

ORIGINAL 1849 (10)

COMMONWEALTH OF PENNSYLVANIA
PUBLIC UTILITY COMMISSION

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: Pennsylvania Power & Light Company :
: Application for approval of a : Docket No.
: Restructuring Plan. : R-00973954
: :
: Further Hearing. :
: :
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Pages 1849 through 1930 Hearing Room 2
North Office Building
Harrisburg, Pennsylvania

Thursday, August 28, 1997

Met, pursuant to adjournment, at 9:40 a.m.

BEFORE:

GEORGE M. KASHI, Administrative Law Judge

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C O N T E N T S

<u>WITNESSES</u>	<u>DIRECT</u>	<u>CROSS</u>	<u>REDIRECT</u>	<u>RE CROSS</u>
Louis A. Guth				
By Mr. Kaplan	1855	--	--	--
By Mr. Kleppinger	--	1860	--	--
By Mr. Caplan	--	1863	--	--
By Mr. Burgraff	--	1867	--	--
Paul R. Moul				
By Mr. Kaplan	1877	--	--	--
By Mr. Simms	--	1887	--	--
Michael J. Gruber				
By Mr. DeBroff	1901	--	--	--
By Mr. Russell	--	1902	--	--
Kevan L. Deardorff				
By Mr. Simms	1912	--	1920	--
By Mr. Kaplan	--	1913	--	--

E X H I B I T S

<u>NUMBER</u>	<u>FOR IDENTIFICATION</u>	<u>IN EVIDENCE</u>
<u>NEV Statements</u>		
1 (Boonin) //	1852	1852
1A (Boonin) //	1852	1852
2 (Day) //	1852	1852
<u>PP&L Statements</u>		
19-R (Guth)	1855	1876
6 (Moul)	1876	1899
6-R (Moul)	1876	1899
<u>PP&L Exhibits</u>		
LAG-1 through 7 (Guth)	1855	1876
PRM-1 through 6 (Moul)	1876	1899

E X H I B I T S (Continued)

NUMBER	FOR IDENTIFICATION	IN EVIDENCE
<u>OTS Statements</u>		
2 (Reed) ✓✓	1900	1900
2-SR (Reed) ✓✓	1900	1900
1 (Gruber) ✓✓	1901	1910
SR-1 (Gruber) ✓✓	1901	1910
3 (Deardorff) ✓✓	1911	1923
SR-3 (Deardorff) ✓✓	1911	1923
<u>OTS Exhibit</u>		
2 (Reed) ✓✓	1900	1900
1 (Gruber) ✓✓	1901	1910
3 (Deardorff) ✓✓	1911	1923
SR-3 (Deardorff) ✓✓	1912	1923

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P R O C E E D I N G S

1
2 ADMINISTRATIVE LAW JUDGE GEORGE M. KASHI: I call
3 this hearing back to order. I apologize for being late.
4 The coffee shop was closed.

5 Are there any preliminary matters this morning from
6 counsel?

7 MR. MULLINS: Your Honor, I spoke to Mr. Nordstrom
8 this morning. It's my understanding that APS will waive
9 cross of OTS Witness Gruber and AARP Witness Cooper. He
10 will not be in attendance.

11 JUDGE KASHI: Who is that?

12 MR. MULLINS: That's Mr. Paul Nordstrom for APS,
13 Allegheny Power.

14 JUDGE KASHI: They read The Peoples settlement and
15 pulled out already?

16 (Laughter.)

17 JUDGE KASHI: Thank you, sir.

18 Yes, sir?

19 MR. LAVELLE: Your Honor, John Lavelle on behalf of
20 New Energy Ventures. We had two witnesses who were
21 scheduled to appear today, and we have been advised by all
22 the parties that no one is going to have cross-examination
23 for either of them.

24 JUDGE KASHI: Two today?

25 MR. LAVELLE: Yes.

1 JUDGE KASHI: I only have Boonin down. Who else?

2 MR. LAVELLE: Ms. Day had previously been designated,
3 but back at the beginning of the hearing, it was determined
4 that no one had cross-examination for her.

5 I have since found out that no one has any
6 cross-examination for Mr. Boonin, either, so I would like to
7 offer their statements.

8 JUDGE KASHI: Surely.

9 MR. LAVELLE: Pursuant to the stipulation of the
10 parties, I'd like to offer and I will present the court
11 reporter two copies of NEV Statement No. 1, which is the
12 direct testimony of David Magnus Boonin; NEV Statement 2,
13 which is the direct testimony of Nancy I. Day; and also NEV
14 Statement No. 1A, which consists of additions and
15 corrections to NEV Statement No. 1.

16 JUDGE KASHI: They will be so marked for purposes of
17 identification, and they will be received into the
18 evidentiary record as agreed to by counsel and so
19 stipulated.

20 (Whereupon, the documents were
21 marked as NEV Statements Nos. 1,
22 1A and 2 for identification and
23 received in evidence.)

24 JUDGE KASHI: Anything further?

25 MR. LAVELLE: That's all, Your Honor. Thank you.

1 JUDGE KASHI: Anything else from any counsel?

2 (No response.)

3 JUDGE KASHI: I understand that there is some
4 question as to the CEO testimony or witnesses and the cross
5 by the company.

6 MR. RUSSELL: Yes, Your Honor. We had indicated we
7 had brief cross for the CEO witnesses, but upon review of
8 their testimony yesterday, we concluded that we did not need
9 to pursue that cross.

10 We tried to contact counsel for CEO to notify them
11 that we would not have cross for them. It's our
12 understanding that at least one of their witnesses may be
13 headed towards Harrisburg in any event.

14 JUDGE KASHI: You mean, even now as we speak, we
15 can't stop them?

16 MR. RUSSELL: I don't think so. We're trying to.
17 We're in contact with their counsel.

18 JUDGE KASHI: Who is counsel for -- oh, Mr. Vough, is
19 that it, Michael Vough?

20 MR. RUSSELL: That's right.

21 JUDGE KASHI: And we just haven't been able to get in
22 contact with him?

23 MR. RUSSELL: No. We talked to him and he informed
24 us that one witness was traveling.

25 JUDGE KASHI: He knows that they are not to be

1 crossed?

2 MR. RUSSELL: That's correct.

3 JUDGE KASHI: And I don't see anyone else on the
4 matrix, so not seeing anyone who wanted to cross them, we'll
5 just take their -- is Vough coming to put their statements
6 in, or did he ask you to do that?

7 MR. RUSSELL: He didn't ask us to do it, Your Honor.

8 JUDGE KASHI: I would expect then that he is going to
9 come and put their statements in by stipulation.

10 This is getting better by the minute here. Anyone
11 else want to withdraw some witnesses?

12 (Laughter.)

13 JUDGE KASHI: I had a late night last night. I was
14 privileged to get the fax from the PECO matter going on in
15 Philadelphia.

16 Do you wish to call your first witness, sir?

17 MR. KAPLAN: Thank you, Your Honor.

18 Pennsylvania Power & Light Company calls Luis A.
19 Guth.

20 JUDGE KASHI: Mr. Guth, would you raise your right
21 hand and be sworn, sir?

22 Whereupon,

23 LUIS A. GUTH

24 having been duly sworn, testified as follows:

25 MR. KAPLAN: Your Honor, pursuant to our standing

1 procedures, I'd like to identify for the record PP&L
2 Statement No. 19-R, a statement of some 33 pages, and
3 Exhibits LAG-1 through 7.

4 JUDGE KASHI: So marked for purposes of
5 identification.

6 (Whereupon, the documents were
7 marked as PP&L Statement No. 19-R
8 and PP&L Exhibits Nos. LAG-1
9 through LAG-7 for identification.)

10 MR. KAPLAN: Your Honor, we have a correction to one
11 of the exhibits.

12 DIRECT EXAMINATION

13 BY MR. KAPLAN:

14 Q. Mr. Guth, would you describe that correction,
15 please?

16 A. Yes. LAG-7 contains four pages that are taken
17 from the Ibbotson Associates Cost of Capital Quarterly, and
18 inadvertently in compiling the exhibit, the third and fourth
19 pages both contained page SG-1 of that report, which is
20 financial information for so-called large cap companies.

21 I had intended to have that page included but then,
22 in addition to that, the page for companies in the electric
23 services business, that is to say the electric utilities,
24 and the correction is to put that proper page in its place
25 in Exhibit LAG-7.

1 MR. KAPLAN: Your Honor, we provided you with a copy.
2 I believe it is in front of you up there. It looks very
3 similar to the pages that are in Exhibit LAG-7 except it
4 states on the top, "Electric Services. This industry
5 comprises 72 companies."

6 JUDGE KASHI: All right, sir. That will be marked
7 for identification as --

8 MR. KAPLAN: It's really a correction to LAG-7.

9 JUDGE KASHI: Good enough. Thank you.

10 BY MR. KAPLAN:

11 Q. Are there any other corrections, Mr. Guth?

12 A. No.

13 MR. KAPLAN: With that, Your Honor, PP&L moves for
14 the introduction into the record of PP&L Statement No. 18-R
15 and Exhibits LAG-1 through 7.

16 JUDGE KASHI: Subject to any timely motions and/or
17 objections made, pending cross-examination, that which has
18 been marked and identified will be received into the
19 evidentiary record.

20 MR. KAPLAN: We have some very brief rejoinder, Your
21 Honor.

22 JUDGE KASHI: All right, sir.

23 BY MR. KAPLAN:

24 Q. Mr. Guth, in order to judge how relevant the
25 sale discussed by Mr. LaCapra yesterday of assets by New

1 England Electric System to Pacific Gas & Electric Company,
2 how relevant those sales are to measuring the market value
3 of PP&L's fossil units, could you discuss what the
4 Commission should consider?

5 A. Yes. Very briefly, I think Mr. LaCapra
6 indicated that there were 4,000 megawatts of capacity
7 involved in the sale.

8 That sale consists of three fossil plants,
9 representing 2,800 megawatts, and 15 hydro units
10 representing 1,200 megawatts.

11 In contrast, PP&L, as I read the data, has
12 approximately 5,650 megawatts in eight fossil plants, about
13 19 units altogether, and 290 megawatts only in three hydro
14 plants including the capacity that they get from Safe
15 Harbor, so that hydro represents 30 percent of the New
16 England Electric System's New England Power Company
17 portfolio, but only 5 percent of the Pennsylvania Power &
18 Light portfolio.

19 Mr. LaCapra noted that in fact Pacific Gas & Electric
20 had bid 45 percent over book value for that portfolio, but I
21 would note that Mr. LaCapra's own estimates suggest that the
22 market value of hydro using his assumptions is something in
23 excess of 2.5 times the book value of hydro. And in
24 particular, I have reference to the 108 megawatt Holtwood
25 unit included in Mr. LaCapra's analysis. That's the

1 Holtwood unit that is one of PP&L's hydro facilities.

2 If you use that ratio or an approximate of it to
3 value the hydro component of the New England Electric
4 System, then I think you'll find that in terms of the book
5 value of the fossil plants sold by New England Electric,
6 what Pacific Gas & Electric paid was less than book, and
7 possibly substantially less than book under almost any
8 assumptions you might calculate.

9 So I don't think that in the main, this sale tells us
10 very much about people willing to pay even as much as book
11 value for fossil units, let alone substantially in excess of
12 book value as Mr. LaCapra suggests in his analysis where he
13 concludes that the market value would be twice book value
14 for those facilities.

15 Q. Mr. Guth, at page 11 of his surrebuttal
16 testimony, Mr. LaCapra states, "Mr. Guth invites me to cite
17 any evidence concerning the willingness of buyers currently
18 to purchase nuclear units at any positive price. He need
19 look no further than Philadelphia. PECO has been very
20 visible in expressing its interest in investing in nuclear
21 assets."

22 Have you considered his response, and do you have a
23 response to him?

24 A. Yes, I do. Yesterday, as I recall, Mr. LaCapra
25 mentioned two plants, specifically the River Bend unit in

1 Louisiana and the Maine Yankee unit. Neither of them,
2 however, seems to me to represent an indication of any buyer
3 willing to purchase nuclear units at any positive price, as
4 I had suggested.

5 And I say that for a couple of reasons. First of
6 all, as Mr. LaCapra noted, there were something like 25
7 bidders for the NETCO fossil and hydro units. In each of
8 these two cases, there was only one bidder, namely PECO, the
9 only one in the country that expressed an interest in
10 purchasing either a share of River Bend that was offered for
11 sale or the Maine Yankee units.

12 Secondly, over the past six weeks, PECO has pulled
13 out of each deal. Each deal has collapsed, in essence
14 because PECO could not arrange terms that it found
15 beneficial, that is to say with a low enough price for
16 taking over the responsibilities of those plants.

17 Specifically with regard to the River Bend unit, the
18 information I have indicates that PECO may have been willing
19 to initially pay something like \$50 million, but then found
20 that it could not justify even that much to buy a
21 280 megawatt share of River Bend.

22 With regard to Maine Yankee, the owners of Maine
23 Yankee concluded from their standpoint that it was more
24 beneficial to them to simply close the plant than to sell it
25 to PECO on any terms that PECO was willing to offer it.

1 computing what is ultimately the regulatory flow of revenues
2 and in computing what is ultimately the market flow of
3 revenues. So the answer would be yes.

4 Q. Thank you. And then in the calculation of
5 income taxes, again staying with the regulatory method used
6 by PP&L, does the method include a calculation of income
7 taxes being paid on that equity return component, again for
8 the duration of the life of the asset?

9 A. I guess the answer is, it depends. It depends
10 upon whether, for purposes of calculating stranded cost, you
11 want to permit the company to have the ability to pay its
12 taxes and have revenues left over sufficient to pay the
13 returns due to equityholders as well as debtholders.

14 If you do, then you include the taxes in the
15 calculation either in terms of their year by year incurrence
16 or, alternatively, in terms of computing the present value
17 of regulatory revenues versus market revenues and then, in
18 effect, grossing those up for the tax responsibility that
19 the company would have in terms of the net present value.

20 So either one of those two would be correct, in my
21 view.

22 Q. And in the performance of the regulatory method
23 that PP&L has presented in this case, which one of those was
24 utilized?

25 A. In the regulatory method, I believe Mr. Schadt

1 did his analysis year by year, so he looked at tax
2 implications as well as all of the other details on a year
3 by year basis.

4 Q. So under the method that PP&L has used in this
5 case, there would be an income tax component for the life of
6 the asset associated with the equity return on the asset?

7 A. Well, the problem I have with your question is
8 that I don't view that as a methodology issue. It is simply
9 a question of whether you intend to include the effects of
10 federal income tax and state income tax policy or not in the
11 calculation, and that applies whether you use the regulatory
12 method or the so-called PECO or book value versus market
13 value method.

14 The tax issue is not a methodological issue, it's
15 just a question of whether you want to do the calculation on
16 a basis that includes the fact of tax liability or you want
17 to do it on the basis of a calculation that ignores the fact
18 of tax liability.

19 Q. And the PP&L calculation assumes a tax
20 liability?

21 A. The PP&L methodology recognizes the tax
22 liability, yes.

23 Q. And includes that in the calculation?

24 A. Correct.

25 Q. That's the main point.

1 MR. KLEPPINGER: Thank you. That's all I have.

2 JUDGE KASHI: Thank you very much, sir.

3 Mr. Caplan?

4 MR. CAPLAN: Thank you, Your Honor.

5 CROSS-EXAMINATION

6 BY MR. CAPLAN:

7 Q. Mr. Guth, my name is Richard Caplan. I
8 represent some independent power producers in this
9 proceeding. I have a very few questions for you.

10 By any chance, have you had occasion to read an
11 article entitled, "Stranded Investments, Utility Estimates
12 or Investor Expectations" which appeared I believe in June,
13 June 1, 1997 in Volume 135, No. 11 of the Public Utility
14 Fortnightly publication?

15 A. I'd have to see it to refresh my memory.

16 Q. I understand that your testimony was limited to
17 a comparison of two methods for calculating stranded costs.
18 Are you familiar with any other methods that have been
19 proposed?

20 A. I am not sure I could parse out separate methods
21 from these basic two approaches. Obviously there will be
22 differences in nuances.

23 Q. Would you agree, sir, that the basis or at least
24 one of the theoretical underpinnings for stranded cost
25 recovery is the concept that the investors in an investor

1 owned utility have certain expected rates of return which
2 would be compromised in a competitive environment, and they
3 made their investments presumably at a time when they did
4 not anticipate that that regulatory bargain would in fact be
5 breached by the introduction of competition into the
6 generating sector of the business?

7 MR. KAPLAN: Your Honor, this is beyond the scope of
8 this witness's testimony. That was Mr. Kahn. That was
9 Mr. Bradford, not Mr. Guth. Mr. Guth's testimony on this
10 point is comparison of the two methods, but not on
11 historical expectations of investors.

12 JUDGE KASHI: Mr. Caplan?

13 MR. CAPLAN: Your Honor, what I am looking at is to
14 see whether in fact Mr. Guth is in a position to say that
15 either of the two methods that he compared is in fact in his
16 judgment the best one that might be available.

17 I mean, I think the Commission is looking for
18 guidance as to what method to use. If it turns out that Mr.
19 Guth in fact thinks that there is some other method than the
20 two that he was asked to look at that might produce a
21 superior result, I think it would be appropriate for the
22 Commission to know that.

23 JUDGE KASHI: I think it goes to the witness's
24 expertise. I'll overrule the objection.

25 THE WITNESS: I'm not sure which question you want me

1 to answer, Mr. Caplan. If the question is, am I aware of a
2 method which I consider superior, the answer is no, I have
3 made no analysis of alternative methods to those two
4 considered here as to whether any of those might in some
5 sense be superior.

6 BY MR. CAPLAN:

7 Q. Have you heard of anybody proposing a method
8 which was based on investor expectations, in other words one
9 in which one did the analysis based on stock price and rate
10 of return to the investor and attempted to determine the
11 amount of cost recovery that would make the investor whole,
12 not the utility whole but the investor whole?

13 A. Of course, each of these methods in and of
14 themselves does something like that in terms of considering
15 what the cost of capital to PP&L is which in turn is based
16 upon investor expectations and willingness to commit equity
17 to PP&L. So it's impossible for me to distinguish between
18 methodologies here and some other methodologies based on
19 investor expectations. It seems to me every one of these is
20 based on investor expectations.

21 Q. But neither of them in fact approaches it from a
22 rate of return analysis, looking at stock prices and
23 dividends; is that correct?

24 A. Not really. In particular in the regulatory
25 method, there is a calculation of a specific return to the

1 equity holder which may take the form of dividend or may
2 take the form of capital appreciation.

3 Obviously, once you get to that level of detail and
4 start looking at issues from the investors' perspective,
5 you've got to take into account the investors' own tax
6 liability and you get into a very subjective and kind of
7 messy calculation because it depends on just who the
8 investors are. But certainly in my view, each of these
9 methodologies considers that factor as well.

10 Q. In comparing these methodologies, did you have
11 occasion to review the Act itself?

12 A. I did read the Act at one point, yes.

13 Q. And is there anything that you saw in the Act
14 from your perspective -- I assume you're not a lawyer?

15 A. Correct.

16 Q. Is there anything in the Act that would impose
17 upon PP&L the obligation of paying any percentage of the
18 stranded cost that it recovers to its stockholders?

19 A. I don't know.

20 Q. Now, in your judgment, are either of these two
21 methods superior because the level of variable forecasting
22 that's required to achieve the result is less, in other
23 words that they are less dependent upon projections of
24 future events, or do they both share the same risks with
25 regard to reliance upon projected future circumstances?

1 A. I think they share the same characteristics
2 because they are fundamentally the same.

3 MR. CAPLAN: I have no further questions of the
4 witness, Your Honor.

5 JUDGE KASHI: Thank you very much, sir.

6 Ms. Moury -- she's out. She indicated she didn't
7 have cross. Mr. Burgraff?

8 MR. BURGRAFF: Thank you, Your Honor.

9 CROSS-EXAMINATION

10 BY MR. BURGRAFF:

11 Q. Good morning, Mr. Guth. My name is Craig
12 Burgraff. I represent the Office of Consumer Advocate.

13 First, if I could, could I refer you to your Exhibit
14 LAG-3?

15 A. Dash three?

16 Q. Dash three.

17 A. I have it.

18 Q. Now, under the data shown here under the
19 heading, "PECO method," you show a regulatory asset figure
20 of \$644 million. I'm interested to know where that came
21 from and how you derived it.

22 A. The entire exhibit was prepared by Mr. Schadt.

23 Q. Mr. Schadt. So under the PP&L method total
24 column, the total generation figure of \$3.57 billion also
25 came from Mr. Schadt?

1 A. That's correct.

2 Q. I'd like to generally refer you to the portion
3 of your testimony dealing with your discussion of discounted
4 cash flows and the wait-and-see option. I believe it's
5 roughly pages 17 and 18 of your testimony.

6 (Pause.)

7 Q. Are you there?

8 A. Yes.

9 Q. You discussed earlier the New England Power
10 sale; did you not?

11 A. Yes.

12 Q. Now, were you aware or did you read certain
13 published market assessment analyses by various analysts
14 concerning that sale before it took place?

15 A. No, I did not.

16 Q. Now, in focusing on the wait-and-see option, I
17 believe you state on lines 15 through 18 at page 18 of your
18 testimony that we have to recognize that a potential
19 purchaser today would have to be compensated for giving up
20 the option to wait and see; is that correct?

21 A. That's what the sentence reads, yes.

22 Q. Now, under PP&L's recommendation in this case,
23 Mr. Guth, essentially aren't PP&L's ratepayers being asked
24 to make the same irrevocable decision, to give up the
25 wait-and-see option, or aren't they being required to, if

1 that would make you more comfortable?

2 A. If I understand your question, you're asking me
3 something about the way in which the Act should be
4 interpreted, and I don't think I'm really qualified to give
5 you an opinion about that.

6 Q. Well, if PP&L's recommendation as far as
7 stranded cost recovery is concerned is accepted by the
8 Commission in this case, wouldn't the result of that
9 essentially be that PP&L ratepayers give up any wait-and-see
10 option?

11 MR. KAPLAN: Your Honor, first of all, the witness I
12 think answered the question, and secondly I have no idea
13 where this is going other than the fact that both under the
14 proposal by OCA and under that by the company, a specific
15 amount is projected and there is no adjustable amount either
16 by their case or our case. Other witnesses have suggested
17 that, but not either of us.

18 MR. BURGRAFF: Your Honor, Mr. Guth's testimony
19 suggests that a buyer, in order to give up a wait-and-see
20 option, essentially would pay less than the value of the
21 asset. I'm simply attempting to test his theory or his
22 recommendation as it applies to the ratepayers in this case.

23 JUDGE KASHI: All right. I'll overrule the
24 objection. Answer the question.

25 THE WITNESS: Well, first of all, that's certainly an

1 incorrect characterization. I think my discussion suggests
2 that what a buyer is willing to pay is precisely affected by
3 his or her evaluation of alternatives including the option
4 of postponing a decision.

5 So it's not paying less than what something is worth,
6 it's determining exactly what it is worth and why typically
7 the type of analysis done by Mr. LaCapra in this case
8 overestimates what people actually are willing to pay.

9 That said, as far as your question is concerned, it
10 seems to me this goes to the nature of how the Act was
11 drawn, what kinds of give and take takes place between the
12 various interests that the Legislature is trying to advance,
13 including the desire to make the transition to a competitive
14 generation market, and really is a very different subject
15 matter from anything that I've considered in my testimony.

16 BY MR. BURGRAFF:

17 Q. Well, by being asked to pay essentially more
18 than, depending our analysis, or slightly less than, under
19 the company's analysis, the net book value of the fossil and
20 nuclear assets in this case, ratepayers forego the
21 wait-and-see option, don't they? In other words, they don't
22 have the chance to try and estimate what they would be
23 willing to pay for these assets?

24 A. The two are as ships passing in the night. One
25 issue goes to what kind of discount rate is appropriate to

1 use in evaluating a decision of a company whether to make an
2 investment or not. The other goes to the question of what
3 kinds of considerations the Legislature entered into in
4 seeking to make the transition to competition in generation
5 versus the traditional regulatory approach.

6 And they simply are two entirely different questions.
7 If your question goes to, why should consumers pay a
8 competitive transition charge under the Act, that addresses
9 a whole host of issues which I assume the Act, in the wisdom
10 of the state Legislature, has resolved. But it certainly
11 doesn't relate to anything that's incorporated in my
12 testimony.

13 Q. Well, let's try it this way, Mr. Guth. Would
14 you advise ratepayers to in essence sell the assets at PP&L
15 market prices and forego the opportunity to see whether the
16 market prices actually turn out higher than those prices?

17 MR. KAPLAN: I object, Your Honor. This is so
18 foreign to this case -- ratepayers are not going to be in a
19 position to sell PP&L assets.

20 MR. BURGRAFF: Well, they're being asked to pay for
21 the assets, which is essentially the same thing.

22 MR. KAPLAN: They're being asked to pay precisely
23 what the Act specifies should be paid, which is a
24 competitive transition charge. That is a rate. They are
25 not being sold assets, and that is completely outside the

1 scope of this case.

2 JUDGE KASHI: And it really calls for a lot of
3 speculation.

4 MR. BURGRAFF: Fine, Your Honor. I'll withdraw the
5 question.

6 JUDGE KASHI: Thank you, sir.

7 BY MR. BURGRAFF:

8 Q. Mr. Guth, under the Office of Consumer
9 Advocate's analysis, PP&L's generating assets essentially
10 have a negative value. If that result is correct, would you
11 advise PP&L to offer its generating assets for sale?

12 A. Let me make sure I understand your question.
13 You say they have a negative value. I think what you meant
14 to say is the market value is at excess of the book value,
15 and therefore, that you have a negative contribution to the
16 measurement of stranded cost. Is that a correct
17 understanding?

18 Q. Yes, the stranded cost is greater than the net
19 book value.

20 A. I don't think whether or not the OCA analysis is
21 correct is terribly relevant. I think the question is if
22 PP&L gets an offer to buy its generating assets at a price
23 that it finds attractive, it ought to sell; and if it
24 doesn't, it shouldn't. All I can say is that the OCA
25 analysis results seem inconsistent at least initially with

1 where the market seems to be settling out.

2 Q. Would you advise them to seek offers?

3 A. I'm not an investment banker. I'm simply an
4 economist. All I can say to them is if an offer is made and
5 the price seems to provide more benefits to their
6 shareholders and their ratepayers than continued ownership,
7 then they ought to consider actively the sale; and if it
8 doesn't, then they shouldn't.

9 Q. On page 17, line 3 of your statement, you begin
10 by saying, "Consider the valuation work of investment
11 bankers;" is that correct?

12 A. Yes.

13 Q. So under this analysis, would you recommend that
14 PP&L seek offers for these assets?

15 MR. KAPLAN: Your Honor, this has been asked and
16 answered.

17 MR. BURGRAFF: Well, Your Honor, he answered it from
18 the perspective of not being an investment banker. However,
19 this part of his testimony seems to be based on the
20 valuation work of investment bankers, so I'm asking him that
21 question.

22 JUDGE KASHI: The objection is overruled.

23 Can you answer the question, sir?

24 THE WITNESS: I think I already did. I'm not an
25 investment banker, and the previous answer stands on just

1 the basis that I gave it.

2 BY MR. BURGRAFF:

3 Q. Mr. Guth, I take it the recent sale of New
4 England Power's generating assets does not change your view
5 of the wait-and-see posture of buyers in the generation
6 asset market.

7 A. It doesn't change my view about what the proper
8 discount rate likely should be in evaluating the market
9 value of generating assets today. You seem to have in mind
10 some notion of a wait-and-see approach as suggesting a
11 proper set of behavior, which is not at all what I had in
12 mind in this analysis or what in fact the literature that I
13 cite by Professor Dixon Pindyke had in mind. That issue
14 certainly goes solely to the question why it is that
15 companies making investment in new projects tend to employ
16 discount rates that are considerably in excess of those that
17 you might otherwise expect.

18 Q. By the way, Mr. Guth, do you know how the sale
19 price in the New England Power matter compares to any
20 forecasted discounted cash flow value for those assets?

21 A. No, I don't.

22 JUDGE KASHI: Is there such an analysis available?

23 MR. BURGRAFF: I don't know. My assumption is they
24 were made. I just wondered if the witness was aware of it.

25 MR. KAPLAN: My suspicion, Your Honor, is that the

1 discounted cash flow analysis conducted by Pacific Gas and
2 Electric Company would be considered one of their most
3 highly confidential documents considering it was probably
4 used in formulating their bid.

5 JUDGE KASHI: You're right.

6 MR. BURGRAFF: I'll let it go. Thank you, Mr. Guth.
7 That completes our questions, Your Honor.

8 JUDGE KASHI: Thank you very much, sir.

9 Mr. Simms?

10 MR. SIMMS: Your Honor, I had earlier informed the
11 company that we had no cross-examination for the witness.

12 JUDGE KASHI: Redirect?

13 MR. KAPLAN: Could I have just about 15 seconds, Your
14 Honor?

15 JUDGE KASHI: Go ahead.

16 (Pause.)

17 MR. KAPLAN: Your Honor, we have no redirect.

18 JUDGE KASHI: Thank you very much. You are excused,
19 Mr. Guth.

20 (Witness excused.)

21 JUDGE KASHI: That which has been previously marked
22 as PP&L Statement 19-R and Exhibits LAG-1 through 7 are
23 received into the evidentiary record without objection.

24 (No response.)

25 JUDGE KASHI: Without objection.

1 (Whereupon, the documents marked as
2 PP&L Statement No. 19-R and PP&L
3 Exhibits Nos. LAG-1 through 7 were
4 received in evidence.)

5 JUDGE KASHI: PP&L, do you want to call your next
6 witness?

7 MR. KAPLAN: Yes, Your Honor. PP&L calls Paul R.
8 Moul.

9 JUDGE KASHI: Raise your right hand to be sworn, sir.
10 Whereupon,

11 PAUL R. MOUL

12 having been duly sworn, testified as follows:

13 MR. KAPLAN: I am identifying for the record pursuant
14 to our standing procedures Pennsylvania Power & Light
15 Company Statement No. 6, a statement of some six pages;
16 Pennsylvania Power & Light Company Statement No. 6-R, a
17 statement of some 36 pages; and Exhibits PRM-1 through 6.

18 JUDGE KASHI: So marked for purposes of
19 identification.

20 (Whereupon, the documents were marked
21 as PP&L Statements Nos. 6 and 6-R
22 and PP&L Exhibits Nos. PRM-1 through
23 PRM-6 for identification.)
24
25

1 DIRECT EXAMINATION

2 BY MR. KAPLAN:

3 Q. Mr. Moul, do you have any corrections in your
4 statements or exhibits?5 A. Yes. I have one correction to the Rebuttal
6 Statement No. 6-R. That correction would be on page 26 at
7 line 14. The third word in that line, the word "nine"
8 should be "seven."9 That is the only correction I'm aware of at this time
10 concerning those statements.11 MR. KAPLAN: Thank you, Mr. Moul. With that, Your
12 Honor, PP&L moves for the introduction into the record of
13 Statement No. 6, Statement No. 6-R and Exhibits PRM-1
14 through 6.15 JUDGE KASHI: Subject to any timely motions and/or
16 objections made pending cross-examination, that which is
17 marked and identified will be received in the evidentiary
18 record.19 MR. KAPLAN: Your Honor, we have some brief rejoinder
20 examination.

21 JUDGE KASHI: Go ahead, sir.

22 BY MR. KAPLAN:

23 Q. Mr. Moul, will you please turn to page 2, lines
24 1 through 10 of Mr. Deardorff's surrebuttal testimony?

25 A. Yes, I have that.

1 Q. At that point he revises his recommended cost of
2 equity by decreasing it from 10.5 percent to 10.25 percent.
3 Why did he do that, and do you agree with his analysis?

4 A. Mr. Deardorff in his surrebuttal reduced his
5 cost of equity by 25 basis points, which he claims was
6 necessitated due to changes in growth forecasts, market data
7 and to correct a computer programming error. Unfortunately,
8 Mr. Deardorff has provided us in his statement no discussion
9 of the specific changes concerning each of these factors,
10 nor has he provided us any details which indicate how these
11 changes contributed to his revised recommendation.

12 The more important factor which should be considered
13 with regard to this updated cost of equity in the
14 surrebuttal testimony relates to the fact that the
15 surrebuttal was filed just seven weeks after his direct
16 testimony was filed on June 27, whereas his surrebuttal was
17 filed on August 14, and it seems to me that in such a short
18 time period such as seven weeks, that to revise the cost of
19 equity recommendation at this time indicates that Mr.
20 Deardorff is taking far too short of a view of capital costs
21 in this proceeding, especially when we're looking towards
22 viewing the company's costs for investments that would exist
23 for up to 30 years in the future. So that in a proceeding
24 such as this where we have this longer-term view of company
25 cost, a short-term view of capital cost over a seven-week

1 period seemed to be inappropriate.

2 Q. Now, on page 3, line 9 in Mr. Deardorff's
3 surrebuttal testimony through page 4, line 12, Mr. Deardorff
4 discusses the pre-tax interest coverage level for PP&L in
5 this case. Has he added anything to support his
6 conclusions?

7 A. What Mr. Deardorff has talked about in his
8 surrebuttal testimony is a set of criteria which he
9 developed relative to the Standard & Poor's benchmarks,
10 which he has attempted to define in the context of an
11 A minus rating as opposed to the A rating which S&P has
12 published for its benchmarks.

13 To the best of my knowledge, there are no published
14 benchmarks for an A minus bond rating by Standard & Poor's.
15 The calculations shown on his page 4 regarding both the A
16 minus rating and the BBB plus rating, to the best of my
17 knowledge, are figures derived by Mr. Deardorff.

18 Moreover, the ranges for all of the bond ratings
19 shown on that page again are ranges developed by him and are
20 not published by Standard & Poor's with regard to its rating
21 process. In fact, Standard & Poor's when it changed its
22 rating process and went to a matrix approach to tailor each
23 company's credit quality to a business position, Standard &
24 Poor's specifically eliminated the range concept in its
25 credit quality analysis. So what we have here is a set of

1 calculations of Mr. Deardorff's and are not necessarily
2 those that are published or used by the rating agencies.

3 The other thing that is interesting about what is
4 contained on these two pages of testimony is that the
5 benchmarks that S&P does publish are to be distinguished
6 from the opportunities that are typically discussed in
7 regulatory proceedings such as these. The benchmarks that
8 S&P puts out are targets which it expects utilities or other
9 companies to achieve in order to attain a particular bond
10 rating.

11 The bottom line is that the 3.39 times pre-tax
12 interest coverage Mr. Deardorff speaks about in his
13 surrebuttal testimony is woefully inadequate for the company
14 to attain the type of credit quality profile it needs to
15 maintain an A bond rating.

16 Q. Thank you. On page 5, line 10 through page 6,
17 line 8, Mr. Deardorff argues that the DCF growth rates have
18 declined between the two cases for PP&L. Do you have any
19 response to that argument?

20 A. Yes. I believe he is responding to some
21 rebuttal testimony I put together, in particular my
22 Statement No. 6-R, page 11, where what I did there
23 specifically was to compare the growth rates for PP&L taken
24 from the evidence Mr. Deardorff presented in his direct
25 testimony in this case with that which he presented in the

1 Company's last base rate case where he also testified; and
2 what I show on page 11 of my testimony is that in fact, the
3 growth rate has increased by 1.5 percentage points using the
4 Value Line forecast between the first quarter of 1995 and
5 the second quarter of 1997, and the growth rate forecast
6 increased by 1 percentage point using the S&P forecast for
7 the similar periods of time. So in fact, the growth rates
8 are up based upon the evidence he presented in both cases.

9 Q. Next, on page 6, lines 14 to 17, Mr. Deardorff
10 refers to an aberrant dividend yield for PP&L. Do you agree
11 with his characterization?

12 A. Well, I'm sort of puzzled, because he really
13 doesn't set forth the parameters that he uses to
14 characterize the PP&L divided yield as aberrant without some
15 sort of parameters or definition. I'm sort of at a loss to
16 know what causes one dividend yield to be aberrant and
17 another one to be normal, however it might be viewed.

18 I think, however, the important thing is --

19 MR. SIMMS: Your Honor, I'm having difficulty
20 hearing.

21 JUDGE KASHI: Can I get counsel to go out there and
22 ask them to please --

23 (Pause.)

24 JUDGE KASHI: Off the record.

25 (Discussion off the record.)

1 JUDGE KASHI: Let's get back on the record.

2 You were discussing Mr. Deardorff's determination of
3 an aberrant dividend yield and criticizing it on the basis
4 that he had not set any type of range for the somewhat
5 flexible word "aberrant;" is that correct?

6 THE WITNESS: Yes, Your Honor.

7 JUDGE KASHI: Okay.

8 THE WITNESS: I suppose the best way to deal with the
9 situation that we have here, even in the absence of a
10 definition or a range that would define what an aberrant
11 yield would be, would be the proposal that I made in my
12 original direct testimony, and that was to look at stock
13 market evidence, interest rate evidence, other capital
14 market evidence for the year 1996. I did that in the direct
15 testimony for the purpose of attempting to synchronize
16 capital costs with the company's other evidence for the base
17 period in this proceeding. But now that we're into 1997 and
18 we have the statement that we do from Mr. Deardorff, I think
19 it would be worthwhile to further emphasize the 1996
20 evidence, because if indeed the yields in 1997 were aberrant
21 due to perhaps the impact on PP&L's stock price due to this
22 proceeding, the benefit we have by looking back to 1996, we
23 then have market evidence that pre-dates the filing of this
24 proceeding and perhaps some of the other ramifications that
25 have been revealed to the capital markets which have

1 impacted the company's stock price in 1997.

2 So perhaps the best way to deal with this issue is to
3 step back, look at the market evidence for 1996. It is
4 synchronized with the other financial information in the
5 base period, and it pre-dates whatever influence on the
6 stock price which has occurred due to this proceeding.

7 BY MR. KAPLAN:

8 Q. Now, turning briefly to Mr. Gruber's surrebuttal
9 testimony, on page 4, lines 3 to 5, Mr. Gruber discusses
10 changes in the cost of capital. Do you have any response to
11 the points made by Mr. Gruber during that discussion?

12 A. Yes, I do. Perhaps I'm reading his testimony
13 too narrowly, but I get the clear impression, at least from
14 the statements made at the top of page 4, that Mr. Gruber is
15 leaving the impression that changes in the cost of capital
16 for PP&L are in the hands of the company due to the types of
17 business decisions it makes. Certainly, business decisions
18 have an impact on a company's cost of capital, but there is
19 a whole host of other influences which impact the company's
20 cost of capital.

21 It's the sentiment in the stock market, it's the type
22 of economic growth that is going on, it's the level of
23 interest rates, and a whole host of market fundamentals over
24 which the company management has no control whatsoever that
25 also impacts the company's cost of capital, and I think the

1 Commission needs to be aware and needs to be concerned about
2 these other influences and impacts that influence the
3 company's cost of capital aside from merely management's
4 decision.

5 It just seems to be somewhat naive to believe that
6 capital costs are totally in the company's hands, because
7 the company raises capital from investors and needs to
8 compete with other similarly situated firms in attracting
9 that type of capital; and hence, these are the factors that
10 need to be considered as well as any business decisions that
11 management may make.

12 Q. And finally, Mr. Moul, Mr. Bradford's testimony
13 at pages 5, lines 29 through 35 makes three assertions
14 regarding your work with the Foley-Thompson results. Do you
15 have any response to these assertions?

16 A. Yes, I do. Mr. Bradford in his surrebuttal
17 testimony at the bottom of page 5 talked about three items
18 concerning my update of what I called the Foley study. Mr.
19 Foley was an employee at the time at NARUC. Specifically,
20 his first allegation was that the returns for the utilities
21 at least in his mind continue to be in the same range as the
22 S&P Industrials. Well, that certainly isn't what is shown
23 by my update.

24 If you look at page 34 of my Rebuttal Statement No.
25 6-R, the returns for the periods 1992 to 1996 were roughly

1 8 percent for electric utilities in general, roughly 4.5
2 percent for PP&L specifically at a time when the S&P 400
3 Industrials were realizing returns of 15 percent. Eight
4 percent of 4 percent by my way of thinking are not in the
5 same range as 15 percent. So I think that is a myth that
6 needs to be dispelled.

7 The second point that Mr. Bradford attempts to make
8 is that utility stocks are generally less volatile. Well,
9 if you look at my Exhibit No. PRM-2 which was attached to my
10 direct testimony at Schedule 9, you see that the standard
11 deviations for the S&P Public Utility Index were 21.95
12 percent as compared with the S&P composite index of 20.39
13 percent, which is, by and large, represented by industrial
14 companies, which indicates that the standard deviations for
15 the utilities are close to the standard deviations of the
16 market in general. So this evidence clearly shows that
17 utility stocks are not generally less volatile, as Mr.
18 Bradford seems to think.

19 The third point he attempts to make in his
20 surrebuttal is that in my update, I have overemphasized
21 market performance for the utilities terminating in the year
22 1996. The point here is that 1996 is important and should
23 be emphasized because it represents the cast-off point that
24 we're using in this proceeding to begin the transition of
25 competition, and 1996 is also reflective of a market

1 assessment of what the risk for the utility industry in
2 general will be in the future; and hence, there is no reason
3 to attempt to diminish the significance of 1996 market
4 evidence in coming up with a cost of equity in this
5 proceeding.

6 MR. KAPLAN: Thank you, Mr. Moul. That concludes the
7 rejoinder examination, Your Honor.

8 JUDGE KASHI: Thank you very much, Mr. Kaplan.
9 Mr. Kleppinger?

10 MR. KLEPPINGER: We have no questions, Your Honor.

11 JUDGE KASHI: Mr. Zalcman?

12 MR. CAPLAN: He's not here, Your Honor.

13 JUDGE KASHI: Mr. Simms, you have indicated that you
14 have extensive cross-examination of this witness. Is that
15 correct?

16 MR. SIMMS: Well, Your Honor, I informed Mr. Russell
17 that I had brief, but after Mr. Moul's rejoinder, I don't
18 know whether it will be brief or extensive.

19 JUDGE KASHI: What I am going to do, given the
20 extensive nature of the rejoinder, and that we would
21 normally be taking our morning recess in ten minutes anyway,
22 and given that Ted's coffee shop is closed and you're all
23 going to have to walk over to the Capitol to get your
24 morning coffee, we're going to take the 15-minute recess at
25 this point. We'll come back and begin with the

1 cross examination of the Trial Staff.

2 We stand in recess for fifteen minutes.

3 (Recess.)

4 JUDGE KASHI: Going back on the record.

5 Cross examination, Mr. Simms.

6 MR. SIMMS: Thank you, Your Honor.

7 **CROSS EXAMINATION**

8 BY MR. SIMMS:

9 Q. Good morning, Mr. Moul.

10 A. Good morning.

11 Q. Mr. Moul, what is PP&L's current rating?

12 A. A- by Standard & Poor's.

13 Q. Now, can we agree that Standard & Poor's publish
14 A rating and BBB rating?

15 A. That is correct. The benchmark criteria for
16 those ratings, correct.

17 Q. Now, in your direct testimony on cost of capital,
18 would I be correct that you appear to focus on revenue
19 requirement calculation?

20 A. I'm not sure I understand your question entirely.
21 My direct testimony goes specifically to the cost of equity.

22 Q. Well, in your direct testimony you do, do you
23 not, testify regarding cost of capital?

24 A. That's correct, I make a calculation of what the
25 company's overall cost of capital would be based upon the

1 ROE that they put in their cost of capital calculation.
2 That was on Schedule 1 of my PRM-2, that's correct.

3 Q. Now, does that cost of capital analysis relate to
4 revenue requirement calculation?

5 A. To the extent that that is used in developing
6 revenue requirements, that would be correct.

7 Q. Now, was it your intent that your cost of capital
8 recommendation also be used as a discount rate calculation?

9 A. I was not specifically asked to come up with a
10 discount rate for net present value purposes, no. I was
11 aware that the inputs in my cost of equity and overall cost
12 of capital would be used in that regard, but I was not
13 retained to specifically develop that.

14 Q. You indicated that you knew that was going to be
15 used in that regard. Was it used?

16 A. By Mr. Schadt it was. I mean, he developed the
17 discount rate. And I knew what he was doing in that regard,
18 but --

19 Q. Let me ask you this question. Is it your
20 testimony the discount rate should be based on a weighted
21 cost of capital calculation using the current cost of
22 capital?

23 MR. KAPLAN: I think Mr. Moul testified that that was
24 not his task. And I think just for clarification, the
25 discount rate was initially developed by Mr. Schadt, and

1 then there was testimony that it was appropriated by
2 Mr. Guth. Mr. Moul calculated the company's weighted
3 average cost of -- well, he calculated the cost of equity,
4 from which the weighted average cost of capital was
5 determined, and Mr. Schadt used that to do his discount.

6 MR. SIMMS: Right, he testified, I believe, Your
7 Honor, that, as Mr. Kaplan said, that he used the weighted
8 cost of capital. My question is simply whether or not
9 believed that the discount rate should be based on a
10 weighted cost of capital that he formulated using the
11 current cost of capital.

12 JUDGE KASHI: All right. The objection is overruled.

13 THE WITNESS: I suppose the answer to the question
14 is, I would have come up with a higher rate. The company's
15 weighted average cost of capital reflected 11.5 percent ROE,
16 which was taken from the last rate case decision.

17 My independent analysis indicated that number should
18 have been higher. To the extent you develop a discount rate
19 on an after-tax basis, as did Mr. Schadt, he just used
20 different inputs.

21 We used the same capital structure, we used the same
22 bedded cost of debt, and the same --

23 JUDGE KASHI: I think I missed the answer to the
24 question. Somewhere the thing was whether or not you
25 believed that the discount rate should be based upon the

1 weighted average cost of capital.

2 Isn't that correct, Mr. Simms?

3 MR. SIMMS: Yes.

4 THE WITNESS: The short answer is yes.

5 BY MR. SIMMS:

6 Q. Now you did refer that the company use 11.5
7 percent cost of equity. Can we agree that the company's
8 cost of equity is based on dated information?

9 A. The cost of equity derived from capital market
10 information, correct.

11 Q. On dated information, from the last base rate
12 case; is that correct?

13 A. Correct, the 11.5 came from the rate case
14 decision.

15 Q. Now, in your exhibits, you refer to a number of
16 sources of information; do you not?

17 A. Yes.

18 Q. And that some of those sources included Value
19 Line and Blue Chip Financial Forecast; correct?

20 A. Correct.

21 Q. Now, page 4 of your direct testimony, you
22 testified that although it is always possible that interest
23 rates could move lower, that possibility is outweighed by
24 the prospect of higher future interest rates; do you not?

25 A. Yes, I said that in the context of making that

1 statement during a period of relatively low interest rates.

2 Q. Mr. Moul, it would help me if you say "yes" or
3 "no," then explain. If you want to be all day, we can. I
4 haven't done much cross examination, so I'm pretty well
5 rested.

6 MR. KAPLAN: Your Honor, I think that's precisely
7 what the witness did.

8 JUDGE KASHI: I'm having difficulty, Mr. Moul, I
9 genuinely am. If, in fact, you can give us a "yes" or "no,"
10 and then go on to explain, I think it would be helpful for
11 the rest of us.

12 THE WITNESS: Certainly, Your Honor.

13 JUDGE KASHI: Thank you.

14 BY MR. SIMMS:

15 Q. Now, looking at your testimony, page 4, lines 7
16 through 9, what evidence have you presented in PRM-1 through
17 PRM-6 to support that statement?

18 A. I'm sorry; could I have that reference again,
19 please?

20 Q. I'm looking at page 4, lines 7 through 9. And my
21 question to you is: What evidence, if any, have you
22 presented in PRM-1 through PRM-6 to support that statement?

23 A. That would be found in PRM-3.

24 Q. PRM-3?

25 A. Yes, the chart on PRM-3.

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MR. SIMMS: If I may have a brief moment, Your Honor.

JUDGE KASHI: Yes.

(Pause.)

BY MR. SIMMS:

Q. What schedule is that?

A. It's a separate exhibit. The way the testimony was organized, there were, how do you say, three attachments. I called them exhibits to my direct testimony.

JUDGE KASHI: It is the last sheet in his testimony, Mr. Simms.

BY MR. SIMMS:

Q. So you used PRM-3, you based that upon interest rate trends from November 1986 to December 1996; is that correct?

A. Yes.

Q. Now, have you had an opportunity to review the Value Line investment survey for August 22, 1997?

A. Yes, I have.

MR. SIMMS: To save time, may I approach the witness, Your Honor?

JUDGE KASHI: Yes, please. If you have something, show it to counsel first.

(Atty. Simms handing document to Atty. Kaplan.)

MR. KAPLAN: Does the witness have a copy of this?

THE WITNESS: No, I do not.

FORM 2

1 (Document handed to witness.)

2 BY MR. SIMMS:

3 Q. Mr. Moul, I'm sorry, I only had one copy of this.
4 Are you familiar with this publication?

5 A. Yes, I am.

6 Q. Could you read into the record the 30-year
7 Treasury Bond rate, the trend, for the year 2000 to 2002?

8 A. The figure there is 6.5 percent.

9 Q. And also, Mr. Moul, are you familiar with the
10 Blue Chip Financial Forecast?

11 A. Yes, I am.

12 Q. Once again, I only have one copy. But could you
13 read into the record for me the Treasury Bond yield for 30-
14 year for the year 2003 to 2007?

15 (Document handed to witness.)

16 JUDGE KASHI: What's the date on that, Mr. Simms?

17 MR. SIMMS: June 1, 1997.

18 JUDGE KASHI: Thank you.

19 THE WITNESS: That figure would be 6.1 percent.

20 BY MR. SIMMS:

21 Q. And could you also read into the record for me
22 the A utility bond yield for the same time period?

23 A. That would be 7.1 percent.

24 Q. Thank you. Now, Mr. Moul, if I could refer you
25 to your rebuttal testimony.

1 A. Yes, I have that.

2 Q. Now, I'd like to refer you to page 13.

3 A. Yes.

4 Q. Now, you testified that stranded cost arise from
5 not only investment in high fixed cost nuclear generating
6 assets, but also from fossil fuel generating assets, high
7 cost purchased power contracts; do you not?

8 A. Yes.

9 Q. Are you testifying that these factors are equally
10 important?

11 A. They're all important. I don't know how else I
12 can respond to your question. They vary company to company
13 in importance.

14 Q. Well, since we are dealing with PP&L, are they
15 equally important for PP&L?

16 A. I think they're equally important. Yes, I
17 believe they're equally important. The magnitude of the
18 dollars associated with each are certainly different. But I
19 think they're all important. I mean, they all give rise to
20 stranded cost. But the dollars, obviously, are different.

21 Q. Can we not agree that with respect to PP&L's
22 nuclear generating plant costs, that it represents 61
23 percent of stranded costs?

24 A. I could accept that subject to check. I haven't
25 made the calculation. It sounds in the ball park.

1 Q. I would refer you to page 32 of Mr. Schadt's
2 testimony, when you have an opportunity to check.

3 Now, referring you to page 28 of your rebuttal
4 testimony, I'm looking at lines 20 through 22, in which you
5 testified that the interest rate on the bonds issued to
6 mitigate costs should represent the carrying charges on the
7 unamortized balance of those stranded costs; correct?

8 A. Yes.

9 Q. Is it your testimony that once CTC is
10 securitized, then a cost of capital of those stranded assets
11 is the interest rate on a newly issued transition bonds?

12 A. Yes, that would be my testimony in that context.

13 MR. KAPLAN: Excuse me. Can I get the reference
14 again?

15 MR. SIMMS: Page 28, lines 20 through 22.

16 BY MR. SIMMS:

17 Q. Now, could you please refer back to page 22 of
18 your rebuttal testimony? And I'm looking at lines 18
19 through 20.

20 A. Yes, I have that.

21 Q. Now, with respect to the interest rate on AAA
22 rated public utility bonds, is it your testimony that the
23 interest rate on PP&L's transition bonds would receive the
24 rate on AAA rated public utility bonds?

25 MR. KAPLAN: Excuse me, Your Honor. Transition

1 bonds?

2 MR. SIMMS: Transition bonds, yes.

3 MR. KAPLAN: We have no transition bonds. We have no
4 securitization request.

5 MR. SIMMS: Well, I think the witness previously
6 indicated that on page 28, lines 20 through 22, that the
7 interest rates on the bonds issued to mitigate these costs
8 should represent the carrying charges on the unamortized
9 balance of those stranded costs. I think that question was
10 answered by the witness.

11 MR. KAPLAN: It was said as an aside to the extent
12 the company engages in securitization.

13 MR. SIMMS: Well, hypothetically.

14 BY MR. SIMMS:

15 Q. Well, put "hypothetically" in front of the
16 question, Mr. Moul.

17 JUDGE KASHI: Hypothetically, if the company does
18 what you say they do?

19 MR. SIMMS: Yes.

20 MR. KAPLAN: On that basis, Your Honor, we do not
21 object.

22 JUDGE KASHI: All right, sir.

23 THE WITNESS: If I recall the question correctly --
24 well, maybe I ought to have the question back again.

25

1 BY MR. SIMMS:

2 Q. Hypothetically -- and I'm referring to your
3 testimony on page 22 -- do you believe that the interest
4 rate on PP&L's transition bonds would exceed the rate on AAA
5 rated public utility bonds?

6 A. They could, yes. By exceed, you mean it could be
7 higher?

8 Q. That's correct.

9 A. Yes.

10 Q. Mr. Moul, if I could just refer you to your
11 Exhibit PRM-1, page 3.

12 Am I correct that you are recommending adding 50
13 basis points to the growth rate, essentially because
14 analysts could not fully account for market-wide factors?

15 A. Correct.

16 Q. So, based upon that answer, are you suggesting
17 that analysts consistently underestimate growth rates by 50
18 basis points?

19 A. No, what I'm saying is that while their estimates
20 might be right on target, there are other factors aside from
21 their forecasts of what earnings would be for a particular
22 utility that also affect the stock price insofar as what
23 investor expectations of growth are.

24 Q. And your testimony is that these analysts do not
25 consider those other factors?

1 A. It's different to respond, because we don't know
2 if they do it or they do it uniformly. Some may, some may
3 not, but we don't know to what extent that those factors may
4 be taken into account.

5 Q. Generally speaking, aren't analysts in the
6 business of trying to be as accurate as possible?

7 A. That's correct, they're trying to do the best job
8 possible to come up with a forecast of a particular
9 company's earnings.

10 Q. Now, on page 8 of your Exhibit PRM-1, you make a
11 reference to maintenance of a strong A bond rating financial
12 profile; do you not?

13 A. Yes.

14 Q. Now, I understand that that was the objective in
15 rate based rate of return regulation. Are you suggesting
16 that that should be the objective in the restructuring of
17 the electric utility industry

18 A. Yes.

19 Q. And your testimony is that that is the objective
20 of the competition act?

21 A. Oh, I don't know that the --

22 Q. Based upon from your perspective as a rate of
23 return analyst.

24 A. I don't know that the act addresses that issue.

25 MR. SIMMS: Your Honor, I believe that concludes my

1 cross examination.

2 JUDGE KASHI: Thank you very much, sir.

3 Do you need a couple minutes, Mr. Kaplan?

4 MR. KAPLAN: Very, very brief, Your Honor.

5 (Off-the-record pause.)

6 JUDGE KASHI: Back on the record.

7 Redirect, Mr. Kaplan?

8 MR. KAPLAN: None, Your Honor.

9 JUDGE KASHI: Thank you very much, sir.

10 You're excused, sir.

11 THE WITNESS: Thank you, Your Honor.

12 (Witness excused.)

13 JUDGE KASHI: That which has been previously marked
14 and identified as PP&L Statement Nos. 6, 6-R, and Exhibits
15 JRM-1 through 6 are received into the evidentiary record.
16 Without objection?

17 (No response.)

18 JUDGE KASHI: Without objection.

19 (Whereupon, the documents marked as
20 PP&L Statement Nos. 6 and 6-R, including
21 Exhibits PRM-1 through 6, were received
22 in evidence.)

23 JUDGE KASHI: Thank you very much, sir.

24 Mr. Simms, do you want to call your witness?

25 MR. SIMMS: Your Honor, Mr. DeBroff will be

FORM 2

1 responsible for Mr. Gruber. But while Mr. Gruber is making
2 his way to the witness stand, it's my understanding from the
3 company that they have no cross examination for OTS Witness
4 Stephen Reed. With that understanding, Your Honor, I would
5 like to at this time have marked for identification the
6 direct testimony of Stephen Reed as OTS Statement No. 2, the
7 attached exhibits, which contains multiple-page schedules,
8 to be marked for identification as OTS Exhibit No. 2, and
9 that the surrebuttal testimony of Mr. Reed be marked for
10 identification as OTS Statement No. 2-SR. And they may be
11 admitted into the record by stipulation.

12 JUDGE KASHI: So marked for purposes of
13 identification, and they are received into the record by
14 stipulation. Thank you, Mr. Simms.

15 (Whereupon, the documents were marked
16 as OTS Statement No. 2, including
17 Exhibit 2, and OTS Statement No. 2-SR for
18 identification and received in evidence.)

19 JUDGE KASHI: Mr. Gruber, do you want to stand and
20 raise your right hand and be sworn, sir?

21 Whereupon,

22 MICHAEL J. GRUBER

23 having been duly sworn, testified as follows:

24 JUDGE KASHI: Please be seated, sir.

25 Mr. DeBroff.

1 MR. DeBROFF: Thank you, Your Honor.

2 **DIRECT EXAMINATION**

3 BY MR. DeBROFF:

4 Q. Mr. Gruber, can you state your full name and
5 title with the Office of Trial Staff?

6 A. My name is Michael J. Gruber, and I am employed
7 as a valuation engineer in the Office of Trial Staff.

8 Q. Thank you. Have you prepared written direct
9 testimony and related exhibits for the purpose of this
10 proceeding?

11 A. I have.

12 MR. DeBROFF: Your Honor, I ask to be marked for
13 identification OTS Statement No. 1 and Exhibit No. 1 of
14 Michael J. Gruber, and also OTS Statement No. SR-1, the
15 surrebuttal of Michael J. Gruber.

16 JUDGE KASHI: So marked for purposes of
17 identification.

18 MR. DeBROFF: Thank you.

19 (Whereupon, the documents were marked
20 as OTS Statement No. 1, including OTS
21 Exhibit No. 1, and OTS Statement No. SR-1
22 for identification.)

23 MR. DeBROFF: And in accordance with our stipulation,
24 Your Honor --

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BY MR. DeBROFF:

Q. One other thing, Mr. Gruber. Your direct testimony and surrebuttal testimony, do you have any corrections to those two at this time?

A. I do not.

Q. Thank you.

MR. DeBROFF: Mr. Gruber is available for cross examination pending any timely motions and/or objections, Your Honor.

JUDGE KASHI: Pending any timely motions and/or objections, that which has been previously marked and identified as Statement 1 and Statement SR-1 will be received into the evidentiary record.

Mr. Russell?

MR. RUSSELL: Thank you, Your Honor.

CROSS EXAMINATION

BY MR. RUSSELL:

Q. Good morning, Mr. Gruber.

A. Good morning.

Q. My name is Paul Russell, I'm representing PP&L in this proceeding.

Mr. Gruber, could you turn to page 8 of your direct testimony? And I'm looking primarily at lines 7 through 14 on that page.

Is it your opinion that recovery of CTC revenues will

FORM 2

1 be risk free?

2 A. Yes.

3 Q. And this would be during the transition period;
4 is that right?

5 A. Yes.

6 Q. Have you considered any other risks that the
7 company might face during the transition period?

8 A. I was only looking at the risk involved with
9 recovery of the CTC.

10 JUDGE KASHI: Wait just one second. When you said
11 that the only risk that you looked at was the CTC, does that
12 imply to me that any of the other risks that the company
13 faces during a transition period do not reflect on or affect
14 the CTC recovery?

15 THE WITNESS: Yes.

16 BY MR. RUSSELL:

17 Q. But you have not looked at or considered any of
18 these other risks; is that correct?

19 A. No, I have not.

20 Q. When you used the phrase at lines 9 to 10,
21 "guaranteeing the company's profitability," were you using
22 that phrase only in the context of the risk-free nature, in
23 your opinion, of CTC recovery?

24 A. Yes.

25 Q. If you turn to page 10 of your direct, at lines

1 16 to 19, would it be your opinion that the average well-
2 informed investor would consider investment in PP&L's
3 recovery of stranded cost and investment in a nine-year
4 Treasury rate to be of equal risk?

5 A. Could you elaborate your question? I'm not quite
6 sure what you --

7 Q. What I'm trying to focus on is the discussion on
8 page 10 of having investors invest in PP&L. And I'm trying
9 to explore your opinion on relative risks between investment
10 in PP&L inherent in that recovery of stranded cost, as
11 compared to investment in a nine-year Treasury note. And
12 basically, I'm asking if you think an investor would
13 consider those risks to be comparable.

14 A. I'm not really concerned with what -- I'm not
15 sure what it would take for an investor to invest in PP&L.
16 I was concerned with the risk involved with recovery of the
17 CTC.

1 Q. Thank you, Mr. Gruber.

2 Could you turn to page 11, still in your direct? I'm
3 focusing now on just 18 and 19 on that page. Would you
4 agree that a number of different events could cause an
5 increase in the price of electricity?

6 A. Yes.

7 Q. And would you agree that one such event could be
8 an increase in the cost of fuel?

9 A. Yes.

10 Q. Could you assume for a minute that the price of
11 electricity increases because of an increase in the price of
12 fuel, and further assume that PP&L also experienced an
13 equivalent increase in its cost of fuel; and under those
14 assumptions, would you agree PP&L would not see an increase
15 in its profits associated with that increase in the price of
16 electricity?

17 A. That could happen, yes.

18 Q. Could you turn to page 17 of your direct,
19 please? Are you aware that PP&L in this proceeding has
20 calculated a total stranded cost claim of approximately
21 \$4.6 billion?

22 A. Yes, I am.

23 Q. And further, are you aware that PP&L has
24 calculated that it can recover only approximately \$4 billion
25 through rates under the rate cap?

1 A. Yes, I am.

2 Q. Would you agree that if the Commission accepts
3 PP&L's calculation of its stranded costs, then the company's
4 shareowners would be forced to absorb \$600 million of the
5 company's total claim?

6 A. If the company can only collect \$4 billion and
7 their stranded costs are \$4.6 billion, that's correct.

8 Q. Would you turn to page 20, still in your direct?
9 I'm looking -- let me give you a line cite -- specifically
10 the answer appearing at lines 4 to 13.

11 Is one of your reasons for --

12 A. Excuse me, did you say page 20?

13 Q. I'm sorry, yes. It's direct testimony, page 20,
14 lines 4 to 13, where you are discussing the sharing.

15 And my question there is, is one of your reasons for
16 proposing a sharing of stranded costs to provide an
17 incentive for PP&L to operate efficiently?

18 A. It's one of the incentives for PP&L to operate
19 more efficiently, yes.

20 Q. Would you agree with me that a fixed CTC
21 recovery level already provides PP&L with an incentive to
22 operate more efficiently?

23 A. Yes, because any savings they get after fixed
24 CTC would be profit for the company, yes.

25 Q. On page 21 now of your direct, the answer at

1 lines 4 to 7, is the take-or-pay buyout cost of long-term
2 supply contracts you reference there the result of the
3 Commission's policy statement on recovery of take-or-pay
4 costs?

5 A. I believe there was a policy statement, yes.

6 Q. Mr. Gruber, are you familiar with that policy
7 statement?

8 A. I know about it and I have read it, but it has
9 been a while, yes.

10 Q. If you know, did the policy statement give local
11 distribution companies the option of recovering through base
12 rates all take-or-pay costs that were demonstrated to be
13 prudently incurred?

14 A. The 90/10 sharing was a special provision for, I
15 don't remember what the type of filing was, but it was a
16 separate filing, yes. If they wanted to go for base rate
17 recovery, they could get 100 percent, yes.

18 Q. And if they elected not to go for base rate
19 recovery and accept 90 percent, they would avoid a prudence
20 review of the take-or-pay costs?

21 A. I believe that was part of the policy statement,
22 yes.

23 Q. On your surrebuttal, page 2, lines 1 to I guess
24 9 where you're discussing the true-up of the CTC, I just
25 want to try to clarify your understanding of the company's

1 proposal.

2 Is it your understanding the company is proposing to
3 extend the CTC to true up for shortfalls from what the
4 Commission authorizes the company to recover?

5 A. I don't believe that that's the company
6 position, no.

7 Q. Could you tell me what you understand the
8 company's position to be?

9 A. The extension of the CTC was primarily for the
10 decommissioning costs, I believe.

11 Q. And that's correct, that was one element. I'm
12 trying to focus on the reconciliation of the CTC.

13 A. The reconciliation of the CTC was done on an
14 annual basis between projected energy and actual energy.
15 The company projected how much they would collect based on a
16 projection of the amount of energy they sell. And if the
17 energy is different, then there's a true-up based on that.

18 Q. And is it your understanding that that true-up
19 is designed to true up back to the level of CTC recovery
20 authorized by the Commission in this proceeding?

21 A. Yes, it is.

22 Q. Still on page 2 of your surrebuttal, at line 17
23 is where the answer begins, carry over to the top of page 3,
24 you talk about the \$800 million cushion.

25 A. Yes.

1 Q. Is that \$800 million a total, in your
2 discussion, your testimony, a total over the transition
3 period? It's not an annual number, is what I --

4 A. No, it's total.

5 Q. Do you have a sense of what an annual number
6 would be equivalent to the \$800 million over the transition
7 period?

8 A. \$800 million divided by seven.

9 Q. Well, I think there would also be a discounting
10 factor, wouldn't there?

11 A. Yes, roughly maybe \$100 million. I'm not
12 exactly sure what it would be, no, on an annual basis.

13 Q. Would you accept, subject to check, it's about
14 \$150 million? Does that sound about right?

15 A. That sounds like it would be in the ballpark,
16 yes.

17 MR. RUSSELL: I have nothing else, Your Honor.

18 JUDGE KASHI: Thank you very much, sir.

19 Redirect, Mr. DeBroff?

20 MR. DeBROFF: One second, Your Honor.

21 (Pause.)

22 MR. DeBROFF: We have nothing, Your Honor.

23 JUDGE KASHI: Thank you very much. You are excused,
24 Mr. Gruber.

25 (Witness excused.)

1 JUDGE KASHI: That which has been marked and
2 identified as OTS Statement No. 1, SR-1 and Exhibit 1 are
3 received into the evidentiary record, without objection?

4 (No response.)

5 JUDGE KASHI: Without objection.

6 (Whereupon, the documents marked as
7 OTS Statements Nos. 1 and SR-1 and
8 OTS Exhibit No. 1 were received in
9 evidence.)

10 JUDGE KASHI: Mr. Simms?

11 MR. SIMMS: Thank you, Your Honor.

12 Your Honor, at this time, the Office of Trial Staff
13 calls to the witness stand Kevan L. Deardorff. He has not
14 been previously sworn.

15 JUDGE KASHI: Would you raise your right hand and be
16 sworn, sir?

17 Whereupon,

18 KEVAN L. DEARDORFF

19 having been duly sworn, testified as follows:

20 MR. SIMMS: Your Honor, pursuant to agreement, I ask
21 that the direct testimony of Mr. Deardorff be marked for
22 identification as OTS Statement No. 3. May it be so
23 identified?

24 JUDGE KASHI: So marked for purposes of
25 identification.

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(Whereupon, the document was marked as OTS Statement No. 3 for identification.)

MR. SIMMS: I ask that a separate document, exhibits, be marked for identification as OTS Exhibit No. 3. May it be so identified?

JUDGE KASHI: So marked for purposes of identification.

(Whereupon, the document was marked as OTS Exhibit No. 3 for identification.)

MR. SIMMS: I ask that the surrebuttal testimony of Mr. Deardorff be marked for identification as OTS Statement No. SR-3. May it be so identified?

JUDGE KASHI: So marked for purposes of identification.

(Whereupon, the document was marked as OTS Statement No. SR-3 for identification.)

MR. SIMMS: And contained in that surrebuttal testimony are exhibits, and I ask that they be marked for identification as OTS Exhibit No. SR-3. May it be so identified?

JUDGE KASHI: So marked for purposes of identification.

FORM 2

1 (Whereupon, the document was marked
2 as OTS Exhibit No. SR-3 for
3 identification.)

4 DIRECT EXAMINATION

5 BY MR. SIMMS:

6 Q. Mr. Deardorff, do you have any corrections to
7 make to your testimony or exhibits?

8 A. Yes, I have two minor corrections.

9 In the index of my direct testimony, the docket
10 number was incorrectly put at a P-docket. It should be an
11 R-docket, the second line.

12 And in my surrebuttal testimony on page 3, line 1,
13 the word "supplemental" should be "direct".

14 MR. SIMMS: Your Honor, with those corrections, I
15 would move for OTS Statement No. 3 and OTS Exhibit No. 3,
16 OTS Statement No. SR-3 and OTS Exhibit No. SR-3 into
17 evidence, subject to any any motions and cross-examination.

18 JUDGE KASHI: Subject to any timely motions and/or
19 objections made, pending cross-examination, that which has
20 been previously marked and identified will be received into
21 the evidentiary record.

22 MR. SIMMS: Mr. Deardorff is available for cross-
23 examination.

24 JUDGE KASHI: Thank you, Mr. Simms.

25 Mr. Kaplan?

1 MR. KAPLAN: Thank you, Your Honor.

2 CROSS-EXAMINATION

3 BY MR. KAPLAN:

4 Q. Good morning, Mr. Deardorff. My name is Donald
5 Kaplan. I'll be examining you this morning on behalf of
6 Pennsylvania Power and Light Company.

7 A. Good morning.

8 Q. Could you please refer to page 6 of your direct
9 testimony? Am I correct that for purposes of this
10 proceeding, you've accepted the company's proposed capital
11 structure ratios and the company's proposed cost of long-
12 term debt and preferred stock?

13 A. Yes, I have.

14 Q. Would you agree that the company has requested
15 an equity return of 11.5 percent in this proceeding?

16 A. Yes.

17 Q. Would you agree that your recommendation was
18 10.5 percent rate of return on equity in your initial
19 testimony, and 10.25 percent in your surrebuttal testimony?

20 A. Yes.

21 Q. Now, would you agree that the Commission
22 authorized the company cost of equity in its last base rate
23 case of 11.5 percent?

24 A. Yes; that is correct.

25 Q. Am I correct that you testified in the last base

1 rate case?

2 A. Yes, I did.

3 Q. Was your recommendation for the cost of common
4 equity 10.63 percent?

5 A. I'll accept that subject to check. I don't have
6 that in front of me at this time.

7 Q. Do you recall that the Commission determined
8 that the cost of common equity in that case was 11.5
9 percent?

10 A. Yes.

11 Q. Just doing the simple math, you would agree that
12 there was a difference between your recommendation in that
13 case and the rate adopted by the company; is that correct?

14 A. Yes.

15 Q. And that was some 87 basis points?

16 A. Yes; that is correct.

17 Q. Is it fair to say, based upon your
18 recommendation in the last base rate case and your
19 recommendation in this case, that you believe that the
20 company's cost of equity capital has declined 38 basis
21 points since the company's last rate case?

22 A. Yes; that is correct.

23 Q. Now, if we apply that 38 basis point reduction
24 in your recommendation in the last base rate case and your
25 recommendation in this case to the Commission's allowed rate

1 of return on equity in the last base rate case of 11.5
2 percent, would you agree that the indicated cost of equity
3 capital would be 11.12 percent?

4 A. As a mathematical exercise, that is correct.

5 Q. Do you recall testifying in a 1995 National Fuel
6 Gas case at Docket No. R-00953299?

7 A. I may have testified in that case, but I don't
8 remember every case.

9 MR. SIMMS: Do you have a copy of his testimony?

10 MR. KAPLAN: If I may approach, the witness, Your
11 Honor?

12 JUDGE KASHI: Show it to counsel first.

13 (Document shown to Counsel Simms.)

14 BY MR. KAPLAN:

15 Q. I'm going to show you a document which I believe
16 is your direct testimony in that docket. Will you just
17 confirm that, hold your finger at the page, and then I'll --

18 (Document handed to witness.)

19 A. Yes.

20 Q. Do you recognize that testimony?

21 A. Yes.

22 Q. Do you recall what your recommendation for the
23 cost of common equity was in that case?

24 A. Yes.

25 Q. What was that, sir?

1 A. My recommendation in that case for common equity
2 was 10.25 percent.

3 Q. Thank you.

4 Do you recall what the Commission decision was in
5 that case?

6 A. No, I do not, not offhand.

7 Q. Would you accept subject to check that it was 11
8 percent?

9 A. I'll accept that subject to check.

10 Q. Of course, we can determine that from the report
11 of the case.

12 And that would be 75 basis points higher than your
13 recommendation; is that correct?

14 A. That is correct.

15 Q. Now, at page 8 of your testimony, if we could
16 turn there, you summarize your 10.5 percent initial
17 recommendation and indicate that it's based on giving equal
18 weight to the results for PP&L and your barometer group; is
19 that correct?

20 A. Yes.

21 Q. Will you agree that the issue in this proceeding
22 is the cost of common equity capital of PP&L, not the cost
23 of common equity capital of the barometer group?

24 A. That is correct.

25 Q. Could you please refer to your Exhibit No. 3,

1 Schedule 5? Would you agree that the average result for
2 PP&L is 10.76 percent?

3 A. Yes; that is correct.

4 Q. Would you agree that referring to your indicated
5 cost of common equity capital for the barometer group -- I'm
6 sorry. Would you agree that the result for the barometer
7 cost of common equity is 10.49 percent?

8 A. That is correct.

9 Q. That would be the average?

10 A. Yes.

11 Q. Of course, your initial recommendation in this
12 case was 10.5 percent; is that correct?

13 A. Yes.

14 Q. Would you agree with me that the average, giving
15 equal weight to a 10.9 percent and a 7.76 percent cost of
16 common equity, would yield 10.625 percent, not 10.5 percent?

17 A. I'll accept your calculation, but that was not
18 the way I calculated it.

19 Q. You did not give equal weight?

20 A. I gave equal weight to my DCF result as I
21 reported it for PP&L and the average for the barometer
22 group, but as I explained in my direct testimony, I
23 disregarded the spot rate, the DCF result for PP&L based
24 upon the spot rate, because it was aberrant.

25 Q. So, therefore, you gave greater weight to the

1 barometer group?

2 A. No.

3 Q. You ignored some of the results for PP&L, but
4 you did not ignore those results for the barometer group?

5 A. I gave equal weight to the 10.43 percent, the
6 52-week average of PP&L, and the average 10.49 percent for
7 the barometer group.

8 Q. And you ignored some of the results for PP&L?

9 A. Just the 11.10 percent, because it was my
10 opinion that it was based upon aberrant data.

11 Q. Please turn back to page 12 of your direct
12 testimony. Now, you assert that, overall, the three
13 indicators in the investment risk you analyzed indicate that
14 PP&L has slightly lower investment risk in comparison to
15 your barometer group; is that correct?

16 A. Yes.

17 Q. Now, lower investment risk should mean lower
18 cost of common equity capital, all else being equal; is that
19 correct?

20 A. Yes.

21 Q. Your own analysis indicates that PP&L's cost of
22 common equity is higher than that of your barometer group;
23 is that also true?

24 A. Yes, but it must be understood, when I qualified
25 it I said slightly. When you get to the point where you're

1 dealing in just hundredths, rounding error could make the
2 difference in being either slightly lower investment risk or
3 slightly higher investment risk. And the same way with the
4 close proximity of the DCF results to the mean; the
5 variation is very small.

6 Q. So you looked at the results and then exercised
7 some judgment on top of the results, mathematical results?

8 A. Yes.

9 Q. Your own personal judgment.

10 A. Yes.

11 Q. Now, if we could turn to page 34 of your direct
12 testimony -- not 34. I don't have the correct reference,
13 but would you agree, Mr. Deardorff, that in your direct
14 testimony you criticize Mr. Moul's barometer group selection
15 in part because PP&L has 31 percent nuclear capacity whereas
16 his barometer group has only 15 percent?

17 A. Yes.

18 Q. And would you agree that your barometer group
19 has nuclear exposure of 49 percent?

20 A. That is correct.

21 Q. Would you agree that a nuclear exposure of
22 nearly half the company's generating assets is a qualitative
23 difference than a nuclear exposure of less than a third?

24 A. Could you repeat the question, please?

25 Q. Would you agree that the exposure to the risks

1 and costs of operating nuclear plants when they constitute
2 nearly half of the company's generating assets is of a
3 qualitatively significant difference than exposure of under
4 one-third?

5 MR. SIMMS: I'm going to object, Your Honor, to the
6 simple form of the question. Could you --

7 MR. KAPLAN: I'll rephrase it, if you would like me
8 to rephrase the question.

9 MR. SIMMS: Yes; rephrase it, please.

10 (Pause.)

11 MR. KAPLAN: Your Honor, we have no further
12 questions. I will withdraw the question at this time.

13 JUDGE KASHI: Thank you very much, sir.

14 Redirect, Mr. Simms?

15 MR. SIMMS: Can I have a brief moment, Your Honor?

16 JUDGE KASHI: Sure.

17 (Discussion off the record.)

18 JUDGE KASHI: Back on the record.

19 Redirect, counsel?

20 MR. SIMMS: Thank you, Your Honor. I do have a few
21 on redirect.

22 **REDIRECT EXAMINATION**

23 BY MR. SIMMS:

24 Q. Mr. Deardorff, do you recall Mr. Kaplan's series
25 of questions regarding your reference to slightly lower

1 investment risk which is set forth on page 12 of your direct
2 testimony?

3 A. Yes, I do.

4 Q. For the record, can you clarify your intent of
5 what you mean by "slightly"?

6 A. I had to say slightly because the averages
7 indicate that there is slightly lower investment risk;
8 however, on further examination of the actual data on
9 Exhibit No. 3, Schedule No. 3, most of the data there
10 indicates that the investment risk is almost identical. The
11 only one that does indicate slightly lower investment risk
12 is the safety rank, and as I pointed out, the rounding error
13 involved with that could possibly put PP&L above the average
14 number for the barometer group; therefore, you would have to
15 consider that in these qualitative type of statements.

16 Q. Mr. Deardorff, do you recall a series of
17 questions by Mr. Kaplan regarding Commission orders in cases
18 in which you made a recommendation for rate of return
19 analysis?

20 A. Yes.

21 Q. Could you give us one recent Commission order in
22 which you testified that the Commission may have adopted
23 your recommendation?

24 A. Yes. The orders that Mr. Kaplan highlighted
25 were rather dated. The more recent case that I testified in

1 was the PECO QRO hearing, and the Commission decided that 10
2 percent on equity was the most correct. That was the cost
3 of equity that I testified to.

4 Q. What's the docket number of that case?

5 A. That was Docket No. R-00973877.

6 Q. And just for the record, Mr. Kaplan made a
7 reference to a National Fuel Gas Company case. What's the
8 docket number for that particular case?

9 A. That was Docket No. R-00953299.

10 MR. KAPLAN: I'm sorry; 29?

11 THE WITNESS: 299.

12 MR. KAPLAN: Yes.

13 MR. SIMMS: Thank you, Mr. Deardorff.

14 That concludes my redirect, Your Honor.

15 JUDGE KASHI: Thank you very much, sir.

16 Mr. Deardorff, you are excused, sir.

17 (Witness excused.)

18 JUDGE KASHI: That which has been marked and
19 identified as OTS Statement No. 3, Exhibit 3, Statement SR-3
20 and Exhibit SR-3 are received into the evidentiary record,
21 without objection?

22 (No response.)

23 JUDGE KASHI: Without objection. Thank you very
24 much, sir.

25

1 (Whereupon, the documents marked as
2 OTS Statements Nos. 3 and SR-3 and
3 OTS Exhibits Nos. 3 and SR-3 were
4 received in evidence.)

5 JUDGE KASHI: I believe that concludes our day. I'm
6 not quite sure how I want to handle this, but our normal
7 custom and habit has been to recess and come back at 1:30.
8 Since we have in fact concluded the hearing for today, and I
9 have directed the intervenors to have a settlement
10 conference for the purposes of developing a unified proposal
11 to be able to submit to the company, I guess it's going to
12 be up to the intervenors as to when they want to come back.
13 I will tell you that I will keep myself available from 2:30
14 on this afternoon should anyone wish to discuss some
15 thoughts, I guess, as to where things are.

16 One second.

17 (Pause.)

18 JUDGE KASHI: Hearing Room 1 will be available for
19 you, so you can have your discussions over there.

20 There's a couple of things that I want to say, and
21 they go without saying, since I'm not going to come in there
22 to convene the matter. One is I expect lead counsel to
23 perform the coordinating roles in trying to get this thing
24 together. If any counsel who is not here has aberrant
25 objection about lead counsel, you will cite to them 52 Pa.

1 Code 5.76, which I cited yesterday.

2 You are all participating in an historic event, which
3 goes without saying, and I'm not saying that to you in any
4 manipulative type of manner other than the fact that I want
5 you to keep that uppermost in your mind. I think that
6 personally, while the matter can absolutely be resolved by
7 litigation -- there's no question; we all know that -- that
8 the best results will probably come from a collaborative
9 effort of all the interests that are involved here. I
10 consider all the interests of the Commonwealth to be fairly
11 represented by the groups that are present in this case.
12 With that said, I think that the result that could come out
13 of such a group would be in the best interest of our
14 constituency, that being the citizens of Pennsylvania, not
15 necessarily each and every one of your constituency.

16 There is obviously a disproportionate sharing of
17 power among the intervenors, if I want to put it that way.
18 We range from Mr. Epstein to Enron. Mr. Epstein obviously
19 cannot place an ad on the Super Bowl. But I don't think
20 that in approaching this that anybody should be thinking
21 that we can advertise our way into a settlement or we can
22 advertise our way against a settlement which is the
23 consensus of the parties. I understand and I'm fully
24 cognitive of the fact that we're dealing with non-regulated
25 corporate entities who play the game differently. There's

1 just no question about that. The instincts are different
2 than the instincts of those who have been groomed and combed
3 through the regulatory process for a number of years. I'm
4 going to ask that you try to temper those instincts, because
5 my bottom line in this is I genuinely want to see this as
6 the Governor and the legislature, and I know as all of you
7 want to see this thing off the ground and moving. My
8 greatest concern is that a litigated effort isn't going to
9 get it off the ground as well as a collaborative effort on
10 your part. I don't want to see this thing in the courts for
11 five years, and I don't want to see a partial settlement
12 like I saw out of PECO.

13 While, granted, there are things that I believe
14 cannot be settled by you people, I believe there are things
15 that should be put into generic proceedings, and I mentioned
16 some of those yesterday. I think that reasonable people can
17 come to a reasonable result without having to be outriders
18 and not on board. You know the saw about the thousand mile
19 journey beginning with the first step, well, the thousand
20 mile journey beginning with the first step goes a lot
21 quicker if we all take the step in the same direction.

22 With that in mind, I will adjourn -- yes, sir, Mr.
23 Kleppinger?

24 MR. KLEPPINGER: Your Honor, I appreciate all of
25 those comments, and I'm anxiously awaiting our discussion

1 this afternoon, but there is a concern that I would like to
2 bring to your attention. There's a variety of parties and
3 intervenors in this case, some of whom have put on
4 substantial formal testimony, others have not, some have
5 conducted cross-examination, some have not; some have done
6 neither. The complication that I see this afternoon is
7 having an open dialogue among the intervenors who have, for
8 lack of a better word, forced the issues in this case when
9 other intervenors may attend that meeting who have cases
10 pending before this Commission, under the same statute,
11 litigating many of the same issues. For my client, I cannot
12 have as open of a dialogue for settlement purposes with
13 those entities in the room; it will have a chilling effect
14 on the openness of the negotiations.

15 JUDGE KASHI: Then I would suggest that you ask them
16 to leave if you're going to talk to the other parties. A
17 conference doesn't necessarily have to be each and every
18 person sitting there in the room talking down the same page,
19 as opposed to a group here and a group there and working it
20 to an ultimate kind of conclusion.

21 MR. KLEPPINGER: The reason I'm bringing it up is
22 that the order directed all intervenors, and I didn't want
23 those other entities to feel they were violating that order
24 if they were excluded from the process.

25 JUDGE KASHI: I understand. I understand. Let me

1 say, I have been informed by Mr. Nordstrom from Allegheny
2 Power that they will not be participating; that they, in
3 fact, have spoken with the Office of Consumer Advocate; that
4 they were directed by their client to return to Washington;
5 and that they anticipate the coordination effort that they
6 will pursue with the other utility companies. So I would
7 expect, perhaps, we will not see any other utility companies
8 at that conference.

9 Obviously, I think that in the role of lead counsel,
10 we all know who's been pushing this thing and who's been
11 taking it, and we all know the people that are just hanging
12 on to the case, for lack of a better word, while claiming to
13 maintain active status. I would hope that -- you can
14 communicate this to whoever you will; that in fact I am
15 leaning to the lead counsel and those people who have
16 directly participated throughout this two-week process and
17 have not sat back and just waited to throw in a particular
18 position. Obviously, any kind of unified proposal has to be
19 rather general, because if it's not rather general, we're
20 not going to be able to encompass all of the positions that
21 I've read by all of the parties in the testimony that has
22 been presented.

23 Again, in that vein, I think the question comes down
24 to the ability to get it going and tinker with it along the
25 way, as opposed to trying to cross the t's and dot the i's

1 immediately. We all know that's not going to work, that's
2 not a secret, and I don't feel badly about making that kind
3 of statement on the record; it's just not going to work that
4 way. I could get a ten-foot whip and it wouldn't work that
5 way. There are sincere differences here; it's just a major
6 change in the way things are going. But again, I think if,
7 in fact, we all make one step in the right direction towards
8 this, we can -- what are we talking about, seven years here?
9 By the time seven years are done, we may have this thing
10 right. But I don't expect to have it right when I submit my
11 decision; if I do the decision by November 13 fully
12 litigated, it's not going to be right, I know that, and it's
13 not going to be right if, in fact, some of the intervenors
14 put their interests ahead of the entire citizenry of
15 Pennsylvania and the wishes of the legislature and the
16 Governor and decide that they have sufficient resources to
17 be able to conduct an advertising campaign to get their will
18 across by revisiting the legislature, for all I know. I
19 don't think that would be helpful at all.

20 I will, once again, conclude. I guess the question
21 is: when are you guys going to get back together again?
22 I'm going to submit an appearance sheet to -- I'll give it
23 to you, Mr. Kleppinger, and it can be passed around, because
24 I would like to see who's in attendance. So you can call it
25 for -- do you guys want to come back at 1:30, it's now ten

1 after 12:00, or --

2 MR. KLEPPINGER: One thirty is fine.

3 JUDGE KASHI: We will adjourn this hearing. The
4 intervenor settlement conference will begin at 1:30 in
5 Hearing Room No. 1. I will make myself available for
6 whatever reasons the parties might think are necessary after
7 2:30, and we will reconvene the hearing tomorrow morning
8 at -- can we sleep till 10:00?

9 MR. RUSSELL: I think so, Your Honor.

10 JUDGE KASHI: We will convene at 10:00 tomorrow
11 morning in Hearing Room No. 2 to conclude the hearing.

12 Thank you very much, counsel.

13 (Whereupon, at 12:12 p.m., the hearing was adjourned,
14 to be reconvened at 10:00 a.m., on Friday, August 29, 1997,
15 in Harrisburg, Pennsylvania.)

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C E R T I F I C A T E

I hereby certify, as the stenographic reporter, that the foregoing proceedings were taken stenographically by me, and thereafter reduced to typewriting by me or under my direction; and that this transcript is a true and accurate record to the best of my ability.

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FORM 2

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