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PROTHONOTARY'S OFFICE
April 27, 1998

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

VIA HAND DELIVERY

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

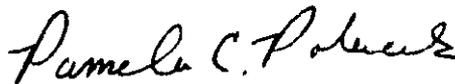
Dear Secretary McNulty:

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

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

Very truly yours,

MCNEES, WALLACE & NURICK

By 
Pamela C. Polacek

Counsel to the PP&L Industrial Customer Alliance

PCP/clc

Enclosures

c: Honorable George M. Kashi (via hand delivery)
Cheryl W. Davis, Office of Special Assistants (w/diskette) (via hand delivery)
Certificate of Service

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission

v.

Docket No. R-00973954

Pennsylvania Power & Light Company

Application of PP&L for Approval
of its Restructuring Plan Under
Section 2806 of the Public Utility Code

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**EXCEPTIONS OF THE
PP&L INDUSTRIAL CUSTOMER ALLIANCE – COMPLAINANTS**

Air Products and Chemicals, Inc.
Alumax
Appleton Papers Inc.
Armstrong World Industries, Inc.
Bethlehem Steel
CertainTeed Corporation
Hercules Cement Company
Hershey Foods Corporation
Horsehead Resource Development Co., Inc.
Lafarge Corporation - Whitehall Plant

Lucent Technologies
Magee Carpet Company
Mount Joy Wire Corporation
Praxair, Inc.
R.R. Donnelley & Sons Company, Inc.
The Stroh Brewery Company
Thomson Consumer Electronics, Inc.
Victaulic Company of America
WEA Manufacturing

DOCKETED

APR 28 1998

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FOLDER**

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Customer Alliance

Dated: April 27, 1998

TABLE OF CONTENTS

| | <u>Page</u> |
|---|-------------|
| TABLE OF AUTHORITIES | iv |
| I INTRODUCTION | 1 |
| II. EXCEPTIONS | 3 |
| I. CONTEXT OF RESTRUCTURING | 3 |
| Exception 1. The ALJ Fails To Acknowledge The Central Economic Development Goals Of The Act. | 3 |
| II. LEGAL AND POLICY FOUNDATIONS OF STRANDED COST RECOVERY | 4 |
| Exception 2. The ALJ Errs In Concluding That A "Regulatory Compact" Or Federal Constitutional Doctrines Should Be Considered By The Commission In Establishing PP&L's Stranded Cost Recovery. | 4 |
| Exception 3. The ALJ Errs In Rejecting The Proposals To Allocate Stranded Costs Between Ratepayers And Shareholders. | 6 |
| III. STRANDED COST CALCULATION METHODOLOGY | 7 |
| Exception 4. The ALJ Errs By Adopting PP&L's Flawed Application Of The Regulatory Methodology To Determine Stranded Generation Costs. | 7 |
| Exception 5. The ALJ's Reasons For Rejecting The OCA And PPLICA Asset Value Methodology Are Inaccurate. | 12 |
| Exception 6. The ALJ Errs In Endorsing PP&L's Possible Foregone Recovery Of Stranded Cost Necessitated By The Rate Cap As A Type Of Mitigation. | 14 |
| IV. MARKET PRICE OF ELECTRICITY | 14 |
| Exception 7. The ALJ Errs In Relying On PP&L's Market Price Forecast. | 14 |

| | <u>Page</u> |
|--|-------------|
| A. The Results Obtained from the EGEAS Model are not Reasonable. | 15 |
| B. No Reasonable Basis Exists for the Commission to Rely on Dr. Jones' Judgmental and Widely Divergent Input Variables. | 18 |
| C. Dr. Jones' "Modeling" of Capacity Prices is Clearly Deficient. | 20 |
| D. Dr. Jones' Modeling of Energy Prices is Flawed. | 21 |
| Exception 8. The ALJ's Criticisms Of The PPLICA Analysis Are Without Basis. | 22 |
| V. REVENUE UNDER REGULATION | 23 |
| Exception 9. PP&L's Fossil Decommissioning Expense Is Not Recoverable Under The Act And Relevant Precedent. | 23 |
| Exception 10. The ALJ Inappropriately Permits PP&L To Recover A regulatory Asset For Future Unrecovered Energy Costs. | 25 |
| Exception 11. The ALJ Inappropriately Permits PP&L To Recover The "Employee Transition Cost" Regulatory Asset. | 26 |
| Exception 12. The ALJ Fails To Address PPLICA's Recommended Regulatory Liability For Pension Plan Over Funding. | 26 |
| Exception 13. The ALJ Inappropriately Rejects PPLICA's Recommended Regulatory Liability For SFAS 106 Trust Fund Earnings. | 27 |
| Exception 14. The ALJ Errs By Permitting PP&L To Recover Its "Department Of Energy Assessment" Regulatory Asset. | 27 |
| Exception 15. The ALJ Errs By Permitting PP&L To Use Unreasonable Retirement Dates For Its Stranded Cost Calculation. | 28 |

| | <u>Page</u> |
|---|-------------|
| VI. DETERMINATION OF PRESENT VALUE | 29 |
| Exception 16. The ALJ Inaccurately Categorizes PPLICA's Stranded Cost Calculation As Disallowing The Recovery Of Income Taxes. | 29 |
| VII. RECOVERY OF STRANDED COSTS | 29 |
| Exception 17. The ALJ's Recommendation To Allow PP&L To Gross-up Its Return On Unamortized CTC Balances Is Not Supported By Record Evidence And Otherwise Inappropriate. | 29 |
| VIII. RATE DESIGN AND TARIFFS | 30 |
| Exception 18. The ALJ's Adoption Of PP&L's Proposed Limitations On The Availability Of Interruptible Rate Schedules (IS-T and IS-P) And Residential Rate Schedules (RTD and RTS) Violates The Rate Cap And Anti-Cost Shifting Provisions Of The Act And Is Otherwise Contrary To The Act's Central Goals. | 30 |
| Exception 19. The ALJ Errs By Rejecting PP&L's Proposal To Extend Application Of Economic Incentive Rates For The Duration Of The Stranded Cost Recovery Period. | 34 |
| IX. PHASE-IN ISSUES | 36 |
| Exception 20. The Act Clearly Permits The Accelerated Phase-in Schedule Advocated By PPLICA. | 36 |
| Exception 21. The PPLICA Pro-Rata Reduction Method For The Phase-in Of Industrial And Large Commercial Customers Is Desirable. | 37 |
| III. CONCLUSION | 39 |

TABLE OF AUTHORITIES

| <u>Cases:</u> | <u>Page</u> |
|--|----------------------------------|
| Butler Township Water Co. v. Pennsylvania Pub. Util. Comm'n, 81 Pa. Commw. 40, 473 A.2d 219 (1984) | 6 |
| Columbia Gas of Pa., Inc. v. Pennsylvania Pub. Util. Comm'n, 149 Pa. Commw. 247, 613 A.2d 74 (1992), <u>aff'd</u> , 535 Pa. 517, 636 A.2d 627 (1994) | 5 |
| Duquesne Light Co. v. Barasch, 488 U.S. 299 (1989) | 4,5,11,30 |
| Philadelphia Electric Co. v. Pennsylvania Pub. Util. Comm'n, 61 Pa. Commw. 325, 433 A.2d 620 (1981) | 11,30 |
| Sayre v. Pennsylvania Pub. Util. Comm'n, 161 Pa. Super. 182, 54 A.2d 95 (1947) | 4 |
| T.W. Phillips Gas & Oil Co. v. Pennsylvania Pub. Util. Comm'n, 81 Pa. Commw. 205, 474 A.2d 355 (1984) | 6 |
| United States v. Winstar Corp., 116 S.Ct. 2432 (1996) | 5 |
| <u>Administrative Decisions:</u> | |
| In re Lukens Steel Co., 58 Pa. PUC 256 (1984) | 4 |
| Pennsylvania Pub. Util. Comm'n v. PECO Energy Company, Docket Nos. R-00973953 & P-00971265, Opinion and Order on Reconsideration entered on January 16, 1998 ("PECO Restructuring Reconsideration Order") | 1,25 |
| Pennsylvania Pub. Util. Comm'n v. PECO Energy Company, Docket Nos. R-00973953 & P-00971265, Opinion and Order entered on December 23, 1997, 181 PUR 4 th 517 ("PECO Restructuring Order") | 1,13,15,17,19, 22,24,30,32,35 |
| Petition for Amendment of the Pennsylvania Power & Light Company Industrial Customer Alliance, Docket No. P-00961131 & R-00963848, Opinion and Order entered on May 22, 1997 | 25 |
| Pennsylvania Pub. Util. Comm'n v. Duquesne Light Co., Docket No. R-00974104, Recommended Decision of John H. Corbett, Jr. | 19,22,34 |
| Pennsylvania Pub. Util. Comm'n v. West Penn Power Co., Docket No. R-00973981, Recommended Decision of Larry Gesoff | 9,10,19,22 |

Statute and Rules:

Page

| | |
|-----------------------------|--------------|
| 52 Pa. Code § 5.533 | 1 |
| 66 Pa. C.S. § 2802(4) | 3,32 |
| §2802(5) | 3 |
| § 2802(6) | 3,31 |
| § 2802(6) & (7) | 31 |
| § 2802(8) | 30,38 |
| § 2803 | 4,6,11,24,25 |
| § 2804(4) | 36 |
| § 2804(4) & (7) | 36 |
| § 2804(4)(i)(A) | 35 |
| § 2804(4)(ii) | 35 |
| § 2804(8) | 37 |
| § 2804(13) | 4,6 |
| § 2804(14) | 4,6 |
| § 2806(e) | 33 |
| § 2808 | 32 |
| § 2802(15) | 4 |
| § 2808(15) | 4 |

I. INTRODUCTION

On April 7, 1998, Administrative Law Judge George M. Kashi issued a Recommended Decision ("R.D.") in this proceeding. Pursuant to 52 Pa. Code § 5.533, the PP&L Industrial Customer Alliance ("PPLICA") submits these Exceptions to the R.D. PPLICA previously submitted a Main Brief (as part of the "Large Customer Group") and a Reply Brief. ("PPLICA M.B." and "PPLICA R.B.," respectively). PPLICA requests that the Commission modify the R.D. consistent with the arguments set forth in those briefs and below.

One general theme underlies most of PPLICA's Exceptions to the R.D. — the need for consistent statewide implementation of Act 138 in order to create a level playing field for electric generation competition that is fair between and among customers, utilities, and generation suppliers. The R.D. fails to meet that need and to follow the principles established by the Commission in PECO.¹ The Commission cannot decide this case in a vacuum absent consideration of the PECO precedent and the aforestated need.

The Commission must ensure that a viable competitive environment develops throughout the entire state. In order for the market to develop, issues such as the forecasted market prices used to quantify stranded costs, the recoverability of specific types of "stranded" costs, the methodology for quantifying those "stranded costs," the procedures for the phase-in of direct access, and the treatment of interruptible and special contract customers must be decided consistently. Many customers and suppliers will do business in more than one EDC service territory. Substantial variations on these issues will not only be inequitable, but will also lead to customer confusion. This inequity and confusion is unnecessary because a single decision maker, the Commission, can ensure consistency.

¹Pennsylvania Pub. Util. Comm'n v. PECO Energy Company, Docket Nos. R-00973953 & P-00971265, Opinion and Order entered on December 23, 1997, 181 PUR 4th 517 ("PECO Restructuring Order"), Opinion and Order on Reconsideration entered on January 16, 1998 ("PECO Restructuring Reconsideration Order").

In addition, lack of consistency by the Commission will lead to absurd results. If the Commission's Order does not correct obvious deviations in the R.D. from the PECO precedent and the ALJ conclusions in the West Penn and Duquesne recommended decisions the following nonsensical conclusions could result:

1. The price of natural gas used at PP&L generating units will significantly differ from the price of gas used at PECO units;
2. The price of oil used at PP&L generating units will significantly differ from the price of oil used at PECO units;
3. The price of coal used at PP&L units will significantly differ from the price of coal used at PECO units;
4. The spread between coal prices and gas/oil prices will be different for PP&L generating units than PECO, West Penn and Duquesne generating units;
5. The rate of general inflation in the PP&L service territory will be different from the rate of inflation in the PECO, West Penn and Duquesne service territories;
6. Nationally recognized, unbiased fuel price forecasts performed by the Energy Information Administration and DRI cannot reasonably be relied upon as indicators of future price movement in any proceeding or for any purpose, but, will be relied on for the Commission's decisions in the PECO, West Penn and Duquesne proceedings;
7. The market price for electricity will be different for PP&L and PECO, although all parties agree that substantial locational differences will not exist in PJM;
8. Generating plants jointly owned by PP&L and PECO will be retired on different dates;
9. Generators in PP&L's service territory would be willing to submit bids that fail to cover startup and no-load costs while generators in the PECO territory would not include those costs in their bids;
10. An accelerated phase-in schedule that the PUC adopted as a reasonable interpretation of the Act is rendered inapplicable by a customer being located in Harrisburg instead of Philadelphia;
11. Although PECO and the Commission can grasp the "complexity" of implementing a pro rata reduction if a stage of PECO's phase-in is oversubscribed, PP&L and the same Commission cannot handle the identical task if one of PP&L's stages is oversubscribed; and,

12. Customers exercising their right of access would be penalized with a high CTC if they are served on Rate Schedules RTS, RTD, IS-P or IS-T.

These obviously erroneous results produced by the R.D. must be rectified by the Commission. Because the R.D. adopts much of its reasoning verbatim from the PP&L Main Brief, PPLICA's Reply Brief already rebutted the R.D.'s reasoning. These Exceptions demonstrate that the R.D. is completely aberrant and will thwart any prospect of a competitive market developing in PP&L's service territory that is fair between and among customers, utilities, and generation suppliers.

II. EXCEPTIONS

I. CONTEXT OF RESTRUCTURING

Exception 1. The ALJ Fails To Acknowledge The Central Economic Development Goals Of The Act.

Exception to: R.D. at 57-64.

The R.D. concentrates almost exclusively on the impact of restructuring on the utility and ignores the fundamental reasons for adoption of the Act — Pennsylvania's need to regain its position as an economic leader. See PPLICA M.B. at 1-5. The citizens of Pennsylvania and the businesses operating in the Commonwealth are paying unjustifiably high prices for electricity. 66 Pa. C.S. § 2802(4). Competitive forces will control the cost of electricity better than continued regulation only if a viable plan for restructuring is implemented in the PP&L service territory that enables a competitive market to develop. See id. §2802(5).

The General Assembly and Governor Ridge recognized the importance of being a leader in deregulation in order to retain, expand and attract businesses to the Commonwealth. Id. § 2802(6). The R.D. frustrates the development of a competitive market and penalizes customers who access the market. The central goal of the Act will not be attained if the pervasive flaws in the R.D. are not corrected.

II. LEGAL AND POLICY FOUNDATIONS OF STRANDED COST RECOVERY

Exception 2. The ALJ Errs In Concluding That A "Regulatory Compact" Or Federal Constitutional Doctrines Should Be Considered By The Commission In Establishing PP&L's Stranded Cost Recovery.

Exception to: R.D. at 57-59 & 65-67 & Proposed Findings of Fact # 29-32.

The R.D. references both a "Regulatory Compact" and federal constitutional doctrines in its discussion of the legal standards for stranded cost recovery. R.D. at 65-67. This reliance is procedural and legally misplaced. Because of page limitations, PPLICA summarizes the salient point below. PPLICA urges the Commission to carefully consider the extensive explanation of this issue extensively in the PPLICA Reply Brief. PPLICA R.B. at 4-14.

- The Commission (and the ALJ) should not procedurally be considering whether a purported "regulatory compact" or constitutional principles entitle PP&L to a specified level of stranded cost recovery; the Commission procedurally should be considering what level of recovery PP&L is entitled to under the Act, Commission precedent, and the evidence submitted in this case. PPLICA R.B. at 9-10.
- With respect to stranded cost recovery, the Act clearly establishes that only an "appropriate" and "just and reasonable" level of stranded costs can be recovered from ratepayers. 66 Pa. C.S. §§ 2808(15), 2804(13) & 2804(14); PPLICA M.B. at 6-20; PPLICA R.B. at 4-9. Because the Act is clear in this regard, the Commission should be concerned only with weighing the evidence before it and balancing the interests of shareholders and ratepayers to determine the just and reasonable level of recoverable stranded costs. 66 Pa. C.S. §§ 2802(15), 2803, 2804(13), 2804(14) & 2808.
- No regulatory compact has ever existed. PPLICA R.B. at 10-14. The Commission has always had the discretion to subject a utility to competition if doing so was in the public interest. In re Lukens Steel Co., 58 Pa. PUC 256, 261 (1984), citing Sayre v. Pennsylvania Pub. Util. Comm'n, 161 Pa. Super. 182, 54 A.2d 95 (1947). In the face of this discretion, the utilities and their investors could not reasonably have believed that the status quo of regulation would continue indefinitely.
- No regulatory compact or federal constitutional principles cited in the R.D. legally entitle PP&L to the amount of stranded cost recommended by the ALJ. PPLICA R.B. 10-14. In Duquesne Light Co. v. Barasch, 488 U.S. 299 (1989), the Supreme Court upheld application of a new provision of the Public Utility Code that precluded recovery of cost that previously would have been included in rates. Id. At 315. It surely cannot be contended that any of the Commission's well-considered decisions in executing its

duty to set just and reasonable rates on an on-going, forward-looking basis as required by the Act and Section 1301 of the Public Utility Code (see PPLICA R.B. at 6) amount to an arbitrary switching of rate methodologies if some costs claimed by PP&L for recovery are disallowed.

- In addition, the Supreme Court in Barasch specifically declined to elevate any one ratemaking methodology to constitutional stature. PPLICA R.B. at 13; Barasch, 488 U.S. at 315-16. The advent of competition for electricity was specifically cited by the Court in reaching a decision on this issue. Barasch, 488 U.S. at 316 n. 10.
- United States v. Winstar Corp., 116 S.Ct. 2432 (1996), has no relevance to this proceeding. PPLICA R.B. at 10-12. Contrary to the parenthetical notation in the R.D. (R.D. at 67), Winstar is not a constitutional taking case; Winstar is a government contract case. No implied "regulatory compact" exists, let alone an express arrangement sufficient for PP&L to invoke a claim under contract law. In addition, unlike Winstar, no promises regarding a specified regulatory treatment were made to induce actions by the electric utilities; the decision to make investments is uniquely within the managerial discretion of the utility and cannot generally be superseded by the Commission. PPLICA R.B. at 11-12.
- Columbia Gas of Pa., Inc. v. Pennsylvania Pub. Util. Comm'n, 149 Pa. Commw. 247, 613 A.2d 74 (1992), aff'd 535 Pa. 517, 636 A.2d 627 (1994), is inapplicable. PPLICA R.B. at 13-14. Columbia Gas deals with a change in accounting procedures on the advice of outside auditors and the possible disallowance of recovery for customer arrearages based on the principle of retroactive ratemaking. PPLICA R.B. at 13-14. To assert that a Commonwealth Court opinion regarding retroactive ratemaking has relevance to the existence of the purported regulatory compact is absurd.

The primary focus of the Commission must be on interpreting the words of the Act and executing the will of the General Assembly. Decisions regarding whether the Commission's level of stranded cost recovery violates constitutional principles can only be determined after the Commission determines what the Act requires. Moreover, the existence (or non-existence, as it is) of a purported "regulatory compact" is irrelevant at this juncture because the Act governs stranded cost recovery.

Exception 3. The ALJ Errs In Rejecting The Proposals To Allocate Stranded Costs Between Ratepayers And Shareholders.

Exception to: R.D. at 77-80 & Proposed Findings of Fact # 59-62.

The R.D. rejects proposals by PPLICA (and others) to allocate stranded costs between ratepayers and shareholders. R.D. at 77-80. The reasons advanced by PP&L (and adopted by the ALJ) in support of this decision are baseless. PPLICA R.B. at 4-9. The Act clearly grants the Commission the discretion to institute the PPLICA proposal to arrive at a just and reasonable level of stranded cost recovery. PPLICA M.B. at 6-11 & 14-16. The Commission must reject the ALJ's recommendation and institute the "equity return disallowance" as advocated by PPLICA.

The Act cannot be construed to limit the Commission's administrative discretion in setting PP&L's future rates (including stranded cost recovery) to a simple inquiry of whether the investments and expenses in current rates were prudent. PPLICA R.B. at 6-7; See R.D. at 78. The definition of "stranded costs" excludes amounts previously disallowed as imprudently incurred. 66 Pa. C.S. § 2803. The Act further empowers the Commission to determine an amount of stranded costs that are just and reasonable to recover from ratepayers. Id. §§ 2804(13) & (14). This duty, and the Commission's duty under Section 1301, clearly require a prospective examination of whether the rates to be charged are a just and reasonable balance between the interests of the utility and the interests of ratepayers. PPLICA R.B. at 6-7.

The ALJ's reliance on Butler Township Water Co. v. Pennsylvania Pub. Util. Comm'n, 81 Pa. Commw. 40, 473 A.2d 219 (1984), and T.W. Phillips Gas & Oil Co. v. Pennsylvania Pub. Util. Comm'n, 81 Pa. Commw. 205, 474 A.2d 355 (1984), is also misplaced. Those cases address a unilaterally instituted Commission policy that rate case expenses should be shared between ratepayers and

shareholders. PPLICA R.B. at 7-8. Those cases are in no manner equivalent to the General Assembly's directive to permit a sharing of statutorily created "stranded costs."

Further, the R.D.'s statement that the OCA proposal would have a "devastating impact" on PP&L is based on PP&L's "apples to oranges" comparison using on its own severely flawed market price forecast. See PPLICA R.B. at 8. The PP&L analysis deals with the entire OCA stranded cost calculation (including its sharing proposal), not the sharing proposal itself. Id. PP&L submitted no such analysis regarding PPLICA's equity return disallowance, which results in a smaller portion of stranded costs being shared by utility investors.²

The Act clearly gives the Commission discretion to determine whether an equitable sharing is needed to produce a just and reasonable level of recoverable stranded costs. PPLICA requests the Commission exercise this discretion in this proceeding by adopting the PPLICA advocated equity return disallowance.

III. STRANDED COST CALCULATION METHODOLOGY

Exception 4. The ALJ Errs By Adopting PP&L's Flawed Application Of The Regulatory Methodology To Determine Stranded Generation Costs.

Exception to: R.D. at 81-83 & Proposed Findings of Fact # 72, 73 & 75-78.

The ALJ recommends adoption of the regulatory method for calculating stranded costs as "appropriate and fully consistent with the Act." R.D. at 81. The R.D. states that when the asset value

²The equity return disallowance compares the present value of revenue requirements associated with stranded generation costs (at a fully grossed up return level with a common equity return component) to a similar calculation without a common equity return component. PPLICA Statement 1, p. 12. Based on the PPLICA stranded generation cost calculation of \$242 million (see PPLICA M.B., Appendix B), the amount of stranded cost shared by ratepayers is \$47 million. PPLICA Statement 1, p. 13. When PPLICA's entire recommendation, including stranded NUG costs and regulatory assets, is considered, the equity return disallowance results in shareholders bearing less than seven percent of PP&L's properly claimed and quantified stranded costs. ($\$47,482,000 \div \$742,120,000 = 6.4\%$)

method and the regulatory method are properly applied, they should theoretically yield comparable results. Id. at 83. The R.D. references the PP&L applications of the methodologies that yield its claim of \$4.5 billion in stranded costs. Id. at 81. PPLICA excepts to the ALJ's recommendation. The ALJ errs by relying on PP&L's flawed application of both methodologies, which produce its inflated stranded cost claim. The Commission cannot permit itself to be dupped into the misconception that PP&L has correctly applied either methodology.

The PP&L "restatement" of its claim that is relied on by the ALJ to illustrate the "comparability" of the two methodologies is flawed and in the record in this case. PPLICA R.B. at 18-20. Although the Company presented what purported to be a simplistic illustration of the comparability concept in its rebuttal testimony, it did not present a recalculation of its own stranded cost claim. See PP&L Statement 8R, pp. 8-18; PP&L Statement 19R, pp. 8-14. Tables C and D attached to PP&L's Main Brief, which show this recalculation for the first time, must be completely disregarded as extra-record evidence. PP&L had the opportunity to introduce these calculations in its rebuttal testimony and chose not to do so. Instead, PP&L relied on a simplistic (and flawed) hypothetical example to attempt to prove this concept.

More importantly, PPLICA witness Kollen thoroughly discredited the simplistic PP&L hypothetical illustration as internally flawed in its treatment of taxes. See PPLICA Statement 3S, pp. 6-11, Surrebuttal Exhibits LK-1 & LK-2; PPLICA R.B. at 18-20. Mr. Kollen explained the flaws in the PP&L illustration as follows:

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

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

The PP&L methodology includes future years income taxes (for more than 40 years) due to equity returns under traditional cost of service regulation in contrast to 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. Again, the two methodologies provide equivalent results only if there are no income taxes, which is not the case.

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. Again, the two methodologies provide equivalent results only if there are no income taxes, which is not the case.

PPLICA Statement 3S, pp. 7-8.

Because of fundamental differences in the treatment of income taxes, the regulatory method as applied by PP&L does not yield a comparable result.

The only way the two methodologies can result in equivalent results is to ignore income taxes, which neither of the methodologies do, or to modify the income tax and after-tax or before-tax discount rate assumptions from what were actually used by the Companies. The PECO methodology results in a quantification of the after tax lost income associated with the generation assets. 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. PP&L misapplies the regulatory methodology and then distorts the asset value methodology to produce its "equivalent" result.

It is important to note that ALJ Gesoff recommends that a lost revenues approach be used to establish stranded cost in the West Penn restructuring proceeding. Pennsylvania Pub. Util. Comm'n v. West Penn Power Co., Docket No. R-00973981, Recommended Decision of ALJ Larry Gesoff, p. 150

("West Penn R.D."). The lost revenues approach adopted in West Penn is not the approach used by PP&L. ALJ Gesoff recommends adoption of an adjustment to the lost revenues approach for income taxes. The R.D. states:

I do not agree, however, with West Penn's use of a net of tax discount rate to determine the present value of its future cash flows. I agree with the OCA that this is inconsistent with providing a gross-up for income taxes in establishing West Penn's revenue requirements.

As the OCA notes above, West Penn fails to acknowledge that the taxes have been reflected in the revenue requirements analysis. This means that using West Penn's after-tax discount rate with respect to revenue requirements that have already been grossed-up for taxes counts the taxes twice. It includes them in calculating going forward revenue requirements, but excludes the effect of this grossed-up revenue requirement in determining the present value of this future cash flow. OCA witness Kahal's testimony shows that West Penn's approach produces a present value of revenue requirements at 1/1/99 that exceeds the book value of the plant at that date. It would provide more cash flow than is necessary to pay off West Penn's investment in the plant at that date.

Accordingly, I accept how the OCA adjusted the Company's analysis to reflect an appropriate discount rate to produce a result consistent with the asset valuation approach used by the Commission in the PECO case.

Id. Based on the record in this proceeding, the valuation methodology used and adopted by the Commission in the PECO proceeding is the appropriate methodology to calculate PP&L's stranded cost.

The restatement of PP&L's claim in its Main Brief contains the identical pervasive flaws that its hypothetical illustration contains. The restatement is overstated because of its treatment of income taxes. PP&L misapplies the asset value methodology by adjusting the treatment of income taxes. PPLICA was not able to fully explore this subject, of course, because of PP&L's failure to introduce the restatement into the record in this proceeding and provide a witness for cross-examination. The Commission cannot reasonably rely on a crucial calculation such as this when the parties have not been given an adequate opportunity to cross-examine and respond to the Company.

Furthermore, PPLICA has illustrated why PP&L's application of the regulatory methodology is fundamentally inconsistent with the definition of stranded cost contained in the Act. PPLICA R.B. at 15-18. First, contrary to the quotation in the R.D. and as PPLICA comments in its Reply Brief, stranded costs are not defined in the Act as "known and measurable net electric generation-related costs, determined on a net present value basis, which traditionally would be recoverable in a competitive generation market and which the commission determines will remain following mitigation by the electric utility." (R.D. at 82 (quoting 66 Pa. C.S. § 2803)). The misquotation of the definition omits a central concept from the definition that eviscerates any conformity between the PP&L application of the regulatory method and the definition; i.e., in order to qualify, a stranded costs must be "traditionally . . . recoverable under a regulated environment but which may not be recoverable in a competitive electric generation market." 66 Pa. C.S. § 2803. As PPLICA explains repeatedly, in the regulated environment, utilities are permitted a return of their investment, and the opportunity to earn a return on the investment. PPLICA M.B. at 26-27; PPLICA R.B. at 16-17. The PP&L regulatory methodology goes beyond providing a return of and opportunity to earn a return on investment and actually guarantees a return on the investment equal to the projected revenue stream for each year of each unit's life. PPLICA M.B. at 24-25. A return on investment is not guaranteed under traditional regulation; only an opportunity to earn a return on investment is guaranteed. See Barasch, 488 U.S. 299, Philadelphia Electric Co. v. Pennsylvania Pub. Util. Comm'n, 61 Pa. Commw. 325, 329, 433 A.2d 620, 623 (1981). PP&L's investors have the opportunity to earn a return through the competitive market; the investors do not need to be guaranteed that opportunity through acceptance of PP&L's regulatory method stranded cost calculation.

The PP&L application of the regulatory methodology is flawed and produces an inflated stranded cost calculation. Based on its flawed treatment of income taxes alone, the PP&L claim is

overstated by \$880 million. OCA Statement 1, p. 13. If the Commission does not correct this error, ratepayers will provide PP&L additional and unnecessary compensation in that amount. In addition, the regulatory methodology is not consistent with the definition of stranded costs under the Act. The Commission must reject the ALJ's recommendation to rely on PP&L's application of the regulatory methodology.

Exception 5. The ALJ's Reasons For Rejecting The OCA And PPLICA Asset Value Methodology Are Inaccurate.

Exception to: R.D. at 81-83 & Proposed Findings of Fact # 72, 73 & 75-78.

In support of the recommendation to employ the regulatory methodology to determine PP&L's stranded costs, the ALJ cites three criticisms of the asset value methodology. R.D. at 81-83. The reasons cited by the ALJ are inaccurate.

First, the ALJ's rejection of the asset value methodology because the PPLICA and OCA stranded cost models are "not in the record" in this case is preposterous. R.D. at 83. As PPLICA explains fully in its Reply Brief responding to an identically worded criticism by PP&L, extensive testimony and exhibits were submitted regarding the PPLICA stranded cost calculation. PPLICA R.B. at 21. The models were sufficiently defined in the record to enable PP&L to file rebuttal testimony and to cross-examine the PPLICA witnesses regarding the calculations. The presentations made by PPLICA and the OCA in this proceeding are comparable to the presentations by each party in the PECO, West Penn and Duquesne restructuring proceedings. Query how the Commission in the PECO proceeding and the ALJ's in the West Penn and Duquesne proceedings could rely on the OCA analyses if those analyses are, according to this R.D., not in the record despite nearly identical presentations by the OCA. The absurdity of the ALJ's statement is evident.

Second, the use of the asset value methodology in the PECO proceeding has a direct influence on the calculation of PP&L's stranded costs in this proceeding. As originally scheduled, PP&L and PECO were operating on nearly parallel schedules. Mr. Falkenberg submitted testimony in both proceedings. The Commission in PECO recognized the inherent logic in Mr. Falkenberg's statements:

- Under traditional regulation, a utility never had the expectation of guaranteed future revenues (PECO Restructuring Order, 181 PUR 4th at 555 n. 71) (see also PPLICA Statement 2, p. 11);
- Under traditional regulation, utilities had a reasonable opportunity to earn a just and reasonable return on investment (PECO Restructuring Order, 181 PUR 4th at 555 n. 71) (see also PPLICA Statement 2, p. 11)

The underlying arguments expressed and adopted by the Commission in PECO have not been rebutted in this proceeding. The superiority of the asset value methodology remains intact.

Third, the asset value methodology does not "present[] numerous problems and complexities" or represent a "mixed, hybrid approach." R.D. at 83. The "problems and complexities" were apparently not insurmountable in the PECO proceeding. PPLICA R.B. at 17. As evidenced by the Commission's use in the PECO proceeding, the asset value methodology is not a "hybrid approach"; rather, the asset value methodology is the correct approach to calculating PP&L's stranded generation cost. PPLICA R.B. at 20-21; PPLICA Statement 3S, p. 12.³

³If the Commission accepts use of the asset value methodology, the Company's proposed treatment of "taxes recoverable" and "accumulated deferred taxes", which were altered for the first time in its Main Brief, must be rejected. See PP&L M.B. at 127-131. As PPLICA explains in its Reply Brief, both of the Company's calculations on these issues are extra-record evidence. PPLICA R.B. at 39-41. Moreover, the Company's claims are incorrect and baseless. Id. Consequently, if the Commission grants PPLICA's exception regarding adoption of the asset value methodology, the Commission should also consider (and reject) the ALJ's Proposed Findings of Fact on the tax issues (Proposed Findings of Fact # 210-212).

Exception 6. The ALJ Errs In Endorsing PP&L's Possible Foregone Recovery Of Stranded Cost Necessitated By The Rate Cap As A Type Of Mitigation.

Exception to: R.D. at 74 & Proposed Finding of Fact # 50.

The R.D. discusses, apparently with approval, PP&L's designation of possible foregone recovery of stranded costs necessitated by the operation of the rate cap as a type of mitigation. R.D. at 74. PPLICA excepts to recognition of foregone recovery as mitigation.

First, because the R.D. does not quantify the effect of the modifications it recommends be made to PP&L's stranded cost claim, it is uncertain whether such foregone recovery will occur. Moreover, if the OCA or PPLICA calculations of stranded costs are adopted (which they should be) PP&L will fully recover its allowed level of stranded costs despite the rate cap. PPLICA M.B. at 20. The issue will consequently be moot. Second, foregone recovery is anticipated and expected under the Act. PPLICA M.B. at 20. As Dr. Kalt recognizes, "the recovery of stranded costs is constrained both in time and in amount." PP&L Statement 1, p. 16. Consequently, foregone recovery cannot be considered a legitimate form of mitigation pursuant to the Act.

IV. MARKET PRICE OF ELECTRICITY

Exception 7. The ALJ Errs In Relying On PP&L's Market Price Forecast.

Exception to: R.D. at 83-112 & Proposed Findings of Fact # 80, 84, 87-90, 92-96, 101-104, 106-125, 128-131, 133, 140-143, 146, 168 & 169.

The R.D. recommends use of the market price forecast performed by PP&L's Dr. Scott Jones for calculation of PP&L's stranded generation cost. R.D. at 112. The R.D. endorses both PP&L's use of the EGEAS model and PP&L's inputs to that model. Id. at 88-92 & 94-111. PPLICA excepts to both aspects of the ALJ's recommendation.

A. The Results Obtained from the EGEAS Model are not Reasonable.

Extensive evidence was submitted in this proceeding explaining the unreasonableness of the results of PP&L's market price forecast. See PPLICA Statement 2, pp. 12-49; PPLICA Statement 2S, pp. 13-38 & 59-65; Tr. 1717-1719 (Aug. 26, 1997). As PPLICA has shown, the cumulative effect of the many errors committed by Dr. Jones severely depresses energy prices. In addition, PP&L capacity prices do not support the addition of capacity necessary to meet expected load growth in the PJM region projected by PP&L's EGEAS run. Because of these flaws, the Commission cannot reasonably rely on the PP&L analysis.

First, PP&L's energy prices are unreasonably depressed. The unreasonableness of PP&L's forecast is obvious when compared to the forecasts presented by OCA and PPLICA. The Commission must recognize that identical forecasts submitted by Mr. Smith and Mr. Falkenberg⁴ were both deemed "credible" in the PECO proceeding. PECO Restructuring Order, 181 PUR 4th at 558. The Commission has already accepted the ENPRO Model used by Mr. Smith. Id. at 559. The Commission also noted Mr. Smith's "overall credibility" and the "substantial merit" of several of Mr. Falkenberg's recommendations. Id. at 558 & 559. Unlike PP&L's Dr. Jones, Mr. Smith and Mr. Falkenberg did not have the luxury of tailoring their analyses to predict a market price forecast showing the best results for their clients in each PJM utility restructuring proceeding; rather, Smith and Falkenberg each performed one forecast of the PJM region that they have presented in each of the restructuring proceeding of the PJM-member utilities. The Smith and Falkenberg analyses are reasonable; the Jones analysis is an outlier in this proceeding.

⁴Contrary to the ALJ's assertion, Dr. Jones is not the only market price forecast witness with extensive experience. See R.D. at 84 n. 19. Mr. Falkenberg's vast experience is detailed in PPLICA Exhibit RJF-1. This experience includes multiple appearances before this Commission. Id.

To illustrate the variance between the Jones forecast and the credible Smith and Falkenberg forecasts, PPLICA has compiled the following table. The OCA energy prices were obtained from OCA Exhibit DCS-12; the PPLICA prices from PPLICA Exhibit SJB-6; and, the PP&L prices from PP&L Exhibit STJ-7 (Revised 9/4/97).

**ENERGY PRICES
\$/MWH**

| Year | OCA | PPLICA | PP&L |
|------|-------|--------|------|
| 1999 | 21.64 | 25.75 | 22 |
| 2000 | 22.62 | 27.88 | 23 |
| 2001 | 24.24 | 28.18 | 24 |
| 2002 | 25.51 | 28.88 | 24 |
| 2003 | 27.08 | 29.42 | 25 |
| 2004 | 28.24 | 29.58 | 26 |
| 2005 | 29.89 | 30.70 | 26 |
| 2006 | 32.18 | | 27 |
| 2007 | 33.64 | | 29 |

The divergence between the OCA and PP&L market prices increases drastically in the ensuing years. See OCA Exhibit DCS-12 & PP&L Exhibit STJ-7 (Revised 9/4/97).

The market prices represented in DCS-12 are identical to the prices used by the Commission to establish PECO's stranded cost recovery. Although PPLICA believes that Mr. Falkenberg's forecast is reasonable, the Commission should not in this proceeding endorse a different measure for these critical decisions that will have a major impact on the development (or non-development) of a competitive market in the PP&L service territory. Adoption of a fundamentally different forecast such as Dr. Jones' will be inequitable to all market participants except PP&L. PPLICA M.B. at 19-20. The

Commission should be mindful of the advantage that PP&L will gain from predicting lower than actual market prices in this proceeding — i.e., a windfall profit to subsidize its competitive future. See OCA Statement No. 2, p. 2.

Second, PP&L's forecasted capacity prices are clearly insufficient. Even with the adjustments made by Dr. Jones in rejoinder testimony, the forecasted capacity prices will not support the addition of capacity necessary to meet expected load growth forecasted by PP&L's EGEAS modeling. PPLICA Statement No. 2S, pp. 13-33 & Exhibit Nos. RJF-11A-R, RJF-11B-R, RJF-13A & RJF-13B; Tr. 1717-1719 (Aug. 26, 1997). Contrary to the ALJ's impression, this issue is not a "tempest in a teapot." R.D. at 86. Investors in the competitive market will only build capacity if they anticipate prices sufficient to recover the capacity and energy cost of a new generator. PPLICA Statement 2, pp. 12-13. The Commission recognized the substantial reliability concerns that can arise if it is uneconomic to build necessary capacity.

Additionally, the shopping credits of this decision are large enough to ensure that it will be economic to build new generation plant that could be necessary to protect reliability. Consequently, the Commission's approach is also consistent with its duty under the Act to preserve reliability.

PECO Restructuring Order, 181 PUR 4th at 541 (emphasis added). The EGEAS modeling predicts that capacity additions will be needed to serve growing demand, but Dr. Jones' capacity prices will not support the construction of that new capacity. If the PJM system lacks sufficient generation resources to serve demand, reliability may be detrimentally impacted. Concerns about reliability are certainly more important than a "tempest in a teapot." The ALJ errs in attempting to minimize the impact of this obvious flaw in the Jones analysis.

B. No Reasonable Basis Exists for the Commission to Rely on Dr. Jones' Judgmental and Widely Divergent Input Variables.

The R.D. also endorses Dr. Jones' inputs to the EGEAS model as "reasonable." R.D. at 94. The critical inputs at issue are the fuel price forecast and inflation forecast. Id. The ALJ criticizes the PPLICA and OCA analyses for relying on forecasts of both inputs that were prepared by independent entities (i.e., EIA and DRI). Id. at 94. The ALJ "reject[s] these fuel price forecasts as unreliable inputs to any model and direct[s] use of fuel price forecasts developed by Dr. Jones." R.D. at 101.

This conclusion is contrary to the weight of the evidence presented in this proceeding; rather, the evidence in this proceeding clearly shows that Dr. Jones' inputs are biased and unreliable. PPLICA Statement 2, pp. 27-35, 37-40 & 63-68; PPLICA Statement 2S, pp. 33-38. Because Dr. Jones' inputs cannot be independently verified (i.e., the inputs are based solely on his uncorroborated judgment), the Commission cannot reasonably rely on his forecast. Dr. Jones' fuel price escalation rates are "a black box that he can assert consistently considers any and all variables" with no way for the parties or the Commission "to determine the relative significance of any single variable, or the logical connections between any two variables." PPLICA Statement 2S, p. 41.

The DRI and EIA forecasts used by the OCA and PPLICA, respectively, in this proceeding are relatively congruent. That is, the DRI and EIA forecast predict approximately equal escalation rates for the fuel types for the period 1995 to 2015. PPLICA Statement 2, Exhibit No. RJF 2.⁵ Exhibit RJF-2 also depicts the escalation rates predicted by ICF (which was presented in the PECO restructuring proceeding). Id. Finally, the exhibit shows Dr. Jones' escalation rates. The striking concept that this

⁵Exhibit No. RJF-2 shows the escalation rates in the Fall 1996 DRI forecast. DRI updated that forecast in Spring 1997. OCA Statement No. 2S, p. 4. The OCA updated its market price forecast and stranded cost calculation to reflect the Spring 1997 DRI forecast. Id. at 4-5. The Spring 1997 forecast showed decreased natural gas price escalation rates and increased coal price escalation rates. Id. at 4.

exhibit, taken as a whole, illustrates is the vast divergence between the three independent, nationally recognized forecasts and Dr. Jones' forecast.

In addition, the Commission and two other ALJs have indicated the view that nationally recognized forecasts (and specifically the DRI forecast) are reasonable inputs to a market price forecast. The Commission in PECO accepted the OCA market price forecast and specifically noted that "Smith's model fairly represents several other important matters such as . . . fuel prices" PECO Restructuring Order, 181 PUR 4th at 559. ALJ Gesoff, noting the Commission's acceptance of the DRI forecast in the PECO decision, found the DRI forecast reasonable for use in the West Penn restructuring proceeding. West Penn R.D., p. 316. ALJ Corbett also recommends reliance on the OCA analysis, including the DRI forecast, in the Duquesne Light Company restructuring proceeding. Pennsylvania Pub. Util. Comm'n v. Duquesne Light Co., Docket No. R-00974104, Recommended Decision of John H. Corbett, Jr., pp. 218 & 273 ("Duquesne R.D.").

In other words, the PECO, West Penn, and Duquesne market price forecasts endorsed by the Commission or ALJs have, as of this date, been premised on a single set of fuel price escalation rates—the Spring 1997 DRI forecast. Endorsement of the ALJ's recommended Jones fuel price forecast in this proceeding would, in effect, lead to the conclusion that some reasonable basis exists for the Commission to believe that fuel prices will be the same for PECO, Duquesne, and West Penn, but will differ significantly for PP&L. Despite any perceived differences between the utilities at issue, no reasonable basis exists for this conclusion; fuel price escalation rates will be relatively equal (if not identical) in all regions of this Commonwealth.

Furthermore, it is inaccurate to state that the independent input forecasts presented in this proceeding lack a "substantive basis." R.D. at 97. As Mr. Falkenberg testifies, in order to verify its forecast the EIA

compares three of its own forecasts (the reference case, low and high) with two DRI forecasts, two IEA forecasts, and forecasts from WEFA, Gas Research Institute ("GRI"), and two other sources. Of these eleven forecasts, seven [including the EIA reference and high cases, the DRI base case, WEFA, both IEA forecasts, and Petroleum Economics Ltd. ("PEL")] predict real *increases* in oil prices over the period 1995 to 2010. The remaining four forecasts that predict constant or declining real prices include the forecasts that EIA and DRI describe as their "low" price scenarios.

PPLICA Statement 2, p. 31. In order to support use of Dr. Jones' forecast, the Commission must make the judgment that all of these other independent organizations that have no interest in the outcome of this proceeding are wrong. As PPLICA witness Mr. Falkenberg explains,

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

PPLICA Statement 2S, p. 37.

The same arguments apply to Dr. Jones' inflation estimate. Rather than rely on disinterested sources, Dr. Jones uses his omniscient personal judgment to predict a much lower rate of general inflation. Id. at 37-38. Again, acceptance of the Jones inflation estimate of 2.5% will lead to the anomalous situation of general inflation being lower in the PP&L service territory than in other areas of the state. Although inflation may vary slightly, the significant differences between the DRI forecast and the Jones forecast are illogical and improbable.

C. Dr. Jones' "Modeling" of Capacity Prices is Clearly Deficient.

The R.D. adopts the Jones market price forecast, including Jones' capacity price forecast. R.D. at 86-87. This forecast fails to support the capacity additions that Dr. Jones' run of the EGEAS model projects will be necessary to meet increased future load demand in the PJM market. One possible reason for the deficiency of Dr. Jones' analysis is his ad.hoc establishment of capacity prices.

Rather than relying on the capacity prices generated by his EGEAS run, Dr. Jones “examined” various items (such as the EGEAS run and capacity contracts prices that PP&L had been offered) and, based solely on his judgment, determined a forward capacity value. PPLICA Statement 2S, p. 15. The R.D. ignores PPLICA’s substantial criticism of Dr. Jones’ methodology. Id. The most salient criticism is that Dr. Jones’ capacity prices reflect only wholesale transactions, which are thinly traded and simply not indicative of a long-term market capacity value in the post-restructuring environment. Id. at 15-16.

Because of the inherent linkage between energy and capacity prices, it is best to rely on one model’s prediction of both. Dr. Jones fails to do so, such failure contributing to the inability of his forecasted capacity prices to support the addition of necessary capacity projected by his model. Dr. Jones’ “modeling” of capacity prices must be rejected.

D. Dr. Jones’ Modeling of Energy Prices is Flawed.

The R.D. adopts the Jones EGEAS analysis. R.D. at 96. The R.D. fails to address, however, the substantial criticisms raised by PPLICA regarding the Jones analysis. See PPLICA M.B. at 32-33 & 37-39. The Jones analysis depicts a cost-constrained, regulated environment, rather than a competitive bid based market. PPLICA Statement No. 2, p. 15. In addition, Dr. Jones’ use of EGEAS contains many other flaws, including understating revenue from intermediate and peaking units and using an ad hoc method for mapping dispatch hours. Id. at 46-47.

The most significant criticism of Jones’ analysis is his treatment of start-up and no-load costs. Although the R.D. attempts to minimize the impact of this issue, because fundamental bidding behavior by generators in the competitive market is involved, the issue is paramount. The R.D. suggests that generators will bid their unit in the market at prices that do not cover the fixed costs of operating the unit that are incurred prior to producing one kilowatt of electricity. R.D. at 92-93. The R.D. states that PPLICA and the OCA do not “have a clear grasp of the incentives facing generators in a competitive

market." R.D. at 92 Apparently, the Commission and ALJs Córbett and Gesoff also do not have a clear grasp of the incentives of the competitive market, as evidence by their acceptance of OCA witness Smith's analysis, which includes start-up costs in bids, in each of the respective proceedings. PECO Restructuring Order, 181 PUR 4th at 559; Duquesne R. D., pp. 204-205 & 272; West Penn R. D., p. 315. It is not reasonable to conclude that generators will exhibit fundamentally different bidding behavior in different areas of the Commonwealth. The R.D. must be modified to reflect inclusion of no-load costs in hourly bids.

Exception 8. The ALJ's Criticisms Of The PPLICA Analysis Are Without Basis.

Exception to: R.D. at 83-112 & Proposed Findings of Fact # 90, 93-96, 101, 104, 108-109, 111-115, 117-122, 125, 129-131, 143, 146 & 168-169.

In the discussion regarding the market price analyses, the R.D. asserts various criticisms of the PPLICA forecast that are without basis. PPLICA excepts to the rejection of its market price forecast based on these unfounded criticisms. Although PPLICA believes it presents a credible and reasonable forecast of future market prices in the PJM region, PPLICA acknowledges the need for consistency between the Commission's decision here and the Commission's decision in the PECO restructuring proceeding. See PPLICA M.B. at 19-20 & 30. Consequently, PPLICA endorses use of the OCA forecast for both; however, PPLICA requests that Mr. Falkenberg's analysis again be deemed "credible" (as it was in the PECO proceeding) and be recognized as a favorable check on the reasonableness of the OCA analysis.

First and foremost, the R.D.'s rejection of independent fuel price and inflation forecasts (as used by PPLICA and OCA) is clearly inappropriate. PPLICA addresses this issue extensively in previous sections of these Exceptions (see Exception 7, Section B, supra), in its Main and Reply Briefs (PPLICA M.B. at 30-32, 39-41 & 44-47; PPLICA R.B. at 29-31), and in its testimony (PPLICA Statement 2,

pp.28-35; PPLICA Statement 2S, pp. 33-38). In sum, on a critical issue such as fuel price and inflation forecasts, it is more prudent for the Commission to rely on forecasts by independent organizations rather than a witness that performs both the fuel price forecast and the market price forecast.

Second, the KPC model used by Mr. Falkenberg is completely appropriate. It is incorrect to state that the KPC model is not tested in the real world (see R.D. at 89); the KPC model has been successfully benchmarked against many "commercial" models and has been relied on in regulatory proceedings. PPLICA Statement 2S, pp. 43-50 & Exhibit No. RJF-14. The model is proprietary (see R.D. at 89), but was made available to PP&L in this proceeding, unlike the EGEAS model which was not provided to the other parties in the proceeding. PPLICA Statement 2S, p 45. Mr. Falk's criticisms of the KPC model were addressed and rebutted by Mr. Falkenberg. See id. pp. 39-40, 43-51 & 60-65. Moreover, Mr. Falk's ability to determine the effects of errors in models was called into question by his inaccurate assessment of the effect of an error in PP&L's modeling. Compare Tr. at 1703 (Aug. 26, 1997) to PP&L Exhibit STJ-7 (Revised 9/4/97).

V. REVENUE UNDER REGULATION

Exception 9. PP&L's Fossil Decommissioning Expense Is Not Recoverable Under The Act And Relevant Precedent.

Exception to: R.D. at 129-32 & Proposed Findings of Fact # 219-223 & 226.

The R.D. recommends that PP&L be permitted to recover as part of its stranded cost claim \$315.867 million for future costs of decommissioning fossil fuel generating units. R.D. at 130-132.

The PECO precedent on fossil decommissioning is a sound application of the Act and relevant precedent. The Penn Sheraton line of cases is clearly applicable to PP&L's claim for these future costs. PPLICA M.B. at 56-60. Future fossil decommissioning costs are not "typically recoverable" in a

regulated environment until actually incurred. Id. Consequently, the costs do not qualify under the definition of stranded costs. 66 Pa. C.S. § 2803.

In addition, contrary to the ALJ's impression, the concerns expressed by the Commission in the PECO proceeding are present here. Costs that may be incurred twenty to forty years in the future to possibly decommission a fossil site are not "known and measurable." PPLICA M.B. at 56-60; PPLICA R.B. at 35-36; PPLICA Statement 3, pp. 30-35. There is no more indication in this proceeding than there was in the PECO proceeding 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." See PECO Restructuring Order, 181 PUR 4th at 560; See also PPLICA Statement 3, pp. 31-32. Consequently, there is no reasonable basis to treat the market participants in the PECO service territory differently than the market participants in the PP&L service territory on this issue. See 66 Pa. C.S. § 2802(8).

Furthermore, the Act does not "clearly permit[] recovery of these retirement costs." PPLICA R.B. at 35-36; See R.D. at 131 n. 39. The General Assembly specifically recognized the recoverability of nuclear decommissioning costs. 66 Pa. C.S. § 2803. If the General Assembly intended fossil decommissioning costs to be recoverable, it would specifically have stated so, rather than making a vague reference to "retirement costs." Moreover, it is reasonable to assume that the Legislature, when passing the Act, recognized the long line of precedent denying recovery for prospective fossil decommissioning costs. PPLICA R.B. at 36. Finally, all claimed stranded costs must meet the general definition in the Act by being "known and measurable" and "traditionally . . . recoverable under a regulated environment"; as PPLICA shows, PP&L's claim for future fossil decommissioning costs meets neither requirement. PPLICA M.B. at 56-60; PPLICA R.B. at 35-36; PPLICA Statement 3, pp. 30-35.

Exception 10. The ALJ Inappropriately Permits PP&L To Recover A Regulatory Asset For Future Unrecovered Energy Costs.

Exception to: R.D. at 126-28 & Proposed Findings of Fact # 196, 198 & 199.

The R.D. permits PP&L to recover its full \$76.815 million claim for "Unrecovered Energy Costs." R.D. at 126-28. The Company's claim includes both actual unrecovered energy costs as of December 31, 1996, and a projection of future unrecovered energy costs for 1997 and 1998. Id. PPLICA excepts to the ALJ's recommendation to allow PP&L to recover the projected unrecovered costs for 1997 and 1998. The projected unrecovered energy costs are not properly recoverable under the Act. PPLICA M.B. at 54-55; PPLICA R.B. at 33-34.

In order to be recoverable under the Act, a regulatory asset must be "known and measurable" and typically recoverable in a regulated environment. 66 Pa. C.S. § 2803. An "expectation" of under-recovery (see R.D. at 127) is not sufficient to satisfy the known and measurable standard. PPLICA M.B. at 52-54; PPLICA Statement 3, p. 17. In addition, these costs were not recoverable in the regulated environment until actually incurred. Id. Consequently, the costs do not qualify for recovery under the definition of stranded costs. See 66 Pa. C.S. § 2803.

Furthermore, as recognized in the PECO proceeding, granting stranded cost recovery for unrecovered fuel costs after the ECR roll-in circumvents the Act's rate cap. PECO Restructuring Reconsideration Order, slip op. at 11. Contrary to the statement in the R.D., the Tentative Order granting approval of the roll-in did not create a regulatory asset for the future unrecovered costs; PPLICA filed a petition for amendment of the Tentative Order, which was granted by the Commission, specifically requesting that the issue of whether future unrecovered energy costs could be properly claimed as a stranded regulatory asset be deferred until this proceeding. Petition for Amendment of the Pennsylvania Power & Light Company Industrial Customer Alliance, Docket Nos. P-00961131 &

R-00963848, Opinion and Order entered on May 22, 1997, slip op. at 9-10. The burden was on PP&L to prove that the unrecovered energy costs were properly recoverable as stranded costs, which PP&L has not done.

Exception 11. The ALJ Inappropriately Permits PP&L To Recover The "Employee Transition Cost" Regulatory Asset.

Exception to: R.D. at 128-129 & Proposed Findings of Fact # 200, 203, 204 & 206.

The R.D. recommends that PP&L be permitted to recover its claimed \$17.106 million regulatory asset for "Employee Transition Costs." R.D. at 128-29. As PPLICA explains fully in its briefs, PP&L's claim fails to meet the "known and measurable" standard under the Act. PPLICA M.B. at 54; PPLICA R.B. at 34-35. Furthermore, the Company's calculation fails to account for normal employee attrition. Id. Consequently, PPLICA requests the Commission modify the R.D. to disallow recovery for the "Employee Transition Cost" regulatory asset.

Exception 12. The ALJ Fails To Address PPLICA's Recommended Regulatory Liability For Pension Plan Over Funding.

Exception to: R.D. at 128-29 & Proposed Findings of Fact # 208-210.

Although the R.D. contains a section titled "Employee Transition Costs and Pension Plan", the ALJ fails to address PPLICA's recommendation that PP&L recognize a regulatory liability for over-funding of its pension plan. R.D. at 128-29. The ALJ does conclude the section by stating that the PPLICA adjustments are "inappropriate and are rejected." Id. at 129. PPLICA excepts to this conclusion.

PPLICA submits extensive testimony dealing with pension plan over-funding. PPLICA Statement 3, p. 14-16. As PPLICA explains, the Act requires PP&L to offset its regulatory assets with any regulatory liabilities. PPLICA M.B. at 55-56. The amounts contributed to the pension plan by the ratepayers in the past must be returned to ratepayers via a regulatory liability in the amount of \$253.832

million. Id. PPLICA requests the Commission recognize a regulatory liability in PP&L's stranded cost calculation for this amount.

Exception 13. The ALJ Inappropriately Rejects PPLICA's Recommended Regulatory Liability For SFAS 106 Trust Fund Earnings.

Exception to: R.D. at 139-40 & Proposed Finding of Fact # 251.

The R.D. rejects PPLICA's proposed regulatory liability for SFAS 106 trust fund earnings. R.D. at 139-40. PPLICA excepts to this recommendation. As PPLICA illustrates, these earnings should properly be credited to ratepayers through a regulatory liability. PPLICA M.B. at 63-65; PPLICA Statement 3, pp. 27-28.

Despite acknowledging that the Commission required PECO to recognize an identical regulatory liability in its stranded cost claim, the ALJ recommends that PP&L not be required to recognize the \$53.990 million regulatory liability. The ALJ states that PP&L has used those trust fund earnings to reduce SFAS 106 expenses, and thus, has already credited ratepayers as part of its stranded cost calculation. R.D. at 140.

As PPLICA explains in its Reply Brief, PPLICA witness Kollen addressed and rebutted the Company's claim in his surrebuttal testimony. PPLICA R.B. at 37; PPLICA Statement 3S, pp. 28-29. Thus, PP&L's ratepayers have not been recompensed for these overpayments. PPLICA respectfully requests the Commission recognize a regulatory liability to compensate the ratepayers for the excess trust fund earnings.

Exception 14. The ALJ Errs By Permitting PP&L To Recover Its "Department Of Energy Assessment" Regulatory Asset.

Exception to: R.D. at 135-36 & Proposed Finding of Fact # 242.

The R.D. recommends recovery by PP&L for its claimed \$16.361 million regulatory asset for DOE assessments. R.D. at 135-36. The R.D. states that PP&L rectified its earlier error by removing

the costs related to the assessment from the Company's stranded generation cost claim. Id. at 136 n. 42. Although the Company claims to have removed the DOE assessment from the stranded generation cost claim, the Company reflected no decrease in its litigation claim to indicate removal. PPLICA M.B. at 62; PPLICA Statement 3S, p. 26. PPLICA submits the double recovery situation should be modified by rejecting the Company's claimed regulatory asset.

Exception 15. The ALJ Errs By Permitting PP&L To Use Unreasonable Retirement Dates For Its Stranded Cost Calculation.

Exception to: R.D. at 141-43 & Proposed Findings of Fact # 256-259.

The R.D. accepts PP&L's use in its stranded cost calculation of retirement dates for jointly-owned PECO/PP&L units that are different from the retirement dates used to calculate PECO's stranded cost. R.D. at 141-43.

The retirement date for units directly impacts the stranded generation cost calculation by determining how many years revenues PP&L will receive from the unit in the competitive market. The longer the unit life, the more revenues PP&L will receive from the unit. The more revenues PP&L receives from a unit, the lower PP&L's stranded cost associated with that unit.

PP&L uses retirement dates for generating units owned jointly by PP&L and PECO (and others) that are inconsistent with the dates used in the PECO proceeding. PPLICA M.B. at 49 & 50; PPLICA R.B. at 38. The Commission cannot permit this illogical result to remain. A generating unit will have a single retirement date. The date will not change based on which utility seeks to use its share of electricity from the unit. Id. The Commission's prior practice of allowing utilities to use different retirement dates for jointly owned facilities is illogical and should not be perpetuated into the competitive market. Id. The R.D. recommends this patently illogical result. The R.D. must be modified to use consistent retirement dates with the PECO proceeding.

VI. DETERMINATION OF PRESENT VALUE

Exception 16. The ALJ Inaccurately Categorizes PPLICA's Stranded Cost Calculation As Disallowing The Recovery Of Income Taxes.

Exception to: R.D. at 145-46 & Proposed Finding of Fact # 277.

The ALJ endorses PP&L's argument that the PPLICA and OCA stranded cost calculations are understated and deny recovery for income taxes. R.D. at 145-46. The PPLICA stranded cost calculation fully includes income taxes. PPLICA R.B. at 41-42; PPLICA Statement 3S, pp. 5-6, 10-11 & 13.

PP&L must pay income taxes only on the portion of the CTC that represents the equity financing of stranded costs during the transition period; the CTC revenue representing the return of the investment is not taxable. PPLICA Statement 3S, pp. 10-11 & 13. Consequently, PPLICA fully accounts and compensates PP&L for the income tax the Company will actually pay. Id. at 5-6.

VII. RECOVERY OF STRANDED COSTS

Exception 17. The ALJ's Recommendation To Allow PP&L To Gross-up Its Return On Unamortized CTC Balances Is Not Supported By Record Evidence And Otherwise Inappropriate.

Exception to: R.D. at 155-156 & Proposed Finding of Fact # 306.

The ALJ recommends that PP&L be permitted to gross-up the rate of return on unamortized CTC balances for income taxes because some of its assets are purportedly financed with securities. R.D. at 155-56. The ALJ states that disallowing the Company's request would be an "unlawful taking of PP&L property without just compensation" and that PP&L has an "entitlement to a reasonable return on its investment." Id.

No record evidence supports the Company's proposal to perform this gross-up. PPLICA R.B. at 45. Because PP&L failed to raise the issue in testimony, the Company should not be permitted approval of a proposal raised for the first time in its brief. In addition, the Commission did not permit

PECO to gross-up the return on any portion of its stranded cost claim. Id.; PECO Restructuring Order, 181 PUR 4th at 567. It would consequently be inequitable for the Commission to afford PP&L different treatment. See 66 Pa. C.S. § 2802(8). Furthermore, contrary to the ALJ's impression, under traditional regulation, PP&L does not have an "entitlement to a reasonable return on its investments" (R.D. at 156); rather, PP&L is entitled to a return of its investment and the opportunity to earn a return on its investments. Barasch, 488 U.S. 299; Philadelphia Electric Co. v. Pennsylvania Pub. Util. Comm'n, 61 Pa. Commw. 325, 329, 433 A.2d 620, 623 (1981). Consequently, no takings issue exists if PP&L's belated attempt to gross-up the return on a portion of its stranded cost claim is rejected (which it should properly be).

VIII. RATE DESIGN AND TARIFFS ⁶

Exception 18. The ALJ's Adoption Of PP&L's Proposed Limitations On The Availability Of Interruptible Rate Schedules (IS-T and IS-P) And Residential Rate Schedules (RTD and RTS) Violates The Rate Cap And Anti-Cost Shifting Provisions Of The Act And Is Otherwise Contrary To The Act's Central Goals.

Exception to: R.D. at 163-65 & Proposed Findings of Fact # 307, 309 & 311-13.

The ALJ adopts the Company's proposal to limit the availability of Interruptible Rate Schedules IS-T and IS-P, as well as Residential Rate Schedules RTD and RTS, to customers taking full requirements service from PP&L as bundled customers. R.D. at 163-65. In support of this conclusion, the R.D. states: "[w]e do not find that the shifting of customers from one rate schedule to another violates the rate cap since no tariffed rates are actually being changed." Id. at 164. PPLICA submits that this bizarre conclusion misinterprets the rate cap protections of the Act and is otherwise contrary to the central foundations of the Act.

⁶PPLICA notes that proposed findings of fact numbers 314 thru 316 are inconsistent with the ALJ's rejection of the proposed tariff changes and must be deleted from the R.D. See R.D. at 167-68.

PP&L submitted unbundled rates for all of the tariff offerings at issue. See PP&L Statement 11, Exhibit OGK-2, pp. 19B, 21, 22, 30A & 30C. Those unbundled rate schedules contained charges for *generation, transmission and distribution*. Id. Those unbundled rate schedules also specified a CTC applicable to customers taking the particular type of service. Id. Under the PP&L proposal, which was adopted by the ALJ, the CTC specified in those rates schedules only applies to customers that continue to take generation service from PP&L. Id. If a customer exercises the right to direct access, it will pay a CTC based on a firm rate schedule instead of the CTC it paid when it was a generation customer of PP&L. Id. This CTC switch is obviously unlawful, unreasonable, anti-competitive, injurious to economic development and wholly inconsistent with Chapter 28. PPLICA M.B. at 71-77; PPLICA R.B. at 45-47.

The change in CTC liability caused by a customer's desire to exercise the right of direct access to competitive supply is drastic. For the PPLICA member companies that currently take interruptible service, this change to a firm rate schedule will increase the members' aggregate annual CTC responsibility by over \$10 million. PPLICA M.B. at 75-76; See PPLICA Statement 1, pp. 47-49. In other words, if all the PPLICA members on interruptible service were able to find electricity in the market at a price equal to the price stated in PP&L's interruptible tariff, the members would experience an aggregate \$10 million annual increase in electricity costs because of accessing the competitive market. This change is based solely on the customer exercising the right of direct access to competitive supply. Tr. at 1066-67 (Aug. 20, 1997) This result belies logic and undercuts the central goals of the Act; i.e., to increase Pennsylvania's economic prosperity via lower production costs for key manufacturing inputs such as electricity (see 66 Pa. C.S. § 2802(6) & (7)).

As PPLICA members explained, an increase in cost such as this will detrimentally impact decisions regarding whether to place new production facilities in Pennsylvania (and the PP&L service

territory) and whether to expand production at existing facilities. PPLICA M.B. at 74-77; PPLICA Statement 4; PPLICA Statement 5. In addition, the CTC switch may result in the discontinuation of production at facilities in the PP&L service territory. This is obviously contrary to the pro-growth intention of the General Assembly in enacting the legislation. See PPLICA M.B. at 1-3 & 5.

Importantly, the General Assembly acknowledged that no customer should be saddled with a *higher electricity bill during the period of stranded cost recovery* simply because of the transition to a competitive market. Under the Act, customers are required to compensate PP&L for the stranded costs the PUC determines are properly recoverable. 66 Pa. C.S. § 2808. In return for this subsidization of PP&L's position in the competitive environment, customers have the protection of various rate caps. Id. § 2804(4).

Once PP&L's period for stranded cost recovery expires, the rate caps also expire. Id. The Act requires that all current rate schedules be unbundled and that no "class of customers can be denied the opportunity to shop." PECO Restructuring Order, 181 PUR 4th at 570. The Company's proposal literally and economically denies interruptible customers the opportunity to shop. See PPLICA Statement 1, p. 47; PPLICA Statement 4; PPLICA Statement 5.

In addition, the proposed restrictions on RTS and RTD increase CTC responsibility by 97% and 15%, respectively, for customers accessing competitive supply. Gilberton Exhibit No. 1. The proposed limitations on the availability of these rates are unreasonable and must be rejected.

The ALJ claims that the proposed availability restrictions do not violate the rate cap "since no tariffed rates are actually being changed." R.D. at 164. This reasoning is flawed. If taken to its logical conclusion, any customer doing the very action guaranteed to them by the Act — accessing competitive supply — could presumably be forced to leave the "unbundled" rate schedule they were formerly taking service on from PP&L. PP&L could then establish whatever terms and conditions and stranded cost

liability it desired for the new "competitive access" rate schedule. The tariff rates on the "unbundled" rate schedule would not change. This result, however, is directly contrary to the Act. No customer can be held captive from the competitive market by PP&L via a punitive tariff provision such as this.

The R.D. itself recognizes the necessity of limiting the tariff modifications approved in this restructuring proceeding to those necessary to unbundle current rates and implement the competitive environment.

Once again, we find the arguments of PPLICA to be persuasive. The Company is attempting to make changes to the terms and conditions of its interruptible service in this proceeding without providing sufficient evidence for such changes. Moreover, these changes do not appear to have any direct relationship to the main purpose of this proceeding, which is to restructure the Company's rates and services to promote a more competitive market for the provision of electric energy.

R.D. at 168 (emphasis added).

This statement is fully consistent with the Act's requirements regarding the contents of restructuring plans.

A restructuring plan under subsection (d) must include, consistent with the determinations of the commission, unbundled prices or rates for generation, jurisdictional transmission, distribution and other services; a proposed competitive transition charge; . . . and revised tariffs and rate schedules implementing the above.

66 Pa. C.S. § 2806(e). The clear intention of the General Assembly was to limit the scope of this proceeding to those issues necessary to create a competitive market. ALJ Corbett recognized this limitation on tariff modifications in his recommendation to deny Duquesne's request to impose restrictions on the availability of interruptible service during the recovery period.

The Duquesne restrictions on the availability of interruptible service are unreasonable and not authorized under the Act. The only tariff changes permissible in the context of this restructuring proceeding are those necessary to introduce a competitive market for generation supply in Duquesne's service territory.

Duquesne R.D., p. 610 (stating the Duquesne Industrial Intervenors position on the issue, which was explicitly endorsed by the ALJ on page 611). PP&L's punitive restriction on the availability of interruptible service bears no relationship to fostering a competitive environment for electricity generation. PPLICA M.B. at 71-77; PPLICA R.B. at 45-47. In fact, the PP&L proposal will irreparably harm the development of the competitive market by holding current interruptible customers economic hostages, unable to escape the necessity of staying on PP&L's bundled service to realize any cost savings. Id.

The ALJ is misguided in concluding that the restrictions on the availability of interruptible service do not violate the Act's rate cap. In addition, forcing customers to pay additional stranded cost liability for accessing the competitive market is contrary to the fundamental purpose of the Act and contrary to sound economic development principles. Even PP&L's witness could not explain how economic development will be furthered by the Company's proposal. Tr. 855-56. For these reasons, the Commission must reject the ALJ's recommendation endorsing PP&L's availability restrictions on interruptible service and residential RTD and RTS service.

Exception 19. The ALJ Errs By Rejecting PP&L's Proposal To Extend Application Of Economic Incentive Rates For The Duration Of The Stranded Cost Recovery Period.

Exception to: R.D. at 165-67.

The R.D. rejects PP&L's proposal to extend the availability of its current economic incentive rate offerings for the duration of the stranded cost recovery period. R.D. at 165-67. The rate schedules at issue are the *Economic Development Incentive and Industrial Development Incentive* credits. See

PP&L Statement 11, Exhibit OGK-2, pp. 19 & 19D. These tariff offerings are scheduled to expire prior to the end of the recovery period. Similar to the ALJ's reasoning regarding the availability restrictions on interruptible service, the R.D. states "we do not believe that the shifting of customers from one rate schedule to another for eligibility reasons represents a violation of the rate cap since no actual rates are being changed." R.D. at 167. This reasoning is a flawed application of the Act's cap on the charges for electric service.

Although the Act refers to a "rate" cap, the focus is not on tariff rates; rather, the focus is on the "charges as of the effective date of this chapter." See e.g. 66 Pa. C.S. § 2804(4)(i)(A). With respect to the economic incentive rates, which are only available to BUSS customers, the cap in Section 2804(4)(ii) applies. Throughout the period of stranded cost recovery "the generation component of a utility's charges to customers who purchase generation from the utility, including the competitive transition charge and intangible transition charge, shall not exceed the generation component charged to the customers that have been approved by the Commission for such service as of the effective date of this Chapter." 66 Pa. C.S. § 2804(4)(ii). If the economic incentive rates are permitted to expire, customers currently on those rates will receive identical service after expiration, but at a higher charge. This clearly violates the Act's rate cap. PPLICA Statement 1R, p. 15.

The PECO decision supports the continuation of these competitively priced tariff offerings throughout the stranded cost recovery period. PPLICA M.B. at 81-82; PPLICA R.B. at 50. In fact, PECO was required to continue the availability of its economic incentive rate, the EER. PECO Restructuring Order, 181 PUR 4th at 571. PP&L's customers should be afforded the equivalent economic incentive opportunities through the continuation of the EDI and IDI credits.

The R.D. must be modified to continue the availability of economic incentive rates throughout the recovery period. To eliminate the incentives prior to then clearly violates the Act's rate cap and anti-cost shifting provisions. 66 Pa. C.S. § 2804(4) & (7).

IX. PHASE-IN ISSUES

Exception 20. The Act Clearly Permits The Accelerated Phase-in Schedule Advocated By PPLICA.

Exception to: R.D. at 171-73 & Proposed Findings of Fact # 347, 348 & 353.

The R.D. adopts a schedule for the phase-in of direct access that the ALJ states is the "mandatory" schedule "established under the Act." R.D. at 171-72. No "mandatory" schedule is established by the Act. The accelerated phase-in advocated by PPLICA, which is identical to the phase-in adopted by the Commission in the PECO proceeding, is a reasonable interpretation of the language of the Act. See PPLICA M.B. at 93-95; PPLICA R.B. at 51-53; PPLICA Statement 1, pp. 58-59.

The ALJ inaccurately interprets the words of the Act as establishing a mandatory three-stage phase-in. R.D. at 171-73. When the words of a statute are ambiguous or subject to multiple meanings, the Commission may look to the intention of the General Assembly and the goals of the Act. PPLICA R.B. at 52-53. The Commission properly looked to the pro-competition goals of the Act in implementing the accelerated phase-in for PECO; the Commission should do the same here.

The ALJ also attempts to distinguish the PECO decision by arguing that PECO had agreed to the accelerated phase-in as part of the Partial Settlement. R.D. at 173 n. 52. The agreement to the acceleration in the Partial Settlement was irrelevant to the Commission's decision to implement the accelerated phase-in schedule.

No legitimate reason exists to treat PECO's customers differently than PP&L's customers on this issue. Although the ALJ may interpret the PECO decision as a "stand alone" decision, fundamental

fairness, as well as the Act's requirement that transitional issues be decided in a manner fair to all ratepayers, investors, utilities and competitors, require that the PECO precedent on this issue be implemented consistently. See 66 Pa. C.S. § 2804(8). The ALJ apparently lacks the faith in PP&L, the Commission, competitive suppliers and the public to be able to institute the accelerated phase-in. PPLICA harbors no such doubts about the ability of PP&L's customers, competitive suppliers and even PP&L itself to implement the identical phase-in procedures adopted for PECO and its customers and competitors.

Exception 21. The PPLICA Pro-Rata Reduction Method For The Phase-in Of Industrial And Large Commercial Customers Is Desirable.

Exception to: R.D. at 171-173 & Proposed Finding of Fact # 353.

The R.D. rejects the PPLICA proposal to institute a pro-rata reduction in eligible load if any stage of direct access phase-in is oversubscribed. R.D. at 172-73. The ALJ bases his decision on the administrative complexity of handling a situation where a customer receives "part of their service from their Alternative Supplier and part from their EDC." Id. at 172. In addition, the ALJ states that a specific competitive disadvantage has not been shown. Id. The ALJ's reasoning and conclusion are flawed and must be rejected.

First, the ALJ faults the pro-rata methodology as "complex" and "creat[ing] more confusion among the public and more administrative difficulty for PP&L and the suppliers." R.D. at 173. Again, PPLICA has no doubt about the ability of PP&L, the public, and the suppliers to implement the identical phase-in proposal as the Commission adopted in the PECO proceeding. PPLICA R.B. at 51-53. Moreover, the ALJ's comments ignore the reality that some large customers already receive service from both an Alternative Supplier and the EDC because of the load limitations in the pilot program. R.D. at

173. PP&L, the suppliers and the customers have been able to grasp the concept of load being supplied partially by a competitive supplier and partially by the EDC in that context.

In addition, the ALJ's statement ignores the fundamental fact that the large customers (PPLICA) and competitive suppliers (Enron) in this proceeding advocate using the pro rata reduction approach. In other words, the customers and suppliers do not perceive unreasonable complexity or confusion from the proposal. The only remaining party that the ALJ must be concerned about is PP&L. Consequently, the ALJ is rejecting a phase-in proposal advocated by the customers and suppliers solely because of PP&L's self-professed "administrative difficulty." See R.D. at 173. This is not sufficient reason to treat PP&L differently from PECO (and PP&L customers differently from PECO customers) on this issue.

Second, it is axiomatic that PPLICA cannot point to a single concrete competitive disadvantage until after phase-in has started. The PPLICA pro-rata approach, however, will avoid such claims both inside and outside of PP&L's service territory. By adopting the pro-rata methodology for PECO customers but not for PP&L customers, the Commission will be creating an artificial and unreasonable distinction between similarly situated businesses in the two service territories. Nothing could be more illogical and inequitable than to deny a similarly situated customer access to any type or amount of competitive supply based solely on the customers location within the Commonwealth. See 66 Pa. C.S. § 2802(8). One of the goals of the Act is to eliminate such discrepancies.

The PPLICA pro rata load reduction approach is reasonable, eliminates potential competitive disadvantage situations, and allows the maximum amount of customers to participate in each stage of direct access phase-in. The Commission must modify the R.D. to permit a pro rata reduction in load if any stage of phase-in is oversubscribed by industrial and large commercial customers.

III. CONCLUSION

The issues before the Commission in this proceeding are critical to the attainment of the economic development goals that motivated the Commonwealth to provide its citizens with the opportunity to access a competitive market for electricity generation. Unfortunately, the Recommended Decision is completely inconsistent with the central premises of the Act and will not provide the Commission with adequate assistance in approving a restructuring plan for PP&L that will attain the goals of the Act. The Recommended Decision overcompensates PP&L for stranded costs through adoption of an unreasonably low market price forecast and a flawed methodology for determining the future value of PP&L's generating units. The Recommended Decision permits PP&L to recover improper stranded regulatory assets and fails to offset recovery with several regulatory liabilities. The Recommended Decision adopts a phase-in proposal that unnecessarily delays access for some customers to the competitive market. The Recommended Decision endorses material changes to the terms and conditions of certain PP&L tariff offerings that are anti-competitive, violate the Act's rate caps, impermissibly shift costs, and are not necessary to introduce a competitive market. The Recommended Decision is wholly inconsistent with the Act and must be modified to correct these obvious and pervasive flaws.

Viewed in isolation, the Recommended Decision would have a devastating and detrimental impact on the development of competition in the PP&L service territory. The Recommended Decision cannot be viewed solely in isolation, however, because the Commission must implement the Act on a statewide basis. When viewed on a statewide basis, the flaws in the Recommended Decision are further magnified by its thorough and defiant inconsistency with the Commission's precedent established in the

PECO restructuring proceeding. The vast majority of the flaws cited by PPLICA in these Exceptions flow directly from the ALJ's failure to follow the Commission's determinations on similar issues in the PECO proceeding.

Fortunately, the Commission has the power to right the course. The Commission can ensure that a consistent set of rules and principles govern the development of a competitive market throughout the Commonwealth. Only through application of consistent principles can the Commission ensure fair and equitable treatment of customers, suppliers, utilities and investors within PP&L's service territory and throughout the entire state. This equitable treatment is absolutely necessary for the entire Commonwealth to enjoy the maximum benefits of competition. PPLICA submits the foregoing Exceptions as a road map for the Commission to follow in reaching this consistency and ensuring the benefits of direct access.

WHEREFORE, the PP&L Industrial Customer Alliance respectfully requests the Commission modify the Recommended Decision consistent with the foregoing Exceptions.

Respectfully submitted,

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Page 2

Docket No. R-00973954

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Page 3

Docket No. R-00973954

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Page 4

Docket No. R-00973954

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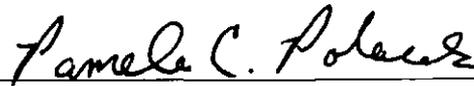
CERTIFICATE OF SERVICE

Page 5

Docket No. R-00973954

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