

customers have received steep discounts and will continue to receive substantial cost reductions, in excess of the benefits of the PP&L system. PP&L further states that the context of this rate proceeding is not retail wheeling. This is a reference to expected competition in the electric industry. It views the PPLICA position as advocating the allocating of massive costs away from industrial customers. PP&L states that it is well aware of the competition it may face and is acting appropriately to prevent potential load loss.

I confirm the previous views I expressed concerning this matter and, as a general matter, accept the PP&L departures. I share the PP&L view of looking at the big picture in characterizing these rate changes for interruptible customers. PP&L appears to be phasing out this interruptible service, indicating a preference for more carefully structured and limited rate reductions. The PP&L proposal also indicates a preference for "value of service" ratemaking rather than "cost of service" ratemaking. I view this as entirely appropriate, given the context. I would rather overtly go to the value of service theory rather than pretend that we are really dealing with cost of service when we are dealing with attempts to meet competition or keep customers. There are many principles involved in ratemaking and cost of service is only one of them.

Especially as a utility enters the competitive arena, value of service (what the market will bear) must become relatively more important, in comparison to cost of service analysis. Of

course, steps should be taken to protect "core" or monopolistic customers and the overall revenue requirement should still be met. However, selective rate reductions rather than cost-based programs, appear to be the wave of the future.

To some degree this is occurring in other utility industries, such as the gas industry. The reductions are tailored to maximize revenue realized while keeping the customer. There must, of course, be an irreducible minimum beyond which money is lost, rather than gained, for the system. However, above that minimum, there is considerable latitude. The consequences of this decision by PP&L might be painful for various customers but I agree with PP&L that the broader picture should be taken into account. These customers are asking what PP&L has done for the customer lately. PP&L is looking to 10 years or more of experience in the past and the immediate future.

I have made some adjustments in the cost of service and allocation category but recommend that no additional adjustments be made here under the heading of rate design. I view the interruptible customers as simply customers within the general class and not as a separate class. They take service like other industrial customers and, to some degree, allow interruption. I also point out that PP&L does have a considerable amount of available capacity, so that interruption might often be more a theoretical possibility than a real problem. In any case, I am recommending no further adjustments to this PP&L proposal.

F. Rate Schedule SE, Street Lighting

A PP&L discussion of this matter, in its main brief, commences at page 281. PP&L responds to the OTS proposal of off-peak rates for this rate schedule. It provides the grounds given as the fact that service is not used during peak hours for several months a year, that the charge can place a financial strain on a given community and that street lighting is a community service from which all customers benefit. There was a further suggestion of higher on-peak rates for winter months and lower off-peak rates for summer months.

PP&L states that this rate schedule has consistently contributed to monthly system peaks since the rate was established in 1982. It finds no change of circumstances. It refers to three generalized statements at public hearings. It also indicates that the proposal would redistribute but not necessarily reduce cost to the communities. PP&L further indicates that off-peak rates are generally used for customers who can shift load. That is not the case in this situation. PP&L further discusses peaks and cost.

OTS discusses this matter, commencing at page 143 of its main brief and at page 67 of its reply brief. It mentions that this rate serves 58 customers. It provides details concerning the service. It then provides a statement of its witness, concerning the off-peak proposal. It states that most of the street lighting takes place during off-peak periods and does not contribute to the system peak. OTS then acknowledges that the PP&L witness testified that this service is on-peak for five months out of the year. It

drops a footnote about load shifting and indicates that this is not the only basis for off-peak rates. OTS then outlines its response to the PP&L on-peak statement. It provides references to the public input hearings. It further states that this rate is an off-peak matter. It outlines its proposal.

In the reply brief, OTS provides a similar introduction. It then responds to the PP&L arguments. It points out that the OTS witness had proposed that rate schedule SE receive no increase in this proceeding. It states that this lack of an increase will relieve some of the budget pressure being experienced by cities and other municipalities. It indicates that ability to shift load is not the only basis for off-peak rates. It reviews the small contribution street lighting makes to peaks. It further argues that this rate schedule should be treated as off-peak service. It outlines its proposal for on-peak rates for five months a year and off-peak rates for seven months a year. It further states that rate schedule SE should not get any increase in rates in this proceeding.

PP&L addresses this matter in its reply brief, starting at page 121. It first states that a small size demand does not mean lack of responsibility for peak cost. PP&L further states that OTS has not justified in any way its proposal to give rate schedule SE a zero increase.

On this topic, I agree with PP&L. I sympathize with the municipalities and the problems they have with price increases. However, I find no good basis in theory for the OTS proposal. This

is not strictly an off-peak service and I agree with PP&L that off-peak rates are normally used to move customers away from peaks. Street lighting demand does not move like industrial demand can move.

There might be some argument on ability-to-pay but this is not normally accepted as a basic theory of ratemaking. OTS also argues about the general service provided by street lighting, indicating that some of the cost should be spread on the customer base generally. This theory has some support and there are other proposals to spread cost over all customers. However, application of this theory approaches the "tax" theory of utility ratemaking, which has been approached reluctantly up until now. I do not recommend application of that theory here. In any case, the public must pay for this service one way or another, either through utility rates or through taxes.

Perhaps some work can be done about providing added notice to municipal customers, considering their budget problems. However, that idea has not been placed before me in this proceeding and really goes beyond the scope of an individual rate proceeding. In any case, I recommend rejection of this OTS initiative.

G. Rate Schedule ISA

PP&L discusses this matter at pages 283-284 of its main brief. This topic has also been discussed under the context of cost of service and allocation. Beth Steel deals with this subject in some depth in its reply brief. PP&L indicates that OCA has stated that a contract should not block application of a portion of

the rate increase to this class. PP&L responds briefly to this allegation but also states that the rate class was designed as a competitive response. It indicates that arbitrary withdrawal of this contract would likely risk loss of load. PP&L refers briefly, in closing, to the testimony provided by OCA.

As stated, Beth Steel responds at length to various arguments raised by OCA and PPLICA. This matter has already been discussed in this Recommended Decision. Beth Steel refers to various matters, including Section 508 of the Public Utility Code, relating to modification of contracts. I accept the PP&L theory of meeting competition and retaining load. I would not disturb the contract. I tend to agree with Beth Steel that the Roaring Creek precedent does not really apply here.

H. Economic Development Credits (EDI/IDI)

This topic is discussed at various points in some of the briefs. The PP&L main brief discussion commences at page 284, under rate design. PP&L states that its treatment of EDI/IDI credits is reasonable. A corresponding OCA discussion commences at page 86 of its main brief, under the revenues heading. As OCA states, PP&L has offered to its industrial customers a series of economic development initiatives (EDI) and industrial development initiatives (IDI), since 1987.

These programs are discussed by a PP&L witness in PP&L Statement 8, commencing at page 15. EDI was made available in 1987. To receive these credits, customers must have signed contracts agreeing to expand production or expand physical

facilities. There were also provisions for new customers. IDI credits were introduced in 1992. This program is similar to the EDI program. PP&L plans to continue these programs, subject to modifications. The PP&L witness states, at his page 18, that the purpose of these programs is to induce expanded output and greater electricity use than would otherwise have occurred. It views these programs as successful in accomplishing their purposes. It further states that both the participants in the programs and the other customers are better off because of these programs.

As OCA points out, PP&L proposes to recover the revenue shortfalls of these programs from the customer classes receiving the credits. OCA has recommended that the revenue shortfall be shared equally between ratepayers and shareholders. It refers to a recent statement by Commissioner Hanger. It proposes a 50/50 sharing. OCA argues that PP&L has not adequately demonstrated that these programs benefit ratepayers. It points to the \$25 million expense. It further argues that other ratepayers should not be responsible for bearing this entire burden. It views the Company demonstrations as seriously flawed. It seeks further documentation.

OCA submits that it is not proper to simply assume that all of the load would have been lost, without the full discount. It further argues that the additional sales have imposed fuel costs on PP&L, at the marginal cost of fuel for the system. It indicates that marginal cost for fuel is higher than average cost. It refers to the testimony of its witness. It also refers to a sharing

approach adopted by other states. References and precedent are provided. It further states that the Sierra Club witness also provided testimony in support of the OCA proposal. It further refers to Commissioner Hanger's statements.

OCA also discusses this matter in its reply brief, at pages 42-43. It outlines the PP&L position and arguments. It states that the PP&L analysis unreasonably assumes that there are no "free riders" on these discounted rates. It further states that PP&L has made no attempt in this case to present an analysis that does not just simply assume that the load would have been lost without the fully discounted rate. It also refers to higher fuel costs which would be associated with this situation. It further states that PP&L shareholders will continue to benefit from these programs, through increased sales. It refers to a New York decision and submits that the benefits to shareholders support a sharing of this shortfall. It again states this proposal that there be a 50/50 sharing.

PPLICCA discusses this matter at pages 15-16 of its reply brief. It observes that PP&L would spread the cost, the revenue shortfall, within the rate classes that participate in this program. It further points out that PP&L recognizes that the entire system benefits from the program.

PPLICCA characterizes the PP&L positions as illogical and inequitable. It further argues that these initiatives benefit all customers and that the costs should be shared accordingly. It views the PP&L proposal as placing a disproportionate burden on,

essentially, other industrial customers. PPLICA states that these credits must be allowed on a system-wide basis, as outlined in the PPLICA Statement No. 7.

As indicated above, PP&L defends its proposal. It states that there should be no serious question regarding PP&L's right to fully recover these credits in rates. It refers to testimony provided by its witness, Mr. Kasper. It outlines the programs. It states that these programs have clearly worked as intended and have produced substantial benefits to the Company's customers. It refers to a cost/benefit analysis.

PP&L further asserts that the record shows that the program deterred a number of industrial customers from constructing substantial on-site cogeneration capacity. In closing, PP&L indicates that shareholders have essentially funded these programs for several years. It suggests that these programs be simply terminated if they are not supported by the Commission. On this point, I agree that PP&L shareholders should not be required to fund these programs.

PP&L next argues that the cost of these programs should be allocated to the beneficiary rate classes. It points to the degree of benefit enjoyed by the various ratepayers. It points out that EDI/IDI programs benefit both participants and non-participants, yet provide far greater benefits to participants. It points to other similar Commission programs. I suggest that a non-participant industrial ratepayer should be no different from a

non-participant residential ratepayer, for purposes of allocation of these shortfalls.

PP&L also refers to the Sierra Club witness's testimony and DSM audits, at page 287. PP&L states that it would not object to requiring companies to perform or present DSM audits, as part of this process. It further states that there should be no rigid requirement that the results must be implemented and that customers should pay for the audits. Concerning these audits, I accept the PP&L position and recommend that it be adopted by the Commission.

PP&L discusses EDI/IDI credits in its reply brief, commencing at page 122. It argues that the credits should be assigned to the rate classes who received benefits, that the 50/50 sharing proposal should not be adopted, that PP&L has proven the benefits of these programs to all ratepayers, that the cases cited by OCA are not good support for the relief sought and that the Sierra Club proposal concerning these credits should be rejected. The Sierra Club contribution to this debate will be discussed under the DSM heading, below.

PP&L reviews OCA arguments and responds. It characterizes the OCA proposal, that cost be shared with shareholders and that the Company should be required to continue the program, as particularly outrageous. It discusses the Commissioner Hanger statements. It further states that the Company is not seeking to shift these economic development costs to captive residential or commercial customers. It argues that the Company has provided the basis and that no additional showing is needed.

It indicates that the calculations of marginal energy costs were done and that, even with this conservative assumption, ratepayers still enjoyed a net savings. It refers to precedent from other jurisdictions and indicates that this is no basis for the relief sought.

I conclude that these programs are fundamentally sound and should be allowed to continue, subject to ongoing review by the Company and the Commission. I find record support for the PP&L positions. These sorts of initiatives are not unique to the electric utility industry and, while they should be carefully monitored, they are a part of contemporary life with respect to utility ratemaking.

As PP&L capacity becomes more in line with demand, these programs should be re-examined. However, I recommend that the Commission allow them to continue, for now. I would not impose the 50/50 sharing proposed by OCA, largely because I find these programs to be cost-justified. As indicated above, I would spread the cost over all ratepayers, and not simply the classes containing the customers directly involved with the programs. This burdens so-called captive customers but I accept this burden, for now. As the electric utility industry enters the competitive mode, this program, as I have indicated above, should clearly be re-examined and subject to ongoing re-examination. However, for now, I accept the PP&L positions, except for the spreading of cost.

I. GS-1 Rate Adjustments

OSBA discusses this matter in its main brief, commencing at page 16. OCA also discusses this matter, commencing at page 311 of its main brief and at page 131 of its reply brief. A discussion of the OSBA position appears within the revenue distribution discussion.

OSBA views the GS-1 class rates as so far out of line with cost that they should be reduced gradually over the years, not all at once with this proceeding. It refers to the principle of gradualism and proposes what is essentially a "phase in" program. However, OSBA expects more PP&L rate base proceedings in the immediate future.

OCA argues that the OSBA proposal should be rejected. It views automatic adjustments as not acceptable ratemaking, at least in this context. It would provide for adjustment of class rates of return only within the general rate case context.

PP&L discusses this matter briefly, commencing at page 287 of its main brief. The fundamental PP&L position appears to be that Mr. Knecht, the OSBA witness, has not sufficiently explained or justified his proposal. OCA, in its reply brief, refers to the main brief of OSBA. It adheres to the position that this initiative should be rejected.

I agree with OCA and PP&L. I commend the OSBA, and its witness, for this innovative proposal but I am not prepared to accept it, for purposes of this proceeding. This is a strange sort

of adjustment clause which is untested and could prove to be mischievous.

J. Demand Side Management

PP&L discusses this topic at pages 288-289 of its main brief. It argues that it has justified the scope of its DSM programs and responds to CEO criticism contained in one of the CEO statements. PP&L states that there can be no doubt that it operates a substantial and effective series of DSM programs. It refers to testimony of its witness, Mr. Farber. It provides details, referencing PP&L Statement 10. It refers to CEO criticism concerning the level of expenditures, based on a comparison with other utilities. It responds that it has adequate capacity for the immediate future and that accelerated investment in DSM would not reduce PP&L's capital costs. It also states that it spends more than other major utilities in Pennsylvania, despite the continued uncertainty over recovery mechanisms. PP&L also responds briefly to other criticisms. It views its program as sufficient in scope and well-focused.

The Sierra Club deals with DSM matters in its main brief. At page 13 it asks me to reconsider a ruling I made at hearing. I will deal with this request below. I observe that PPLICA dealt with this matter in its reply brief, commencing at page 45. The Sierra Club continues with the argument that the Commission should address incentives and lost revenues now, relating to DSM. This is at page 14 of its main brief.

The Sierra Club states that its witness attempted to testify as to the appropriate method of addressing these matters while the DSM Order of the Commonwealth Court is subject to a petition before the Pennsylvania Supreme Court. It mentions the motion of the industrial customers and then continues with its argument. It would have the Commission reverse my ruling excluding development, or limiting development, of this matter at hearing.

It addresses DSM again, starting at page 18 of its main brief. It urges the Commission to act and not simply react to the industry. It recommends a requirement that audits be performed by business customers. It refers to the testimony of its witness and to various conclusions and observations provided by that witness. It suggests such things as having shareholders absorb some of the revenues that are lost. It also refers to economic discount rates. It again suggests energy audits. It suggests a meaningful option for cost-effective DSM programs relating to all customers. It refers to New York experience. It compares this proposal favorably to the traditional economic development rates.

It asks the Commission to create a system benefits charge based on electricity sales by the utility. It also refers to stranded benefits and other emerging matters. It goes on with references to peak reduction measures and related programs. It also refers to performance-based incentives. It refers to experience in other states. It provides several conclusions and recommendations of its witness. It recommends a non-bypassable system benefits charge for recovering DSM costs. It refers to the

Federal Energy Regulatory Commission and freedom allowed to the states concerning this matter. It then, starting at page 24, refers to the relief requested which includes the future holding of public input hearings for PP&L customers.

The PPLICA discussion concerning this topic relates mainly to the Sierra Club request to reverse my ruling about stricken testimony. I will discuss this below.

PP&L discusses these matters near the end of its reply brief. Starting at page 128, it refers to the request to reopen the record, made by the Sierra Club. It also refers to the request of Sierra Club to address the tying of economic development discount programs to maximum cost-effective DSM. PP&L states that it does not object to a non-binding audit but does not favor the broad recommendations made by Sierra Club. It refers to the EDI/IDI programs. It also discusses the system benefits charge and suggests that this is a matter best addressed in a pending generic DSM proceeding at Docket No. I-900005. It indicates the view that the Sierra Club proposals are poorly defined and premature.

Starting at page 131 of its reply brief, PP&L responds to the CEO, concerning this matter. I have referred to discussions, above, concerning this topic. PP&L asserts that the CEO has simply failed to provide any factual evidence that a major expansion and refocusing of the DSM program would be in the best interests of PP&L and its customers. It refers to certain developments in the briefs. It refers to the "base load" argument of CEO, that non-heating customers should be included in programs.

I have considered the various alternatives to the current PP&L program, as outlined in this proceeding. Many of the ideas might be good but I consider much of the development to be beyond the scope of this ratemaking proceeding. In any case, I offer no modifications, based on the positions taken by these various parties.

X. ADDITIONAL ISSUES

Various other matters were addressed, matters which do not fall easily under the various topic headings which have been used so far. The main topic remaining is the ECR or energy cost rate, a mechanism whereby a utility is reimbursed for what it spends on energy.

A. The Energy Cost Rate Itself

PP&L addresses this matter in its main brief, commencing at page 290. It responds to a DOD development at hearing. This PP&L discussion relates somewhat to development by Sierra Club at page 16 of its main brief. There the Sierra Club suggests that the ECR be eliminated unless the Company can show that it is maximizing benefits of wholesale market purchases, for customers.

PP&L argues that the ECR is used by each Pennsylvania electric utility and is a Commission-approved mechanism allowed pursuant to Section 1307 of the Public Utility Code. It traces the ECR back to 1978. It refers to substantial benefits and levelization of costs. I accept the PP&L position and recommend no change to the ECR mechanism, within the context of this proceeding.

B. The ECR and Off-System Sales

The PP&L discussion of this topic commences at page 291 of its main brief. It begins this discussion with a useful background statement which sets up the situation. That background statement, at pages 291-293, follows:

In this proceeding, the Company has proposed an innovative modification of the ECR to reflect the expected return of capacity costs and revenues attributable to off-system

capacity sales that will terminate in the near future. The Company's proposal specifically addresses the return of a 945 MW slice of system capacity and energy sold to Jersey Central Power & Light Co. ("JCP&L").

In PP&L's 1982 base rate case the Commission determined that PP&L had excess generating capacity and, as a remedy, disallowed recovery of all return on a 945 MW slice of the Company's system. After that case, PP&L sold that capacity to JCP&L. In the Company's 1984 base rate case, all of the costs and revenues associated with that 945 MW were allocated out of PUC jurisdictional rates. The same approach was followed in this filing.

On January 1, 1996, this sale to JCP&L begins to wind down over a five-year period. One-fifth of the 945 MW, or 189 MW will return to PP&L each year. Absent an innovative solution, PP&L will have to choose among three alternatives for addressing this returning capacity: (1) find another buyer in the bulk power market, (2) file periodic retail base rate cases, or (3) absorb the associated costs.

After analysis, PP&L concluded that none of these three options was satisfactory or in the public interest. The bulk power market is becoming increasingly competitive and prices are being driven inexorably toward marginal costs. Periodic base rate filings require the commitment of significant resources by all participants, most particularly the Commission and its staff. And, finally, the Company is not in a financial position to begin absorbing additional costs. Accordingly, PP&L developed an innovative alternative which it presented in this case.

Under its proposal in this case, the Company would reflect the full costs of each "slice" of returning capacity in the ECR, as well as credit all revenues from off-system sales. The capacity could serve a range of uses that would ultimately benefit customers, e.g., serving native load, or making off-system capacity-related PJM installed

credit, output reservation and transmission entitlement sales.

At the end of the second paragraph, PP&L drops the following footnote:

PP&L also has sold capacity and energy to Atlantic City Electric (125 MW slice of all coal-fired plants) and Baltimore Gas & Electric (125 MW slice of the Susquehanna Plant). The Company has followed the same ratemaking practices with these sales as it has with the JCP&L sale and would intend to follow the same ECR treatment.

PP&L proceeds to point out that this returning capacity can provide a valuable resource for meeting customer demand or to provide other valuable functions, such as making additional off-system sales. This could produce considerable revenue which would be credited to customers, under the PP&L plan.

PP&L notes opposition, by three witnesses. PPLICA, OCA, DOD and the Sierra Club address this matter.

PP&L provides the fundamental basis for opposition as the idea that the costs are not subject to ongoing review. The Company recognizes that its proposal is innovative and novel but expresses disappointment with the responses of the other parties. It points out that the costs of the returning facilities are known, that customers would immediately see the benefits from off-system capacity sales, that the proposal will tend to avoid base rate proceedings and that monitoring can deal with overearnings. PP&L urges the Commission to examine the proposal carefully and to reject the positions of the opposition.

Starting at page 294, PP&L proposes the taking of two steps if its main proposal is not accepted. PP&L, at pages 294-295, provides a brief and coherent statement concerning these two steps, which follows:

Should the Commission not accept the Company's proposal, then fairness and sound ratemaking principals require that two steps be taken as to the ECR.

First, if the Commission decides to exclude from the ECR any capacity costs associated with expiring contracts, then all revenues from off-system capacity-related sales also should be excluded from the ECR and treated as an element of base rates only (PP&L St. 7-R, pp. 34-35). This is the traditional ratemaking practice and would permit the Company to retain revenues from incremental off-system capacity-related sales to at least partially offset the cost of capacity returning under expiring agreements. Significantly, even Mr. Baron notes the propriety of this approach (PPLICA St. 7, p. 76).

Second, the Company should be entitled to retain all energy-related savings made possible by the return of this capacity to PP&L. For example, when the first increment of JCP&L capacity returns on January 1, 1996, the Company's capacity costs will increase by about \$35 million and its energy costs will decrease by about \$15 million. Under current regulatory practice in Pennsylvania, the Company's shareholders would absorb a \$35 million cost increase and ratepayers would automatically receive a \$15 million cost decrease through the ECR. Under the Company's preferred proposal, both the capacity costs and the energy savings would be reflected in the ECR, along with all of the revenues received from other off-system capacity-related sales. If the Company's preferred proposal is rejected, however, at a minimum, the Company should be permitted to retain the energy savings to offset a portion of the capacity costs that produced those savings. Although this would not be a

complete solution to the problem, it would at least avoid the fundamental mismatch of costs and savings described above and could help the Company avoid the need for an immediate rate filing to reflect the returning JCP&L capacity and energy (PP&L St. 7-R, p. 35).

To me, these seem to be fair steps which should be taken, and I recommend them if the basic proposal is not approved. These two steps essentially keep the capacity off the books until there is a base rate case.

OCA discusses this matter, commencing at page 313 of its main brief and at page 133 of its reply brief. OCA states that the main proposal has the effect of raising the total rate increase request in this case to approximately \$440 million, rather than the \$261 million identified by PP&L. OCA would reject the proposal. It points out that these capacity costs have not been in jurisdictional rates for nearly 10 years. It suggests a danger of overearnings by PP&L. It suggests that PP&L can always bring a base rate case. It proceeds to review the situation, providing background.

OCA suggests that the PP&L proposal would essentially circumvent the review of issues critical to the determination of rates. It gives the example of the excess capacity issue. It also discusses the possibility of what it terms perverse incentives. It states that, if PP&L fails in its marketing efforts, then it would automatically receive full recovery of costs from ratepayers. It addresses various PP&L arguments and refers to the testimony of its own witness. It also refers to incentives for cost control. It further views the PP&L proposal as one-sided.

OCA would also reject the PP&L argument that it be permitted to retain the energy savings from this capacity, if its proposal is denied. OCA views this argument as not reasonable, in the context of this proceeding. It states that this alternative proposal would continue to allow PP&L to selectively pick the ratemaking treatment that is most advantageous to it, at a particular point in time. It refers to testimony of its witness relating to ratemaking options. It suggests that the alternative proposal could result in ratepayers paying energy rates through the ECR which are higher than PP&L's actual cost of energy supply. OCA suggests that PP&L make this request in an ECR proceeding.

OCA, in its reply brief, refers to arguments in its main brief. It also refers to the PP&L presentation. It submits that PP&L has overlooked serious flaws in its proposal. It refers to the four benefits identified by PP&L at page 294 of its brief. It states that it has addressed these matters but makes certain key points. OCA first suggests that avoidance of base rate filings is one of the primary detriments to the PP&L proposal. It states that, if the PP&L load is not growing, it will be necessary to determine whether the returning capacity is excess capacity.

OCA again touches on the overearnings problem. It suggests that other parties might have to bring a base rate proceeding, if PP&L does not. It also discusses what it views as perverse incentives. This relates to the possible failure of marketing efforts and the automatic recovery from ratepayers of

cost, through the ECR. OCA again suggests rejection of the primary PP&L proposal.

OCA also states that the alternative PP&L proposal, to retain the energy savings associated with this capacity, is premature and should not be adopted in this case. It states that PP&L should retain the right to make such a proposal in an appropriate proceeding, when the capacity returns to the PP&L system.

DOD discusses this topic in its main brief, commencing at page 16. It reviews the background. It questions incentive. It suggests a shifting of business risks to the ratepayers. It suggests that the OTS witness appears to support PP&L. DOD then refers to testimony of its own witness suggesting a modification of the ECR, by returning to methods used before 1994. DOD also suggests that base rate treatment of capacity is the appropriate regulatory treatment, not use of the ECR. DOD further refers to a recent PP&L contract for sale of capacity to JCP&L. It suggests that this sale could be relevant. It further suggests some PP&L agreement with the DOD position.

The Sierra Club addresses this matter very briefly at page 16 of its main brief. It would deny the PP&L proposal until and unless the Commission can find that PP&L has complied with new competitive bidding regulations, in dedicating the capacity and energy for its customers.

PPLICA addresses this matter, starting at page 32 of its main brief and at page 43 of its reply brief. It states that PP&L

wants automatic increases to its retail customers, to offset reduced future revenues associated with this JCP&L transaction. It refers to \$35.5 million in revenue requirement for January 1, 1996 and corresponding increases over five years. It further states that the credit associated would be approximately \$20.8 million for the test year. PPLICA argues that the proposal would amount to requiring the Commission to approve, prospectively, single issue rate increases, without consideration of other matters. It points out that PP&L has numerous options for handling this matter.

PPLICA continues with reference to the approximately \$21 million offsetting ECR credit, which it discusses elsewhere in its brief. It further states that, should the PP&L proposal relating to JCP&L be rejected, PP&L will withdraw its proposal to credit the ECR for off-system capacity revenues but credit base rates, again resulting in the net increase to base rates of \$240 million. It proceeds with its discussion and refers to risks being transferred. PPLICA would retain this matter in base rates.

PPLICA again reviews the matter in its reply brief. PPLICA refers to PP&L Statement No. 7-R, pages 34-35, and to the PP&L proposal that, if its JCP&L proposal is rejected, then all revenues from off-system capacity-related sales should be excluded from the ECR and treated as an element of base rates. PPLICA again indicates opposition to the fundamental PP&L proposal. It indicates agreement with the proposal that, if the Commission decides to exclude from the ECR any capacity costs associated with expiring wholesale contracts, then all revenues from off-system

capacity-related sales should be excluded from the ECR and treated as an element of base rates only. It refers to PPLICA Statement No. 7, page 77, and other documents. PPLICA further indicates its opposition to the approach of crediting revenues to the ECR.

PP&L again addresses this matter in its reply brief, commencing at page 134. It refers mainly to the OCA blanket opposition to the fundamental PP&L proposal. It argues that OCA narrowly focuses on hypotheticals. It further states that OCA ignores the very real benefits of the PP&L proposal, particularly immediate benefits of revenue credits through the ECR.

PP&L expresses disappointment concerning the OCA position that the PP&L alternative is not reasonable. PP&L refers to fundamental unfairness of placing the full cost of the returning facilities on PP&L, but giving the full net benefit of energy savings to ratepayers. It views the OCA reasons as lacking merit. It refers to unjust enrichment of ratepayers.

It views the OCA proposal that PP&L address this matter on an ECR case basis as inappropriate. It states that the Commission has before it all facts necessary to decide this issue now and argues that the Commission should make the requested modification. It argues that the first slice will return very shortly after the new rates go into effect and that an overearnings situation is not likely at that point.

The primary PP&L proposal might be a good idea but, for me, it is overly innovative and too automatic. PP&L argues that it would serve, probably, to avoid base rate proceedings. However, as

expensive as they are, base rate proceedings are a proper tool for managing utilities and setting appropriate rates. The ECR mechanism serves to avoid more frequent rate proceedings, as energy costs fluctuate. However, there is reason for the ECR and appropriate checks involved in the ECR mechanism.

I do not see the necessary checks and balances in this PP&L proposal. Moreover, the proposal appears to depart too far from traditional ratemaking, even though we appear to be moving into a regulatory context. PP&L points out that complaints can be brought against its ongoing rates. However, this can be a cumbersome and slow process.

Although the PP&L primary proposal is tempting, I recommend that it be rejected. On the other hand, I find the PP&L alternative proposal to be acceptable. Moreover, I agree with the fundamental unfairness argument of PP&L. I recommend that the Commission accept this alternative proposal which is provided at pages 294-295 of the PP&L main brief and at pages 34-35 of PP&L Statement No. 7-R, of Mr. Kleha.

C. Exclusion of Sierra Club Testimony

The Sierra Club, starting at page 13 of its main brief, requests that my exclusion of certain testimony by its witness be reversed. I have already referred to this request, above. It provides a plan, for use if my ruling is reversed. PPLICA responds to this request, commencing at page 45 of its reply brief. In addition, PP&L touches on this matter, commencing at page 128 of its reply brief. PP&L opposes a reversal of my ruling and suggests

that I disregard this request for purposes of the Recommended Decision. PPLICA responds at more length.

PPLICA, starting at page 45 of its reply brief, provides background relating to this request. It observes that the original motion to strike was made by PPLICA. It outlines the substantial argument which was presented at that time. It refers to a one month delay before the Sierra Club asked that I certify the matter up to the Commission. It refers to my clear rejection of this proposal. It refers to argument at the briefing stage of this matter. It refers to Commission regulations. It stresses the need for timeliness of requests. This problem of timeliness is, of course, particularly significant for proceedings where there is an overall time limit on litigation. It even addresses some of the merits of the Sierra Club positions.

I am in fundamental agreement with the positions taken by PPLICA, concerning this matter. I see no reason to further discuss this situation. I adhere to my original ruling and to my ruling denying certification. I further observe that the Sierra Club did not bring the matter before the Commission itself, prior to the close of the record or at any time before briefs were filed.

D. OCA Financial Impact

OCA addresses this topic, commencing at page 321 of its main brief. It refers to testimony in the rebuttal phase, by PP&L witness Berish. This witness responded to the OCA rate reduction recommendation. OCA submits that the Berish argument, that the OCA recommendations would unreasonably impair PP&L's financial

condition, as based on incorrect assumptions and must be dismissed. It provides further arguments. Among other things, it refers to rate of return. I see no reason to address this matter, directly. I add this section to the Recommended Decision only to point out the OCA argument and for the sake of completeness. I observe that OCA would reduce PP&L test year rates by \$66,464,000.

E. PP&L Public Input Issues

PP&L, commencing at page 296 of its main brief, provides several pages of discussion relating to public input hearings. Once again, I refer to this section largely for the sake of completeness and to point out the arguments presented by the party.

PP&L reviews, and characterizes, testimony. It groups comments into four major categories. It provides some of its own responses. It touches on such matters as its proposal to modify its rate schedule RTS position. It also touches on impact for individual businesses and economic development in the region. It addresses the contributions of Mr. Epstein in some detail. It views certain issues raised by Mr. Epstein as totally refuted by PP&L and not relevant. It suggests that they be disregarded.

I see no reason to specifically rule on what PP&L here presents. I deal with some of these matters elsewhere in this Recommended Decision.

XI. CONCLUSION

In accordance with the foregoing discussion, I conclude that Pennsylvania Power & Light Company has shown the need for \$2,463,631,000 in annual operating revenues, an increase of \$61,744,000. I recommend that this increase be allowed and that additional relief be granted, and additional requirements be imposed, as indicated above;

THEREFORE, THE FOLLOWING ORDER IS RECOMMENDED:

1. That Pennsylvania Power & Light Company shall not place into effect the rates contained in Supplement No. 50 to Tariff Electric-Pa. P.U.C. No. 200, the same having been found to be unjust, unreasonable and, therefore, unlawful.

2. That Pennsylvania Power & Light Company may file tariffs or tariff supplements containing rates, provisions, rules and regulations which are consistent with the Recommended Decision and are designed to produce annual operating revenues not in excess of \$2,463,631,000, on a Pennsylvania jurisdictional basis.

3. That the tariffs or tariff supplements mentioned in paragraph two, above, may be filed to become effective on one day's notice.

4. That Pennsylvania Power & Light Company shall file detailed calculations, with its tariff filing, which shall demonstrate, to the Commission's satisfaction, that the filed rates comply with the Commission's order concerning this proceeding.

5. That Pennsylvania Power & Light Company shall comply with all directives, conclusions and recommendations contained in

the body of the Recommended Decision, which are not the subject of an individual directive in these ordering paragraphs, as fully as if they were the subject of a specific ordering paragraph.

6. That the complaints filed by other parties to this base rate proceeding, docketed at R-00943271, that is, docket numbers R-00943271C0001 through R-00943271C0145, are granted or denied to the extent consistent with the Recommended Decision.

7. That, upon Commission approval of the tariffs filed in compliance with the Commission's order, these proceedings at R-00943271 shall be closed.

Robert A. Christianson
ROBERT A. CHRISTIANSON
Administrative Law Judge

DATED: 7/28/95

R-00943271

TABLE I
PENNSYLVANIA POWER & LIGHT COMPANY
INCOME SUMMARY
(Thousands of Dollars)

| | Pennsylvania Public Utility Commission Jurisdictional Basis | | | | | | |
|-------------------------------|---|------------------------|---|--------------------|-----------------------------------|----------------------------|--------------------------------|
| | Pro Forma Present Rates (1) | Company Adjustments | Pro Forma Present Rates (Revised) (2) | ALJ Adjustments | ALJ Pro Forma Present Rates | ALJ Revenue Increase | Total Allowable Revenues |
| | \$ | \$ | \$ | \$ | \$ | \$ | \$ |
| Operating Revenue | 2,402,255 | (368) | 2,401,887 | 0 | 2,401,887 | 61,744 | 2,463,631 |
| Expenses: | | | | | | | |
| O & M Expense | 1,372,927 | 2,481 | 1,375,408 | (54,505) | 1,320,903 | | 1,320,903 |
| Depreciation | 320,797 | 0 | 320,797 | (15,274) | 305,523 | 0 | 305,523 |
| Regulatory Debits/Credits | (29,208) | 0 | (29,208) | 0 | (29,208) | 0 | (29,208) |
| Taxes, Other | 186,553 | (17) | 186,536 | (745) | 185,791 | 3,149 | 188,940 |
| Income Taxes: | | | | | | | |
| State | 54,478 | (387) | 54,091 | 5,763 | 59,854 | 6,440 | 66,294 |
| Federal | 154,601 | (1,099) | 153,502 | 16,128 | 169,630 | 18,254 | 187,884 |
| Deferred Income Taxes | (15,424) | 0 | (15,424) | 5,346 | (10,078) | 0 | (10,078) |
| Investment Tax Credit | (8,625) | 0 | (8,625) | 0 | (8,625) | 0 | (8,625) |
| Emission Allowances | (466) | 0 | (466) | 0 | (466) | 0 | (466) |
| Total Expenses | 2,035,633 | 978 | 2,036,611 | (43,287) | 1,993,324 | 27,843 | 2,021,167 |
| Net Inc. Available for Return | 366,622 | (1,346) | 365,276 | 43,287 | 408,563 | 33,901 | 442,464 |
| Rate Base | 5,017,178 | 530 | 5,017,708 | (239,474) | 4,778,234 | | 4,778,234 |
| Rate of Return | 7.31% | | 7.28% | | | | 9.26% |

(1) PP&L Exhibit Future 1, Schedule D-1

(2) PP&L Exhibit Future 1 (Revised), Schedule D-1

TABLE I(A)
PENNSYLVANIA POWER & LIGHT COMPANY
RATE OF RETURN

| | <u>Structure</u> | <u>Cost</u> | <u>After-Tax Weighted Cost</u> |
|--------------------|------------------|-------------|--|
| Total Cost of Debt | | | 3.71% |
| Long-term Debt | 46.53% | 7.97% | 3.71% |
| Short-term Debt | 0.00% | 0.00% | 0.00% |
| Preferred Stock | 7.59% | 7.31% | 0.55% |
| Common Equity | 45.88% | 10.9000% | 5.00% |
| | <u>100.00%</u> | | <u>9.26%</u> |

After-Tax Interest Coverage 2.50

TABLE I(B)
PENNSYLVANIA POWER & LIGHT COMPANY
REVENUE FACTOR

| | |
|---|--------------------------|
| 100% | <u>1.00000000</u> |
| Less: | |
| Uncollectible Accounts Factor | 0.00000000 |
| PUC, OCA, OSBA Assessment Factors | 0.00000000 |
| Gross Receipts Tax | 0.04400000 |
| Capital Stock Tax | <u>0.00700049</u> |
| | 0.94899951 |
| State Income Tax Rate | <u>0.10990000</u> |
| Effective State Income Tax Rate | <u>0.10429505</u> |
| Factor After Local and State Taxes | 0.84470446 |
| Federal Income Tax Rate | <u>0.35000000</u> |
| Effective Federal Income Tax Rate | <u>0.29564656</u> |
| Revenue Factor (100% - Effective Tax Rates) | <u><u>0.54905790</u></u> |

TABLE II
PENNSYLVANIA POWER & LIGHT COMPANY
SUMMARY OF ADJUSTMENTS
(Thousands of Dollars)

PENNSYLVANIA PUBLIC UTILITY COMMISSION JURISDICTIONAL BASIS

| Adjustments | Rate Base | Revenues | Expenses | Depreciation | Taxes-Other | State Income Tax | Federal Income Tax | Deferred Income Taxes |
|--------------------------------------|------------------|----------|-----------------|-----------------|--------------|---------------------|-----------------------|-----------------------------|
| | \$ | \$ | \$ | \$ | \$ | \$ | \$ | \$ |
| RATE BASE: | | | | | | | | |
| Excess Capacity | (239,474) | | | | | | | |
| REVENUES: | | | | | | | | |
| EXPENSES: | | | | | | | | |
| Benefit Savings/Employee Red. | | | (171) | | | 19 | 53 | |
| Susq. Unit 1 "Early Window" Deferral | | | (2,035) | | | 224 | 634 | |
| Environmental Remediation Costs | | | (326) | | | 36 | 102 | |
| Uncollectible Accounts: | | | | | | | | |
| Regular Uncollectible Accounts | | | (1,234) | | | 136 | 384 | |
| On-Track Program | | | (130) | | | 14 | 41 | |
| Rate Case Expense | | | (373) | | | 41 | 116 | |
| Nuclear Decommissioning: | | | | | | | | |
| Contingency Factor | | | (2,516) | | | 277 | 784 | |
| Post-Shutdown Earnings | | | (2,436) | | | 268 | 759 | |
| Fossil Fuel Plant Decommissioning | | | (45,284) | | | 4,977 | 14,107 | |
| | | | 0 | | | 0 | 0 | |
| | | | 0 | | | 0 | 0 | |
| | | | 0 | | | 0 | 0 | |
| | | | 0 | | | 0 | 0 | |
| DEPRECIATION EXPENSE: | | | | | | | | |
| Fossil Fuel Plant Depreciation | | | | (15,274) | | | | 5,346 |
| TAXES: | | | | | | | | |
| Gross Receipts Tax | | | | | (745) | 82 | 232 | |
| Adjustments to Taxable Income | | | | | | (1,066) | (3,023) | |
| Tax Deficiency Accruals | | | | | | (213) | (804) | |
| Interest Synchronization (Table III) | | | | | | 968 | 2,743 | |
| TOTALS | <u>(239,474)</u> | <u>0</u> | <u>(54,505)</u> | <u>(15,274)</u> | <u>(745)</u> | <u>5,763</u> | <u>16,128</u> | <u>5,346</u> |

TABLE III
PENNSYLVANIA POWER & LIGHT COMPANY
INTEREST SYNCHRONIZATION
(Thousands of Dollars)

Pa. P.U.C. Jurisdictional Basis

| | <u>Amount</u> \$ |
|-------------------------------|---------------------|
| Company Rate Base Claim | 5,017,708 |
| ALJ Rate Base Adjustments | <u>(239,474)</u> |
| ALJ Rate Base | 4,778,234 |
| Weighted Cost of Debt | <u>3.71%</u> |
| ALJ Interest Expense | 177,272 |
| Company Claim (1) | <u>186,079</u> |
| Total ALJ Adjustment | 8,807 |
| Company Adjustment | <u>0</u> |
| Net ALJ Interest Adjustment | 8,807 |
| State Income Tax Rate | <u>10.99%</u> |
| State Income Tax Adjustment | <u>968</u> |
| Net ALJ Interest Adjustment | 8,807 |
| State Income Tax Adjustment | <u>968</u> |
| Net ALJ Adjustment for F.I.T. | 7,839 |
| Federal Income Tax Rate | <u>35.00%</u> |
| Federal Income Tax Adjustment | <u><u>2,743</u></u> |

(1) PP&L Exhibit Future 1 - Revised
Schedule D19, Page 1, Line 13 (Pa. Jurisdictional Basis)