

EXHIBIT NO. 1

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Statement of Reasons

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**Pennsylvania Power & Light Company
Restructuring Plan Filing
Docket No. R-00973954
Statement of Reasons**

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PROTHONOTARY'S OFFICE

1. Introduction

Pursuant to the provisions of the Electricity Generation Customer Choice and Competition Act (the "Act") and the schedule established by the Pennsylvania Public Utility Commission ("Commission" or "PUC"), Pennsylvania Power & Light Company ("PP&L" or the "Company") is filing its Restructuring Plan to introduce retail competition for the sale of electricity in its service territory. The Company's filing includes four major components:

- (1) Terms and conditions for open access retail competition, including a proposal to provide comparable access to the Company's transmission and distribution system, procedures and rules under which the Company will participate as a supplier of electricity, and an extensive proposal for customer education;
- (2) A calculation of the Company's stranded or transition costs as defined in the Act, including efforts to mitigate stranded costs;
- (3) Unbundled rates for the generation, transmission and distribution of electricity, including a Competitive Transition Charge ("CTC") to recover stranded costs, a proposed rate design to facilitate and encourage full and fair competition, send appropriate price signals

to customers, comply with the rate caps contained in the Act, and implement significant rate reductions for incremental usage of electricity; and

- (4) Proposals for continued ratepayer protection, including an expanded Company program for assistance to low-income customers and other measures to assure continued safe, reliable and efficient service to customers at reasonable rates.

As the PUC is aware, PP&L has been and continues to be a strong and active proponent of retail competition. The Company advocated a rapid transition to retail competition during the PUC's 1995 investigation of electric utility retail competition and in the subsequent legislative process which led to the adoption of the Act. PP&L continues its track record of support with this Restructuring Plan, which is designed to comply fully with the letter and spirit of the Act and to promote a fair and full transition to retail competition.

While the issues presented in this proceeding are novel and somewhat complex, PP&L does not believe that the review of its filing must necessarily entail a lengthy and contentious litigated proceeding. First, many of the potentially controversial issues regarding retail competition have been resolved by the Act. The Act is a blueprint for electric utility restructuring and proper application of its provisions should avoid an extensive and unproductive philosophical debate about the major components of a fair transition to retail competition.

Second, PP&L's Restructuring Plan should not be controversial. As explained in more detail below, the Company has carefully sought a balanced approach that treats all interests fairly and equitably and which is consistent with the broad consensus behind the Act. This approach was undertaken intentionally to avoid controversy and to demonstrate PP&L's continued support for retail competition.

Third, PP&L's Restructuring Plan fully supports the basic objective of the Act. The ultimate goal of the Act is to address the rate disparity that exists among Pennsylvania utilities and the fact that Pennsylvania rates, on average, are significantly higher than the national average. PP&L's overall rates are below the Pennsylvania average and only slightly above the national average. In fact, PP&L's residential rates are below the national average. PP&L's rates today are essentially the same as they were in 1986, and under the rate cap established by the Act, will not increase until July 1, 2001, at the earliest. Adjusted for inflation, PP&L's rates today are over 25% lower in real terms than they were in 1986. In addition, PP&L is proposing a significant rate reduction in this filing for incremental usage by customers. PP&L has achieved the Act's ultimate goal of reasonable and competitive rates.

PP&L looks forward to a full and balanced review of its Restructuring Plan and is hopeful that many issues can be resolved by consensus in a way that promotes a smooth and rapid transition to retail competition.

2. Summary of PP&L's Restructuring Filing

As explained in the testimony of Dr. Joseph Kalt of the Economics Resource Group ("ERG"), there has been a national trend toward deregulation and increasing competition in traditionally regulated industries. For a variety of reasons, this trend has extended to include the electric utility industry, where it is now generally agreed that the generation of electricity is not a "natural monopoly" and should be opened up to competition.

Consistent with this trend, Pennsylvania has adopted sweeping legislation to introduce retail electric competition in the Commonwealth. This legislation reflects an in-depth examination of the legal and policy issues underlying retail electric competition. The Act begins with 21 "declarations of policy" and 16 "standards" to guide the Commission in reviewing "restructuring" proposals to be filed by each Pennsylvania electric utility. Broadly stated, these policies and standards establish four over-arching requirements: (1) fair and even-handed rules for retail competition for customers and suppliers; (2) opportunity for the recovery of stranded costs; (3) an efficient and non-discriminatory rate design that complies with the rate caps established in the Act; and (4) continued ratepayer protections. As set forth below, PP&L's Restructuring Plan meets each of these goals and should be approved.

A. Retail Competition

In accordance with the Act, the Company proposes a three-step phase-in to retail competition. Beginning January 1, 1999, 33% of each customer class (as

measured by class peak load) will be eligible for retail competition (including those customers enrolled in the Company's pilot program). On January 1, 2000, another 33% of each customer class will be eligible. Full retail access is planned for January 1, 2001.

Details regarding customer participation are set forth in the testimony of Henry W. Baumann and in the Company's proposed tariff. The enrollment period will begin six months before each step of the phase-in. If, after an "open season" enrollment, a rate class is over-subscribed, customers will be selected on a random basis. Any serious competitive problems caused by the phase-in will be resolved on a case-by-case basis.

Customers who are selected for retail access will be notified by mail and will be sent a list of alternative energy suppliers that have been licensed by the PUC. Customers will deal directly with alternative suppliers, may contract with more than one supplier and may change suppliers at their discretion. Customers may return to PP&L as the supplier of last resort and receive Basic Utility Supply Service. Customers returning to PP&L will be treated as "new" customers. They will not be eligible for certain "closed" rate options and must sign one-year service agreements to avoid unfair "gaming" of the system that would impose costs on other customers.

As explained in the testimony of Bernard J. Bujnowski, the Company is installing a major new customer accounting system to accommodate the requirements of retail competition. PP&L will handle all billing unless the customer requests a separate bill from its alternative supplier for purchases from that supplier. The

Company will provide and maintain standard PP&L meter installations for all customers, including those participating in the retail access program. Customers must compensate PP&L for any non-standard meter facilities.

As explained by Mr. Baumann, alternative suppliers must be licensed by the PUC and satisfy any requirements of PJM or its successor. The Company is proposing fees for certain services provided to alternative suppliers, including billing and general administration.

As explained in the testimony of William H. Whitehead, the Company anticipates that an independent system operator ("ISO") will be in place before the start of retail competition on January 1, 1999. For that reason, PP&L has not proposed separate interconnection and transmission rules and procedures for alternative suppliers. Alternative suppliers will be provided transmission service under the PJM Open Access Tariff and a rate schedule designed to recover retail transmission costs currently in bundled rates. If an ISO is not in place, PP&L reserves the right to implement procedures and requirements for alternative suppliers necessary to preserve safe, reliable and efficient operation of its system.

PP&L plans to participate as a generation supplier to customers in its service territory and elsewhere. The Company is proposing a separation of its generation function from its transmission and distribution functions with appropriate "firewalls" and a Code of Conduct to ensure fair competition. The details of these actions are described in the testimony of Robert M. Geneczko.

PP&L plans an extensive program of customer education to ensure that customers understand retail competition and can participate on an informed basis. Details of the education program are provided in the testimony of Dawn G. Lennon.

B. Stranded Costs

As defined in the Act, "transition or stranded costs" are "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. For calculation purposes, the Company divided its stranded costs into four categories: nuclear generation, fossil generation, NUG contracts and regulatory assets. For Company-owned generation (nuclear and fossil), PP&L compared the annual revenue requirements on a traditional cost-of-service basis for each plant over its remaining life with the annual revenues each plant is expected to receive from the sale of its output under market prices. The PUC jurisdictional portion of the difference between these two revenue streams was discounted to net present value at January 1, 1999, using the Company's weighted after-tax cost of capital as the discount rate. A similar calculation was made for non-utility generator ("NUG") contracts over the remaining term of the agreements. For the generation-related portion of regulatory assets, the Company calculated the annual amortization of

these assets on a traditional cost-of-service basis and discounted the PUC jurisdictional portion to net present value.

The details of these calculations are explained in the testimony of Joseph R. Schadt. Inputs to Mr. Schadt's stranded cost model were provided from various sources. The 1996 base year data for revenue requirement calculations were taken from the Company's books, with appropriate ratemaking adjustments and jurisdictional allocations as described in the testimony of Michael J. Berish and Joseph M. Kleha. Support for the cost of equity calculation is provided in the testimony of Paul R. Moul, a recognized cost of capital expert. Depreciation data is set forth in the testimony of Donald S. Hoch. Fuel price inputs were provided by Dr. Scott T. Jones of ERG. Projected capital additions and O&M expense projections were provided by the Company's Nuclear Department and the Power Production and Engineering Department. Decommissioning costs were developed from studies submitted in the Company's 1995 base rate case.

On the market revenue side of the equation, market prices and market revenue by plant were supplied by Dr. Jones, who undertook an extensive analysis of the expected future energy and capacity prices in the relevant markets.

Applying the definition in the Act, Mr. Schadt compared the difference between the annual revenue requirement on a cost-of-service basis with anticipated market revenues, discounted this difference to net present value and calculated PP&L's stranded costs at \$4.6 billion.

As explained by Mr. Ronald E. Hill, this figure already reflects extensive past mitigation efforts by the Company to control costs. These efforts, which are summarized in his testimony, include: refinancing high cost capital (about \$100 million in savings), O&M cost reductions (15% real reduction in last 10 years), reductions in planned capital expenditures (\$671 million), employee reductions (approximately 25% since 1985), inventory-related reductions (over \$125 million), excellent nuclear operations, gas/oil co-firing at the Company's Martins Creek plant, buy-out of NUG contracts and extensive economic development initiatives.

The net result of these past mitigation efforts is reasonable rates for customers. As explained by Dr. Susan F. Tierney of ERG, PP&L's rates are essentially the same today as they were in 1986, and over 25% lower in real terms when adjusted for inflation. PP&L's rates are well below the Pennsylvania average and just marginally above the national average. PP&L's residential rates are below the national average.

One of the goals of the Act is to spur high cost utilities to cut costs and reduce rates. PP&L has been actively pursuing this goal for years and has passed the savings on to its customers. PP&L has done an outstanding job of maintaining reasonable rate levels for its customers. In accordance with the requirements of the Act, those past efforts should be considered by the PUC in determining the reasonableness of the Company's stranded cost claim.

PP&L also has reflected anticipated future mitigation in its stranded cost claim, including projected reductions in capital additions, O&M expense and

workforce reductions, NUG buyouts and a depreciation reserve transfer described in the testimony of Mr. Hoch. As explained by Mr. Schadt, these future mitigation efforts reduced the Company's stranded cost claim by over \$1 billion.

Moreover, as explained in the testimony of Douglas A. Krall, because of expected market price increases, the rate caps in the Act and the limit on the transition period, the Company is not expected to fully recover its stranded costs. As explained in Mr. Krall's testimony, PP&L's currently expects that the CTC, as proposed will collect stranded costs of approximately \$4.2 billion.

Given the Company's extensive past mitigation efforts, its commitment to over \$1 billion in future mitigation and the fact that the proposed CTC is not projected to recover over \$400 million in stranded costs, the Company submits that its stranded cost claim is just and reasonable and should be approved.

C. Rate Design and Unbundling

In accordance with the requirements of the Act, the Company has "unbundled" its rates into the generation, transmission and distribution functional categories. This basic unbundling was accomplished using the Company's existing rates and the cost allocation study approved by the PUC in the Company's 1995 base rate case. A description of the procedures for developing unbundled rates is presented in Mr. Kleha's testimony. A proof of revenues demonstrating that the present bundled rates and proposed unbundled rates produce the same revenues is provided in the testimony of Oliver G. Kasper.

As explained in the testimony of Mr. Krall, the proposed CTC is the difference between the Company's current bundled rates and the sum of the transmission and distribution costs and the projected market price of generation. The CTC will decline from year-to-year to reflect an expected increase in the market price of generation in order to avoid exceeding the generation rate cap. PP&L's proposed reconciliation of the CTC is described in Mr. Kleha's testimony. The Company proposes to track over/under collections caused by actual versus projected sales and either reduce or extend the term of the CTC to reflect these differences.

The Company also is proposing to extend the CTC for nuclear decommissioning cost recovery. As explained by Mr. Kleha, the Company seeks to recover the cost of decommissioning its nuclear plant over the remaining life of the plant through an extension of the CTC as authorized in the Act for "good cause shown." This proposal recognizes the important health and safety issues associated with nuclear decommissioning, is consistent with PUC precedent for the funding of nuclear decommissioning costs, will reduce the Company's stranded cost claim, will help the Company preserve its status as an "electric utility" for NRC purposes and will have only a modest impact on rates (\$.15/month for an average Rate Schedule RS customer).

The unbundled rates proposed by the Company, will consists of three parts – transmission and distribution ("T&D") charges, CTC and generation charge. Those customers who choose an alternative energy supplier will pay the T&D charge, CTC and a market price for generation separately negotiated with the alter-

native supplier. Those customers eligible for retail competition but who continue to purchase energy from PP&L, will pay the T&D charge, CTC and a generation charge, equal to the "prevailing market price." Those customers not eligible for retail competition (during the transition period) will simply pay an unbundled version of the same rates they pay today.

As part of its filing, the Company also is proposing an innovative Progressive Rate Design. Under this proposal, the Company plans to collect one-half of the CTC through a fixed charge and one-half through a variable (per kwh) charge. Calculation of the CTC will be based on historical usage to ensure that, in the first instance, the customer's rate design complies with the rate caps established by the Act. This proposal will be mandatory for all classes except residential customers. Residential customers can choose the innovative design or a traditional unbundling in which all of the CTC will be collected in the energy block charges.

The Company believes that this innovate rate design provides several important benefits. It moves toward marginal cost pricing which sends more efficient price signals to customers and is more consistent with a competitive market. It offers customers a significant rate reduction for incremental usage, which should spur development of a competitive market, provide for significant rate reductions for customers and promote economic development.

The Company also is proposing various tariff changes outlined in Mr. Kasper's testimony. As he explains, several provisions of the Company's current rates, e.g., interruptible service, demand free days, EDI and IDI credits, the Com-

petitive Rate Rider and Price Response Service, were designed and intended for a utility providing bundled electric service. These provisions simply are not workable with unbundled rates and a competitive generation market, and the Company is proposing to limit or close these offerings. To avoid disruption and to adhere to the rate caps in the Act, the Company is generally proposing to "grandfather" these provisions to customers for whom PP&L remains the supplier of last resort. Customers who choose an alternative supplier will not be eligible for these rates and will pay a T&D charge and CTC based on equivalent firm rates for which they qualify. Customers who choose an alternative supplier and subsequently return to PP&L will be treated as "new" customers and will not be eligible for these provisions.

Finally, the movement to retail competition in Pennsylvania will be affected significantly by developments at federal level, where the Federal Energy Regulatory Commission ("FERC") is actively pursuing open access and retail transmission issues. The inter-relationship between federal and state issues, the current status of the Pennsylvania-New Jersey-Maryland ("PJM") power pool restructuring and development of an ISO, and the federal/state jurisdictional separation of the Company's transmission and distribution facilities are explained in Mr. Whitehead's testimony.

D. Additional Protections for Low-Income Customers

As explained above, the Act and PP&L's filing provide for several important ratepayer protections. These protections include significant rate caps,

extending for up to nine years from the effective date of the Act, the availability of PP&L as the "supplier of last resort," and a broad commitment to continued safe and reliable electric service.

In addition, and in accordance with the spirit of the Act, PP&L is proposing to expand its programs for low-income customers who have trouble paying their electric bills. As explained in the testimony of Timothy R. Dahl, PP&L has been a national leader in providing support and assistance to low-income customers. PP&L proposes to extend that commitment by increasing its financial support for its On-Track Program by \$7 million over the next five years. The costs of this program and related programs, will be recovered in the universal service component of the Company's delivery charge, as provided for in the Act.

3. Conclusion

For the reasons set forth above, PP&L's Restructuring Plan complies with the letter and spirit of the Act, is just and reasonable and in the public interest and should be approved.