



COMMONWEALTH OF PENNSYLVANIA
PENNSYLVANIA PUBLIC UTILITY COMMISSION
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Re: Pa. P.U.C. v. Pennsylvania Power
and Light Company
Docket No. R-00943271

Dear Secretary Alford:

Enclosed please find an original and nine (9) copies of the Main Brief of the Office of Trial Staff (OTS) for filing in the above-captioned proceeding. Copies are being served upon all active parties of record.

Very truly yours,

Johnnie E. Simms
Senior Prosecutor
Office of Trial Staff

JES:sjh

Enclosures

cc: Honorable Robert A. Christianson
Parties of Record

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Chief Administrative Law Judge
Robert Christianson, Presiding

PENNSYLVANIA PUBLIC UTILITY
COMMISSION

v.

PENNSYLVANIA POWER & LIGHT
COMPANY

Docket No. R-943271

MAIN BRIEF
OF THE
OFFICE OF TRIAL STAFF

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INFO. CONTROL DIV.

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JUN 16 1995

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Dated: June 16, 1995

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FOLDER

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I. INTRODUCTION

A. History Of Proceeding

On December 30, 1994, Pennsylvania Power & Light Company ("PP&L" or "Company"), filed Tariff Supplement No. 50 to Tariff Electric - Pa. P.U.C. No. 200, setting forth proposed changes and increases in base rates to become effective February 28, 1995. The tariff contained proposed changes in rates, rules and regulations calculated to produce an increase of \$261,000,000 in base rates revenues, or an average increase of 11.7 percent in PP&L's annual retail base revenues.

At the conclusion of evidentiary hearings on May 26, 1994, approximately 144 complaints had been filed with the Secretary's Office of the Pennsylvania Public Commission ("Commission") against PP&L's proposed rate increase.^{1/} Complaints or Petitions to Intervene were filed by the Office of Consumer Advocate ("OCA"), the Office of Small Business Advocate ("OSBA"), the Department of Defense ("DOD"), Bethlehem Steel Corporation, PP&L Industrial Customer Alliance ("PPICA"), Sierra Club ("Sierra"), M&M/Mars, Central Eastern Pennsylvania Fuel Oil Dealers ("CEPFOD"), University/College Coalition ("UCC"), Crown American

^{1/} Eric Epstein as one of the individual complainants, actively participated in the proceeding. Also the Company timely filed answers to all of the Complaints filed in the proceeding.

Corporation and Commission on Economic Opportunity ("CEO"). The Office of Trial Staff ("OTS") was directed by the Commission to participate and has taken an active role in this proceeding.

By Order entered January 27, 1995, the Commission suspended PP&L's proposed rates and ordered an investigation to examine the lawfulness, justness and reasonableness of the proposed rates, rules and regulations.^{2/} The case was assigned to Administrative Law Judge ("ALJ") Michael C. Schnierle and a prehearing conference was held on March 7, 1995.^{3/} On or about March 15, 1995, ALJ Robert Christianson was assigned to replace ALJ Schnierle as the presiding officer in this proceeding.^{4/}

Thereafter, in accordance with the schedule established for evidentiary hearings in this proceeding, with some modifications, 17 days of evidentiary hearings were held for the purpose of receiving testimony. In

^{2/} On January 26, 1995, the Company filed a Supplement with the Secretary's Office of the Commission announcing that Supplement No. 50 to Tariff Electric-Pa. P.U.C. No. 200 was suspended until September 28, 1995.

^{3/} On March 8, 1995, ALJ Schnierle issued a Second Prehearing Order outlining the agreed upon procedural schedule and the Brief requirements.

^{4/} On or about March 31, 1995, ALJ Christianson was named Acting Chief Administrative Law Judge.

addition to the evidentiary hearings, public input hearings were held in PP&L's service territory of Harrisburg, Lancaster, Williamsport, Wilkes-Barre, Scranton, Hazleton, Pottsville, Bethlehem, and Allentown for the purpose of receiving testimony from the customers of PP&L.

OTS presented the testimony of five witnesses, viz: Kevan L. Deardorff, Joseph J. Sivulich, Paul M. Yarolin, Charles T. Weakley, III and Paul J. Metro. The record in this proceeding closed on May 26, 1995. The OTS now submits this Main Brief in support of the positions set forth in the testimony of its witnesses in this proceeding.

As set forth in detail below, it is the position of the Office of Trial Staff that Pennsylvania Power and Light Company should receive no more than \$20,455,000 of its claimed request. See, Appendix A, Table I.

B. Burden of Proof

All parties should recognize that the burden of proof resides with the utility continuously throughout the proceeding and presents the guiding principle for resolving disputed, and arguably all, claims subsumed within proposed as well as existing tariffs. The natural propensity of a utility to overlook its obligation to prove with substantial evidence each of the elements of its cause of action (i.e., each of the claims composing the proposed and existing tariffs) suggests further exposition on this matter.

The burden of proof to establish the justness and reasonableness of every element of the Company's rate increase rests solely upon the public utility in all proceedings under Section 1308(d) of the Public Utility Code. The standard to be met by PP&L is set forth at Section 315(a) of the Public Utility Code:

Reasonableness of rates. In any proceeding upon the motion of the Commission, involving any proposed or existing rate of any public utility, or in any proceeding upon complaint involving any proposed increase in rates, the burden of proof to show that the rate involved is just and reasonable shall be upon the public utility (emphasis added).

66 Pa. C.S. §315(a).

The relevant statutory provision of Section 315(a) of the Public Utility Code evince a legislative intent that the utility carry the burden of proving the justness and reasonableness of proposed and existing rates. This burden of proof extends to justifying every accounting entry questioned during the investigation.

The Commonwealth Court in reviewing Section 315(a) interpreted the utility's burden of proof in rate proceedings as follows:

Section 315(a) of the Public Utility Code, 66 Pa. C.S. §315(a), places the burden of proving the justness and reasonableness of a proposed rate hike squarely on the public utility. It is well-established that the evidence adduced by a utility to meet this burden must be substantial.

Lower Frederick Twp. v. Pennsylvania Public Utility Commission, 48 Pa. Commw. 222, 226-227, 409 A.2d 505, 507 (1980). See also, Brockway Glass v. Pennsylvania Public Utility Commission, 63 Pa. Commw. 238, 437 A.2d 1067 (1981). The legislative intent regarding the extent of a utility's burden of proof is further supported by the pronouncements of the Pennsylvania Supreme Court in Burleson v. Pennsylvania Public Utility Commission, 501 Pa. 433, 461 A.2d 1234 (1983), which clearly defined the dimensions of this obligation.

While the Burleson case involved a billing dispute, obliging the customer complainant to carry the burden of proof, the same rationale applies to a utility's obligation in a proceeding arising out of its general rate filing. Submission of the proposed tariff and supporting data may establish a prima facie case. However, data composing a prima facie case do not meet the utility's burden of proving the elements of its proposed tariff with substantial evidence. As noted by the Supreme Court in Burleson "there is clear distinction between the weight of evidence required to support a prima facie case and the weight necessary to meet a complainant's burden of proof."

The Commission has continued to affirm the utilities' burden of proof in base rate proceedings. In Pennsylvania Public Utility Commission v. Breezewood Telephone Company, 74 Pa. PUC 431 (1991), the Commission made the following ruling:

Thus, where a party has raised a question concerning an element at issue, the affirmative burden of proving justness and reasonableness of its claim is upon BTC.

Id. p. 442.

OTS submits that it is critical that the Administrative Law Judge and the Commission recognize that it is incumbent upon PP&L to affirmatively prove the reasonableness of every element of its claims in this proceeding. A review of the record will demonstrate unequivocally that in many instances the Company has failed to prove the reasonableness of every element of its claims. There can be no dispute that in many instances, PP&L's claims should be rejected based on the Company's failure to sustain its burden of proof and that OTS's adjustments to PP&L claims should be recommended by the Administrative Law Judge and adopted by the Commission.

II. SUMMARY OF ARGUMENT

In this proceeding, Pennsylvania Power & Light Company requested a rate increase from retail customers of \$261,000,000, or an average increase of 11.7 percent. The Office of Trial Staff submits that the Company should be permitted a rate increase of no more than \$20,455,000 over its pro forma adjusted revenues at present rates. OTS Appendix A, Table 1. Specifically, OTS will show that a number of the Company's claims are either contrary to the Public Utility Code, Appellate Court decisions, public interest, or failed the burden of proof requirement for public utilities.

In reviewing the rate base claims of PP&L, OTS proposes several adjustments. For example, upon reviewing the Company's cash working capital, OTS discovered a number of errors, which has resulted in adjustments. Notably, the Company's original claim for cash working capital was negative (\$392,000) with a Pennsylvania jurisdictional claim of negative (\$530,000). Yet, when OTS determined that PP&L's cash working capital/lead lag study contained a number of errors, which resulted in a Pennsylvania jurisdictional negative cash working capital allowance of (\$12,279,000), the Company on rebuttal claimed a zero cash working capital; however, a claim of zero does not cure the errors in the Company's cash working capital/lead lag study. By claiming zero, the Company's Rate Base

will be overstated by a minimum of \$530,000 not considering the errors discovered by OTS in PP&L's lead lag study.

In this proceeding, OTS has determined that PP&L has capacity over and above what is necessary to meet peak demand plus that capacity to insure that there is a margin to allow for day-to-day variations in the operating condition of installed generation. Based in part on the Company's admission that its non-utility generation is as reliable as its owned and leased generation, OTS has included the non-utility generation in the calculation of PP&L's reserves at the time of peak. Consequently, PP&L has 564 MW of excess capacity with a maximum reserve requirement of approximately 16 percent to satisfy its obligation to its customers, which results in an adjustment of \$239,474,000 to the Company's net production plant in service.

Decommissioning expense is the cost incurred when removing a major electric generating unit or station from utility service. In this proceeding, PP&L has proposed to recover in advance the cost of retiring sixteen (16) fossil fuel generating units at five different sites, as well as the decommissioning costs for two large nuclear units at the Susquehanna Steam Electric Station.

PP&L has estimated that the dismantling and demolishing of the 16 fossil fuel units will cost approximately \$628.5 million in 1994 dollars.

This results in an annual decommissioning claim of \$55,570,000. PP&L has estimated that the dismantling and demolishing of the two nuclear units will cost approximately \$804 million in 1993 dollars. This results in an annual decommissioning claim of \$12.6 million for Unit 1 and \$17.4 million for Unit 2.

OTS has clearly demonstrated on the record in this proceeding that PP&L's claim for prospective net negative salvage on the 16 fossil fuel plants should be rejected. Under Pennsylvania law, a claim for prospective net negative salvage is appropriate only when the plant poses a "special" health risk. Heretofore, such a risk has only been found in connection with the decommissioning of a nuclear plant. In any event, PP&L has not demonstrated that the fossil fuel plants at issue here present a "special" health risk to the public requiring the allowance of prospective net negative salvage.

In regard to the nuclear units, OTS has demonstrated that this claim is inflated by \$11.7 million because it includes contingency costs and an allowance for inflation. The Commission has found in previous cases that the inclusion of these costs in a decommissioning fund is inappropriate. Consequently, OTS recommends that these costs be removed from the nuclear decommissioning claim.

Depreciation expense is the annual allowance for the recovery of the loss of value to utility property which occurs due to usage or the

passage of time. In this filing, PP&L has proposed to reduce the life spans for the fossil fuel units at Martins Creek (Units 1 & 2), Sunbury and Holtwood and extend the life spans at Conemaugh and Keystone. In addition, PP&L has proposed to change from modified sinking fund to straight line depreciation at the Susquehanna nuclear plant for property installed prior to January 1, 1989.

OTS supports the life extensions at Conemaugh and Keystone because the record demonstrates that these units will not be retired as early as PP&L had previously stated and reflects a management trend to extend the lives of fossil fuel plants. However, OTS strongly opposes the shortening of life spans at the identified plants because such a proposal (which alleges that these units will be retired in the year 2003) is inconsistent with PP&L management's stated plans to continue to operate these fossil fuel units until at least the year 2014. OTS also opposes the change from modified sinking fund to straight line depreciation at Susquehanna because it would create a higher revenue requirement for PP&L in this proceeding. Moreover, the record demonstrates that such a change is not required to ensure that PP&L fully recovers its depreciation cost.

Additionally, the Company presented a rate case expense claim of \$1,491,000 with a two year normalization without any support, other than its witness admission that he "had no better choice". Clearly, such an

admission does not diminish the fact that the Company has provided no analysis to support its claim. In contrast, OTS provided detailed analysis and explanations as to why PP&L's rate case expense should be normalized over a four year period, which results in an adjustment of \$373,000. Further, the Company included a claim for \$5,400,000 for Environmental Remediation Expense despite acknowledging that an agreement between PP&L and the Department of Environmental Resources on provided for an annual expenditure of \$5,000,000.

PP&L proposes to change from a cash to an accrual basis of accounting for pension under SFAS 87. The Company is requesting the SFAS 87 pension expense of \$10,224,000 and rate base of \$5,273,000 for the capitalized portion on a PUC jurisdictional basis. OTS submits that the Company's claim for pension expense should be limited to the annual pension contribution calculated by the Company's actuary in compliance with ERISA and IRS rules. The Commission has consistently ruled that they will not allow the rate recovery of pension expense absent a finding that a payment obligation will incur during the test year at issue. In the instant proceeding, PP&L has provided no evidence that a payment obligation will incur during the test year ending September 30, 1995. In the absence of such evidence there is no merit to the Company's claim.

Moreover, the Company is also requesting recovery of a deferred expense associated with accumulated deferred Post-Retirement Benefits Other than Pensions ("OPEBs"). The Company is requesting to recover \$1,797,000 for the 17.3 amortization of the \$31,095,000 of accumulated deferred OPEB expenses. In addressing the same issue, the Commonwealth Court has ruled that recovery of an expense associated with the amortization of the regulatory asset of accumulated deferred OPEB expenses is barred by the doctrine of retroactive ratemaking. Consequently, OTS's recommendation should be adopted.

In addressing PP&L's claim for uncollectible accounts expense, OTS has made several adjustments. Namely, the first adjustment centers on the issue of whether the Company will be allowed to use an amount of \$16,800,000 to fund the reserve to the Company's projected requirements or use the actual 1995 write-offs of \$15,566,000. OTS submits that the only credible answer to the issue, is to allow a claim for uncollectible accounts of the actual 1995 write-offs of \$15,566,000. In another area of uncollectible accounts, OTS made an adjustment due to the failure of PP&L to recognize additional revenues from the Low Income Home Energy Assistance Program for its participants in the OnTrack Payment Program.

In this proceeding, the Company has claimed Early Window Deferrals for Susquehanna Units 1 and 2. It is the position of OTS that these

early windows claims should be disallowed, because the Company failed to claim recover the expenses at the first opportunity and the recovery constitutes impermissible retroactive ratemaking.

Finally, with respect to the Company's expense claims in this proceeding, the Company has requested funding for six new social programs and two existing programs. The total projected funding requirement for these programs is \$6,700,000 with \$3,500,000 to be funded by ratepayers and \$3,170,000 to be funded by PP&L. OTS is recommending total disallowance of the costs relating to three of the programs, which is identified as Build-A-Neighborhood Program, Affordable Housing Program, and Small Business Program. The disallowance of these programs results in a reduction of \$2.5 million to the Company's overall claim of \$3,530,000 for social programs. The basis for OTS's recommended disallowance is that (1) these programs are not drive by specific Commission approved regulatory goals; (2) there is no discernable benefit to ratepayers; (3) these programs are being funded by forced contributions; (4) these programs are not compatible with the competitive environment evolving in the electric industry; and (5) the ratepayers funding of these programs is illegal. Consequently, OTS's recommendation to reduce the Company's overall claim for social programs by \$2.5 million should be adopted.

The Company's claimed return on common equity of 13.00 percent is overstated. A fair and reasonable return on common equity for the company is 10.63 percent. Correspondingly, the company's claimed overall return is overstated. A fair rate of return on investment based on the record of this proceeding is 9.14 percent.

Rate structure is the process by which revenues allowed as a result of a rate proceeding are properly allocated to the various customer classes based upon the costs incurred by the utility to serve the class.

OTS has taken a position on the following rate structure issues: (1) An analysis of other Pennsylvania electric companies and the concept of gradualism indicates that PP&L's residential minimum monthly charge should be increased by no more than \$1.10; (2) The 12 Coincident Peak cost of service study demonstrates that Rate Schedule RTS should be increased in the manner proposed by PP&L if the Company is granted any revenue increase in this proceeding; (3) Comments by RTS customers at the Public Input Hearings indicate that the Commission should institute an investigation to determine whether these customers were enticed to obtain this service with overly optimistic promises of lower rates in comparison to Rate Schedule RS; and (4) Since Rate Schedule SE primarily operates during off-peak months of the year, it should be converted to an off-peak rate.

III. RATE BASE

A. PP&L's Cash Working Capital Should Be Reduced For Ratemaking Purposes.

Cash Working Capital ("CWC") is the amount of funds necessary to operate a utility during the interim between the rendition of service, including the payment of related expenses and the receipt of revenue in payment of services rendered. OTS St. 4, p. 42. A lead lag study measures the differences in time between (1) the time services are rendered until payment of those services are received and (2) the time between when a utility has incurred an expense and the actual payment of the expense. Id., p. 42.

The Company's original claim for CWC was negative (\$392,000) with a Pennsylvania jurisdictional claim of negative (\$530,000).

The Company's Claim for CWC is set forth as follows:

1.	Operation & Maintenance expense	\$17,467
2.	Average Prepayments	11,041
3.	Accrued taxes	(284)
4.	Interest payments	(28,032)
5.	Preferred dividend payments	(722)
		<hr/>
	Total cash working capital requirement	(\$530)

After reviewing the Company's claim, OTS recommends a Pennsylvania jurisdictional negative CWC allowance of (\$12,279,000), which represents a reduction of \$11,749,000 to the Company's claim of (\$530,000). OTS Ex. 4, Sched. 9.

OTS is recommending adjustments to two components of the total CWC claim; the claim related to Operations and Maintenance ("O&M") expenses and the funds invested in prepayments. *Id.*, Column 3. In this proceeding, the Company has calculated a total CWC allowance of \$20,238,000 related to O&M expense. The Pennsylvania Public Utility Commission jurisdictional amount is \$17,467,000 which is approximately 86.30% ($\$17,467,000/\$20,238,000$) of the total amount. PP&L Ex. Future 1, Sched. C4, p. 2. OTS is recommending a Pennsylvania Public Utility Commission jurisdictional allowance of \$13,749,000, which represents a reduction (\$3,718,000) to the Company's claim. OTS witness Weakley computed an average revenue lag of 35.0 days and a corresponding average expense lag of 31.3 days. OTS St. 4, p. 44. Consequently, the net revenue lag of 3.7 days is a reduction of 1.2 days to the Company's claim. OTS Ex. 4, Sched. 10.^{5/}

^{5/} OTS witness Weakley adjusted the revenue lag to correct a Company error. The revenue lag associated with 20 day due date customers was reported as 42 days. The 42 days comprised of a 15 day lag for
(continued...)

Additionally, OTS is proposing adjustments to the lags for payroll and other miscellaneous O&M expenses. OTS St. 4, p. 45.

With respect to payroll, the Company has divided payroll into two groupings, payroll-salary and payroll-hourly. For payroll salary the Company has calculated a lag of 11 days and a payroll hourly lag of 16 days. OTS Ex. 4, Sched. 10. The lags of 11 and 16 days were multiplied by respective gross payrolls to determine PP&L's CWC needs for payroll expense. The Company's CWC claim for payroll is overstated, because PP&L failed to take into consideration that it only remits funds equal to net payroll, with all federal income tax and FICA withholdings being deposited with an authorized banking authority at a later date. OTS St. 4, p. 46.

Accordingly, the withholdings for payroll salary is now lagged at 12 days and payroll-hourly at 17 days. OTS Ex. 4, Sched. 10, Col. 2, lines 10 and 12.

^{5f}(...continued)

midpoint of service, a 3 day lag for billing and 24 day collection lag. PP&L confirmed that the correct lag should be 22 days and not 24 days. The correct total lag is now 40 days for the 20 day due date customers. Tr. 502. When averaged with the revenue lags for the other revenue classes, the overall weighted revenue lag reduces from 35.6 to 35.0 days. OTS Ex. 4, Sched. 10.; PP&L Ex. Future 1, revised.

OTS's appropriate lag for withholdings is based upon the new federal deposit rules effective for the 1993 tax year. Briefly, OTS witness Weakley testified as follows in explaining the new federal deposit rules:

All depositors are classified as either monthly or bi-weekly depositors. Bi-weekly depositors are required to deposit their taxes by the Wednesday after payday, if payday falls on a Wednesday, Thursday or Friday. For all other paydays, the deposit is due by the Friday following payday. However, if the employer accumulated \$100,000 or more in liability during a bi-weekly period the funds must be deposited on the first banking day after the \$100,000 threshold is reached. This regulation would apply to PP&L because annual withholdings would be \$65,161,000 (\$48,996,000 + 16,165,000) and definitely in excess of \$100,000 at each paydate. (emphasis added).

OTS St. 4, pp. 47-48.

It appears that PP&L failed to reflect the new federal deposit rules in its claim for CWC. Accordingly, there should be no dispute that OTS's adjustment should be adopted by the ALJ and the Commission.

In another area of CWC, OTS recommended a lag of 33 days for "Other O&M" expense items, which is an increase of one day to the Company's proposed lag of 32 days. OTS Ex. 4, Scheds. 12 and 13.^{6/} In recommending its adjustment, OTS witness Weakley using the same

^{6/} The Company computed an average lag of 32 days based on an analysis of invoices over a three month period ended July 31, 1994. PP&L Attachment II-B-4, p. 30.

methodology as the Company, spot checked various invoices relating to materials and supplies. OTS St. 4, p. 49. During that review process, OTS witness Weakley questioned an invoice for \$173,440 to Stamet, Inc., which included an invoice of \$170,000 for two Firth solids pumps. On cross-examination, PP&L acknowledged that two Firth solids pumps had been capitalized and were included in ratebase. Tr. 519. Since the two Firth solids pumps is an element of ratebase, the Company is already earning a return on and return-off these capital expenses for these pumps. Consequently, OTS witness Weakley reduced this invoice to \$3,440 (\$173,440 - \$170,000) for the purpose of the CWC calculation, which resulted in an increase in lag days to 33.

In this proceeding, the Company made a claim for average prepayments on a 13 month average of six items: insurance nuclear, insurance other, NRC annual fees, PUC assessment, postage and Other. OTS St. 4, p. 49. OTS has reviewed the Company's average prepayments, and is proposing adjustments to the 13 month average balances for the PUC Assessment, Insurance, Postage and Other category for a reduction of \$8,031,000 to the Company's Pennsylvania Public Utility Commission jurisdictional claim of \$11,041,000. *Id.*, p. 50. OTS's adjustment for the PUC Assessment is based on the fact that the Company discovered an error in its original claim and submitted a revised calculation, which resulted in an

increase in the original claim of \$379,000 to \$1,782,000. OTS Cross-Examination Ex. 12. With respect to the Company's claims for postage and insurance, OTS is recommending that the total claims of \$156,000 and \$5,547,000 (\$2,264,000 + \$3,283,000) be eliminated. The total elimination is based on the fact that both the postage and the insurance claims are duplicative. As OTS witness Weakley testified, PP&L has claimed postage as average prepayments, however, postage is traditionally handled in the lead/lag study and should remain there, as it is adequate compensation to PP&L. OTS St. 4, p. 52. In balances reflected as prepayments do not reflect any attempt by PP&L to determine a minimum postal supply balance but merely the balances at given points in time and is therefore duplicative of the claim within the lead/lag study. *Id.*, p. 52. Similarly, PP&L has claimed insurance prepayments as average prepayments and within the O&M CWC expense claim, thus there is a duplication in the claim.

In reviewing the "other prepayments", OTS witness Weakley noticed that the balance for March 1994 greatly exceeded all other monthly balances. PP&L Historic 1, Sched. C-4, p. 3. The balance for March 1994 is critical, since the balance included interest of \$24,138,000 for long-term debt and \$42,992,000 in cash dividend payments as prepayments. OTS St. 4, p. 54. The reason for the balance for March 1994 greatly exceeding all other monthly balance is due to fact that the payment date of April 1,

1994 fell on the Good Friday holiday and the commercial paper markets were closed, PP&L had to deposit these funds prior to April 1, 1994. *Id.*, p. 54. Consequently, a large balance is reflected for the month of March 1994.

OTS is recommending that balances relating to long-term debt interest and dividend payment be removed from the prepayment balances. The balances are below the line expense items, and ratepayers should not be required to provide working capital for these items.

Accordingly, with the removal of long-term debt interest and dividends from other prepayments, the average thirteen month balance is reduced from \$6,758,000 to \$1,594,000 or by \$5,164,000. OTS St. 4, p. 54.^{7/}

In the rebuttal phase of the proceeding, the Company has proposed for the first time "no allowance for cash working capital." PP&L St. 3-R, p. 2. PP&L has proposed no allowance for CWC, because OTS witness Weakley has recommended a "substantial negative cash working allowance". *Id.*, p. 2. PP&L acknowledged that the Commission has

^{7/} Note that OTS's recommended negative CWC allowance of (\$12,279,000) does not represent a final recommended allowance for CWC. As noted by Mr. Weakley, it is important that all adjustments to the Company's claims for revenue, expense, taxes and rate base must be consistently brought together in the ALJ's Recommended Decision, and again in the Commission's Final Order.

adopted the interest offset adjustment in prior cases based on the hypothetical lag in the payment of bond interest; however, the offset should not be used to reduce working capital below zero. PP&L St. 3-R, p. 2. OTS submits that the Company's claim that the "offset should not be used to reduce working capital below zero" is a red-herring. The argument is red-herring, because the total net Company original claim for CWC was a negative (\$392,000) with a Pennsylvania jurisdictional claim of negative (\$530,000). OTS St. 4, p. 42. In essence, the Company's argument that it is inappropriate to reduce CWC below zero did not apply to its original claim, but should apply to OTS's recommendations is without merit. Moreover, the fact that the Company on rebuttal is proposing no allowance for CWC, does not warrant consideration, since the Commission's Opinion and Order suspending the instant proceeding, provided in pertinent part as follows:

5. That this investigation shall include consideration of the lawfulness, justness, and reasonableness of Respondent's existing rates, rules and regulations.

Pennsylvania Public Utility Commission v. Pennsylvania Power & Light Company, R-943271, (January 27, 1995).

Accordingly, whether PP&L proposed no allowance for CWC, OTS has the right pursuant to the Commission's Opinion and Order to review the Company's existing rates, and determine whether such rates are just and

reasonable. OTS has determined that the Company's CWC should be a Pennsylvania jurisdictional negative CWC allowance of (\$12,279,000) and based on the arguments presented by OTS, the recommendations should be adopted by the ALJ and the Commission.^{8/}

B. OTS's Pension Expense Adjustment Affects
PP&L's Rate Base.

In the Expense Section of this Main Brief, OTS will present arguments in support of its recommendation that the Company's claim for pension expense be disallowed in its entirety. This adjustment will reduce, on a PUC jurisdictional basis, rate base by \$5,273,000. OTS Ex. 4, Sched. 2. OTS witness Weakley explained as follows as to why a pension expense adjustment affects rate base:

When an employee's time is charged to a capital project (as oppose to O&M expense), the value of the payroll and employee benefits are then added to the cost of the capital project which will be included in the Company's rate base.

OTS St. 4, p. 15.

^{8/} Some of the adjustments were based on admitted errors by the Company. The Pennsylvania jurisdiction equivalent is \$12,279,000. The Revenue Requirement equivalent amount is \$1,621,000. See, Appendix A, Table II, attached to this Main Brief.

Consequently, if the ALJ and the Commission adopts OTS's recommendation to disallow the Company's claim for pension expense, there should be a concomitant adjustment to PP&L's rate base by \$5,273,000.^{2/}

C. PP&L's Proposal Accrue A Return Component Equivalent To The Applicable AFUDC Rate On Its Electric Plant Held For Future Use Should Be Denied And/Or Modified.

In this proceeding, PP&L is requesting the Commission to approve the accruing of a return component equivalent to the applicable Allowance For Funds Used During Construction ("AFUDC") rate on future use property investments. OTS St. 5, p. 28. PP&L proposes to include all accrued amounts as part of Electric Plant in Service at the time the plant is placed into service. *Id.*, p. 28. PP&L is not making a request in this proceeding to include Electric Plant Held For Future Use in its future test year rate base claim. PP&L St. 7, pp. 27-28.

OTS is recommending that the ALJ and the Commission deny PP&L's request to begin accruing a return component equivalent to the applicable AFUDC rate on its future use property investments. Additionally, OTS is recommending that the Commission deny PP&L's request to include

^{2/} The Pennsylvania jurisdiction equivalent is \$5,273,000. The Revenue Requirement equivalent is \$727,000. See, Appendix A, Table II, attached to this Main Brief.

all accrued amounts as part of the Electric Plant In Service at the time such plant is placed into service. OTS St. 5, p. 29.

In Barasch v. Pennsylvania Public Utility Commission, 516 Pa. 142, 95 PUR 4th 521, 532 A.2d 325 (1987), affirmed and Duquesne Light Company v. Barasch, 488 U.S. 299, 98 PUR 4th 253, 102 L.Ed.2d 646, 109 S.Ct. 609 (1989) ("Barasch"), the Supreme Court prohibited the recovery for plant held for future use in rate base or by amortization. OTS is fully aware that since Barasch, the Commission has permitted utilities to accrue carrying charges equivalent to AFUDC on their investments in land held for future use. See, Pennsylvania Public Utility Commission v. Pennsylvania Power Company, 67 Pa. PUC 91, 127, 93 PUR 4th 189 (1988) and Pennsylvania Public Utility Commission v. Pennsylvania-American Water Company, 68 Pa. PUC 343, 354, 97 PUR 4th 469 (1988). Notwithstanding, the Commission's rulings, OTS is of the opinion that to allow utilities to accrue carrying charges equivalent to AFUDC on plant held for future use is a subterfuge of the intent of the Court's ruling in Barasch, which prohibited recovery of the costs in question either by inclusion in rate base or by amortization. A key to the Court's ruling in Barasch is the fact that the Federal Energy Regulatory Commission's ("FERC") Uniform System of Accounts permits the accrual of AFUDC on electric plant held for future use (including land) only for the period of construction.

If the Commission adopts PP&L's proposal to accrue carrying charges equivalent to AFUDC on plant held for future use, as an alternative, OTS is recommending that such allowance be only for accounting purposes. OTS St. 5, p. 30. As OTS witness Metro explained, the prudence determination of the plant held for future use would occur during a future rate case when the electric plant value is claimed in rate base. Id., p. 30.

Accordingly, OTS's recommendation should be adopted to deny and/or modify PP&L's proposal to begin accruing a return component equivalent to the applicable AFUDC rate on its electric plant held for future use.

D. There Should Be An Adjustment Of \$239,474,000 To Reduce The Company's Net Production Plant In Service Associated With Excess Capacity.

The Commission has defined excess capacity to mean capacity over and above what is necessary to meet peak demand plus that capacity to insure that there is a margin to allow for day-to-day variations in the operating condition of installed generation. See Pennsylvania Public Utility Commission v. Philadelphia Electric Company 37 PUR 4th 381, 386 (1980). In accordance with that definition, the Commission in Pennsylvania Public Utility Commission v. Pennsylvania Power & Light Company, R-842651

(1985), adopted the recommendation that PP&L should be denied the entire return on a 945 MW slice of its system.

In the instant proceeding, the Company's projected owned and leased capacity at September 30, 1995 is 8,540 MW (winter ratings). PP&L St. 9, p. 5. The Company's total owned or leased capacity levels is reduced by firm capacity sales to other utilities. OTS St. 5, pp. 4-5. The net resources at the time of peak, excluding Firm Capacity Sales to Other Utilities is 7,334 MW for the winter of 1995/1996. PP&L Ex. JFS-1. The reserves at the time of peak, for the winter of 1995/1996, without including Non-Utility Generation ("NUG") load and Interruptible customer resources, is 609 MW.

With respect to the inclusion of interruptible customer resources, PP&L believes that the most appropriate reserve level for assessing PP&L's reserve margins are the reserves at the time of peak that include the load associated with Interruptible customers. PP&L St. 9, pp. 11-12. PP&L's belief that interruptible load should be included in the reserves at the time of load is premised on the fact that the Company exercises control over the addition of owned and leased generation and partial control over the addition of interruptible load. PP&L St. 9, pp. 11-12.

In evaluating NUGs as a resource, PP&L shows NUG generation as an installed capacity; however, PP&L is the opinion that NUG

generation should not be utilized in the calculation of reserves at time of peak. PP&L St. 9, pp. 11-12.^{10/} The reserves at the time of peak, with interruptible load and NUG generation included, is 1428 MW for the winter 1995/1996. PP&L Ex. JFS-1. This level of reserve at the time of peak established a reserve margin, as a function of winter peak demand, of 21.2 percent. OTS St. 5, p. 8.

PP&L considers an appropriate reserve margin to be within a range bound by a minimum reserve requirement of approximately 12 percent and maximum reserve requirement of approximately 22 percent to satisfy its obligation to its customers. PP&L St, 9, pp. 12-13. For the purposes of this proceeding, PP&L believes that its reserve margins should be determined on its owned and leased generation and the available interruptible load. OTS St. 9, p. 13. On the other hand, OTS recommends that the ALJ and the Commission should determine that PP&L reserve margins is based on PP&L's owned and leased generation, available interruptible load, and NUGs. Accordingly, one of the main issues in this proceeding is whether NUGs should be included in the calculation of PP&L's reserve margins.

^{10/} PP&L's opinion is primarily based on the fact that the Company did not exercise control over the original addition of the NUGs and currently does not exercise control over the addition of NUGs. PP&L St. 9, pp. 11-12. PP&L Exhibit JFS-1, shows 474 MW available from NUG generation.

After reviewing PP&L's Exhibit JFS-1 and the responses to OTS interrogatories, OTS through its witness Paul J. Metro, concluded that PP&L has 564 MW of excess capacity. OTS St. 5, p. 12. In reaching that conclusion, OTS is recommending that the ALJ and the Commission reduce PP&L's net Production Plant in Service associated with 564 MW of excess generating resources. Id., p. 12.

As previously noted, PP&L considers an appropriate reserve margin to be within a range bound by a minimum reserve requirement of approximately 12 percent and a maximum reserve requirement of approximately 22 percent; however, OTS witness Metro is of the opinion that PP&L's reserve margin should be a single figure. OTS St. 5, p. 13. It must be noted that the purpose of a reserve margin is to supply customer demand under reasonable conditions equal to a loss of load criteria of no more than one event in ten years. Id., p. 13. Accordingly, the reserve margin under this scenario should be a single figure.

In recommending a single reserve margin, OTS witness Metro determined that the reserve margin should be equal to PP&L's allocated portion of PJM's overall reserve requirement, which is determined over a defined planning period, and expressed as a function of winter peak load, plus an additional forced outage factor. OTS St. 5, p. 13. Based on these factors, OTS is recommending that PP&L should have resources that provide

approximately 16 (15.72%) percent reserve margin. *Id.*, p. 13. OTS submits that the 12 percent reserve margin required by PJM established a reserve above the winter peak load of approximately 807 MW.^{11/} It is important to note that OTS included an additional 250 plus MW relating to forced outages. OTS St. 5, p. 14. Additionally, PP&L is a member of the PJM power pool, and as a member, a major benefit is that PP&L's peak occurs in the winter while PJM's other utilities are summer peaking. Accordingly, PP&L should be able to utilize the PJM power pool to serve loads that are greater than the 16 percent reserve requirement. OTS St. 5, p. 15. Consequently, OTS considers resources over and above the 16 percent reserve margin as excess generating capacity.

As previously discussed, PP&L believes that NUGs should not be included in PP&L's capacity calculations. On the other hand, OTS believes that NUGs should be included in PP&L's capacity calculations. OTS St. 5, pp. 16-17. In support of its position, OTS has presented several reasons for including NUGs in PP&L's capacity calculations as follows:

First, NUG generation should be included in PP&L's capacity calculations because Federal Law requires electric utilities to purchase power from NUGs.

^{11/} The 807 MW is 3.23 times greater than the 1994 experienced forced outages of 250 MW. OTS Ex. 5, Sched. 3.

Second, NUG generation is as reliable as PP&L's own generation as shown in OTS Cross-Examination Exhibit No. 3

Third, there is an inherent risk with bringing large nuclear plants on line; whether PP&L had bad timing and luck with the development of Susquehanna 1 and 2 or whether PP&L had poor planning and vision toward the development of NUG generation, the result of PP&L's action and/or inaction lies solely with PP&L and its shareholders.

Fourth, NUG power is used by PP&L to meet its daily demand and therefore should be counted as a Resource at the time of peak.

Fifth, NUG power is recognized by PJM as a resource for installed capacity for accounting purposes.

OTS St. 5, p. 17.

The reserves at the time of peak, with interruptible load and NUG load included, is 1,428 MW for the winter of 1995/1996. PP&L Ex. JFS-1. The level of reserve at the time of peak established a reserve margin, as a function of winter peak demand, of 21.2 percent. *Id.*, p. 17. OTS has listed five reasons for the inclusion of NUGs, and believe that these are legitimate reasons, worthy of consideration by the ALJ and the Commission. OTS submits that if NUGs are not to be considered as part of an electric utility's reserve capacity, then there needs to be an evaluation of the NUG program as presently constituted in the Commonwealth of Pennsylvania. PP&L's

primary reason for not including NUGs, is essentially premised on their lack of control in determining whether to purchase or not to purchase NUGs. OTS submits that whether PP&L exercised control over the addition of NUGs is not the controlling factor. The controlling factor should be reliability, which PP&L has acknowledged that NUGs is as reliable as PP&L's own generation and vision by the management of PP&L. With respect to vision, in PP&L's most recent base rate case at Docket No. R-842651, the ALJ in recommending that PP&L had excess capacity, noted that "bad luck" or implied that the lack of vision associated with Susquehanna Unit 2 was a factor in determining that PP&L had excess capacity. Also, it must be noted that in PP&L's most recent base rate case at Docket No. R-842651, the Commission denied the entire return on a 945 mw slice of its system.

Accordingly, OTS's recommendation is not a new determination of excess capacity, but rather a continuation of excess capacity from PP&L's most recent base rate case. In essence, PP&L's excess capacity since the last base rate case has not disappeared, but merely decreased over the years.

OTS Exhibit 5, Schedule shows an average excess generation level of 564 MW. OTS witness Metro explained how the excess available resources were calculated in OTS Exhibit 5, Schedule 1 as follows:

1. Schedule 1, for the year 1995/1996, Mr. Metro added the net resources at the time of peak with the resource available from the Interruptible load plus the resources available from NUG generation. This summation equals the total available resources at the time of peak.
2. Mr. Metro subtracted the Forced Outage Factor that was added over and above the forced outage amount included within the 12 percent reserve requirement. The amount remaining represents the net available resources at the time of the winter peak load.
3. Mr. Metro then multiplied the projected winter peak load by the PJM 12 percent reserve requirement. This level of load represents the amount of generation that is needed to meet the 12 percent reserve requirement.
4. OTS Exhibit 5, Schedule 1 shows the yearly excess capacity levels as a function of the 12 percent reserve margin. For example, for the year 1995/1996, the net available resources minus the PJM 12 percent requirement equals an excess available resource of 371 MW.
5. The nine year excess available resources were averaged to derive a nine year average excess available resources.

OTS St. 5, pp. 20-21.

As previously discussed, OTS witness Metro included an additional forced outage of 250-290 MW over and above the forced outage amount included within the 12 percent reserve requirement. OTS St. 5, p. 19. Upon receiving PP&L's rebuttal testimony, it was obvious that the

Company was confused as to why Mr. Metro included an additional forced outage of 250-290 MW. As OTS witness Metro explained, the intent of the 250 MW per year forced outage was to create a factor that was not duplicative of the forced outage already included in the 12 percent PJM minimum reserve requirement. OTS St. SR-5, p. 3. Simply put, the forced outages was not intended to represent actual forced outages during peak, but was intended to supplement the peak period forced outages already included with the 12 percent PJM reserve margin calculation. Id., p. 3.

In determining that PP&L had excess capacity, as previously noted, OTS witness Metro used a nine year average to represent the excess generation adjustment. OTS St. 5, p. 21. The nine year average will permit PP&L to plan for future firm capacity sales to other utilities and plan for future generating capacity additions. Id., p. 22.

Also, OTS's excess capacity adjustment include the incremental return of capacity associated with the five year phase-out of the JCP&L agreement. By way of further explanation, beginning January 1, 1996 and each year thereafter, the 945 MW slice will be reduced by 189 MW until the agreement terminates at the end of the year 2000. PP&L St. 7, p. 22. Consequently, the phase-out will increase PP&L's resources by 189 MW in each of the succeeding five years. In recognition of the incremental return of capacity, PP&L is proposing that the calculation of its ECR be modified to

permit the recovery of the Pennsylvania jurisdictional portion of the non-energy revenue requirements associated with bulk power capacity and energy agreements which have terminated, in whole or in part, and have not been replaced with new agreements and/or otherwise reflected in the calculation of the Company's base rate charges. PP&L St. 7, p. 21. OTS does not oppose the Company's ECR proposal, since the net capacity resources used to calculate OTS's excess capacity adjustment include the addition of 189 MW of capacity in each of the five years 1996 through 2000 as the JCP&L agreement is phased out. OTS St. 5, p. 27.

Accordingly, OTS's recommendation that the Commission reduce PP&L's claimed rate base by \$239,474,000 associated with the net production plant in service related to 564 MW of excess capacity should be adopted.^{12/}

^{12/} The Pennsylvania jurisdictional equivalent is \$239,474,000. The Revenue equivalent amount is \$33,047,000. See Appendix A, Table II, attached to this Main Brief.

IV. EXPENSES

A. Decommissioning Expense

Decommissioning expense is the cost incurred when removing a major electric generating unit or station from utility service. OTS St. 2, p. 4. In this proceeding, PP&L has proposed to recover in advance the cost for retiring sixteen (16) fossil fuel generating units at five different sites, as well as the decommissioning costs for two large jointly owned^{13/} nuclear units at the Susquehanna Steam Electric Station ("SSES"). PP&L St. 13, p. 2.

PP&L witness Thomas S. LaGuardia has testified that the dismantling and demolishing of the 16 fossil fuel steam electric generating stations^{14/} are estimated to cost approximately \$628.5 million (1994) dollars. This results in an annual decommissioning expense claim of \$55,570,000. PP&L St. 3-R, Attachment 1. He has further testified that the dismantling and demolishing of the two nuclear units at SSES are estimated

^{13/} Only 90% of the Susquehanna Steam Electric Station is owned by PP&L. The remaining 10% is owned by Allegheny Electric Cooperative. PP&L witness Mr. LaGuardia has testified that he did not reduce his cost estimate to properly reflect the ownership share. Tr.970-971. Consequently, OTS witness Mr. Sivulich has testified that only \$724 million of the estimate is applicable to PP&L. OTS St. 3, p. 21.

^{14/} The fossil fuel units have been identified as follows: Holtwood 15 & 16 (2 units); Holtwood 17 (1 unit); Sunbury 1 & 2 (2 units); Sunbury 3 (1 unit); Sunbury 4 (1 unit); Martins Creek 1 & 2 (2 units); Martins Creek 3 & 4 (2 units); Brunner Island 1 & 2 (2 units); Brunner Island 3 (1 unit); Montour (2 units). PP&L St. 13, p. 2.

to cost approximately \$804 million (1993) dollars. PP&L St. 13, p. 3. This results in the claimed annual cost for decommissioning of \$12.6 million for Unit 1 and \$17.4 million for Unit 2. PP&L St. 3, p. 20.

OTS witness Joseph J. Sivulich has testified that based upon sound ratemaking principles, PP&L's claim for fossil fuel decommissioning costs should be denied in total. In addition, Mr. Sivulich has testified that PP&L's claim for nuclear decommissioning costs is inflated and should be reduced by \$11,745,000. OTS St. 2, pp. 12 & 20. The fossil fuel and nuclear decommissioning expense claims will be discussed separately in the following sections.

1. PP&L's Request For \$55,570,000 Of Annual Decommissioning Expense For Its Fossil Fuel Plants, Should Be Denied.

In regard to fossil fuel production plant (for ratemaking purposes), the Commission has traditionally allowed a utility to recover the net of positive salvage value^{15/} and the cost of removal^{16/} on a current

^{15/} Positive "salvage value" is generally defined as the amount received for property retired, less expenses incurred in connection with the sale or in preparing for the sale; or if retained, the amount at which the recoverable material is charged to materials and supplies, or the appropriate account. OTS St. 3, p. 5.

^{16/} The "cost of removal" is defined as the cost of demolishing, dismantling, tearing down or otherwise removing electric plant, including the cost of transportation and incidental handling. OTS St. 3, p. 5.

basis for book and ratemaking purposes. In this regard, the Commission uses a five year average of actually experienced net salvage as a leveling device. Experienced salvage and cost of removal are normally booked in the year incurred, in accordance with the Uniform System of Accounts. See, West Penn Power Company v. Pennsylvania Public Utility Commission, 54 Pa. P.U.C. 602 (1981). If something extraordinary occurs, experienced salvage and cost of removal can be accumulated and amortized over some future period of time under the Extraordinary Property Loss provisions of the Uniform System of Accounts. OTS St. 2, p. 6.

PP&L witness Mr. LaGuardia was contracted by the Company to estimate the cost of dismantling sixteen of its fossil fuel generating units at five different locations. Mr. LaGuardia assumed that all of these generating units would be retired using 1994 technology. PP&L Ex. TSL-4. PP&L witness Ronald J. Bernini used Mr. LaGuardia's estimates of the cost of dismantling the fossil fuel units at the end of 1994 and 1993, respectively. He then estimated the annual charge that would be necessary to write off the cost estimate over the remaining lives of the units, while allowing for a 5.5% after tax return on the annual sinking fund and inflating the cost estimate by 4.0% per year. PP&L St. 3; p. 22. Consequently, the Company is clearly requesting permission to depart from the Commission's traditional treatment

of salvage by providing for prospective negative salvage of non-nuclear generation plant.

OTS witness Mr. Sivulich has testified that PP&L's entire claim for annual decommissioning expense for fossil fuel power production plants of \$55,570,000^{17/}, should be denied. OTS St. 2, p. 12. OTS witness Mr. Sivulich has offered the following factors in support of his position:

- (1) The Company is making a blatant claim for prospective net negative salvage, which my counsel informs me, has been disallowed by this Commission since the Penn Sheraton decision in 1962. See Penn Sheraton Hotel v. Pennsylvania Public Utility Commission, 198 Pa. Superior Ct. 618, 184 A.2d 324 (1962) ["Penn Sheraton"]. This decision prohibited the Commission from charging current ratepayers for the prospective removal of steam mains in the city of Pittsburgh. Since 1970, the Commission has evolved a plan to handle all net salvage on a current basis for all utilities with the noted exception of nuclear plant decommissioning expense.

^{17/} Mr. Sivulich revised his adjustment from \$52.818 million to \$55.570 million in response to the update made by PP&L witness Donald S. Hoch. Tr. 2035-2036.

- (2) The Company's claim does not meet the criteria for inclusion in the only notable exception to the Commission's ban on prospective net negative salvage. That is to say, this claim does not meet the overriding need to protect the public from a very real radioactive danger as in the decommissioning of Nuclear Power Plants.
- (3) The calculations and assumptions underlying the Company's claimed decommissioning expense are speculative.^{18/}
- (4) The Company will recover prudently incurred net negative salvage expense on

^{18/} In this regard, the fossil fuel power plant decommissioning cost estimate is based on at least 49 major assumptions. PP&L Ex. TSL-1, pp. 3-7. A change in any one of these major assumptions could result in a significantly lower cost estimate. Moreover, Mr. LaGuardia has included \$95.9 million in contingencies (extra costs that may be incurred under some unexpected occurrence) in his fossil fuel decommissioning estimates. OTS St. 2, p. 14. OTS Ex.2, Sched. 6 provides a tabulation of the contingency dollar amounts included in the Company's cost estimate and decommissioning expense claim for fossil fuel power plants. The Commission has recognized that contingencies are speculative and has rejected them in nuclear production plant decommissioning allowances. See, Pennsylvania Public Utility Commission v. Pennsylvania Power and Light Company, 59 Pa. P.U.C. 332, 383 (1985); Pennsylvania Public Utility Commission v. Pennsylvania Power and Light Company, 57 Pa. P.U.C. 559, 604 (1982); See, also, Pennsylvania Public Utility Commission v. Pennsylvania Power Company, 64 P.U.C. 308, 350 (1987). Here the Commission apparently approved a contingency fee but did not discuss the merits of the claim, perhaps because no party opposed it.

eligible plant and equipment after they have been retired.^{19/}

OTS St. 2, pp. 12-13.

The record in this proceeding demonstrates that PP&L's claim is filled with uncertainty. For example, PP&L witnesses have admitted that the actual retirement of the fossil fuel units will not occur until much beyond the year 2003, which is identified in DAK-4 as the year many of these units will be retired. Tr. 1896. In this regard, PP&L's 1994 "Resource Planning Report" states the following at p. 4-7 "[b]ecause current studies indicate continued operation of its fossil and hydro units are cost-effective, PP&L does not anticipate any major generating unit retirements during the 20 year planning period." See, OTS Cross Examination Ex. 2. Since all the costs projected by PP&L witness Mr. LaGuardia are proposed to be recovered based upon the projected retirement dates in DAK-4, the resulting cost estimates must be viewed with skepticism. In fact, the actual retirement of

^{19/} In fact, PP&L has submitted a claim for net negative salvage in this proceeding, which has been supported by OTS. OTS witness Mr. Sivulich has testified that \$20,168,757 of annual net salvage should be allowed for ratemaking and book purposes. He states "I would like to point out that this is the appropriate vehicle for recovering the cost of decommissioning fossil fueled power production units after each unit has been retired in the future." OTS St. 2, p. 10.

the fossil fuel generating units will occur over many years and, as a result, will not place a large burden on the Company in any one year.^{20/}

A recent Commission order further supports OTS witness Mr. Sivulich's position against the recovery of prospective net negative salvage in connection with the retirement of a fossil fuel power plant. In Pennsylvania Public Utility Commission v. West Penn Power Company, Docket No. R-00942986 (entered December 29, 1994), the Commission determined that West Penn Power Company was prohibited from recovering prospective net negative salvage for four (4) fossil fuel power plants under the Penn Sheraton decision:

... We reject the Company's assertions that "Pennsylvania has [a] unique regulatory practice" and that our policy "is out-of-step with the rest of the world." [citation omitted]. We do so precisely because our precedent sought to separate current and future negative salvage in order to ensure that customers are not required to pay the net expenses associated with retiring plant and equipment before those costs are actually incurred. The Company's alternative approach, in our view, is contrary to that long-standing rule and precedent because it would substitute an uncertain and speculative claim in place of the current cost approach. (Emphasis supplied).

^{20/} Moreover, the actual dismantling of each unit could take nearly three (3) years. PP&L Ex. TSL-1, p. 1 indicates that Mr. LaGuardia's estimated duration of dismantling activities range from 20.18 months for Holtwood to 34.97 months for Brunner Island.

Order at pp. 61-62.

In response, PP&L witness Mr. Hoch has argued that the cost of decommissioning associated with the retirement of the fossil fuel plants will be of such a magnitude that it must be paid for in advance. PP&L St. 4-R, pp. 14-17. He also contends that the existence of certain safety hazards (such as the presence of asbestos) associated with the dismantling of a power plant is sufficient justification for departure from current Commission net negative salvage practices. In addition, he claims that "...the Company's proposal is consistent with the ratemaking treatment accorded net salvage in most other jurisdictions, where it is reflected on a prospective basis as an element of the annual accrual rate." PP&L St. 4-R. p. 16.

However, PP&L has not refuted OTS witness Mr. Sivulich's basic contention that the level of decommissioning expense associated with each fossil fuel plant, when examined separately, is not significant enough to depart from the Commission's practice of treating net negative salvage on a current basis. In this regard, Mr. Sivulich has estimated that if PP&L witness Mr. LaGuardia's total Sunbury SES decommissioning cost estimate were divided by four (representing four generating units) and then divided by Mr. LaGuardia's estimated number of months to decommissioning, the result would be approximately \$1 million per month. Tr. 1686. A review of

PP&L's negative net salvage claim by month for the years 1990-1994 indicates that individual claims exceeded \$1 million (for Steam Production) on at least nine (9) occasions and was close to \$1 million (greater than \$800,000) on four (4) other occasions during this period. See, OTS Ex. 2, Sched. 7, pp. 2-3. This evidence supports OTS witness Mr. Sivulich's position that the level of decommissioning expense, when examined separately, is not significant enough to depart from the Commission's practice of treating net negative salvage on a current basis.

PP&L witness Mr. Hoch's second argument is similarly flawed. The existence of safety or health hazards (including the presence of asbestos) does not create "special" circumstances which would require the Commission to allow prospective net negative salvage. PP&L witness Mr. LaGuardia has testified as follows under cross examination:

- Q. Now, with regard to these plants that you've personally inspected, can you identify any unusual safety concerns with regard to these fossil fuel plants as opposed to other fossil fuel plants for which you have provided dismantling cost estimates?
- A. Nothing more unusual than dealing with asbestos, for example, in some of the older units. That's always a safety concern in terms of making sure it's handled properly as it should according to federal and state regulations, and some potential for hazardous materials that may exist in terms of PCBs or acids and caustics that might be

residual after operations. But that's common in all power plants, so that's not an unusual hazard from that standpoint.

Q. Exactly. So with regard to other power plants of the same vintage, you would expect to find the same situation with regard to needing to deal with things like asbestos?

A. That's correct. (Emphasis supplied).

Tr. 963-964.

The above cited verbal exchange demonstrates that Mr. LaGuardia did not recognize the PP&L fossil fuel power plants as "special" or that they presented the kind of safety or health hazards that would require significantly higher dismantling costs than any other fossil fuel plant of similar vintage. Certainly nothing has been presented in this proceeding which would distinguish the units involved here from the fossil fuel units at issue in the recent West Penn order, which was cited earlier.

Mr. Hoch's third argument is the easiest of the three to refute. His contention that PP&L's claim would be allowed in other regulatory jurisdictions completely ignores the fact that PP&L is regulated by the Pennsylvania Public Utility Commission and must adhere to the requirements of the courts of the Commonwealth of Pennsylvania. In this regard, there is a Pennsylvania court decision which prohibits the recovery of prospective net negative salvage for non-nuclear fueled power plants.

In summary, OTS submits that the traditional treatment for fossil fuel plants of net negative salvage on a current basis for plants that are actually retired, should continue. This separation of current and future negative salvage is necessary to ensure that customers are not asked to pay the net expense of retiring plant and equipment before these costs are actually incurred, which may occur many years into the future.

Accordingly, OTS recommends that the ALJ and the Commission reject the Company's proposed operating expense claim for the test year ended September 30, 1995 of \$55,570,000^{21/} related to the future decommissioning of fossil fuel power production plant that is still in service.

2. PP&L Has Inflated Its Nuclear Fueled
Production Plant Decommissioning Expense
By \$11,745,000.

Nuclear fueled production plant decommissioning expense is defined as the present yearly expense of recovering the cost of retiring two nuclear fueled generating units at the SSES in the future over the estimated remaining lives of those units. OTS St. 2, pp. 19-20. PP&L witness Mr. LaGuardia has testified that the dismantling and the demolishing of the two nuclear units at SSES are estimated to cost approximately \$804 million

^{21/} The Pennsylvania Jurisdiction equivalent amount is \$45,284,000. The Revenue Requirement equivalent amount is \$47,718,000. See, Appendix A, Table II, attached to this Main Brief.

(1993) dollars. PP&L St. 13, p. 3. This claim translates into a claimed annual cost for decommissioning of \$12.6 million for Unit 1 and \$17.4 million for Unit 2. PP&L St. 3, p. 20.

The Company's current request for nuclear fueled production plant decommissioning expense is based on a site specific study performed by Mr. LaGuardia. PP&L Ex. TSL-2. Unit 1 has an operating license which expires in the year 2022, while Unit 2 has an operating license which expires in the year 2024. PP&L Ex. TSL-2, p. 2-1. PP&L's share of the decommissioning cost of \$315.5 million for Unit 1 and \$408.4 million for Unit 2 in 1993 dollars was escalated at a rate of 4% to estimate the cost of decommissioning in the years 2022 and 2024, respectively. The projected value of the decommissioning trust in 2022 for Unit 1 and 2024 for Unit 2 was determined assuming the trust realizes a 5.5% annual after-tax rate of return. The value of the trust was then deducted from the estimated cost of decommissioning to determine the net amount of additional decommissioning funds which must be provided for through the annuity method. This resulted in the claimed annual cost for decommissioning of \$12.6 million for Unit 1 and \$17.4 million for Unit 2. See, PP&L St. 3, p. 20. In effect, PP&L is requesting a \$22.9 million increase in its decommissioning expense for nuclear fueled power production plants, which would raise the total amount of this expense to \$30,042,000. See, PP&L Ex. Future 1, Sched. D-11.

In response, OTS witness Mr. Sivulich has recommended an allowance of \$18,297,000 for nuclear decommissioning expense instead of the \$30,042,000 claimed by the Company. This results in an OTS adjustment of \$11,745,000. See, PP&L's response to OTS-RB-41, which has been included in OTS Ex. 2, Sched.2, p. 2. This allowance is based upon Mr. LaGuardia's 1993 cost estimate without the \$122.8 million in contingencies^{22/}, the inflation factor cost estimate of 4% per year and the trust fund estimated after-tax 5.5% per year growth. OTS St. 2, p. 22.

Mr. Sivulich's recommendation is based upon the methodology employed by the Commission in providing for nuclear decommissioning expense in past PP&L rate cases. For example, in PP&L's 1984 rate case, the Commission allowance for nuclear decommissioning expense was calculated based upon the current best estimate of decommissioning cost without any contingencies and without any reflection of an inflation or growth factor for the decommissioning fund. Pennsylvania Public Utility Commission v. Pennsylvania Power & Light Company, 59 Pa. P.U.C. 332

^{22/} According to PP&L witness Mr. LaGuardia, the \$122.8 of contingencies represents 18% of the total cost estimate in 1993 dollars. Tr. 1063. The details of the contingency included in Mr. LaGuardia's cost estimates are provided in the Company's response to OTS-RB-39, which has been included in OTS Cross Examination Ex. 17. A further elaboration of the contingency percentages by estimation category is provided at OTS Ex. 2, Sched. 3.

(1985)^{23/}. The approach advocated by Mr. Sivulich and previously adopted by the Commission has been referred to as the "accrual method." The Commission explained its rejection of PP&L's 25 % contingency factor as follows:

The Massachusetts Department of Public Utilities rejected an identical 25 % contingency factor for decommissioning costs at the Millstone Nuclear units. [Citation Deleted]. The Company has failed, in this case, to demonstrate that the 25 percent is anything but conjecture on its part. We cannot permit the ratepayers to be subject to a contingency factor which is too speculative in nature and which is as likely to fluctuate downward as upward as the state of the art develops. The Company's 25 % contingency factor is rejected. (Emphasis in original).

59 Pa. P.U.C. at p. 384.

The prior Commission orders clearly indicate that the Commission is willing to consider periodic increases to the level of funding based upon new cost estimates, but is unwilling to accept increases in the cost estimates based upon contingencies or inflation. Moreover, OTS witness Mr. Sivulich has testified that it can be inferred from the above cited orders that the non-recognition of any future increase resulting from the trust

^{23/} The Commission had rejected a 25 % contingency factor proposed by PP&L in its 1982 rate proceeding as well. In this regard, See Pennsylvania Public Utility Commission v. Pennsylvania Power & Light Company, 57 Pa. P.U.C. 559, 606-607 (1982).

fund earnings will offset some of the increases in cost due to inflation^{24/}.
OTS St. 2, p. 23. In this regard, PP&L witness George T. Jones has stated in response to an interrogatory that "PP&L will review the Susquehanna Decommissioning Cost Estimate at two-year intervals, or more frequently, if there are material changes to the applicable estimation information, to assure that the estimate is kept current throughout the life of the plant." See, OCA Cross Examination Ex. 15, Sched. II, Q. 2. If the applicable estimate information is going to be kept current during the life of the plant, there is no need to allow for a contingency or inflation factor.

In response, PP&L witness Mr. Bernini has argued that OTS witness Mr. Sivulich has accurately stated that in PP&L's last base rate proceeding, the Commission approved a nuclear decommissioning expense allowance based on the "accrual method" advocated by Mr. Sivulich rather than the "annuity method" (the addition of an inflation factor) proposed by PP&L in this case. However, Mr. Bernini claims Mr. Sivulich did not properly apply the accrual method because he failed to reflect the recovery of

^{24/} The Commission has previously determined that it is inappropriate to recognize inflation in regard to a nuclear decommissioning fund when the company plans to periodically update its cost levels and decommissioning technology in future proceedings. See, Pennsylvania Public Utility Commission v. Pennsylvania Power Company, 64 Pa. P.U.C., 308, 351 (1987).

deficiencies in prior accruals over a one year period, as was done in the previous case.^{25/} PP&L St. 3-R, p. 9. According to Mr. Bernini, if the deficiencies are amortized over a one (1) year period, PP&L's claim would be increased by \$102.7 million (\$125.6 million per PP&L St. 3-R, Attachment 2 less Company claim of \$22.9 million). PP&L St. 3-R, p. 9.

However, OTS witness Mr. Sivulich has testified that Mr. Bernini's criticism of his application of the accrual method is invalid. The deficiencies identified by Mr. Bernini in this proceeding were actually incurred over a period of 11 or 12 years. See, PP&L St. 3-R, Attachment 2. In PP&L's last proceeding, the Company's calculation apparently included an extra component for a Susquehanna Unit 1 deficiency as a true up mechanism for imbalances that arose over a very short time period (a period of 1 to 2 years). However, a one (1) year true up is clearly not appropriate in the current proceeding since Attachment 2 to PP&L St. 3-R indicates that the deficiencies at issue here accrued over a 12.33 year period for SSES Unit 1 and a 10.175 year period for SSES Unit 2. OTS St. SR-2, p. 2. OTS witness Mr. Sivulich has testified as follows in response to Mr. Bernini's allegation:

^{25/} OTS witness Mr. Sivulich amortized the deficiency over the remaining life of the plant or thirty (30) years. OTS Ex. 2, Sched. 2.

... It is difficult to believe that Mr. Bernini is suggesting that a \$102.7 million deficiency, which was created over an 11 or 12 year period, should be amortized over one year for ratemaking purposes. In fact, the Company utilizes remaining life depreciation for its utility property, which requires that any past deficiencies in depreciation be recovered over the future (remaining) life of the asset. Accordingly, I believe that if there is an under recovery caused by changing cost estimates, it should be recovered over the remaining life of the nuclear unit. My position is further supported by the fact that the Company did not make any claim for a "deficiency makeup" in its current nuclear decommissioning expense claim. (See, OTS Exhibit No. 2, Schedule 2). Consequently, it appears that the Company realized that the one year amortization would not be an appropriate claim in this proceeding. (Emphasis supplied).

OTS St.SR-2, pp. 2-3.

PP&L witness Mr. Bernini's criticism of the OTS position is further weakened by the fact that the numbers he employed to produce the alleged increase in PP&L's claim of \$102.7 million are inflated by the \$123 million of contingencies that OTS witness Mr. Sivulich has recommended be disallowed. See, OTS Cross Examination Ex. 17; PP&L St. 3-R, Attachment 2.

In any event, the record clearly demonstrates that OTS witness Mr. Sivulich properly applied the accrual method in determining the appropriate level of decommissioning expense for PP&L. Moreover,

Commission precedent indicates that PP&L should not be allowed to recover a contingency amount in this proceeding. Further, the record demonstrates that since PP&L plans to update its claim for nuclear decommissioning expense every two years, it should not be allowed to include an inflation factor in its decommissioning claim.

In summary, OTS submits that PP&L's claim for Nuclear Decommissioning Expense of \$30,042,000, should be reduced by \$11,745,000^{26/} because it has been improperly inflated by the Company's inclusion of contingency and inflation factors. Consequently, OTS recommends an allowance of \$18,297,000 for Nuclear Decommissioning Expense.

B. Depreciation Expense

PP&L witness Mr. Hoch has testified that the actuarial techniques used in the current depreciation study are the same as those employed in a prior service life study completed in 1981, which was accepted by the Commission in its final order at Docket No. R-842651. PP&L St. 4, pp. 4-5. The calculation of the annual depreciation accruals reflects the application of the service life parameters from the service life

^{26/} The Pennsylvania Jurisdiction equivalent amount is \$8,581,000. The Revenue Requirement equivalent amount is \$9,043,000. See, Appendix A, Table II, attached to this Main Brief.

study and the straight line remaining life method of depreciation. The interim survivor curves used as a parameter of the life spanning depreciation procedure for power production facilities in Steam Production, Nuclear Production, Hydro Production and Other Production are based on an interim retirement study completed in 1993. PP&L St. 4, p. 5. In the instant filing, the deactivation dates and resulting life spans used for the life spanning calculations have been reduced for the Martins Creek Units 1 and 2, Sunbury SES and Holtwood SES. The deactivation dates and life spans have been extended for Conemaugh SES and Keystone SES. PP&L St. 4, p. 6.

OTS witness Mr. Sivulich has testified that he supports the extensions at Conemaugh and Keystone SESs but strongly opposes the shortening of spans at Martins Creek, Sunbury and Holtwood. OTS St. 3, pp. 25-26. In addition, Mr. Sivulich has testified that he opposes PP&L's proposal to change from modified sinking fund ("MSF") to straight line depreciation at Susquehanna SSES. OTS St. 3, pp. 32-33. The fossil fuel and nuclear depreciation issues will be discussed separately in the following sections.

1. PP&L's Fossil Fuel Power Production Plant
Depreciation Expense Should Be Reduced By
\$18,642,000.

PP&L's depreciation expert, Mr. Hoch, initially disavows any responsibility for the shortening of the life spans of the Martins Creek (Units 1 & 2), Sunbury and Holtwood SESs. He testifies that PP&L witness Douglas A. Krall is responsible for recommending the shortening of the respective life spans. PP&L St. 4, p. 6. Mr. Krall has testified that the life spans were shortened because of possible changes in air pollution requirements. PP&L St. 5, p. 10. A review of PP&L Ex. DAK 4 indicates that the life span is derived from the deactivation date estimate. Mr. Krall apparently "revised" the deactivation dates for Martins Creek Units 1 & 2 from the year 2015 to 2003. He "revised" the deactivation date of Sunbury Units 1, 2, 3, & 4 from the year 2010 to 2003. Finally, he "revised" the deactivation date of Holtwood 17 from the year 2009 to 2003. PP&L Ex. DAK 4. PP&L witness Mr. Hoch has admitted that the increase in depreciation expense due to the shortened life spans is approximately \$18,641,711^{27/}. Tr. 113.

^{27/} The effect can be seen by referring to the Company's response to OTS-RB-43 (included in OTS Cross Examination Ex. 2) and comparing the total depreciation expense on Attachment 1 (of this response), which utilizes the longer life spans from the 1989 Depreciation Study, with the amount of the claim for the future test year ended September 30, 1995
(continued...)

OTS witness Mr. Sivulich has testified that the reduction in the life spans for Martins Creek (Units 1 & 2), Sunbury and Holtwood SESs is clearly improper^{28/} based upon the following:

1. They [the shorter life spans] are only utilized for this rate case to generate a higher revenue requirement.
2. There are no management plans to retire these units early.
3. There are no management plans to retire any power production unit in the next twenty years. Page 4-7 of the May, 1994 Pennsylvania Power & Light Company Resource Planning Report indicates that the company has no plans to retire any major generating unit in the twenty year planning period. See OTS Cross Examination Exhibit No. 2.

^{27/}(...continued)

shown on page 1 of 14 of V-D-1a. OTS has rounded the \$18,641,711 amount to \$18,642,000.

^{28/} Conversely, OTS witness Mr. Sivulich has testified that he strongly supports the Company's proposal to extend the estimated life spans for the Keystone and Conemaugh SESs. In this regard, he states "[t]he extending of the life spans at Conemaugh SES and Keystone SES is reasonable and reflects management plans for these units. In fact, the longer life spans for these two plants reflects an industry trend of maintaining, upgrading, and extending the life spans of fossil fueled power plants as a less costly option to building new power production units." OTS St. 2, pp. 25-26.

4. The company is adding sizeable capital additions to each of these units to continue their existence as long as economically possible. See Schedule 4 of OTS Exhibit No. 2.
5. There are no government mandates that would force these units to be retired early.
6. Air pollution regulations are currently being met by PP&L. See Schedule No. 5 of OTS Exhibit No. 2.
7. PP&L is maintaining all of its generating units to ensure maximum life spans. ^{29/}

OTS St. 2, pp. 26-27.

The record in this proceeding is filled with evidence that demonstrates that the reduced life spans are inappropriate. For example, PP&L witnesses have consistently testified that PP&L has no plans to retire any generating unit within the next 20 years^{30/}. Tr. 110. In addition,

^{29/} In addition, consistent with PP&L's plans to not retire any generating units within the next twenty (20) years, OTS witness Mr. Sivulich has recommended that the Company consider lengthening the life spans of its fossil fuel power production plants in future depreciation studies for book and ratemaking purposes. Mr. Sivulich states "[i]t is likely that the 1989 Depreciation Study overstates total depreciation expense for these plants. However I have not proposed to reduce depreciation expense to reflect an expansion of life spans." OTS St. 2, p. 29.

^{30/} Significantly, PP&L witness Mr. Krall has also admitted under cross examination that the NARUC Manual on Depreciation Accounting Practices provides that depreciation accounting is directly tied to the retirement of the plant. In this regard, he read into the record a passage
(continued...)

Mr. Krall has testified that " [a] decision was made to reflect the possibility that they would be retired earlier in the depreciation schedule... Again, we're using the term "retirement date," and I don't want to leave the impression that we have a current plan to retire those plants on 2003." Tr.188.

Moreover, PP&L witness Mr. Hoch has admitted that reducing the life spans of these stations would produce a higher revenue requirement for PP&L than if the original life spans were continued. Tr. 111.

PP&L witness Mr. Krall provides the primary response^{31/} to the position taken by OTS witness Mr. Sivulich on the reduction in the life spans. Mr. Krall testifies that the revised deactivation dates are appropriate due to the advancing age of the units, economic analyses performed by the Company and possible changes in the environmental regulations applicable to

^{30/}(...continued)

from the manual which states that "it is inherent that the cost of the plant itself will remain on the books of the company until the plant is retired." Tr.1910-1912.

^{31/} PP&L witness Mr. Hoch briefly argues that Mr. Sivulich has improperly testified that "through continual maintenance, a utility would be able to keep the plant operating indefinitely...." PP&L St. 4-R, p. 18. In fact, Mr. Sivulich's testimony does not make such an assumption. However, Company operating engineers did make such a statement to Mr. Sivulich during an on-site plant inspection discussion about the effect of maintenance on the life spans of the Sunbury and Martins Creek generating units. OTS St. SR-2, p. 9. Mr. Sivulich's testimony does indicate that PP&L is maintaining its generating units in a manner that will allow them to operate well past the proposed shortened retirement date of 2003. OTS St. 2, pp. 27-28.

the Company. In addition, he claims that the relatively small size of the units in question, place them at a disadvantage in economic comparisons with larger units such as those at Montour and Susquehanna. PP&L St. 5-R, pp. 11-16.

Initially, OTS submits that Mr. Krall merely repeats, at great length, information that was discovered by the parties through interrogatories and discussions with Company personnel. Mr. Krall also ruminates, at great length, about the "possible" impact of the SO₂ and NO_x requirements of the Clean Air Act Amendments ("CAAA"). OTS believes that in many instances PP&L has offered the most "draconian" requirement that could possibly be implemented under Titles I or III of the CAAA in an attempt to demonstrate that its compliance costs could be very high. In fact, PP&L acknowledges that with regard to many of the requirements it fears will be implemented, scientific studies have not yet been completed and regulations have yet to be written. See PP&L St. 5-R, p. 10. Moreover, Mr. Krall has testified as follows with regard to the cost to comply with CAAA air toxics:

A ...they address hazardous emissions from fossil fuel power plants. The study results have been evolving, so we have been aware since that time, or the passage of the Act, November 15, 1990, that there was an exposure. We have learned a little bit more about that exposure as time has gone on.

- Q. But are there any specific requirements at this time?
- A. No, there aren't.
- Q. And what is the basis for your cost estimate related to this?
- A. For air toxics?
- Q. Yes.
- A. We're guessing that we might have to install some sort of ultra-high efficiency particulate collection or possibly specialized flue gas scrubbing to go after some specific toxin that might be identified. (Emphasis supplied).

Tr. 169-170.

Mr. Krall has also testified that PP&L is exploring alternatives to the possible retirement of these units in 2003. In this regard, he has stated that PP&L would consider re-powering the fossil fuel units in question or other generating stations, as well as technical options for replacing that capacity. Tr. 162. Moreover, Mr. Krall has testified that PP&L will also have allowances available to it that would serve to minimize the cost of CAAA compliance. Tr. 1901. Mr. Krall has further acknowledged that at the point PP&L's full exposure with regard to CAAA compliance is known and certain, it will have ample opportunity (at that time) to make the

decisions necessary to pursue the most cost effective method of compliance.

Tr. 1940-1941.

In short, the record demonstrates not only that the Company has no actual intention to retire these fossil fuel units in the year 2003, but that its claims of huge compliance costs if they continue to employ the units after 2003 are extremely speculative at best. However, OTS witness Mr. Sivulich has testified that the conflicting plans presented by the PP&L witnesses in this proceeding evidence a more disturbing possibility. In this regard, PP&L witness Mr. Krall has testified that "PP&L has taken these actions out of concern that failure to recognize the possibility of an earlier retirement date could increase unnecessarily the amount of undepreciated investment which would have to be recovered from customers at that time." PP&L St. 5-R, p. 10. (Emphasis supplied). OTS witness Mr. Sivulich has testified that this statement demonstrates that PP&L is not appropriately planning for the future in regard to its utility plant. Depreciation estimates should reflect the well-considered plans of management. However, the record in this proceeding indicates that the reduction of these life spans for depreciation purposes is

clearly at odds with PP&L management's apparent plans to run its generating plants for as long as it is economically viable.^{32/} OTS St. SR-2, pp. 10-11.

In any event, the record clearly demonstrates that PP&L has failed to demonstrate that it is appropriate to reduce the life spans for Martins Creek (Units 1 & 2), Sunbury (Units 1, 2, 3 & 4) and Holtwood 17. Accordingly, OTS recommends that PP&L's claim for Fossil Fuel Power Production Plant Depreciation Expense be reduced by \$18,642,000^{33/}.

2. PP&L's Claim For Susquehanna SES Power
Production Plant Depreciation Expense,
Should Be Reduced By \$30,388,000.

Property installed at the Susquehanna SES prior to January 1, 1989 is depreciated using a system of depreciation known as modified sinking fund ("MSF").^{34/} Under the terms of the agreement, the

^{32/} In this regard, PP&L's Resource Planning Report indicates that there are no planned generating unit retirements for the next twenty (20) years. Tr. 1899-1900.

^{33/} The Pennsylvania Jurisdiction equivalent amount is \$15,191,000. The Revenue Requirement equivalent amount is \$16,007,000. See, Appendix A, Table II, attached to this Main Brief.

^{34/} This method was approved by the Commission in its final order at Docket No. R-842651 (entered April 26, 1985) and subsequently modified by the Commission at Docket No. P-880332 (entered December 29, 1988), to permit PP&L to comply with the requirements of Statement of Financial Accounting Standards No. 92. Annual depreciation expense for property covered by this agreement is comprised
(continued...)

depreciation expense increases each year through 1998 and will revert to straight line remaining life depreciation on January 1, 1999. For example, the total depreciation expense for 1994 is \$127,916,725 and for 1995 is \$141,316,228. PP&L St. 4, p. 12. Plant installed after December 31, 1988 is depreciated using the straight line method with the average life span procedure and remaining life technique. OTS St. 2, p. 30.

The MSF method was constructed by the Company and accepted by this Commission as a means of deferring a portion of the large revenue requirement increase which occurred in connection with the in service dates of Susquehanna Units 1 and 2, respectively. In this regard, PP&L witness Mr. Hoch has stated that "[t]he primary reason for proposing this methodology was to minimize the impact on customers' rates associated with placing Unit 1 in service. This methodology was also proposed and approved for Susquehanna SE Unit 2 at Docket No. R-842651." PP&L St. 4, p. 10.

However, in this proceeding the Company is proposing a revision that will result in a higher level of depreciation expense for this rate case. Mr. Hoch has testified that "[t]he Company is proposing to include in

^{34/}(...continued)

of annual depreciation calculated by the MSF and the annual amortization amount of \$19.7 million related to the order at Docket No. P-880332. OTS St. 2, p. 30.

customers' rates a levelized amount of depreciation in place of the annually increasing amount. This levelized amount would remain in effect until January 1, 1999, at which time the depreciation expense amount would decrease to the straight-line level and the amortization, approved by the Commission in 1988, would terminate." PP&L St. 4, pp. 12-13. Included in a Company response to an OCA interrogatory (OCA Set II Q. 4) is information which indicates that the effect of the Company's levelizing proposal is to increase the test year Susquehanna depreciation expense by \$30,388,074. See, OTS Cross Examination Ex. 2.

OTS witness Mr. Sivulich has testified that PP&L's request to change from MSF to straight line for property installed at Susquehanna prior to January 1, 1989, should be denied for the following reasons:

1. It increases the Company's current revenue requirement by \$30.4 million with no apparent benefit to PP&L's customers.
2. Unlike the 1988 petition, this proposed change is not mandated by the Financial Accounting Standards Board.
3. Allowing the MSF agreement to run its normal course will result in a lower revenue requirement for PP&L's customers in the present case.
4. Continuing the present MSF until 1999 will not prevent the company from recovering all of the depreciation expense that it is entitled to. (Emphasis supplied).

OTS St. 2, pp. 32-33.

In his Rebuttal testimony, PP&L witness Mr. Hoch alleges that the disallowance of the Company's proposal would not be fair and would prevent PP&L from recovering all of its investment in nuclear plant. He states "... the Company could not be assured of recovering all of the depreciation expense that 'it is entitled to' unless it made annual rate filings that reflect those annual depreciation changes...." In addition, Mr. Hoch states the "rejection of the proposal to levelize MSF depreciation could only result in an additional factor driving the need for rate filings during the period through 1998." PP&L St. 4-R, p. 3.

In response, OTS witness Mr. Sivulich has testified that Mr. Hoch has attempted to confuse matters by merely discussing one side of the issue:

...The continuation of the [MSF] depreciation agreement until its conclusion at the end of 1998 will not prevent PP&L from obtaining full depreciation recovery. Mr. Hoch is undoubtedly aware that under MSF PP&L is allowed to book increasing depreciation amounts through 1998. The allegation that PP&L will not actually collect these amounts from ratepayers unless it files rate cases each year is of no consequence since whenever PP&L does file a rate case in the future, it will be allowed to utilize the increased depreciation it was allowed to book under MSF. Further, there is no validity to the claim that increasing depreciation expense by \$30 million in the present case may make it unnecessary for

PP&L to file for a rate increase in the next three years. As indicated in PP&L's current filing, depreciation is only one of many issues in a rate case. No single issue will determine whether this Company files for a rate increase. (Emphasis supplied).

OTS St. SR-2, p. 6.

Thus, it is clear that PP&L will not be denied a full recovery of its depreciation cost if MSF is continued for the identified assets through 1998. PP&L is being treated fairly if it is required to continue with MSF because it will be allowed to recover depreciation expense in the future that has been booked in accordance with a previous Commission order. Moreover, Mr. Hoch's claim that such a result will cause PP&L to file more frequent rate cases is similarly flawed because he acknowledged under cross examination that he was not aware of a single instance in the past where PP&L had filed for a rate increase based solely upon the need to change its depreciation rates. Tr. 1857.

Accordingly, OTS recommends that PP&L's request to change from MSF to straight line depreciation for Susquehanna SES property installed prior to January 1, 1989, be denied. Consequently, PP&L's

Susquehanna depreciation expense for the future test year should be reduced by \$30,388,000^{35/}.

C. The Company's Rate Case Expense Should Be Adjusted In Order To Reflect A 4-Year Normalization Of Its Expense.

In this proceeding, the Company has made a rate case expense claim of \$1,491,000. PP&L Ex. Future 1, Sched. D-7. For the purpose of this proceeding, PP&L has reflected a 2-year normalization of rate case expense, which results in an annual rate case expense of \$746,000 (\$1,491,000\2). Id. OTS does not question the prudence of the \$1,491,000 claim, but rather, the Company's use of a "2-year normalization" for its rate case expense.

In reviewing the Company's filing, OTS attempted to determine the rationale for PP&L's claim for a 2-year normalization of its rate case expense in this proceeding. Interestingly, the Company failed to provide the ALJ and the Commission with a logical rationale for its claim, and appears to be relying solely on the prima facie case of its original filing. The only explanation for requesting a 2-year normalization of its rate case expense was

^{35/} The Pennsylvania jurisdiction equivalent for this amount is \$23,832,000. The Revenue Requirement equivalent amount is \$25,112,000. See, Appendix A, Table II, attached to this Main Brief.

presented by PP&L witness Bernini on cross-examination in pertinent part as follows:

A. . . .The reason I used two years is, to be perfectly honest with you, I had no better choice (emphasis added).

I know that in the last case, we used two years, so I decided to use two years in this case.

Q. So you used it because you used it before?

A. That's correct.

Tr. 536.

While it is admirably that Mr. Bernini offered a "perfectly honest" admission that a two year normalization of PP&L's rate case expense was only selected because "he had no better choice", such an admission does not diminish the fact that the Company has provided no analysis to support its claim. Clearly, the Company has failed its burden of proof requirement pursuant to Section 315(a) of the Public Utility Code. In contrast, OTS through its witness, Charles T. Weakley, III, provided detailed analysis and explanations as to why PP&L's rate case expense should be normalized over a four year period, which results in an adjustment of \$373,000. OTS Ex. 4, Sched. 5.

As OTS witness Weakley explained, "the Commission views prudently incurred rate case expense as an ongoing, although recurring at

irregular intervals, expense relative to the rendering of the utility service; thus subject to normalization for ratemaking purposes." OTS St. 4, p. 20. In Pennsylvania Public Utility Commission v. West Penn Power Company, 73 Pa. PUC 454, 492, 119 PUR4th 110, (1990), the Commission endorsed OTS's concept that "normalization is the concept which specifically addresses prospective recovery of an expense, such as rate case expense, which recurs at dramatically fluctuating levels."

As previously noted, the issue is the length of the normalization period for PP&L's rate case expense in this proceeding. For normalization purposes, the company's history regarding frequency of rate filings is an essential element in determining rate case expenses. OTS St. 4, p. 20. As OTS witness Weakley testified, "the frequency should be determined by computing the average number of months that expire between the filing dates of a company's base rate case filings." Id., p. 20. After determining the filing frequency of base rate filings, the normalized expense claim is determined by multiplying by a fraction, the numerator of 12 months and the denominator being the number of months representing the frequency of filings. Id., p. 20. OTS Exhibit No. 4, Schedule 5, demonstrates that OTS analyzed a twenty year period of PP&L's rate filings, and an average of forty eight months was calculated by adding the filing intervals months of the respective rate case filings and dividing that total number by the five interval

periods. Upon concluding that PP&L has filed on average, a rate case every four years, Mr. Weakley divided PP&L's rate case claim of \$1,491,000 by four years, which results in an adjustment of \$373,000 to rate case expenses in the future test year based on a four year normalization.

In the absence of its own analysis to support a two year normalization of PP&L's rate case expense, PP&L witness Bernini in rebuttal implied that OTS's analysis for a four year normalization is flawed. PP&L witness Bernini suggests that the "flaw" can be corrected by eliminating from OTS's analysis the 125 month filing interval from PP&L's last base rate case to the instant proceeding as set forth in OTS Exhibit No. 4, Schedule No. 5. In support of its position to eliminate the 125 month filing interval, PP&L witness Bernini suggests that the conditions surrounding the extended stay out period are unlikely to occur again in the near future. PP&L St. 3-R, pp. 5-6.

In response, it is quite obvious that PP&L's assertion as to what may or may not occur in the future is speculation and has no evidentiary weight in this proceeding. The fact that PP&L's witness Bernini would propose the elimination of the 125 month filing interval demonstrates a lack of understanding that the company's history regarding the frequency of rate case filings is an essential element in determining the normalized level of rate case expense for ratemaking purposes. OTS St. 4, p. 20.

Hypothetically, the 125 month filing interval may be an aberration in PP&L's frequency of rate case filings, likewise, PP&L's 15 and 16 month filing intervals may be aberrations due to the construction of Susquehanna Units 1 and 2. OTS St. SR-4, p. 2; OTS Ex. 4, Sched. 5. The purpose for averaging historical filing intervals is to mitigate the aberrations of long and short periods that may have occurred during the historical period as presented in OTS Exhibit No. 4, Schedule 5. Furthermore, as OTS witness Weakley explained, "the reason for normalizing rate case expense based on a historical average is that no one knows when PP&L will file its next base rate case." OTS St. SR-4, p. 2.

Based upon the above discussions there should not be any dispute that PP&L's adjustment to the analysis performed by OTS is flawed and without merit, and should be rejected. Accordingly, OTS's adjustment of \$373,000 to PP&L rate case expense claim should be adopted.^{36/}

^{36/} The Pennsylvania jurisdiction equivalent for this amount is \$373,000. The Revenue Requirement equivalent amount is \$393,000. See, Appendix A, Table II, attached to this Main Brief.

D. Funding For PP&L's Social Programs Is Inappropriate For Rate Case Treatment.

1. Introduction

In this proceeding, "PP&L has introduced six new social programs and funding for two existing programs." OTS St. 4, p. 31. The total projected funding requirement for these programs is \$6,700,000 with \$3,530,000 to be funded by ratepayers and \$3,170,000 to be funded by PP&L." Id., p. 31. The eight programs and the requested funds from PP&L ratepayers is as follows:

PROGRAM	TOTAL FUNDING \$	RATEPAYER FUNDING \$
1. Build-A-Neighborhood	2,000,000	1,000,000
2. Affordable Housing	2,000,000	1,000,000
3. Small Business	1,250,000	500,000
4. Winter Emergency Plan	250,000	- 0 -
5. Keep Warm Plan	1,000,000	1,000,000
*6. Operation Help	50,000	- 0 -
*7. Cares	30,000	30,000
8. Payment Protection Plan	120,000	- 0 -
TOTAL	6,700,000	3,530,000
* Existing Programs		

PP&L St. 11, p. 31.

The above listed new programs is the product of a Social Initiatives Task Force consisting of seven PP&L employees, which produced a report dated November 14, 1994, entitled "PP&L Partners: Communities in Action" that identified customer and community needs and recommended social initiatives to address those needs. OTS St. 4, p. 32; OTS Cross-Examination Ex. 14. The Company in this proceeding has provided four objectives for its new social initiatives, which are to (1) provide meaningful cost-beneficial services; (2) demonstrate PP&L's commitment to addressing social concerns; (3) offer a significant financial commitment for program development and implementation; and (4) enhance PP&L's role and visibility in service area communities. OTS St. 4, p. 35; OTS Cross-Examination Ex. 16, p. 2 of Attachment 1.

OTS lauds PP&L's recognition and willingness to address the socio-economic problems of its service territory.^{37/} While PP&L's commitment to its customers' socio-economic problems is laudable, the issue in this proceeding is whether the proposed programs addressing those socio-economic problems are in the public interest and appropriate for ratemaking treatment. After a careful review of the applicable answers to interrogatories

^{37/} PP&L has made a commitment to fund the programs for at least three years regardless of the outcome of the rate case. The level of the commitment will depend on the final Opinion and Order of the Commission. OTS Cross-Examination Ex. 16, p. ii.

and the Company's explanations surrounding the new social programs, OTS is recommending total disallowance of the costs relating to the Build-A-Neighborhood, Affordable Housing, and Small Business Programs. OTS St. 4, pp. 35-36. The disallowance of these programs results in a reduction of \$2.5 million to the Company's overall claim of \$3,530,000 for social programs. Id., p. 36.^{38/} The basis for OTS's recommended disallowance is that "(1) these programs are not driven by specific Commission approved regulatory goals; (2) there is no discernable benefit to ratepayers; (3) these programs are being funded by forced contributions; (4) these programs are not compatible with the competitive environment evolving in the electric industry; and (5) the ratepayers funding of these programs is illegal." Id., p. 36.

Before discussing the merits of OTS's recommended disallowance, it is appropriate at this time to summarize the Company's descriptions of the Build-A-Neighborhood, Affordable Housing, and Small Business Programs. PP&L through its witness, Thomas C. Stathos, answered the question, "What is the Build-A-Neighborhood Program?", --- in pertinent part as follows:

^{38/} The Pennsylvania jurisdictional equivalent for this amount is \$2,500,000. The Revenue Requirement equivalent amount is \$2,634,000. See, Appendix A, Table II, attached to this Main Brief.

Most community representatives contacted by PP&L indicated that improving urban neighborhoods is a critical need. The deterioration of urban neighborhoods threatens the economic and social viability of cities and metropolitan areas. The flight of urban businesses and homeowners to suburbia has relegated some downtown areas and their surrounding neighborhoods to de facto second-class status. Promoting the development of strong neighborhoods addresses a variety of key issues such as affordable housing, crime, economic development, and civic pride.

PP&L St. 11, p. 17.

In answering the question, "What is the Affordable Housing Program?", ---

PP&L witness Stathos answered in pertinent part as follows:

The availability of adequate and affordable housing for limited-income families is lacking in many urban areas. It is not uncommon for low-income families in urban areas to spend a disproportionate amount of their disposable income on rent. High housing costs are a significant impediment preventing these customers from paying the full amount of their electric bills. The affordability is exacerbated in some cases because many of these buildings are poorly insulated.

PP&L St. 11, p. 19.

Finally, in answering the question, "What is the Small Business Program?", -

-- PP&L witness Stathos answered in pertinent part as follows:

Small businesses often play an important role in maintaining the viability of the neighborhoods where they are located. Neighborhood grocery stores, for example, are very important to people

Small businesses often play an important role in maintaining the viability of the neighborhoods where they are located. Neighborhood grocery stores, for example, are very important to people who lack transportation or have limited mobility because of physical impairments. Significant job growth is generated by small businesses, but they are very susceptible to failure in their first several years of existence. Many small start-up businesses begin in downtown urban areas because they cannot afford to lease buildings in prime locations. In addition, they often lack the capital or other necessary resources to locate their businesses in shopping malls.

Under the Small Business Program, PP&L would provide a variety of services to existing and new small businesses in urban areas. A "new" business would be defined as being in existence for less than one year. The Company's efforts would be coordinated with community development organizations that are addressing the needs of small business owners.

PP&L St. 11, p. 20.

Based upon the above quotes from the direct testimony of PP&L witness Stathos, it is clear that in this proceeding, PP&L is seeking to receive permission from the Commission to use ratepayers' monies to address the "socio-economic " problems of its urban service territory. OTS believes that such an expenditure of ratepayers' monies is illegal and potentially presents an obligation on the Commission to resolve issues never contemplated by the Public Utility Code.

2. The Funding Of PP&L's Social Programs Constitutes Unreasonable Rate Discrimination.

As previously noted, PP&L's attempt to address the social problems of its urban service territory is apparently well-intended, but inappropriate for rate case treatment by the Commission. In recent years, the Commission has allowed utilities to institute programs to assist their respective ratepayers who most need assistance in paying their bills. See Pennsylvania Public Utility Commission v. Philadelphia Electric Company, R-891364 (May 16, 1990); Pennsylvania Public Utility Commission v. Equitable Gas Company, R-901595 (November 21, 1990). PP&L's request in the instant proceeding goes beyond assisting ratepayers who may need assistance in paying their bills, to funding programs to solve the socio-economic problems of its urban service territory.^{39/}

^{39/} PP&L appears to be influenced by its understanding or misunderstanding that "the BCS (the Commission Bureau of Consumer Services) has taken the lead in promoting social initiatives among electric and gas utilities. It has encouraged companies to implement programs such as fuel funds, special outreach services, low-income weatherization, and CAPs. Recognizing that the state legislature has shied away from addressing low-income problems and issues, BCS has filled the vacuum left by the General Assembly. With its ability to influence the behavior of utilities, BCS has used them as 'government by other means.' If, in the eyes of BCS, state government fails to adequately protect the health and safety of low-income consumers, then the Bureau will take action." OTS Cross-Examination Ex. 16, p. 24.

While the appellate courts in Pennsylvania have not ruled on the specific issue of whether the Commission can utilize ratemaking as a tool to solve the specific socio-economic remedies advocated by PP&L in the instant proceeding, the Commonwealth Court, in dicta, opined that such ratemaking is prohibited by the Public Utility Code:

We can agree with the appellants that ratemaking should not be made more difficult by the employment in the process of personal socio-economic theories or, indeed, any consideration other than of the law and the facts of record. Decisions concerning the kind and extent of subsidy which should be afforded to needy residential customers should, it seems, be left by regulatory agencies and courts to the legislative branch of government, as indeed the Commission seems to have concluded in its Generic Study just mentioned. Certainly there is nothing in Pennsylvania law which now empowers the Commission to require one customer simply to pay another's utility bill; and, as we have mentioned, the utility may not and could not for the long be required to provide such subsidy out of its capital (emphasis added).

United States Steel Corporation v. Pennsylvania Public Utility Commission,

37 Pa. Commonwealth Ct. 173, 185, 390 A.2d 865 (1978). While

Commonwealth Court was addressing whether the Commission could require one customer pay another's utility bill, OTS believes that the ruling is analogous to PP&L's request that customers pay for urban neighborhood revitalization, start-up costs for small businesses or provide affordable

housing for other customers. The same principle applies in that socio-economic decisions concerning the kind and extent of subsidies for needy customers should be left to the legislative branch of government. Once again, while PP&L's proposals differ in some respect from the subsidization of low-income individuals unable to pay their bills, the principles applied in Process Gas Consumers Group v. Pennsylvania Public Utility Commission, 511 Pa. 88, 99, 511 A.2d 1315 (1986), is the same that should apply in the instant case. The Court concluded in Process Gas that the Commission's power does not include the power to tax. Simply put, the Commission has no power to authorize "forced contributions" or place a tax on ratepayers to pay for socio-economic theories proposed in a ratemaking proceeding.

It must be noted that the Public Utility Code, specifically suggests that the Commission's main function in ratemaking is to assure that every rate made, demanded, or received by any public utility shall be just and reasonable. 66 Pa. C.S. §1301. In ensuring just and reasonable rates, Section 1304 of the Public Utility Code, 66 Pa. C.S. §1304 provides, in pertinent part, as follows:

No public utility shall, as to rates, make or grant any unreasonable preference or advantage to any person, corporation, or municipal corporation, or subject any person, corporation, or municipal corporation to any unreasonable prejudice or disadvantage. No public utility shall establish or maintain any unreasonable difference as to rates,

either as between localities or as between classes
of services. . . (Emphasis added)

OTS submits that PP&L's proposal to fund the Build-A-Neighborhood, Affordable Housing, Small Business programs results in the unreasonable rate discrimination concept prohibited by the Public Utility Code. There should be no question that the Company's request is rate discrimination. The Company's proposal centers around its urban service territory, but fails to address the low-income customers in the rural areas, or provide affordable housing in non-urban areas, or provide assistance for non-minority businesses in the non-urban or urban service territory. There are a host of rate discriminatory issues in the Company's proposal, moreover, in the instant proceeding, the ALJ and the Commission must address the concerns of the Commission On Economic Opportunity ("CEO") regarding the mechanism used by PP&L in distributing funds for community programming throughout its five regions. CEO Brady St., p. 10. Also, the Commission will have to address whether the funds should be in the form of a block grant. *Id.*, p. 7. It is quite interesting that while the Federal government is contemplating dismantling Housing and Urban Development and the Small Business Administration, PP&L is proposing that the Commission become a pseudo "Housing and Urban Development and the Small Business Administration". Clearly such a role by the Commission was

not contemplated by the Public Utility Code. If there is a desire for the Commission to authorize such programs by utilities, then the Public Utility Code needs to be amended.

Aside from the obvious statutory and appellant decisions prohibiting the Commission's adoption of PP&L's proposal there are also practical considerations as well. First of all, these programs are not compatible with the competitive environment evolving in the electric industry. Notably, at present the Company is proposing that the \$3,530,000 be funded by all customer classes. OTS St. 4, p. 39. There is no question that the electric industry is moving towards deregulation and competition.

OTS witness Weakley explained as follows:

Competitors of PP&L in this environment will not be burdened by regulatory costs such as social programs. To compete, PP&L will need to shed these costs from the competitive customers. My concern is that these costs will become stranded and ultimately be shifted to those captive customers with no competitive alternatives. The expansion of social costs, at this time, does not appear to be compatible with the newly developing electric industry.

OTS St. 4, p. 40.

Consequently, as the Commission address the issues associated with deregulation of electric industry and competition, one of the issues will be costs of stranded investments and/or the costs of social programs.

Second, during this proceeding, the Company has made a number of references to the Commission's desire to assist troubled payment customers. However, OTS does not believe that the Commission's desire to assist troubled payment customers extends to rehabilitating urban neighborhoods in PP&L's service territories and assisting in the establishment of small business for new customers.

Finally, there is no identifiable cost benefit to PP&L's customers, as the Company has not any performed cost benefit analysis relative to these programs. One of the benefits listed by PP&L has been the potential lowering of accounts receivable write-offs; however it is pure speculation as to whether any net savings will develop in the absence of a cost benefit analysis. In some instances, such as the Build-A-Neighborhood and Affordable Housing Programs, to the extent the benefits of these programs are extended to non-electric heating customers, no benefits will accrue to PP&L customers. OTS St. 4, p. 37. To the extent these programs are extended to new PP&L customers, reductions in uncollectible accounts cannot materialize, as those customers could potentially increase uncollectibles. Id., p. 38.

An adoption of the social programs as proposed by PP&L is not only against the Public Utility Code and court decisions, but is also bad public policy. Accordingly, the proposal should be rejected.

3. The Keep Warm And Cares Extension Programs Should Be Adopted With Modifications.

The Keep Warm Program and the Cares Extension Program should be adopted with modifications. Namely, the modifications should include that the programs be conducted as a three year pilot program. After three years, the Company should have an independent cost benefit analysis conducted to determine the benefit of the programs. Additionally, all the funds expended for the programs should be detailed in an annual report detailing receipts, expenditures and any accumulated excess funds. OTS St. 4, p. 41.

Both the Keep Warm Program and the Cares Extension Program represents a continuation of the Commission's Policy of assisting payment troubled customers through weatherization, conservation to name a few of the benefits. Consequently, the benefit to all customers is the potential for a reduction in collection costs, uncollectible accounts and preventing a customer from becoming payment troubled.

In adopting the modifications suggested by OTS, the programs has the potential of benefiting all customers, and should be adopted by the ALJ and the Commission with the modifications.

E. PP&L's Environmental Remediation Expense Claim Should Reflect The Actual Dollars Associated In The Agreement Between DER And PP&L For Environmental Liabilities.

In this proceeding, PP&L has an environmental remediation expense claimed of \$5,400,000. PP&L Ex. Future 1, Sched. D-16. The Company's claim is based on the estimate of environmental assessments/remediation payments expected to be made during 1995. OTS St. 4, p. 18. By way of background information, the environmental remediation program is intended to proactively reduce the environmental liabilities that result from standard past practices at operating facilities. *Id.*, p. 17. The environmental remediation expense is the cost of cleaning up various sites including manufactured gas plants, substations, utility pole sites with PCB spill histories and decommissioned power plants. *Id.*; p. 17.

After reviewing the Company's original filing, OTS recommended that PP&L's remediation expense claim be reduced by \$1,304,000. OTS Ex. 4, Sched. 3. OTS's original recommendation was based upon the fact that PP&L's claim was speculative in nature and based primarily on potential future costs. OTS St. 4, p. 18. Between the filing of OTS's direct testimony and the filing of PP&L's rebuttal testimony, PP&L and the Department of Environmental Resources ("DER") reached an agreement on April 27, 1995 regarding the Company's ongoing clean up

efforts. OTS St. SR-4, p. 5. The agreement provides in pertinent part that during that next 10 years, PP&L will investigate all 134 sites and spend up to \$5 million a year on investigation and clean up operations. PP&L Ex. MJB-9. In recognition of the agreement between PP&L and DER, OTS reduced its recommended disallowance from \$1,304,000 to \$326,000 (\$400,000 x 81.4815 %).^{40/} OTS St. SR-4, p. 5.

PP&L through its witness, Michael J. Berish, acknowledged that the claimed amount of \$5,400,000 assumed that an agreement between PP&L and DER would result in the implementation of an environmental remediation program in the future year. PP&L St. 2-R, p. 3. In essence, PP&L made its claim of \$5,400,000 because negotiations between the parties had been centered around \$5 million. As previously noted, it was only after PP&L prepared its original filing that an agreement was reached between PP&L and DER. A synopsis of the agreement was provided in PP&L Exhibit MJB-9, which clearly indicates on page 2 that "PP&L will spend up to \$5 million a year on investigation and clean-up operations" (emphasis added). Clearly, there is a \$400,000 difference in the amount agreed upon by PP&L and DER in their agreement, and the amount requested by PP&L

^{40/} 81.4815 % represents the Pennsylvania Public Utility Commission jurisdictional allocation.

in this proceeding.^{41/} Accordingly, OTS's recommended disallowance of \$326,000 should be adopted by the ALJ and the Commission.^{42/}

F. PP&L's Claim For Pension Expense Should Be Limited To The Annual Cash Contribution Calculated By The Company's Actuary.

In this proceeding, PP&L proposes to change from a cash to an accrual basis of accounting for pension under SFAS 87. OTS Ex. 4, Sched. 7. The Company is requesting the SFAS 87 pension expense of \$10,224,000 and rate base of \$5,273,000 for the capitalized portion on a PUC jurisdictional basis. OTS St. 4, p. 13. OTS is in disagreement with the Company's pension expense claim, and accordingly has made adjustments on a PUC jurisdictional basis to Operations and Maintenance expenses by \$10,224,000 and rate base by \$5,273,000, respectively. OTS Ex. 4, Sched. 2.^{43/}

^{41/} On cross-examination, PP&L witness Berish acknowledged that the press release reflected in PP&L Exhibit MJB-9 did not differ in any respect from the agreement . Tr. 2012

^{42/} The Pennsylvania jurisdiction equivalent for this amount is \$326,000. The Revenue Requirement equivalent amount is \$342,000. See, Appendix A, Table II, attached to this Main Brief.

^{43/} The Pennsylvania jurisdictional equivalent for this amount is \$10,224,000. The Revenue Requirement equivalent amount is \$10,773,000. See, Appendix A, Table II, attached to this Main Brief.

By way of background information, OTS witness Weakley explained that there are two pension expense calculations that are computed annually by a company's actuary; the plans are SFAS 87 pension expense and the pension contribution/cash contribution that must be made to comply with ERISA (Employee Retirement Income Security Act) and IRS rules.

OTS St. 4, p. 11. OTS witness Weakley explains the difference as follows:

The SFAS 87 pension expense is accrued on the books of a company and is adjusted at year end to the actuarial determined amount. There are no payments made to the pension plan for the SFAS 87 pension expense since this expense does not represent a company's pension liability but rather represents the amount that must be recorded on a company's books in order to comply with General Accepted Accounting Principles (GAAP).

The second calculation performed by the actuary is the determination of a company's annual pension contribution computed in compliance with ERISA and IRS rules. It is this calculation that requires a payment into the pension plan. The difference between the cash contribution and the book expense will be recorded on the books as a prepaid asset where the payment exceeds the expense or as a liability if the payment is less than the expense.

OTS St. 4, pp. 11-12.

It must be noted that the purpose of SFAS 87 is to allow the user of the financial statements to compare the pension plans and expenses among different companies. OTS witness Weakley has testified that SFAS

87 does not address funding requirements of the plan or the ratemaking treatment of the expense and should not be use for any purpose other than the disclosure of financial data for book purposes. OTS St. 4, p. 11.

Accordingly, the Company request for SFAS 87 ratemaking treatment should be rejected, since the amount is not designed to be recovered in a rate proceeding. OTS St. 4, p. 11.

OTS submits that the Company's claim for pension expense should be limited to the annual pension contribution calculated by the Company's actuary in compliance with ERISA and IRS rules. OTS St. 4, p. 13. In this instance, there is no cash contribution required. Since 1988, the maximum allowable and minimum required cash contribution level has been zero for PP&L. Id., p. 13. Simply put, due to the overfunding, no contributions are required for the future test year; nor are any tax deductible contributions allowed under current Internal Revenue Service regulations. Id., p. 14. The position advocated by OTS of treating pension expense on a "cash only" basis is consistent with the Commission's rulings on this issue. For example, in Pennsylvania Public Utility Commission v. West Penn Power Company, 73 Pa. P.U.C. 454, 119 PUR 4th 110 (1990), the Commission determined that pension expense should be treated on a cash basis:

. . . We agree with the OTS that pension expense should be treated on a "cash only" basis. As pointed out in the OTS filings on this issue, WPP's pension is currently overfunded, and IRS regulations will allow no tax deductible contributions for 1990. It is the contributions that WPP will actually make to the pension fund during the test year (\$0) which is the relevant amount in considering the allowable expense for ratemaking purposes (emphasis added).

p. 488.

OTS has offered a similar recommendation in this proceeding.

OTS witness Weakley testified that the pension fund is an entity separate from the Company with its own assets, liabilities, revenues and expenses. However, the Company is required to make payments to the fund subject to minimum ERISA limitations and maximum limitations of the Internal Revenue Code. These rules insure that the contributions are sufficient to meet future obligations and do not result in excessive asset levels.^{44/} OTS St. 4, p. 15.

The Commission confirmed its ruling that pension expense should be treated on a "cash only" basis in Pennsylvania Public Utility Commission v. West Penn Power Company, R-942986, (December 29, 1994), as follows:

^{44/} The amount contributed to the fund is determined by the actuary and is based on the Company's funding policy. OTS St. 4, p. 14.

On review of this issue, we agree with the ALJ's recommendation. The record evidence shows that the Company will be required to make a payment into the pension fund during the test year. We emphasize, however, that our decision today to allow the Company's claim for SFAS 87 pension expenses for ratemaking purposes should not be construed as a reversal of our position in West Penn 1990. Indeed, we are convinced that our West Penn 1990 decision and our ruling in the instant proceeding on the issue of SFAS 87 pension expenses are consistent. In West Penn 1990, we made clear our view that we will not allow the rate recovery of pension expense absent a finding that a payment obligation will incur during the test year at issue. *Id.*, p. 488. The ALJ is correct in finding that the first determination is whether a payment to the pension fund is due during the test year. We are convinced that clearly it is.

Opinion and Order at p. 44.

In the instant proceeding, the future test ends September 30, 1995, and there is absolutely no record evidence that the Company will be making a cash contribution to its pension fund during the test year. PP&L Ex. Future 1, Revised, p. 1. On rebuttal, PP&L witness Berish testified that "PP&L "presently" intends to reinstate cash contributions to its pension fund as early as the third quarter of 1996." PP&L St. 2-R, p. 13. In response, OTS submits that PP&L witness Berish reliance on "presently intends" suggests that the cash contributions are simply projection that should be classified as speculation. In any event, if the 1996 plan year contribution (if

allowed) actually occurs, such payments do not actually have to be made until March 15, 1998. OTS St. 4, p. 15.

Accordingly, OTS recommends that PP&L's claim for pension expense be limited to the annual pension contribution computed in compliance with ERISA and IRS rules. Since PP&L has failed to satisfy these requirements, the total claim of \$10,224,000 should be disallowed.^{45/}

G. PP&L's Request For Recovery Of A Deferred Expense Associated With Accumulated Deferred OPEB Expenses Should Be Rejected.

The term Post-Retirement Benefits Other than Pensions ("OPEBs") refers to all benefits provided by the Company to its retirees other than pension benefits. OTS St. 4, p. 2. These benefits typically include, but are not limited to, medical, dental and life insurance. *Id.*, p. 2. In December 1990, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 106 ("SFAS

^{45/} Mr. Weakley's pension expense adjustment affects rate base because when an employee's time is charged to a capital project (as oppose to O&M expense), the value of the payroll and employee benefits are then added to the cost of the capital project which will be included in the Company's rate base. OTS St. 4, p. 15. Accordingly, on PUC jurisdictional basis there should be a reduction to rate base by \$5,273,000. OTS Ex. 4, Sched. 2.

106").^{46/} OTS witness Weakley has testified that SFAS 106 requires that OPEB costs be viewed as deferred compensation earned during the period of active employment. The estimated future OPEB costs must be charged to expense (accrued) during the same period an employee is providing the service necessary to earn these benefits. OTS St. 4, p. 3. Simply put, SFAS 106, for financial reporting purposes, requires the expected cost of the benefits to be charged to expense during the years employees render service rather than some 20-25 years into the future when the employees are retired and these expenses are actually paid.

On December 4, 1992, PP&L filed a petition with the Commission requesting permission to defer the incremental OPEB costs that the Company was required to recognize beginning January 1, 1993. OTS St. 4, p. 8. By Order entered May 6, 1993, the Commission granted PP&L permission to defer the incremental OPEB costs or to establish a regulatory asset for such costs. *Id.*, p. 8.

In the instant proceeding, the Company's SFAS 106 claim of \$27,654,000 as presented in PP&L Exhibit Future 1, Schedule D-6, includes an "amortization of the deferred expense" component of \$1,797,000. OTS

^{46/} SFAS 106 required employers to change from a pay-as-you-go (cash) method of accounting for OPEB's to an accrual basis of accounting for these costs for fiscal years beginning after December 15, 1992. OTS St. 4, p. 2.

St. 4, pp. 8-9. The \$1,797,000, represents a 17.3 year amortization of the \$31,095,000 of deferred OPEB costs which the Company claims has been accumulated for the period January 1, 1993 (when SFAS 106 was adopted) to September 30, 1995. *Id.*, p. 9. The \$31,095,000 consists of \$10,770,000 for calendar year 1993, \$8,711,000 for the nine months ended September 30, 1994 and \$11,614,000 for the twelve months ended September 30, 1994 and \$11,614,000 for the twelve months ended September 30, 1995. OTS Ex. 4, Sched. 6.

OTS submits that based upon a decision by the Pennsylvania Commonwealth Court, PP&L's request to recover \$1,797,000 for the 17.3 year amortization of the \$31,095,000 of accumulated deferred OPEB expenses should be denied by the ALJ and the Commission. The Commonwealth Court's decision in Irwin A. Popowsky, Consumer Advocate v. Pennsylvania Public Utility Commission, 642 A.2d 648 (1994) ("PP&L"), indicates that PP&L's request to recover an expense associated with the amortization of the regulatory asset of accumulated deferred OPEB expenses is barred by the doctrine of retroactive ratemaking. It is self evident that the Commission will not set future rates to allow a utility to collect past

losses.^{47/} In this regard, PP&L prohibits the use of an amortized expense associated with deferred accounting to avoid the prohibition against retroactive ratemaking.

In the rebuttal phase of the case, PP&L did not specifically address the direct testimony of OTS witness Weakley as it related to an adjustment to the Company's SFAS 106 claim. However, the Company through its witness, Ronald J. Bernini did respond on rebuttal to the testimony of OCA witness Catlin's recommendation regarding the Company's SFAS 106 claim. PP&L St. 3-R, pp. 6-8. Accordingly, OTS will respond to the arguments presented by PP&L in responds to the recommendation of OCA witness Catlin.

Most of the arguments advanced by PP&L on rebuttal were rejected by Commonwealth Court in the PP&L case. First, PP&L witness Bernini testified that he disagreed with OCA witness Catlin's testimony that PP&L could have sought recognition of the expenses under SFAS 106 at an earlier point in time and thereby avoided the deferred costs claimed in this case. PP&L St. 3-R, p. 6. In addition, PP&L witness Bernini testified that the adoption of SFAS 106 and the change from cash to accrual accounting

^{47/} Ratemaking, by its nature, is prospective. Columbia Gas of Pennsylvania, Inc. v. Pennsylvania Public Utility Commission, 149 Pa. Commonwealth Ct. 247, 613 A.2d 74 (1992), affirmed, _____ Pa. _____, 636 A.2d 627 (1994).

for these costs was clearly an extraordinary and non-recurring event, which justifies recovery of these deferred costs in current rates. PP&L St. 3-R, p. 7.^{48/}

However, as previously referenced, Commonwealth Court dismissed similar arguments on the premise that the costs were anticipated at an earlier time and could have been recovered in an earlier proceeding:

Because the incremental costs were, in fact, anticipated before the request for declaratory order was filed and because the costs are recurring and could otherwise be recoverable in rates, the exception for "extraordinary" expenses does not apply. Therefore, the incremental costs would be prohibited by the rule against retroactive ratemaking and the PUC's order improperly assures future recovery. Accordingly, the order of the Pennsylvania Public Utility Commission is reversed. (Emphasis added)

PP&L, pp. 653-654.

The Commonwealth Court in PP&L concluded that PP&L could have recovered those costs had it filed a rate case rather than a request to the Commission for a declaratory order.

^{48/} Although cases have not clearly defined the extraordinary exception by example, a weather related expense caused by an "act of God" is generally considered extraordinary. See, Commonwealth of Pennsylvania v. Pennsylvania Public Utility Commission, 17 Pa. Commonwealth Ct. 351, 331 A.2d 598 (1975) (flood damage); Pennsylvania Public Utility Commission v. Pennsylvania Gas and Water Company, 57 Pa. P.U.C. 204 (1983) (cold weather maintenance expenses for thawing and repairing frozen mains).

Moreover, PP&L cannot support its claim that SFAS 106 costs is extraordinary (thereby effecting an exception to the doctrine of retroactive ratemaking) because the Company did not produce one element of evidence to suggest that the SFAS 106 ruling was not unanticipated.^{49/} See, Philadelphia Electric Company v. Pennsylvania Public Utility Commission, 93 Pa. Commonwealth Ct. 410, 502 A.2d 722 (1985). In addition, the Commonwealth Court in PP&L states that "extraordinary" cannot merely mean unanticipated, but to be extraordinary it must also be "a substantial, one-time expense or a substantial item that will not appear as a continuing expense and could otherwise never be recovered in rates because, like the weather related expenses, it would be normalized out of the test year as abnormal." In the instant proceeding, PP&L merely testified that the SFAS 106 cost is "extraordinary and non-recurring event", but failed to provide any evidence as to why it is an "extraordinary and non-recurring event" contrary to the Commonwealth Court's ruling in PP&L.

^{49/} SFAS 106 was released in December 1990 and not made effective until January 1993. This change had been under consideration for a long time. On November 22, 1982, the Financial Accounting Standards Board released a statement of preliminary views proposing that the accrual method be imposed for accounting of OPEBs, and on September 29, 1989, a proposed draft of the standards requiring the accrual method was released. See, BNA, Inc., Securities Regulation and Law Report, Vol. 14, No. 46, p. 2051, November 26, 1982; BNA Pension & Benefits Reports, Vol 16, No. 41, p. 1765, October 9, 1989.

Accordingly, PP&L's recovery of \$1,797,000 for the 17.3 amortization of the deferred expense of \$31,095,000 should be denied. This disallowance will reduce O&M expenses by \$1,561,000 on a Pennsylvania jurisdictional basis.^{50/}

H. PP&L's Claim For Uncollectible Accounts Expense To Fund Its Reserve Account Should Be Rejected.

Uncollectible accounts are specific receivables that are determined to be uncollectible in whole or in part, either because the debtors cannot pay or because the creditor finds it impracticable to enforce payment. OTS St. 4, p. 22. OTS witness Weakley testified as follows as to how utilities generally recognize uncollectible accounts for ratemaking purposes:

Generally for ratemaking purposes, utilities compute uncollectible accounts expense on an annual prospective basis. While the uncollectible accounts expense is a prospective claim, its genesis begins with an historic analysis of actual net write-offs to gross revenues and the development of an historic write-off ratio. Net write-offs are gross write-offs less recoveries of amounts previously written-off. This ratio is then

^{50/} The Pennsylvania jurisdiction equivalent for this amount is \$1,561,000. The Revenue Requirement equivalent amount is \$1,645,000. See, Appendix A, Table II, attached to this Main Brief.

applied to projected revenues to determine the proper prospective allowance.^{51/}

OTS St. 4, p. 23.

In this proceeding, the Company has claimed \$16,932,000 for uncollectible accounts expense. The total expense is comprised of three elements: an amount of \$16,800,000 for uncollectible electric service accounts receivable, \$120,000 for property damage accounts receivable and \$12,000 in other accounts receivable. OTS Cross-Examination Ex. 9.

The \$16.8 million for uncollectible electric service accounts receivable was developed by the Company by separating receivables into three categories: receivables referred for collection, receivables related to deferred payment plans and receivables related to accounts that are current to over 90 days delinquent. OTS St. 4, p. 24. To these amounts the Company applied write-off percentages that were based on historical experience and adjusted for known changes. *Id.*, p. 24. Based upon this information, the Company developed an uncollectible accounts provision requirement of \$30,719,000.

^{51/} When there exists a definite upward or downward trend in actual write-offs, the historic analysis may not be representative of the future and therefore may not produce an accurate prospective claim. OTS St. 4, p. 23

As of October 1, 1994, the Company's uncollectible accounts provision balance was \$29,485,000. OTS Cross-Examination Ex. 9, Attachment 1. Consequently, when the beginning balance of \$29,485,000 is reduced by 1995 projected write-offs of \$15,566,000 a net provision of \$13,919,000 remains. *Id.*, p. 25. The Company's claim of \$16,800,000 is the funding needed to restore the provision to the projected requirement of \$30,719,000 (\$16,800,000 + \$13,919,000). OTS Cross-Examination Ex. 9, Attachment 1.

It must be made clear that OTS does not contest how the projected uncollectible provision of \$30,719,000 was calculated for book purposes, but rather, what should be the appropriate claim for ratemaking purposes. As previously noted, the Company's claim of \$16.8 million is the amount of dollars needed to fund the reserve to the Company's projected uncollectible accounts provision balance requirements of \$30,719,000.

Tr. 476. In essence, the \$16.8 million does not reflect PP&L's projected actual write-offs; however, PP&L has projected actual write-offs of \$15,566,000. OTS Cross-Examination Ex. 9.^{52/} OTS's recommendation uses the \$15,566,000 rather than the \$16,800,000 into the development of the total uncollectible accounts expense claim. OTS St. 4, p. 26.

^{52/} The figures of \$16.8 million and \$15.5 million dollars, respectively, are the numbers provided by the Company. OTS Ex. 9, Attachment 1.

The only issue is whether the Company will be allowed to use an amount \$16,800,000 to fund the reserve to the Company's projected requirements or use the actual 1995 write-offs of \$15,566,000. OTS submits that it is simply inappropriate to have the ratepayers reimburse PP&L for an arbitrary amount relating to the funding of a reserve. It is appropriate for ratepayers to reimburse PP&L for a normalized projected level of uncollectible accounts expense based on the actual direct write-offs that will occur, which is \$15,566,000.

On rebuttal PP&L witness Berish suggests that \$16,932,000 is appropriate because the budgeted write-off for the future of \$15,566,499 is abnormally low when compared to historic experience. PP&L St. 2-R, pp. 6-7. Additionally, the Company suggests on rebuttal that \$16,932,000 is appropriate because PP&L did not reflect the incremental uncollectible accounts expense associated with its requested rate increase. Id., p. 7. In response, OTS would remind the ALJ and the Commission that the benefits of low-income programs should be the reduction in uncollectible accounts expense. Moreover, OTS witness Weakley demonstrated that PP&L's actual write-offs is showing a decreasing trend, even though revenues have been increasing. OTS Ex. 4, Sched. 14, p. 3. Despite the decreasing trend in actual write-offs of uncollectible accounts expense, PP&L's funding reserve failed to show the same decreasing trend. The Company has been unable to

present any evidence to support why it continues to need a reserve for uncollectible accounts not reflective of its actual write-offs of uncollectible accounts expense.

In the absence of such evidence, the ALJ and the Commission should adopt the recommendation of OTS to reduce PP&L's claim by \$1,234,000.^{53/}

I. PP&L Has Overstated The Funding Requirement Relative To The Uncollectible Accounts Of The OTPP.

By way of background, PP&L has created a customer assistance program known as OnTrack Payment Program ("OTPP"). The pilot program is intended to assist 2,000 residential customers, whose household incomes are at or below 150 percent of the poverty level guidelines. OTS St. 4, p. 28. The OTPP is designed to establish an affordable monthly payment based on the customer's ability to pay a percentage of their income for electric service. Id., p. 28.

In this proceeding, the Company is claiming \$942,625 in OTPP related expenses. Tr. 871. The total claim is comprised of two distinct elements, which are \$232,625 for administrative costs and \$710,000 for an

^{53/} The Pennsylvania jurisdiction equivalent for this amount is \$1,234,000. The Revenue Requirement equivalent amount is \$1,300,000. See, Appendix A, Table II, attached to this Main Brief.

uncollectible account expense. The \$710,000 is subsequent divided between \$322,000 in revenue shortfall or billing deficiency and \$388,000 in arrearage forgiveness. OTS St. 4, p. 29.

In reviewing the \$710,000 for uncollectible account expense, both the revenue shortfall and the arrearage forgiveness was based on 2,000 potential OTPP customers of \$161 times and \$194 times, respectively.

Tr. 874. The averages of \$161 and \$194 respectively were based on the actual experience of the approximate 1,000 customers currently in OTPP.

The Company has overstated its expense for OTPP by \$140,000 by failing to give recognition to potential Low Income Home Energy Assistance Program

("LIHEAP") funding. The Company has projected the average LIHEAP grant at \$233 per customer. Tr. 879. By using the 2,000 potential OTPP

customers that an additional \$466,000 in additional revenues that the

Company failed to include in its filing. OTS St. 4, p. 30. Accordingly, the

uncollectible accounts expense related to the OTPP should be reduced by

\$140,000 to \$570,000.

PP&L on rebuttal suggested that a "substantial number of OTPP participants may not be eligible for LIHEAP funds. PP&L St. 11-R, p. 2.

The Company failed to provide a specific number for the record of the OTPP participants who would not be eligible for LIHEAP funds. Clearly, the

Company knows or should know the exact number of OTPP heating

customers not eligible for LIHEAP funds. In fact using the Company's own calculations as set forth on page four of PP&L's witness Stathos' rebuttal testimony suggests that \$140,000 is a conservative adjustment by OTS.

Consequently, the adjustment of \$140,000 to uncollectible accounts expense claim of the Company should be adopted.^{54/}

J. PP&L's Early Window Deferrals Claims For Susquehanna Unit No. 1 and Susquehanna Unit No. 2 Should Be Denied.

In this proceeding, the Company has claimed Early Window Deferrals for Susquehanna Units 1 and 2. PP&L Ex. Future 1, Sched. D-14. As explained by OTS witness Weakley, Susquehanna Unit No. 1 went into service on June 8, 1983 and was recognized in rates effective August 22, 1983 pursuant to the Commission's Order entered on August 22, 1983 at Docket R-822169. OTS St. 4, p. 16. Susquehanna Unit No. 2 went into service on February 12, 1985 and was recognized in rates effective April 26, 1985 pursuant to the Commission's Order entered on April 26, 1985 at Docket R-842651. *Id.*, p. 16.

OTS witness Weakley defined Early Window deferrals as follows:

^{54/} The \$140,000 was included in OTS's Total Uncollectible Accounts expense adjustment.

Early window deferrals, with respect to electric utilities, are accounting mechanisms which allow for the timing differences between the date of commercial operation and base rate recognition of a generating facility. Simply, the early windows allowed PP&L to accumulate these costs in a deferred account.

OTS St. 4, p. 15.

The Company's adjustment amortizes the early window deferrals applicable to Susquehanna Units 1 and 2 over a period of ten years. The annual amortization claim for Unit 1 is \$894,000 and for Unit 2 is \$305,000.

PP&L Ex. Future 1, Sched. D-14. Early window deferrals of Units 1 and 2 were authorized by the Commission in its Order at Docket Nos. P-820367, entered July 29, 1982 and P-830461, entered November 9, 1983, respectively, for accounting purposes only. OTS St. 4, p. 16.

It is the position of OTS that these early windows claims should be disallowed, because the Company failed to claim any recovery of the expenses at the first opportunity and the recovery constitutes impermissible retroactive ratemaking. In the case of Unit 1, the Company had the opportunity to make a claim to recover the associated early window costs in its 1984 base rate case, but failed to do so. On rebuttal, the Company asserted that it did not make a claim in its 1984 base rate case, because of a desire "to minimize the amount being requested." PP&L St. 3-R, pp. 11-12. The Company's explanation regarding Unit 1 is without merit, the failure to

file for recovery of these costs at the earliest opportunity (1984 base rate case) is fatal to PP&L's claim. In this regard, see, Columbia Gas of Pennsylvania, Inc. v. Pennsylvania Public Utility Commission, 149 Pa. Commonwealth Ct. 247, 613 A.2d 74 (1992), affirmed, _____ Pa. _____, 636 A.2d 627 (1994).

With respect to Unit 2, OTS submits that the Company could have filed at an earlier date and not waited ten-years to seek recovery of these costs. OTS St. 4, p. 17. On rebuttal, PP&L testified that the Company "had a corporate objective of delaying its next retail base rate case until 1994-1995 time frame to maintain base rate stability." PP&L St. 3-R, p. 12. The Company's explanation lacks merit, as the Commonwealth Court in Irwin A. Popowsky, Consumer Advocate v. Pennsylvania Public Utility Commission, 642 A.2d 648 (1994) opined in dicta that "the policy reasons behind this rule are that if retroactive ratemaking is allowed, it makes the "test year" method of ratemaking meaningless and the general principle that those customers who use power should pay for its production rather than requiring future ratepayers to pay for past use." Clearly, the fact that PP&L waited ten-years to recovery the deferred expenses, violates this statement by Commonwealth Court, and in that violation, the request for recovery of Unit 2 constitutes impermissible retroactive ratemaking.

Consequently, the Commission should adopt the recommendation of OTS in denying the deferred expense recovery of Susquehanna Units 1 and 2 of \$894,000 and \$305,000, respectively.^{55/}

^{55/} The Pennsylvania jurisdiction equivalent for this amount for Unit 1 is \$2,035,000. The Revenue Requirement equivalent amount for Unit 1 is \$2,144,000. The Pennsylvania jurisdiction equivalent for this amount for Unit 2 is \$1,886,000. The Revenue Requirement equivalent amount for Unit 2 is \$1,987,000. See, Appendix A, Table II, attached to this Main Brief.

V. RATE OF RETURN

A fair overall rate of return for PP&L is an overall cost of capital of 9.14%, based on a return on common equity of 10.63%.

OTS presented its expert witness, Kevan Deardorff, who testified that a fair rate of return for PP&L is 9.14%. OTS recommends that the ALJ and the Commission disallow the 10.22% overall return range and the 13.00% return on common equity requested by PP&L as excessive, based on the record of credible evidence in this proceeding.

In determining a fair rate of return the Commission should be guided by the established standards set forth in the landmark cases of Bluefield Water Works and Improvement Co. v. Public Service Commission of West Virginia, 262 U.S. 679 (1923), and Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591 (1944). In Bluefield, supra, the court stated:

A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate,

under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate of return may be too high or too low by changes affecting opportunities for investment, the money market and business conditions generally.

Bluefield Water Works & Improvement Co. V. Public Service Commission of West Virginia, 262 U.S. 679, 692-3 (1923).

[I]t is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.

Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591, 603

(1944). These pronouncements guided OTS witness Mr. Deardorff in making his fair rate of return recommendation. OTS St. 1, pp. 4-5.

A. Capital Structure

OTS accepts as reasonable the capital structure claimed by the company of 46.53% long term debt, 7.59% preferred stock and 45.88% common equity. OTS St. 1, p. 13. Mr. Deardorff's analysis of the capitalization ratios of a barometer group of electric utilities indicates that PP&L's recommended capital structure is reasonable in comparison to the industry.

Mr. Deardorff examined the capital structure ratios for both PP&L and a barometer group of electric companies. OTS Ex. 1, Sched. 2, p. 1. The barometer group's actual 1994 and estimated 1995 debt ratios are 45.89% and 45.25%, respectively. PP&L's claimed debt ratio as of 9/30/95 is 46.53%, or .64 percentage points above the barometer group's historical debt ratio and 1.28 percentage points above that group's projected debt ratio. OTS St. 1, pp. 13, 14. In addition, PP&L's 45.88% common equity ratio is near the upper end of the barometer group's ten-year historical equity ratio range of 42.66% to 45.37%. OTS Ex. 1, Sched. 2, p. 2.

B. Cost of Debt and Preferred Stock

The OTS accepts as reasonable PP&L's 7.97% cost rate of long term debt. Analysis by Mr. Deardorff determined that the range of

embedded cost rate of debt for the barometer group is between 5.18% and 7.99%. PP&L's 7.97% figure is within that range. OTS St. 1, p. 14.

The OTS also adopts PP&L's 7.31% cost rate of preferred stock. This figure falls within the electric company barometer group cost rate range of 5.81% and 7.84%. OTS St. 1, p. 14.

C. Return on Common Equity

1. Methodology Used

The OTS submits that the 13.00% return on common equity recommended by PP&L witness Paul Moul is excessive, and that the credible evidence in this record supports a return on common equity of 10.63%.

To arrive at this recommendation, Mr. Deardorff employed the discounted cash flow method (DCF) to current market data for PP&L and to Mr. Moul's electric company barometer group. Mr. Deardorff gave significant weight to the PP&L analysis results because the company's business is based solely on electricity production and sale and PP&L has adequate financial and market data available for use in a DCF analysis. OTS St. 1, p. 16.

2. Barometer Group

Mr. Deardorff used the barometer group to "smooth out" any aberrations associated with using a single company for analysis. In addition,

the barometer group is also used as a suitable benchmark to satisfy the regulatory guideline which provides PP&L the opportunity to earn a return equal to that of similar risk enterprises. OTS St. 1, p. 17.

Mr. Deardorff used the identical barometer group selected by PP&L. The electric companies selected were: Allegheny Power System, Inc., American Electric Power Company, Atlantic Energy, Inc., Baltimore Gas & Electric Co., Delmarva Power & Light Co., DPL Inc., Potomac Electric Power Co., and Public Service Enterprise Group. These companies were chosen because they have the following common characteristics: (i) they are contained in the Standard & Poor's Utility Compustat data base; (ii) they have SIC Code 4911 (Electric Service) and 4931 (Electric and other services combined); (iii) they have common stock which is traded on the New York Stock Exchange; (iv) they operate in Pennsylvania or its six contiguous states; (v) they have not cut or omitted their dividends, and (vi) they have 1993 operating revenues above \$750 million. PP&L St. 12, p. 19.

3. Economic Factors

a. Economic Variables

In his analysis, Mr. Deardorff made comparisons of important economic variables and examined their impact on electric utilities. This 20 year historical perspective encompassed the Moody's "A" Utility Bond

Yield, the U.S. T-Bills rate, the prime interest rate, and the percent change in the CPI compared to the average dividend yield for the barometer group for the same period. Mr. Deardorff also examined a sample of economic experts' quarterly forecasts for 1995 and 1996 and yearly forecasts for 1996 to 2005. OTS Ex. 1, Sched. 3.

b. Dividend Yield and Bond Yield Relationship

In his analysis, Mr. Deardorff found a direct relationship between the bond yield and dividend yield variables. OTS Ex. 1, Sched. 3. This relationship is important, as one recommending a representative dividend yield for a prospective period should consider the potential impact to bond yields. OTS St. 1, p. 19. Here, bond and dividend yields were generally in a relatively narrow range over the past nine years. OTS St. 1, p. 10.

c. Interest and Inflation Rates

Forecasting professionals are expecting Treasury Bill (T-Bill) yields to be the 6.0% to 6.5% range. Inflation is forecast to be between 3.2% and 3.5% over the next two years. OTS St. 1, p. 19. As a result, the real rate of interest is expected to be in the 2% to 3% range. Over the next five years, forecasting professionals expect T-Bills to peak at 6.5% and

then decline to 5.5%. Inflation is expected to decline from a high of 3.5% to 3.3% over the same period. Therefore, the real rate of interest is expected to remain within the equilibrium range of 2% to 3%. OTS St. 1, p. 19.

Forecasting professionals also expect interest rates on long-term "A" rated utility bonds to increase from the current 8.5% to 8.8%, and then to return to 8.5% within the next year. The yields on "A" utility Bonds are expected to peak at 8.8% in the second quarter of 1995 and then decline to the 8.0% to 8.2% range over the next ten years. OTS St. 1, pp. 20, 21.

In recent years, Federal Reserve policy has greatly alleviated inflationary fear. If the Federal Reserve continues its anti-inflationary policy, investors' inflationary expectations will continue to decrease resulting in lower and more stable interest rates. OTS St. 1, p. 20. Decreased inflation and interest rates will lessen a utility's investment risk with a resultant lower cost of capital.

d. Debt Cost Rates

The spread for debt cost rates between the higher "A" rated utility bonds and the lower cost rates on equal grade industrial bonds has narrowed from 56 basis points in 1983 to approximately 5 basis points for the 1993-1994 period. This narrowing occurred as a result of interest rate

stability. In the past, high and volatile interest rates increased the overall investment risk of regulated utilities in comparison to non-regulated firms. OTS St. 1, p. 22.

In late 1981, interest rates peaked and then began to decline. The overall investment risk of public utilities also began to decline. This investment risk will continue to parallel the decline in long-term interest rates and result in a lower cost of capital to utilities in relation to their industrial counterparts. OTS St. 1, p. 22.

D. Discounted Cash Flow Analysis (DCF)

The method Mr. Deardorff employed in determining a cost of common equity is the discounted cash flow method (DCF). Mr. Deardorff's analysis employs the standard discrete DCF model, $k = D_1/P_0 + g$, where D_1 is the dividend expected during the year, P_0 is the current price of the stock, and g is the expected growth rate of dividends. For purposes of calculating a dividend yield applicable to the formula, D_0/P_0 (the current dividend divided by the current price) must be adjusted by $1/2$ the expected growth rate in order to account for changes in the dividend rate in period 1.

In theory, the DCF method advocates the use of the most-current dividend yield. For purposes of ratemaking, one must determine a dividend yield that is representative of the prospective period when new rates

will be in effect. Ratemaking is essentially a forward looking, as well as a long-run, process. An analysis cannot be based solely on short-term spot market data. Investors are continually changing their opinions concerning the relative worth of debt and equity on a monthly, weekly, or even a daily basis, based on changes in the economy or the financial position of a company. A spot rate of return which may seem appropriate for current ratemaking purposes may be too high or too low at a later point in time depending upon changing economic conditions in the marketplace. OTS St. 1, pp. 23-24.

Conversely, longer-run average data avoids problems associated with short-run aberrations, but runs the risk of being characterized as "stale" data. This problem becomes very pronounced especially during periods of distinct upward or downward trends.

A regulator who sets rates for a future period must make a "best" judgment concerning representative stock prices and dividend rates. With regard to a "best" judgment, Mr. Deardorff chose to utilize dividend yields calculated using current spot prices and 52 week averages. The results of Mr. Deardorff's DCF analysis are on OTS Ex. 1, Sched. 4, pp. 1-2. However, the following table summarizes the results of his DCF analysis:

	<u>Range</u>	<u>Average</u>
Eight Company Barometer Group	10.30 - 10.50%	10.40%
Pennsylvania Power & Light Co.	10.43 - 10.90%	10.67%

As a check on the reasonableness of these ranges,

Mr. Deardorff also performed a DCF analysis using forecasted dividend yields and growth rates. OTS Ex. 1, Sched. 4, p. 3. He found the Value Line five year future projection for the barometer group adjusted dividend yield to average 6.81 percent, with a projected growth rate of 2.44 percent for the same five-year forecast period. OTS St. 1, p. 25. Using Value Line's dividend yield and dividend growth rate projections, the expected DCF rate of return in five years would be 9.25 percent for the barometer group. In contrast, the projected five year DCF expected rate of return for PP&L would be 9.40 percent. These results suggest that Value Line expects rates of return to continue to decline over the next three-to-five years for these electric companies. OTS St. 1, p. 25.

Two assumptions regarding general market conditions underlie the DCF results in general. First, the payout ratio will remain reasonably constant so that the rate of dividend growth will closely follow the growth rate of earnings per share. OTS Ex. 1, Sched. 4, p. 4 presents the historical and forecasted payout ratios for the barometer group and PP&L. While over relatively short periods of time the payout ratios display some volatility, over

the longer-term there has been a tendency for it to revert to the mean. If investors are relatively confident that payout ratios are mean reverting then they can expect the rate of growth of dividend and earnings to be similar over the long-run.

The following summarizes investors' expectations with respect to payout ratios for the barometer group and PP&L:

	<u>Range for 1986-1994</u>	<u>Mean</u>	<u>1994</u>	<u>Forecast</u>
Barometer Group	68.85-95.11	81.75	84.72	79.25
PP&L	70.44-91.26	78.92	91.26	81.40

The second assumption is that the price/earnings ratio will remain the same from time of purchase to time of sale. Mr. Deardorff did not contend that the P/E ratio would be the same for the prospective period. However, for cost of capital purposes in a rate-making context, he made this strict assumption. Failure to do so would make a specific estimate of a rate of return for the prospective period much more complex.

Both assumptions are required in a constant growth DCF model so that the dividend yield and the growth rate can be assigned specific values. OTS St. 1, p. 25. For the barometer group the P/E ratios on average are expected to increase slightly over the next five years from 11.2

to 11.8. For PP&L, the P/E ratio is expected to decline from 12.4 to 10.5 over the next five years. OTS Ex. 1, Sched. 4, p. 5.

1. Dividend Yield

OTS believes that the a representative ratemaking dividend yield must be calculated over a time frame that avoids the problems of short-term aberrations and "stale" data series. For purposes of the OTS DCF analysis, Mr. Deardorff placed equal emphasis on the most recent spot and 52 week average dividend yields. The following table summarizes his dividend yield computations for the barometer group and PP&L.

	<u>Dividend Yields</u> <u>(Adjusted)</u>	
	<u>Spot</u> <u>2/22/95</u> <u>(%)</u>	<u>52-week</u> <u>Average</u> <u>(%)</u>
Barometer Group	7.30	7.50
PP&L	8.15	7.68

Source: OTS Ex. 1, Sched. 4, pp. 1-2.

In this case, the dividends used in the dividend yield calculations are Value Line's projected dividends (D_t) which reflect a full years growth. Therefore, the standard growth rate adjustment discussed supra is not necessary in this analysis. OTS St. 1, p. 28.

2. The Growth Rate

To arrive at a representative dividend growth rate for the prospective period, Mr. Deardorff surveyed several series of both projected growth rates and historical growth rates. The growth rate estimates are based on a survey of Value Line estimates, Standard & Poor's consensus estimates, internal and external growth rates, ten-year log-linear dividend growth rates, and 12-month dividends and earnings growth rates. OTS Ex. 1, Sched. 4, p. 6.

As a source of growth rates, Value Line provides an abundance of information including projected and historical growth rates. Sufficient data is available from Value Line to calculate expected internal and external growth rates. In addition, Value Line has a very wide circulation and is easily available to individual investors. Individual investors comprise the bulk of electric utility ownership. According to the Standard & Poor's Stock Guide (S & P), March, 1995, individual investors own 67.99 percent of the shares of the electric companies in the barometer group and 77.11 percent of the shares of PP&L.

S & P, on the other hand, has more limited data availability. S & P reports a consensus of projected earnings growth rates for some of the barometer group companies, but not projections of dividend growth rates.

However, S & P does have the advantage of surveying more than one analyst for each company. OTS St. 1, p. 29.

The ten-year log-linear growth rates are derived from a linear regression of log-transformed dividends using time as the independent variable. The log-transformation is necessary because the dividends, earnings, and price times series data for electric companies is non-linear with respect to time. Regression analysis requires that the data be in a linear form. The log-transformation essentially straightens the data into a linear form. OTS St. 1, p. 30.

The internal and external growth rates for the barometer group and PP&L are developed in OTS Ex. 1, Sched. 4, p. 7. The internal growth rate is the result of the product of the expected retention rate (b) and the expected earned rate of return (r). A company realizes this growth by reinvesting retained earnings back into the company. External growth is the product of the expected issuance rate for new common stock share (s) and the expected accruals (v). A company realizes this growth by issuing new common stock at a price above current book equity.

In his analysis of growth rates, Mr. Deardorff arranged the columns in OTS Exhibit No. 1, Schedule No. 4, page 6 in order of the importance in determining a representative growth rate. OTS St. 1, p. 31. Under normal circumstances Mr. Deardorff would give primary weight to

expected growth rates as opposed to historical growth rates simply because more information is implicitly contained in the expected growth estimates. The bulk of the research evidence has indicated analysts' growth forecasts to be superior to historically-oriented growth measures in forecasting growth. Forecasting professionals have already accounted for historical data in their estimates along with expectations of a wide array of economic variables. To give significant weight to historical growth rates would result in a double count. OTS St. 1, p. 31.

Based upon his analysis, Mr. Deardorff concluded that investors could reasonably expect to achieve a growth rate of 2.75 to 3.25 percent for the barometer group. OTS Ex. 1, Sched. 4, p. 6. The forecasted growth rates for the barometer group are 1.4 percent for dividends, 2.66 percent for the internal and external growth estimate, and 3.0 percent for earnings $((3.4+2.63)/2)$. The average growth from these three variables is 2.35 percent. OTS St. 1, p. 32.

While Mr. Deardorff would normally give significant and equal weight to these three variables in his final growth rate recommendation, it is apparent that the expected dividend growth rates are forecasted to be set temporarily low. In the most recent issue, Value Line suggests that electric utilities are in the process of lower payout ratios for several reasons. Some of these reasons are a slowdown in earnings, future funds needed for

compliance to Phase 2 of the Clean Air Act, and future funds needed for new capacity. Therefore, Mr. Deardorff chose to give primary weight to forecasted earnings and historical dividend growth. The range of growth rates for these variables is 2.3 percent to 3.4 percent. From these results Mr. Deardorff concluded that the narrower range of 2.75 to 3.25 percent is appropriate for the barometer group. OTS St. 1, p. 32.

Mr. Deardorff concluded that investors could reasonably expect to achieve a growth rate of 2.50 to 3.00 percent for PP&L. OTS Ex. 1, Sched. 4, p. 4. Mr. Deardorff found the growth rates for forecasted and historical dividends to range from 1.0 to 3.5 percent. Based upon these growth rates, he opined that a more narrow growth rate range of 2.40 to 3.00 percent is appropriate for PP&L. He also gave little weight to PP&L's forecasted dividend growth because, as with the barometer group, these growth figures are temporarily low. OTS St. 1, pp. 32-33.

Given these representative dividend yields and using the midpoint of the growth rate ranges, Mr. Deardorff applied the DCF formula with the results of his expected market rate of return on equity analysis presented on OTS Sched. 4, pp. 1 and 2. Based upon these DCF results, Mr. Deardorff believes that 10.25 to 11.00 percent represents a reasonable rate of return on common equity for a electric utility. OTS St. 1, p. 33.

The OTS recommendation for PP&L in this proceeding is 10.63 percent, which is the midpoint of the range.

Mr. Deardorff also checked the DCF analysis with updated information and found the results to be consistent with his original recommendation. The updated DCF results are as follow:

	Spot Average	52 weekly Average
Barometer Group	10.56	10.43
PP&L	10.27	9.24

T.P. 1815-1816.

However, this update contains short term aberrations in the price of PP&L's stock due to the uncertainty surrounding the instant rate case litigation and the possibility of a dividend cut. T.P. 1500-1502. The use of a single company to determine the cost of equity may be unreliable due to such sort term aberrations. OTS St. 1, p. 17, ll. 3-9. As a result, one should give lesser weight to the updated PP&L information and greater weight to the barometer group results.

E. Investment Risk Adjustment

In this proceeding, Mr. Deardorff examined the financial risk and business risk indicators as well as the total investment risk indicators presented in the Company's direct testimony. As a result of this

examination, he concluded that PP&L has a negligible financial risk differential in comparison to the barometer group. OTS St. 1, p. 33.

In fact, an examination of the business risk indicators presented by the Company shows that PP&L currently has less business risk in comparison to the barometer group.

PP&L's witness, Mr. Paul R. Moul, presented seven indicators of business risk in PP&L Statement 12, pages 22-26. Only one ratio (dividend yield) indicated higher risk. Five categories (Coefficient of variation, operating ratio, coverage ratio, quality of earnings, and internally generated funds) indicated less business risk for PP&L in comparison to the barometer group.

Total investment risk indicators were also examined. This examination indicated that there is conflicting evidence presented by Mr. Moul regarding the differences in total investment risk between PP&L and the barometer group. The Company witness presented a comparison of betas as an indicator of differences in total investment risk between PP&L and the barometer group PP&L Ex. PRM-1, Sched. 13, p. 1. The betas reported for Merrill Lynch indicated that PP&L has more investment risk while the betas reported for Value Line indicated that PP&L has less investment risk.

F. Market Pressure, Selling and Issuance Expense

Mr. Deardorff also considered market pressure and selling and issuance expenses in making his recommendation. Market pressure and selling and issuance expenses are an additional cost of capital that are incurred at the time of stock issuance. However, the current market price of common stock already reflects these items, as investors have already capitalized market pressure and issuance expenses in determining the value of the stock at the time of purchase. Mr. Deardorff's analyses are market based, and these items have already been taken into consideration. As a result, there are no additional adjustments to account for Market pressure and issuance expenses. OTS St. 1, p. 36.

G. Overall Weighted Cost of Capital

The OTS recommended rate of return on common equity results in an overall weighted cost of capital of 9.14 percent. OTS Exh. 1, Sched. 5.

H. Interest Coverage

Mr. Deardorff performed an interest coverage analysis which demonstrates the fairness and confirmed the reasonableness of his rate of return recommendation. OTS Ex. 1, Sched. 5. presents Mr. Deardorff's interest coverage calculations which will provide PP&L an opportunity to

achieve a pre-tax interest coverage of 3.52 times. OTS Ex. 1, Sched. 6 presents the results of an analysis of experienced interest coverages for the period of 1984 to 1993 for the barometer group and PP&L. The following is a summary of those experienced interest coverages:

	<u>Range for 1984-1993</u>	<u>Mean</u>	<u>1994</u>
Barometer Group	2.33 - 3.33	3.00	3.05
PP&L	1.54 - 3.33	2.77	3.33

The pre-tax interest coverage of 3.52 times exceeds the ten-year range of coverages for the barometer group and PP&L.

The Standard & Poor's pre-tax interest coverage benchmarks for an "A" rated electric company range between 2.75 for an above average business position and 4.50 for a below average business position. PP&L's calculated interest coverage of 3.52 meets the Standard & Poor's target of 3.5 for an average business position. OTS St. 1, p. 38.

In conclusion, the coverage analysis indicates that the 9.14 percent recommendation for overall rate of return is fair and reasonable. It also indicates that Mr. Moul's 10.22 percent overall rate of return recommendation which produces 4.03 times coverage is excessive.

I. Critique of PP&L's Cost of Capital Testimony

Mr. Moul's cost of capital testimony and his resultant rate of return recommendation are flawed in two ways. First of all, Mr. Moul has made several serious errors in his DCF analysis. Second, Mr. Moul has incorrectly given weight to the Comparable Earnings, Risk Premium and CAPM models.

Mr. Moul was able to inflate his DCF results by making an unwarranted ex-dividend adjustment to his dividend yields and an unwarranted .5 percent upward adjustment to his growth rates to reflect market factors. The ex-dividend adjustment is inappropriate because Mr. Moul was unable to supply any academic evidence in support of an ex-dividend adjustment to dividend yields in the context of the DCF analysis. Additionally, Mr. Moul was unable to provide any investor influencing financial publication that provides ex-dividend adjusted dividend yields to investors for their investment decision making purposes.

Mr. Moul's .5 percent adjustment to account for market factors should be rejected for two reasons. First, Mr. Moul's growth estimate of 3.5 percent already accounts for this information. In making his 3.5 percent estimate, Mr. Moul has relied upon analysts projections as they appear on Schedule 10, Pages 1 and 2 of Exhibit PRM-1. Analysts projections are based upon not only company specific information but market factors such as

those listed by Mr. Moul on PP&L St. 12, p. 43. The addition of the .5 percent to his 3.5 percent growth rate is therefore a double count.

Mr. Moul's .5 percent adjustment should be rejected for an additional reason. Mr. Moul has not presented any quantitative evidence to support the claim that the market factors result in an additional .5 percent growth to the company. Mr. Moul acknowledged on cross examination that these factors could result in a negative adjustment. Without sufficient quantitative evidence to support a specific number this adjustment should be rejected.

1. CAPM Method

Mr. Moul believes that his risk premium and CAPM results should be given significant weight along with the DCF results. This is improper, and these methods should be rejected for ratemaking purposes. The reason for this rejection lies in the underlying use of these methods by investors. The risk premium model (RP) and the Capital Asset Pricing Model (CAPM) are relevant to investors in their investment decision making process, but this relevancy does not carry over to the ratemaking process.

The RP and CAPM methods give results which indicate to an investor what the equity cost rate should be if current economic conditions are the same as those present during the historical period risk premiums were

determined. By comparing RP and CAPM results with current expected equity returns (DCF results), an investor can make rational decisions to buy and/or sell. When expected DCF returns are higher than those indicated by the RP and CAPM historical norms, an investor would have an incentive to buy. The reverse is also true. OTS St. 1, p. 41.

The relevancy of these methods does not carry over to the ratemaking process because one is never certain that the economic conditions underlying the historical period (during which the risk premiums were calculated) are the same at present or in the future. Mr. Moul's risk premium is based on the Ibbotson & Associates study which dates back 65 years. This historical period included economic conditions of inflation in excess of 12 percent, "A" rated utility bond yields in excess of 17.0 percent and other unusual economic scenarios. Those conditions do not exist at present nor are they expected to recur in the near future. Id.

Since economic conditions today are different from those during the historical period, the risk premiums used in Mr. Moul's RP and CAPM models are adversely affected. The RP and CAPM models do not directly measure the current rate of return on common equity as does the DCF model. These methods determine the rate of return on common equity by indirectly observing the current cost of debt. An implicit assumption in these methods is that the variables which determine the equity cost rate and debt

cost rate are the same. This allows the analyst to apply a constant risk premium. OTS St. 1, p. 42.

In actuality, the variables determining the cost rates in the two markets are different. Changing economic conditions cause these variables in the two markets to change which, over time, results in changing risk premiums. Therefore, the use of a constant risk premium progressively fails to capture the effect of changing economic conditions. Id.

The credibility of the CAPM model has also been questioned by others. OTS Exhibit 1, Schedule 9 presents an New York Times article dated February 18, 1992 which summarizes a CAPM study conducted by professors Eugene F. Fama and Kenneth R. French. Their study examined the importance of beta (CAPM's risk factor) in explaining returns on common stock. In CAPM theory, the higher a stock's beta the higher the expected return on that stock. The professors found that the model did poorly in predicting actual returns. As a result of this new information, Mr. Deardorff believes that rational investors will give less credibility to expected equity returns that are calculated using the simple CAPM model. OTS St. 1, p. 43.

2. Comparable Earnings Method

Mr. Moul also believes that the comparable earnings results should be given some weight. This method should also be rejected for ratemaking purposes. Mr. Moul's comparable earnings method merely computes historical book returns for unregulated companies. Mr. Deardorff believes that it is more appropriate to determine a cost of capital by using expectational models such as the DCF model rather than a model based on historical data. Similarly, he believes that it is more appropriate to assess market returns of companies in the same industry rather than book returns of companies that are dissimilar. OTS St. 1, p. 43.

To support his belief, Mr. Deardorff provided an analysis that demonstrates that Mr. Moul's unregulated companies are viewed quite differently than PP&L. In OTS Exhibit No. 1, Schedule 8, Mr. Deardorff compared the debt to total capital ratio and the percent of institutional holdings of the unregulated companies used in Mr. Moul's Comparable Earnings analysis to the Barometer Group of Eight Electric Companies and PP&L. The average debt ratio for Mr. Moul's unregulated companies is 21 percent, compared to 46 percent for the eight electric companies and 49 percent for PP&L. Institutional investors hold 52.8 percent of the shares of the unregulated companies compared to 29.7 percent for the eight electric companies and 21.0 percent for PP&L. OTS Ex. 1, Sched. 8. Clearly,

institutional investors view the unregulated companies used in Mr. Moul's Comparable Earnings analysis differently than they do the electric companies.

VI. RATE STRUCTURE

Rate Structure is the process by which revenues allowed as a result of a rate proceeding are properly allocated to the various customer classes based upon the costs incurred by the utility to serve the class.

A. Rate Design & Cost of Service

The OTS recommended revenue requirement increase is approximately \$20,455,000. Appendix A, Table I (attached to this Main Brief). If PP&L is granted an increase in this proceeding which is consistent with the adjustments proposed by OTS, OTS witness Paul M. Yarolin has recommended that the minimum monthly charge for residential customers (Rate Schedule RS) be increased by \$14,076,018 and that Residential Service - Thermal Storage (Rate Schedule RTS) be increased by \$3,438,666. OTS St. 3, p. 10.

If the Company were to be granted a revenue requirement in excess of that recommended by OTS, Mr. Yarolin has testified that it should be allocated in the following manner: (1) the minimum charge for Rate Schedule RS should be set at \$5.90 per month (as discussed below); (2) the rates under Rate Schedule RTS should be set at the level proposed by the Company; and, (3) the remaining balance of the revenue requirement should be distributed among all rate schedules, except Rate Schedules RTS and SE

(as discussed below), in the same relationship as that proposed by the Company. OTS St. 3, pp. 10-11.

PP&L witness Joseph M. Kleha has testified that PP&L's cost allocation studies incorporate the 12 coincident peak method ("12 CP"), which is based on the average of the twelve monthly coincident class demands at the time of the system monthly peak loads. PP&L St. 7, p. 5. OTS fully supports the 12 CP cost of service study because it best represents the costs attributable to each of the services provided by PP&L. See, OTS St. SR-3, p. 13. OTS has provided testimony on the following rate structure issues: (1) the Minimum Monthly Charge increase proposed by PP&L for residential customers (Rate Schedule RS); (2) the proposed rates under Residential Service-Thermal Storage (Rate Schedule RTS) and related matters; (3) a revenue distribution which is compatible with the recommended OTS increased revenue requirement or at other revenue requirements (discussed above); and, (4) Rate Schedule SE - an energy only street lighting service. Each of these issues are discussed separately in the following sections.

1. PP&L's Residential Minimum Monthly Charge Should Be Increased By No More Than \$1.10.

The minimum monthly charge (or customer charge) is a recurring charge which is imposed independently of the quantity of energy (KWH) used. Its purpose is to recover customer related cost such as meter reading, billing, collecting, accounting, metering equipment and service connections. These costs will vary directly with the number of customers served. OTS St. 3, p. 3. The present residential minimum monthly charge under Rate Schedule RS is \$4.80 per month. The Company proposes in this proceeding to increase this charge to \$7.20 per month or by 50%. PP&L St. 8, p. 7.

OTS witness Mr. Yarolin has testified that a one-time increase of \$2.40 or 50% in the minimum monthly charge would be excessive. Instead, Mr. Yarolin has recommended a more gradual increase in this proceeding of \$1.10 to \$5.90 per month. OTS St. 3, p. 4. In support of his position, Mr. Yarolin states "[t]his amounts to an approximate increase of 23 percent. In addition, I have reviewed the current minimum charges for the other Pennsylvania electric utilities. This review demonstrates that the OTS recommended \$5.90 minimum monthly charge falls within the range of other

Pennsylvania electric utilities.^{56/} OTS St. 3, pp. 4-5. The revenue increase resulting from changing the minimum charge for 1,066,365 (PP&L Ex. OJK 2, p. 1) residential customers from \$4.80 per month to \$5.90 per month would be approximately \$14,076,018 (1,066,365 x \$1.10 x 12). OTS St. 3, p. 5.

Although the Company did not specifically address the OTS proposed minimum monthly charge of \$5.90 in its Rebuttal testimony, PP&L witness Oliver J. Kasper did state several reasons why a minimum charge of less than the Company proposed \$7.20 would be inadequate. His reasons are as follows: (1) the use of a lower customer charge spreads the recovery of the remaining customer costs over too large an amount of customer usage. Also, including these costs in KWH charges sends the wrong price signal and makes revenue recovery less stable; (2) its current customer charge (minimum monthly charge) is understated since it has not filed a base rate case in 10 years; and, (3) increasing the customer charge by \$2.40/month would not cause an undue hardship on the vast majority of residential

^{56/} The minimum charges for other Pennsylvania utilities are presented at OTS Ex. 3, Sched. 1.

ratepayers and won't cause customers to ration access to the electric system^{57/}. PP&L St. 8-R, p. 7.

In response to Mr. Kasper's first point, OTS submits that he has assumed that the Company's proposed increased annual revenue requirement of \$261,634,767 (OGK 2, Tabulation of Revenue Effects, p. 4) will be adopted in this proceeding and that the \$30,711,312 (1,066,365 x \$2.40 x 12) proposed revenue increase in the residential minimum monthly charge is a necessary element in determining the Company's increased annual revenue requirement. As indicated above, OTS disagrees with the Company's proposed revenue requirement increase of \$261,634,767 and has proposed a significantly reduced revenue requirement increase of approximately \$20,455,000. OTS witness Mr. Yarolin has testified that based upon the OTS proposed revenue requirement increase and the concept of gradualism, decreasing the Company's proposed increase in the residential minimum monthly charge from \$7.20 to \$5.90 (along with other OTS recommended rate design proposals) would adequately meet PP&L's overall

^{57/} Mr. Kasper also argues that the \$7.20/month customer charge would not be the highest in the state, but the \$4.80/month customer charge (proposed by OTS) would be the lowest among major electric utilities in the state. PP&L St. 8-R, p. 7. However, OTS witness Mr. Yarolin has observed that the \$7.20 minimum monthly charge proposed by the Company would be the second highest rate among electric utilities in Pennsylvania. OTS St. SR-3, p. 6. See, OTS Ex. 3, Sched. 1.

revenue requirement, while fully supporting the PP&L endorsed 12 CP cost of service study. OTS St. 3, p.4. This is especially true if the Company is granted an increase in this proceeding that is significantly lower than the increase requested by PP&L. Consequently, Mr. Kasper's concern about spreading the remaining customer costs over too large of a customer energy use base, would not be applicable under the OTS recommended revenue requirement increase.

Mr. Kasper's second point, that PP&L is justified in requesting a \$2.40/month increase in the minimum charge because it has not filed for a rate increase in ten (10) years, is also not persuasive. PP&L had the option to file a base rate case within the last 10 years if it believed it was entitled to an increase. OTS witness Mr. Yarolin has testified that a determination as to whether the proposed increase in the minimum charge is too high, should be based upon the concept of gradualism and whether the charge is consistent with the minimum monthly charges of similarly situated electric companies in Pennsylvania. OTS St. SR-3, p. 5.

Mr. Kasper's third point, that a \$2.40/month increase in the minimum charge would not cause a hardship, should be rejected because it is not supported by any empirical evidence. The statement merely represents Mr. Kasper's opinion. In contrast, OTS witness Mr. Yarolin has testified that in his opinion, any additional charges (above the \$1.10/month increase

proposed by OTS) would cause a concern among a segment of the Company's ratepayers. Thus, the rationing of usage by these customers is a reality that must be recognized. OTS St. SR-3, pp. 5-6.

2. Residential Service - Thermal Storage
(Rate Schedule RTS) Should Be Increased
In Accordance With PP&L's Proposal.

Rate Schedule RTS is a time-of-day type of service currently serving 14,544 residential customers which permits customers to manage their usage during off-peak periods. The rate is designed to provide an incentive for customers to install time-of-day metering and electric thermal storage space conditioning equipment. The customer has the option of choosing on-peak hours of 7:00 A.M. to 5:00 P.M., 8:00 A.M. to 6:00 P.M., or 9:00 A.M. to 7:00 P.M. The customer is charged for any demand in excess of the 2 KW allowed during the on-peak period. PP&L Ex. OGK 1.

The current monthly minimum charge for RTS customers is \$10.95 and would be increased to \$15.00/month under PP&L's proposal. For any excess demand beyond the first 2 KW, the charge would increase from \$5.80 per KW to \$6.50 per KW. The energy usage block would increase from 2.84 cents per KWH to 4.5 cents per KWH. PP&L Ex. OGK 1.

OTS witness Mr. Yarolin has testified that if PP&L is granted an increase in this proceeding it should first be recovered from Rate Schedule RTS in the manner proposed by the Company^{58/}:

Based upon the Company's Exhibit OGK-3, now labeled as OTS Exhibit No. 3, Schedule 2, the rate of return for Residential Thermal Storage (Rate RTS) under present rates is -2.36%. Under the Company's proposed rates, the rate of return would change to -.43%. Because of the negative rate of return, an increase in this service is warranted. It would be unfair to other customers not to increase the rates for this service to the proposed level since the RTS customers are not providing sufficient revenues to cover the cost of providing service.

OTS St. 3, p. 7.

OTS witness Mr. Yarolin has further testified that if PP&L is granted an increase less than it requested, the increase to Rate Schedule RTS should still be applied in the manner proposed by the Company. OTS St. 3, p. 7.

3. The Commission Should Initiate An Investigation Of Rate Schedule RTS.

Although OTS has recommended that Rate Schedule RTS receive the increase proposed by PP&L even if an increase of less than the

^{58/} If Residential Thermal Storage is increased to the Company's proposed level, the revenue increase for this rate schedule would be \$3,438,666. OTS St. 3, p. 7.

full amount is granted by the Commission, OTS is concerned that some of these customers may have been induced to commit to the service with overly optimistic promises of lower rates when compared to Rate Schedule RS (Residential Service). Several RTS customers at the Public Input Hearings demonstrated the apparent perception that the Company's calculation of their proposed increase is incorrect. Public Input Tr. 125. In addition, there is some confusion by certain customers as to the period of time that they would experience lower charges when compared with Rate Schedule RS (Residential Service). Moreover, their testimony further indicates that these customers made significant investment in equipment in order to take advantage of the Residential Thermal Service offering. Public Input Tr. 115.

OTS witness Mr. Yarolin has testified that an investigation is needed to provide answers to several outstanding questions:

I am particularly concerned about the relatively new RTS customers who have made a large investment in equipment with an understanding that they would realize significant savings when compared with Rate Schedule RS. After making this investment, these customers are now being informed that the rates would be increased. This result may be unfair. With Rate RTS showing a negative return under present and proposed rates as shown on OTS Exhibit No. 3, Schedule 2, a question is raised as to whether the economic benefits to the Company are adequate. For these reasons, I recommend that the Commission institute an investigation of this matter to determine whether these service

offerings were made with inflated promises to attract customers. Among the questions which need to be answered are: (1) What, if any, promises were made to these customers?; (2) Under what conditions were any such promises made?; (3) Whether any savings were promised over a specific time period? and, (4) Whether representations were made as to how long it would take to recover the investment required to obtain RTS service?

OTS St. 3, p. 12.

In response, PP&L witness Mr. Kasper has testified that there is no need for an investigation because the confusion occurred as a result of PP&L sending a letter to its RTS customers to explain how they would be affected by the proposed increase. Unfortunately, instead of making things clearer, the letter actually added to the confusion. However, Mr. Kasper claims that a second letter was sent that resolved all issues. PP&L St. 8-R, p. 24. The second letter (PP&L Ex. OGK 9), however, fails to address, at all, the issues that OTS witness Mr. Yarolin identified in his testimony.^{59/}

^{59/} OTS acknowledges that Mr. Kasper states in his Rebuttal testimony that PP&L intends to make changes in its RTS service. In this regard: (1) applications for service under the current Rate Schedule RTS will be accepted only through December 31, 1995; (2) after December 31, 1995, customers wanting such service will have to elect a new rate schedule with new technology and rates; and, (3) customer locations served under Rate Schedule RTS will continue to receive service under that rate for the life of the currently installed thermal storage system. The Company will not propose to reduce the present differential between the RS and RTS Rate Schedules for these customers. PP&L St. 8-R, p. 12. While OTS
(continued...)

Accordingly, for the reasons discussed above, OTS requests that the Commission institute an investigation of the circumstances under which customers obtained service under Rate Schedule RTS.

4. Rate Schedule SE Should Be Considered An Off-Peak Rate For Municipalities And Governmental Agencies.

Rate Schedule SE is an unmetered (Tr. 823) energy only street lighting service that currently serves 58 customers. Rate Schedule SE is available only to municipalities or other governmental agencies for the operation of mercury vapor, high pressure sodium, or metal halide street lighting systems in public areas. The installation, ownership, operation and maintenance of the street lighting equipment is provided by the municipality or governmental agency. PP&L Ex. OGK 1. In the present and proposed tariffs, the Company has two rates. The first rate involves the municipality's lighting equipment on the Company's pole. This rate has a current charge of 6.9361 cents per KWH and would be increased to 9.50 cents per KWH. The second rate applies to those municipalities who own the lighting equipment and the pole. Under the Company's proposal, the rate would increase from

^{59/}(...continued)

believes that these proposed changes address some of the concerns identified in Mr. Yarolin's testimony, they are insufficient to cause OTS to withdraw its request for an investigation.

the current 2.5258 cents per KWH to 4.30 cents per KWH. PP&L

Ex. OGK 1.

OTS witness Mr. Yarolin has testified that Rate Schedule SE should be considered an off-peak rate:

The conversion of Rate Schedule SE to an off-peak rate is appropriate for several reasons. The first reason is that street lighting is used mostly during off-peak periods. The Company has provided twelve months of system peaks in response to OTS-RS-31D, which is now labeled as Schedule 3 of OTS Exhibit No. 3. From April through October, the peak periods occurred during daylight hours where street lighting would not be necessary. For the remaining five months, the peak periods occurred during the hours when street lighting was necessary. The second reason involves the ownership of equipment utilized to provide the service. For example, the proposed increase is 37% in the energy charge in those cases where the municipality owns the street lighting equipment and the Company owns the pole. Where the municipality owns both the street lighting equipment and the pole, the Company proposes to increase the energy charge by 70%, which can place a financial strain on a given community. The total revenue percentage change for Rate Schedule SE after the proposed ECR and Base Rate Credit Adjustment have been included would be 20.49%. Finally, since street lighting is a community service, all customer classes benefit directly or indirectly from the service.

OTS St. 3, pp. 14-15.

Since most of the street lighting takes place during off-peak periods (as demonstrated above), and does not contribute in any significant

way to the system peak, OTS believes that the SE rate should be considered an off-peak rate and be priced accordingly. In this regard, OTS witness Mr. Yarolin has stated that "the Company [should] be instructed to file a tariff with the Commission which establishes Rate Schedule SE, Energy Only Street Lighting Service as an off-peak rate. Consequently, Rate Schedule SE should not get any increase in rates in this proceeding." OTS St. 3, p. 15

In his Rebuttal testimony, PP&L witness Mr. Kasper testified that Rate Schedule SE should not be considered an off-peak rate since it is on-peak 5 months out of a twelve month period and because Mr. Yarolin did not present any evidence that the proposed increase to Rate Schedule SE could place a financial strain on a given community.^{60/} PP&L St. 8-R, pp. 46-47.

In response to Mr. Kasper's first argument, OTS witness Mr. Yarolin has demonstrated that 7 months out of 12 the monthly system peak occurs during daylight hours and the 62 KW that is attributable to street

^{60/} Mr. Kasper has also alleged that off-peak rates are generally for customers who can shift load to off-peak periods and that street lighting does not have that flexibility. PP&L St. 8-R, p. 47. However, OTS witness Mr. Yarolin has testified that the ability to shift load is not the only criterion to determine whether a service is on-peak or off-peak. A determination can also be made based upon whether the service is primarily used during on-peak or off-peak periods, as he demonstrated in his testimony. Mr. Yarolin has demonstrated that street lighting primarily occurs during off-peak periods of the year. See, OTS Ex. 3, Sched. 3, p. 2.

and area lighting during on-peak periods is due to traffic lighting only. Moreover, on a twelve (12) month average, the total street lighting and area lighting contributes only .2% of demand on the total system. See, OTS Ex. 3, Sched. 3, p. 2. These data clearly indicate that during the major part of the year, street lighting is an off-peak service.

With regard to Mr. Kasper's second argument, the record indicates that the rates for street lighting are a concern as indicated during the Public Input Hearings held throughout the Company's service territory. In this regard, John Cawley from the City of Scranton testified about the budget shortfalls of municipalities and cities and the affect the street lighting increase will have on their budgets. Public Input Tr. 376. Similar concerns were expressed in the City of Wilkes Barre (Public Input Tr. 406 & 413), City of Hazleton (Public Input Tr. 465) and the City of Bethlehem. Public Input Tr. 629. Consequently, the record demonstrates significant concern about the ability of these cities to pay a significant increase.

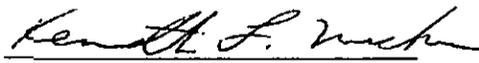
Accordingly, the record demonstrates that Rate Schedule SE is in fact an off-peak rate and should be so designated by the Commission. The change can be accomplished by ordering PP&L to file a tariff filing which provides an on-peak rate for the five (5) winter months (November through March) and a (lower) off-peak rate for the remaining seven (7) summer

months (April through October). Moreover, as discussed above, Rate Schedule SE should not get any increase in rates in this proceeding.

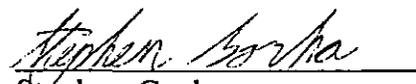
VII. CONCLUSION

For the reasons set forth above, the Office of Trial Staff respectfully submits that the Pennsylvania Power & Light Company's proposed Supplement No. 50 to Tariff Electric - Pa. P.U.C. No. 200 should be rejected. The rates contained in these Supplements are not just and reasonable or otherwise in accordance with the Public Utility Code and the Commission's Regulations. The Administrative Law Judge should issue a Recommended Decision and the Public Utility Commission should issue an Opinion and Order directing Pennsylvania Power & Light Company to file appropriate designed tariffs which will recover no more than \$20,455,000 in additional base rate revenue.

Respectfully submitted,


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Senior Prosecutor


Johnnie E. Simms
Senior Prosecutor


Stephen Gorka
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The Office Of Trial Staff
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Dated: June 16, 1995

APPENDIX "A"

PENNSYLVANIA POWER & LIGHT
R-00943271
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TABLE I
INCOME SUMMARY

	COMPANY Proforma Present Rates	OFFICE OF TRIAL STAFF [-----]			
		Adjustments	Present Rates	Allowances	Proposed
	\$	\$	\$	\$	\$
OPERATING REVENUE	2,402,255	-368	2,401,887	20,455	2,422,342
DEDUCTIONS:					
O&M EXPENSES	1,343,253	-67,922	1,275,331	0	1,275,331
DEPRECIATION	320,797	-39,023	281,774		281,774
TAXES, OTHER	186,553	-19	186,534	1,043	187,577
INCOME TAXES:					
CURRENT STATE	54,478	12,744	67,222	2,133	69,355
CURRENT FEDERAL	154,601	36,120	190,721	6,048	196,769
DEFERRED TAXES	-15,424	0	-15,424		-15,424
ITC	-8,625	0	-8,625		-8,625
TOTAL DEDUCTIONS	2,035,633	-58,100	1,977,533	9,224	1,986,757
INCOME AVAILABLE	366,622	57,732	424,354	11,231	435,585
MEASURE OF VALUE	5,017,178	-251,480	4,765,698		4,765,698
RATE OF RETURN	7.31%		8.90%		9.14%

TABLE II
Summary Of OTS Adjustments

Issues	Rate Base	Revenues	Expenses	Depr.	Taxes Other	Current FIT	Current PA CNI	Combined Deferred Inc Taxes	ITC	Revenue Impact of Adjustments	Impact on Interest Sync.	Revenue Impact Net of Int. Sync.
MEASURE OF VALUE:												
CWC(1/8) - AUTO	0									0	0	57.8565
CWC - CTW	-11,749									-1,956	-335	-1,621
EXCESS CAPACITY - PJM	-239,474									-39,864	-6,817	-33,047
PENSIONS - CTW	-5,273									-878	-151	-727
	0	0								0	0	0
	0	0								0	0	0
	0	0								0	0	0
CWC(INT OFFSET) - AUTO	5,016									835	142	693
REVENUES:												
COMPANY REVISION		-368	0		-19	-109	-38			368		
	0	0	0		0	0	0			0		
	0	0	0		0	0	0			0		
	0	0	0		0	0	0			0		
	0	0	0		0	0	0			0		
EXPENSES:												
UNCOLL. ACCOUNTS EXP. (AUTO)			0			0	0			0		
UNCOLL ACCTS - CTW			-1,234			384	136			-1,300		
SOCIAL PROGRAMS - CTW			-2,500			779	275			-2,634		
SFAS 106 - CTW			-1,561			486	172			-1,645		
PENSIONS - CTW			-10,224			3,185	1,124			-10,773		
EARLY WIN UNIT 1 (REVISED)-CTW			-2,035			634	224			-2,144		
EARLY WIN UNIT 2 (REVISED)-CTW			-1,886			588	207			-1,987		
RATE CASE - CTW			-373			116	41			-393		
ENVIRON REMEDIATION (REVISED)			-326			102	36			-342		
DECOMM NUCLEAR - JJS			-8,581			2,673	943			-9,043		
DECOMM FOSSIL (REVISED) - JJS			-45,284			14,107	4,977			-47,718		
COMPANY REVISIONS			6,082			-1,895	-668			6,409		
DEPRECIATION:												
SINKING FUND - JJS				-23,832		7,425	2,619			-25,112		
FOSSIL PLANT LIVES - JJS				-15,191		4,733	1,669			-16,007		
	0			0		0	0			0		
	0			0		0	0			0		
	0			0		0	0			0		
TAXES, OTHER:												
	0				0	0	0			0		
	0				0	0	0			0		
	0				0	0	0			0		
	0				0	0	0			0		
	0				0	0	0			0		
INCOME TAXES:												
	0					0	0			0		
	0					0	0			0		
	0					0	0			0		
CONSOL TX SAV - DEFERRED TAXES-												
	0					0	0			0		
	0					0	0			0		
ITC												
INTEREST SYNCHRONIZATION						2,912	1,027		0	7,174		
TOTAL ADDITIONS / DEDUCTIONS	-251,480	-368	-67,922	-39,023	-19	36,120	12,744	0	0	-147,010		
COMPANY MEASURE OF VALUE	5,017,178									-94,119	RTN DIF @	10.63%
OTS MEASURE OF VALUE	4,765,698									-241,129	REV RDCTN	

TABLE III
RATE OF RETURN

Per Company	Structure	Cost	Weighted Cost
Total Debt	46.53	0.0797	3.7080
Long Term Debt	46.53	0.0797	3.7080
Short Term Debt	0.00	0.0000	0.0000
Preferred Stock	7.59	0.0731	0.5550
Common Equity	45.88	0.1287	5.9050
TOTAL	100.00		10.1700

Per Staff	Structure	Cost	Weighted Cost
Total Debt	46.53	0.0797	3.7080
Long Term Debt	46.53	0.0797	3.7080
Short Term Debt	0.00	0.0000	0.0000
Preferred Stock	7.59	0.0731	0.5550
Common Equity	45.88	0.1063	4.8770
TOTAL	100.00		9.14

PENNSYLVANIA POWER & LIGHT
R-00943271
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CERTIFICATE OF SERVICE

I hereby certify that I am serving the foregoing document(s), either personally, by facsimile, by first class and/or overnight/express mail, upon the persons addressed below:

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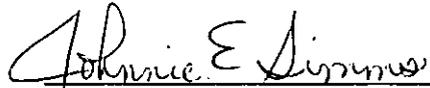
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Johnnie E. Simms, Senior Prosecutor
Office of Trial Staff

Dated: June 15, 1995

R-00943271