



COMMONWEALTH OF PENNSYLVANIA
PENNSYLVANIA PUBLIC UTILITY COMMISSION
P.O. BOX 3265, HARRISBURG, PA 17105-3265

June 15, 1998

IN REPLY PLEASE
REFER TO OUR FILE

R-00973954

Good

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Application of Pennsylvania Power & Light Company for Approval of Restructuring
Plan Under Section 2806 of the Public Utility Code.

To Whom It May Concern:

This is to advise you that an Opinion and Order has been adopted by the
Commission in Public Meeting on June 4, 1998 in the above entitled proceeding.

An Opinion and Order has been enclosed for your records.

Very truly yours,

James J. McNulty
Secretary

Enclosure
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R-00973954 Carol

**PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17105-3265**

Public Meeting held June 4, 1998

Commissioners Present:

John M. Quain, Chairman, Concurring in result - Statement attached
Robert K. Bloom, Vice Chairman, Concurring in result
David W. Rolka
Nora Mead Brownell

**APPLICATION OF
PENNSYLVANIA POWER & LIGHT COMPANY
FOR APPROVAL OF RESTRUCTURING PLAN
UNDER SECTION 2806 OF
THE PUBLIC UTILITY CODE**

Docket No. R-00973954

OPINION AND ORDER

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I. INTRODUCTION

A. Background

On December 3, 1996, Governor Thomas J. Ridge signed into law the Electricity Generation Customer Choice and Competition Act, P.L. 802, No. 138, effective January 1, 1997, 66 Pa. C.S. §§2801-2812 (Act). The Act restructured Pennsylvania law relating to retail electric service in the Commonwealth. Retail customers now have the ability to choose their electric generation supplier (EGS). 66 Pa. C.S. §2802(12). Previously, a consumer procured its electric service as a package from the jurisdictional public utility, or monopoly, with the authority to serve the customer's geographic region, in this case Pennsylvania Power & Light (PP&L). The package, mentioned above, included what are now the three basic components of competitive electric utility service, the generation, transmission, and distribution of electricity. The focus of this Opinion and Order is the generation portion of electric utility service. Competition in the electric generation market in the Commonwealth will be implemented in three (3) phases beginning on January 1, 1999, following the conclusion of Pennsylvania's Pilot Programs. 66 Pa. C.S. §2806(b). All retail customers of electric distribution companies (EDCs) in Pennsylvania will have the opportunity to choose their EGS by January 2, 2000. 66 Pa. C.S. §2806(b)(3).

In accordance with the Act, all Pennsylvania EDCs, such as PP&L, are required to file restructuring plans for review and approval by this Commission. 66 Pa. C.S. §2806(d). Said restructuring plans must provide for the transition from the monopolistic provision of all electric service, to the competitive market for generation. The Act requires that the restructuring plans address the following matters: (1) unbundled prices or rates for generation, jurisdictional transmission, distribution and other services;

(2) the calculation and recovery of reasonable stranded costs¹ through a proposed competitive transition charge² (CTC); (3) a proposed universal service and energy conservation cost-recovery mechanism to ensure the continuation of safe and reliable service and programs for the assistance of low-income customers; (4) procedures for ensuring that retail customers have direct access to all licensed electric generation suppliers; (5) a discussion of the impacts of the proposed plan on the utility's employees; and (6) revised tariffs and rate schedules implementing the aforementioned factors.

66 C.S. §2806(e).

B. History of the Proceedings

On January 24, 1997, at Docket No. M-00960890, F0005, this Commission established a schedule for filing of the restructuring plans.

On April 1, 1997, in accordance with the Act, and the schedule established by this Commission, Pennsylvania Power & Light Company (PP&L or Company), filed its Restructuring Plan. See Opinion and Order entered January 24, 1997, at Docket No. M-00960890.F0005. PP&L in its proposed Restructuring Plan, as revised during this proceeding: (a) proposed the unbundling of its rates, the establishment of both a CTC and specific tariff provisions to ensure customers direct access to all licensed EGSs;

¹ Stranded costs, as defined by the Act, include an electric utility's known and measurable generation-related costs which would have been recoverable in the former regulated market, but may not be recoverable in a competitive electric generation market. For specific costs see Title 66 Pa. C.S. §2803 *Definitions*.

² Competitive transition charge, as defined by the Act, is a charge which is applied to every customer's bill and is designed to recover an electric utility's stranded costs as determined by the Commission under Sections 2804 (relating to standards for restructuring of electric industry) and 2808 (relating to competitive transition charge). 66 Pa. C.S. §2803.

(b) projected its stranded costs as defined by the Act, at \$4.5 billion; (c) proposed a plan to meet its universal service obligations, including a mechanism to recover the costs of those obligations; (d) described the implementation of a consumer education program; and (e) proposed procedures for implementing PP&L's responsibilities as provider of last resort as required by the Act.³ 66 Pa. C.S. §2807(e)(3) (Last Resort Service).

Copies of the proposed Restructuring Plan were served on all parties that were active participants in PP&L's last general base rate investigation at Docket No. R-00943271. Additionally, PP&L provided copies to any persons who requested copies. PP&L provided notice of its Restructuring Plan filing to all customers via billing insert beginning with the April 1997 billing cycle. The Company further provided a one-page summary of its proposed Restructuring Plan to all individuals on the Commission's Executive Director's Stakeholder list. In addition, notice of the filing was published in newspapers of general circulation throughout PP&L's service territory.

PP&L's proposed Restructuring Plan was thereafter assigned to presiding Administrative Law Judge (ALJ), George M. Kashi. A first prehearing conference convened in Harrisburg on April 18, 1997. Thirty six (36) parties were permitted to intervene in this proceeding. Of that group, eighteen (18) intervenors have maintained active party status. Additional prehearing conferences were held in Harrisburg on May 16, 1997 and on July 15, 1997.

³ The Act provides that where a customer either, contracts for electric energy and it is not delivered, or does not choose an alternative electric generation supplier, the distribution company or commission-approved alternative supplier shall acquire electric energy at prevailing market prices to serve that customer and shall recover fully all reasonable costs. 66 Pa. C.S. §2807(3).

The following are active parties in Docket No R-00973954: Office of Consumer Advocate (OCA), Office of Small Business Advocate (OSBA), Office of Trial Staff (OTS), Allegheny Power, American Association of Retired Persons (AARP), Commission on Economic Opportunity (CEO), Delmarva Power & Light, Enron Power Marketing Inc.(Enron), Environmentalists, Local 1600, International Brotherhood of Electric Workers (IBEW), Eric Epstein, Gilberton Power, Mid-Atlantic Power Supply Association (MAPSA), New Energy Ventures (NEV), Pennsylvania Petroleum Association (PPA), PP&L Industrial Customer Alliance (PPLICA), Schuylkill Energy Resources (SER), and United States Department of Defense.

The following are inactive parties: Allegheny Electric Cooperative, American Energy Solutions, Anthracite Regional Power Producers (ARIPPA), Bethlehem Steel, Center for Energy and Economic Development (CEED), Duke Energy Trading Marketing, Dupont Power Marketing, Electric Clearinghouse Inc., ERI Services Inc., GPU Energy, Kraft Foods, Noram Energy Management, PECO Energy Company, Pennsylvania Association of Plumbing Heating & Cooling Contractors (PAPHCC), Pennsylvania Electric Consumers Council, PP&L Rate Payers Association, and Pennsylvania Retailers Association, Vastar Power Marketing.⁴

In addition, formal complaints against the PP&L's proposed Restructuring Plan were filed by OCA, PPLICA and the Environmentalists.

PP&L submitted, with its filing, extensive supporting information, including the direct testimony and supporting exhibits of seventeen (17) witnesses and responses to the Commission's filing requirements. PP&L also responded to numerous

⁴ This list is taken from Table A to PP&L Main Brief which contained a list of the parties.

interrogatories and data requests. In addition, an informal technical conference was held in Harrisburg on May 2, 1997, at which PP&L made available several of its witnesses to answer questions and further explain their testimony. See PP&L Brief at 10.

On July 2, 1997, the intervenors submitted extensive direct testimony addressing almost every aspect of PP&L's Restructuring Plan. On August 5, 1997, PP&L responded to the intervenors' direct testimony by filing rebuttal testimony and exhibits sponsored by twenty witnesses. A number of the intervenors submitted surrebuttal statements on August 15, 1997.

Evidentiary hearings were held in Harrisburg on August 18-22 and August 25-29, 1997 and on September 9, 1997. During those hearings 284 exhibits and the testimony of 57 witnesses were admitted into evidence. The transcribed record, which includes the cross examination of the direct testimony at evidentiary hearing, consists of 2,337 pages. The evidentiary record was closed on September 9, 1997.

Thirteen (13) public input hearings were held during the weeks of May 30, 1997 and September 2, 1997. Public input hearings were held in Allentown (June 2), Bethlehem (June 2 and September 3), Harrisburg (May 30 and September 3), Hazelton (June 4), Lancaster (May 30 and September 2), Pottsville (June 4), Scranton (June 3 and September 4), Williamsport (June 5), and Wilkes-Barre (June 3). A total of 75 persons testified at the public input hearings.

Following the evidentiary hearings, the parties were directed by the presiding ALJ to enter into settlement discussions. The intervenors were also directed to present PP&L with a unified proposal for settlement. (Tr., p. 1593 (8/26/97)). To accommodate those discussions the post-hearing briefing and decision schedule was extended several times. Orders extending the briefing schedule and the date for

Commission decision in the case were issued on September 12, 1997, October 17, 1997, November 25, 1997 and December 24, 1997.

Main Briefs and supplements were filed on February 13, 1998. Reply Briefs were filed on February 27, 1998.

On April 7, 1998, the Recommended Decision (R.D.), of ALJ Kashi was issued. ALJ Kashi, in substantial part, found PP&L's restructuring proposals to be consistent with the Act and he recommended their adoption. ALJ Kashi reached 433 Findings of Fact, mostly adopted from the Main Brief of PP&L. Those findings are incorporated herein by reference and modified in accordance with the discussion contained in this Opinion and Order.

With reference to PP&L's claim for stranded costs, ALJ Kashi recommended the adoption of the position of PP&L witness Scott T. Jones, Ph.D., concerning the methodology and calculation of the Company's stranded cost claim. Thus, ALJ Kashi recommended that PP&L recover, through the CTC, approximately \$4 billion in stranded costs. (R.D., p. 112; Finding of Fact No. 50, citing PP&L St. 2, p. 18 and PP&L St. 10-R, p. 3, provides for a CTC designed to recover \$4.001 billion).

Exceptions to the R.D. were received from the following parties: PP&L; OCA; Environmentalists; OTS; SER; PPA; NEV East; MAPSA; Enron; OSBA; CEO; ARIPPA; PECO Energy Company, and PPLICA.

Replies to Exceptions were filed by the following parties: PP&L, Enron, IBEW, MAPSA, and PPLICA, OCA, OTS and ARIPPA.

The Application of PP&L is ripe for disposition.

C. Summary

PP&L proposed to retain rates at current levels while providing a modest administratively determined generation credit for shopping customers. PP&L's proposal would determine the amount of recoverable stranded costs by the difference between current revenues and those revenues PP&L would anticipate receiving in a competitive market, although the CTC would not be derived from the stranded cost determination.

This Commission has rejected that approach in other restructuring proceedings as inconsistent with both the letter and spirit of the Act and contrary to the development of a competitive market. We must reject such an approach in this case as well. The Act requires the unbundling of the transmission and distribution charge and a CTC designed to recover authorized stranded costs over the recovery period. See *Application of PECO Energy Company for the Approval of its Restructuring Plan Under Section 2806 of the Public Utility Code and Joint Petition for Partial Settlement, et al.*, Docket No. R-00973953, et al. (Order entered December 23, 1997) (*PECO Energy Restructuring Order*);⁵ *Application of Duquesne Light Company for Approval of its Restructuring Plan Under Section 2806 of the Public Utility Code*, Docket No. R-00974104, et al. (Order entered May 29, 1998) (*Duquesne Restructuring Order*); and *Application of West Penn Power Company for Approval of Restructuring Plan Under Section 2806 of the Public Utility Code*, Docket No. R-00973981 (Order entered May 29, 1998) (*West Penn Restructuring Order*). The residual difference between those charges and the present bundled rate is then available to customers to use as a shopping credit with which to purchase generation.

⁵ The *PECO Energy Restructuring Order* has been modified by a Settlement (Order entered May 14, 1998), which, unless otherwise noted, does not modify the reasoning underlying those substantive determinations contained therein.

OCA properly used an asset valuation methodology that we adopt as the most supportable given the record of this case, although we conclude that the OCA has made certain inappropriate adjustments to its market valuations of the stranded costs of the Company. Our adjustments to the OCA presentation provide for the Company's jurisdictional separations, recognition of the effects of generation based administrative and general costs, and recognition of Company claims for capacity additions, taxes other than income, productivity and the life of the Keystone and Conemaugh generation units, *infra*. Further, we have accepted the Company estimate of capacity factors for non-utility generation (NUG). We have accepted OCA's computation of transmission and distribution charges at 1.7 cents/Kwh, which rejects the Company proposed depreciation reserve swap.

The combination of the above summarized adjustments to OCA's analysis results in a finding of \$2.864 billion in stranded costs. We conclude that it is just and reasonable to authorize PP&L to recover 100% of that amount. Based upon the record, the law, and guiding precedent, the Commission concludes that this amount should be recovered over eight and one-half years with a pretax return of 10.86% on the unamortized balance of stranded costs. The system average "shopping credit" will be 3.73 cents/Kwh in 1999.

The Company has deferred any filing for securitization of its stranded costs pending the outcome of this restructuring proceeding. We believe that securitization of a substantial portion of recoverable stranded costs would benefit all consumers and the Company. Our specific reasoning is detailed below.

II. CONTEXT OF RESTRUCTURING

A. Background

The Act substantially changes the manner in which electric utility companies will be regulated in the Commonwealth of Pennsylvania. Historically, the functions of electric utilities fell into three broad categories: generation of electricity; transmission of electricity (moving electricity from the generating source to other areas); and distribution (delivering electricity directly to end-users). See Indianapolis Power & Light Company v. Pa. P.U.C., ___ A.2d ___, No. 1597 C.D. 1997 (May 7, 1998) (*IP&L* hereafter). During the period of time from the initiation of state regulation of electric utilities, Public Service Company Law, Act of July 26, 1913, P.L. 1374, No. 854 (repealed), until the promulgation of the Act, electric rates and service had been regulated. Rates and services were provided to the user in a “bundled” fashion. That is, the utility provided and the customer paid, one rate which included the charges for all three general functions performed. This type of electric utility regulation proceeded from the theory that electric service was a “natural monopoly.” As ALJ Kashi noted, a natural monopoly is a business which, by reasons of scale or scope, is provided more efficiently by one company than by competing companies. (R.D., p. 57).

The natural monopoly concept, discussed above, was premised on the theory that the duplication of facilities, if for instance there would have been more than one electric utility company in a single service territory, resulted in an additional financial burden on the customers by forcing them to maintain duplicate systems where one would serve the purpose as effectually and at less cost. See Perry County Telephone & Telegraph Co. v. P.S.C., 265 Pa. 274, 108 A. 659 (1919).

The Public Service Law and successive legislation recognized that in exchange for a government-granted monopoly to provide service in an exclusive service

territory, public utilities were both exempted from competition and also obligated to provide service within their franchised territory. The regulation of rates and service in a monopolistic market was necessary in the absence of competition in the market. See *IP&L* (citing *General Motors Corp. v. Tracy*, 519 U.S. 278 117 S. Ct. 811, 136 L. Ed. 2d 761 (1997) (discussion pertaining to the development of a single, local franchise in the gas industry.)

As a result of economic, political and policy changes relating to the production of electric power, the General Assembly concluded, "it is now in the public interest to permit retail customers to obtain direct access to a competitive generation market as long as safe and affordable transmission and distribution service is available at levels of reliability that are currently enjoyed by the citizens and businesses of this Commonwealth." 66 Pa. C.S. §2802(3).

The federal initiatives to expand competition deserve mention. The Federal Energy Regulatory Commission (FERC) dramatically expanded the availability of transmission by issuing, in 1996, *Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, 61 Fed. Reg. 21,540 (1996), FERC Stats. & Regs. ¶31,036 (1996), order on reh'g, Order No. 888-A, 78 FERC ¶61,220 (1997), order on reh'g, Order No. 888-B, 62 Fed. Reg. 64,688 (1997), 81 FERC ¶61,248 (1997) (FERC Order No. 888).

FERC Order No. 888 required the public utilities to unbundle wholesale contracts and offer open access non-discriminatory transmission to all eligible customers, including retail customers in states implementing retail competition, while providing for the recovery of stranded costs incurred as a result of opening up the transmission system. Also at the federal level, in 1992, Congress passed the Energy Policy Act which

specifically empowered the FERC to order public and privately owned utilities to grant access to their transmission systems for qualified entities engaging in wholesale power transactions. 16 U.S.C. §824(j) and (k).

Of course, this Commission Order does not directly or indirectly set transmission rates. Any terms and conditions for transmission service for each separate rate classification are those established by FERC.

B. Summary of The Act

The Act, ultimately, substitutes competition and market forces for the determination of the generation prices in lieu of the previous regulated monopoly system. In adopting the Act, the General Assembly recognized the need for a fair transition from regulation to competition. 66 Pa. C.S. §2802(9).

In section 2802(12), the General Assembly declares that:

The purpose of this chapter is to modify existing legislation and regulations and to establish standards and procedures in order to create direct access by retail customers to the competitive market for the generation of electricity while maintaining the safety and reliability of the electric system for all parties. Reliable electric service is of the utmost importance to the health, safety and welfare of the citizens of the Commonwealth. Electric industry restructuring should ensure the reliability of the interconnected electric system by maintaining the efficiency of the transmission and distribution system.

66 Pa. C.S. §2802(12)

In order to protect customers while transitioning to a competitive market for generation of electricity, Section 2804(4) of the Act provides for rate caps. 66 Pa. C.S. §2804(4) These rate caps are designed to protect customers from increases in rates

over the levels in effect at the time of adoption of the Act, that might result from the transition to a competitive market.

The Legislature recognized, as reflected in the Act, that electric utilities and their investors have invested billions of dollars in generating facilities. Further, because some of these costs may not be recovered in a competitive market the electric utilities should be permitted to recover such costs during the transition period to the extent possible within the rate cap. 66 Pa. C.S. §2802(15).

The Act also seeks to promote safety and some uniformity a competitive environment for the generation of electricity by requiring that:

[E]lectric utilities unbundle their rates and services to provide open access over their transmission and distribution systems to allow competitive suppliers to generate and sell electricity directly to consumers in this Commonwealth. The generation of electricity will no longer be regulated as a public utility function except as otherwise provided for in this chapter. Electric generation suppliers will be required to obtain licenses, demonstrate financial responsibility and comply with such other requirements concerning service as the commission deems necessary for the protection of the public.

66 Pa. C.S. §2802(14).

To effectively implement direct access to generation, the Act sets forth certain other standards relating to the structure of electric utility companies. Specifically, the Commission may permit, but shall not require, an electric utility to divest itself of facilities or to reorganize its corporate structure. 66 Pa. C.S. §2804(5).

In the alternative, where an electric utility company retains facilities relating to the transmission and distribution of electric service, the Act provides this

Commission with the authority over the manner in which electric utility companies provide access to these services. Specifically the Act provides:

Consistent with the provision of Section 2806, the commission shall require that a public utility that owns or operates jurisdictional transmission and distribution facilities shall provide transmission and distribution service to all retail electric customers in their service territory and to electric cooperative corporations and electric generation suppliers, affiliated or nonaffiliated, on rates, terms of access and conditions that are comparable to the utility's own use of its system.

66 Pa. C.S. §2804(6).

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

In addition to providing for a retail access pilot (66 Pa. C.S. §2806(g)), under which 5% of PP&L's customers were permitted to have direct access, the General Assembly also obligated each electric distribution company to implement, in conjunction with the Commission, a consumer education program that "shall provide consumers with the information necessary to help them make appropriate choices as to their electric service." 66 Pa. C.S. §2807(d)(3).

The Act further seeks to protect customers who, for any number of reasons, do not or cannot obtain service from a competitive electric supplier. In this regard, the Act contains specific policy determinations concerning continuation of programs that currently assist low-income customers and other public purpose programs. 66 Pa. C.S. §2802(10) and (17).

The Act also contains requirements applicable to electric companies that are intended to provide all customers with reliable transmission and distribution service and to provide all customers with a supplier of last resort. 66 Pa. C.S. §2802(16).

It is in the context of the foregoing, that we consider PP&L's restructuring proposal.

III. LEGAL AND POLICY FOUNDATIONS OF STRANDED COST RECOVERY

PP&L has argued that a “regulatory compact” under traditional regulation of electric companies entitles it to recover 100% of its “lost revenues” as stranded costs. See PP&L St. 1, pp. 11-12. ALJ Kashi endorsed PP&L’s emphasis on the regulatory compact theory as justification for his recommendation concerning the just and reasonable level of stranded costs to be established in this proceeding. (R.D., pp. 65-66). We reject the Recommended Decision and PP&L’s conceptual approach as inconsistent with the Act and traditional ratemaking.

Other parties to the proceeding, notably OTS, OCA, and PPLICA, proposed that PP&L’s opportunity for stranded cost recovery should be “shared” between the Company and its ratepayers. (R.D., pp. 77-80). PP&L, citing *Butler Twp. Water Co. v. Pa. P.U.C.*, 473 A.2d 219 (Pa. Cmwlth. 1984); *T.W. Phillips Gas & Oil Co. v. Pa. P.U.C.*, 474 A.2d 355 (Pa. Cmwlth. 1984); and our discussion in *PECO Energy Restructuring Order*, urged the rejection of these proposals. On consideration of the positions of the parties, ALJ Kashi recommended the rejection of any ratepayer/shareholder sharing of PP&L’s stranded costs. (R.D., p. 80).

Finally, PP&L citing federal constitutional doctrines, and the effect on investors and its regulated activities, advocated the recovery of 100% of its claim for stranded costs.⁷

⁷ PP&L further offered *Columbia Gas of Pa., Inc. v. Pa. P.U.C.*, 613 A.2d 74 (Pa. Cmwlth. 1992) for the proposition that “denying the recovery of costs caused by a change in regulatory requirements would be fundamentally unfair under the Public Utility Code.” (R.D., p. 66, n. 10).

A. Resolution

Contrary to the conclusion in the Recommended Decision, the Commission is not required to grant a utility recovery of 100% of its claimed stranded costs upon either constitutional principles or a “regulatory compact” theory. However, the Commission determines that it shall allow 100% recovery of PP&L’s proven, non-mitigable stranded costs. Conversely, we must conclude, as set forth below, that the proper level of stranded costs is lower than PP&L’s claim. Consequently, we shall reject the ALJ resolution of this issue, consistent with this Opinion and Order. The Exceptions of the parties are granted to the extent consistent with our discussion.

1. Requirements of the Act

The Act conveys authority to the Commission to approve a competitive transition charge (CTC) for the recovery of transition or stranded costs the Commission believes to be “just and reasonable.”⁸ In this case, as explained in detail, below, we find that PP&L has established \$2.864 billion in just and reasonable stranded/transition costs. We determine that this is the amount which is 100% of PP&L’s net, non-mitigable stranded costs as demonstrated in this record.

⁸ The Act defines CTC as “a nonbypassable charge applied to the bill of every customer accessing the transmission or distribution network which [charge] is designed to recover an electric utility’s transition or stranded costs as determined by the Commission under sections 2804 (relating to standards) and 2808 (relating to competitive transition charges). 66 Pa. C.S. §2803 (Emphasis supplied).

We adopt the following reasoning as stated in our *PECO Energy Restructuring Order*: “[w]hile the parties advocate various proposals, the Act requires the Commission to determine an amount of stranded cost recovery that is just and reasonable.” Section 2804(13) grants the Commission, consistent with the standards in Section 2808, the “power and the duty to approve a Competitive Transition Charge (CTC) for the recovery of transition or stranded costs it determines to be just and reasonable to recover from ratepayers.” 66 Pa. C.S. §2804(13). Section 2804(14) requires the Commission to establish a transition to a competitive market that shall be “orderly, protect electric system reliability, be fair to ratepayers, and provide the investors in Pennsylvania electric utilities with a fair opportunity to fully recover the amount of transition or stranded costs that the commission determines to be just and reasonable.”⁹ 66 Pa. C.S. §2804(14). Thus, the “just and reasonable” standard is applicable to the total authorized stranded cost recovery. (*PECO Energy*, slip op., pp. 63-64).

2. Legislative Interpretation

The process by which the Commission is obligated to unbundle PP&L’s rates into generation, transmission and distribution components is fundamentally a ratemaking process. Through this process, the Commission must determine PP&L’s total cost of service (including capital costs), must properly allocate those costs among generation, transmission and distribution portions of PP&L’s operations, and must translate those costs into individual rates. The Commission also must determine, based on record evidence, what portion of PP&L’s assets will become uneconomic or stranded in the unregulated market for

⁹ In reaching its determinations of “just and reasonable” stranded cost recovery, the Commission also considers and balances the other “Standards for Restructuring of Electric Industry” in Section 2804 as well as the statutory “Declarations of Policy” included in Section 2802. 66 Pa. C.S. §§2802 and 2804.

generation. Finally, the Commission must develop an appropriate rate, the CTC, that will permit PP&L to recover those stranded costs over a reasonable period of time. These are traditional ratemaking functions as exercised by the Commission since its inception in 1913.

The phrase “just and reasonable” in the Act, addressing stranded costs, is that same standard that has long been the benchmark in regulated utility ratemaking. Section 1301 of the Public Utility Code has provided a substantial body of decisions that offer guidance regarding that standard. 66 Pa. C.S. §1301. The meaning of the term “just and reasonable” can be summarized as stated by the Pennsylvania Supreme Court:

the term “just and reasonable” was not intended to confine the ambit of regulatory discretion to an absolute or mathematical formulation but rather to confer upon the regulatory body the power to make and apply policy concerning the appropriate balance between the prices charged to utility consumers and returns on capital to utility investors consonant with constitutional protections applicable to both.

Pennsylvania Public Utility Commission v. Pennsylvania Gas and Water Co., 492 Pa. 326, 337; 424 A. 2d 1213, 1219 (1980) certiorari denied, 454 U.S. 824, 102 S.Ct. 112, 70 L.Ed. 2d 97.

In order to determine the amount of recovery that the Commission finds “just and reasonable,” the Commission first must identify the level of stranded costs that actually exist pursuant to the definition of “transition or stranded costs” in Section 2803:

“Transition or stranded costs.” 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. This term includes:

(1) Regulatory assets and other deferred charges typically recoverable under current regulatory practice, the unfunded portion of the utility's projected nuclear generating plant decommissioning costs and cost obligation under contracts with nonutility generating projects which have received a commission order, the recoverability of which shall be determined under section 2808(c)(1) (relating to competitive transition charge).

(2) Prudently incurred costs related to cancellation, buyout, buydown or renegotiation of nonutility generating projects consistent with section 527 (relating to cogeneration rules and regulations), the recoverability of which shall be determined pursuant to section 2808(c)(2).

(3) The following costs, the recoverability of which shall be determined pursuant to section 2808(c)(3):

- (i) Net plant investments and costs attributable to the utility's existing generation plants and facilities.
- (ii) The utility's disposal of spent nuclear fuel.
- (iii) The utility's long-term purchase power commitments other than the costs defined in paragraphs (1) and (2).
- (iv) Retirement costs attributable to utility's existing generating plants other than the costs defined in paragraph (1).
- (v) Other transition costs of the utility, including costs of employee severance,

retraining, early retirement, outplacement and related expenses, at reasonable levels, for employees who are affected by changes that occur as a result of the restructuring of the electric industry occasioned by this chapter.

The term includes any costs attributable to physical plants no longer used and useful because of the transition to retail competition. The term excludes any amounts previously disallowed by the commission as imprudently incurred. To the extent that the recoverability of amounts that are sought to be included as transition or stranded costs are subject to appellate review as of the time of the commission determination, any determination to include such costs shall be reversed to the extent required by the results of that appellate review.

66 Pa. C.S. §2803.

No transmission or distribution costs are recoverable as transition or stranded costs because transmission and distribution will remain monopoly services under regulated rates. Consistent with traditional ratemaking standards, transition or stranded costs must be "known and measurable." Only "net" transition or stranded costs are recoverable. Any generation related stranded costs must be offset by "negative" stranded costs from the increase in value of other generation related assets. Only "unmitigated", i.e., costs that will remain after mitigation, stranded costs are recoverable. The recoverable stranded cost amount must be identified on a "present value" basis as of the date that competition begins, January 1, 1999. Lastly, costs attributable to physical plants that are no longer used and useful as a result of the transition to retail competition may be recoverable. Previously disallowed imprudent costs are not recoverable. 66 Pa. C.S. §2803.

We would additionally observe that our interpretation of the Act is consistent with the development of the legislation. The Legislative history of the Act indicates that there is no intent to provide recovery of 100% of a utility's claimed stranded investment. Senator Brightbill, one of the sponsors of the Act, noted that a key difference between the Act and California's statute is that the Act does not mandate 100% recovery of a utility's stranded investment.¹⁰ Similarly, Representative Tulli, a sponsor in the House of Representatives, said: "it is important to emphasize that we took pains to do things with this bill that would not mandate the full recovery of stranded investment by utilities, nor would it prevent them from petitioning the PUC and possibly getting it."¹¹ While we do not suggest that the statements of these legislators are legally cognizant legislative history of the Act, these statements are useful guides to this agency in affirming our interpretation of the Act. *Popowski, et al. v. Pa. P.U.C.*, __ Pa. __, 706 A.2d 1197 (1997) (citing *Alpha Auto Sales v. Dept. of State*, 537 Pa. 353, 644 A.2d 1536 (1994)) ("An administrative agency's expert interpretation of a statute for which it has enforcement responsibilities is entitled to great deference."). The Act is clear that the Commission has discretion to permit recovery of up to 100% of the utility's proven nonmitigable stranded costs.

Also, under the just and reasonable standard pursuant to traditional regulation, a utility was never entitled to a guaranteed recovery of revenues. Under traditional regulation, rates were set to provide a reasonable opportunity for the utility to earn an anticipated revenue requirement, including an authorized

¹⁰ 180 Legislative Journal of the Senate of Pennsylvania 2692 (November 25, 1996).

¹¹ 180 Legislative Journal of the House of Representatives 2567 (November 25, 1996)

return on its investment. *Federal Power Commission v. Hope Natural Gas Co. (Hope)*, 320 U.S. 591 (1944).

In summary, in order to recover each component of the requested amount, PP&L has the burden to prove, based on substantial evidence in the record, that each request would recover the net present value of the unmitigated, net, known and measurable generation related expense within the definition of stranded costs. PP&L has the burden to prove that such costs would have been recoverable under traditional regulation but will not be recoverable in a competitive market. Once identified as appropriately recoverable stranded costs, the Commission must determine a just and reasonable amount authorized for recovery.

The Recommended Decision, conversely, would provide PP&L a guarantee of recovery of all claimed revenues regardless of whether such costs are truly stranded. In a competitive generation market, such expanded guaranteed revenues are inappropriate. In a competitive market, utilities retain the opportunity to earn a reasonable return on transmission and distribution assets while being set free to earn as much on their investment in de-regulated generation as their efficiency in the market can provide.

Finally, as explained in detail below, we adopt the asset valuation methodology, generally proposed by OCA, and as modified herein, as the primary analysis upon which to base our approvals for PP&L stranded cost recovery. We note, however, that the amount of stranded costs which we find to be reasonable is recoverable from ratepayers, only. We reject any sharing of costs by ratepayers and shareholders as the OCA proposed in this matter.

B. Mitigation of Stranded Costs

Mitigation of stranded costs includes any efforts that reduce the amount of stranded costs that will be recovered from ratepayers and falls into three general categories. First, mitigation efforts can increase the future market value of a potentially stranded asset. Examples of such mitigation efforts would include improving operating efficiency of a plant, thereby maximizing the market revenues that will be derived from the plant, increasing its value and mitigating the potential stranded amount. Second, a mitigation effort can directly avoid or reduce the value of a potentially stranded asset on the company's books. Examples of such mitigation efforts would include foregone capital additions, sale of assets, accelerated depreciation, and write-down or write-offs of book values. Third, a company can mitigate stranded investment through the maximum appropriate and possible use of transition bonds.

PP&L still has additional opportunities to mitigate stranded costs in the future based on the foregoing considerations. In addition, competitive markets will provide PP&L with substantial new opportunities to mitigate stranded costs. For example, Section 2808 identifies sale of generating assets as an appropriate mitigation effort. 66 Pa. C.S. §2808.

Additionally, PP&L's generating assets have a residual value that will be available for PP&L's use in easing its transition to competitive markets, even if such value was not directly quantified in the determination of the stranded cost. For example, a generating asset may have additional value because of existing connection to the transmission system or more intensive use of the site. Once stranded investment recovery is complete, PP&L is free to operate, shut down, or sell the plant as it deems fit. Since the stranded plants are expected to

have useful lives beyond the CTC recovery period, there may be a significant residual value of these assets available for PP&L's use. This opportunity would not exist under traditional ratemaking. Under traditional ratemaking, PP&L would credit the net revenues received upon sale of a consumer financed asset against the revenue requirement that consumers are expected to pay in the future.

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

1. PP&L Mitigation

PP&L indicates that its system average existing rate of 7.21 cents/kwh is below the statewide average of \$7.93 cents/kwh and that it has effectively worked to keep rates low in the past by taking advantage of lower market interest rates to refinance, limiting Operation & Maintenance (O&M) expenses to an increase that is below the rate of inflation, reducing employment significantly, reducing inventory, and investing in economic development initiatives to increase sales and spread its fixed costs over a larger sales base. We agree with PP&L that its efforts have avoided rate increases, but note that under traditional regulation a utility is expected to provide least cost service.

PP&L also presents several examples of future mitigation of stranded costs during the restructuring period through the buyout of Nonutility Generation (NUG) contracts, assumed reductions in Operations and Maintenance costs

(O&M) and Administrative and General (A&G) expenses, and reduced capital expenditures. The Act places a duty on utilities to mitigate stranded costs. Several parties argue that PP&L should be required to bear significantly greater mitigation responsibility. We accept PP&L's position that its efforts are sincere and effective, but we cannot conclude that PP&L's mitigation initiatives are superlative.

PP&L identifies a significant additional mitigation opportunity. In its 1994 rate case, the Commission approved PP&L's proposal to switch Susquehanna depreciation in 1999 from the modified sinking fund method to straight line depreciation. The Commission approved PP&L's request, which has the effect of reducing the annual depreciation expense for Susquehanna by \$70 million. The 1994 rate case Order required PP&L to reduce base rates by \$70 million in 1999 to reflect the reduced annual depreciation expense. See 85 Pa. P.U.C. 306, 354-356 (1995).

PP&L argues that the scheduled January 1, 1999, reduction of the bundled regulated rate is no longer appropriate because of the transition to competition and the rate caps. PP&L argues that when the 1999 rate reduction was adopted by the Commission, PP&L was entitled also to file a new rate case requesting an increase for other increased expenses. Now, with the rate cap in effect, such a rate increase is precluded and implementation of the previously authorized rate reduction in essence would be single-issue ratemaking. (PP&L Main Brief, pp. 36-37).

Instead, PP&L proposes to use the \$70 million to accelerate amortization of regulatory assets and NUG stranded costs. OCA witness LaCapra argued that consumers must receive the benefit of the generation expense

reduction. We agree with these positions as they serve to mitigate PP&L's stranded costs. The 1994 Order required the benefit of the reduced depreciation expense to be flowed through to ratepayers beginning on January 1, 1999. In addition, in this proceeding, we must adopt a methodology that recovers a just and reasonable level of stranded costs.

(a) Resolution

Pursuant to its 1994 rate case, PP&L was ordered to reduce rates in 1999 by \$70 million. We find that the revenue requirement of each year's recoverable CTC should be reduced by \$70 million to use the savings to mitigate stranded costs and ensure that consumers receive the benefit of the savings. Under this proposal, the savings will end at the conclusion of the CTC recovery period. If a direct reduction to the bundled rate were to be adopted instead, consumers who shop would forego savings and the rate reduction would have to remain in effect not only for the rate cap period, but for an indeterminate period thereafter. That result would distort regulated rates, since generation will no longer be a part of regulated rates upon expiration of the CTC. In contrast, linking the savings to the CTC reflects the fact that generation will be a competitive function after January 1, 1999, and provides for an expiration of the recovery period.

IV. STRANDED UTILITY GENERATION

Section 2803 defines transition and stranded costs and provides the framework in which we must assess the various approaches and claims of the parties. 66 Pa. C.S. §2803.

In particular, the definition of stranded costs requires that the costs are: 1) in fact stranded, meaning not recoverable in a competitive market; 2) stranded as a result of the transition to competitive markets; 3) generation related, not transmission or distribution costs; 4) known and measurable; 5) determined over the life of the asset; 6) only a "net" amount; 7) unmitigated; and 8) determined on a net present value basis as of January 1, 1999.

A summary of the recoverable stranded costs for utility generation, nuclear decommissioning expense, regulatory assets and NUG contracts is summarized in Attachment B to this Opinion and Order. We note that the information is presented for summary purposes only, and that the precise numbers will be adjusted in the compliance filing as accepted by the Commission.

A. PP&L's Lost Revenues Methodology

PP&L proposed to determine its stranded utility generation using a "regulatory method." Under this approach, its witness, Schadt, performed a year by year assessment of the revenue requirement that its generation assets would have the opportunity to recover under existing rates, including the Company's authorized rate of return, and compared those revenues to the amount that PP&L anticipated would be recovered by generation assets each year in the competitive generation market.

The difference between these figures, the "lost revenues," was discounted to a net present value as of January 1, 1999, using PP&L's after tax weighted average cost of capital of 7.92% as the discount rate. Using this method, PP&L projected that its utility generation plant with a book value of \$3,820.86 million as of January 1, 1999, (a revised figure) and would result in lost revenues of \$3,494.64 million. This is the amount that PP&L requested for recovery as stranded utility generation.

The OCA and PPLICA used an "asset valuation" method, patterned after that which was adopted by the Commission in *PECO Energy Restructuring Order*, and also *Duquesne Restructuring Order*, and *West Penn Restructuring Order* to determine the value of stranded utility generation. Under an "asset valuation" method the net book value of the utility's generation plant as of January 1, 1999, is compared to the value of the plant in a competitive market.

ALJ Kashi recommended the use of PP&L's proposed method.
(R.D., p. 83).

1. Resolution

On consideration of the record in this matter, we agree with PPLICA and OCA that the "lost revenues" approach is not conceptually sound. The major flaw in the method is that it is premised on a revenue stream which purports to duplicate regulated expected revenues in a competitive environment. This is contrary to the goals of the Act and inconsistent with traditional ratemaking. Utilities are not guaranteed the right to receive any particular level of revenues, including its authorized rate of return, under traditional regulation. *Hope, supra.*

Rather, even under traditional regulated ratemaking, rates are designed to provide the utility an opportunity to earn the authorized rate of return. The lost revenues method proposal of PP&L would guarantee PP&L revenues in the competitive market that were never guaranteed under traditional ratemaking. The Act requires that we end the regulation of generation, not expand it. The task at hand is to determine stranded investment, not lost revenues.

We also agree with OCA that the lost revenues approach used by PP&L requires other analytical leaps of faith that simply are unsupportable under traditional regulation. PP&L's method assumes perfect regulated ratemaking in each and every year of the remaining useful lives of PP&L's generation plant. PP&L's approach assumes that PP&L would have a full rate case each and every year, that the Commission would grant PP&L's requests precisely, that there would be no regulatory lag, and that PP&L would earn precisely its authorized rate of return each and every year. Traditional regulation has never come close to matching PP&L's assumption of guaranteed revenues. We find any methodology which locks in these assumptions inappropriate.

OCA notes that the lost revenues method, if properly done, can be adjusted to yield the same results because both fundamentally must consider the same assumptions concerning the competitive market, as will be discussed in greater detail below. However, we find no benefit to performing complex adjustments in order to "fix" the lost revenues method when the asset valuation method may be used directly to determine the impact of the competitive market on the value of a utility's generation plant.

We must determine what portion of the value of PP&L's investment in utility plant will be stranded in the competitive market. We adopt PPLICA and

OCA's conceptual approach, consistent with our decisions in Duquesne and APS/West Penn, because the asset valuation approach directly addresses our task. If this proceeding were intended to guarantee PP&L revenue neutrality as the transition is made to a competitive generation market, there would be no possibility of consumer savings and no development of competition during the transition to competition. Clearly that is not the intent under the Act. Thus, we reject as conceptually unsound a "lost revenues" approach which incorporates *guaranteed revenue neutrality, including return on investment, as part of the stranded generation principal amount.*

Since we reject PP&L's "lost revenues" approach as conceptually inappropriate, it is not necessary to review it in detail. However, some discussion is appropriate to reveal why it did not achieve results comparable to the asset valuation methods. In short, PP&L did not utilize the method properly.

First, PP&L assumed earning its authorized return of 11.5% each and every year and grossed up the revenue requirement for federal and state income taxes payable on the return. PP&L's use of the pre-tax rate of return is inconsistent with its use of the after-tax rate of return in discounting the revenue stream to a net present value. As OCA indicates in its Reply Brief, this error is a primary inconsistency that permits PP&L's proposal to bear no discernible relationship to the book value of its plant and greatly overstates stranded costs.

Second, as PPLICA witness Kollen explains, PP&L's method permits recovery of the present value of expenses that no longer exist. PP&L's argument would require consumer payment for income taxes due to equity financing in future years even though the CTC will accelerate the recovery of the underlying generation costs and no such taxes will be due. The taxes in years

beyond the CTC recovery period will never be incurred because the value of the underlying asset already will have been fully recovered during the shorter CTC recovery period. It is taxation that will actually exist during the recovery period that must be considered.

In summary, the PP&L lost revenues claim is not conceptually sound. Utilities are not guaranteed the right to receive any particular level of revenue or the authorized rate of return under traditional regulation. We therefore reject as unsound a lost revenues approach which incorporates guaranteed revenue neutrality, including return on investment, as part of the stranded generation amount.

B. Net Book Value.

Because this proceeding must determine the amount of PP&L's stranded investment in utility generation, and not just its "lost revenues," it is necessary to determine the net book value of PP&L's utility generation as of January 1, 1999. PP&L indicated that the net book value will be \$3,820.858 million.

1. Depreciation Swap

PP&L proposed to transfer \$205 million of depreciation reserve from T&D to the production function as a mitigation measure, claiming that doing so will reduce stranded costs by \$317 million. PP&L indicates that the excess reserves are available because the Commission approved extension of the depreciation lives of T&D facilities in the 1994 rate case.

OCA, the Department of Defense ("DOD"), and the Environmentalists object to this proposal as an anti-competitive cost shifting that inappropriately increases Transmission and Distribution (T&D) rates. Regulated T&D customers have already funded the higher depreciation reserve and the proposed transfer of the excess reserve to the generation function effectively results in future distribution rates being higher than necessary.

As OCA notes, the inclusion in the Act of the reallocation of depreciation reserves as a potential mitigation measure in no way requires approval of any particular proposed reallocation that is not reasonable. For these reasons, the proposal is rejected. As noted below, retention of the excess depreciation reserve within the T&D function requires a corresponding increase in net book value for generating plant.

2. Resolution

We adopt the OCA position not to permit the depreciation reserve shift, and reject the PP&L position. This results in a net book value of \$4,017.095 million.

C. Construction Work In Progress ("CWIP")

All parties agree that the starting point for a determination of the net book value is the plant in service as of January 1, 1999. In its Initial Brief, PP&L indicates that its initial statement of the net book value of \$3,820.858 million includes CWIP that will be in service as of January 1, 1999. OCA agrees that the proper net book value must be determined as of January 1, 1999, to include CWIP in the adopted January 1, 1999, net book value. However, OCA submits that the

\$108.928 million in CWIP is only included in PP&L's Initial Brief, is not in the record of this case, and therefore must be excluded from consideration.

While PP&L's identification of the value of CWIP as \$108.928 million may have been first identified in PP&L's Initial Brief, PP&L clearly requested the recovered amount as part of its initial claim for \$3,820.858 net book value as of January 1, 1999, so no adjustment is required.

1. Resolution

We adopt the PP&L treatment of CWIP. PP&L points out that the initial values of the OCA do not include CWIP values for property being added in 1997 and 1998. During that time, PP&L expects to add \$108,928,000 to its generating property. The net plant in service of the OCA did not include this value. As this is a known and measurable change it should be reflected in the OCA calculations.

D. Market Valuations of PP&L's Utility Generation

We conclude that the EGEAS model as applied by PP&L witness Jones does not credibly reflect real world power plant operations. As noted by PPLICA witness Falkenberg, PP&L witness Jones' use of the EGEAS model provides:

projections that appear totally unrealistic compared to actual history.

Even more revealing is the terrible job of modeling that both PP&L and PECO did regarding Eddystone units 3 and 4. . . The actual 1995 generation was about

1900 gwh, some 15 times greater than Mr. Bustard projects for 1999. ...

However, the PP&L modeling of Eddystone 3 and 4 is even worse than projected by PECO's models. In the EGEAS runs, the 1997 generation projected for Eddystone was virtually insignificant and only a small fraction of the actual 1995 generation of these important units.

Q. Did PP&L's EGEAS model fare any better for its own Martins Creek 3 and 4 units?

A. No. This is a really telling modeling result. In 1995, these units were 100% oil fired. PP&L plans to convert these units to 50% natural gas firing. This fact, and the above referenced decline in reserve margins, suggest that, in the years ahead, Martins Creek 3 and 4 should substantially increase their output. However, the PP&L EGEAS modeling shows a decline in generation from these units from the 1995 actual level of 1032 gwh to 733 gwh in 1997 and only 502 gwh 1999. In fact, the EGEAS projections show Martins Creek 3 and 4 generation dropping to 397 gwh in 2003.

Q. How well did PP&L's EGEAS model perform in producing logical generation estimates for PECO's marginal units?

A. Very poorly. For example, EGEAS projects that in 1997, Eddystone 3 and 4, Delaware 7, 8, Cromby 2, and Schuylkill 1 combined would produce only 373 mwh or about 12% of 1995 actual. EGEAS projects that by 1997 the output of PECO's CT's will drop to 21 gwh, also only 12% of 1995 actual. What is even more telling is the fact that by 1999 EGEAS predicts that the generation of all these marginal units will drop even further. In addition, the EGEAS model seriously underpredicted the output of every

single plant listed above, by far more than 50%. Clearly, EGEAS is not even coming close to predicting the generation of marginal units, and therefore is seriously understating marginal energy costs.

PPLICA Statement 2-S, Surrebuttal Testimony of Falkenberg, pp. 52-54, 55.

PP&L witness Jones' modeling is unacceptable to the Commission both because the Commission must consider the reasonableness of a witness' results and consider the ramifications for reliability. PP&L witness Jones fails on both these criteria. PPLICA witness Falkenberg summarized how PP&L witness Jones' analysis raises serious reliability concerns:

Based on my review of PP&L's EGEAS runs, and the capacity prices forecast by Dr. Jones, I have determined that a substantial error exists in the Jones study. If Dr. Jones' judgments about the market capacity prices are correct, his forecast of market energy prices is too low.... While Dr. Jones asserts in his rebuttal testimony that this is not a problem, he has not provided a correct economic or financial analysis to demonstrate his claims. Rather, as will be discussed later, all that Dr. Jones provides is an incorrect cash flow analysis. The calculations I am presenting stem directly from Dr. Jones' market price assumptions, and his EGEAS runs and clearly demonstrate that the new combustion turbine capacity Dr. Jones assumes will be added in PJM (starting in 1999) will be uneconomic every single year of operation.

PPLICA St. 2-S at 16-17.

Dr. Jones assumes that new CT capacity will be added in PJM starting in 1999. However, based on his own assumptions (the cost of new units, book and tax lives, the rate of inflation and, etc.) it would be

uneconomic to build such units as they would fail to recover their cost every year from 1999 to 2015.

PPLICA St. 2-S, p. 17.

As the Commission noted in *PECO Energy*, market prices must be reasonably sufficient to support continued reliability. The commission views the preservation of reliability as a serious issue and the evidence in this case suggests that PP&L witness Jones' market price forecast raises concerns about reliability.

In contrast, the modeling of OCA witness Smith supports reliability while remaining conservative on market prices. PJM currently plans for a 20% reserve requirement, PP&L St. No. 7, p. 23. OCA witness Smith assumed a going forward reserve requirement of 18% although he indicated that this might not be achieved by 2000. OCA St. No. 2, p.18. Reserve margins have the effect of requiring additional generation not in the market and raising prices. Because OCA witness Smith uses a lower reserve margin than is actually in place in PJM, his assumption is conservative.

OCA witness Smith's results support the addition of new capacity needed to meet reliability concerns. He testified that his estimate of the cost of new capacity, \$550/kw, is conservative because the following factors may serve to increase market prices, which would have the effect of decreasing the actual stranded costs for PP&L calculated by OCA witness Smith. These factors are:

- Greater interest costs during construction;
- Increase in CC/CT equipment costs from current market which represent a historical low point;
- Greater land costs (See OCA St. No. 2 for basis);

- Greater project development costs, representing the “soft costs” needed for the legal, financing, and permitting efforts needed to develop a successful project;
- Non standardized plant features, reflecting tradeoffs between plant design and capital costs. For example, combined cycle units with the most complex and efficient steam cycles will tend to cost more, as will units with bypass stack or multiple shaft design...;
- Selective Catalytic Reduction equipment for control of NOx emissions on CC units. The turnkey equipment costs underlying [Smith’s] estimate include dry low NOx burners but not equipment for catalytic reduction of NOx or CO2 emissions. To the extent that SCR or other control measures are actually required for some or all of the CC generating units built into PJM additional capital and operating costs would be required;

OCA St. 2 at pp. 13-14.

While OCA witness Smith’s results support the required addition of new capacity, PP&L’s do not. PP&L estimated future capacity prices beginning with current contracts for sale of capacity held by PP&L. PP&L currently makes short-term or spot capacity sales and makes sales in the forward market. PP&L St. No. 7, p. 45. All the witnesses projected that capacity prices would rise sharply as PJM moved from the current state of capacity excess to a balance of demand for, and supply of, capacity. See: PP&L St. No. 7, p.45-46; OCA St. No. 2, Ex. No. DCS-7; OCA St. No. 2-8, Ex. No. DCS-101; PPLICA St. No. 2-5, Ex. No. RJF-9-b.

The evidence suggests that PP&L witness Jones’ capacity values and forecasts are not reasonable. PPLICA witness Falkenberg makes a convincing

argument that PP&L witness Jones has not adequately reflected the linkage between capacity and energy prices:

What is clear from my meeting with PP&L's consultants is that Dr. Jones really did not rely on EGEAS to create any linkage between capacity and energy prices. Rather, the EGEAS simulation only impacts market energy prices and had no direct connection to market capacity prices. Thus, Dr. Jones relied on only one aspect of the EGEAS model and he ignored the implications of EGEAS regarding the profitability of new capacity. The result is that Dr. Jones' judgment tells him that developers will build substantial new capacity in PJM and lose money on it every year for the next two decades. I believe this is totally unrealistic and, much like Dr. Jones' assumptions about the infinite ability of suppliers to reschedule maintenance, reveals a limited understanding of the complexity of the issues at hand.

PPLICA St. 2-S, p. 18.

PP&L witness Jones has not identified any clear method to relate the cost of new generation to the market price of capacity. As noted by PPLICA witness Falkenberg at the time he prepared his testimony in this proceeding:

Each of the other six experts computed market capacity prices based on some form of modeling approach. Whether their method was simple or complex, each expert presented a methodology or a mathematical formula that related the market price of capacity to the cost of new capacity and a host of other factors.

PPLICA St. 2-S, p. 35.

In contrast, we find that the OCA pricing methodology for fuels, fuel price spread, and inflation as the most reasonable and objective in the record. The

OCA use of the DRI, published estimates of fuel prices and inflation is a reasonable projection of future conditions. We conclude that the OCA presentation is the most well-founded and credible, and it is adopted.

The forecast of fuel price is a crucial component of the market valuation, because fuel prices greatly influence the marginal cost of the last unit needed to meet demand, thereby establishing the market price of electricity. The market price of electricity directly affects the net margin of a generating plant. In contrast to OCA witness Smith's use of a well-recognized and independent fuel forecast, PP&L witness Jones presented his own fuel price forecast solely for the purpose of presentation in this proceeding. He also provided PP&L's forecast of market prices of electricity. We agree with PPLICA witness Falkenberg's point that it is difficult for the Commission to have confidence that the results of such an exceedingly complex forecast have not been driven by the desire to produce a specific market price result.

When a fuel price forecast has been prepared for no purpose other than a specific regulatory proceeding, and the same witness is preparing both the fuel price and resulting electric market price forecasts, there is no possible way that the Commission can be certain that the fuel price assumptions were not driven by a desire to produce a specific market price result. The only way to avoid this apparent conflict is to insist upon independent data sources.

PPLICA Statement 2, p. 29.

In fact, the Jones fuel forecast has serious problems. Jones began with fuel prices for 1996 that are 20% below actual prices and did not escalate

them at all to year 2000 prices, the starting point of his analysis. From the year 2000, he escalated fuel prices at 2.5% annually, assuming that there would be no future occasional spikes in prices as there have been historically. He has, therefore, forecast declining real fuel prices over the life of the analysis.

We agree with the position of the OCA and PPLICA that Dr. Jones has underestimated market prices through the use of his fuel forecast. As PPLICA witness Falkenberg stated:

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

PPLICA St. 2-S, p. 35.

In contrast, OCA witness D. Smith used the DRI Spring, 1997, fuel forecast which is a nationally respected, objective forecast used by the industry for many purposes external to this case. The DRI forecast used by OCA witness D. Smith is consistent with historical experience and is significantly more credible than that of PP&L witness Jones. We note that other PA utilities proposed use of the DRI fuel forecast. In *PECO Energy*, the Commission adopted the DRI fuel forecast proposed by PECO and utilized by OCA witness D. Smith. *See Also, Duquesne Light Company and West Penn Power.*

PP&L asserts that the EIA and DRI forecasts project a divergence between the real prices of oil and gas versus the real price of coal. PP&L asserts that divergence of gas and oil prices from coal and uranium prices is both illogical

and unprecedented for competing fuels. This criticism of the OCA and PPLICA presentation is misplaced. As noted by PPLICA witness Falkenberg, the marginal unit will not be a coal unit, but an oil or gas unit, and these units will set the price for all units operating in the same hour.

Another fundamental issue in projecting net margin is the modeling of market bidding that determines plant dispatch by PJM. A generation unit must recover all of its costs through its market price, including start-up or no load costs. PP&L witness Jones does not adequately address this issue.

The combined cycle plants simulated in PP&L witness Jones' application of EGEAS are not baseload units, implying that either daily cycling is required or that units must run at night at minimum load, raising higher average heat rates in either case. As Mr. Falkenberg pointed out, using the Potomac Electric Power Co. (PEPCO) Dickerson fossil units as an example:

The PEPCO Dickerson units are among the most efficient gas fired CT's in PJM. Despite having a reported full load heat rate of 10,840 btu/kwh, the 1995 average heat rates for these units was 11,988 btu/kwh. A similar situation emerged with PECO's Croydon units. These are among the most efficient CT oil fired CT's in PJM. Despite the fact that these units have a reported full load heat rate ranging from 10,100 to 12,000 btu/kwh, the station average heat rate for 1995 was 15,875 btu/kwh. Cycling effects produce a substantial impact on CT average cycle heat rates that simply cannot be ignored. . .

PPLICA St. 2-S, pp. 30-31.

By ignoring the effect of cycling, PP&L witness Jones has underestimated market price, raising his estimate of stranded costs.

PPLICA witness Falkenberg also notes that PP&L witness Jones confused high heating values and low heating values and overstated combined cycle generation and capacity revenue, each of which contribute to an overstatement of his estimate of PP&L's stranded generation through an understatement of market prices.

We conclude that the Jones analysis is not reasonable. Basic economic principles indicate that prices will be bid higher when there is not enough supply in the market to meet demand. The market will provide prices to support the addition of new capacity when it is needed. The record in this case reveals general agreement that the PJM market may require additional capacity beginning around the year 2000. Yet, the market prices projected by PP&L witness Jones are not sufficient to support the cost of new capacity. The Act requires that reliability must be maintained as we make the transition to a competitive market. Adoption of a proposal that does not recognize electric prices that are sufficient to support the provision of needed capacity additions does not protect reliability, would be irresponsible, and would violate the Act. Thus, PP&L witness Jones' forecast fails this basic test of reasonableness as well as statutory mandate to ensure reliability.

We conclude that OCA witness Smith's modeling of future environmental costs conservatively uses known and measurable costs while not including unquantifiable future costs, lending a reasonable conservatism to his results. We also conclude that OCA witness Smith's use of lower nuclear capacity factors is both reasonable and results in a higher stranded utility generation amount than that used by PP&L witness Jones. We reject the criticism by PP&L of OCA

witness Smith's aggregation of smaller generating units, use of dual fuel units and imports because OCA witness Smith's use of these assumptions is reasonable.

(a) Resolution

We find the net book value of PP&L's utility generation to be \$4,017.095 million. This is the number that must be compared to the market value of PP&L's utility generation to determine the amount that will be stranded due to competition. In this proceeding, PP&L witness Jones, OCA witness D. Smith, and PPLICA witness Falkenberg presented studies that forecast future energy prices and the likely dispatch of each unit to ascertain the revenue that can be expected from each plant. OCA and PPLICA offset the expenses necessary to produce those revenues, resulting in a net margin for each plant as a present value as of January 1, 1999, reflecting the price that a willing buyer would pay for each plant on January 1, 1999. The market value is then subtracted from the net book value as of that date to determine the value of stranded utility generation. The OCA and PPLICA method reflects the market valuation methodology that we adopt.

The ALJ concluded that PP&L's forecasted energy and capacity prices provide a consistent and reasonable basis to determine its stranded costs of generation. (R.D., p. 112). We disagree.

The forecast of fuel price is a crucial component of the market valuation, because it significantly affects the predicted market price of electricity and therefore the net margin of a generating plant. PP&L witness Jones developed his own fuel price forecast solely for the purpose of presentation in this proceeding. He also provided PP&L's forecast of market prices of electricity. We agree with PPLICA witness Falkenberg's point that it is difficult to have confidence that

the results of such an exceedingly complex forecast have not been driven by the desire to produce a specific market price result.

In fact, the Jones fuel forecast has serious problems. He began with 1996 fuel prices that are 20% below actual prices and did not escalate them at all to year 2000 prices, the starting point of his analysis. From the year 2000, he escalated fuel prices at 2.5% annually, assuming that there would be no future occasional spikes in prices as there has been historically. He has, therefore, forecast declining real fuel prices over the life of the analysis.

In contrast, OCA witness D. Smith used the DRI Spring, 1997, fuel forecast. The DRI forecast is a nationally respected, objective forecast used by the industry for many purposes external to this case. The DRI forecast used by OCA witness D. Smith is significantly more credible.

A second fundamental issue in projecting net margin is the modeling of market bidding that determines plant dispatch by PJM. A generation unit must recover all of its costs through its market price, including start-up or "no load" costs. PP&L witness Jones does not adequately address this issue.

The OCA forecasted energy and capacity prices, as adjusted herein, provide a consistent and reasonable basis to determine PP&L's stranded costs of generation. The record in this proceeding demonstrates that the ENPRO model is a realistic and reliable model for projecting energy prices. While numerous issues have been raised by various parties concerning the appropriate inputs to the model, the record demonstrates that inputs selected by OCA witness Smith are consistent and properly reflect expectations in a competitive market. Many facts and assumptions are necessary to make this determination, and it is the total approach

used by the OCA witness D. Smith that we find the most credible and reasonable in the record in this proceeding.

We adopt the OCA pricing methodology for fuels, fuel price spread, and inflation. The OCA use of the DRI published estimates of fuel prices and inflation is a reasonable projection of future conditions. For all of these reasons, we conclude that OCA witness D. Smith's presentation is the most credible in the record of this case. Accordingly, we conclude that the OCA presentation is the most well-founded and credible, and it is adopted.

E. Adjustments to Market Valuation

Adoption of OCA witness D. Smith's study establishes an initial determination that the market value of PP&L's generation assets in a competitive market is \$3,044.22 million, as indicated by the record herein. There are several adjustments to OCA's recommendations that have been raised by other parties. We shall modify the OCA approach consistent with our discussion below.

1. Productivity Adjustment

Another element in projecting generating costs is the variable Operation and Maintenance Expenses (O&M) of each unit. Variable O&M Expenses are those associated with the production of energy as contrasted with fixed O&M which are costs associated with maintaining plants ready to operate.

Dr. Jones forecasted variable O&M Expenses by escalating current variable O&M costs for each plant. Dr. Jones explained that the experience in industries that have moved from regulation to competition is that O&M Expenses

increase, for a period of time, at rates that are less than the rate of inflation. For this reason, Dr. Jones selected escalation rates for variable O&M Expenses of 2% for 1997-2000, 1.5% for 2001-2005 and 2.5% for 2006-2016.

OCA's and PPLICA's witnesses simply applied the inflation forecasts contained in the DRI and EIA fuel price forecasts to current levels of variable O&M costs. (R.D., p. 107).

In most of its presentation of operating costs, PP&L assumed a 2.5% annual escalation in costs. For administrative and general costs, a component of operation and maintenance expense, PP&L reflected increased productivity of its generation by assuming a reduced cost escalation of 2% annually for each year from 1997-2001. The OCA analysis incorporated PP&L's productivity adjustment, but OCA witness LaCapra assumed an additional productivity improvement by reducing the OCA cost escalation factor by 0.2% annually for the remaining lives of the plants. We agree that productivity improvements are likely in a competitive generation market and have adopted productivity adjustments in the other restructuring cases. In this case, however, OCA has not substantiated its proposal that its additional productivity adjustment is reasonable beyond that already proposed by PP&L and incorporated by OCA. Elimination of this additional OCA productivity adjustment decreases the OCA's statement of the market value of PP&L's generation by \$66.2 million.

Productivity improvements are likely in a competitive generation market. Here we adopt the PP&L position as supported in the record.

2. Taxes Other than Income Taxes

PP&L incorporated the capital stock and Public Utility Realty ("PURTA") taxes at their 1996 level, escalated at 2.5% over the life of each generating facility. PP&L is not assuming a tax rate increase, but an escalating tax revenue increase as the value of its assets escalates over time. OTS, OCA, and PPLICA each opposed the Company's claim. OTS and PPLICA argued that capital stock taxes should remain constant over the life of each generating facility, but that PURTA taxes should decline over time in net plant balance resulting from depreciation (PPLICA St. 3 - S, p. 31)

(a) Resolution

We find PP&L's assumption more reasonable than an assumption that tax revenues would remain flat or decline, and therefore adopt an adjustment of \$133.795 million as an increased operating expense in OCA witness LaCapra's determination of net margin.

3. Reserve Requirements

Reserve requirements refer to the amount of capacity which is required above expected demand to serve unexpected contingencies such as an unplanned outage of a generating station. PJM currently plans for a 20% reserve requirement. However, Dr. Jones concluded that competitive pressures will lower reserve requirements to 18%. Mr. Smith also assumed a going forward reserve requirement of 18% although he indicated that this might not be achieved by 2000. PPLICA's witness did not address reserve requirements. (R.D., p. 107).

It is noted that reserve requirements affect energy prices by determining the timing of additions of new capacity. As new capacity is added marginal energy prices will generally decline because the new capacity is more efficient (less fuel or BTUs to produce each kWh). Thus, perhaps counter-intuitively, higher reserve requirements mean lower energy prices. Therefore, Dr. Jones adoption of an 18% reserve requirement, as compared to the current 20%, increases energy prices and lowers stranded costs. If Dr. Jones had continued to employ a 20% requirement, it would have forced the model to add new efficient additions at an earlier date and energy prices would have been lowered. Accordingly, the 18% reserve requirement is conservative and again properly and consistently reflects the future effects of competition. (R.D., p. 107).

4. Environmental Costs

In projecting energy prices it also is necessary to include certain environmental costs which will affect the cost of operating the marginal cost generating unit. As explained by Dr. Jones, the EGEAS model permits input costs of emission allowances as an adjustment to fuel price escalators. Dr. Jones explained how EGEAS models SO₂ emission allowance.

Dr. Jones did not include NO_x allowances as a cost in developing energy prices because of the great uncertainties in the development of technology to reduce NO_x emissions, uncertainties as to the levels of controls required for NO_x, the fact that NO_x controls are applied only in the ozone period of May through September and the lack of a developed market for NO_x allowances. (R.D., p. 108).

OCA witness D. Smith contended that NO_x emission allowances will increase energy prices by something less than \$1/Mwh. He also argued that NO_x allowances would have a significant effect on PP&L's net revenues, but he did not quantify such effect.

In rebuttal, Dr. Jones explained the history of declining SO₂ allowance prices and that the competitive market would similarly drive down NO_x compliance costs. Dr. Jones concluded that electricity prices would rise from about \$.05/Mwh to \$.30/Mwh as a result of NO_x emissions with the higher end of the range being experienced late in the transition period when NO_x standards tighten. Therefore, the combination of a minor price effect occurring late in the transition period has a very small effect due to the present value impact. (R.D., pp. 108-109).

No party responded to Dr. Jones' rebuttal on NO_x emission costs. The evidence demonstrates that NO_x emission costs are not a relevant factor.

5. NUG Output

An additional input to energy price models is the output of NUGs. While there is no dispute that the output of energy from these sources must be included in modeling energy prices, there is a dispute concerning the capacity factor at which these units will operate. Dr. Jones used a 90% capacity factor based upon actual historic experience provided by PP&L witness Mr. Krall within PP&L's service territory.¹²

¹² The capacity factor is relevant because, all other things being equal, higher levels of output by the NUGs will reduce energy prices by displacing the dispatch of a higher cost marginal unit.

OCA witness Mr. La Capra argues that PP&L has overstated NUG output by 10-15%. However, as explained in Mr. Krall's rebuttal testimony, the NUG capacity factors used by PP&L were those actually experienced for the 3 years 1994-1996 on PP&L's system. As Mr. Krall also explained, most NUGs have now been on line for some time and early operation and start up issues have been resolved. Because there are strong incentives for high output created by payments on the basis of kWh output, these units are, and will remain, well maintained. PP&L contends that it is, therefore, reasonable to conclude that future output levels will equal or exceed recent historic levels. (R.D., p. 109).

OCA has provided no reasonable basis to reject use of these actual capacity factors for NUGs. OCA's use of a lower capacity factor for NUGs would understate stranded costs by \$56.911 million. (R.D., p. 109).

6. Revenues from Ancillary Services

Another element which was considered in forecasting the market price of energy is ancillary services. The only ancillary service that affects the market price of energy is spinning reserves. By including the spinning reserve units as units dispatched, EGEAS includes the effects of a spinning reserve requirement in its determination of hourly energy prices.

It is also noted that the revenues received from spinning reserve operators are likely to cover only the variable costs (start up and no load costs). Accordingly, such revenues will not reduce PP&L's stranded costs of generation because they will recover only variable costs and can contribute nothing toward the recovery of fixed costs. (R.D., p. 110).

Although there are potentially other sources of revenues from ancillary services, these revenues will not affect market clearing prices for energy. Furthermore, the amounts of these revenues are not significant. As noted by Dr. Jones, revenues derived from payments for non-spinning reserves should be very small given the large amount of capacity in PJM and the relatively small non-spinning reserve requirement. Similarly, frequency and voltage regulation will be provided at cost and would produce no contribution to fixed or stranded costs. (R.D., p. 110).

While the OCA raised questions about ancillary services, PP&L rebuttal has demonstrated that the effects of ancillary services on market clearing energy prices have been properly reflected in the EGEAS model. OCA provided no response in surrebuttal. Therefore, there is no remaining issue. (R.D., p. 110).

F. Administrative and General Expense

PP&L argues that the generation portion of its A&G expense, totaling \$402.691 million, must either be added to stranded generation, permitting recovery as a stranded cost as part of the OCA market valuation, or returned to T&D and recovered through regulated rates. PP&L argues that the OCA approach essentially disallows recovery of these costs. PP&L notes that PECO allocated most of its A&G expense to T&D, while the Commission reallocated a portion of the A&G expense to generation instead, reducing the T&D rate and increasing the resulting utility generation stranded costs. We agree with PP&L that the full \$402.691 million must be included as an operating cost used to determine the net margin of PP&L's utility generation.

1. Resolution

We adopt the Company position on Administrative and General Expenses. PP&L addressed the OCA analysis on this point and states that the OCA analysis does not properly incorporate the impact of administrative and general expenses allocated to the production function. We agree that the full amount of A&G expense must be included as an operating cost to determine the net margin of PP&L's utility generation.

G. Capital Additions

PP&L, as part of its projections, has included capital additions to its generating facilities for their remaining life. The OCA has recognized these additions as expenses in its analysis, but the OCA treatment is in conflict with treatment of these additions for tax purposes. By treating these additions as expenses, a full deduction is taken for tax purposes in the year of the addition. The property, however, will have to be amortized for tax purposes under IRS tax depreciation guidelines. The OCA treatment, as proposed, creates an overstatement of net market revenue by overstating the tax deductions.

In its determination of stranded utility generation, OCA witness La Capra treats the expense of capital additions and the offsetting tax deductions as net expenses in the year in which they are incurred. PP&L argues that the tax deductions are in fact not available in the year of the expense, but only in later years. PP&L argues that OCA's approach therefore understates the actual cost of capital additions by overstating the impact of the associated tax deductions. We agree with PP&L. OCA's determination of market value should be reduced by

\$165.3 million to reflect the actual timing of the expense and the related tax deductions.

1. Resolution

We direct that the treatment of capital additions be consistent with IRS guidelines, and that the OCA market value be reduced by \$165,318,000.

H. Accumulated Deferred Taxes

As part of its presentation on market value, the OCA has included an adjustment to reflect the 1999 balance of accumulated deferred taxes. This adjustment appears to attempt to reflect the historic Pennsylvania P.U.C. practice of offsetting rate base by the accumulated deferred tax balance. PP&L in its regulatory model also reflected this historic practice. This is a primary reason for a difference in perceived values between the OCA and PP&L from their methodologies. This offset reflects the concept that the source of the asset as part of the capitalization of the company is not from shareholders but from tax timing benefits. Our treatment of this asset is to provide for its recovery in the regulatory assets of the company, rather than the generating plant assets. PP&L has argued that the value of OCA's accumulated deferred tax adjustment must be modified to reflect their market value adjustments in Table D of their Brief. That is a presumption that the source of recovery of the asset is from the market and stranded transactions. Since the recovery is from the regulatory assets, no market value adjustment is necessary under the OCA proposal. However, adjustment of the OCA proposal is necessary to reflect an incorrect 1999 beginning balance and jurisdictional assignment. An adjustment of \$76 million is being made to reduce the accumulated deferred tax balance for 1999 to reflect PP&L's Exhibit JRS-1a

revised stranded cost claim and to provide for a jurisdictional separation of the balance.

1. Resolution

The OCA accumulated deferred tax adjustment to its market value calculation must be adjusted to correct a beginning balance and provide for a jurisdictional separation.

I. PUC Jurisdictional Allocation

PP&L included \$659.7 million in net book associated with plant presently in service to wholesale customers. PP&L included this amount in its jurisdictional retail book value because the wholesale contracts will expire during the transition period. PP&L indicates that the expiration of the contracts is a fact, providing assurance that the increased book value is known and measurable. PPLICA supports PP&L's statement of the proper jurisdictional allocation. (PP&L St. 3-R, P.13).

OCA submits that the associated plant previously was excluded from rates as excess capacity not used and useful to serve jurisdictional retail customers. However, states the OCA, PP&L's 1982, 1984, 1994, rate cases did not entirely exclude the subject capacity from rates. A portion of this capacity is already in rates and only the return on the investment has been excluded from rates. In prior rate decisions in PP&L's last rate case in 1994, and more recently in energy cost recovery (ECR) proceedings, the Commission rejected PP&L's proposed finding that the capacity would be required to serve retail customers when the contracts

expire. Instead, the Commission deferred such a decision to a future time when such a determination would be required.

1. Resolution

On consideration of the positions of the parties, we conclude that such a determination is in fact necessary at this point in time. The instant proceeding is the last one in which regulated generation rates will be adopted. Consequently, now is the time that a stranded cost determination is being made. We agree with PP&L that the capacity was in fact built to serve jurisdictional customers and would be necessary capacity to serve jurisdictional customers, if not for the transition to a competitive market, and that a portion of the capacity already is included in rates. The previous excess capacity will be needed to meet reasonable reserve levels and to maintain reliability (PP&L St. 10-12, pp. 30-31). The transition to competition in fact leaves such investment stranded. Thus, we reject OCA's jurisdictional adjustment, and adopt PP&L's jurisdictional allocation, adjusted as described herein.

In summary, we reject OCA's exclusion of capacity as wholesale contracts expire. Since we are including the book value of this capacity in our jurisdictional allocation of stranded costs, it also is appropriate to include the net margin that will be derived from the additional capacity in determining the market value of PP&L's utility generation. OCA's market value did not include this capacity. It is therefore appropriate to use the full jurisdictional allocation, increasing market value by \$336 million (est).

J. Retirement of Generating Plant

1. Keystone/Conemaugh Life Extension

OCA witness LaCapra, as well as PPLICA witness Kollen, adjust the market value of PP&L's generation by \$71.3 million to reflect additional net margin available from an assumed life extension for PP&L's ownership share in the Keystone and Conemaugh generating stations. They make the adjustment based on the record in the PECO proceeding in which PECO presented a longer remaining book life for its ownership interest in the same plants. OCA and PPLICA suggest that a consistent result is required because the generation unit is the same regardless of different ownership shares or book value. (OCA St. 1, p. 16).

(a) Resolution

We agree with OCA and PPLICA that the operating life of a plant, if in fact extended, is extended regardless of ownership shares. However, there is no evidence in the record of this case to support an assumption that the operating life of the plant will in fact be extended. Neither OCA nor PPLICA presents a life extension study or other evidence supporting the assumption. In contrast, PECO presented its own accounting treatment that supports a longer remaining life than does PP&L's. It was PECO that advocated use of the longer useful life without objection from any party.

In this case, PP&L has presented uncontroverted evidence that it is only a part owner of the plants that are operated by GPU and has no ability unilaterally to extend the operating life of the plants. PP&L also indicates that the

various owners of the plants use different useful lives for the plants for ratemaking purposes. For these reasons, we reject the life extension assumption based on the record of this case, and subtract \$71.3 million from the OCA's statement of the market value of PP&L's utility generation (PP&L St. 10-R, pp. 36-37).

(b) Residual Land Value

The OCA recommended an escalation in land value used as an offset to stranded costs. In determining the market value of PP&L's generation assets, OCA included a separate value of \$66.09 million to reflect the residual value of the land upon which PP&L's non-nuclear units are situated.

(i) Resolution

We cannot agree that this adjustment is known and measurable and supported by substantial evidence and conclude that PP&L presents several valid arguments in Statement 22-R that support rejection of the OCA proposal. Our primary reason for this, beyond computational problems, is that the land value is a portion of the net negative salvage realized from the decommissioning of the fossil unit. As we are not including the fossil decommissioning claim as a stranded cost, we should not include any escalated land value as an offset. In determining the market value of PP&L's generation assets, OCA included a separate value of \$66.09 million to reflect the residual value of the land upon which PP&L's non-nuclear units are situated.

(c) Plant retirement dates

OCA principal witness LaCapra accepted the PP&L retirement dates with the exception of the Keystone and Conemaugh units, while OCA witness D. Smith did not assume any life extension to increase net margin. PP&L argues that the OCA utilizes a second life extension assumption. In determining the net margin that PP&L's plants will provide, OCA witness LaCapra used the plant lives presented by PP&L in all cases except for the Keystone/Conemaugh life extension discussed above. PP&L is in fact arguing that OCA witness D. Smith's market prices for electricity are overstated because his determination of market prices for electricity do not reflect the book life retirement dates of PP&L's plants as incorporated in OCA witness LaCapra's net margin determination. PP&L witness Jones argues that lower priced new capacity will displace existing capacity from the market, lowering the market price. In his view, plant retirement dates, whether early, upon the end of book life, or following a life extension, is a primary determinant of the future market price of electricity. PP&L argues that OCA witness Smith's market price analysis assumed that PP&L's plants will continue to operate throughout the period of analysis. PP&L argues that the plants should be assumed to retire on their scheduled date of retirement and that the market will provide replacement new capacity that is less expensive.

(i) Resolution

OCA witness D. Smith did not assume that PP&L's plants would continue to operate beyond their book lives. Smith correctly assumes that the cost of new entry or long-run marginal cost will substantially establish the market price of electricity in the years in question. Plant retirement dates, whenever they are,

are not central to this analysis. We agree with OCA witness D. Smith's reasoning based upon basic economic principles.

Thus, PP&L's second, "life extension" argument misunderstands OCA witness Smith's analysis. We reject the PP&L position. No adjustment to the market value of PP&L's utility generation is appropriate.

The value of some of the other recoverable stranded costs must be adjusted as well to reflect the appropriate jurisdictional allocation.

Summary

Summary of stranded utility generation:

Net Book Value	\$3,820.86 million
Depreciation Swap	+ <u>196.868</u>
TOTAL	\$4,017.095
Market Value	\$3,044.22 million
Life Extension	71.3
Productivity Factor	66.2
A&G expense	402.791
Capital Additions	165.3
Taxes Other Income	133.8
Jurisdictional Allocation	(336.61) (est)
Deferred Tax Adjustment	<u>76.2</u>
TOTAL	\$2,465.35
Utility Stranded Plant	\$1551.765 million

We agree with OCA and PP&L that the stranded cost methodology is appropriate and adopt OCA's calculation, as adjusted to incorporate PP&L's jurisdictional allocation.

V. OTHER STRANDED AND TRANSITION COSTS

A. Regulatory Assets and Liabilities

PP&L presented a claim for regulatory assets on a net present value basis as of January 1, 1999, totaling \$384 million. During the course of this proceeding, PP&L revised its claim to \$354.326 million. PPLICA argues that PP&L has a net regulatory liability of \$55.588 million. OCA recommends recovery of net regulatory assets of \$259.249 million. On consideration of this claim, we shall adopt the position of the OCA as adjusted herein.

As noted, PP&L advocated the regulatory method to calculate its stranded costs. Under this method, the Company compared the revenue stream it could have received under traditional cost-of-service regulation with the stream of revenue it could receive in a competitive market. PP&L discounted the difference between these two amounts to January 1, 1999 using a discount rate of 7.92%, which is PP&L's after-tax weighted average cost of capital ("WACC").

The OCA asserted that PP&L overstated its level of stranded costs by applying an after-tax discount rate to calculate the present value of its pre-tax revenue requirement. (OCA Main Brief, pp. 21-23).

Further, the OTS and the OSBA opposed PP&L's discount rate and the application of the rate.

In sum, PP&L criticized OCA and OSBA's discount rate positions as creating a mismatch between pre-tax returns on its revenue stream, earnings on equity and debt, and the after tax financial environment under which stranded costs will be

recovered. We shall be consistent with our use of the asset value method, and adopt the OCA discount rate. As noted in OCA's Exceptions:

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

(OCA Exc., p. 13).

On the basis of the foregoing, OCA's rate will be used.

B. Deferred Fuel

PP&L has claimed \$76.815 million in net present value of deferred fuel expense. This amount reflects actual under recoveries for 1996, claimed under recoveries for 1997, and claimed under recoveries for 1998. The principle arguments against the claims were provided by the OCA and PPLICA, who would deny the 1997 and 1998 requests as not known and measurable.

1. Resolution

A major element of the claimed amounts sought by PP&L are payments to fifteen non-utility generators operating on the PP&L system. These payments have been fully recovered under Pennsylvania ratemaking in the past in accordance with the Public Utility Regulatory Policies Act of 1978 (PURPA). These payments are also requested for

recovery as a separate item for the post January 1, 1999. In PP&L Exhibit JMK 6, a full detail of these expenses updated to June, 1997, is provided. Unlike *PECO Energy Restructuring Order*, where all NUG expenses were claimed to be at market, such is not the case with PP&L. Therefore, in order to assure the recovery of NUG costs, we will permit the recovery of \$76.815 million in net present value of deferred fuel expense, as proposed by PP&L.

2. Employee transition and pension costs

There are three components of PP&L's claim for employee transition and pension costs and an additional claim for an offsetting regulatory liability raised by PPLICA. PP&L claims Voluntary Early Retirement Program, FAS-106 post-retirement benefit costs other than pensions, and employee severance and pension expenses.

a. VERP

In the 1994 rate case, the Commission allowed amortization of a Voluntary Early Retirement Program ("VERP") annual expense of \$13.132 million over 5 years, while reducing the related employee expenses included in base rates.

(i) Resolution

No party challenges recovery of this previously authorized amount as a regulatory asset with a remaining net present value as of 1/1/99 of \$14.085 million, and we approve the expense.

b. SFAS-106

PP&L claims a net present value of stranded FAS-106 post-retirement benefit costs of \$8.730 million. In 1993, PP&L changed from a cash basis to an accrual basis for SFAS 106 employee retirement benefits other than pensions. In the 1994 rate case, the Commission approved the change and permitted PP&L to defer the additional expense for amortization over a 20-year period (PP&L St. 8, p. 22; PP&L St. 8-R, pp. 41-42).

(i) Resolution

All parties agree that PP&L is entitled to recovery as a regulatory asset of \$8.730 million to reflect the present value of the unamortized balance as of December 31, 1998, and we approve the expense.

PPLICA argues that there is an offsetting regulatory liability of \$53.99 million to reflect the interest earned on trust fund balances which must be credited to ratepayers.

Also, PP&L makes no claim for the interest on trust fund earnings in this case. PP&L already has included recognition of such earnings in its formulation of the claim. Therefore, we reject the need for any additional adjustment.

c. Pension Overfunding

PPLICA argues that PP&L's pension plan is over funded by ratepayer contributions and that the Commission should reflect an associated regulatory liability. PPLICA presents the value of PP&L's pension fund as \$1,187.224 million as of

December 31, 1996, with an accumulated benefit obligation of \$694.986 million and a projected benefit obligation of \$886.704 million, resulting in a regulatory liability of \$253.832 million as of December 31, 1998.

(i) Resolution

In *PECO Energy Restructuring Order*, the Commission initially agreed with the industrial customers to recognize a regulatory liability to ensure that overfunding is credited to ratepayers since overfunding eventually would be reconciled to ratepayer benefit under traditional regulation. However, upon reconsideration, we reversed the initial resolution of this issue. Thus, we have concluded that recognition of pension overfunding could be recognized as a regulatory liability, but that it was inappropriate to do so in that case because the utility generation valuation methodology adopted already incorporated the adjustment as a reduced future operating expense. Similarly, in this case, the Commission adopts OCA's valuation that already includes reduced future pension expense (OCA St. 3, p. 11). This treatment increases the value of PP&L's generation, providing full credit to ratepayers as reduced recoverable utility generation stranded costs. Thus, no additional adjustment is appropriate.

Based on the foregoing, this Commission adopts the OCA valuation which already includes reduced future pension expense.

d. Employee Transition Costs

PP&L requests recovery of additional projected 1997-2001 employee severance and pension expenses. PP&L claims a 1997 expense of \$5.014 million; 1998 expenses of \$6.782 million; 1999 expenses of \$4.157 million; 2000 expenses of \$3.118 million; and 2001 expenses of \$4.211 million. In formulating this claim, PP&L

assumed a 5 year amortization of each year's costs, brought to a net present value as of January 1, 1999, and allocated a portion to generation, resulting in a total claim for \$17.106 million (R.D. p. 128).

PPLICA argues that the entire claim should be rejected as highly speculative because PP&L did not document any specific plan for employee reduction during 1997-2001, precluding a finding of any known and measurable amount of the expense. OCA argues that a portion of this claim is covered by the previous retirement incentive programs (OCA St. 3, p. 11).

(i) Resolution

Section (3)(v) of the definition of "transition or stranded costs" in Section 2803 includes, "costs of employee severance, retraining, early retirement, outplacement and related expenses, at reasonable levels, for employees who are affected by changes that occur as a result of the restructuring of the electric industry occasioned by this chapter." While we agree with PPLICA and OCA that PP&L's claim is not documented as well as perhaps it could be, the employee severance costs are clearly recoverable as a transition cost. PP&L's claim is not for past expenses covered by the 1994 rate order; it is for additional employee severance expenses as a result of the transition to a competitive generation market.

Both PPLICA and OCA argue that the pension plan is over funded in any event, so any recoverable amount would be limited to the incremental cash expense not presently covered in rates. As discussed, the Commission has separately considered the reduced operating expense that results from PP&L's employee transition plan as part of PP&L's productivity improvement, and rejected OCA's proposed additional productivity adjustment. Granting the full cash expense, however, would effectively grant PP&L

double recovery for the same productivity improvement. Assuming that the Commission allows the expense, PPLICA calculates the actual incremental cash expense as \$5.502 million, which we accept (PPLICA St. 3, p. 23).

We shall accept PP&L's employee severance and pension expenses, but agree with PPLICA that the incremental cost of \$5.502 million is the recoverable amount.

C. Fossil Fuel Plant Decommissioning

PP&L does not seek direct recovery of any existing fossil fuel plant decommissioning expense already included in rates as a separate stranded cost. Instead, PP&L incorporates a net present value of \$315.867 million to reflect an operating expense for future fossil decommissioning expenses in the year of plant retirement and the subsequent two years. This operating expense is part of PP&L's determination of the lost revenues approach in the valuation of its stranded utility generation. PP&L argues that the Act requires recovery of such costs (PP&L Ex. JRS 1, p. 8). The OCA and PPLICA recommend the Commission exclude the claimed costs in their entirety (R.D. p. 130).

1. Resolution

Section 2803(3)(iv) of the definition of, "transition or stranded costs" in Section 2803 permits the recovery of non-nuclear plant retirement costs pursuant to the Commission's discretion under Section 2808(c)(3). PP&L does not request recovery of any stranded non-nuclear plant retirement costs that are presently included in rates. PP&L has not met its burden to prove that any particular future retirement cost would be a recoverable stranded cost. PP&L has not presented any actual retirement plans, documented any known and measurable decommissioning expense that meets normal ratemaking standards, demonstrated that the costs would be recoverable under traditional

regulation, demonstrated that the cost will in fact be stranded, or demonstrated that the costs will be non-mitigated. PP&L's claim therefore does not meet the basic requirements for stranded cost recovery and must be rejected.

Under traditional regulation, fossil fuel decommissioning expense may be recoverable when the cost is incurred for the actual retirement of a plant. PP&L is correct that *Penn Sheraton* does not stand for the proposition that fossil decommissioning costs may not be recoverable under traditional ratemaking (*Penn Sheraton Hotel v. PA PUC*, 198 Ct. 618, 184 A.2d 324 (1962)). Both *Penn Sheraton* and long-standing Commission precedent, however, preclude a present determination of recovery of prospective, speculative decommissioning expense. In order to be recoverable under traditional regulation, the cost must be known and measurable and actually incurred. PP&L has not met its burden to prove that any future fossil decommissioning expense will exist at a particular date and in a known and measurable amount. The Commission explicitly rejected PP&L's claim for future fossil decommissioning expense in its last rate case, and essentially the same claim is rejected now.

Our rejection of future fossil decommissioning expense is consistent with our rejection of an assumption that plant lives will be extended.

Prospective fossil decommissioning expense does not meet the standards for present incorporation into rates. As indicated in *PECO Energy Restructuring Order*, *West Penn*, and *Duquesne Restructuring Orders*, the traditional ratemaking standards for fossil decommissioning expense are clearly distinguished from those applicable to nuclear plant decommissioning. Substantial public health considerations are present. Nuclear plant decommissioning expense is already included in rates, is federally mandated for urgent public health and safety reasons, and is required under the Act. Future fossil plant

decommissioning is neither federally mandated nor urgent for public health reasons, and is not required under the Act.

D. Nuclear Decommissioning Expense

PP&L indicates that the jurisdictional annual nuclear decommissioning expense is \$9.5 million and does not claim any current under funding or other adjustments to the contribution rate. PP&L initially includes the same \$9.5 annual decommissioning expense as an ongoing operating expense that is considered as part of the market valuation of utility nuclear generation. Thus, in its first proposal, nuclear decommissioning expense is part of the company's claim for stranded utility generation, and there is no separate recovery needed for ongoing nuclear decommissioning expense.

OCA witness Catlin recommends no specific changes to PP&L's claim, but separately identifies the nuclear decommissioning stranded cost as contemplated under the Act. OCA did not include the nuclear decommissioning expense as part of its determination of PP&L's stranded utility generation. Excluding the OCA jurisdictional allocation that we reject, the resulting stranded nuclear decommissioning cost has a net present value of \$128.9 million (est).

As a preferred alternative, however, PP&L proposes recovering decommissioning expense as a per Kwh distribution charge for the duration of the useful lives of its nuclear facilities. Under this approach, PP&L would retain existing ratemaking treatment, with \$9.5 million of jurisdictional funding allocated to each class on a demand basis and calculating the charge on a per Kwh basis.

PPLICA and OCA oppose the annuity method, arguing that no net consumer savings result and that it is preferable for ratepayer responsibility for nuclear

decommissioning to end upon the conclusion of the transition period. The alternative proposal is not necessary in order to permit reasonable recovery of stranded costs while providing adequate opportunities for the development of a competitive market (PPLICA St. 3-S, p. 33). The Environmentalists opposed PP&L's proposals, arguing that PP&L must have an incentive to minimize nuclear decommissioning costs (Environmentalists St. 2, p. 28).

1. Resolution

Section 1 of the definition of, "transition or stranded costs" provides for full recovery of the unfunded portion of the utility's projected nuclear generating plant decommissioning expense, and Section 2 provides that the Commission may find it just and reasonable pursuant to Section 2808(c)(3) of the Act to permit recovery of stranded non-nuclear plant retirement costs. It is incumbent upon this Commission to ensure full recovery of nuclear decommissioning expense pursuant to federal law, the Act, and basic health and safety concerns. We agree with OCA and PP&L that the stranded cost methodology is appropriate and adopt OCA's calculation, as adjusted to incorporate PP&L's jurisdictional allocation.

E. DOE Assessments

The 1992 Energy Policy Act Amendments to the Federal Power Act impose an assessment on utilities for Department of Energy expenses for decommissioning of its uranium enrichment facility. PP&L seeks recovery of \$16.361 million as a regulatory asset after agreeing with PPLICA and OCA that its initial claim would provide double recovery because the expense was also included as part of the operating expense of the Susquehanna nuclear plants in PP&L utility generation valuation (OCA St. 3, p. 7).

PP&L eliminated the claim from its stranded generation request and seeks recovery as a regulatory asset (PP&L St. 8 - R, pp. 56-57).

1. Resolution

We agree with PPLICA and OCA that the expense is properly considered as a fuel expense since that is how it is reflected on PP&L's books. Double counting would be inappropriate in any event. Since we adopt OCA's utility generation valuation methodology that considered the expense, no adjustment is necessary and we reject additional recovery as a regulatory asset.

F. Susquehanna Deferred Refueling Expenses

PP&L seeks recovery of a jurisdictional amount of \$7.996 million as the net present value of incremental O&M expenses during refueling and inspection outages. PP&L argues that under current ratemaking approved by the Commission since 1983, PP&L has deferred recognition of such expenses and amortized the prior expense until the next episode (PP&L St. 8, p. 25).

PPLICA, OCA and OTS argue that the Commission has never granted PP&L the authority to defer these costs and that no regulatory asset exists (R.D., pp. 136-139).

1. Resolution

Under traditional ratemaking, the expense is not a deferred regulatory asset for special amortization, just recoverable as a normalized expense through base rates. The 1983 Order approved only the right to seek recovery of the expense, which has never

been included as an additional component in rates since that time. In the 1994 rate case, the expense was normalized as an annual expense and incorporated into base rates. There is no regulatory asset requiring additional recovery.

G. Net FAS-109 Taxes Recoverable

During the development of the record in this case, all parties agreed that PP&L has a regulatory asset for SFAS-109 recoverable taxes that reflect tax benefits that already have been flowed through to ratepayers although PP&L still will have to pay the underlying taxes in the future. All parties also agreed that PP&L has an offsetting regulatory liability for FAS-109 Investment Tax Credits that have already been obtained by the company but have not yet been flowed through to ratepayers (R.D., pp. 140-141).

1. Resolution

The value of the regulatory asset is not the revenue requirement pursuant to a taxing and ratemaking reimbursement that no longer exists. Instead, the value of the regulatory asset and the amount that consumers should pay PP&L is the net present value of the tax obligation that must be paid now that the recovery period has changed. It is the different tax consequences of the CTC recovery period that changes the value of the regulatory asset.

No party disagrees that the timing of taxes due to the government and payment to PP&L by consumers changes as a result of the end of regulated generation rates. The period for both payment of taxes to the government and reimbursement from ratepayers previously extended over a period of up to 30 years, while it is now being compressed into the duration of the CTC recovery period. The tax benefits, "reverse" at

an earlier date to match the compressed CTC recovery period. This fundamentally changes the revenue requirements of the regulatory asset under traditional regulation.

PP&L's initial claim for the SFAS-109 regulatory asset did not consider the changed revenue requirement of the SFAS-109 claim. PP&L's initial claim therefore was significantly understated, is inaccurate, and must be rejected as a basis for the recoverable asset notwithstanding the acceptance of the claim by PPLICA and OCA (PPLICA St. 3, pp. 9-13). The correct claim must incorporate the reversal of taxes over the CTC recovery period. We therefore grant PP&L's revised claim on a net present value basis for \$397.6 million based on its presentation (PP&L St. 8-R at 16-17).

H. 1994 Rate Case Expense

PP&L claims a regulatory asset of \$184,000 to reflect the unamortized balance of its 1994 rate case expense (PP&L St. 8, p. 26).

1. Resolution

As OTS and OCA argue, the 1994 rate case authorized recovery of a four year normalized rate case expense that is incorporated into existing rates, not deferral and amortization of a single rate case expense. In that case, PP&L did not object to normalization, only arguing that a shorter period should be used. Under traditional regulation, the Commission has routinely normalized rate case expense since 1980. PP&L's accounting treatment of rate case expense as an amortization is not relevant to ratemaking treatment. The claim is rejected as a regulatory asset.

I. Consumer Education

Approved consumer education expenses pursuant to the Commission's Consumer Education Order and this decision are recoverable as transition costs. However, the record provides no useable calculation of the expense. For purposes of this decision, we assume a consumer education budget of \$5 per residential customer for each of four years, for a total budget of \$21.62 million. This figure will be adjusted in the Commission's compliance filing Order to reflect the approved consumer education plan.

J. Unchallenged Regulatory Assets

PP&L requests regulatory asset recovery for Common Plant in the amount of \$7.783 million, Susquehanna Early Window Costs in the amount of \$9.83 million, and Retired Miner Healthcare Costs in the amount of \$6.308.

1. Resolution

No party challenges these claims and they are granted.

The following is a summary of our determinations:

Summary of Net Recoverable Regulatory Assets and Liabilities

Unrecovered Energy Costs	\$ 76.815	million
Employee Expenses		
VERP	14.09	
FAS-106	8.73	
Employee transition	5.502	
FAS-109 Taxes	397.6	
Consumer Education	21.62	
Common Plant	7.783	
Retired Minors Healthcare	6.308	
SSES Early Window	9.83	
 TOTAL	 \$ 548.278	 million

K. Non-Utility Generating Contracts (“NUGs”)

PP&L requests \$656.87 million in stranded costs for NUGS, including the costs of two buyouts. OCA values the claim at \$574.708 million and PPLICA values the claim at \$556.30 million. OCA would use its forecast of market prices instead of PP&L’s in determining the stranded cost. Since we adopt OCA’s market price forecast as the most reasonable in the record of this case, OCA’s market prices should be used in evaluating the stranded costs of NUGs as well. For this reason, we use OCA’s valuation of the NUG stranded cost of \$574.708 as the starting point for our determination.

1. Resolution

OCA also would use its jurisdictional allocation. However we adopt PP&L’s jurisdictional allocation, requiring an increase of OCA’s stranded NUG costs in the stranded NUG cost of \$4.068 million. The OCA also adjusted PP&L’s capacity factors for its NUGs. We also find that the PP&L’s estimate is acceptable.

PP&L assumed the actual capacity factors experienced over the 1994-1996 period to formulate its claim. OCA argues that the actual output experienced is very high and unlikely to be maintained over the long-run. OCA witness LaCapra assumes an 80% annual capacity factor for NUGs. While OCA may be correct that the NUGs may not be able to maintain their historic performance, there is no factual support in the record to assume capacity factors reduced to 80%. Therefore, the value of PP&L's stranded NUGs is increased by \$56.911 million, resulting in a total recoverable claim of \$635.687 million.

The Anthracite Region Independent Power Producers Association ("ARIPPA"), Gilberton Power Company, and Schuylkill Energy Resources argue that the determination of recoverable NUG contracts costs as stranded costs in this proceeding provides an economic incentive for PP&L to engage in, "contractual gamesmanship." In Exceptions, ARIPPA notes that the Recommended Decision ignored the testimony arguing that PP&L will receive stranded costs related to the NUG contracts regardless of the actual power purchased. ARIPPA indicates that the NUGS only get paid based on actual power generated and delivered to PP&L, providing PP&L with an incentive to undermine the contracts or minimize delivered amounts, thereby permitting PP&L to retain the stranded cost without incurring the associated expense.

Thus, in sum, we find that PP&L has documented \$2.864 billion in total stranded costs that actually exist. We find that it is just and reasonable for PP&L to recover 100% of these costs over the transition period as calculated and discussed in the next section.

VI. RECOVERY OF TRANSITION AND STRANDED COSTS AND CTC CALCULATION

A. CTC Design

PP&L argues that it should be permitted to maintain current rates and to determine the CTC as a residual charge. Under its approach, PP&L would continue to collect its capped rates from all customers, while establishing a shopping credit based on the administratively determined price of energy for customers choosing to shop and determining the CTC as the entire residual amount (PP&L St. 9, pp. 23-26).

1. Resolution

The Act requires that we determine the CTC, “from the bottom up” based on authorized recoverable stranded costs. A CTC calculated, “from the top down” as a residual amount bears no relation to the determination of recoverable stranded costs in this proceeding and must be rejected. PP&L computes a T&D rate, and then a market based price for energy and capacity. The difference between the market based pricing (including T&D rate) and the current bundled bill would be applied to stranded cost recovery (CTC). Our “bottom-up” calculation is to compute a T&D rate, and a specific CTC for stranded cost recovery. The difference between those charges (T&D plus CTC) and the present bundled rate is then available to customers to use as a shopping credit to offset their new supplier charges. Moreover, as we enter the era of competitive, deregulated generation, this Commission will not establish an administratively determined market price for generation that directly imposes the parameters for savings from selecting a competitive supplier.

B. Prohibition on Cost Shifting

PP&L proposed a generation price for Basic Utility Service ("BUS") for non-shopping customers based upon the annualized, average cost of such service, subject to the rate cap. As discussed above, the BUS price would also directly affect customers who shop, because PP&L proposes that we adopt a CTC that is the residual after the BUS amount is subtracted from the unbundled cost of generation in existing rates.

In addition, PP&L initially proposed a Customized Rate Design for the CTC that would be mandatory for non-residential customers, but made the proposal optional for all customer classes in response to the objections of PPLICA and OSBA. Under the proposal, the CTC rate would be different for each customer based on 1996 usage. In simplified form, PP&L proposes that half of each customer's CTC would be collected through a fixed charge while the remainder would be recovered based on the customer's usage. Under its proposal, a customer with the same usage as in 1996 would pay the same CTC as under a direct cents/Kwh CTC. A customer increasing usage, however, would pay less towards the CTC while a customer reducing usage would pay more towards the CTC. PP&L argues that such a, "halfway" move towards marginal pricing will promote economic development by reducing the CTC on incremental usage and lessen the distorted price signals engendered by having a CTC (PP&L St. 9, p. 20).

OCA and the Public Interest Parties oppose the Customized Rate Design. OSBA and PPLICA initially opposed the Customized Rate Design, but do not object to its optional availability. We do not accept PP&L's arguments as support for adoption of its complex proposal. It is the fact that a CTC exists to permit a utility to recover stranded costs that distorts the price signals of a competitive generation market. It is the fact that the CTC exists to permit the utility to recover stranded costs that limits and delays the full opportunity for competitive generation to promote economic development. We also agree

with many of the objections raised by OCA and the Public Interest Parties. The proposal intentionally encourages increased consumption, shifting the CTC burden and penalizing customers who reduce consumption (OCA St. 4, pp. 8-13). As PPLICA states, the proposal essentially adopts a, "take or pay" charge for half of recoverable stranded costs.

The Customized Rate Design must be viewed in concert with other issues in this case. PP&L proposed to charge capped rates, provide no consumer savings during the CTC recovery period, and not reconcile CTC revenues annually. This decision provides for consumer savings and the resulting economic development benefits directly through the competitive market. No complex rate design is necessary to provide a marginal benefit. This decision provides for annual reconciliation of recovered CTC revenues. No complex rate design is necessary to ensure PP&L's recovery of CTC revenues.

1. Resolution

We cannot accept PP&L's Basic Utility Service Rate and Customized Rate Design. The CTC shall be calculated on a per/Kwh basis, allocated to each class. PP&L properly used the cost of service study in its most recent base rate proceeding for this purpose as required. The revenue requirement of the CTC shall be allocated on a class basis to assure there is no interclass cost shifting. The record in this case supports the use of a declining CTC over the transition period and an extension of the recovery period to June 30, 2007.

The CTC must be calculated as the amount necessary to fully amortize the authorized recoverable stranded and transition costs over the recovery period, including a return on the unamortized principal balance as described above. All customers will pay the unbundled transmission and distribution rate. Non-shopping customers will pay the

unbundled rate for generation such that the total rate will precisely reflect currently the existing rates. A proportionate amount of the unbundled generation rate collected from non-shopping customers will be allocated to CTC recovery (R.D., pp. 150-151).

Customers choosing to shop will pay their chosen supplier instead of PP&L for generation. These customers will continue to pay a temporary charge for PP&L's stranded generation related costs to PP&L through the CTC. The residual amount leftover from the unbundled generation rate and the CTC amount is the Shopping Credit.

Section 2808(b) provides that the utility and a customer may mutually agree on an alternative payment methodology. PP&L shall cooperate with consumer requests for an alternative CTC payment methodology that fully collects the same present value of CTC responsibility without bypass by the consumer or over collection by PP&L.

C. Reconciliation and Tracking

PP&L proposes an annual determination of over and under collections of CTC recovered dollars through a Section 1307 reconciliation proceeding. PP&L proposes that the actual CTC will not be adjusted to reflect actual recovery (PP&L St. 3, p. 17). Instead, the CTC recovery period would be shortened or extended as necessary. PP&L argues that there is good cause to adopt its proposal because rates will be at the capped level under its proposals. However, rates will be below capped levels, so the argument is moot. We conclude that the Act requires an annual reconciliation proceeding pursuant to Section 1307(e) based on actual sales and that good cause to adopt an alternative reconciliation method may only be found after hearings in the required annual reconciliation proceeding. The CTC shall be calculated based on annual 1999 sales of 33,090,377 MWH, escalating at 1.5% annually and monthly receipt of revenues.

D. CTC Recovery

The CTC distorts market prices and directly impacts the competitive market because it limits the opportunities for consumers and competitive suppliers to achieve savings and earn profits, respectively. The parties have presented various proposals for adjusting CTC recovery levels in each year to address their concerns. We conclude that the facts of this case and the stranded recovery authorized herein support the use of a declining CTC over the transition period. We conclude that it is appropriate to use a declining CTC in order to properly balance PP&L's earnings in the early years of the transition and reasonable customer savings during the entire transition period.

Section 2808(b) provides a general rule that the CTC recovery period should expire by December 31, 2005. The Act modifies the general rule, however, if "... the Commission, in its discretion and for good cause shown, orders an alternative payment period." We find that PP&L's large amount of stranded costs supports an extended transition period until June 30, 2007, in order to permit PP&L full recovery of its stranded costs while ensuring that suppliers have a reasonable opportunity to compete and consumers have a reasonable opportunity to save during the transition period.

E. Return on Unamortized CTC Balance

In the absence of full recovery on January 1, 1999, PP&L agrees with our methodology in *PECO Energy Restructuring* Order that the Company should receive a return on the unamortized principal balance of recoverable stranded costs (R.D., pp. 112-116).

The rate of return to be incorporated into the CTC recovery calculation has been argued as part of sharing responsibility. OCA agreed that no return should be

provided in the CTC calculation and that straight amortization be employed. Conversely, PP&L proposed that its long term debt rate of 10.86%, including the gross up for taxes, reflects proper recovery. We believe that pre-tax return of 10.86% on the unamortized balance of stranded costs, including the gross-up for taxes, is just and reasonable, given the reduced risk profile of the recovery mechanism versus historic ratemaking. The Company has deferred any filing for securitization of its stranded costs pending the outcome of this proceeding. We believe that securitization of a substantial portion of the stranded cost finding would benefit all consumers and the Company.

VII. RATE DESIGN AND TARIFFS

Prior to addressing individual tariffs and rate design issues, we find it appropriate to summarize our directions in this regard in order that PP&L may submit a compliance filing that will meet our expectations. It is directed that PP&L incorporate these general directives in its compliance filing unless specifically indicated to the contrary in this Opinion and Order.

First, PP&L is directed to unbundle all tariff classes based on the allocation of costs and the rate design in its last base rate case as well as this Opinion and Order. Such unbundling will permit all customer classes to procure generation competitively. Specific tariff rules and regulations shall be those currently approved and on file with the Commission or directed to be filed by the Commission except as modified in this Opinion and Order.

Second, all existing special contracts shall remain in effect under their specific terms and conditions. A contract that explicitly prohibits shopping in contemplation of passage of the Act shall remain unchanged. However, any customer with a contract that does not explicitly prohibit shopping must be permitted to shop if that customer so desires. Upon We note that some contracts may have to be renewed. However, any rate caps remain applicable as provided in Section 2804(4).

Finally, no contract may permit bypass of the CTC. Any existing contract that purports to do so must assign customer payments to full recovery of the allocated CTC and provide the associated discount as a credit to the customer against other portions of the bill. As rates are unbundled, customers with existing

discounts must receive a discount allocated to the distribution and transmission portion of the bill unless the nature of the discount is exclusively on the generation component.

A. Customized Rate Design

As an alternative to collecting its CTC on a strict usage (kWh) basis, PP&L also proposed what it refers to as a customized rate design (CRD). According to this design, one half of a customer's CTC would be recovered through usage-based charges, while the remainder will be recovered through a fixed customer charge. (PP&L M.B., p. 147).

PP&L asserts that the CRD would stimulate growth in the Pennsylvania economy by providing rate reductions for incremental usage, and would effect a movement toward marginal cost pricing. (*Id.*, pp. 148-149).

PP&L originally proposed that the CRD method of recovering CTC revenues be optional for residential customers and mandatory for non-residential customers served on major rate schedules. However, PP&L revised its proposal and now proposes that the CRD be optional for all customer classes. (*Id.*, p. 148).

A number of parties opposed PP&L's proposed CRD. OCA argues that it is inefficient because the marginal cost of transmission and distribution is higher than the embedded revenue requirement. Thus, a flat transmission and distribution charge and a fixed CTC may not send the proper price signals to customers with regard to marginal usage. (OCA M.B., pp. 83-85). OCA also contends that the CRD is a promotional rate design which inappropriately

encourages energy use by shifting CTC responsibility from customers who increase usage to customers who conserve energy. (Id., p. 85-86).

PPLICA argues that the CRD violates the rate cap and cost shifting prohibitions contained in Chapter 28, and amounts to a take-or-pay charge for 50% of PP&L's recoverable stranded costs. See Large Customers M.B., pp. 77-80. However, PPLICA is willing to accept the proposed CRD if it is to be optional to all customer classes. (Large Customers M.B., p. 80; R.B., p. 48).

The Public Interest Parties and PPA/PAPHCC also objected to the proposed CRD for reasons similar to those of OCA and PPLICA. (Public Interest Parties M.B., p. 45; PPA/PAPHCC M.B., 8-9). OSBA opposes the CRD as being detrimental to small business customers, but is willing to accept it if it is optional for all classes. (OSBA M.B., pp. 35-37).

The ALJ concluded that PP&L's proposed CRD appeared to be an attempt by the Company to shield itself from some of the uncertainty involved in having the recovery of the CTC totally dependent on customer usage, which cannot be predicted with 100% accuracy. As a result, ALJ Kashi found PP&L's proposed rate design to be questionable for the reasons set forth by OCA. He, therefore, recommended that it be rejected and that the Company be required to design its CTC according to its original \$/kWh format. (R.D., p. 157).

1. Resolution

Inasmuch as there have been no exceptions filed on this issue, we will adopt the ALJ's recommendation subject to the general directives set forth above.

B. Small Business Customer Rates

OSBA raised concerns regarding two aspects of PP&L's rate unbundling proposal which it believes will adversely affect small business customers. The first of these relates to the demand charge in Rate Schedule GS-1.

OSBA asserts that since the demand charge under this rate schedule only applies to billing demand above 5 kW, customers with billing demands less than this amount will see no reduction in their transmission/distribution service bill relating to the market rate demand credit because they pay no demand charge. Also, the OSBA argues that smaller GS-1 customers will face rates that are below PP&L's forecast market rates. (*Id.*, p. 38). To resolve this problem, the OSBA proposes that the existing demand charge remain in the component of the rates designated for transmission and distribution, and that market demand charge revenues be backed out of the first and possibly second block energy rates. (*Id.*).

PP&L indicated that the OSBA proposal would adequately recover delivery service revenue requirements approved in the Company's last base rate case and, thus, is willing to accept this proposal. (Tr. 1051-1052; 1099). As a result, the ALJ recommended that it be approved. (R.D. at 158).

The second of the OSBA's concerns relates to PP&L's proposal to recover all transmission and distribution costs through a flat energy charge and a fixed customer charge in Rate Schedules GS-1 and GS-3. OSBA contends that PP&L's elimination of the declining block rate design for the recovery of these cost components may result in larger customers with higher load factors subsidizing very small customers because small customers will provide less in revenue

than their allocated costs. OSBA recommends that PP&L's current declining block rate design be maintained for these rate schedules until further examination of this issue can be conducted in a future rate proceeding. (Id., pp. 38-39).

The ALJ found no evidence to suggest that delivery charges are such a significant component of the current blocked rate structure for the GS-1 and GS-3 rates that the shifting of this structure from delivery service rates to the CTC will have the detrimental affect which OSBA alleges. For these reasons, the ALJ concluded that it was inappropriate to discard the Company's simplified rate design in favor of OSBA's proposal, and, therefore, recommended that the OSBA's proposal be rejected.

The OSBA filed Exceptions to the ALJ's recommendation arguing that the ALJ improperly approved PP&L's proposal to revise its rate design for the GS-1 and GS-3 rate classes through the elimination of the present declining block structure of those rates.

1. Resolution

With respect to the first issue raised by the OSBA, we have previously rejected PP&L's proposed administratively determined market price of energy so that PP&L's proposed changes to GS-1 rates based on that proposal are moot.

With respect to the second issue raised by OSBA, we note that PP&L has proposed to change the rate structure of its existing GS-1 and GS-3 rates so as to recover all T&D charges through a flat energy charge and a fixed customer charge, thus eliminating the existing declining block rates. In reviewing

the record on this issue, we are of the opinion that OSBA has correctly observed that this change would shift intraclass costs and has not been supported on the record by the kind of studies normally submitted by the parties and relied upon by the Commission in resolving such a rate design issue. As stated previously, all existing tariffs generally should remain available on their present terms. Tariff changes are only appropriate if meeting the standards of traditional ratemaking or if the transition to competition requires such a change. We cannot accept PP&L's argument that the simplicity of eliminating the declining blocks requires approval of this proposal since PP&L itself has proposed a complex declining block rate structure for CTC recovery. As a result, PP&L's proposed change is denied.

C. Provider of Last Resort Service

Under traditional regulation, a utility has the duty to serve all customers in its electric distribution territory, including transmission and distribution service, as well as providing generation services. Although under the Act, customers may select an alternative supplier of generation services, the utility retains the duty to serve all customers as an EDC. The Act is quite clear that all customers must have a guaranteed supplier of generation in all circumstances. Section 2802(16) declares that the EDC should continue to "be the provider of last resort in order to ensure the availability of universal electric service in this Commonwealth unless another provider of last resort is approved by the commission." 66 Pa. C.S. §2802(16).

Section 2807(e)(1) of the Act requires that PP&L, as an EDC, shall have the continuing duty to serve all customers, including, "the delivery of electric energy and the production or acquisition of electric energy for customers," until the CTC collection period has ended. 66 Pa. C.S. §2807(e)(1). The Act imposes

certain responsibilities on the EDC to provide Provider of Last Resort (PLR) services to all customers unless an alternative provider has been identified by the Commission. Thus, as an EDC, PP&L must provide all PLR services until directed otherwise. The duty to serve applies not only to customers who do not choose a competitive generation supplier. The duty also protects customers who cannot find a willing EGS and customers whose suppliers fail to deliver. All customers without a competitive supplier shall be served by the EDC pursuant to the applicable tariff and are entitled to the full protection of the applicable rate cap provisions.

PP&L proposed to use its Generation Supply Group, a licensed EGS, to provide PLR service. PP&L proposed to serve its PLR customers under its Basic Utility Supply Service (BUSS), which would consist of a generation charge, a delivery charge, and the CTC. The proposed generation charge would be the projected market price of energy. PP&L further proposed a Purchased Generation Cost Rate (PGCR) that would be applicable after the phase-in to those PLR customers without hourly meters and would be subject to a reconciliation. (PP&L M.B., pp. 158-159).

OCA stated its position that the generation rates charged to PLR customers should not exceed prevailing market rates, including all reasonable costs. In this regard, OCA argued that PP&L's market price should be adjusted to account for line losses, differences in class load shapes, and differences between residential and average retail market prices. (OCA M.B., p. 80). OCA also argued for further adjustments to include "certain administrative and general costs that will be required to market, aggregate load, reconcile load and supply, deal with PJM, write contracts, etc." (OCA M.B., p. 78). OCA advocated that "all customers [should] receive rate savings, and alternate suppliers [should] have to

compete based upon their ability to provide favorably priced electric generation when compared to the market-based retail generation price reflected in the Company's rates." (OCA M.B., p. 81). It further asserted that PLR customers should have the same opportunity to receive electric energy at market-based prices as those customers who choose to shop for and receive energy from alternative suppliers. (OCA M.B., pp. 81-83).

The Competitive Intervenors objected to the rates as proposed by PP&L because, under the Company's proposal, they argued, the rates would be at wholesale prices which would be passed through to customers without a markup. (Competitive Intervenors M.B., p. 17). The Competitive Intervenors argued that PP&L's proposal attempts to circumvent the mandatory rulemaking requirement of Section 2807(e), 66 Pa. C.S. §2807(e). (Competitive Intervenors M.B., pp. 19-20, footnotes omitted).

SER/Gilberton also argued that PP&L's proposal would result in rates which are below actual costs. (SER/Gilberton M.B., pp. 6-11). SER/Gilberton claimed that, "[s]hould PP&L fail to add to the wholesale acquisition cost of each unit of electricity all expenses reasonably incurred in performing the supplier-of-last-resort service (including, for example, a 'buying group' service charge or commission), it would be guilty of predatory pricing that would impede fair competition." (SER/Gilberton M.B., p. 10). SER/Gilberton argued that the Commission should require that the BUSS energy price be set at not less than the standard offer price for the same class of service marketed by PP&L's unregulated Generation Supply Group. (SER/Gilberton M.B., p. 11).

In his recommended decision, the ALJ determined that PLR customers should be afforded the same opportunity to receive market-based

generation rates as those customers who choose to go elsewhere for their electric energy. (R.D., p. 163). The ALJ was persuaded that rates should be genuine market-based retail rates that include all reasonable costs incurred to obtain the energy. Consequently, the ALJ found that during the phase-in period, PP&L's generation rates for its PLR customers should be based on its projected market price of generation as adjusted in the manner suggested by OCA. (*Id.*). He also recommend adoption of the SER/Gilberton position that these rates should at no time be set below the standard offer price for the same class of service marketed by PP&L's unregulated Generation Supply Group. The ALJ recommended rejection of PP&L's Purchased Generation Cost Rate as premature, cautioning that the Company must await the promulgation of regulations by the Commission, as required under Section 2807(e)(2) of the Act, before the provisions of Section 2807(e)(3) may be fully implemented.

PP&L filed Exceptions to the Recommended Decision arguing that its proposal is fully consistent with Section 2807(e)(3) of the Act, which provides that the provider of last resort service shall acquire energy at "prevailing market prices" and recover "all reasonable costs." In addition, PP&L argues that since the PGCR would not become effective until the end of the phase-in period, until that time, it would continue to charge non-shopping customers its Commission approved, tariffed rates. As a result, PP&L concludes that the ALJ's hybrid pricing scheme for last resort service during the phase-in period be rejected. (PP&L Exc., pp. 7-9).

Enron also filed Exceptions to the Recommended Decision. Enron argued that the ALJ erred in recommending a scheme for serving PLR customers which is inconsistent with the law and the evidence. As a result, Enron recommends rejection of the ALJ's proposed resolution. (Enron Exc., pp. 13-19).

MAPSA and OCA both filed Reply Exceptions. MAPSA argued that PP&L's Exceptions should be denied and OCA argued that it is appropriate for all customers to benefit from the Act during the phase-in period through rate savings. (MAPSA R. Exc., pp. 3-4; OCA R.Exc. pp. 4-7).

1. Resolution

Because section 2807(e)(1) imposes the duty to serve on the EDC - a Commission-regulated entity - PP&L cannot shift this responsibility to its Generation Supply Group which is a licensed EGS. As such, we expressly reject PP&L's proposal to use its Generation Supply Group to provide PLR services. In addition, we agree with the ALJ and the OCA that PP&L's proposal to use a Purchased Generation Cost Rate is premature. Section 2807 specifies that future provisions for the market-based pricing of PLR generation shall be adopted by regulations at a later date.

Similarly, we must reject PP&L's proposals for returning customers. The Act provides no basis for treating PLR customers any differently than customers who never chose generation service from an EGS. Returning customers are still protected by the same rate cap as if they had not left, and returning customers must be served on the same terms as would other similar customers who did not previously receive generation services from an EGS.

No substantial evidence supports the need to impose any switching fee at this time. As with all other new costs of service related to the administration of direct access, we do not adopt any additional charges to the customer or EGS until a finding that a net incremental cost exists. Again, we find ourselves in

agreement with the ALJ and the OCA that rate RTS customers are entitled to the same opportunity to shop without penalty upon return as any other class of customer. (R.D. at 162; OCA M.B., p. 81; OCA R.B. at 33-34).

To summarize, all customers without a competitive supplier shall be served by PP&L, not the Generation Supply Group, pursuant to the applicable tariff and are entitled to the full protection of the applicable rate cap provisions. Returning customers shall be treated no differently than customers who never chose generation service from an EGS and are entitled to the same rate cap provisions as if they had not left.

D. Availability of Tariff Rates

PPLICA objects to PP&L's proposal to make its interruptible and price response rate schedules, as well as Rate Schedules RTD and RTS, available only to those customers who currently take service under these schedules and elect to remain bundled sales customers of PP&L. SER/Gilberton objects to these proposals as well. Both of these parties object mainly to the fact that, under these proposals, customers of the affected rate schedules who choose to buy energy from a competitive provider would be charged a CTC based on the firm rate schedule applicable to their level of load, rather than on their current rate schedule. (Large Customers M.B., pp. 71-77, SER/Gilberton M.B., pp. 3-4).

PPLICA asserts that an interruptible customer's CTC liability is based on embedded stranded costs, and is naturally smaller than that of a firm customer. PPLICA argues that such liability for an interruptible customer should not change simply because that customer chooses to access the competitive market. (Large Customers M.B., pp. 72-74). PPLICA contends that PP&L's

proposals are in violation of the cost shifting prohibitions of Chapter 28 because they cause interruptible customers who exercise their right of access to pay higher rates. Additionally, PPLICA asserts that PP&L's proposals would result in the collection of greater CTC revenues from interruptible customers than would otherwise occur. This would lead to an earlier termination of the CTC which would, in turn, result in all other customers on the PP&L system paying a lower CTC than they otherwise would. (*Id.*, p. 74). Finally, PPLICA also contends that PP&L's proposals with regard to the rate schedules in question violate the pro-competition and pro-business growth goals of Chapter 28 of the Act by producing higher prices for electric service, and restricting access to the competitive market for those customers affected. (*Id.*, pp. 75-77, 82-83).

In response, PP&L argues that the benefits of interruptible service provided to the Company and its customers are related totally to generation service. PP&L asserts that there is never a need for interruptions of delivery service on its system because the Company never experiences any local transmission or distribution emergencies that would require such interruptions. Therefore, PP&L concludes that customers that purchase energy from a competitive provider and receive only delivery service from PP&L should not receive the discounts offered under interruptible service rates, but should be served under rate schedules for firm service. (PP&L M.B., pp. 144-146; R.B., p. 56-58). PP&L makes a similar argument with regard to its Residential Thermal Storage (RTS) rates. (PP&L R.B., p. 59).

As discussed previously in this Opinion and Order, customers on 11 tariffs are entitled to shop and are protected by the applicable rate cap. Each interruptible tariff, as well as residential rate schedules RTD and RTS, for which PP&L has proposed similar limitations, must be unbundled in order to permit

customers to shop. While we agree that PP&L has done so, it does impose a higher CTC based on a firm rate schedule for customers that shop.

PPLICA filed Exceptions to the Recommended Decision on this issue, arguing that the ALJ's adoption of PP&L's proposed limitations on the availability of interruptible rate schedules and residential rate schedules violates the rate cap and anti-cost shifting provisions of the Act's central goals. (PPLICA Exc., pp. 30-34).

1. Resolution

Based on the foregoing, we agree with PPLICA that PP&L's proposal is anti-competitive, impermissibly shifts costs, violates the rate cap provisions, discriminates against customers who shop, and is contrary to reliability considerations by undermining the availability of interruptible service. As a result, we reject PP&L's changes to its other interruptible schedules as unsupported by substantial evidence.

E. Economic Incentive Rates

PP&L offers a number of incentive rates in the form of riders, rate schedules and billing options which it argues, are designed to promote economic growth and/or improve the Company's load factor. (PP&L M.B., p. 150). Although many of these incentive rates are scheduled to terminate in the relatively near future, PP&L is proposing to extend their availability through the end of the CTC application period so as not to violate the rate cap required by Section 2804(4) of the Act. However, PP&L is proposing to limit the availability of incentive rates to customers presently being served under them, and using PP&L's

BUSS service for their energy supplies. Also, customers who temporarily use alternative competitive energy suppliers and return to PP&L's BUSS service will not be eligible to receive service under the incentive rates.¹³ According to PP&L, the reason for these proposals is that the incentive rates were designed to benefit the Company and its customers from a generation standpoint, and have no relation to delivery service. Thus, customers who do not utilize PP&L for their generation supply services would provide no benefit to the Company under the terms and conditions of the incentive rates. Therefore, PP&L argues, the rates should not be made available to these customers. (*Id.*, pp. 151-153).

OCA objected to PP&L's proposals as they relate specifically to the Competitive Rate Rider (CRR). Since the discounts offered under the CRR would apply to the CTC (as well as the delivery charges), OCA contends that such discounts could result in cost shifting through the CTC reconciliation process, in violation of the Act. OCA argues that the Act requires the CTC to be nonbypassable, and therefore, prohibits the discounting of the CTC on behalf of any customer. (OCA M.B. pp. 86-87).

Competitive Intervenors also appear to object to PP&L's proposals. They advocate the necessity for the Company to eliminate its incentive rates as originally scheduled. The Competitive Intervenors cite the Commission's rulings in the *PECO Restructuring Proceeding* in support of their claim. (Competitive Intervenors M.B., pp. 56-58).

¹³ PP&L notes that there is one exception to the requirement to use BUS service. Unlike the other incentive rates, the Competitive Rate Rider (CRR) does not require the use of BUS service. However, PP&L states that discounts under the CRR are limited to delivery charges and the CTC. (PP&L M.B., p. 152, Fn. 75).

SER/Gilberton also opposed PP&L's proposal with regard to the economic incentive rates. SER/Gilberton argued that such a proposal is anti-competitive because it discourages customers from choosing an alternative power supplier, and because such incentive rates would allow PP&L's regulated Electricity Delivery Group to undercut the future retail market. (SER/Gilberton M.B., pp. 4-5). SER/Gilberton also argues, as does the OCA, that PP&L's proposal with regard to the CRR violates the requirement that the CTC be nonbypassable. (*Id.*, pp. 5-6).

PPLICA supported PP&L's proposal to extend the availability of incentive rates, and objects to OCA's opposition to this proposal. PPLICA argues that it is OCA's proposal to eliminate the incentive rates as originally planned that is contrary to the Act. This is so, according to PPLICA, because the elimination of these rates would violate the rate cap, and would cause cost shifting since PP&L would then have extra resources available which must necessarily benefit other rate classes or the Company's shareholders. (Large Customers M.B., pp. 80-82). PPLICA also rejects the argument of The Competitive Intervenors that the Commission's *PECO Restructuring Order* decision requires the elimination of the economic incentive rates. PPLICA contends that the *PECO* decision requires that all competitively priced services such as interruptible service, economic development rates and special contracts must be continued throughout the transition period. (PPLICA R.B., p. 50).

The ALJ, although indicating that he would advocate limiting the applicability of the various incentive rates to only BUS customers of PP&L, did not support the Company's proposal to extend the applicability of these rates beyond their original termination dates. As a result, the ALJ recommends that PP&L's proposal be rejected. (R.D., p. 167).

1. Resolution

PPLICA filed Exceptions to the Recommended Decision arguing, generally, that the ALJ erred by rejecting PP&L's proposal to extend the application of economic incentive rates for the duration of the stranded cost recovery period. Specifically, PPLICA argues that eliminating the incentives prior to this time clearly violates the Act's rate cap and anti-cost shifting provisions. Consequently, they argue that the Recommended Decision must be modified to continue the availability of economic incentive rates throughout the recovery period. (PPLICA Exc., pp. 34-36).

On consideration of the foregoing, as well as the record on this issue, we conclude that PP&L may not limit the availability of incentive rates to customers purchasing generation from PP&L. This is suggestive of anticompetitiveness and would be contrary to the Act. If the nature of the discount in the existing tariff is specifically within the generation component, a customer choosing to purchase generation from an EGS will receive no continuing benefit from remaining on the PP&L schedule. However, we do not agree that economic development rates are inherently allocable only to generation. Unless the existing benefits are specified as generation benefits in the tariff, each rate must be unbundled in a manner that allocates the existing discount, pro rata, to each component of the bill. A shopping customer, therefore, would lose the generation portion of the discount.

All existing, "competitive" tariffs shall continue to be offered to any eligible customer who does not yet have the opportunity to choose a competitive

supplier. Once the phase-in is completed, and all customers may choose a competitive supplier, the incentive rate schedule shall be closed to new customers. Regulated "competitive" tariffs will no longer be appropriate, although PP&L may offer competitive generation through its unregulated affiliate(s). We do not otherwise require the extension of any tariff schedule for an individual customer, but PP&L must provide a rate to all customers consistent with the rate cap.

F. Interruptible Service Tariff Provisions

PPLICA objects to two PP&L proposals relating to interruptible service. The first of these concerns the Company's proposal to remove the limitations on the frequency and duration of economic interruptions that exist in its currently effective tariff. PPLICA contends that such a change diminishes the value of interruptible service without providing any compensatory decrease in rates. PPLICA argues that this effectively raises the cost for interruptible customers over and above the level of rates as of January 1, 1997, in violation of the Act's rate cap. (Large Customers M.B., pp. 84-85).

In response to PPLICA's complaint, PP&L asserts that the limitations existing under the current tariff are not sufficient to protect other BUSS customers from the increasing average cost of service resulting from interruptible customers using energy when prices are high. (PP&L M.B., pp. 146-147).

The ALJ agreed with PPLICA that PP&L is attempting to decrease the value of its interruptible service in this proceeding without a reduction in rates and concludes that there is not sufficient evidence to justify this change. Therefore, the ALJ recommends that PP&L's proposal to remove the limitations regarding the frequency and duration of economic interruptions be rejected.

The second proposal to which PPLICA objected related to a change in the price charged to a customer who chooses to "buy through" an interruption. The current charge is the sum of the charges normally incurred under the rate plus the PJM billing rate for the buy-through period. The proposed charge is the otherwise applicable charge plus the estimated spot price of replacement capacity and energy. PPLICA contended that this proposed change should be rejected because 1) it was unsupported in Company testimony; 2) it provides customers with no certainty as to what the actual buy-through charge will be, nor does it provide a procedure to reconcile actual spot prices with the Company's estimates; and 3) it violates the Act's rate cap because if the Company's estimate is incorrect, the customer may pay more to buy through an interruption than it would under rates in effect on January 1, 1997. (*Id.*, pp. 86-87).

With regard to this objection, PP&L contends that its proposed estimated spot price more accurately reflects actual circumstances than a pre-established rate. It also states that the PJM tariff is currently being reviewed by FERC, and final provisions regarding sales and purchases relating to usage by interruptible customers during economic interruptions have not been determined. (PP&L R.B., pp. 60-61). PP&L argues that its proposal cannot be said to violate the rate cap since it is not known whether or not a presently unknown spot price exceeds a presently unknown PJM billing rate. Furthermore, PP&L asserts that there is no reason to conclude that any errors it may make in estimating the spot price would be substantial, or would be detrimental to the interruptible service customer. (*Id.*, p. 61). PP&L states that the only alternative to its proposal "would be to wait until actual spot prices are known which may be long after the transaction has taken place, thereby defeating the ability of large customers to weigh the 'buy through' option against an interruption." (*Id.*)

The ALJ recommended that PP&L's proposed change in its buy-through charge for interruptible service be rejected.

1. Resolution

Upon review of the record on this issue, we find the arguments of PPLICA to be persuasive. PP&L 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 its rates and services to promote a more competitive market for the provision of electric energy. Therefore, we adopt the ALJ's recommendation on this issue.

G. Transmission and Distribution Unbundling

In its proposed tariff, PP&L unbundled its rates into three components, namely, the delivery charge, the market price of energy, and the CTC. However, both PP&L and PPLICA agree that the delivery charge must be further unbundled into transmission and distribution components. This is because customers who arrange to receive transmission service from PJM under its Open Access Transmission Tariff should not have to pay PP&L a rate that includes charges for transmission service that it is not providing. These customers should only be required to pay a distribution charge to PP&L. Thus, the unbundling of the delivery charge is necessary. (PP&L M.B., pp. 157-158; Large Customers M.B., pp. 92-93). PPLICA's witness Baron provided worksheets detailing such an

unbundling. (PPLICA St. No. 1, Exhs. SJB-7-13). PP&L appears to accept PPLICA's proposed unbundling method. (PP&L St. No. 12-R, p. 8).

1. Resolution

Because this proposed unbundling of delivery service appears to be necessary and reasonable, and because there is no objection to it, the ALJ recommended that it be adopted.

Upon our review of the record on this issue, we agree with the ALJ's recommendation.

H. Federal/State Jurisdictional Determination

FERC has determined that it has jurisdiction over the transmission of electric energy in interstate commerce by a public utility. Thus, there is a need to distinguish between facilities used for transmission and those used for distribution. PP&L further explains this need as follows:

In Order No. 888, FERC found that once retail service was unbundled, there would be a need to draw a distinction between facilities that are used for transmission and those used for local distribution because, in determining the extent and scope of its exclusive jurisdiction, FERC has concluded that it has jurisdiction of retail transmission in interstate commerce to the point of local distribution. Order No. 888, 61 Fed. Reg. at 21,627. FERC also stated that it would defer to state recommendations on where to draw the jurisdictional line, provided that state regulators specifically evaluate seven specific indicators and any other relevant facts and make recommendations consistent with the essential elements of Order No. 888.

(PP&L M.B. p. 156).

The seven indicators to which PP&L refers are as follows:

1. Local distribution facilities are normally in close proximity to retail customers.
2. Local distribution facilities are primarily radial in character.
3. Power flows into local distribution systems; it rarely, if ever, flows out.
4. When power enters a local distribution system, it is not recognized or transported to some other market.
5. Power entering a local distribution system is consumed in a comparatively restricted geographical area.
6. Meters are based at the transmission/local distribution interface to measure flows into the local distribution system.
7. Local distribution systems will be reduced voltage.

(PP&L St. 12, pp. 17-18. Id., pp. 156-157)

PP&L states that in applying these tests, it has concluded, subject to Commission and FERC approval, that its facilities operating at voltages of 69 kV and above are transmission facilities; and facilities operating at less than 69 kV are local distribution facilities. (Id., p. 157).

No party opposed PP&L's analysis and proposal with regard to this issue and, as a result, the ALJ found the proposal to be reasonable and recommended that it be adopted.

We agree with the ALJ's recommendation.

I. Modifications to Terms and Conditions of Existing Tariffs

PP&L has proposed various modifications to existing tariff rules, which it explains as follows:

- Rule 4 is changed to indicate that the Company may upon request supply services over and above those which the Company would normally provide, if the customer agrees to pay the Company a fair and non-discriminatory price for those related services.
- Rule 9E was changed to indicate that the Budget Billing interest rate is changed from the number 1% per month to one-twelfth of the average of 1-year Treasury Bills for the months of September, October, and November of the previous year.

In Tariff 210, changes include the following:

- Rule A has been amended to exclude fuel supply disruption from qualifying for backup power supply.
- Paragraph E(5) has been added to Rule 6A to indicate that a customer-

specific, fixed, per month CTC developed by the Company, which will equal 100 percent of the customer's estimated CTC revenue, will be applied if the customer elects to install on-site generation on or after January 1, 1999.

Paragraph E(5) was based on Section 2808(a) of the Act, which permits recovery through a non-bypassable CTC of stranded costs from customers that install new on-site generation facilities. Under Section 2808(a), the CTC for such customer should be fixed and recover the customer's fully allocated share of stranded costs.

(PP&L M.B., pp. 153-154).

The ALJ recommended that the proposed changes to PP&L's tariff provisions be adopted because they appear to be reasonable and have not been opposed by any party in this proceeding.

Except for paragraph E(5), which is discussed below, we agree with the ALJ and adopt his recommendation here.

J. Tariff E(5) Self Generation

Section 2804(2) provides that restructuring shall permit, "reasonable and fair opportunities to self-generate and interconnect" to the transmission and distribution system. PP&L made no proposals to address this statutory directive in its restructuring plan. However, PP&L proposed a new Rule 6A, paragraph E(5), that requires a customer installing self-generation after January 1, 1999, to pay a CTC for generation no longer purchased from PP&L. PP&L's proposal did not

consider the Section 2808(a) that provides that only self-generation that, “significantly” decreases use of the transmission and distribution network must be subject to a separate recoupment of otherwise avoided payment of a customer’s allocated CTC responsibility. As in *PECO Energy Restructuring*, PPLICA proposes to define “significant” to permit a 25% reduction in system usage without additional CTC responsibility.

As an EDC, PP&L must provide a reasonable and fair opportunity for customers to self-generate and interconnect pursuant to Section 2804(2). The Environmentalists proposed net metering provisions and rules to facilitate interconnection of self generators with the transmission and distribution system.

1. Resolution

Consistent with *PECO Energy Restructuring*, We find that only reduced usage exceeding 10% of the pre-1999 use of the system requires payment of additional CTC. Consequently, we conclude that PP&L must provide reasonable opportunities for both large and small customers to interconnect self-generation. We adopt the proposals of the Environmentalists for net metering and interconnection, except that we do not require PP&L to purchase the generation of any customer. With customer choice and direct access, a self-generating customer may contract to buy and sell electricity with any willing EGS. PP&L must, however, as an EDC, provide the opportunity for self generation through reasonable net metering and interconnection provisions.

K. Interconnection Standards

As noted, we conclude that given PP&L's organizational structure, it may be difficult to avoid non-comparable treatment of its competitive division. Thus, we agreed with the position most advocated by Enron, that the Interim Code applicable to PP&L should be the PEA Codes, as amended and adopted by this Commission in *PECO Energy Restructuring* until final regulations are effective. PP&L should be governed by these interim guides as to interconnection standards.

Also, PP&L did not propose a specific Supplier Tariff, although it did propose as part of its presentation many terms that would be included within a Supplier Tariff. We agree with the EGSs that implementation of retail direct access pursuant to the Act requires a comprehensive Supplier Tariff that includes all rules, procedures and protocols appropriate and necessary for the seamless and efficient implementation of retail direct access. We direct PP&L to include a specific Supplier Tariff as part of its compliance filing. The compliance filing Supplier Tariff must reflect all applicable F.E.R.C. and PJM rules while supplementing those rules to reflect all aspects of the interaction between PP&L and an EGS necessary and appropriate for the efficient implementation of retail direct access. The Supplier Tariff is not a services agreement, however. It is a set of rules and procedures. It should include no fees or other charges except as have been approved by the Commission upon documentation of incremental cost. The Supplier Tariff must address customer sign-up and switching, balancing, billing, and data exchange. The compliance filing Supplier Tariff shall be consistent with this Order and all other relevant Commission regulations and Orders, that have been adopted to date concerning relevant issues, procedures and protocols.

L. Net Metering

PP&L's metering should be consistent with the ALJ recommendations. Also, in addition to concurring with and adopting the ALJ's recommendation that PP&L must allow customers the option, in conjunction with their EGS, to request the use of a, "qualified meter," that has been approved by the Commission, we also direct that PP&L shall be responsible for all physical work related to the meter, and the customer shall pay as a regulated rate any net incremental cost incurred by PP&L as a result of the customer's metering choice.

VIII. PHASE-IN ISSUES

As discussed previously, the Act requires that competition in the electric generation market in the Commonwealth be implemented in three (3) phases beginning on January 1, 1999. 66 Pa. C.S. §2806(b). We were granted the authority, pursuant to the Act, to order electric utility companies to submit proposals for retail access pilot programs beginning on April 1, 1997. 66 Pa. C.S. §2806(g). Consistent with Section 2806, PP&L submitted a proposal which was approved by this Commission. The scheduled for implementation of direct access pursuant to the Act is as follows:

... the following schedule for phased implementation of retail access shall be adhered to unless a determination is made by the Commission under subsection (c) [which allows for an additional six-month transition period under certain circumstances]:

(1) As of January 1, 1999, a maximum of 33% of the peak load of each customer class shall have the opportunity for direct access.

(2) As of January 1, 2000, a maximum of 66% of the peak load of each customer class shall have the opportunity for direct access.

(3) As of January 1, 2001, all customers of electric distribution companies in this Commonwealth shall have the opportunity for direct access.

66 Pa. C.S. §2806(b)

A. Phase-in Timetable

PP&L proposed a phased implementation schedule that tracked that mandated by the Act. (R.D., p. 171). PP&L proposed an initial sign-up period for each phase-in period during which all customers interested in participating in competition can notify the Company. If any rate classes are over-subscribed, PP&L will conduct a random selection among customers seeking to participate. (PP&L witness Henry W. Baumann, PP&L Sts. 14 and 14-R; PP&L St. 14-R, p. 4).

Enron, OSBA and PPLICA believed that the above methodology should not apply to the selection of commercial and industrial customers, based on the possibility that non-participating customers may suffer a competitive disadvantage over participating customers. (R.D., p. 172).

PPLICA witness Stephen Baron asserts that the most appropriate methodology for selecting industrial customers is on a first-come, first-served basis, with the customer designating a desired level of load for participation. PPLICA St. 1, pp. 58-59. If there is an over-subscription of load, Mr. Baron proposes a pro-rata reduction to each subscriber's nominated load. To alleviate any remaining competitive disadvantages, Mr. Baron proposes that PP&L begin selection for the second phase and implement such a selection process by permitting retail access for up to 66% of peak load beginning January 2, 1999. PPLICA St. 1, p. 59.

Enron witness Mr. Bowen advocates a similar approach. Under Enron's proposal, Enron would be willing to accept the "first through the meter" approach, where Enron would supply the first portion of the customer's electricity

received in a given hour and the EDC would supply the remainder. Enron would also be willing to "follow the customer's load" and provide a fixed percentage of its customers' load throughout the day. Enron St. 5.0, p. 20.

OSBA witness Robert Knecht suggests a variation on PPLICA's and Enron's approach to apply to commercial customers. He suggests that minimum levels of customer participation be set for the GS rate classes for each of two phase-in years. Under Mr. Knecht's proposal, if a rate class is over-subscribed and the random drawing produces too few customers, those few customers selected should be limited in the amount of their load that is subject to competition. OSBA St. 1, p. 53.

ALJ Kashi further rejected the various proposals for phasing in customer choice that would require customers to receive part of their service from their Alternative Supplier and part from their EDC. He agreed with PP&L witness Dr. Tierney, who remarked that such phase-in proposals would create more confusion among the public and more administrative difficulty for PP&L and the suppliers. (R.D., p. 173 citing PP&L St. 9-R, p. 50).

Further, customers who are participating in the PP&L's pilot program can enroll in and will be selected for retail access as described above, with one exception. Customers who are participating in PP&L's pilot program, but which are not selected for the first or second phase of retail access can elect to be "grandfathered" into retail access. However, customers in the Primary and Transmission/Subtransmission groups who have load limits in the pilot program will be limited to that level of load when "grandfathered" into retail access. PP&L St. 14, pp. 4-5. ALJ Kashi concluded that the intervenors failed to provide record support that would justify a departure from this proposal.

Exceptions were filed to the R.D. by PPLICA, SER/Gilberton, Enron, and OSBA. These parties, in various objections, dispute the ALJ's interpretation of this Commission's discretion under the Act as that discretion relates to the phased implementation of direct access. Most of these parties would point to the *PECO Energy Restructuring Order* to conclude that the ALJ rendered an unnecessarily narrow interpretation of our authority.

1. Resolution

On consideration of the Recommended Decision, we reject his recommendation and PP&L's proposal, consistent with our discussion.

As noted, PP&L proposes that 33% of the non-coincidental peak load of each tariff class have direct access on January 1, 1999, that 66% shall have direct access on January 1, 2000, and that all customers shall have direct access on January 1, 2001. PP&L argued that this phase-in schedule is the only one permitted under the Act and attempted to distinguish this case from the Commission determination in *PECO Energy Restructuring Order*. In *PECO Energy Restructuring Order*, the Commission adopted a phase-in schedule permitting a maximum of 33% of the peak load of each class to be eligible for direct access on January 1, 1999, a maximum of 66% to be eligible for direct access on January 2, 1999, and all customers to be eligible for direct access on January 2, 2000. In this case, PPLICA (a coalition of 19 industrial companies, the U.S. Department of Defense, and the Federal Executive Agencies) and the Competitive Intervenor (Enron, MAPSA, NEV, the Pennsylvania Petroleum Association, and the Pennsylvania Association of Plumbing, Heating, and Cooling Contractors) all supported the *PECO Energy Restructuring Order* schedule as both

consistent with the Act and necessary to alleviate competitive disadvantages. PECO, in Exceptions, agrees with PP&L concerning the statutory interpretation for the phase-in, but argues that the Commission should adopt the same phase-in for PP&L as adopted for PECO in order to remain consistent with the reciprocity and fairness concepts of the Act.

PP&L and ALJ Kashi were of the view that the phase-in schedule adopted by the Commission in *PECO Energy Restructuring Order* was permissible because the Partial Settlement included the agreement of PECO and other parties to use that schedule. Such a distinction must be rejected. The Commission rejected the Partial Settlement that was an "all or nothing" proposal, so inclusion of any issue resolved in the Partial Settlement provides no basis for our decision in the case. Moreover, it is unreasonable to argue that the Commission can rely on the agreement of the parties to ignore a statutory directive if, as PP&L argues, the Act permits only one mandatory phase-in schedule

To the contrary, the Commission bases its decision on the precise statutory language. PP&L concedes that Pennsylvania Courts accord the Commission-broad discretion in interpreting the Public Utility Code. See Popowski supra. We conclude that Section 2806 provides the Commission with the discretion to adopt a phase-in schedule that permits a maximum of 33% of the non-coincidental peak load of each tariff class to have the opportunity for direct access on January 1, 1999, a maximum of 66% to be eligible for direct access on January 2, 1999, and all customers to be eligible for direct access on January 2, 2000. 56 Pa. C.S. §2806. This schedule is in the public interest in order to provide the benefits of direct access expeditiously. Moreover, the schedule is appropriate both to minimize competitive disadvantages among customers and

among EDCs and to facilitate an orderly transition without confusion due to different phase-in schedules for different EDCs in overlapping media markets.

PP&L argues that the phase-in schedule adopted in *PECO Energy Restructuring Order* is contrary to the “compromise” supporting passage of the Act. However, this Commission must apply the language that is actually in the Act. PP&L provides no support for its argument that its proposed phase-in schedule is more consistent with the Act or more “orderly” than that adopted by the Commission.

The plain language of Section 2806(b) does not support PP&L’s interpretation that the Act provides the Commission with no discretion. 66 Pa. C.S. §2806(b). Any argument that the Commission has no discretion to adopt a phase-in schedule within the parameters of Section 2806(b) ignores the phrase “a maximum of” that directly grants the Commission discretion. As PP&L argues in its Reply Brief, rules of statutory construction do not permit an interpretation of the Act in a manner that would render specific language superfluous. If the legislature intended “a maximum of” to mean “exactly,” the phrase “a maximum of” would not have been used.

Moreover, this interpretation is further supported by the general rule in subsection (a), “consistent with the Commission’s discretion under this section.” 66 Pa. C.S. §2806(b). If the Commission’s discretion were limited to extending the schedule pursuant to subsection (c), the language in subsection (b) would have provided a precise lead for phase-in on a precise date instead of using the phrases “a maximum of” and “as of.”

Section 2806(b) of the Act begins with the statement, "Recognizing that approximately 5% of the peak load will have direct access through pilot programs..." 66 Pa. C.S. §2806(b). Clearly the transition began on January 1, 1997, the effective date of the Act, and the phase-in to direct access began with the phase-in of 5% of customer load during the pilots. Interpreting "as of" to mean "commencing on" would require ignoring the afore-cited provisions.

Lastly, the statutory directive in Section 2806(b)(4) grants the Commission both the discretion and the responsibility to adopt a phase-in plan that "prevents competitive disadvantages among similarly situated customers within a customer class," 66 Pa. C.S. §2806(b)(4). We conclude that the phase-in schedule that we adopt is the simplest, most effective means to minimize such competitive disadvantages and is in the public interest.

B. Phase-in Selection for Commercial and Industrial Customers

PP&L proposed that all customer classes be included within each phase-in schedule on a "first-come, first-served" basis with a lottery if any class is oversubscribed. OSBA indicated that PP&L recognizes that full load participation of a customer within a phase-in group could provide it with a competitive advantage compared to similar customers not yet permitted to shop and proposes to review and attempt to resolve such matters on a case-by-case basis. PP&L witness Baumann agrees that the company presents no guidelines or procedures for such a review. PPLICA advocated the same partial load inclusion on a pro rata basis as the industrial groups in *PECO Energy*. OSBA made a similar proposal for Rate GS commercial classes. Enron supported pro rata industrial and commercial load participation in the event of oversubscription, suggesting that the partial load

served by the EGS either should be considered "first through the meter" or following the customer's load at a fixed percentage throughout the day.

1. Resolution

Competitive disadvantages for customers excluded from the earlier phase-in groups is a material concern for commercial and industrial customers, as reflected in the proposals of OSBA and PPLICA. We address the PPLICA and OSBA concerns by applying the PPLICA proposal to large commercial customers and all industrial tariff classes.

We refer the parties to the Tentative Order adopted by the Commission on April 23, 1998, *Proposed Enrollment Procedures Applicable to Electric Distribution Companies and Electric Generation Suppliers During the Phased-In Implementation of Direct Access*. This Tentative Order is presently out for public comment, although a Final Order will be adopted in advance of PP&L's compliance filing. The precise dates and procedures for compliance with the phase-in will be established in the Order accepting the compliance filing.

The ALJ required parties to brief the inclusion of pilot participants in the new phase-in schedules. Pursuant to the PP&L Pilot Order, all pilot participants are automatically included in the first phase-in group to the extent of their pilot load. Thus, "grandfathering" pilot customers is not an issue.

On consideration of the positions of the parties, we shall also adopt the ALJ's recommendation which supports system-wide "first-come, first-served" selection for residential customers, the OSBA proposal to split small commercials on a "first-come, first-served" basis, and a pro-rata subscription for industrial and

large commercial customers. Therefore, in its compliance filing, PP&L shall provide a division of GS-1 and GS-3 classes into large users and small users and provide supporting documentation. Small commercial customers will be enrolled on a first come, first-served basis following the same procedure as residential customers. Large commercial customers will be enrolled following the same procedures as industrial customers, with the participating load of each customer reduced pro rata in the event that its tariff class is oversubscribed. Partial load purchased from a competitive supplier shall be considered first through the meter unless the customer has metering that permits actual load following-throughout the course of the day.

IX. CODE OF CONDUCT AND COMPETITION ISSUES

In moving toward generation competition, this Commission must ensure that competition can occur on a level playing field, without discrimination or inappropriate competitive advantage to any market participant. We must aim for development of a foundation of fair economic terms during the transition period through stranded cost recovery and regulated rates. We must be vigilant against permitting one market participant to receive an inappropriate advantage over another. Without such a foundation, we cannot realize our efforts to effect a competitive market in which all participants have a full and fair opportunity to compete.

The Commission is charged under the Act with overseeing the development of a competitive retail electric generation market in a manner that treats both shareholders and customers fairly. Establishing standards of conduct to govern the relationship between electric distribution companies and their affiliated electric generation suppliers is an important part of ensuring that the competitive retail electric generation market will function in a way that fulfills the Act's directive to allow "electric generation suppliers and end-use customers to utilize and interconnect with the transmission and distribution system on a non-discriminatory basis at rates, terms, and conditions of service comparable to the transmission and distribution company's own use of the system to transport electricity from any generator of electricity to any end-use customer." 66 Pa. C.S. §2803.

A. Purpose and Goal of Codes of Conduct and Competitive Access Rules

The purpose of the Act is the creation of "direct access by retail customers to the competitive market for the generation of electricity." 66 Pa. C.S. §2802(12). "Direct Access" is defined as "the right of electric generation suppliers and end-use

Direct access is defined as the right of electric generation suppliers and end-use customers to utilize and interconnect with the transmission and distribution system on a non-discriminatory basis at rates, terms, and conditions of service comparable to the transmission and distribution company's own use of the system to transport electricity from any generator of electricity to any end-use customer." 66 Pa. C.S. §2803.

The declaration of policy in the Act directs this Commission to implement a transition to a competitive retail generation market in Pennsylvania. 66 Pa. C.S. §2802. Indeed, the Act requires that the "procedures established under this chapter provide for a fair and orderly transition." 66 Pa. C.S. §2802(12). Thus in its efforts to permit the development of a competitive market which will operate fairly and in a manner that fulfills the statutory directives, the Commission must adopt certain competitive safeguards. A vibrant competitive market cannot develop without both customer choice and a level playing field among competitors.

B. Basis and Extent of PP&L's Proposed Code of Conduct

In its Restructuring Plan filing, PP&L submitted a proposal to restructure its retail electric business and a Retail Access Code of Conduct to remain in place until the Commission adopts regulations establishing a permanent Code of Conduct. *See* PP&L St. 13-R, Ex. RMG-4. Unlike other electric utilities in Pennsylvania, PP&L has proposed no legally separate entity that will provide competitive market generation services. Instead, PP&L has proposed to operate a functionally separate, "Electric Delivery Group," or "EDG" now doing business under the name, "PP&L Access," and a functionally separate, "Generation Supply Group," now doing business under the name "PP&L Energy Plus."

Enron strongly objected to PP&L's proposal. Enron argued that PP&L's proposal is an attempt to maintain the initial advantage PP&L now enjoys. (Enron St. 6.1, p. 8).

Section 2804(5) is clear that the Commission may not require corporate reorganization as part of a restructuring plan. However, PP&L's proposed organizational structure raises serious competitive safeguard issues at the outset. Problems are immediately evident in PP&L's restructuring plan. The duty to provide PLR service is a duty of the regulated EDC. Yet, PP&L proposed to provide PLR service through the Generation Supply Group at competitive market rates. In effect, PP&L's proposal obscures any separation between the EDC and the EGS, or regulated rates and competitive market rates. We agree with Enron's criticism that PP&L's proposal would essentially have the PP&L EDC deliver a huge market share to its affiliated EGS at the onset of competition.

As discussed above, the Act requires PLR service to be provided by the EDC at regulated rates for the present time. 66 Pa. C.S. §2807(e). Structural separation of an EDC from fully independent generation entities is preferable to reliance on even the most well-intended functional separation. In the absence of divestiture or structural separation, functional separation must be implemented diligently. The EDC must have no reason or ability to treat its competitive supplier affiliates any differently than any other competitive supplier. Functional separation without legal separation must not provide any basis for any competitive advantage or opportunity for the marketing entity.

PP&L proposed a Code of Conduct to govern interaction between its EDC and EGS groups based on the consensus recommendations of the Competitive Supplier Working Group. This interim Code of Conduct would remain in effect until such time as

final regulations adopting a Code of Conduct become effective. The ALJ agreed with PP&L's position and determined that the rules and protections submitted by PP&L would "assure a fair and open market without unfairly handicapping PP&L as a competitor." (R.D. at 180).

1. Resolution

We find PP&L's proposed Code of Conduct to be inadequate. When the Commission issued proposed regulations for the Code of Conduct, the work product of the consensus working group was rejected as an inadequate, "least common denominator." It was not the proper starting place for proposed regulations and is not the proper starting place for an interim Code of Conduct.

PP&L agreed that a Code of Conduct should be uniform throughout Pennsylvania. We agree with the comments of several parties that, given its organizational structure, PP&L will avoid non-comparable treatment of its competitive division only with great difficulty. PP&L must do so nonetheless. Certainly, the Commission cannot soften the standards that are applicable to other EGSs and EDCs because of the organizational form that PP&L has chosen.

We agree with Enron that the Interim Code applicable to PP&L should be the Pennsylvania Electric Association Code, as amended and adopted by the Commission in *PECO Energy Restructuring Order* until final regulations are effective. *PECO Energy Order on Compliance Filing*, Docket No. (February 5, 1998). This Code shall be effective immediately for all matters related to the January 1, 1999, phase-in and thereafter, while the Pilot Code will continue to apply only to the pilot program and only until January 1, 1999.

Additionally, PP&L's functional separation must not provide a basis for any competitive advantages or opportunities for the marketing entity. We shall assert the same level of review of transactions between the regulated and the competitive entity as we would with an affiliate. Thus any transactions between PP&L's EDC and its EGS division must be approved similar to affiliate transactions under Chapter 21 of the Public Utility Code. 66 Pa. C.S. §§2101- 2107. In order to ensure a "level playing field," proposed contracts between the EDC and the EGS divisions for all goods and services, including power, must not involve any anti-competitive cross-subsidy. Further, PP&L must not engage in transactions concerning the competitive generation industry unless it is for goods or services made available to competitors on comparable terms and conditions.

In summary, PP&L will be subject to the Pilot Code for the duration of the pilot program (until January 1, 1999). On January 1, 1999, PP&L will be subject to the Pennsylvania Electric Association Code, as amended and adopted by the Commission in *PECO Energy Restructuring Order* until final regulations establishing a permanent Code of Conduct are effective. *PECO Energy Order on Compliance Filing*, Docket No. (February 5, 1998).

C. Additional Competitive Restrictions Proposed

1. Prohibit Use of "PP&L" Name

Enron objected to the use of the PP&L name for PP&L's EGS. (Enron St. 6.1, p. 2). Enron claimed that although it is possible that some entrants will find advantages of their own, overcoming the name and goodwill advantages of the incumbent EDCs will be daunting at best. Enron St. 6.1, p. 9. Enron further argued that PP&L's

proposed Code of Conduct would lead to customer confusion because it does not go far enough to prevent PP&L's non-regulated operations from using the name of the EDC in a manner in which customers could reasonably imply that the electric generation supply is being provided by PP&L as the EDC rather than PP&L as the electric generation supplier. (Enron St. 6.0 , p. 31-33; *see also* Enron St. 6.1, pp. 1-4) .

The ALJ determined that PP&L should be permitted to use its name for both the EDC and the EGS, reasoning that the name is a shareholder asset that will best identify the entities for the benefit of the customers. R.D. at 180-84. The ALJ further noted that the Act does not mandate that all marketplace advantages and disadvantages be leveled. R.D. at 183.

This Commission has determined that PP&L should be subject to the Pennsylvania Electric Code of Conduct as amended by us in the *PECO Energy Restructuring Order*. In the *PECO Energy Restructuring* matter, we examined the use of the regulated utility's name and determined it to be an area where certain proscriptions are appropriate. (*PECO Energy Restructuring Order* at 131).

In submitting its proposed Code of Conduct for the *PECO Energy Restructuring* matter, PECO stated it would not allow its competitive affiliate to use the PECO name to suggest that PECO would provide better distribution service if power is purchased from a PECO affiliate or that supply purchased from other competitors may be less reliable, or that generation services are in fact being provided by the EDC. This Commission determined that PECO did not go far enough. In that proceeding, we held that the limitations regarding the use of PECO's name should not be limited to the use of a name by its affiliate. Additionally, neither the competitive affiliate nor the EDC was permitted to "suggest any of the proscribed items in any manner, either directly or

indirectly.” *PECO Energy Restructuring Order* at 131. Moreover, the EDC and its competitive affiliates may not make suggestions that competitors or customers “must contract or refrain from contracting for any goods or services in order to receive any EDC service on the same terms and conditions as any other supplier or customer.” *Id.*

a. Resolution

As in the *PECO Energy Restructuring* matter, PP&L’s competitive division shall refrain from using the PP&L name to suggest, either directly or indirectly, that PP&L will provide better distribution service if power is purchased from the PP&L competitive division, or that supply purchased from other competitors may be less reliable, or that the generation services are in fact being provided by the EDC. PP&L, as the EDC, may not promote its competitive EGS any differently than non-affiliated suppliers. Lastly, PP&L and its competitive division may not suggest or imply that any competitor or customer must contract or refrain from contracting for any goods or services in order to receive any EDC service on the same terms and conditions as any other supplier or customer.

2. Prohibit Joint Marketing

PP&L’s proposed Code of Conduct allows for its EDC and its EGS to engage in joint marketing. When questioned about this proposed practice during the hearing, PP&L witness Mr. Geneczko agreed that PP&L’s Generation Supply Group will have access to bill inserts on the same terms and conditions as other electric generation suppliers. Tr. 586 (8/18/97).

The ALJ was satisfied with PP&L's assurance that its EDC and EGS would engage in joint marketing "only . . . as long as comparable opportunities are available to other suppliers and the purpose of the joint effort is economic development." PP&L M.B. at 174; Tr. 554 (8/18/97). The Competitive Intervenors note that joint marketing should be prohibited unless comparable opportunities are provided to other EGSs. See Enron Exceptions at 30, fn. 62. Also, OCA advocated supplement PP&L's Code of Conduct with a provision that would prohibit joint marketing. (OCA M.B., p. 107; R.B., 99. 40-41). OCA was mainly concerned with the proper separation of the Company's education efforts from marketing efforts.

a. Resolution

Given PP&L's "functional separation" structure, this Commission is wary of allowing joint marketing even if comparable opportunities are offered to other EGSs. The potential for cross-subsidy and unfair trade practices is much greater than we could expect with a structural separation. PP&L's assurances of comparable treatment and informing competitors of marketing arrangements on a "rather immediate" basis do little to allay the concerns of unfair competitive advantage. (PP&L M.B. at 174). For this reason, we will prohibit the use of joint marketing or joint packaging regulated services with the services of the Generation Supply Group unless PP&L's EDC offers, not merely comparable, but, the same promotion of services to non-affiliated suppliers.

3. Require that Surplus Power Be Offered to Alternate Suppliers

There was a suggestion that PP&L should be required to offer any surplus power to Alternate Suppliers. (Enron St. 6.0, p. 37). PP&L argued that ordering such a requirement would clearly be beyond the Commission's jurisdiction. (PP&L M.B. at 174).

The ALJ determined that the sale of surplus power to Alternate Suppliers is a wholesale transaction. (R.D. at 183). Accordingly, such a transaction would fall squarely within the FERC's exclusive jurisdiction under the Federal Power Act ("FPA").

a. Resolution

We are in agreement with the ALJ that the sale of power from the EDC or from one EGS to another is a wholesale transaction. Section 201 of the Federal Power Act gives the FERC plenary and exclusive jurisdiction over such sales except where Congress has made explicitly subject to regulation by the States. 16 U.S.C. § 824(b)(1). *Federal Power Comm'n. v. Southern California Edison Co.*, 376 U.S. 205, 216 (1964)). See also *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 53 (1986); *Mississippi Power & Light Co. v. Mississippi*, 487 U.S. 354, 374 (1988). The fact that power will ultimately be used to serve retail customers does not change the wholesale nature of the transaction. *Pacific Gas and Elec. Co.*, 77 FERC ¶ 61,265 at 62,088 n.43 (1996).

4. Require the Delivery Group to Make Non-Delivery System Information Available to All Alternate Suppliers

Enron witness Mr. Dirmeier suggests the need for an Internet bulletin board to document information shared between the Electric Delivery Group and the Generation Supply Group. PP&L objected to this proposal, stating that the recommendation is too broad. (PP&L M.B. at 175). PP&L further stated that company personnel will meet from time to time to discuss confidential matters of a corporate nature, such as personnel, or matters relating to joint work outside of the Electric Delivery group's service territory. (PP&L St. 13-R, p. 15; PP&L M.B. at 175).

The ALJ appeared to agree with PP&L, citing PP&L's statement that Enron's request is too broad and unsupported by the Act. It is unclear whether the ALJ intended to make a determination on this issue.

a. Resolution

We are deeply concerned that PP&L may be taking a cavalier approach to its self-imposed "functional" separation. However, we will reject Enron's position noting that comparable treatment of supply services and tariff rules to affiliated suppliers and competitors would include simultaneously making available market information to all suppliers. See PECO Energy Restructuring Order at 130-131. We expect PP&L to adhere to standards pertaining to comparable direct access relative to market information. Also, we note that PP&L will be required to comply with the interim code of conduct as discussed herein, as well as our regulations on that subject when finalized.

5. Prohibit Market-Driven Contracts Before Choice is Implemented

Enron has proposed that in the time before direct access begins to be phased in, PP&L should not be permitted to enter into "market priced" contracts unless PP&L first offers to competitive suppliers the opportunity to bid to provide service to the customer and that customers who entered into such contracts subsequent to the date on which the Act was passed may cancel such contract. (Enron St. 6.0, p. 46). PP&L argued that requesting the Commission to "open up" pre-existing market-based contracts is an attempt to gain Commission intervention in a competitive market which would favor PP&L's competitors.

The ALJ appeared to agree with PP&L, citing the utility's assertion that long term contracts benefit utility customers. (R.D. at 184). It is unclear whether the ALJ intended to make a determination on this issue.

a. Resolution

Prior to access to customer choice, utility customers are required to pay the tariff rates. Contracts between PP&L and a customer at other than normal tariff rate would require Commission approval for a separate tariff provision. If such contracts or tariffs allowing price flexibility have been approved, we will not disturb the agreements. Any other attempts to secure long term contracts by the Delivery Group at below tariff rates prior to the implementation of choice for that particular customer is prohibited.

6. Require PP&L to Permit Alternate Suppliers to Bill for Distribution Services and Be the Sole Contact for Customer Service

The Commission currently permits two billing options: (1) the EDC will provide a bill for all basic services to customers who have not chosen a generation supplier and those who have chosen a generation supplier but asked to receive a single bill; and (2) the EDC will provide a bill for all basic services customers who have chosen a generation supplier but asked to receive separate bills for generation services from the supplier.

The Competitive Intervenors advocated allowance of another option: a single bill issued by the generation supplier which would include the EDC's applicable charges. Competitive Intervenors M.B. at 46. PP&L cautioned that resolution of this issue should await a Commission rulemaking. PP&L M.B. at 176. PP&L further argued, however, that the Act "explicitly specifies a presumption that the EDC shall have the duty to provide a single bill, including competitive generation services, to all customers unless

the customer chooses to receive a separate bill directly from its EGS.” PP&L M.B. at 177-78.

The ALJ agreed with PP&L, also finding a presumption in the Act that the EDC would provide the single bill if the single bill option was elected by the customer. (R.D. at 186). The ALJ concluded that resolution should await a Commission rulemaking. (R.D. at 185).

a. Resolution

Section 2807(c) of the Act addresses customer billing and provides in pertinent part:

(c) Customer billing -- Subject to the right of an end-use customer to choose to receive separate bills from its electric generation supplier, the electric distribution company may be responsible for billing customers for all electric services consistent with the regulations of the commission, regardless of the identity of the provider of those services.

66 Pa. C.S. §2870(c) (emphasis added).

While the Act expressly provides for an EDC to issue a single bill, we disagree that there is a presumption that it is the EDC who has a duty to issue the bill. As we have stated in a prior order, “...there is nothing in the Act that would prohibit the supplier single bill option.” *Final Order re: Guidelines for Maintaining Customer Services at the Same Level of Quality Pursuant to 66 Pa. C.S. §2807(D), and Assuring Conformance with 52 Pa. Code Chapter 56 Pursuant to 66 Pa. C.S. §2809(E) and (F)*, Docket No. M-00960890F0011 (July 11, 1997), p. 29. However, we decline to provide for that option in this case based upon the record before us. We intend to examine this

issue at a later time in the context of a rulemaking and encourage the EGSs to participate in that proceeding.

7. Limitations on the Provision of Non-Utility Services

Several intervenors have raised concerns over the marketing of non-traditional utility services by PP&L without sufficient controls to prevent cross-subsidization between the regulated and unregulated operators. See Enron St. 6.0, p. 18; Tr. 570 (8/18/97); NEV Exceptions at 10. PP&L interpreted the intervenors' argument as proposing a ban on marketing products such as electronic thermostats, Power Watch™ devices and Heat Comfort™ controls. (PP&L M.B. at 176-77).

The ALJ also interpreted the issue as one involving a ban on marketing non-traditional utility services and goods. (R.D. at 185). The ALJ determined that the Act did not prevent utility involvement in non-generation products and services. (R.D. at 185).

a. Resolution

This Commission has grave concerns over the possibility of cross-subsidization between competitive and non-competitive services. In this instance, our concerns are heightened due to PP&L's chosen structure of only a "functional" separation between its competitive and non-competitive divisions. It is critical that there is no anti-competitive cross-subsidization between the regulated and the non-regulated goods and services. With the adoption of the PECO Code of Conduct, we believe that we have provided sufficient safeguards to prevent cross-subsidization.

D. Further Unbundling of Distribution Rates or Services

1. Metering, Billing and Collection Services

Several intervenors have argued in this proceeding that customer metering and billing services should be unbundled from other EDC customer services in order to create an additional opportunity to provide value-added services to consumers. See Enron St. 4.0, p. 3. As noted by the Commission in the *PECO Energy Restructuring Order*, the Commission has addressed these issues through various working groups, rulemakings and Orders. *PECO Energy Restructuring Order* at 138. Although Section 2804(3) of the Act provides that "the Commission may require the unbundling of other services" in addition to basic unbundling of transmission, distribution, and generation services, the Commission concluded in the *PECO Energy Restructuring Order* that Section 2807 of the Act, which sets forth the duties of electric distribution companies, does not assume that any additional unbundling is required and that "EDCs continue to have the duty to provide all distribution services, including metering and billing, in compliance with existing Commission requirements." Id. at 138-39. The ALJ concluded that the record established in this proceeding mandates the same conclusion. (R.D. at 187-188).

a. Customer Billing

As discussed above, several of the intervenors have argued that a customer should be able to receive a single bill from its EGS that includes EDC charges. See Enron St. 5.0, pp. 6-7; Competitive Intervenors M.B. at 45-50. Section 2807(c) of the Act provides that the EDC may be responsible for billing customers for all electric services but grants the customer the right to choose to receive a separate bill from its

generation supplier. The Commission has initiated a rulemaking to address the manner and details of the interaction between customers, suppliers, and EDCs at Docket No. M-00960890.F0011.

The Commission recognized in the *PECO Energy Restructuring Order* that there may be potential benefits of such proposals but concluded that it is inappropriate to unbundle billing based on the record presented in that proceeding. *PECO Energy Restructuring Order* at 139. Subsequently, the Commission permitted competition for billing and metering services in the PECO full settlement. *PECO Energy Restructuring - Full Settlement Order*. The ALJ concluded that the record in this proceeding did not support the unbundling of billing and metering services.

b. Metering

Several parties advocated the unbundling metering services and allowing and competitive entry into the retail market. See Competitive Intervenors M.B. at 50. The parties asserted that customers should be able to choose a more sophisticated type of meter (such as real time meters) if it would fit their needs.

The ALJ rejected the notion of unbundling metering services but supported this Commission's "qualified meter" standard set forth in the *PECO Restructuring Order*. In that Order, we permitted PECO customers, in conjunction with their EGS, to request the use of a "qualified meter" that has been approved by the Commission based on the recommendations of a working committee composed of interested parties. *PECO Energy Restructuring Order* at 141. Subsequently, the Commission permitted competition for billing and metering services in the PECO full settlement. *PECO Energy Restructuring - Full Settlement Order*.

c. Resolution

We are in general agreement with the ALJ who stated that service issues such as the foregoing shall be addressed in other Commission regulations and Orders. As indicated in the Commission's rulemaking at Docket No. L-00970120, the Commission has decided that it is unnecessary to unbundle metering as a competitive service at this time. In that rulemaking, the Commission outlined the standards and procedures to ensure that customers have real options for competitive metering while retaining all physical work related to metering as a regulated EDC function. The Commission will ensure that the list of qualified meters includes all meters necessary to support market services such as two-way communication, remote readings, time-of-use capability, and net metering.

2. Require Delivery Group to Supply Customers Not Eligible to Choose Alternate Suppliers During the Phase-In.

PP&L proposed that customers not yet eligible to choose would be served by its competitive generation supplier during the phase-in period. PP&L St. No. 10-R (Krall). PP&L explained, however, that customers not yet eligible to choose would be served under traditional regulated rates. Tr. 743 (8/19/97).

The Competitive Intervenors objected to PP&L's proposal, arguing that such an arrangement would allow PP&L's competitive division a huge embedded customer base. Competitive Intervenor M.B. at 14. The Competitive Intervenors warned that such an arrangement would impede market development and would reduce the functional separation requirements to little more than a ruse designed to leverage historic

monopoly power to create a competitive advantage upon entering the competitive environment. (Competitive Intervenor's M.B. at 15).

a. Resolution

It is the EDC and not an affiliated EGS who has the duty to serve. This duty is derived from EDC status, not as a PLR. These customers must remain on regulated rates and protected by the rate cap without change to any terms or conditions of service, except as expressly approved by Commission order. 66 Pa. C.S. §2807(c) and (e). Accordingly, PP&L's functional separation must remain a separation and its Generation Supply Group is not permitted to supply generation to customers ineligible for customer choice during the phase-in period.

E. "Open Architecture" Standards for Metering and Other Distribution Services

PP&L advocated that the installation of the actual metering hardware should remain part of the regulated distribution services. PP&L argued that competition should be limited to data collection and information services related to a customer interface utilized under a "Standardized and Open Architecture" data stream. (PP&L St. 21-R, p. 12; PP&L M.B. at 179). PP&L advocates the use of the standards currently being developed by the IEEE SCC-31 Standards Coordinating Committee. *Id.*

The ALJ appeared to agree with PP&L's position, citing PP&L's statement that metering hardware should remain part of distribution services. It is unclear whether the ALJ intended to make a determination regarding this issue.

1. Resolution

The Commission wholly supports the use of standards for all metering and distribution services. We are not, however, convinced that installation of metering hardware should remain a regulated distribution service. As we explore the possibility of opening ancillary services to competition, we may conclude that meter installation is an area that should be open to the market. Despite such a possibility, we are not willing to open this service to the marketplace at this time.

F. Treatment of Partial Payments by Customers

Enron suggested as an alternative to the “priority” method of applying partial payments that payments received from customers by PP&L should be applied to services provided by PP&L and services provided by the supplier on a pro rata basis. (R.D., p. 189). Enron acknowledged the amount of PP&L’s non-recovery would increase if payments are provided to the supplier on a pro rata basis, but asserted this increase in the amount of the EDC’s non-recovery would not increase the EDC’s cost of providing service. (R.D., p.189).

PP&L noted in its Initial Post-Hearing Brief that the Commission has already considered and rejected the pro rata payment approach advocated by Enron. (Init.P-H.B., p. 180; R.D., p. 189). Instead, the Commission decided that the “priority” method of applying partial payments is preferable to the “prorata” method, particularly in terms of administering the process and complying with applicable Chapter 56 provisions at 52 Pa. Code §§ 56.23 and 56.24. (R.D., p. 189).

ALJ Kashi, on consideration of the positions of the parties, noted that the Commission’s preference for the “priority” method of applying payments, particularly in

terms of administering the process and complying with applicable Chapter 56 provisions. (R.D., p. 189).

1. Arguments on Exception

Enron excepts to the ALJ's refusal to recommend that partial payments be applied on a pro rata basis. Enron contends the ALJ failed to recognize pro rata application of partial payments is the only reasonable way to assure that a disproportionate amount of delinquencies are not allocated to suppliers, and to prevent double recovery of uncollectible expenses by PP&L. (Enron Exc., p. 37).

2. Resolution

We shall adopt the "priority" method of applying partial payments. The adoption of this order of priority for partial payments reflects our general desire that regulations and Orders pertaining to customer services issues shall control these issues. PP&L's procedures for applying partial payments shall comply with the guideline relating to partial payments found in the *Final Order Re: Guidelines for Maintaining Customer Services at the Same Level of Quality Pursuant to 66 Pa. C.S. §2807(d), and Assuring Conformance with 52 Pa. Code Chapter 56 Pursuant to 66 Pa. C.S. §2809(e) and (f)*, Docket No. M-00960890F0011 (July 10, 1997) (Appendix B, Guideline H). This will ensure that the method of applying partial payments is consistent across Pennsylvania. The concern that the "priority" method will result in a disproportionate amount of delinquencies allocated to suppliers is mitigated by the policy that, unlike the EDC, suppliers can address and control delinquencies quickly through cancellation of contract.

G. Allocation of PJM Intertie Capacity

Enron witness Richard D. Tabors urged the Commission to require PP&L to make its PJM-allocated intertie benefits available to either its former retail customers who choose an alternative generation supplier or to that customer's supplier. Enron St. 8.0, p. 3. PP&L argued that the requested relief is beyond the scope of the Commission's jurisdiction, power and authority. PP&L M.B. at 180.

The ALJ determined that this transaction involved the sale of wholesale power. R.D. at 188-89. Accordingly, the ALJ determined that this issue fell within FERC's exclusive jurisdiction and was in fact considered by the FERC in its PJM Restructuring order. R.D. at 188-89 (citing *Pennsylvania-New Jersey-Maryland Interconnection*, 81 FERC ¶61,257 (1997)).

1. Resolution

Enron's request regarding PP&L's PJM-allocated intertie benefits has less to do with wholesale transactions than it does with obtaining a protected corridor on the very limited interties that connect PJM with the rest of the Eastern Interconnection. PJM's limited ability to import power from outside its territory has a direct impact on the capacity reserve required of its member companies. At this time, this Commission is unwilling to take steps to interfere with the current allocation of intertie benefits.

H. Customer "Slamming"

PP&L argued that incidences of slamming will be minimized if the customer is directly involved in the process of changing electric suppliers. (R.D., p. 190).

Under PP&L's proposal, an alternative supplier may provide written notification to PP&L of a customer's decision to purchase electricity from that alternative supplier. (R.D., pp. 190-191). PP&L will then send the supplier's written notification to the customer and request that the customer inform PP&L if any of the information is inaccurate. (R.D., p. 191). If the customer does not respond, PP&L will assume the supplier's notification information is correct. (R.D., p. 191).

Enron contended that the "written evidence" requirement should not require "direct" written communication from the customer through a letter of authorization or an agency agreement, nor should it require that the customer execute the document submitted to the EDC. (R.D., p. 190). Enron argued that "written evidence of the customer's request" should include any document which evidences to the EDC that customer consent was received by the supplier. (R.D., p. 190).

ALJ Kashi noted that Section 2807(d) of the Act requires the Commission to promulgate regulations to ensure that customer consent is obtained prior to a change of electric suppliers, and that the Commission has issued a *Proposed Rulemaking Order Establishing the Standards for Changing A Customer's Electric Supplier* at Docket No. L-00970121 in April 1997. (R.D., p. 190). ALJ Kashi recommended the PP&L proposal since it accomplishes the same goal as the Commission's proposed regulations: to ensure that a customer consents to the switching of its generation supplier. (R.D., p. 190).

1. Arguments on Exceptions

OCA argues that the ALJ erred in recommending acceptance of PP&L's proposal irrespective of the *Rulemaking Order Establishing Standards for Changing a*

Customer's Electric Supplier, Docket No. L-00970121 entered February 27, 1998. (OCA Exc., p. 30). Because this Order had not been issued when the parties filed briefs in this case, OCA argues that PP&L's proposal should only be accepted to the extent it complies with the Final Rulemaking Order at Docket No. L-00970121. (OCA Exc., p. 30).

2. Resolution

We adopt the PP&L proposal subject to modification to conform with the final IRRC-approved Commission *Order Establishing Standards for Changing a Customer's Electric Supplier*, Docket No. L-00970121. In this way, consumers across Pennsylvania will receive consistent and fair treatment when changing suppliers.

X. CUSTOMER EDUCATION

Pursuant to 66 Pa. C.S. §2807(d)(3), each electric distribution company (EDC), in conjunction with the Commission, prior to the implementation of any restructuring plan under Section 2806 of the Act, shall implement a consumer education program informing customers of the changes in the electric industry. Section 2807 (d)(3) specifies that "The program shall provide consumers with information necessary to help them make appropriate choices as to their electric service." 66 Pa. C.S. §2807(d)(3).

A. Scope of Customer Education

1. Positions of the Parties

PP&L indicated that it would support and actively participate in a statewide Customer Education Program (CCEP) effort. PP&L stated that a statewide effort alone would not effectively educate customers. (PP&L M.B., p 183). PP&L, while acknowledging the statewide approach, Docket No. M-00981036 (Order entered January 16, 1998), believed that the most useful tools to educate are reference materials, i.e., print, audio, and website. Also, PP&L believes that the best way to educate is to mobilize and equip people in the community, using community based organization. (PP&L M.B., p. 184).

PP&L provided a five-year preliminary budget for its CCEP. Further, PP&L supported its CCEP with customer research and committed to conducting a full evaluation of its program. Finally, PP&L stated that it will not use its CCEP to market competitive business products. (PP&L M.B., p. 1185 citing PP&L t. 17-R, pp. 22-23).

The OCA took the position that PP&L's consumer education effort should be modified. First, OCA indicated that the Customer Choice Handbook of PP&L is excessively narrow in scope and should be modified. OCA generally criticizes the Handbook as "fail[ing] to motivate customers to take part in the pending competitive market." (OCA R.B., p. 38).

2. ALJ's Recommendation

The ALJ essentially accepted PP&L's CCEP as proposed.

3. Resolution

In considering this matter, we note that we adopted an Order, entered February 27, 1998, for the *Creation and Implementation of a Statewide Consumer Education Program for Electric Restructuring in the Commonwealth of Pennsylvania*, Docket No. M-00981036. That Order established a Consumer Education Board (CEB) which will address the details of the EDC's individual education plans. Each EDC has been asked to submit their education plan to the Commission's CEB according to a schedule beginning in May 1998. The CEB will make any recommendations to the EDC. A majority vote of the CEB is necessary in order to obtain approval of each EDC plan. If there are no objections to the plan approved by the CEB, then it will be deemed approved five days after the Board acts. Although the CEB will have review and advisory authority, the Commission will retain authority over the final content of all consumer education.

B. Funding Levels and Recovery

In considering this matter, we note that the precise cost for PP&L's consumer education program should be determined through the CEB. Until that figure is determined, PP&L will assume funding at \$5 per residential household for each of four years at the present time. This will be a total of approximately \$21.62 million for PP&L. We will adopt a final number upon acceptance of the Company's compliance filing. We authorize full recovery of this amount as a transition cost pursuant to the CTC. We understand PP&L's preference for a final consumer education plan prior to adoption of a budget. However, funding for consumer education as a recoverable transition expense must be adopted in this proceeding. Even the best thought out plan must be flexible enough to change with experience and perhaps require different funding levels or emphases.

PP&L filed its Restructuring Plan and its CCEP proposals prior to Commission adoption of a Statewide Consumer Education program administered by the CEP. The Commission has determined that both a statewide campaign and a local initiative are necessary for effective consumer education. PP&L's plan identifies several important components of effective consumer education but does not present the kind of comprehensive effort that we envision.

In summary, we approve the CCEP subject to the foregoing.

XI. UNIVERSAL SERVICE AND CUSTOMER ASSISTANCE PROGRAMS

A. Specific Programs

PP&L proposed to increase its annual funding for universal service programs and energy conservation programs from \$7 million to approximately \$14.3 million by the year 2002. PP&L operates five programs that provide energy assistance to low-income customers. These programs and their current level of funding are as follows: Customer Assistance and Referral Evaluation Service (CARES) - \$260,000; Operation HELP - \$795,000; Winter Relief Assistance Program (WRAP) - \$3,023,300; Keep Warm Plan - \$1,000,000; and On Track Payment Program Pilot (OnTrack) - \$2,000,000.

The Company proposed to move OnTrack from its pilot phase to a full-time program. PP&L proposed to increase the annual level of funding for OnTrack from \$2 million (serving 1,040 customers) to \$9 million over a three-year period beginning January 1, 1999 to serve about 10,000 customers. PP&L proposed to retain the same eligibility criteria, but requested the flexibility to enroll customers who have mitigating circumstances as long as their annual household incomes do not exceed 175 percent of the federal poverty level. PP&L stated approximately 58,000 customers may be eligible for OnTrack. (R.D., pp. 194-196).

PP&L proposed to maintain the current level of annual funding for CARES, WRAP, and the Keep Warm Plan. PP&L proposed to continue to focus its weatherization activities on electric heat customers because it has the highest electric heat saturation in the Commonwealth. (R.D., pp. 196, 199).

PP&L supported allowing OnTrack customers to choose Alternative Suppliers, if the following conditions are met: (1) Participants must receive a single bill from PP&L. (2) Alternative Suppliers provide a pro rata reduction in energy supply charges; and (3) The Alternative Suppliers write-off the monthly supply portion of the revenue shortfall for OnTrack customers. PP&L argued that without such a pro rata reduction, the amount of the monthly bill reduction could reduce the transmission and distribution portion of the customer's bill to less than zero. (R.D., pp. 200-201).

CEO recommended that PP&L increase its annual funding level for OnTrack to \$23 million to serve 40 percent of the low-income households (71,000 customers). CEO also advocated that PP&L increase the annual funding level for WRAP to \$7.22 million. Using 1990 U. S. Census data, CEO's witness Kuennen determined that PP&L serves between 198,000 and 210,000 low-income customers. (CEO St. 1, p. 6) and (R.D., pp. 197-199).

The OCA recommended that PP&L increase its annual funding for OnTrack to \$11.7 million to serve 18,500 customers and increase its annual funding for weatherization (WRAP, Keep Warm Plan) to \$4.7 million. The OCA Witness Brockway also proposed that PP&L increase funding levels for the baseload program, under WRAP. (R.D., pp. 197-199).

AARP recommended that PP&L provide deep discounts to all low-income households. (R.D., pp. 198).

B. Allocation of Universal Service Program Costs

PP&L proposed to allocate its universal service charges on a per customer basis to residential and general service customers. PP&L's stated this approach is consistent with the Commission's Final Guidelines for Universal Service and is consistent with rate treatments for these programs in PP&L's most recent base rate case. PP&L opposed CEO and OCA's proposal to transfer expenses. PP&L recommended the Commission reject this method because it falsely assumes that low-income customers do not pay any portion of their bills. (R.D., pp. 199-200).

A number of intervenors recommended a kWh assessment of universal service program costs on all customer classes. (R.D., pp. 199).

CEO witness Kuennen and OCA witness Brockway suggested that PP&L's current level of write-offs and credit and collection expenses associated with non-OnTrack low-income customers could be "transferred" to fund an expanded OnTrack Program rather than booking write-offs and credit and collection expenses associated with these amounts. (R.D., pp. 199-200).

C. ALJ's Recommendation

ALJ Kashi recommended that the Commission accept PP&L's proposal to fund universal service programs at \$14.3 annually. The ALJ also agreed with PP&L's design of its weatherization programs that focus on electric heat customers. (R.D., pp. 198-199).

The ALJ accepted PP&L's proposal to allocate universal service costs to the residential and general service classes. The ALJ cited the Commission's action in

PECO Restructuring as reason for accepting PP&L's proposal. The ALJ also rejected the OCA's proposal to transfer write-offs and collection expenses to fund universal service costs. (R.D., p. 199-200).

The ALJ accepted PP&L's proposal for treatment of OnTrack customers who choose alternative suppliers. (R.D., p. 200).

D. Exceptions of Parties

OCA excepts to the ALJ's decision that PP&L's proposed funding levels for its universal service programs are sufficient to meet the needs of the Company's customers. OCA recommends that the Commission direct PP&L to increase its annual funding for OnTrack to \$11.7 million to serve 18,500 customers and increase its annual funding for weatherization to \$4.7 million. For several reasons, the OCA submits that PP&L's proposal is not adequate. OCA states that although PP&L's funding levels are commendable; moderate increases are necessary to meet the need of low-income customers in PP&L's service territory. OCA's proposed funding level for OnTrack is well below the dollar value of uncollectibles associated with low-income customers and represents 0.5% of the Company's revenues. PP&L's low-income customers pay a higher percentage of their monthly incomes (20% for general use customers and 46% for heating customers) compared with average income customers (2.3% for general use customers and 4.5% for heating customers). Finally, OCA argues that PP&L provided no evidence that OCA's proposed increase (\$700,000) for LIURP services is unreasonable. (OCA Exc., pp. 30-31).

OCA also excepts to the ALJ's recommendation that PP&L focus its weatherization efforts on electric heat customers. The OCA argues that because baseload customers comprise two-thirds of PP&L's low-income customers, usage

reduction services are needed to make bills more affordable for these customers. (OCA Exc., pp. 31).

OCA excepts to the ALJ's rejection of OCA's proposal to target more customers for participation in OnTrack. The ALJ rejected OCA's proposal citing prohibitive costs to PP&L to enroll thousands of customers. The OCA argues that the ALJ's reasons for rejecting the proposal are flawed. The OCA points out that PP&L's proposal to increase OnTrack enrollment from 1,040 to 10,000 customers is significant. OCA submits that by proposing to significantly increase the size of OnTrack, PP&L expects that the infrastructure for program delivery either exists or can be developed timely. OCA argues that once the size of a program significantly increases, the Company will have already solved the practical problems of managing a full-scale program. (OCA Exc., pp. 32-33).

OCA excepts to the ALJ's failure to adopt OCA witness Brockway's recommendation that uncollectible amounts be reprogrammed to help fund universal service programs. OCA continues to assert that the level of write-offs associated with low-income customer uncollectibles should be considered when determining an appropriate level of funding for OnTrack. Consideration of low-income uncollectibles recognizes the advantages with low-income customers' transfer from a delinquent debt posture to none of a reasonable opportunity to make complete payments. (OCA Exc., pp. 33-34).

OCA excepts to the ALJ's recommendation to accept PP&L's proposal to allocate universal service charges on a per customer basis to residential and general service customers. OCA points out that PP&L's proposal allows large industrial customers to bypass the universal service charge and argues that permitting any class to escape paying their fair share of these costs violates the Act. OCA recommends that the

Commission adopt a non-production revenues allocation of universal service costs if it rejects a kWh allocator. (OCA Exc., pp. 34-36).

The CEO excepts to the ALJ's finding that the universal service funding levels proposed by the intervenors are not supported by the Act or the record. The CEO argues that the ALJ has failed to recognize the full level of need, established on the record, for universal service programs. The CEO states that PP&L's own estimates show that 58,000 of 177,000 low-income households in PP&L's service territory are payment troubled. PP&L's proposed CAP enrollment level will serve only 5.6% of the eligible population. The CEO estimates that between 198,000 and 210,000 households are low-income and points out that PP&L did not dispute their estimate. The CEO argues that PP&L's proposals universal service do not meet the requirements of the Act. (Exc., pp. 2-4).

The CEO excepts to the ALJ's finding that PP&L has properly chosen to focus its weatherization activities on electric heat customers. The CEO established that PP&L could develop and implement cost effective water heat and baseload only programs for PP&L's 122,000 low-income customers. (CEO Exc., pp. 4-5).

The CEO excepts to the ALJ's finding that the sole intent of the Act is to restructure the electric industry to reflect competitive forces in the marketplace. The CEO argues that the Act allows for expansion of universal service programs by referring to the existing programs as that level which must be continued at a minimum. The CEO also excepts to the ALJ's finding that implementing OCA's pilot proposals would be time consuming and expensive for the level of benefits received. The CEO argues that the purpose of a pilot is to determine whether the technology is feasible, meaningful, and cost-effective. (CEO Exc., p. 5).

The Environmentalists except to the ALJ's decision to accept PP&L's proposed participation levels of its universal service programs. The Environmentalists argue that PP&L's proposed level do not meet the requirements of the Act. The Environmentalists recommend that the Commission direct PP&L to fund its OnTrack at \$11.7 million annually and Keep Warm and WRAP at \$7.2 million annually. (Environmentalists Exc., pp. 23-24).

The Environmentalists except to the ALJ's finding that PP&L has properly chosen to focus its weatherization activities on electric heat customers. The Environmentalists argue that PP&L's proposal excludes two-thirds of the eligible customers and recommends that the Commission direct PP&L to include baseload customers in its WRAP program. (Environmentalists Exc., p. 25).

The Environmentalists except to the ALJ's decision to accept PP&L's conditions upon supplier choice for OnTrack participants. The Environmentalists argue that PP&L's proposal will deny OnTrack participants the ability to choose a supplier. The Environmentalists argue that while the Act allows PP&L to recover the full costs of universal service program, there is no ability for suppliers to recover these charges. The Environmentalists argue it is unfair for the Commission to request suppliers to absorb these costs. (Environmentalists Exc., pp. 25-26).

E. Resolution

The Act includes many provisions designed to ensure that electric service is universally available in Pennsylvania as we make the transition to a competitive generation market. Section 2802(9) declares that, "electric service is essential to the health and well-being of residents, to public safety, and to orderly economic development, and electric service should be available to all customers on reasonable terms and

conditions.” 66 Pa. C.S. §2803. Section 2802(10) declares that “the Commonwealth must, at a minimum, continue the protections, policies and services that now assist customers who are low- income to afford electric service.” 66 Pa. C.S. §2802(10). Section 2803 defines, “Universal service and energy conservation,” as, “policies, protections and services that help low-income customers to maintain electric service. The term includes customer assistance programs, termination of service protection and policies and services that help low-income customers to reduce or manage energy consumption in a cost-effective manner, such as the low-income usage reduction programs, application of renewable resources and consumer education.” 66 Pa. C.S. §2803. Section 2804(9) of the Act requires that “the Commission shall ensure that universal service and energy conservation policies, activities and services are appropriately funded and available in each electric distribution service territory.” 66 Pa. C.S. §2804(9).

Section 2804(15) requires the restructuring plan to include an initial proposal indicating how the EDC’s universal service and energy conservation responsibility will be met. 66 Pa. C.S. §2804(15). On July 10, 1997, the Commission issued a Final Order establishing Guidelines (Guidelines) for such programs as part of each utility restructuring plan, supra.

1. Funding Levels and Customer Enrollment.

We agree with PP&L’s proposed funding levels for 1999. We also agree with OCA that the proposed Company funding levels for the CAP and LIURP programs are insufficient to meet the needs of PP&L’s customers beyond 1999. We adopt the OCA funding levels, though not the OCA enrollment numbers as that will be dependent upon the evaluation presently being conducted. Consistent with sound management, the CAP program should be expeditiously expanded to meet the community’s needs. We also

adopt the OCA funding recommendation for a Renewables Pilot Program. Further, we agree with both the OCA and Environmentalists that this area lends itself to development through a pilot program. We conclude that the funding levels proposed by OCA will make universal service appropriately available and funded as required by the Act, while considering the need for service, existing funding level, administrative concerns and budget constraints.

2. CAP Needs Assessment, Funding and Eligibility.

PP&L did not base its proposed CAP funding on any specific needs assessment. The record does not include useable net costs per customer. The Commission also finds that PP&L's CAP proposal does not meet the level of need in its service territory. We agree that the OCA CAP funding level of \$11.7 million better reflects the needs assessment.

Through census data, PP&L and Commission on Economic Opportunity ("CEO") witness Kuennen both identify about 177,000 customers at or below 150% of the federal poverty guidelines in its service territory. PP&L says about 58,000 of these customers have been identified as payment troubled, rendering them eligible for Universal Service program participation.

PP&L has proposed to double its currently identified Universal Service funding of \$7.0783 million to \$14.3 million by 2002, with the increase directed to PP&L's On Track program. On Track is PP&L's Customer Assistance Program ("CAP"). On Track- PP&L proposes to establish its pilot On Track program as a permanent program, increasing enrollment from the current level of 1040 by 3000 annually to an enrollment target of 10,000 by 2002. In order to meet this enrollment ramp-up, PP&L proposes to spend approximately \$5.875 million in 1999, \$7.75 million in 2000,

\$9.625 million in 2001, and the target \$9.1 million in 2002 and thereafter. PP&L did not base its proposed funding on any specific needs assessment.

PP&L's impact evaluation of On Track is due now. The record does not include useable net costs per customer. PP&L has indicated a direct gross program cost of \$600 per customer, but that does not include any of the avoided costs of traditional collections, such as uncollectible expense, payment agreements and similar costs. The impact evaluation should provide net costs of serving a CAP customer as well as recommendations for improving the cost-effectiveness of the program.

CEO argues that the target for On Track enrollment should be about 71,000, or about 40% of those below 150% of poverty. CEO supports annual funding at \$9 million in 1999, \$10.5 million by 2002 and \$12.5 million by 2005.

OCA witness Brockway argues that On Track should be ramped-up to funding of about \$11.7 million annually, serving about 18,500 customers. She argues that this funding level is substantially below the expenses currently allocated to low income uncollectibles, and that customers can be both better served and more cost-effectively served by increasing enrollment in On Track. We agree with OCA that redirection of existing low income uncollectible and other collections expenses can substantially fund increased On Track participation.

PP&L proposes a serious expansion of On Track, but we agree that the goals should be moderately increased through a slightly more aggressive ramp-up and adopt the OCA's proposal. PP&L should fund On Track at its proposed level of \$5.875 in 1999, \$8.0 million in 2000, \$10.0 million in 2001 and \$11.7 million in 2002. We agree with OCA that the administrative issues raised by expanding enrollment will be

faced in expanding PP&L's proposed enrollment levels. The additional administrative issues raised by a moderate further expansion of enrollment are not substantial.

PP&L proposes that On Track customers be permitted to choose a competitive supplier, but that On Track customers must receive a single bill only from PP&L. Additionally, PP&L proposes that comparable program benefits must be provided by the EGS directly from their own funds. We reject both of these proposals. The Act gives customers a choice to obtain a separate bill for generation from their EGS. As discussed below, Universal Service program costs are fully recoverable from ratepayers. Even if the Commission had the authority to require an EGS to provide a bill discount to low-income customers, such a policy would require that the Commission allocate a portion of PP&L's Universal Service and uncollectible expense to the EGSs, instead of permitting PP&L to retain the entire amount of ratepayer funding.

In its compliance filing, we direct that PP&L shall indicate a fixed percentage of the On Track discount that will be applied to each portion of the bill pro rata, including generation. The generation benefit is portable and will not be lost if a customer chooses a competitive supplier. All OnTrack participants must have the same opportunity to shop as any other customer.

3. WRAP Baseload Program and Renewables Pilot.

Providing LIURP services is a cost-effective way to reduce unpaid bills, and LIURP expansion is an important companion to the expansion of On Track. Section 2803 specifies the use of renewables as an appropriate component of a Universal Service and Energy Conservation Program, and we agree that such a pilot should be developed as part of the LIURP funding level. Further, PP&L must expand program availability for its usage reduction program to serve an appropriate number of non-

heating, low-income customers. Customers above 150% of federal poverty guidelines with special circumstances should have usage reduction services available. Ratepayer funded utility programs should primarily serve low income customers below that 150% level. We adopt the OCA LIURP funding level of \$4.7 million.

WRAP is the name of PP&L's Low-Income Usage Reduction Program. (LIURP). Keep Warm is a similar program funded at \$1 million annually to serve customers from 151%- 200% of poverty. PP&L proposes to retain existing funding for WRAP at \$3.0 million, for a constant total funding level of \$4.023 million. PP&L wants to retain its focus on electric heat customers, arguing that electric heat is a greater proportion of PP&L's residential service than for any other Pennsylvania electric utility. PP&L also wants to retain its current allocation of 25% of its usage reduction budget for households between 150% and 200% of poverty.

PP&L estimates that 32,500 low income electric heat customers are in need of LIURP services. The Commission on Economic Opportunity ("CEO") estimates that about 55,000 low-income customers use electric heat while 123,000 low income customers do not. CEO argues that the non-heating customers must be served as well, and that there are many cost-effective measures that can be used.

CEO proposes total usage reduction spending of \$4 million in 1999, \$5.25 million by 2002 and \$6.5 million by 2005. CEO provides substantial analysis of PP&L's funding and completion rate to document significant additional need for LIURP services. We agree that providing LIURP services is a cost-effective method to reduce unpaid bills, and that LIURP expansion is an important companion to the expansion of On Track.

OCA proposes spending a total of \$4.7 million, including a WRAP baseload program and a renewables pilot. Two-thirds of PP&L's low-income customers are non-heating customers that should be served. The OCA documents the success of baseload LIURP programs. In particular, the refrigerator replacement program has already been piloted by PP&L and has been successful for several utilities. Within the proposed spending level that is only \$700,000 above PP&L's proposal, OCA witness Brockway advocates a substantial redirection of spending priorities to baseload customers and those below 150% of poverty.

Unlike LIPURP, which assumes that a customer is in the program for a multi-year period, LIURP is a program that serves a customer once and then moves on to serve other customers. For this reason the program need serve a smaller number of customers in a given year to achieve a comparable level of program availability as LIPURP.

Section 2803 specifies the use of renewables as an appropriate component of a Universal Service and Energy Conservation Program. 66 Pa. C.S. §2803. PP&L did not propose any renewables program. The Environmentalists and OCA propose adoption of a pilot renewables program as adopted in *PECO Energy Restructuring Order*. We agree that such a pilot should be developed as part of the LIURP funding level adopted.

We agree that PP&L must expand program availability for its usage reduction program to serve an appropriate number of its non-heating low-income customers. We also agree that customers above 150% with special circumstances should have usage reduction services available, but that ratepayer funded utility programs should primarily serve low-income customers below 150% of poverty. PP&L is directed to make these adjustments.

4. Cost Recovery

There will be a reconcilable Universal Service Fund Charge ("USFC") that is separately identifiable for cost accounting but included within the distribution portion of a customer's bill. The USFC shall be reconcilable pursuant to Section 1307(f) of the Public Utility Code, 66 Pa. C.S. §1307(f). The reconciliation will be based on all net program costs as indicated in the Guidelines.

Section 2804(8) of the Act requires the Commission to establish, "an appropriate cost recovery mechanism which is designed to fully recover the electric utility's universal service and energy conservation costs over the life of these programs." 66 Pa. C.S. §2804(8). The Guidelines do not permit the funding for Universal service to be the last priority after rate cap or CTC considerations:

[F]unding for universal service and energy conservation programs should not be determined after all other funding requirements are met. The total amount of dollars available under the rate cap should be adjusted to meet all of the requirements of the Act including universal service and energy conservation.

The record is insufficient to conclude that implementation of the required funding levels requires any particular amount of additional funding in any given year or whether the targeted funding can be achieved within the rate caps during any year in which rates remain capped. Any incremental expense over the amount included in current rates, as determined pursuant to the Guidelines, is recoverable through a deferred regulatory asset to be collected after rate cap expiration.

PP&L proposes to allocate Universal Service and Energy Conservation Program costs on a per customer basis. A per customer allocation appears to require all

customers to contribute equally but in fact would have little impact in spreading the costs of universal service. In the Guidelines, we indicated that we considered it inappropriate to adopt a single per kWh for all customer classes, but did not intend to suggest that per kWh pricing itself is inappropriate. Universal service program costs previously have been allocated only to the residential class and charged on a per kWh basis. In order to avoid cost shifting, we retain that principle.

F. Resolution Summary

We adopt the OCA's funding levels for OnTrack and LIURP, though not the enrollment numbers as that will be dependent upon the evaluation presently being conducted. We direct the Company to fund OnTrack at the following funding levels: \$5.875 million in 1999, \$8.0 million in 2000, \$10.0 million in 2001, and \$11.7 million in 2002. We also direct that the generation OnTrack benefit is portable and will not be lost if a customer chooses a competitive supplier.

We direct the Company to fund LIURP at \$4.7 million. The Company should develop a renewables pilot program as part of the LIURP funding level. We also direct PP&L to expand program availability for LIURP to serve an appropriate number of its non-heating low-income customers. We also agree that customers above 150% of the poverty guidelines with special circumstances should have usage reduction services, available, but that ratepayer funded utility programs should primarily serve low-income customers below 150% of the poverty guidelines. We direct PP&L to make these adjustments to its LIURP.

In order to avoid cost shifting, we direct that PP&L allocate universal service costs only to the residential class on a kWh basis. Finally, the USFC shall be

reconcilable pursuant to Section 1307(f). The reconciliation will be based on all net program costs as indicated in the Guidelines.

XII. ENVIRONMENTAL ISSUES

Environmentalists proposed that the Commission require all retail electricity suppliers to disclose their fuel mix and key air and other waste emissions to consumers in the form of a label and that the PJM Independent System Operator track transactions to support disclosure and labeling. Environmentalists also recommended that the Commission require that all power purchased in Pennsylvania come from plants meeting the latest environmental standards. (R.D., pp. 200-201).

The OCA also advocated fuel mix disclosure. The OCA proposed that PP&L provide funding of \$700,000 for photovoltaic and active solar water heating pilots. (R.D., pp. 201,203).

A. ALJ's Recommendation

ALJ Kashi recommended that the Commission reject the Environmentalists proposals because the Commission lacks jurisdiction to adopt these proposals. (R.D., pp. 202-203).

The ALJ recommended that the Commission reject the OCA's recommendation to fund renewable energy pilots. (R.D., p. 203).

B. Exceptions of Parties

The OCA and the Environmentalists except to the ALJ's decision to reject OCA's proposal for a renewables pilot. The parties argue that in PECO, the Commission ordered PECO to implement the renewables pilot proposed by OCA Witness Brockway

and request the Commission to adopt this proposal. (OCA Exc., pp. 36) and (Environmentalists Exc., pp. 22-23).

The Environmentalists except to the ALJ's recommendation to reject its environmental disclosure proposal. The ALJ reasoned the Commission lacked the power to require the PJM ISO to adopt the Environmentalists proposal. The Environmentalists argue that the Commission Customer Information Disclosure Order at L-00970126, established a fuel mix disclosure protocol that requires cooperation between similar parties. Finally, the Environmentalists argue that environmental disclosure complements the Commission's endorsement of fuel mix disclosure. (Environmentalists Exc., pp. 20-22).

The Environmentalists except to the ALJ's decision to reject the *Environmentalists recommendation for an emissions portfolio standard (EPS)*. The Environmentalists dispute the ALJ's reasoning that the Commission lacks jurisdiction to implement the Environmentalists' proposal. The Environmentalists argue that the Act at §2809(b) allows the Commission to establish conditions for licensing and §2802(21) grants authority for the Commission to work with state regulators to promote changes to federal law and regulation. The Environmentalists point out that while the Commission may not have direct authority over environmental problems, its can exercise oversight authority. The Environmentalists recommend that the Commission accept its EPS proposal. (Environmentalists Exc., pp. 27-30).

C. Resolution

On the basis of the record before us, we will reject the Environmentalists' proposal for disclosure and EPS. However, at this time, we decline to adopt the ALJ's ruling that we lack jurisdiction over these matters. We note that all parties will be required to

comply with our regulations at Docket No. L-00970126 when they become final. Also, we note that we have addressed the renewables pilot in the Universal Service discussion by accepting OCA's proposal.

XIII. PUBLIC INPUT HEARING CONCERNS

As noted, thirteen Public Input hearings were held during the weeks of May 30, 1997 and September 2, 1997. (R.D., p. 203). Public input hearings were held in Allentown (June 2), Bethlehem (June 2 and September 3), Harrisburg (May 30 and September 3), Hazleton (June 4), Lancaster (May 30 and September 2), Pottsville (June 4), Scranton (June 3 and September 4), Williamsport (June 5), and Wilkes-Barre (June 3). A total of 75 persons testified at the public input hearings.

We have reviewed the Public Input testimony and the considerations raised are duly noted.

XIV. CONCLUSIONS OF LAW

1. The Commission has jurisdiction over the Pennsylvania Power & Light Company (PP&L) Restructuring Plan filing at Docket No. R-00973954;

2. PP&L's Restructuring Plan as modified by the directives contained in this Opinion and Order is consistent with the requirements and standards of Section 2804 of the Electricity Generation Customer Choice and Competition Act (Act), 66 Pa. C.S. §2804, in that it, inter alia:

(a) Will ensure the continuation of safe and reliable electric service to PP&L's customers;

(b) Is consistent with the implementation schedule set forth in Section 2806 of the Act, 66 Pa. C.S. §2806;

(c) Complies with the rate caps set forth in Section 2804(4) of the Act, 66 Pa. C.S. §2804(4);

(d) Ensures that PP&L will provide transmission and distribution service to all retail electric customers in its service territory and to all alternative generation suppliers, either affiliated or nonaffiliated, on rates, terms of access and conditions that are comparable to PP&L's own use of its system;

(e) Ensures that PP&L's restructuring does not unreasonably discriminate against one customer class to the benefit of another;

(f) Ensures that universal service and energy conservation policies, activities and services are appropriately funded and available in PP&L's territory;

(g) Provides for a competitive transition charge for the recovery of transition or stranded costs in accordance with Section 2808 of the Act, 66 Pa. C.S. §2808;

(h) Ensures an orderly transition to a competitive generation market that protects electric system reliability, is fair to customers and provides PP&L and its investors with a fair opportunity to fully recover its just and reasonable stranded costs;

(i) Is consistent with the requirements of Section 2807 of the Act, 66 Pa. C.S. §2807, regarding the obligations applicable to electric distribution companies.

XV. ORDER

IT IS ORDERED:

1. That the Exceptions filed by the various Parties to the Recommended Decision of Administrative Law Judge George M. Kashi, issued April 7, 1998, are granted and denied consistent with this Opinion and Order.

2. That the Recommended Decision of Administrative Law Judge George M. Kashi issued April 7, 1998, in Docket No. R-00973954, is hereby adopted, in part, modified in part, and rejected in part, consistent with this Opinion and Order.

3. That the Application of Pennsylvania Power & Light Company for approval of its restructuring plan pursuant to Section 2806(d) of the Public Utility Code, 66 Pa. C.S. §2806(d), filed on April 1, 1997 and docketed with the Pennsylvania Public Utility Commission at No. R-00973954, is hereby accepted as herein modified.

4. That Pennsylvania Power & Light Company shall remain the provider of last resort consistent with the determinations made herein and the requirements of 66 Pa. C.S. §2802(16).

5. That Pennsylvania Power & Light Company shall phase-in direct access to alternative generation suppliers in the manner specified in this decision, pursuant to the following schedule:

- (a) a maximum of 33% of the peak load of each class to be eligible for direct access on January 1, 1999;

- (b) a maximum of 66% to be eligible for direct access on January 2, 1999; and
- (c) all customers to be eligible for direct access on January 2, 2000.

6. That consistent with the determinations and findings herein, Pennsylvania Power & Light Company shall be permitted to recover the amount of stranded costs set forth in the tables attached hereto, subject to the compliance filing. The amount of stranded costs permitted by this Opinion and Order shall be recovered through the application of a competitive transition charge to customers' bills.

7. That the competitive transition charge authorized in this Opinion and Order may be collected from January 1, 1999 until June 30, 2007, or for a shorter period of time as the Commission deems appropriate.

8. That the competitive transition charge authorized in the preceding ordering paragraph is subject to the following requirements:

- a. The competitive transition charge may be collected from January 1, 1999 until June 30, 2007.
- b. The competitive transition charge shall be calculated and applied consistent with the directives contained herein.
- c. The competitive transition charge shall be reconciled based on annual sales and may be modified on an annual basis as required by 66 Pa. C.S. §2808(f).
- d. Any reconciliation and modification of the competitive transition charge shall be done on a customer class basis.

- e. The competitive transition charge shall be calculated in a manner recognizing monthly receipt of competitive transition charges revenues.

9. That Pennsylvania Power & Light Company shall modify its transmission and distribution revenue requirement and rate structure to incorporate the adjustments, including cost allocation method, as directed herein.

10. That the Distribution Group of Pennsylvania Power & Light Company continue to provide service to existing customers through existing tariffs throughout the transition period, and all special contracts shall remain in force, except as modified in this Opinion and Order.

11. That Pennsylvania Power & Light Company comply with the determinations contained herein relating to customer billing and metering and that Pennsylvania Power & Light Company reflect this action in its compliance filing.

12. That, pending the outcome of the Commission's rulemaking proceeding on a generic Code of Conduct, Pennsylvania Power & Light Company shall modify its proposed Code of Conduct as herein directed.

13. That Pennsylvania Power & Light Company's proposed Universal Service and Energy Conservation Programs are approved as modified herein.

14. That Pennsylvania Power & Light Company participate in the state-wide consumer education initiative, which the Commission established in its decision in the *Application of PECO Energy Company* at Docket No. P-00973953 (Opinion and Order entered December 23, 1997); that in its compliance filing, Pennsylvania Power & Light Company include a comprehensive plan for consumer education with an associated

budget for both mass media and local educational efforts and set forth its proposals for its role in consumer education; and that Pennsylvania Power & Light Company recover the costs of its consumer education program from its ratepayers.

15. That Pennsylvania Power & Light Company shall, within twenty days of entry of the Commission's final Opinion and Order at this docket, submit a compliance filing that incorporates all of the conclusions and directives contained in this Recommended Decision, including, but not limited to:

- a. For each tariff class or schedule, the compliance filing shall:
 - (1) identify the unbundled charges for generation, transmission and distribution service;
 - (2) identify the CTC, calculated to recover the authorized principal amount, consistent with the allocation methodology, collection period, monthly amortization, total sales, and return adopted herein; and
 - (3) identify all other adjustments necessary to the terms and conditions of service to reflect a competitive generation market as provided herein.
- b. Each tariff class or schedule shall reallocate Administrative and General expense as provided herein without including a separate return component for capitalized items.
- c. Provide for a new supplier tariff providing procedures for competitive generation supply consistent with this Opinion and Order.

16. That Pennsylvania Power & Light Company submit an original and eight copies of its compliance filing with the Commission. An electronic version (in Microsoft Word 6.0) shall accompany the filing.

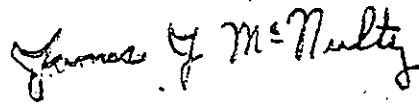
17. That Pennsylvania Power & Light Company shall serve a copy of its compliance filing together with any required supporting data and analysis on all Parties of Record to this proceeding by hard copy and with electronic versions attached consistent with prior Commission directives relative to electronic versions on the same date that such filing is made with the Commission.

18. That all parties to this proceeding may file written comments concerning non-compliance with the Commission's Opinion and Order within seven (7) days after the filing of Pennsylvania Power & Light Company's compliance filing.

19. That, in addition to the specific requirements contained in the foregoing ordering paragraphs, Pennsylvania Power & Light Company shall comply with all other directives contained in this Opinion and Order.

20. That the Formal Complaints filed by the various parties be and are hereby granted or denied to the extent set forth in this Opinion and Order.

BY THE COMMISSION

A handwritten signature in cursive script, reading "James J. McNulty".

James J. McNulty
Secretary

(SEAL)

ORDER ADOPTED: JUN 4 1998

ORDER ENTERED: JUN 15 1998

APPENDIX

Attachment A

Pennsylvania Power & Light

CTC, T&D and Shopping Credit in Cents per kwh

Declining CTC Revenue Requirement with kwh consumption as indicated (See Notes)

Stranded: \$ 2,864,719,000

kwh Growth Rate

1.50%

Pre-Tax Return: 10.86%

Year	kwh consumed	CTC Revenue Requirement	CTC Rate With GRT	T&D Rate	Bundled Rate Today	Shopping Credit
1999	33,090,377,000	\$ 562,473,718	1.78	1.70	7.21	3.73
2000	33,586,732,655	\$ 537,928,912	1.68	1.70	7.21	3.83
2001	34,090,533,645	\$ 510,630,519	1.57	1.70	7.21	3.94
2002	34,601,891,649	\$ 480,269,626	1.45	n/a	n/a	4.40
2003	35,120,920,024	\$ 446,502,663	1.33	n/a	n/a	4.50
2004	35,647,733,825	\$ 408,947,516	1.20	n/a	n/a	4.61
2005	36,182,449,832	\$ 367,179,203	1.06	n/a	n/a	4.61
2006	36,725,186,579	\$ 320,725,066	0.91	n/a	n/a	4.61
2007	18,638,032,189	\$ 141,335,739	0.79	n/a	n/a	4.61

Notes:

GRT Gross up is $1/(1-GRT)$, or 1.0460251, to reflect payment of GRT on the GRT revenue receipt.

Revenue requirement represents amortization of stranded; monthly interest; and rate reduction.

The shopping credit is the bundled rate less the sum of the T&D rate plus the CTC with GRT rate.

Attachment B

Pennsylvania Power & Light Restructuring

Category/Item:

Stranded Generation:

Generating Plant Book Value	\$ 4,017,095,000
Generation Market Value	\$ (2,465,338,000)

Total Stranded Generation	\$ 1,551,757,000
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Decommissioning:

Nuclear Decommissioning	\$ 128,989,000
Fossil Decommissioning	\$ -

Total Decommissioning	\$ 128,989,000
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Net Regulatory Assets:

Energy Costs	\$ 76,815,000
FAS 106 / PBOP	\$ 8,730,000
VERP	\$ 14,085,000
Employee Transition Costs	\$ 5,502,000
US DOE Assessments	\$ -
Susquehanna Early Window	\$ 9,830,000
Common Plant	\$ 7,783,000
Retired Miners Health Care Costs	\$ 6,308,000
Rate Case Expenses	\$ -
Susquehanna Deferred Refuel Costs	\$ -
Net Taxes Recoverable (FAS 109)	\$ 397,610,000
Consumer Education	\$ 21,620,000

Regulatory Liabilities:

Pension Overfunding; Investment Tax Credit Liability in Net FAS 109 Asset Amount	\$ -
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TOTAL NET REGULATORY ASSETS	\$ 548,283,000
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<u>NUG Stranded:</u>	\$ 635,690,000
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TOTAL STRANDED:	\$ 2,864,719,000
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**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Application of Pennsylvania Power	:	PUBLIC MEETING
& Light Company for Approval of	:	June 4, 1998
its Restructuring Plan Under Section	:	JUN-OSA-240
2806 of the Public Utility Code	:	Docket No. R-00973954

Application of Metropolitan Edison	:	PUBLIC MEETING
Company for Approval of its	:	June 4, 1998
Restructuring Plan Under Section	:	JUN-OSA-236
2806 of the Public Utility Code	:	Docket No. R-009748008, et al.

Application of Pennsylvania Electric	:	PUBLIC MEETING
Company for Approval of its	:	June 4, 1998
Restructuring Plan Under Section	:	JUN-OSA-237
2806 of the Public Utility Code	:	Docket No. R-00974009, et al.

STATEMENT OF CHAIRMAN JOHN M. QUAIN

The Commission has, over the course of the past several public meetings, addressed the restructuring of three major electric companies. Today, we finalize the restructuring decision of Pennsylvania Power & Light Company, and consider the restructuring cases of two GPU subsidiaries, Metropolitan Edison Company and Pennsylvania Electric Company. The Commission has, by separate Motion in earlier cases, addressed the issue of the phase-in of competition. The Commission has approved what amounts to a two year phase-in.

I have, in the past, dissented in favor of a three year phase-in. I remain of the opinion that a three year phase-in is preferable, but the Commission has set a course for the implementation of competition that I am reluctant to alter at this juncture. Consistency of application supports certainty for all participants. To attempt to impose a

different phase-in schedule for half of our electric utilities will not contribute to an orderly transition to electric competition throughout the Commonwealth. Consequently, I will concur in the result of the phase-in section of the Motions in the cases of Metropolitan Edison Company and Pennsylvania Electric Company, and with respect to the final order for Pennsylvania Power & Light Company.

I also extend my appreciation to the Judge and the parties in these cases for their hard work, and for the quality of the record presented to us.

June 4, 1998

A handwritten signature in black ink, appearing to read "John M. Quain", written over a horizontal line.

JOHN M. QUAIN, CHAIRMAN

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