable. PECO proposes two methods for recovering these costs.

First, PECO identifies recovery of nuclear decommissioning expenses as a stranded cost. If this approach is used, PECO indicates an existing underrecovery of

---

[63] PECO Stmt. No. 3 at 13.

$233.8 million through 12/31/98.[64] In addition, PAIEUG witness Kollen argues that decommissioning expenses will not all exist on the first day of decommissioning, such that the trust fund will continue to accrue earnings until fully spent.[65] We agree that such earnings should be credited to consumers if the stranded cost approach is adopted.[66]

However, we prefer to adopt PECO's alternative approach to fund nuclear decommissioning expense. PECO witness Cohn,[67] Navy witness Smith,[68] and PAIEUG witness Kollen[69] all express concern that recovery of nuclear decommissioning expense as a stranded cost may preclude favorable IRS and NRC treatment. They are concerned that contributions to the fund may not be qualified contributions for direct deposit, receiving favorable tax treatment. In addition, trust fund earnings could be taxed at a higher rate. PECO suggests, and the other witnesses agree, that the tax benefits can be retained if contributions are considered as annuities collected through regulated rates. PECO has indicated that annual contributions of $22.7 million as an annuity payment to the trust fund would provide for full funding.[70]

We therefore adopt the annuity approach. PECO agrees that it does not need to request any recovery of stranded costs related to underfunding of nuclear decommissioning expense with this approach. Instead, PECO will continue to collect

---

[64] This is a revised amount based on PECO's acceptance, through the rebuttal testimony of Mr. Cohn, that PECO mistakenly failed to include trust fund earnings of $2.918 million through 12/31/98. PECO St. 3-R. This revision is based on PAIEUG witness Kollen's testimony. PAIEUG, St. 3.

[65] Mr. Kollen has calculated a net present value of these additional earnings of $32.940 million.

[66] This adjustment is consistent with Commission precedent, most recently adopted in the 1994 PP&L rate case at Docket No. R-943271.

[67] PECO Stmt. No. 3 at 13-14.

[68] Navy Stmt. No. 1 at 23; Navy Stmt. No. 1-R at 13.

[69] PAIEUG Stmt. No. 3 at 47, PAIEUG Stmt. No. 3S at 20-21.

[70] PECO Stmt. No. 3 at 16, No. 3-R at 26; Navy Stmt. 1 at 23.

$22.7 million annually as a regulated cost of service rate. Since an almost identical amount already is included in rates, there is no net rate effect. We adopt this approach because it utilizes tax benefits to fund nuclear decommissioning expense in full while requiring a lower annual consumer contribution.

d. Stranded Costs Recovery Pursuant to Section 2808(3)

i. Utility Generation

a. Methodology

PECO claims a total book value of $6.688 billion in generation assets and that $3.825 billion of those assets will be stranded. The amount of utility generation plant investment that will be stranded is the net difference between the depreciated value of the investment on the company's books as of 12/31/98 and the future market value of those assets. Thus, it is necessary to determine the book value of PECO's generating assets as of 12/31/98 and compare that value to its value upon restructuring.[71]

b. Present book value

We generally accept PECO's documentation of the depreciated value of the company's generation plant on its books based on PECO witness Cohn's testimony. However, two adjustments are appropriate, as described below, resulting in a total book value as of 12/31/98 of $ 6.639 billion.

---

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

such as capital, operations and maintenance, or taxes, are falling in either real or nominal terms.

Thus, we must conclude that neither witnesses Hieronymus nor Bustard provides reasonable testimony upon which we can make a decision. PECO's third witness, Mr. Venkateshwara (ICF), provides stronger testimony. However, we conclude that it cannot provide the basis for our decision in this proceeding without some of the modifications suggested by other witnesses in this proceeding.[84]

Moreover, PECO replaced ICF witness Venkateshwara with witness Rose beginning with the rebuttal round of testimony. Witness Rose replaced ICF's own fuel forecast prices initially presented by witness Venkateshwara with the lower fuel price estimates issued in the spring, 1997 forecasts by DRI. While we make no finding that either fuel forecast is more reliable than the other, we do conclude that the inadequately explained change casts doubt on the ICF recommendation presented through witness Rose. As witness Falkenberg concluded, the change is an example of "the ephemeral nature of PECO's increasingly results oriented assumptions." [85]

We have reviewed the record concerning this issue in extraordinary detail in order to make a factual finding of the future market value of PECO's generating assets that is supported by the evidence. Our conclusion requires the exercise of judgment based on the evidentiary record.

---

[84] We consider witness Venkateshwara's testimony, as modified by the recommendations of other witnesses, useful as a diagnostic "check" on the reasonableness of our resolution of this issue.

[85] PAIEUG Stmt. 2S at 64.

Though there is no single proposal that we find completely convincing on every component of its analysis, we adopt the testimony of OCA witness Smith as the most reasonable determination of future market value in the record and therefore determine a market value of PECO's stranded generation plants of $ 3.96 billion as of 12/31/98. Witness Smith's testimony is the most credible, and least criticized of any of the other market value witnesses, and produces a result approximately midway between the other two most credible models. We are also convinced that witness Smith performed an objective analysis of the issues in this proceeding, a task that the Commission believes no other party truly performed. As he testified:

> My analysis is intended to assist the Commission by providing a balanced, non-utility perspective on generation market issues. My general approach in developing assumptions and methods used in the analysis was not, however, to develop a high bound or "counter" to the Company's analysis. As shown in my discussion of the costs and carrying charges associated with new generating units, I have sought a reasonable expected value outcome on each issue. I believe that I have chosen assumptions that have equal likelihood of being above or below the actual outcome.[86]

Witness Smith provided further evidence of the reasonableness of his recommendations and his overall credibility by not adjusting PECO's treatment of nuclear capacity factors and reserve requirements in a way that increases stranded cost recovery. Witness Smith did not recommend any adjustments to PECO's proposals even though adjustments would have reduced PECO's stranded cost recovery significantly and would have been consistent with his credible testimony in the May 22, 1997 QRO proceeding.[87]

---

[86] OCA Stmt. 2 at 26.

[87] The entire record of the QRO proceeding was admitted into the record of this case as IPL Exhibit 2.

In this proceeding, PECO assumed a reserve requirement of 18% and nuclear capacity factors consistent with industry averages, just as it did in the QRO proceeding.[88] In the QRO proceeding, the OCA argued that there was no factual basis for an 18% reserve requirement based either on PJM's historic or announced future requirements.[89] In the QRO proceeding, the OCA calculated that use of PECO's own actual nuclear performance factors instead of industry averages would reduce stranded cost recovery by $643 million.[90] We conclude that this discussion reaffirms our view that witness Smith recommended the most broadly reasonable result rather than advocating in every case an approach that would minimize stranded cost recovery by PECO.

The general "contribution margin" methodology used by witness Smith has not been challenged by any party, and no party opposes the model used by witness Smith. PAIEUG witness Falkenberg did not object to witness Smith's use of the ENPRO model, and PECO Witness Bustard testified that "the ENPRO model appears to be an adequate model for projecting market value."[91] The Commission is familiar with the ENPRO model and perceives it to be quite suitable to the task of estimating the generation market revenues for PECO.

We find that witness Smith's model fairly represents several other important matters such as unit commitment, NUG operations, fuel prices, imports and exports, and heat rates. The rebuttal testimony of PECO witness Hieronymus and Bustard and the surrebuttal testimony of witness Smith and PAIEUG witness Falkenberg leads us to conclude that witness Smith's testimony is the most reasonable presented in

---

88 PECO Stmt. No. 7 at 11.

89 OCA M.B. at 33 (QRO proceeding).

90 OCA M.B. at 35 (QRO proceeding).

91 Rebuttal testimony of witness Bustard, PECO Stmt. No. 4-R at 24.

the record of this proceeding. PECO witness Bustard indicates that witness Smith's capacity value projection "is relatively consistent with the projections of the three PECO models."[92] Witness Bustard indicates that witness Smith's all hours market value for energy is 9% higher than the three PECO projections when levelized over the period 1999 through 2015. We accept witness Smith's explanation that most of the difference is due to "differences in our input assumptions such as capital costs, O&M costs, and energy price."[93] In addition, we agree with witness Smith's approach to fuel use by dual fuel units, the cost of new generation, and the use of average heat rates. Lastly, we accept witness Smith's discount rate of 7.6% for this purpose as the most reasonable in the record. It is approximately the same as the 7.53% adopted by the Commission in our May, 1997 QRO decision and was also recommended by PAIEUG Witnesses Kollen and Falkenberg in this proceeding.

In adopting witness Smith's proposals, we emphasize that we are not adopting each and every assumption and input, however. We find substantial merit in several of the specific considerations utilized by witnesses Venkashwatara and Falkenberg and find that witness Smith's result best balances all of our considerations.

d. Summary of Net Stranded Utility Generation.

Applying the foregoing principles, we find that PECO's book value of generation assets is $6.639 billion. We conclude that these assets will have a market value of $3.96 billion, resulting in a total stranded cost of utility generation of

---

92 Id.

93 Surrebuttal testimony of witness Smith, OCA Stmt. No. 2S at 5.

$2.679 billion.[94] This is the amount of utility generation assets that must be considered for "just and reasonable" recovery.[95]

ii. Fossil Decommissioning Expense

PECO claims recovery of $126.6 million in stranded costs for future fossil decommissioning expenses. The definition of "transition or stranded costs" in Section 2803 of the Act includes "retirement costs attributable to the utility's existing generation plants" other than nuclear decommissioning costs as a potentially recoverable stranded cost within the Commission's discretion under Section 2808(c)(3).

However, the Commission finds that PECO's claim for separate recovery of future costs related to fossil plant decommissioning expenses cannot be approved, because future or prospective fossil plant decommissioning expenses are not traditionally recognized in rates in Pennsylvania.[96]

Under traditional regulation, consumers do not necessarily pay any cost for fossil decommissioning, even when decommissioning actually occurs. No determination would be made by the Commission until the plant was in fact retired and the net salvage value can be determined. The net salvage value, whether positive or negative, would be included in the company's revenue requirement at the time. Thus, if PECO were claiming a decommissioning expense for a present fossil plant retirement, we could

---

[94] In the compliance filing, PECO is directed to adjust this amount to reflect the proper allocation of certain generation expenses that have been excluded from T&D expenses, as discussed in Section IV-C.

[95] This amount includes the 607 million previously authorized for stranded cost recovery of utility generation in the May 22, 1997 QRO.

[96] Penn Sheraton Hotel, Co., v. Pa. PUC, 198 Pa. Superior Ct. 618, 184 A.2d. 324 (Pa. Super. 1962).

determine the net retirement cost of the plant, including both decommissioning expense and net salvage value. However, PECO presents no such claim.

Prospective fossil decommissioning expenses are not recoverable under traditional ratemaking or as a stranded cost, because they are not "known and measurable" without a specific plan to decommission a particular plant at a particular time and in a particular manner. At this point in time, the record contains no evidence that any particular existing fossil plant will in fact have to be decommissioned at all, when such decommissioning might occur, the extent of decommissioning that will be required, the future use of the plant and its site, or the cost of the decommissioning found to be needed. At this point in time, no one knows whether a generation plant will require total dismantling to "greenfield" status or some other less expensive level of dismantling. Depending on the future use, existing plants connected to the transmission system and their sites may have significant residual "salvage" value, partly offsetting, or even surpassing any cost of decommissioning.

For these reasons, we agree with the recommendation of Navy witness Smith, OCA witnesses La Capra and Catlin, and PAIEUG witness Kollen that PECO's proposed recovery of potential fossil decommissioning costs does not meet the statutory definition of recoverable stranded costs and must be denied.

iii. Other Utility Transition Costs

PECO claims $25 million in transition costs for consumer education and an additional $8 million for legal and other expenses related to its restructuring filings.

directly mitigate PECO's stranded investment claim, because they lower the book value of the assets compared to what the book value otherwise might have been on 12/31/98.

PECO has lowered the book value of the Limerick nuclear plant through accelerated depreciation. By Opinion and Order entered on February 23, 1996, the Commission approved PECO's request to accelerate the depreciation on its investment in Limerick in recognition that much of the cost of Limerick would become stranded in future competitive markets. By January 1, 1999, PECO will have accelerated the depreciation on its base plant investment in Limerick during 1997 and 1998 by $161.6 million. PECO St.1, p.16. In addition, PECO will have reduced the book value of the Limerick common plant by $40.9 million and for early window costs by $22.7 million, for a total Limerick related accelerated depreciation during 1997 and 1998 of $225.2 million.[100] PECO St. 1, pp. 16-18. These efforts also directly mitigate PECO's stranded investment claim because they lower the book value of the assets compared to what the book value otherwise might have been on 12/31/98.

In addition, PECO proposes to transfer $176 million of overaccrued depreciation reserve from distribution to generation based on updated depreciation studies and calculated reserve levels. PECO St. 1, p. 19. While Section 2808(c)(4)(iii) of the Act identifies the reallocation of depreciation reserves as an example of mitigation, PECO's proposed reallocation is not a mitigation benefit to consumers. The proposed reallocation would increase future distribution expenses, inappropriately shifting distribution revenues to subsidize generation costs. It is therefore anti-competitive, and is not approved.

---

[100] PECO's stranded cost claim in this proceeding does not assume any additional mitigation of its investment in Limerick from 1999 forward through accelerated depreciation as contemplated in the Petition approved by the Commission in February, 1996.

provide PECO with substantial new opportunities to mitigate stranded costs. For example, Section 2808 identifies sale of generating assets as an appropriate mitigation effort, and PECO has indicated that it plans to transfer its generating assets to an affiliate.[101]

Additionally, PECO's generating assets have a residual value that will be available for PECO's use in easing its transition to competitive markets, even if such value was not directly quantified in the determination of the stranded cost. For example, a generating asset may have additional value because of existing connection to the transmission system or more intensive use of the site. Once stranded investment recovery is complete, PECO is free to operate, shut down, or sell the plant as it deems fit. Since the stranded plants are expected to have useful lives beyond the CTC recovery period, there may be a significant residual value of these assets available for PECO's use. This opportunity would not exist under traditional ratemaking. Under traditional ratemaking, PECO would credit the net revenues received upon sale of a consumer financed asset against the revenue requirement that consumers are expected to pay in the future.

In addition to the residual value of utility assets, PECO will have significant other earnings opportunities as a result of the transition to competitive markets. PECO also will be free to compete in competitive generation markets as well as unrelated industries. These financial opportunities are at least partly supported in the early years by ratepayer contributions that have enabled PECO to develop expertise, name recognition and other assets.

---

[101] Section 2808(a) makes the recovery of stranded costs for a generation asset "contingent on continued operation at reasonable availability levels of the generation facilities for which recovery has been approved, except when the generation facility is uneconomic on a production cost basis because of the transition to a competitive market." Thus, upon transfer, stranded costs associated with the asset would be removed from the CTC.

previously was a cost of capital based on debt and equity necessary to finance investment or expenses over a period of up to 30 years or more has been converted into a new regulatory asset, the CTC, to be recovered over a much shorter period. The capital at issue is fundamentally low risk, and the cost of that capital is more analogous to low cost debt or an "interest rate" based on the delayed receipt of CTC revenues. These differences serve to focus the underlying questions that we must address concerning this issue in this proceeding: 1) should PECO be permitted to collect a cost of capital on its recoverable stranded costs? 2) if so, should PECO be permitted to recover its full cost of capital, inherently based on the cost of its equity and providing a full return or full profit on its stranded costs? or 3) is it more appropriate for PECO to recover a cost of capital through the CTC that more closely reflects a low-risk debt rate?

We conclude that it is just and reasonable to include a cost of capital in our determination of the CTC in order fully to reimburse PECO for the authorized principal amount of recoverable stranded costs.[107] We have concluded that PECO should receive a rate of return on the unamortized balance of its authorized recoverable stranded costs at a rate consistent with PECO's receipt of payment and the risk of non-recovery. The duration and risk associated with long-term debt is commensurate with that associated with the CTC recovery during the transition period. We substantially agree with PECC witness Mitnick's characterization of this issue:

> I question whether the cost of capital is the proper discount rate to use on a stream of riskless income. With stranded cost recovery under the true-up provision there is no risk that the

---

[107] The Act is silent concerning whether any cost of capital may be, may not be or must be collected as part of the CTC, and if so, how this Commission is to determine the appropriate cost of capital to be included. In contrast, Section 2812(g) explicitly requires the recovery of all capital costs and transaction expenses related to the issuance of transition bonds. In addition, the definition of "transmission and distribution costs" in section 2803 "includes the return of and return on facilities."

based on their perception of the need to "jump start" or "forestall" competition. We think it preferable to avoid an approach that would so directly affect the market. We prefer to adopt a levelized amortization of recoverable stranded costs so that market participants are not faced with changing financial considerations other than the real market price of electricity.

d. CTC Revenue Allocation and Recovery

Section 2808(a) directs that "every customer accessing the transmission and distribution network shall pay a competitive transition charge. Additionally, "the costs to be recovered shall be allocated to customer classes in a manner that does not shift inter-class or intra-class costs and maintains consistency with the allocation methodology for utility production plant accepted by the Commission in the electric utility's most recent base rate proceeding."

We accept generally PECO's proposal for CTC revenue allocation based on compliance with the foregoing principles and our discussion concerning unbundling. PECO witness Sundermeir proposes to collect the CTC as a per kwh charge with blocking based on usage for residential customers and on demand for commercial classes.[114] OCA witness Smith[115] and the Environmentalists[116] note that different customer classes may have differing levels of kwh growth over the transition period. In order to minimize any possible cost shifting, we continue the approach that we utilized in the QRO proceeding, and recommended in this proceeding by OCA witness Smith, to allocate the CTC revenue requirement to each tariff class based on 1997 sales, and then reconcile actual revenues on a class basis.

---

114 Xander Direct, PECO Stmt. No. 14 at 8-9.

115 OCA Stmt. No. 4 at 11-12.

116 Environmentalists Brief at 15.

We agree with PECO's proposal that the CAP discount must be allocated to each component of the current bill upon unbundling.[142] All CAP customers must have the opportunity to choose a competitive supplier. In its compliance filing, PECO shall indicate a fixed percentage of the dollar value of any CAP discount, as the level of discount may change from time to time, that will be applied to the distribution, CTC, and generation portion of the bill. The discount allocated to the generation portion of the bill will be portable if the customer chooses an alternative supplier.

We agree that LIURP is a cost-effective program that should be continued, as modified by the proposals of OCA witness Brockway, at an annual funding level of $5.6 million, including a renewables pilot program. We adopt the Environmentalists' proposal that customers with usage over 110% of class average shall be eligible for LIURP, but this does not mean that all services must be provided to all participating households or that prioritization is not appropriate.

We generally support the use of community based organizations to deliver universal service and conservation related programs. However, we are constrained by statute and by experience to assure that proper financial and managerial controls are implemented. 66 Pa.C.S. §2804 (9) states:

> The commission shall encourage the use of community-based organizations that have the necessary technical and administrative experience to be the direct providers of services or programs which reduce energy consumption or otherwise assist low-income customers to afford electric service. Programs under this paragraph shall be subject to the administrative oversight of the commission which will ensure that the programs are operated in a cost-effective manner.

---

142 Xander Direct at 7.

To the extent that community based organizations are utilized in the delivery of universal service and energy conservation policies, activities or services, PECO shall require (in addition to any other reasonable requirements it may impose), that such community based organizations agree in writing to make all books, records and receipts related to such participation and funding available for inspection, review and duplication by PECO and the Commission. CBOs shall also undertake in writing to keep books and records according to generally accepted principles. Such books and records shall be audited annually by an independent licensed professional accountant or auditor. Such annual audit reports shall be made available to PECO, the Commission and the public upon request.

K. Consumer Education

1. Introduction

The promise of customer benefits from electric competition will only be fulfilled through a comprehensive education program. This important policy consideration in the implementation of electric competition was thoroughly discussed during the legislative debate and the final passage of the Act. The expectations of the Act are significant and the Commission and PECO must endeavor to meet those expectations. There are a number of key policy issues which need to be addressed.

The customer education process must have specific direction so the industry, consumers and this Commission can be assured that education efforts are designed to reach all customers in ways which are most responsive to their cultural and educational needs. Since program expenditures will be recovered from ratepayers, the Commission has an obligation to determine whether the consumer education funds meet

Before we set forth the specific guidelines of the consumer education program, we applaud PECO Energy for its efforts to address this issue. We commend the willingness of PECO to develop a meaningful consumer education program -- one which links PECO Energy's historical resources and good will with the community at large.

We also recognize that PECO proposes to spend $24 million over three years toward consumer education programs. This calculates to be approximately $5.33 per customer per year. This level is the highest per capita commitment in the country. If this formula was applied statewide, the consumer education budgets of the EDCs would be $84 million. The Commission wishes to commend the Company for its significant efforts to recognize the importance of consumer education in the implementation of electric competition. However, the focus and allocation of resources is as important as the amount of resources.

2. **Issues**

There are two primary issues discussed in this record which are critical components to the overall goal of effective consumer education. They are: 1) A statewide plan for consumer education; and 2) a local consumer education plan including the role of community based organizations. It is important to note that the statewide plan and the local plan must contain adequate feedback and formal evaluation mechanisms, as well as auditing and review mechanisms as discussed above for CBO's providing universal service and conservation programs, in order for the Commission to determine the success of the program.

a. Statewide Consumer Education Plan

The $24 million proposed for PECO's Customer Education Plan includes the following: television, radio, cable, newspaper and magazines. In this electronic age, consumer education does not recognize geographic boundaries. This geographic issue alone begs for a statewide approach for the use of mass media in consumer education.

In addition to the geographic reasons, this approach makes sense for two other reasons. First, economies of scale work in the advertising business as well as the utility business. A coordinated statewide approach should lower the costs for all the EDCs. Second, a statewide approach to these highly visible tasks insures a consistent, honest and competitively neutral approach to consumer education. We find that a statewide program to fund consumer education using these media is both practical and effective.

This statewide approach to centralizing mass media education had its genesis during the electric restructuring pilot program. There was a significant concern that customers would respond to deregulation in the same manner as had been experienced by other states who had previously undergone this process; i.e. mass confusion, low interest, and pilot program quotas not being met. We challenged the industry to expand consumer education efforts by informing consumers throughout the state that electric generation competition was beginning, and to encourage immediate enrollment in the pilot program.

The Pennsylvania Electric Association (PEA) developed a strategy with our input to use two TV commercials with very distinct objectives. The strategy was to raise awareness of the pilot programs, and to alert consumers to direct mailings that would

follow from the individual companies. The second television commercial was developed as a reminder to those consumers chosen for the pilot program to select a supplier. The results were overwhelming. Within the two week enrollment period, Pennsylvania's electric utility pilot program achieved an overall response rate of over 17%, almost four times the planned goal of 5% per company. Over 900,000 Pennsylvanians chose to participate in a pilot program with only 254,000 openings. In the first phase of the pilot, approximately 70% of the customers who enrolled in the pilot program selected a generation supplier. We commend PECO for their vision in participating in this program. This level of customer participation exceeds that of any other state in the nation.

This statewide approach should be administrated from a financial and technical perspective by the PEA. During the electric pilot program PEA demonstrated their ability in coordinating the mass media education effort, and, while we cannot order them to do so, we would like to request them to step forward and take charge of this effort on behalf of the member companies. If the PEA declines this responsibility, an alternate mechanism may be created to manage this effort. PECO is therefore directed to appropriate 65% of the consumer education budget, or $15.6 million dollars, over the phase in period.

The content of the mass media campaign will be directed by a committee comprised of the following organizations: The Office of Consumer Advocate (OCA), the President of PEA, the Executive Director of the Energy Coordinating Agency of Philadelphia, the Chair of the Consumer Advisory Council, and the Chairman of the Commission. The Commission will have final authority over the final content of all consumer education advertising. The Committee will be directed to create a mechanism to track the success of this program and submit it to the Executive Director of the Commission for approval.

b. Local Consumer Education Plan

While 65% of the consumer education budget is allocated to the statewide effort, local community based efforts must also be encouraged. Therefore, PECO is directed to use 35% of its consumer education budget toward local efforts.

Local efforts may include community based organizations (CBOs) and other consumer interest groups to assist in the education of all Pennsylvania consumers. PECO's desire to use CBOs in their consumer education process is a sound approach, as expressed in this proceeding.[145]

Some CBOs have been very effective in partnering to develop consumer education efforts. To the extent that the objectives of the local consumer education plan can be accomplished through CBOs, we encourage their involvement. We have developed a core curriculum for training instructors and we expect to continue to have cooperation from community based and other organizations to facilitate a wide distribution of resources.

c. The Company's Role In Education

As outlined in our draft core curriculum, the Commission's education plan is divided into six topic areas which include sub-sections. The overall topic areas are: 1. Competition in the Electric Industry; what it is and how it works; 2. Effective Consumer Decision Making; 3. Selecting an Appropriate Supplier; 4. Understanding and Paying Your Bill; 5. Customer Rights and Responsibilities; and 6. Other topics including

---

[145] PECO Stmt. 17.

21. That, in addition to the specific requirements contained in the foregoing ordering paragraphs, PECO Energy Company shall comply with all other directives contained in this Opinion and Order.

BY THE COMMISSION,

James J. McNulty
Secretary

SEAL

ORDER ADOPTED: December 11, 1997

ORDER ENTERED: DEC 23 1997

APPENDIX B

PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17105-3265

Public Meeting held January 15, 1998

Commissioners Present:

John M. Quain, Chairman , Joint Concurring & Dissenting Statement attach
Robert K. Bloom, Vice Chairman, Joint Concurring & Dissenting Statement attac
John Hanger
David W. Rolka
Nora Mead Brownell

Application of PECO Energy Company for Approval of its Restructuring Plan Under Section 2806 of the Public Utility Code and Joint Petition for Partial Settlement	R-00973953
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	P-00971265

OPINION AND ORDER

(Restructuring Reconsideration Order)

BY THE COMMISSION:

By Motion adopted on December 11, 1997, and by Opinion and Order entered on December 23, 1997, this Commission approved a Restructuring Plan for PECO Energy Company (PECO) based upon modifications to PECO's original Application in this proceeding. Presently before this Commission for review are six (6) Petitions for Reconsideration, Clarification, and/or Amendment of the December 23, 1997 Order individually filed on January 7, 1998, by: (1) PECO, (2) Enron Energy Services Power, Inc., and Enron Power Marketing, Inc., (individually: EESPI and EPMI, or collectively: Enron) (Enron Petition), (3) the Office of Consumer Advocate (OCA), (4) the Consumer Education and Protective Association (CEPA), the Tenant Action

These two net plant adjustments result in a total increase of $134.3 million in the book value of PECO's stranded assets and an equal increase in PECO's recoverable stranded costs.

2. **Deferred Fuel Expense.**

a. **Fuel Expense Through Energy Cost Adjustment (ECA) Roll-In on December 31, 1996.** At page 71 of the December 23, 1997 Order, we granted recovery of a regulatory asset for deferred fuel expenses and nuclear performance incentives actually recognized on PECO's books as of December 31, 1996, the date at which the ECA was rolled into base rates. The May 22, 1997 Qualified Rate Order (QRO) granted recovery of this expense. Since the QRO is irrevocable, the same recovery was authorized in the December 23, 1997 Order. The December 23, 1997 Order characterized this item as recovery of $96.162 million for the underlying expense and interest to the net present value date of December 31, 1998.

PECO properly points out that the QRO, in fact, categorized the total recoverable amount as $96.162 based on a quantification of interest only through June 30, 1997, not the relevant net present value date in this proceeding of December 31, 1998. PECO is correct that the recoverable amount would be $109.33 million if interest were calculated to the net present value date of December 31, 1998, and that OCA witness La Capra accepted this quantification. We shall accept this correction which increases PECO's stranded costs by $13.2 million.

b. **Fuel Expense Post December 31, 1996.** In the December 23, 1997 Order, we denied PECO's recovery of unrecovered fuel expense beyond December 31, 1996, based on the recommendations of OCA witness La Capra and PAIEUG witness Kollen. Those witnesses argued, and we agreed, that the reconciliation provisions of an ECA permit recovery only based on actual experience and documentation of the costs. Future energy costs are inherently not "known and measurable" at this point in time, could

not now be granted pursuant to an ECA, and, therefore, cannot qualify as recoverable stranded costs under the Act. The December 23, 1997 Order denied PECO's request for stranded cost recovery of $22 million for each of 1997 and 1998 and for $22.7 million for each year through the conclusion of the proposed transition period, December 31, 2005.

In its Petition for Reconsideration, PECO revises its prior claim instead to request recovery of $29.4 million for unrecovered fuel expense through November 30, 1997, and to allow recovery for additional fuel expense through December 31, 1998, as part of the CTC reconciliation proceedings. PECO has not asked for reconsideration of the denial of recovery for fuel costs beyond December 31, 1998.

At the outset, as several parties pointed out in their Answers to PECO's Petition, a petition for reconsideration of a final order is not an appropriate vehicle for presenting a new proposal or new evidence not in the record of the proceeding.[4] The decision in this case, whether within the December 23, 1997 Order or upon this reconsideration, can be based solely on the proposals and the record of this proceeding. For this reason, PECO's request for $29.4 million for unrecovered fuel expense through November 30, 1997, and its proposal to include additional fuel expense through December 30, 1998, in the CTC reconciliation must be denied. In addition, PECO's presentation of additional "evidence" concerning partial-year 1997 fuel costs through the Affidavit of Alan Cohn is a post-record submittal and cannot be considered in this proceeding.

By way of further clarification, we also will address the underlying issue. PECO requested, and we approved, the elimination of PECO's ECA pursuant to an Order adopted on May 22, 1997 at Docket Nos. P-00961126 and R-00963838 (the Roll-in Order). In the Roll-in Order, we explicitly defined calendar year 1996 fuel costs not fully

---

[4] We note that PECO's proposal is not new and novel under the *Duick* standard, *supra*, in that PECO could have made this proposal on the record in this proceeding.

recovered due to the elimination of the ECA as a regulatory asset typically recoverable under current regulatory practice and, therefore, recoverable as stranded costs in this proceeding. In this proceeding, we have determined the recoverable amount to be $109.33 million, as discussed in this Opinion and Order, *supra*.

In contrast, we explicitly declined to identify post-1996 fuel expenses as recoverable stranded regulatory assets. Instead, we granted PECO the right "to defer and to seek to recover" such costs in this proceeding. In the Roll-in Order, we granted PAIEUG's request for an amendment of this Commission's Tentative Order, issued on December 19, 1996, to clarify that "the actual figure (for recovery of post-1996 fuel expenses), if it is to be allowed at all, will be set in PECO's restructuring proceeding." The Roll-in Order specified that, consistent with our long-standing practice, granting PECO the right to defer the expense for accounting purposes has no direct ratemaking implication. PECO's characterization in its Petition that the Roll-in Order "confirmed" the recoverability of 1997 and 1998 fuel costs is insupportable. Upon approval of the elimination of the ECA and the roll-in of variable energy costs into base rates as of December 30, 1996, PECO relinquished the right to have its fuel costs reconciled automatically because the annual fuel cost expense was subsumed into rates.

The Roll-in Order explicitly found that the rolled-in rates would be considered the rates subject to the rate cap that went into effect on January 1, 1997. PECO's rates were capped at January 1, 1997 levels for 54 months from January 1, 1997, but for exception(s) to the rate cap under the Act. Section 2804(4)(III)(D) of the Act provides that a significant increase in unit fuel cost such that the utility would not be able to earn a fair rate of return could be an exception to the rate cap.

PECO does not assert that its fuel expenses constitute a valid exception to the rate cap, however. In its Answer to PECO's Petition, the OCA recalled OCA witness Catlin's testimony that recovery of 1997 and 1998 fuel costs would be inappropriate while

PECO remained under traditional regulation without a demonstration that its existing rates are inadequate. (OCA Stmt. No. 3 at 17.) PECO merely asserts that it is entitled to recover an alleged underrecovery of its fuel costs despite the fact that PECO eliminated its fuel cost adjustment clause in 1996. PECO cannot, by definition, both subsume its fuel expense into base rates and request an annual reconciliation of fuel costs. Granting stranded cost recovery for fuel costs after the December 30, 1996 effective date of the roll-in and the rate cap would circumvent the rate cap and render the end of the reconciliation provisions meaningless. For these reasons, the relief sought through PECO's request for reconsideration of this issue is denied.

3. Deferred Limerick Common Plant.

On page 76 of the December 23, 1997 Order, we authorized recovery of the same $175.8 million for deferred Limerick Common Plant expense as was authorized pursuant to the May 22, 1997 QRO. PECO correctly identifies a Commission error in identifying this amount as $158.3 million in the stranded cost recovery tabulation total on page 101 of the Order. Correction of this error increases stranded costs by $17.5 million.

4. SFAS 106 Deferred Costs.

PECO claimed recovery of $32.615 million for the unamortized balance of 1993 and 1994 deferrals that had previously been included in rates pursuant to a 1994 settlement agreement. We granted full recovery of this amount on a net present value basis of $20.394 million as of December 31, 1998. No party seeks reconsideration of this issue.

We denied PECO's additional claim for $67.965 million for stranded costs related to its 1994 early retirement programs (VSIP/VRIP expenses). PAIEUG witness Kollen testified these expenses would not have been recoverable under traditional ratemaking. We adopted generally the analysis of witness Kollen that stranded cost

Appendix

Replacing page 101 of the Restructuring Order:

Recoverable Regulatory Assets	$ millions Restructuring Order 12/23/97	$ millions Restructuring Reconsideration Order	$ millions Net Change
SFAS 106	20.394	20.394	0
Deferred Fuel Expense	96.162	109.3	13.168
SFAS-109 Deferred Taxes	1,687.1	1,216.3	(470.8)
Compensated Absences	16.587	16.587	0
Miscellaneous Nuclear expenses	0	0	0
Limerick Early Window	65.446	65.446	0
Deferred Limerick Common Plant	158.3	175.8	17.5
Deferred Common Plant for Peach Bottom, Eddystone, & Salem	17.4	17.4	0
Unamortized Loss Reacquired Debt	158.311	158.311	0
SUBTOTAL	$2.2197 billion	$1.7796 billion	($440.132 million)
Offsetting Regulatory Liabilities			
Pension Fund Overcollection	(217.347)	0	217.347
SFAS 106 Trust Earnings	(150.861)	(150.861)	0
SUBTOTAL	($368.208 million)	($150.861 million)	($217.347 million)
Non-utility Generating Contracts	0	0	0
Nuclear Decommissioning Expense	0	0	0
TOTAL SECTION 2808(c)(1) and (2) STRANDED COSTS	$1.8515 billion	$1.6267 billion	($222.785 million)
Utility Generation	$billions	$billions	$billions
Book Value	6.639	6.773	134.3
less market value	3.96	3.96	0
Total Stranded Generation Cost	2.679	2.813	134.3
Fossil Decommissioning Expense	0	0	0
Other Transition Costs	.033	.033	0
Reallocation of A&G Expense to Generation	.461	.461	0
TOTAL RECOVERABLE STRANDED ASSETS	$5.024 billion	$4.935 billion	($88.5 million)

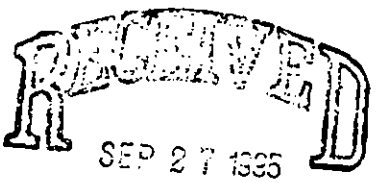
APPENDIX C

PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17105-3265

Public Meeting held September 27, 1995

Commissioners Present:

John M. Quain, Chairman
Lisa Crutchfield, Vice Chairman
John Hanger -Concurring & Dissenting in part-Statement attached
David W. Rolka
Robert K. Bloom



Pennsylvania Public Utility Commission, et al.	Docket Nos. R-00943271C001-C0145
M&M/Mars, Inc.	Intervenor
Bethlehem Steel Corporation	Intervenor
University/College Coalition	Intervenor

v.

Pennsylvania Power & Light Co.

OPINION AND ORDER

its subsequent base rate case in 1984. The Company voluntarily elected not to seek recovery at that time. It is not that these costs, for Susquehanna 1 and 2, were imprudently incurred, but, as pointed out by the ALJ, the Company has waited too long to claim recognition of the Susquehanna 1 costs. We have previously made clear our position that the recovery of deferred "early window" costs is not to become part of routine regulatory practice.

Therefore, the Exceptions filed by PP&L on the recommendation of the ALJ with regard to the treatment of the Susquehanna 1 costs, are denied. The Exceptions of the OCA are denied consistent with our discussion herein.

H. Susquehanna Refueling Outage Expense

The OCA observes that PP&L normalizes refueling outage costs by, typically, amortizing over 18 months, the period between refueling outages. PP&L proposes that we look at the most recent outage for each unit as a measure. It also states that the annual amortization associated with reload six at Susquehanna 2, reflected in the future test year, was unusually high. The OCA reviews the PP&L rebuttal testimony and relies on its own surrebuttal testimony. This involves, in part, a comparison between Unit 1 and Unit 2.

The parties differ about the relative costs of the units. The OCA would base an amortization on the costs of reload eight at Susquehanna Unit 1 and of reload seven at Unit 2. The jurisdictional adjustment is slightly more than $1 million. In its Reply Brief, the OCA responds to PP&L's assertion that its adjustment is arbitrary and unsupported, again referring to the problems experienced with reload six at Unit 2. The OCA would have the cost reflect the most recent outages at the units.

PP&L, in its Main Brief, refers to the OCA's avoidance of the Unit 2 reload six costs. It compares these costs to those for Unit 1 reload eight projected costs, and would have Unit 2 reload six found to be reasonable. PP&L characterizes the OCA's adjustment as arbitrary and unsupported. In its Reply Brief, PP&L argues that it is more appropriate to determine the refueling outage expenses based on the most recent actual costs (Unit 1 reload seven and Unit 2 reload six) rather than the estimated data relied upon by the OCA.

The ALJ noted that the OCA's fundamental argument is that costs for reload six at Unit 2 were abnormally high and should not be used as a measure for ratemaking purposes. The ALJ stated that the OCA approach seems to be arbitrary and that he would strive for consistency in ratemaking, rather than jumping from one measure to another, depending on the result, or depending upon particular details of the data. The ALJ concluded that he does not find reload six at Unit 2 to be so out of line that it should not be used as an appropriate measure for this ratemaking calculation. He accepted the PP&L position and rejected the proposed adjustment. (R.D., p. 63).

The OCA excepts to the ALJ's recommendation on this issue.

The OCA notes that the Company normalizes refueling outage costs by amortizing the costs of the outage over the period between refueling outages, which is typically around 18 months. The OCA argues that the ALJ erred in accepting PP&L's determination of future test year refueling outage expense, which was based on the completion of the amortization of Reload Outage 7 and the initiation of Reload Outage 8 at Susquehanna Unit 1 and the amortization of Reload Outage 6 at Unit 2.

The OCA also argues that, due to the unusually high level of expense associated with Reload Outage 6 at Unit 2, the OCA witness adjusted the amortization of refueling outage costs to reflect the annualized level of costs based on the most recent outage for each unit as of the end of the test period. The OCA further asserts that the ALJ's finding that the costs for Reload 6 at Unit 2 were not "so out of line that it should not be used as an appropriate measure for this ratemaking calculation" fails to consider the many problems that occurred during Reload 6. (OCA Exc., pp. 31-33).

In response to these Exceptions, the Company counters that, despite repeated assertions to the contrary, the OCA did not, in fact, utilize data for the "most recent" Susquehanna refueling outages to develop its claim. For example, continues the Company, the OCA proposes to utilize the cost of Reload 7 at Susquehanna 2, even though this outage has not even begun and will not be completed until several months after the end of the future test year. Moreover, the OCA's contention that the cost of Reload 6 for Unit 2 was abnormally high is wrong. Most of the increases in cost which occurred during this outage were capital costs, not operating and maintenance expenses. The Company presented extensive evidence that the operating and maintenance expenses incurred for this outage were not abnormal. These costs were virtually the same as other outage costs, which the OCA accepted without objection. (PP&L R. Exc., pp. 19-20).

On review of this issue, we conclude that the recommendation of the ALJ is in accord with the evidence as developed in this proceeding. The basic argument of the OCA is that costs for Reload six at Unit 2 were abnormally high and should not be used as a measure for ratemaking purposes. We find the OCA's position on this issue to be arbitrary. As we stated earlier, we believe that it is in the public interest that we strive for consistency in ratemaking, where appropriate, rather

than switching from one measure to another, depending on the result, or depending on the particular details of the data. The costs for Reload six at Unit 2 were not so out of line that it would be inappropriate to use these results for this ratemaking calculation.

For these reasons, the Exceptions of the OCA on this issue are denied.

I. Environmental Remediation Costs

The OTS discusses this topic, commencing at page 84 of its Main Brief. PP&L's discussion commences at page 105 of its Main Brief. PP&L refers to the OTS' adjustment and to the OCA's adjustment. The OTS pursued a challenge to this claim.

The OTS criticizes the PP&L claim as speculative in nature and based primarily on potential future costs. It points out that, between the filing of the OTS direct testimony and the filing of rebuttal testimony, PP&L and the Department of Environmental Resources (DER) reached an agreement concerning cleanup efforts. The agreement provides for a 10 year program which will have an impact on 134 sites. In recognition of this agreement, the OTS reduced its disallowance recommendation by a considerable amount. The OTS points out that the agreement calls for PP&L to spend up to $5 million a year.

The OTS points out that PP&L's claim had been based on $5.4 million a year. The OTS focuses on this $400,000 difference and recommends a slightly smaller disallowance. Commencing at page 32 of its Reply Brief, the OTS points out that its final adjustment was based on PP&L information. The OTS notes the proposal of $5.4 million and the apparent final agreement at $5 million or, perhaps, less. It proposes a $326,000 reduction.

charges for such a block makes customers aware of their increased consumption even if that consumption rate may be priced at a lesser rate.

D. Rate Schedule RTS

PP&L's position is that this rate schedule is only available to customers who install certain electric thermal storage systems equipped with timing devices that permit PP&L to pre-set the time during which electric heat and/or hot water heating occurs. This rate, in comparison to rate schedule RS, has a lower per kwh charge in a single billing block, a higher monthly demand rate and additional demand charges for usage over 2 kw during peak periods. PP&L makes the following claim in that regard:

> Rate Schedule RTS was developed as a load management tool during the early 1980s, when the Company sought to reduce peak load growth. The thermal storage technology offered the opportunity to shift heating load from the peak period of the day through the use of timing devices. Thermal storage provided significant advantages over other load management tools (PP&L St. 8-R, pp. 13-15). In particular, the Company's peak load growth in the mid- to late-1970s and early 1980s displayed a growing morning peak problem. Thermal storage would allow the Company to shift heating load to the evening, alleviating the morning peak
>
> (R.D., pp. 231 to 241 citing PP&L St. 6-R, pp. 10-11; Exh. JJS-10 and JJS-11; Tr. 2123).

PP&L notes that Rate Schedule RTS was introduced in 1984 and attracted approximately 14,000 customers by early 1995. By the late 1980s, the Company became aware that a general shift in peak usage towards the evening by non-RTS customers would, over the long term (after 1995), create an evening peak on PP&L's system, which would reduce the benefits of the RTS rate. (R.D., pp. 231-241 citing PP&L St. 6-R, pp. 3-7). Consequently, the

Company began phasing out advertising promotions and grants for thermal storage customers in 1991 and by 1995 it had entirely discontinued them. As a result, fewer and fewer customers have subscribed to the RTS service in recent years: 806 in 1993, 549 in 1994, and only 145 in the first quarter of 1995. (R.D., pp. 231-241 citing PP&L St. 6-R, p. 8; Ex. JJS-9). PP&L also commenced a pilot program to study the effect and feasibility of installing direct dispatch controls on RTS units, permitting the Company to use real-time pricing and improve the relative revenue contribution from RTS units. (R.D., pp. 231-241 citing Tr. 723-27; PP&L St. 8-R, pp. 17-18).

PP&L proposes to modify the rate schedule by accepting new customers only until December 31, 1995, (2) thereafter allowing eligible persons to use the new rate schedule to incorporate newer technology and appropriate terms, conditions and rates, (3) providing service to existing RTS locations through the life of the existing thermal storage units, and (4) proposing no reduction in the existing 2.3¢ per kilowatt hour differential between RTS and RS customers before December 31, 1999. (R.D., p. 232).

PP&L claims that this proposal is broadly similar to the OCA's and was favorably received by the OCA's witness. PP&L claims the proposal is based on changing load patterns and changes in technology. PP&L views the proposal as a good balance of all customer interests, despite the RTS low rate of return, and concludes that no investigation is warranted. PP&L notes that the RTS rate does contribute to fixed cost and does improve the Company peak load profile even though the negative return of the RTS class on a fully-allocated basis is a matter of concern for PP&L. (R.D., pp. 232-234).

PP&L's dismisses most of CEPFOD's claims as irrelevant to the issue. PP&L claims that RTS was a load management tool,

that it did have some success, and that RTS helps achieve important load management objectives. PP&L further claims that the program's failure was not discerned until 1987 and denies that it ignored the problem until today. (R.D., pp. 239-240).

The OTS' position, described through their witness, is that any increase must first be recovered from the RTS rate class. The OTS also proposes an investigation of the RTS rate schedule -- partly from the concern that some customers were induced to go to this service with overly optimistic promises. (R.D., p. 234).

The OCA has significant concerns about this RTS rate schedule. The OCA is concerned that the cost study shows a negative rate of return for this class and that PP&L has proposed a 17.39 percent increase for these customers. The OCA is concerned that this is higher than the increase proposed for RS customers. The OCA further points out that some RTS customers may experience an improper increase under the circumstances. (R.D., pp. 234-236).

The OCA further points out that this rate did not produce the results intended by PP&L. OCA would not unduly emphasize the cost of service results, considering the nature of this service. It proposes modifications, providing details. The OCA comments favorably on the fact that PP&L has since adopted many of the OCA's recommendations. (R.D., p. 235).

The OCA discusses two further points of disagreement. First, the OCA declines to endorse a date certain for terminating entry i.e., December 31, 1999. Second, the OCA disagrees with a closing date. The OCA prefers to have the rate close with the issuance of the Commission Order. PP&L seeks some time for customer response. It states that, in the alternative, PP&L be directed to fully inform applicants of the conditions relating to

this rate, prior to their signing up for service. The OCA disagrees with the CEPFOD proposals and views them as unduly burdensome. (R.D., pp. 234-236).

CEPFOD also has a position with regard to residential rate design. CEPFOD's primary recommendation is to abolish the RTS rate and to require credits by PP&L to RTS ratepayers. CEPFOD views the matter as blatantly market expansive by providing these high user customers with relatively cheap electric service. (R.D., pp. 236-239).

CEPFOD further claims that PP&L is seeking to maximize sales. CEPFOD details alleged promotional efforts and massive subsidies before suggesting that PP&L be prohibited from harming current ratepayers to compensate for their policy miscalculations. CEPFOD claims that it has been unfairly hurt by subsidization and that PP&L has long been aware of the peaking problem. (R.D., pp. 237-239).

CEPFOD reviews the positions taken by the parties, including its own positions. It suggests that PP&L should not be rewarded for its imprudence, by allowing it to shift the RTS subsidy to other customers. It characterizes its position as being based on several undisputed facts. It first states that PP&L knew that the RTS rate was a load management failure during 1987. It further asserts that rate RTS is a subsidized service. It states that rate RTS increases the evening peak for PP&L. (R.D., pp. 238-239).

CEPFOD goes on to discuss the competition aspect with oil and gas suppliers. It refers especially to price competition. It refers to the negative rate of return and characterizes this as not a recent development. It also refers to incremental cost. It suggests that rate RTS does not contribute to fixed cost recovery. It also suggests that the

rate does not recover fuel costs. It goes on to refer to timers and various developments. It regards PP&L modifications as too late. It also characterizes its own recommendations as fair to all customers. (R.D., pp. 238-239).

CEPFOD then refers to the third RS block and to the RS customer charge increase. It indicates that demand charges should be paid by heating customers. It provides additional numbers relating to blocking and the customer charge. It takes the position that they are not cost-supported. (R.D., pp. 239-240).

The ALJ recommended adoption of the PP&L/OCA proposal with some modification. The ALJ modifications are to accept the PP&L delay time but recommend that the customer notice be required as outlined by OCA. The ALJ noted CEPFOD concerns, particularly with regard to policy failure and competitive impact, but concluded that CEPFOD's position was overstated notwithstanding the record evidence of negative rates of return and pricing differentials. (R.D., pp. 240-241).

PP&L and the OCA support the ALJ's recommendation by claiming that the ALJ properly rejected CEPFOD's misplaced arguments and properly refused to endorse OTS' proposals for rate investigations. (PP&L R. Exc., pp. 34-35; OCA R. Exc., p. 25). Both OTS and CEPFOD except to the recommendation by decrying the ALJ's refusal to recommend an investigation or a determination that PP&L was refusing to eliminate a subsidy with anti-competitive impacts. (OTS Exc., pp. 20-22; CEPFOD Exc., pp. 7-10).

After consideration of the positions of the parties, we shall affirm the ALJ. We agree with the ALJ that the facts in this case do not warrant the investigation requested by the OTS. In addition, we do not believe the facts warrant the conclusion

drawn by CEPFOD that PP&L's approach to rates constitutes anti-competitive behavior. We draw this conclusion, in part, because PP&L has presented sufficient credible testimony explaining their approach and, in addition, has presented several reasonable proposals for managing any shortcomings with this rate that underscore, in our opinion, the absence of any deliberately anti-competitive behavior.

E. Interruptible Service

In this proceeding, PP&L proposed to significantly alter the interruptible rate option under schedules, LP-4 and L-5 [39]. (See PP&L discussion under this topic heading, rate schedules LP-4 and LP-5 and LP-6, interruptible option, at page 270 of PP&L's main brief).

Under the current rate structure, customers whose loads are interruptible pay reduced demand and energy charges as compared to firm customers. The exact level of savings, or discount, from the firm rate, is dependent upon the customer's classification, size, relative firm and interruptible load, on-peak load factor, and total hours use of demand. (PP&L Stmt. 8, pp. 12-13).

In addition to the benefit to be received by the utility of load retention (a response of the utility to economic concerns of customers, some of whom were at risk of closure, and contraction or relocation of operations), interruptible load enabled the utility to avoid the need for generation capacity

---

[39] Rate Schedule IS-1 in the interruptible option for greenhouse lighting. Interruptible Service by Agreement ("ISA") provides for interruptible rates and service by individual contract to large customers who take service at 66,000 volts or higher. LP-6 -- Large Power Service at Transmission Voltage (High Load Factor) Rate, is a new rate representing the Company's response to prevent load loss from energy intensive industrial users with multi-plant locations. (PP&L Stmt. 8, pp. 8-9).

In this proceeding, the Company has proposed an innovative modification of the ECR to reflect the expected return of capacity costs and revenues attributable to off-system capacity sales that will terminate in the near future. The Company's proposal specifically addresses the return of a 945 MW slice of system capacity and energy sold to Jersey Central Power & Light Co. ("JCP&L").

In PP&L's 1982 base rate case the Commission determined that PP&L had excess generating capacity and, as a remedy, disallowed recovery of all return on a 945 MW slice of the Company's system. After that case, PP&L sold that capacity to JCP&L. In the Company's 1984 base rate case, all of the costs and revenues associated with that 945 MW were allocated out of PUC jurisdictional rates. The same approach was followed in this filing.

On January 1, 1996, this sale to JCP&L begins to wind down over a five-year period. One-fifth of the 945 MW, or 189 MW will return to PP&L each year. Absent an innovative solution, PP&L will have to choose among three alternatives for addressing this returning capacity: (1) find another buyer in the bulk power market, (2) file periodic retail base rate cases, or (3) absorb the associated costs.

After analysis, PP&L concluded that none of these three options was satisfactory or in the public interest. The bulk power market is becoming increasingly competitive and prices are being driven inexorably toward marginal costs. Periodic base rate filings require the commitment of significant resources by all participants, most particularly the Commission and its staff. And, finally, the Company is not in a financial position to begin absorbing additional costs. Accordingly, PP&L developed an innovative alternative which it presented in this case.

Under its proposal in this case, the Company would reflect the full costs of each "slice" of returning capacity in the ECR, as well as credit all revenues from off-system

In response to the Exception of the Sierra Club, the Company notes that the Club presented no evidence to support its proposal. In contrast, asserts the Company, the many benefits of the ECR are addressed in PP&L's Initial Brief, pp. 290-291, and fully support its continuation. (PP&L R. Exc., p. 38)

On review of this issue, we concur with the ALJ's recommendation, that the Company's primary proposal be rejected but that the Company's alternative proposal be accepted.

Although this issue is presented in the context of ECR, it is really a second "excess capacity" matter. In 1983, the Commission found 945 MW of excess capacity equivalent to the PP&L ownership of the new Susquehanna 1 plant and excluded a return on PP&L's investment in a 12.6% slice of its system. All return of investment through depreciation, as well as operation and maintenance expenses, was included in rates. In 1985, the Commission disallowed all common equity return on the 945 MW of Susquehanna 2, and PP&L sold the capacity by contract to JCP&L. As noted in our discussion supra, these contracts are now expiring, and PP&L's primary proposal on this issue was to include all costs and sales of such capacity in the ECR. As discussed supra, we reject this primary proposal.

Alternatively, the Company proposes, and the ALJ recommends, keeping all expenses and revenues derived from this capacity off-system until such time as they are included in base rates. We approve this recommendation as part of the normal ratemaking process. The capacity associated with the JCP&L contract should remain non-jurisdictional, and the Company is free to market an eventual total of 945 MW of capacity, thereby retaining revenues from the incremental off-system capacity related sales.

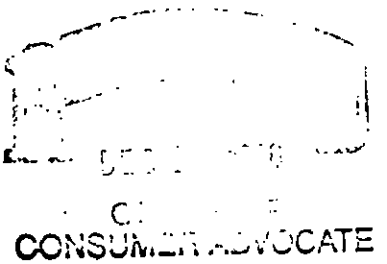
APPENDIX D

PENNSYLVANIA
PUBLIC UTILITY COMMISSION
HARRISBURG, PA 17105-3265

Public Meeting held December 19, 1996

Commissioners Present:

John M. Quain, Chairman
Lisa Crutchfield, Vice Chairman
John Hanger
David W. Rolka
Robert K. Bloom



Pennsylvania Power & Light Company's Application For Approval Of The Roll-In Of The Energy Cost Adjustment And State Tax Adjustment Surcharge Effective January 1, 1997.

Docket No. P-00961131
R-00963842

TENTATIVE ORDER

BY THE COMMISSION:

On December 13, 1996, Pennsylvania Power & Light Company (PP&L or the Company) filed an Application with the Commission pursuant to 52 Pa. Code § 53.102 of the Commission's regulations. The Application requests special permission to file a tariff supplement on less than 60 days statutory notice. The proposed tariff supplement provides for the Company's energy cost rate (ECR) and state tax adjustment surcharge (STAS) to be rolled into base rates. Additionally, the Application requests, among other matters, that PP&L be authorized to defer certain unrecovered energy costs as "regulatory assets" or "other deferred charges" and, that such amounts are recoverable as a "transition or stranded cost" in PP&L's restructuring plan to be filed in 1997.

The Commission further grants the Company's request to declare that unrecovered energy costs incurred as of December 31, 1996, and such costs which may be incurred as a result of the ECR roll-in are, "regulatory assets and other deferred charges". Under normal regulatory practice, these undercollections would be reconciled in filings to be made in April of 1997 and would be recovered from customers over the next automatic adjustment clause period, provided that the costs incurred were prudently incurred and reasonable in amount. When granting this declaration the Commission notes that it believes the appropriate forum to address the prudence and reasonableness of these undercollections is in conjunction with a filing submitted by the Company in response to Section 2806 of the Electricity Generation Customer Choice and Competition Act (Act). It would not be proper for the Commission to rule, with finality, on the prudence and reasonableness of these undercollections, and the length of the amortization period until such time as the matter can be thoroughly reviewed by all interested parties. Additionally, the Company's application of its ECR up through December 31, 1996, is subject to audit pursuant to Section 1307(d) of the Public Utility Code. The under-collections associated with this ECR application are subject to adjustment should the results of the 1307(d) audit so warrant.

Accordingly, the Company's under recovered energy and other costs that have been deferred to date may continue to be accumulated and deferred post-December 31, 1996. In the Commission's opinion, these accumulated deferrals are "regulatory assets and other deferred charges typically recoverable under current regulatory practice" within the meaning and scope of Section 2808(c)(1). As such, these are costs that are recoverable in the future as part of an electric utility's Competitive Transition Charge, Intangible Transition Charge, or an automatic adjustment clause, so long as the total charges do not exceed the electric utility's rate cap. **Therefore,**

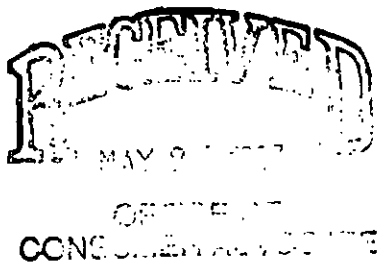
APPENDIX E

PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17105-3265

Public Meeting held May 22, 1997

Commissioners Present:

John M. Quain, Chairman
Robert K. Bloom, Vice Chairman
John Hanger
David W. Rolka
Nora Mead Brownell



Pennsylvania Power & Light Company's Application for Approval of the Roll-In of the Energy Cost Adjustment and State Tax Adjustment Surcharge Effective January 1, 1997	Docket Nos. R-00963842
Petition for Amendment of the Pennsylvania Power & Light Company Industrial Customer Alliance	P-00961131

OPINION AND ORDER

BY THE COMMISSION:

This matter comes before the Commission by way of a Petition for Modification filed by the Pennsylvania Power & Light Company Industrial Customer Alliance ("Petitioners") to a Tentative Order entered December 19, 1996 at the above Commission Dockets.

On the merits, Petitioners' first issue is the most easily addressed. Our ordering paragraph number 4 states that "the difference between the roll-in rates and a figure that reflects the Company's average fuel costs, which difference is $31.5 million per year ... ." (Emphasis added). Both PP&L and the Petitioners agree that our Tentative Order did not intend to establish that figure as a set amount. Whatever the figure may be, our intent clearly was to establish that the actual figure, if it is to be allowed at all, will be set in PP&L's restructuring proceeding.

The second issue concerns the Petitioners' arguments that we have declared, in the limited context of PP&L's ECR filing, that the energy cost differential based on the difference between rolled-in rates and prospective average fuel prices are, per se, recoverable in the context of PP&L's restructuring filing as a component of the Competitive Transition Charge, Intangible Transition Charge or an automatic adjustment clause under Section 1307 of the Public Utility Code, 66 Pa. C.S. §1307. Petitioners have forcefully argued that this basic issue of recovery, regardless of the amount, must be left to the restructuring proceeding. PP&L has argued that its ability to recover an amount has been resolved, and it is only the amount which will be determined in the restructuring proceeding.

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 the 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

APPENDIX F

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, PA 17105-3265

Public Meeting held July 10, 1997

Commissioners Present:
John M. Quain, Chairman
Robert K. Bloom, Vice-Chairman
John Hanger, Dissenting - Statement attached
David W. Rolka, Dissenting - Statement attached
Nora Mead Brownell, Statement attached

Final Order Re: Guidelines for Universal Service And Energy Conservation Programs Made Pursuant to 66 Pa. C.S. §2803 §2802(17), 2804(8) and 2804(9).

Docket No. M-00960890F0010

ORDER

BY THE COMMISSION:

On April 25, 1997, the Commission issued a Tentative Order which proposed guidelines for universal service and energy conservation programs. The Tentative Order established a comment period ending May 14, 1997 during which public comment could be submitted. Comments were received from 52 parties. A list of these commentors is attached to this order as Appendix A.

We have considered all of the comments that were submitted. We appreciate and thank all the commentors who provided worthwhile suggestions to improve the guidelines for universal service and energy conservation programs. We have identified issues that were common to a majority of the comments, and will address them in this order. For convenience, we have attached the guidelines for universal service and energy conservation as Appendix B to this order. We have changed the format from the Tentative Order to summarize the comments. We have changed the order and renamed several sections to improve the organization and clarity of the guidelines. Appendix E provides a comparison of the tentative order format and the format used in this final order. Unless otherwise noted, all section numbering refers to the final order format.

Policy Statement, even though the Commission doubted those plans could be affordable. NFG's evaluation found that their program is cost-effective and that customer payment behavior improved. The evaluator recommended that NFG implement a tiered-rate discount. The Commission recently approved a request from NFG to expand its program from 1,000 participants to 5,000 participants. Because NFG's evaluation found the rate discount acceptable, the Commission approved NFG's request to use a tiered-rate discount. If an evaluation finds that a rate discount does not provide affordable payments, the Commission would expect an EDC to revise its payment plan. Another example of a successful variance from the Policy Statement is PP&L's payment plan. Under this plan that considers F.(5)(e), three payment options are calculated. This approach allows the agencies who administer PP&L's program to decide the payment amount that best suits the needs of the household and the utility. PP&L has results from two interim evaluations that show PP&L's method of determining payments is an acceptable approach. By using this approach, customers generally have affordable payments; and under most circumstances CAP payments are similar to what customers have historically paid.

6. CAP participants and competitive supply.

We are adding a section that provides guidance for parties to deal with CAP participants and competitive supply as part of their restructuring plans. As a general policy matter, the Commission supports CAP participants acquiring supply in the competitive market and allowing competitive suppliers to be involved in providing electric supply to CAP participants. The guidelines provide four goals that program designs should meet when CAP participants acquire supply in the competitive market.

G. Cost Recovery Of Universal Service And Energy Conservation Programs.

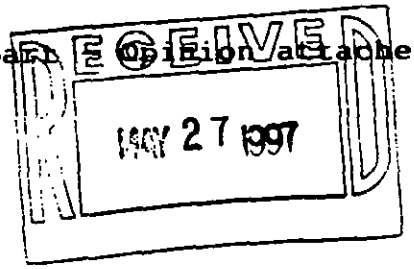
Several commentors support a kwh assessment on all customer classes. We cannot accept this recommendation because it places a disproportionate responsibility for funding universal service and energy conservation programs on high kwh (high volume) users in violation of Section 1301. Further, the Act at §2804(7) prohibits interclass and intraclass cost shifting. Assessing a funding mechanism on kwh use is inconsistent with rate treatments for these programs in recent base rate cases.

APPENDIX G

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Commissioners Present: Public Meeting held May 22, 1997

John M. Quain, Chairman, Statement attached
Robert K. Bloom, Vice Chairman
John Hanger, Statement attached
David W. Rolka, Dissenting in part Opinion attached
Nora Mead Brownell



Application of PECO Energy Company	:	
For Issuance Of A Qualified Rate	:	
Order Under Sections 2808 and 2812	:	
Of The Public Utility Code	:	
Pennsylvania Public Utility	:	Docket Nos.
Commission,	:	R-00973877
Office of Consumer Advocate,	:	R-00973877C0001
The Environmentalists,	:	R-00973877C0002
Office of Trial Staff,	:	
Office of Small Business Advocate	:	
and	:	
Consumers' Education and Protective	:	
Association, *et al.*,	:	
Honorable Vincent J. Fumo, Senator,	:	
Honorable Angel L. Ortiz, Councilman,	:	
Allegheny Power,	:	
Indianapolis Power and Light Company,	:	
Enron Capital and Trade Resources,	:	
Pennsylvania Power and Light Company,	:	
Minority Energy Coalition,	:	
GPU Energy,	:	
Lance Haver, and	:	
Philadelphia Area Industrial Energy Users	:	
Group,	:	
Intervenors	:	
v.	:	
PECO Energy Company	:	

OPINION AND QUALIFIED RATE ORDER

May 22, 1997

proceeding. Accordingly, we deny PECO's Exception concerning its cost of common equity recommended in this proceeding and adopt a common equity cost rate of 10.00 percent.

5. Conclusion

The following table summarizes our determinations regarding the appropriate capital structure and cost of capital rates to be used in this proceeding.

Capital Structure	Ratio	Cost Rate	Weighted Cost
Debt	44.60%	8.47%	3.78%
MIPS Debt	3.19%	9.21%	0.29%
Preferred Stock	3.09%	7.70%	0.24%
Common Equity	49.12%	10.00%	4.91%
	100.00%		9.22%

This results in an after-tax discount rate of 7.53 percent.

F. Equity Buy Back and Transaction Costs

1. Use of Proceeds - Special Dividend

In its Application, PECO indicated that it would use a portion of the securitization proceeds to reduce its common equity capitalization. (PECO Statement No. 4, p. 14). The OTS and the OCA proposed reducing common equity through a special dividend. PAIEUG argued that the refunding expense from the common equity buy back would be inappropriate for recovery through the ITC. PECO rejoined that

APPENDIX H

APPENDIX OF EXHIBITS

Statement 1: Direct Testimony of Richard LaCapra (August 27, 1997)

Statement 1-S: Surrebuttal Testimony of Richard LaCapra (August 27, 1997)

Exhibit RCL-1 (August 27, 1997)

Exhibit RCL-2 (August 27, 1997)

Exhibit RCL-3 (August 27, 1997)

Exhibit RCL-4 (August 27, 1997)

Exhibit RCL-5 (August 27, 1997)

Exhibit RCL-6 (August 27, 1997)

Exhibit RCL-7 (August 27, 1997)

Exhibit RCL-8 (August 27, 1997)

Exhibit RCL-9 Revised (September 2)

Exhibit RCL-10 (August 27, 1997)

Statement 2: Direct Testimony of Douglas C. Smith (August 25, 1997)

Statement 2-S: Surrebuttal Testimony of Douglas C. Smith (August 25, 1997)

Exhibit DCS-1 (August 25, 1997)

Exhibit DCS-2 (August 25, 1997)

Exhibit DCS-3 (August 25, 1997)

Exhibit DCS-4 (August 25, 1997)

Exhibit DCS-5 (August 25, 1997)

Exhibit DCS-6 (August 25, 1997)

Exhibit DCS-7 (August 25, 1997)

Exhibit DCS-8 (August 25, 1997)

Exhibit DCS-9 (August 25, 1997)

Exhibit DCS-10 (August 25, 1997)

Exhibit DCS-11 (August 25, 1997)

Exhibit DCS-12 (August 25, 1997)

Exhibit DCS-13 (August 25, 1997)

Exhibit DCS-14 (August 25, 1997)

Exhibit DCS-15 (August 25, 1997)

Statement 3: Direct Testimony of Thomas S. Catlin (August 27, 1997)

Statement 3-S: Surrebuttal Testimony of Thomas S. Catlin (August 27, 1997)

Schedule TSC-1 (August 27, 1997)

Schedule TSC-2 (August 27, 1997)

Schedule TSC-3 (August 27, 1997)

Schedule TSC-4 (August 27, 1997)

Schedule TSC-5 (August 27, 1997)

Statement 4: Direct Testimony of Lee Smith (August 21, 1997)

Statement 4-S: Surrebuttal Testimony of Lee Smith (August 21, 1997)

Exhibit LS-2 (August 21, 1997)

Exhibit LS-3 (August 21, 1997)

Exhibit LS-4 (August 21, 1997)

Exhibit LS-5 (August 21, 1997)

Exhibit LS-6 (August 21, 1997)

Exhibit LS-7 (August 21, 1997)

Exhibit LS-8 (August 21, 1997)

Exhibit LS-9-R (September 2, 1997)

Exhibit LS-10-R (September 2, 1997)

Exhibit LS-11-R (September 2, 1997)

Exhibit LS-12-R (September 2, 1997)

Statement 5: Direct Testimony of Barbara Alexander (August 20, 1997)

Statement 5-S: Surrebuttal Testimony of Barbara Alexander (August 20, 1997)

Exhibit BA-1 (August 20, 1997)

Exhibit BA-2 (August 20, 1997)

Exhibit BA-3 (August 20, 1997)

Statement 6: Direct Testimony of Nancy Brockway (August 29, 1997)

Statement 6-S: Surrebuttal Testimony of Nancy Brockway (August 29, 1997)

Exhibit NB-1 (August 29, 1997)

Exhibit NB-Surrebuttal-1 (August 29, 1997)