PENNSYLVANIA PUBLIC UTILITY COMMISSION
HARRISBURG, PENNSYLVANIA 17105

	PUBLIC MEETING August 8, 2002 **AUG-2002-OSA-245* thru OSA-251***
PPL Electric Utilities Corporation	**Docket Nos. R-000168850C0001**
Pennsylvania Power Company	**R-00016851C0001**
Metropolitan Edison Company	**R-00016852C0001**
Pennsylvania Electric Company	**R-00016853C0001**
Duquesne Light Company	**R-00016854C0001**
PECO Energy Company	**R-00016856C0001**
West Penn Power Company	**R-00016857C0001**

CONCURRING STATEMENT OF COMMISSIONER TERRANCE J. FITZPATRICK

These proceedings involve the complaints filed by the Office of Consumer Advocate (OCA) against the requests of the above-named electric utilities to recover increased state tax liability pursuant to 66 Pa. C.S. §2804(16). Administrative Law Judge (ALJ) Wayne Weismandel issued Decisions in which he recommended dismissing the complaints. Exceptions were filed by certain parties, mainly OCA and groups of industrial customers. The Office of Special Assistants (OSA) now recommends that we deny these Exceptions and dismiss the Complaints. I agree with the OSA recommendations.

In my view, the ALJ and OSA are correct in concluding that the issues raised here fall outside the scope of a "single issue rate case" under 66 Pa. C.S. §2804(16). This conclusion is based upon a legal interpretation of the statute. It is unfortunate, however, that the Commission did not reach this conclusion three months ago when the legal issue was ripe for decision in the context of OCA's "Petition for Review of and Answer to a Material Question." If the Commission had addressed the legal issue then, as I argued that it should, everyone involved would have been spared the time and expense associated with the additional hearings, briefs, etc. Since the purpose of a trial-type hearing is to resolve factual issues[1], and our decision in this case turns on a legal issue, the additional proceedings over the past few months have not served any useful purpose.

In the future, I hope that the Commission makes administrative efficiency a higher priority.

DATED: **August 8, 2002**

Terrance J. Fitzpatrick
Commissioner

[1] *See e.g., Diamond Energy Company v. Pa. Public Utility Commission*, 653 A.2d 1360 (Pa. Commw. 1995).

PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17105-3265

Public Meeting held August 8, 2002

Commissioners Present:

Glen R. Thomas, Chairman
Robert K. Bloom, Vice Chairman
Aaron Wilson, Jr.
Terrance J. Fitzpatrick, Statement attached
Kim Pizzingrilli

Office of Consumer Advocate R-00016856C0001

v.

PECO Energy Company

OPINION AND ORDER

BY THE COMMISSION:

Before the Commission are the Exceptions filed by the Office of Consumer Advocate (OCA) and the Philadelphia Area Industrial Energy Users Group (PAIEUG) to the Recommended Decision (R.D.) issued on July 16, 2002, by Administrative Law Judge (ALJ) Wayne L. Weismandel. Timely Replies to Exceptions have been filed by PECO Energy Company (PECO or Company).

History of the Proceeding

On October 29, 2001, PECO filed a Petition to increase its State Tax Adjustment Surcharge (STAS) pursuant to Section 2810 of the Public Utility Code

(Code), 66 Pa. C.S. §2810, to permit PECO to recover increased Revenue Neutral Reconciliation (RNR) tax liability. The proposed increase in rates had the effect of increasing the Company's rates above the rate cap established in Section 2804(4) of the Code, 66 Pa. C.S. §2804(4), for certain retail rate schedules.

Petitions to Intervene in this proceeding were filed by by the Office of Small Business Advocate (OSBA), PAIEUG and the Mid-Atlantic Power Suppliers Association (MAPSA). On November 19, 2001, the OCA filed a Complaint against the Company's Petition.

By Order entered December 21, 2001, we approved, as modified, the Company's Petition and rejected a settlement proposed by the Parties. In that Order, it was expressly stated that approval of the Company's rates at that time did not preclude this Commission from "considering the further issues raised" in the OCA's November 19th Complaint. (Order entered December 21, 2001 at PUC Docket No. R-00016856, p. 4). At that time, we directed that the OCA's Complaint be adjudicated within sixty days. In that Order, we also granted intervention in the Complaint proceeding by the OSBA, MAPSA, and PAIEUG.

By Secretarial Letter dated January 3, 2002, we advised the Parties that the time frame for consideration of the OCA's November 19th Complaint would be extended until February 21, 2002. Also in January of 2002, the OCA and PAIEUG filed Petitions for Review in the Pennsylvania Commonwealth Court seeking review of our Order of December 21, 2001. Those Petitions for Review were quashed by the Commonwealth Court on March 21, 2002, and jurisdiction was returned to this Commission.

On April 15, 2002, the OCA filed a Petition for Review of and Answer to a Material Question. That Petition was filed in response to an earlier ruling by the ALJ

regarding the scope of these proceedings and related discovery requests. The ALJ had limited the scope of these proceedings to the information required to be filed by the applicant requesting RNR adjustments under 52 Pa. Code §§54.95(c), 54.97(a) and 54.97(b)(1).

By Order entered May 9, 2002, we granted, in part, the OCA's Petition (Material Question Order). Pursuant to the Material Question Order, the OCA was given latitude to explore the Company's quarterly earnings data. However, we expressly declined to rule on the relevance of such data to proceedings brought under Section 2804(16)(ii) of the Code. We also determined that the ALJ properly limited inquiries into potentially offsetting tax savings to 2001 tax savings and barred the exploration of other expense issues. The Material Question Order further provided for a litigation schedule for the proceeding.

After the receipt of written testimony and evidentiary hearings, the ALJ issued his Recommended Decision on July 16, 2002. In that Recommended Decision, the ALJ recommended a finding that the earnings data introduced by the OCA into these proceedings are not relevant to a Section 2804(16)(ii) proceeding. The ALJ also recommended an over-all determination that the record before him was insufficient to justify altering this Commission's previous determination that the rates proposed by the Company are just and reasonable. Accordingly, the ALJ dismissed the OCA's November 19, 2001 Complaint.

Timely Exceptions were filed by the OCA and PAIEUG. Replies to Exceptions were filed by PECO on July 30, 2002.

Discussion

We note that we are not required to consider expressly or at great length each and every Exception raised by a party to a proceeding. *University of Pa. v. Pa. P.U.C.*, 86 Pa. 410, 485 A.2d 1217, 1222 (1984). Any Exception or argument that has not been specifically addressed herein shall be deemed to have been duly considered and denied without further discussion.

Prior to addressing the specific Exceptions of the OCA and PAIEUG, it will be helpful to quote the Public Utility Code section which is at the heart of this proceeding. Section 2804(16)(ii) of the Code provides as follows:

> Section 2804. Standards for restructuring of the electric industry
>
> The following interdependent standards shall govern the commission's assessment and approval of each public utility's restructuring plan, oversight of the transition process and regulation of the restructured electric utility industry:
>
> * * * * *
>
> (16) The following shall apply:
>
> * * * * *
>
> (ii) With regard to any portion of the change in an electric distribution company's tax liability under section 2810 [relating to RNR] which would cause it to exceed the rate cap, the electric distribution company may file a single issue rate proceeding under section 1308(a) to recover that amount. The commission shall adjudicate, within 60 days, whether the resulting rates are just and reasonable.

Section 2810 of the Code provides for "revenue-neutral reconciliation" which is known as "RNR." As noted by the Parties and the ALJ in this action, PECO's RNR filing is one of several filings by electric distribution companies (EDCs). This is the first series of these proceedings to come before the Commission under Section 2804(16)(ii) of the Code.

The General Assembly has expressed its intent with regard to the RNR process in Section 2810(a) of the Code which reads as follows:

> It is the intention of the General Assembly that the restructuring of the electric industry be accomplished in a manner that allows Pennsylvania to enjoy the benefits of competition, promotes the competitiveness of Pennsylvania's electric utilities and maintains revenue neutrality to the Commonwealth. This section is not intended to cause a shift in proportional tax obligations among customer classes or individual electric companies. It is the intention of the General Assembly to establish this revenue replacement at a level necessary to recoup losses that may result from the restructuring of the electric industry and the transition thereto.

As we review the Exceptions of the Parties and the Recommended Decision, the foregoing legislative intent must be kept in mind. We read this intent as a fairly simple concept. The proportionate tax obligations of the electric distribution utilities will not change as a result of the advent of competition into the energy industry. Similarly, the rate caps in place pursuant to Chapter 28 of the Code may be adjusted, when necessary, pursuant to Section 2804(16) to ensure that electric distribution utilities collect appropriate revenues, through rates, to satisfy their state tax obligations as set forth in Section 2810.

While the OCA and PAIEUG have each filed Exceptions, PAIEUG's Exceptions mirror the OCA's first, second and fourth Exceptions. We will review PAIEUG's Exceptions in conjunction with our discussion of those of the OCA.

OCA Exception No. 1, PAIEUG Exception No. 3.

The OCA's first Exception cites error in the standard used by the ALJ. According to the OCA, the ALJ erred by using a standard limited to a review of the information that is required to be provided under 52 Pa. Code §§54.95(c) (relating to recovery of RNR tax liability), 54.97(a) (calculation of surcharge related to RNR tax liability) and 54.97(b) (relating to STAS filings). The OCA argues that the ALJ engaged in a simple computational review which resulted in an automatic pass-through of calculated tax liability. The OCA states that this analysis ignores the express language of the Code and fails to give meaning to all the words of the statute. (OCA Exc., p. 5).

To support its argument, the OCA describes Section 2804(16) of the Code as a three-part provision. Section 2804(16)(i) governs RNR recovery that does not cause an EDC to exceed the rate cap. The OCA places significance on the fact that Section 2804(16)(i) does not require an EDC to file a single-issue rate case or mandate a specific adjudication regarding the justness and reasonableness of the RNR charge. Also, the OCA notes that Section 2808(16)(i) references the STAS regulations when addressing a utility's ability to increase rates up to the level of its rate cap. (*Id.*, pp. 5-6).

The OCA contrasts Section 2804(16)(i) with Section 2804(16)(ii) and noted that the latter Section does not permit an EDC to utilize an automatic adjustment clause such as the STAS or Section 1307 when RNR recovery would move an EDC above its rate cap. Section 2804(16)(ii) requires this Commission to adjudicate whether the

resulting rates above the rate cap are just and reasonable. The OCA finds that the absence of any reference to the STAS provisions is notable. (OCA Exc., p. 6).

The OCA next examines Section 2804(16)(iii) which relates to the obligation of an EDC to remit taxes for retail customers if a retail customer's electric generation supplier (EGS) fails to pay the tax. In that Section, the OCA points out that if the EDC has pursued all indemnification measures called for by the Code, it may seek recovery of its resulting tax liability without filing a single-issue rate proceeding. According to the OCA, the distinction between the Sections which do not require a single-issue rate proceeding and the one that does is significant. (OCA Exc., p. 7).

The OCA points out that there is no requirement for a single-issue rate proceeding and a just and reasonable adjudication when an EDC does not propose to move above the rate cap or is recovering liability stemming from tax indemnification. The single issue rate case and just and reasonable determination is required only when an EDC proposes to increase rates above the rate cap without incurring the liability for indemnification. The OCA argues that the difference in treatment is meaningful and clearly shows that the General Assembly did not intend that RNR recovery, above the rate cap, was meant to be a simple flow through exercise. (OCA Exc., pp. 7, 8).

The OCA states that the rules of statutory construction require that the Code be "interpreted to give meaning to the language of the Act and to recognize these distinctions in the Act so that the intent of the General Assembly is properly carried out." According to the OCA, if we permit the Company to increase rates above the rate cap based upon compliance with our regulations at 52 Pa. Code §§54.95(c), 54.97(a) and 54.97(b), we will have eliminated the statutory language calling for a single issue rate proceeding and an adjudication of the resulting rates as just and reasonable. (*Id.*, p. 8).

PAIEUG offers an abbreviated version of the OCA reasoning in its third Exception. According to PAIEUG, the ALJ determined that PECO's proposed rates were just and reasonable merely because he determined that they were known and measurable. PAIEUG argues that a just and reasonable determination requires an examination of a utility's rate of return. (PAIEUG Exc., pp. 6-7).

PECO Reply

PECO argues that the OCA's position in this case is factually incorrect because it assumes that the Company's entire claim which falls above the rate cap was designed to be recovered through the STAS mechanism. According to PECO, only the transition cost component of the claim was included in the STAS mechanism. PECO asserts that the energy/capacity rate component was reflected in a base rate change designed as a pro-competitive "shopping credit" increase. (PECO R.Exc., p. 6).

PECO argues that its claim is consistent with the Commission's regulations at 52 Pa. Code §54.91, et seq., which establish the process for RNR recovery under Section 2804(16)(ii) of the Code. PECO asserts that while its claim is made in the context of Section 1308(a) of the Code, there is nothing special about the STAS mechanism that would prevent its use in the context of a Section 1308(a) proceeding. (PECO Exc., p. 6-7).

PECO also argues that while the OCA characterizes the ALJ's Recommended Decision as using the STAS mechanism as an automatic pass-through, the simple fact is that the OCA failed to raises any substantial, relevant issue in the case. Since the OCA only raised two issues, rate of return and tax offsets, and those issues were properly determined to be irrelevant, the Recommended Decision may appear to be a "pass through" but that is because no legitimate objection was raised. (PECO Exc., pp. 7-8).

Disposition

We will deny both the OCA's first Exception and PAIEUG's third Exception. We agree with the ALJ's reasoning on the appropriate standard to be applied in this proceeding. As noted by the ALJ, Section 2804(16)(ii) provides for the limited scope of this proceeding.

The OCA's first Exception is an introduction for the Exceptions that follow which relate to consideration of rate of return and offsetting tax savings. This first Exception stresses the OCA's argument that the ALJ has failed to properly use a "just and reasonable" standard as required by the Section 2804(16)(ii) by engaging in a pass-through type of analysis. (OCA Exc., p. 5).

At page 12 of the Recommended Decision, the ALJ stated the following:

> The proceeding contemplated by the applicable statutory provisions is of limited and narrowly focused scope. Any non-general rate case is less sweeping in issues to be considered than a general rate case. *Cf.*, *Popowsky v. PA PUC*, 683 A.2d 958 (Pa. Cmwlth. 1996), *cert. denied*, 543 Pa. 733, 673 A.2d 338 (1996). A single issue rate proceeding is the most strictly limited type of a non-general rate case.

The ALJ observed that this Commission possesses a great deal of flexibility in our ratemaking function. The ALJ quoted *Popowsky v. Pa.PUC*, 542 Pa. 99, 665 A.2d 808 (1995) as follows:

> In determining just and reasonable rates, the PUC has discretion to determine the proper balance between interests of rate-payers and utilities. *Pennsylvania Public Utility*

Commission v. Philadelphia Electric Co., 522 Pa. 338, 342-43, 561 A.2d 1224 (1989). As this Court stated in *Pennsylvania Public Utility Commission v. Pennsylvania Gas and Water Co.*, 492 Pa. 326, 337, 424 A.2d 1213, 1219 (1980), *cert. denied*, 454 U.S. 824, 102 S.Ct. 112, 70 L.Ed.2d 97 (1981),

> There is ample authority for the proposition that the power to fix "just and reasonable" rates imports a flexibility in the exercise of a complicated regulatory function by a specialized decision-making body and that the term "just and reasonable" was not intended to confine the ambit of regulatory discretion to an absolute or mathematical formulation but rather to confer upon the regulatory body the power to make and apply policy concerning the appropriate balance between prices charged to utility customers and returns on capital to utility investors consonant with constitutional protections applicable to both.

Popowsky, 542 Pa. 99, 107-108, 665 A.2d 808, 812.

From the foregoing, it is clear that we are not restricted to a single, formulaic exercise when we pursue our ratemaking function. Clearly, the OCA and PAIEUG are challenging the meaning of a single issue rate case as that term is used in Section 2804(16)(ii). We will address the OCA's and PAIEUG's specific arguments regarding rate of return and offsetting tax liabilities below. However in the context of the OCA's and PAIEUG's Exception on this point, their arguments clearly push for more than a single issue rate proceeding. The approach taken by the ALJ in this case was appropriate and conformed to the statutory guidelines for this proceeding as expressed in Section 2804(16)(ii) of the Code.

We also agree with PECO that the OCA and PAIEUG could have raised several objections to the filing had there been record evidence to support those objections.

(*See*, PECO Exc., pp. 7-8). Thus, what may appear to be an automatic pass-through by use of the STAS mechanism is actually an approval of the filing because there has been no relevant and supported objection raised.

OCA Exception No. 2, PAIEUG Exception No. 2

The OCA's second Exception argues that the ALJ erred when he refused to examine offsetting tax savings which have occurred since the rate caps were established. In his Recommended Decision, the ALJ only permitted an examination of those changes which occurred for 2001. According to the OCA, the ALJ concluded "that changes in actual taxes paid have either flowed through in prior year STAS adjustments or were otherwise irrelevant." (OCA Exc., pp. 8-9).

The OCA begins its discussion of this Exception by pointing out that the RNR is designed to "keep the Commonwealth's tax revenue whole as restructuring was implemented in the Commonwealth." (OCA Exc., p. 9). The RNR baseline was established based upon actual cash payments of taxes by electric distribution utilities for the 1995-1996 tax year "with the intent that this tax revenue level, adjusted for load growth, be maintained." (*Id.*). However, the OCA argues that there could be many changes in the actual state taxes paid by an EDC from the time when the rate caps were established or since the Electricity Generation Customer Choice and Competition Act (Act), 66 Pa.C.S. §§2801, et seq., was enacted. Despite those changes in actual taxes paid, the OCA asserts that those changes may not have been reflected in STAS adjustments because STAS adjustments relate to tax rates, not taxes paid. Thus, the OCA argues that to the extent the ALJ relied on a theory that STAS adjustments would have reflected prior tax changes, the Recommended Decision is incorrect. (OCA Exc., p. 9).

According to the OCA, in order to determine whether an increase above the rate cap is warranted, it is necessary to consider all changes in state tax liability since the Act went into effect. The OCA states that the rate caps set under the Act reflected all state taxes paid by the EDCs when the caps were established. Since those rate caps reflected all state taxes paid, the OCA argues that a single-issue rate proceeding designed to determine whether the rate caps should be adjusted for taxes must include an analysis of the changes in all state taxes, not just the RNR tax. (OCA Exc., p. 10).

The OCA cites to *Popowsky v. Pa. PUC*, 683 A.2d 958 (Pa. Cmwlth 1996) *(Equitable)* for the proposition that a single issue rate case involving taxes should consider more than just the tax involved. In *Equitable*, the OCA states that the Commonwealth Court upheld a Commission decision which approved a rate increase for Equitable Gas Company solely to recover an increase in SFAS expense because we had also considered offsetting savings and Equitable's rate of return. The OCA argues that *Equitable* supports its position here because we considered "all savings in health care costs and other post employment expenses, and not just changes in the SFAS 106 expense when considering the single issue." (OCA Exc., pp. 10-11).

The OCA also argues that the magnitude of the changes in actual taxes paid by the EDCs is relevant. Although the OCA does not reference changes in PECO's liability, it describes reductions in state taxes paid by Metropolitan Edison, Pennsylvania Electric Company and Duquesne Light Company as examples of companies that have experienced significant reductions in taxes paid. The OCA then reiterates its concern that not all of those tax reductions have flowed through to rate payers in prior year STAS adjustments because they have not all been the result of changes in tax rates. (*Id.*, p. 11).

According to the OCA, if this issue is restricted to mathematical computations of RNR tax changes, there is no need for a single issue rate proceeding or a just

and reasonable determination as set required by the statute. If that were the intent of the General Assembly, the OCA argues that there would be no distinction for RNR changes resulting in rates above the rate cap and rates within the rate cap. (OCA Exc., pp. 11-12).

In its last point under this Exception, the OCA argues that the ALJ erred in concluding that even if offsetting tax savings were to be considered, the STAS mechanism would have already flowed those savings through to ratepayers. The OCA notes that the ALJ correctly determined that the STAS mechanism is intended to permit an EDC to recover increased tax expenses that result from tax law changes which occur between base rate cases. However, the OCA asserts that the ALJ erred by failing to recognize that EDC taxes are driven not only by tax rates (which are picked up by STAS adjustments), but also by changes in the tax base on which the tax rate is applied. The STAS does not reconcile to actual taxes paid; it only goes to whether an EDC has collected its prior estimate of tax liability. Accordingly, the OCA argues that the STAS mechanism is not designed to and has not reconciled to actual taxes paid and, therefore, will not have acted to flow through offsetting tax savings to ratepayers as suggested by the ALJ. (OCA Exc., pp. 13-14).

PAIEUG echoes the OCA's argument that the ALJ has erroneously relied upon STAS adjustments as a means for offsetting tax savings to have flowed through to consumers. PAIEUG notes that the tax offsets it argues for involve taxes paid. STAS reconciliations merely reflect tax rates. According to PAIEUG, the single issue rate proceeding should encompass all changes in an EDC's state tax liability. (PAIEUG Exc., p. 6).

PECO's Reply

PECO rejoins that the OCA's Exception which calls for examination of a utility's entire state tax liability since implementation of electric restructuring in

Pennsylvania conflicts with the plain language of Section 2804(16)(ii). That Section simply calls for the single issue examination of that portion of an EDC's RNR claim which results in rates above the rate cap and whether the resulting rates are just and reasonable. In addition, PECO argues that the examination of prior years' tax experience for the purpose of recalculating that tax expense in order to adjust present rates constitutes retroactive ratemaking, which is not permitted. PECO cites to *Philadelphia Electric Company v. Pa. PUC*, 502 A.2d 722 (Pa. Cmwlth. 1985), for that proposition. (PECO R.Exc., pp. 8-11).

Disposition

In our Material Order, we ruled that only evidence concerning contemporaneous tax savings would be considered. (Material Order, p. 9). Based upon our view of the record and the arguments of the Parties, as well as Section 2804(16)(ii) of the Code, it is clear that a review of other years' taxes would take this proceeding far beyond the limited, single issue proceeding envisioned. We also agree with the ALJ that the 60 day time frame established by the statute provides guidance on the scope of this proceeding.

The ALJ is correct that this is a narrowly focused, single issue proceeding. In this regard, PECO is correct that the language of the statute is clear. In the words of the ALJ, if a general, base rate case calls for a searchlight, and a general multi-issue case requires a flashlight, a Section 2804(16)(ii) case uses a laser. (R.D., p. 12). The focus of this case is the Company's RNR tax liability as set forth in Section 2810, and that portion of PECO's rate request for RNR liability recovery which brings the Company's rates above the rate cap. The analysis required to adjudicate that limited tax liability does not encompass the host of tax issues that the OCA and PAIEUG seek to raise.

We also are mindful of the 60-day time frame established by Section 2804(16)(ii). The host of issues which the OCA and PAIEUG seek to raise in the context of prior tax savings, together with the rate of return claims, are wide ranging and complex. Tax issues and the appropriate recovery of taxes in utility rates can be among the more complex matters which come before this Commission. Had the General Assembly intended the broad and far ranging type of inquiry urged by the OCA and PAIEUG here, it would not have established such an abbreviated schedule by statute, together with the limitation that the proceeding focus on a single issue.

For the foregoing reasons, the OCA's second Exception and PAIEUG's second Exception are denied.

OCA Exception No. 3

The OCA argues in its third Exception that the ALJ erred when he concluded that the STAS mechanism was an appropriate mechanism for recovery of costs above the rate cap. Again, the OCA points to the different treatment afforded recovery of RNR changes which result in rates above the rate cap and changes which result in rates below the rate cap. According to the OCA, while the statute provides for use of the STAS mechanism for recovery of amounts which fall below the rate cap, no such treatment is expressed for matters falling above the rate cap under Section 2804(16)(ii). Thus, the OCA argues that there is no support in the Act for using the STAS mechanism in this instance. (OCA Exc., pp. 14, 15).

The OCA also argues that the ALJ erred when he determined that "a rate resulting from the STAS is automatically just and reasonable... ." (OCA Exc., p. 15). The OCA points to the Policy Statement at 52 Pa. Code §69.52(E) which provides that surcharges which come into effect under the STAS mechanism are not to be deemed

Commission made rates. Thus, according to the OCA, the STAS mechanism cannot be deemed to automatically produce just and reasonable rates according to the Policy Statement which implemented the STAS mechanism. Notwithstanding this limitation, the OCA complains that the ALJ has reached this precise conclusion. (*Id*).

PECO Reply

PECO observes that our regulations recognize that the STAS mechanism is merely a rate vehicle and that the rate claim is to be made pursuant to Section 1308(a) of the Code. According to PECO, the Company's claim is supported by substantial evidence of record. Thus, while the ALJ focused on the rate mechanism for recovery of the claim, the claim itself is valid, supported and just and reasonable. (PECO R.Exc., pp. 11-12).

Disposition

We agree with the ALJ that the STAS mechanism is an appropriate vehicle for recovery of increases in RNR liability and deny this Exception. Our regulations at 52 Pa. Code §54.97(a) expressly provide for recovery of increases in RNR taxes through the STAS mechanism. As discussed by the ALJ, the STAS mechanism is used to provide a means for utilities to collect increased tax expenses in rates which are the result of tax-law changes which occur between base rate cases. (R.D., p. 20).

To the extent that the OCA argues that the STAS mechanism does not lend itself to an examination of underlying, base rate case type issues, we again are guided by Section 2804(16)(ii)'s single-issue rate proceeding limitation as well as the 60-day time frame.

Our regulations at 52 Pa. Code §§ 54.95 and 54.97 were expressly designed to set forth the procedure by which EDCs subject to Section 2804(16) of the Code may seek rate adjustments to address increases in tax liability, including increases to the RNR tax. (52 Pa. Code §54.91). At 52 Pa. Code §54.95(c)(3), it is specifically contemplated that an EDC will use a surcharge mechanism to recover its RNR tax liability. From the foregoing, it should come as no surprise that the STAS mechanism has been considered available for these types of cases.

The OCA is correct that STAS involves tax rates, not necessarily actual taxes paid. We are also mindful that our Policy Statement at 52 Pa. Code §69.52(E) contains the caveat noted by the OCA. However, neither of these two points invalidates the use of the STAS mechanism as a means for an EDC to adjust rates to reflect increases in its RNR liability. Simply put, the concerns of the OCA go to a base rate case analysis. The RNR recovery procedures set forth in Section 2804)(16)(ii) of the Code as well as our regulations are designed for a single-issue rate proceeding which permits an EDC to properly recover RNR increases through rates. The STAS is an effective and appropriate mechanism to accomplish that task in between base rate cases. The OCA's third Exception is denied.

OCA Exception No. 4; PAIEUG Exception No. 1

In its fourth Exception, the OCA argues that the ALJ erred when he determined that an EDC's rate of return is irrelevant in a single issue rate proceeding. The OCA asserts that this finding by the ALJ is inconsistent with the plain meaning of just and reasonable rates. Since Section 2804(16)(ii) expressly requires a finding that RNR adjustments resulting in rates above the rate cap must result in rates which are just and reasonable, the OCA argues that the issue of rate of return is extremely relevant in this proceeding. (OCA Exc., p. 16).

The OCA first assigns error in the ALJ's distinction between "earnings" and "return on equity." The OCA notes that counsel for several EDCs explained that return on equity is merely an EDC's earnings expressed as a percentage of its rate base. Thus, to the extent the ALJ struggled to differentiate between "earnings" on the one hand, and "rate of return" on the other, that effort was not meaningful in determining whether "earnings" or "rate of return" was significant in a just and reasonable rate determination. (OCA Exc., p. 16-18).

What would have been meaningful, according to the OCA, is for the ALJ to have concluded that a determination that a rate is "just and reasonable" includes an examination of a utility's rate of return. The OCA cites to the rules of statutory construction at 1 Pa. C.S. §1903 which requires that words and phrases are to be construed according to their common and approved usage. As viewed by the OCA, the phrase "just and reasonable" has a specific meaning that has been established by many years of case law. (*Id.*, pp. 17-18).

The OCA cites to several cases which it claims firmly establish that a determination that a rate is just and reasonable mandates an examination of a utility's rate of return. In *Pennsylvania Petroleum Association v. Pennsylvania Power & Light Company*, 488 Pa. 308, 412 A.2d 522 (1980), the Pennsylvania Supreme Court held: "Public utility rates must be 'just and reasonable.'...A 'just and reasonable' rate means a rate that will give a utility a fair return." (Citation omitted, 488 Pa. at 310-11, 412 A.2d at 523-24). The OCA also cites to *National Fuel Gas Distribution Corporation v. Pennsylvania Public Utility Commission*, 464 A.2d 546 (Pa. Cmlwth. 1983), which held that: "A determination that a utility's rates are unjust or unreasonable usually rests on a factual finding that the imposition of those rates unreasonably benefits the utility's investors at the expense of the utility's ratepayers." (*Id.*). (OCA Exc., pp. 18-19).

In arguing that rate of return is a necessary component of "just and reasonable" rates, the OCA also cites to one of our previous decisions in *Leaman v. GTE North Incorporated*, 1994 Pa. PUC LEXIS 90. In *Leaman*, we stated:

> The Public Utility Code requires all utility rates to be "just and reasonable." The Supreme Court of Pennsylvania has interpreted the phrase "just and reasonable." A "just and reasonable" rate means a rate that will give the utility a fair rate of return. Thus, determining whether a telephone company's rates are "just and reasonable" requires determining whether the telephone company's rates are producing a fair rate of return. Leaman presented no financial information regarding GTE's rate of return on its Pennsylvania intrastate rates.

The foregoing quote from our *Leaman* order is stated by the OCA to clearly establish that a just and reasonable determination must include an analysis of a utility's rate of return. (OCA Exc., pp. 18-19).

The OCA also argues that the filing requirements for a Section 1308(a) proceeding as well as this Commission's Order setting forth the information requirements for RNR filings clearly envision a rate of return examination. In the proceeding which established the filing requirements for a Section 2804(16)(ii) proceeding, the OCA submitted comments recommending that the Commission require an EDC to file an income statement and earnings information. The OCA notes that we determined not to impose such a requirement specifically for the RNR filing because EDCs must provide detailed quarterly earnings reports which include an income statement and rate base calculations. Thus, we had determined that such information would already be available, not that it was irrelevant. (OCA Exc., p. 21).

Similarly, the OCA argues that our regulations at 52 Pa. Code §54.95(a) provides that an EDC proposing to increase its rates pursuant to Section 2804(16)(ii) of the Code shall file a single issue rate proceeding under Section 1308(a) of the Code. According to the OCA, our regulations also provide for certain mandatory information to be included in a filing under Section 1308(a). Our regulations at 52 Pa. Code §53.52 (c) expressly provide that when utilities propose rates which represent increases over certain thresholds in a Section 1308(a) proceeding, an income statement, balance sheet and earnings information must be included with the filing. The OCA reads this requirement as further evidence that the Commission will consider rate of return information in any proceeding where a just and reasonable rate determination must be made. (OCA Exc., pp. 22-23).

Turning to the ALJ's determination that earnings or rate of return is irrelevant, the OCA assigns error on several grounds. The OCA notes that the ALJ referenced Section 2804(4)(iii) of the Code which expressly requires that the Commission consider rate of return before permitting an EDC to exceed its rate cap. The ALJ noted that Section 2804(16)(ii) does not contain a similar requirement. According to the OCA, that difference is of no moment. The OCA reiterates its argument that the just and reasonable requirement in Section 2804(16)(ii) necessarily includes a consideration of rate of return under Pennsylvania law. As the OCA sees it, a Section 2804(4)(iii) analysis takes into consideration "what is fair under all of the circumstances of the Act. *Under Section 2804(16)(ii), the analysis is more akin to a determination of just and reasonable rates within the context of a traditional base rate case.*" (OCA Exc., p. 26, emphasis added).

Second, the OCA states that the ALJ concluded that since taxes are remitted to the government, there is no impact on earnings if the EDC is permitted to collect the taxes. The OCA repeats its arguments that the STAS mechanism relates to the rate of

taxation, not taxes paid. Thus, to the extent that taxes are over or undercollected in relation to actual taxes paid, that disparity will have an effect on earnings and, thereby, the EDC's rate of return. Again the OCA notes that the STAS mechanism is merely intended to address tax rate changes between base rate cases; it does not capture changes in taxes since the time when rates are set. (*Id.*).

According to the OCA, the ALJ concluded that the rates currently charged have been established as just and reasonable. Since the ALJ viewed taxes collected through STAS to be pass-throughs without an impact on earnings, he determined that the resulting rates remain, *prima facie*, just and reasonable. (OCA Exc., p. 25). However, the OCA argues that the question is not whether just and reasonable rates remain just and reasonable, the question is whether increasing those rates to exceed the rate cap result in rates that are just and reasonable. (*Id.*, pp. 25-26).

The OCA again asserts that the ALJ's interpretation of Section 2804(16)(ii) standards reduces the RNR increase to a simple pass-through with no review. However, the OCA points out that if that had been the intent of the General Assembly, it would have treated these types of cases the same way it treated RNR increases which remained below the rate cap. The OCA argues that by requiring that the Commission engage in a just and reasonable determination in these types of proceedings, the General Assembly intended these matters to be treated differently. That includes an examination of rate of return according to the OCA. (*Id.*).

The OCA also argues that the ALJ considered the 60-day time frame for these types of cases to be significant. In his Recommended Decision, the ALJ discussed the abbreviated 60-day time frame set forth in the statute and found that time frame to dictate a much narrower review than that suggested by the OCA. However, the OCA points out that it presented testimony which developed a methodology for considering rate

of return which could easily have been accomplished within the mandated time. In addition, the OCA noted the ALJ's concern that the RNR filing timelines mandated that all electric utilities would file for rate cap exception at the same time. However, the OCA argues that not all EDCs would experience RNR changes which would bring their rates above the rate cap. (OCA Exc., pp. 25-26).

PAIEUG argues the same essential theories in its first Exception that are expressed by the OCA and summarized above. (PAIEUG Exc., pp. 4-5).

PECO Reply

PECO argues that because Section 2804(16)(ii) is clear that rate of return issues are outside of the scope of these proceedings, the OCA's discussion of policy issues which support a rate of return examination are meaningless. PECO quotes the ALJ's Recommended Decision and agrees that an examination of Section 2804 of the Code reveals that rate of return questions are declared relevant under four subsections of Section 2804, but not under Section 2804(16)(ii). That distinction clearly establishes that rate of return is not a relevant inquiry in this proceeding. (PECO Exc., pp. 13-16).

PECO also notes that the cases cited by the OCA to support its theory that a "just and reasonable" determination requires a rate of return analysis predate the enactment of Section 2804(16)(ii). In addition, PECO argues that the cases cited by the OCA discuss "just and reasonable" in the context of general ratemaking proceedings and were decided prior to the enactment of Section 2804. (*Id.*, p. 15).

Disposition

Again, the OCA and PAIEUG ignore the plain meaning of Section 2804(16)(ii) and attempt to engage in a general rate case type of review. That Section clearly provides for a much narrower inquiry than the OCA and PAIEUG would prefer. Quite simply, a single issue proceeding, designed to be filed, argued and concluded within 60 days, is not meant to include a rate of return analysis.

We find that the ALJ was correct in his assessment of this issue. He stated, in pertinent part, as follows:

> Examining respondent's rate of return to determine if rate caps should be allowed to be exceeded is certainly legitimate, but the proceeding would not be a single issue rate case! The legislature drew this distinction and it cannot be ignored. Only 66 Pa. C.S. §2804(4)(iii)(G), speaking through 66 Pa. C.S. §2804(16)(ii), directs that the proceeding be a "single issue rate proceeding." The other statutory provisions, 66 Pa. C.S. §§2804(4)(iii)(A), (C), (D), and (F), do not contain the phrase "single issue rate proceeding" for the simple reason that examining whether a rate of return is or is not "fair" encompasses many issues. As the Commission is without authority to change the statutory provisions, in order to maintain the proceeding called for by 66 Pa. C.S. §2804(16)(ii) as "a single issue rate proceeding" an examination of respondent's earnings must be ruled irrelevant.

(R.D., pp. 14-15).

As recognized by the ALJ, there is a clear distinction between Section 2804(4)(iii)(C) of the Code governing other increases in Federal or State tax rates and the language contained in Section 2804(16)(ii). Specifically, other requests by EDCs for rate cap relief due to tax increases under Section 2804(4)(iii)(C), are required to be accompanied by a showing that absent relief, the utility will be deprived of an opportunity to earn a fair rate of return. However, changes under Section 2810 (relating to RNR) fall

within Section 2804(4)(iii)(G), a completely separate category under the rate cap exceptions, which then refers to Section 2804(16) for the specific procedures that must be followed. No similar burden of proof of demonstrating that the relief is needed to allow the utility to earn a fair rate of return is included in Section 2804(16). Based upon this distinction between these two categories of rate cap exceptions, we are satisfied that the Company need not demonstrate that the ability to earn a fair rate of return will be compromised if it is not permitted to recover increases in RNR tax liability.

The ALJ also expressed concerns about whether the 60 day time frame lends itself to a rate of return analysis. The ALJ compared this time frame to the six-month suspension period, plus three additional months pending decision for a non-general rate case brought under Section 1308(b) of the Code. The ALJ noted that the Company as well as eight other jurisdictional electric utility companies using STAS must make simultaneous filings due to the timing of RNR rate announcements and the period within which RNR rate petitions must be filed. Each of those companies must have their rate proceedings determined within substantially the same time period. According to the ALJ, this serves to emphasize the extremely narrow and limited scope contemplated for these types of proceedings. (R.D., p. 15). We agree with the ALJ on this point as well. The time frame imposed on these cases clearly does not permit a rate of return analysis.

Above, we quoted a portion of the OCA's Exception on this point. It bears repeating here. The OCA stated: "Under Section 2804(16)(ii), the analysis is more akin to a determination of just and reasonable rates within the context of a traditional base rate case." (OCA Exc., p. 26). It is understandable that the OCA takes that position. However, it is contrary to the intent of the General Assembly as expressed in Section 2810(a) of the Code and as that intent is carried out in Section 2804(16)(ii). The OCA's fourth Exception and PAIEUG's first Exception are denied.

OCA Exception No. 5

In this Exception, the OCA asserts that the ALJ erred when he criticized the OCA for failing to introduce earnings information from prior points in time. The OCA argues that OCA Exhibit 1 is the Commission's Bureau of Fixed Utility Services' Quarterly Earnings Report for the Period Ending December 31, 2001. According to the OCA, this Exhibit contains a summary of the reported return on equity for each EDC from 1993 to the present. The OCA notes that the ALJ questioned the relationship between earnings and return on equity. However, the Quarterly Earnings Report presents that information in terms of each EDC's actual return on equity. (OCA Exc., pp. 26-27).

The OCA states that while a more detailed review of prior period returns on equity or earnings may have been useful in this proceeding, such a review is not necessary for the determinations to be made here. The OCA argues that the calendar 2001 equity return it used in this case is appropriate to assess the Company's current earnings adequacy. The OCA further argues that use of its OCA Exhibit 1, together with the methodology it presented in this case, is adequate for purposes of determining whether or not the Company's current return on equity supports a determination that the resulting rates are just and reasonable. (*Id.*).

PECO Reply

PECO asserts that the OCA's earnings arguments are irrelevant regardless of whether they were criticized by the ALJ or not. Regardless, PECO also argues that the OCA has stipulated that PECO's earnings fall below the range expressed by the OCA witness as requiring adjustment to the RNR claim. (PECO R.Exc., pp. 16-17).

Disposition

Given our earlier determination that a rate of return analysis is not mandated in this proceeding, this Exception is moot. We also note PECO's arguments that even if the OCA's position and arguments were accepted, PECO's earnings would fall below the range expressed by the OCA as indicated a need for adjustment to PECO's claim.

OCA Exception No. 6

The OCA reiterates its disagreement with the ALJ's conclusion that a 60-day time frame for resolution necessarily restricts the scope of this case. Noting the ALJ's concerns regarding the time needed for a typical rate of return review, the OCA argues that it has presented a methodology for such a review that can be accomplished within the time frame provided by the statute. The OCA argues that use of its methodology (or one like it) is necessary for the Commission to arrive at a just and reasonable determination. (OCA Exc., pp. 28-29).

The OCA asserts that using publicly available information, its witness was able to establish a cost of common equity range of 8.5 percent to 10.4 percent for determining whether a requested rate increase above the rate cap would produce just and reasonable rates. According to the OCA, we could establish a minimum benchmark cost of equity value within that range. If the Company's reported return on equity, after accounting for the increased RNR expense, exceeds that minimum benchmark, then the OCA would propose a finding that the increased rate is not just and reasonable. The basis for this position would be that the utility's earnings are already sufficient, even with the additional tax expense so there is no need to move above the rate cap. The OCA also suggests that an interim result could occur when a utility's return on equity prior to

calculation of the RNR expense exceeds the benchmark, but falls below the benchmark, then the OCA would propose that an increase of no more than necessary to reach the Commission approved return on equity benchmark would be appropriate. (OCA Exc., pp. 28-31).

PECO Reply

The Company argues that the OCA's proposed methodology fails to acknowledge the plain meaning of Section 2804(16)(ii) of the Code. First, the OCA's proposal considers prior period tax levels of non-Section 2810 taxes – expenses not included in the mandated Section 2804(16)(ii) analysis. Second, to the extent the OCA's methodology would argue that PECO should not recover its RNR liability through rates falling above the rate cap, the OCA's own benchmarks would be violated. That is, PECO's rate of return currently falls below that level which the OCA has declared would require a downward adjustment on recovery. (PECO Exc., pp. 17-18).

Disposition

Similar to the OCA's fifth Exception, this Exception is also moot due to our determination that a rate of return analysis is neither required nor contemplated by Section 2804(16)(ii). However, we note that the OCA's methodology itself presents a host of issues not envisioned by a single issue rate proceeding. That methodology, and the information it uses, are subject to challenges which go far beyond a single issue proceeding and certainly moves beyond a 60 day time period for litigation and resolution.

OCA Exception No. 7

In this Exception, the OCA states that while the Company's earned or adjusted return on equity is below the OCA's suggested benchmark, there is insufficient evidence of record relating to any offsetting state tax savings for PECO. According to the OCA, absent that information, there is an insufficient basis upon which the Commission can find that the proposed increase is just and reasonable. Accordingly, the OCA excepts to the ALJ's recommendation to approve the proposed increase. (OCA Exc., p. 32).

PECO Reply

PECO argues that the OCA persists in expanding the single issue Section 2810 RNR tax inquiry beyond the statutory mandate. PECO asserts that the tax offsets which the OCA seeks to examine relate to taxes which are not governed by Section 2810. (PECO Exc., pp. 18-19).

Disposition

We have previously determined that off-setting taxes (other than current year savings) are not relevant to this single issue RNR proceeding. Given that the basis for this Exception is the failure to include an examination of off-setting taxes, it is denied for the reasons expressed in our discussion of the OCA's second Exception and PAIEUG's second Exception.

OCA Exception No. 8

The OCA argues that its due process rights were violated when the schedule for this case was abbreviated by the issuance of a Secretarial Letter. While the OCA acknowledges that the statutory time frame for this action is 60 days, and that time frame has long since passed, the OCA argues that this Commission had previously set a litigation schedule in our Material Question Order. Following the scheduling guidelines set forth in the Material Question Order, the Parties and the ALJ established a litigation schedule. However, when this Commission shortened the schedule by Secretarial Letter, the OCA argues that we modified a prior order without notice and an opportunity to be heard. (OCA Exc., p. 33).

As argued by the OCA, the Secretarial Letter violated Section 703(g) of the Code which requires that notice and an opportunity to be heard must be provided before this Commission modifies a prior Order. In addition, the OCA asserts that our action violated Section 331(d) of the Code by constraining the authority of the ALJ to regulate the course of the proceedings. The OCA also points to several of our regulations which provide authority to a presiding ALJ regarding authority to set hearing dates, authority to dispose of procedural matters and the authority to regulate the course of hearings. Finally, the OCA argues that the abbreviated hearing schedule deprived it of a meaningful opportunity to be heard on the merits of the action. (*Id.*).

PECO Reply

PECO argues that no substantive harm was suffered by PECO as a result of the procedural change, accordingly, any defect in the action which accomplished the change is immaterial and waivable. Initially, PECO points out that this proceeding has lasted far longer than the 60 day time frame envisioned by the statute. Accordingly, the

OCA has been afforded approximately seven more months to prepare and try its case than the statute envisioned. (PECO Exc., pp. 19, 20).

PECO also asserts that the OCA's position regarding its rate of return analysis is that the record has provided this Commission with more than enough information upon which to make an informed decision. To that extent, the OCA should not be permitted to argue that it had insufficient time to develop its case. To the extent that the OCA argues that more time was needed to examine tax off-sets, PECO argues that such issues were clearly irrelevant to a Section 2804(16)(ii) review. Accordingly, no additional time was necessary to develop those issues and the OCA suffered no harm. (PECO Exc., pp. 20-21).

Disposition

We are well aware of the effort that the time frame for these cases place on the Parties, our ALJ's and other Commission staff. We have repeatedly referenced in this Opinion and Order our reservations regarding the 60 day time frame and expansion of the issues in this proceeding beyond those called for by Section 2804(16)(ii). We compliment all of the Parties involved for their effort and dedication in bringing this matter before us in the time frame allotted.

Regardless of the change in the litigation schedule, we note that the OCA's Complaint was filed on November 19, 2001. That is over eight months ago. During that time, the parties have engaged in extensive discovery. There have been a substantial number of Prehearing Conferences as well as evidentiary hearings.

In view of the foregoing, no Party has been prejudiced, nor has anyone's due process rights been violated by a change in the schedule. Further, the modification of

our Material Question Order was merely procedural, no substantive rights of any party were affected. Because the Secretarial Letter made no substantive modifications to our Material Question Order, we find that the provisions of Section 703(g) of the Code did not apply.

For the foregoing reasons, the Exceptions of the OCA and PAIEUG will be denied. We will adopt the Recommended Decision of ALJ Weismandel to the extent that it is consistent with this Opinion and Order; **THEREFORE,**

IT IS ORDERED:

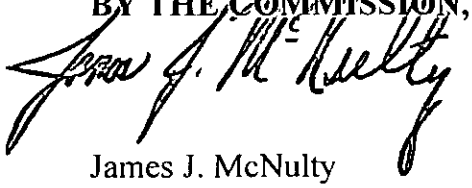
1. That Exceptions of the Office of Consumer Advocate filed at this docket on July 24, 2002, are denied.

2. That the Exceptions of the Philadelphia Area Industrial Energy Users Group filed at this docket on July 24, 2002, are denied.

3. That the Recommended Decision of Administrative Law Judge Wayne L. Weismandel issued July 16, 2002 is adopted, to the extent that it is consistent with this Opinion and Order.

4. That the Complaint of the Office of Consumer Advocate filed at this docket is dismissed.

BY THE COMMISSION,



James J. McNulty
Secretary

(SEAL)

ORDER ADOPTED: August 8, 2002

ORDER ENTERED: August 8, 2002