

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Uniform Cover and Calendar Sheet

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1. REPORT DATE: August 22, 1995	2. BUREAU AGENDA NO.: AUG-95-ALJ-123*
3. BUREAU: ALJ	
4. SECTION(S):	5. PUBLIC MEETING DATE: August 31, 1995
6. APPROVED BY: Chief ALJ: Robert A. Christianson Phone: Ext. 7-6108	
7. PERSONS IN CHARGE: ALJ Christianson 7-6108	
8. DOCKET NO: R-00943271, <input type="checkbox"/> R-00943271C0001-C0145	

9. (a) **CAPTION** (abbreviate if more than 4 lines)
(b) **Short summary of history & facts, documents & briefs**
(c) **Recommendation**

- (a) Pennsylvania Public Utility Commission, etc. v. Pennsylvania Power & Light Company
- (b) On December 30, 1994, PP&L filed Supplement No. 50 to Tariff Electric-Pa. P.U.C. No. 200, to become effective February 28, 1995. This filing contains changes to produce \$261,635,000 in additional annual revenues. This filing was suspended by operation of law until September 28, 1995. A prehearing conference was held on March 7, 1995. Approximately 14 days of evidentiary hearings were held in Harrisburg. Eleven public input hearings were held. Main and Reply Briefs were filed.
- (c) Judge Christianson issued a decision granting limited relief and imposing various requirements.

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**DOCUMENT
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PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, Pennsylvania 17105-3265

PENNSYLVANIA PUBLIC UTILITY
COMMISSION, ETC.

v.

PENNSYLVANIA POWER &
LIGHT COMPANY

PUBLIC MEETING -

AUGUST 31, 1995

AUG-95-ALJ-123*

DOCKET NOS.

R-00943271;

R-00943271C0001-C0145

STATEMENT OF CHAIRMAN JOHN M. QUAIN

Polling Issue # 1 - Excess Capacity

Polling Issue #36 - Energy Cost

The excess capacity issue in this case is a difficult one. A resolution of this issue must balance a variety of concerns including such items as: (i) the Pennsylvania-Jersey-Maryland (PJM) power pool, (ii) the presence of non-utility generation (NUG) on the PP&L system, (iii) the significant capacity issues related to the extreme weather conditions experienced during the winter of 1994 and summer of 1995; (iv) changes at the Federal level relating to the wholesale capacity market; and (v) the appropriate capacity reserve margin for this utility.

The various parties offered specific recommendations related to this issue. The Office of Trial Staff (OTS), the Office of Consumer Advocate (OCA) and the Administrative Law Judge (ALJ) each included in their analysis of excess capacity, the existence of 504 megawatts of non-utility generation. It is important to note that while PJM recognizes the presence of NUG capacity for reliability purposes, PP&L makes no specific payment for capacity to these units. Rather, the contracts are production based only. As noted in this Commission's Electric Outlook Report issued in July, 1995, this capacity declined to 474 as of June, 1995 and the continuing feasibility of a second unit is the subject of a separate proceeding before this Commission. Giving due consideration to the record evidence and the various concerns listed above, I cannot conclude that any excess capacity currently exists on the PP&L system. Moreover, this record is wholly insufficient to support an adjustment to ratebase which would result in a penalty to shareholders stemming from the existence of NUG's in the PP&L service territory.

Lastly, I reach my decision based on an analysis of the record regarding an appropriate reserve margin for this Company. I conclude that there is a lack of substantial evidence which supports the establishment of a *different reserve margin today, as compared* to that arrived at by the Commission in 1985 when the Second Susquehanna Unit came on line. Moreover, the capacity concerns related to the weather conditions of both the winter of 1994 and the summer of 1995 provide vivid reminders of the need for adequate reserve

margins in the same range as that found by this Commission ten (10) years ago. Thus, I conclude a reserve margin of 22% remains appropriate. Hence, no excess capacity exists on the system today.

However, my analysis also leads me to conclude that excess capacity would exist if we were to permit recovery of the 945 megawatts associated with the Jersey Central Power & Light (JCP&L) contract. PP&L proposes to recover such capacity through the ECR mechanism as the aforementioned contract draws to a close and the associated capacity is returned to the PP&L system. Thus, I conclude that the capacity associated with the JCP&L contract should remain non-jurisdictional. Consequently, PP&L should market such capacity, as it has in the past, and bear the risks and benefits associated with doing so.

In summary, I reject the excess capacity adjustment to rate base, and poll with the Company on Issue #1. Also, I will not permit inclusion in the ECR, the costs associated with the return from capacity to JCP&L, and thus, poll with the ALJ on Issue #36.

8-31-95
DATED


JOHN M. QUAIN, CHAIRMAN

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, Pennsylvania 17105-3265

PENNSYLVANIA PUBLIC UTILITY
COMMISSION, ET. AL.

V.

PENNSYLVANIA POWER &
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R-00943271;

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STATEMENT OF CHAIRMAN JOHN M. QUAIN

Polling Issue Nos. 14, 15, 16, 17 and 18 - Nuclear Decommissioning Costs

The Administrative Law Judge (ALJ) has included in his Recommendation an adjustment to the trust payment which reflects potential post shutdown earnings of the trust fund. By its definition, this recognition would result in the fund being inadequate at the time of shutdown, and would be dependent upon future earnings to meet the decommissioning needs of the station. The NRC has provided regulations at 10 CFR §50.75 which require the licensee to provide assurance that the fund balance will be sufficient at the cessation of commercial operation. Therefore, I disagree with this portion of the ALJ's recommendation.

In all other respects, I support the ALJ's recommendation relating to decommissioning expense.

8-31-95
DATED


JOHN M. QUAIN, CHAIRMAN

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DOCKET NOS.
R-00943271;
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STATEMENT OF CHAIRMAN JOHN M. QUAIN

Polling Issue #26 - Equity Return

I have reviewed the record in this proceeding and find that a return on equity based solely upon the estimates of the discounted cash flow method is inadequate. I find it is necessary to include the risk premium method in my decision making analysis. Therefore, I poll a range of 11.5% to 11.75%.

8-31-95-
DATED


JOHN M. QUAIN, CHAIRMAN

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PENNSYLVANIA PUBLIC UTILITY
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v.

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PUBLIC MEETING-
AUGUST 31, 1995
AUG-95-ALJ-123*
DOCKET NO: R-00943271
REVISED

STATEMENT OF VICE CHAIRMAN LISA CRUTCHFIELD

Polling Issue No. 1 - Excess Capacity
Polling Issue No. 36 - Energy Cost Rate

I agree with Pennsylvania Power & Light Company's ("Company" or "PP&L") argument in its main brief and particularly its Exceptions that none of the claimed plant in service in this rate case represents excess capacity. The record indicates that, including the 474 megawatts ("MW") of non-utility generated ("NUG") capacity, the Company's reserve margin calculations result in a reserve margin of 18.4 % for the upcoming winter of 1995-1996.

<u>CAPACITY</u>	<u>PEAK DEMAND</u>	<u>RESERVE MARGIN</u>	<u>PERCENT RESERVE</u>
7,964 MW	6,725 MW	1,239 MW	18.4 %

I support the Company's position that a 18.4% reserve margin which includes all of the Company's capacity (including non-utility generated capacity) is an appropriate reserve margin based on precedent and based upon the 18% to 39% reserve margins the other major jurisdictional electric utilities in Pennsylvania have been allowed to have by this Commission.

It is critical for the health and safety of the ratepayers of any electric utility that the utility plan its capacity resources to provide for a sufficient quantity of capacity reserve. The importance of maintaining system reliability cannot be ignored in a rate case by failing to provide for sufficient reserves to meet the peak day requirements of the utility's native load customers. While the appropriate reserve margin amount is a matter of judgment and depends upon the specific circumstances of that particular utility, I believe that the 18.4% reserve shown for PP&L is reasonable. The Office of Consumer Advocate ("OCA") and the Office of Trial Staff ("OTS") recommend 15% and 16% reserve margins, respectively. These reserves are inadequate especially considering the electric energy emergency declared during January 1994 and the record electrical demands experienced this past July.

It should be noted that I disagree with the Company's argument that capacity related to purchases from non-utility generators should be excluded from the determination of an

appropriate capacity reserve margin. While I recognize that PP&L's purchases of NUG capacity are based upon PP&L's energy-only avoided costs, I find it inconsistent to include these purchases as PJM installed capacity for accounting purposes but not as available capacity in this case. Nevertheless, the resultant reserve margin which includes NUG capacity is reasonable.

Moreover, I do not support the ALJ's recommendation to adopt the OTS position to reduce the claimed rate base by \$239 million because it represents 564 megawatts of excess capacity. I reject OTS's recommendation because I believe its methodology in calculating excess capacity is flawed. The OTS adjustment is not based on a historic test year or a future test year determination of excess capacity for the PP&L system. This adjustment is based upon a computation of a nine year average capacity analysis beyond the future test year which includes 945 MW of returning PP&L capacity which was disallowed in PP&L's 1982 base rate proceeding and subsequently sold to the Jersey Central Power and Light Company ("JCP&L"). The record evidence indicates that this JCP&L sale will begin to terminate in 1996 with one-fifth of the 945 MW, or 189 MW, returning to PP&L each year. I cannot support penalizing the utility for a potential excess capacity situation that may or may not develop at some point beyond the future test year of the instant proceeding.

While I am not recommending that an excess capacity adjustment be made in this case, I am not allowing the cost of the previously determined excess capacity related to the JCP&L sale to be borne by the customers of PP&L at this time as the Company requested. It appears to me that it would be more equitable to adopt the alternative position offered by the Company and recommended by the ALJ on Issue 33 with a clarification. This alternative position provides that if the Commission decides to exclude from the ECR any capacity costs associated with expiring contracts, then (1) all revenues from off-system capacity related sales also should be excluded from the ECR and treated as an element of base rates only and (2) the Company should be entitled to retain all energy-related savings made possible by the return of this capacity to PP&L (emphasis added). I am willing to adopt this alternative position if clarified to allow PP&L to exclude not all revenues from off-system capacity related sales from the ECR, but only any incremental off-system capacity related sales resulting from the returning capacity.

8/31/95

DATE


LISA CRUTCHFIELD
VICE CHAIRMAN

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, Pennsylvania 17105-3265

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STATEMENT OF VICE CHAIRMAN LISA CRUTCHFIELD

Polling Issues No. 14 through 18 - Nuclear Decommissioning Costs

The appropriate ratemaking treatment for Nuclear Decommissioning Expense was a contested issue in this proceeding with five separate sub-issues recommended by various parties. The Administrative Law Judge ("ALJ") accepted Pennsylvania Power & Light Company's ("Company") claim for all of the sub-issues except for adjustments to eliminate the contingency allowance and adjustments to include post shut-down earnings. The ALJ found the contingency factor to be speculative and to be unnecessary due to the fund's present ability to earn a return commiserate with or slightly above inflation. Additionally, the ALJ rejected the Company's claim to exclude post shut-down earnings accruals based on the belief that money unused during the decommissioning process will be available to earn some return and therefore, the ALJ reduced the Company's nuclear decommissioning expense claim by \$2,436,000.

I agree with the ALJ regarding post shut-down earnings as I do not believe that any Nuclear Regulatory Commission regulations preclude the practice of continuing to invest the unused money in the investment fund and earn a reasonable return while drawing only the necessary money to pay for decommissioning costs. I, however, disagree with the ALJ's recommendation regarding eliminating the contingency allowance and accepting the Company's claim of a 5.5% trust fund earnings rate.

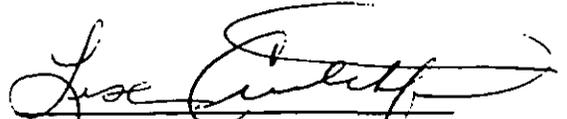
First, I do not agree with eliminating the contingency allowance because providing for a contingency allowance is a routinely accepted engineering cost estimation practice which is an important factor considered in any construction/dismantling project. This is even more critical in the decommissioning process considering all of the potential health and safety risks and considering there is little experience with this type construction project. I believe that the contingency allowance presented by the Company is reasonable and should be approved.

Second, I do not support the ALJ's recommendation to accept the Company's claim for a 5.5% nuclear decommissioning trust fund earnings rate. Since the ALJ recommended approving the Company's proposal to eliminate the "black lung" restrictions on the type of securities in which money manager's can invest the decommissioning trust fund, then I accept the Office of Consumer Advocate's ("OCA") position that the Company's trust fund earnings estimate rate of

5.5% is understated. While the OCA recommendation of a 7.5% estimated earnings rate and the resultant \$9,157,000 adjustment appears excessive, no other party to this proceeding recommended a more reasonable approach. I, therefore, am willing to accept the OCA recommendation for the purposes of this proceeding but recommend that this issue be revisited in any future proceedings involving the proper decommissioning annuity allowance for PP&L.

8/30/95

DATE



LISA CRUTCHFIELD
VICE CHAIRMAN

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, Pennsylvania 17105-3265

PENNSYLVANIA P.U.C.
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PUBLIC MEETING -
AUGUST 31, 1995
AUG-95-ALJ-123*
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STATEMENT OF COMMISSIONER JOHN HANGER

Polling Issue Nos. 1 and 33
Excess Capacity and ECR

An excess capacity adjustment is a determination that a utility in fact has more generating capacity than is needed to meet the requirements of its customers, including a reasonable reserve to ensure reliability. It is not a determination that a decision to expand capacity made in the recent or distant past was prudent or imprudent when made or appears to have been prudent or imprudent with hindsight. It is a determination of the capacity that is used and useful in providing service to utility customers during the ratemaking period.

In 1983, this Commission found 945 MW of excess capacity equivalent to the PP&L ownership of the new Susquehanna I plant and excluded a return on PP&L's investment in a 12.6% slice of its system. All return of investment through depreciation, as well as operation and maintenance expenses, was included in rates. In 1985, this Commission disallowed all common equity return on the 945 MW of Susquehanna II, and PP&L sold the capacity by contract to Jersey Central Power & Light. The JCPL contracts are now expiring, and PP&L has proposed including all costs and sales of such capacity in the ECR. While this proposal is properly rejected, PP&L alternatively has proposed keeping all expenses and revenues derived from this capacity off-system until such time as they are included in base rates. This is "normal" ratemaking and should be approved.

In its calculation of excess capacity, OTS included the returning 189 MW per year of JCPL contract capacity in its determination that PP&L averaged 564 MW of excess capacity. Since the majority polling today is to keep the returning capacity off-system until such time as it is included in base rates, it is not appropriate to count such capacity towards a determination that PP&L now has excess capacity. Without consideration of the returning JCPL capacity, it is not clear that PP&L in fact has excess capacity. It should be noted that the continuing exclusion of the 945 MW JCPL capacity is in fact a recognition that such capacity remains excess until otherwise included in rates. The decision indicated today is a decision not to make an additional excess capacity adjustment.

It is necessary to focus some attention on the reserve margins as discussed in this case. Pennsylvania Power & Light has the good fortune of being a winter peaking utility in PJM, which is a summer peaking power pool. PP&L has the advantage of needing extra capacity in the winter, just when the sum of the other utilities with which it pools reserves have spare power to provide.

For PP&L, reliability is a direct function of being a part of the summer peaking PJM. As a member of the PJM pool, PP&L cannot assure reliability solely based on its own resources; it is interdependent with the reliability of the PJM pool as a system. If PJM needs to curtail usage in the summer, even when PP&L does not have a capacity problem unto itself, PP&L may still be required to shed load or take other measures pursuant to its PJM commitment. Conversely, if PP&L has too little generation from its own resources to meet its customer demand, PP&L's reliability would be protected so long as the PJM pool as a whole had enough power to meet the pool's demand.

PP&L gets great benefit from this relationship. While other utilities are assigned reserve requirements of 20% or 22%, PJM has determined that PP&L need only maintain a 12% reserve margin. This is primarily because PP&L is less of a contributor to the PJM system summer peak than other utilities in the pool. Consequently, PP&L has a lower reserve requirement than it would if it were in a pooling relationship with other utilities with more similar peak requirements. Indeed, if PP&L were also a summer peaking utility, a 12% reserve margin would be unreasonable.

While this peak requirement compatibility with its pool partners is of substantial benefit to PP&L at its ratepayers, it simply means that PP&L can maintain equivalent reliability with lower reserve margins than utilities whose peaks coincide more closely with those of its pool partners. For PP&L, having a lower reserve margin does not mean that reliability is being compromised in any way.

Since PJM assigns PP&L a 12% reserve requirement, the ALJ and OTS were quite conservative by adopting a 16% reserve for PP&L's purposes in this case. This result provides for a substantial additional reserve cushion above and beyond what even PJM deems necessary. This is an appropriate reserve margin both to ensure reliability and to balance the difficulties for PP&L in providing an exact amount of needed capacity at all times and the interests of ratepayers who by law may only pay for capacity that is in fact used and useful.

Lastly, it is necessary to focus attention on the disputes in this case concerning whether NUG capacity should be included in determining whether excess capacity exists. Just as it is not useful to ponder whether the decision to build the Susquehanna nuclear plants was wise or defensible, it is not

productive to say that existing NUG capacity should not count towards PP&L's reserve margin simply because the purchases are required by law. Susquehanna and NUG capacity simply exist for PP&L. The question before us is whether any excess capacity exists at this time that should not be included in rates. Just as the JCPL capacity that is not on-system cannot contribute to excess capacity, so must the NUG capacity that is on-system be counted.

August 26 1995

DATED

John Hanger

JOHN HANGER, COMMISSIONER

**PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, Pennsylvania**

**PENNSYLVANIA P.U.C.
ET AL.**

v.

**PENNSYLVANIA POWER
& LIGHT COMPANY**

**PUBLIC MEETING-
AUGUST 31, 1995
AUG-95-ALJ-123*
DOCKET NO. R-943271**

STATEMENT OF COMMISSIONER JOHN HANGER

**Polling Issue No. 7
Discount Rate**

PP&L has proposed using a discount rate of 7.5% in determining its expense for pensions and postretirement benefits other than pensions. OCA has presented convincing evidence that the assumption concerning the earnings of its funds can reasonably be increased to 8.5% to reflect current market conditions. Among other data presented, OCA has shown that in 1995, PP&L's own actuarial witness in this case has provided actuarial reports which increased the discount rate for American Water Works from 7.25% to 8.75%. The same actuary also increased the 1994 discount rate of 7% for Philadelphia Suburban Water Company to 8.5% for 1995, and from 7.0% to 8.7% for UGI Utilities, Inc. Another actuary increased NFG's discount rate to 8.5% for 1995 as well.

These facts are strong indications that an 8.5% discount rate is more reasonable for PP&L's purposes than an unnecessarily conservative 7.5% assumption. This change reduces expenses by \$461,000 for postretirement benefits and by \$7,056,000 for pension expense.

August 30, 1995
DATED

John Hanger
JOHN HANGER, COMMISSIONER

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, Pennsylvania

PENNSYLVANIA P.U.C.
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STATEMENT OF COMMISSIONER JOHN HANGER

Polling Issue No. 8
SFAS 112 Claim

In the case of pension expenses, funds are actually set aside and use of the accrual method consistent with SFAS 87 actually lessens ratepayer expense over an extended period of time. In the case of long-term disability and survivor benefits, however, no funds are actually set aside. Of greater importance, PP&L has argued only that it is consistent to fund this expense based upon an accrual methodology, and not that it is the ratepayers' interests to do so.

Accounting standards such as the SFAS 112 use of accrual methodology need not be automatically incorporated into ratemaking. There must be an affirmative reason to do so. The company is in fact providing these benefits on a pay as you go basis. The Company is not caught with a regulatory asset problem. Consistency may be good, but it is not enough.

August 30, 1995

DATED

John Hanger

JOHN HANGER, COMMISSIONER

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, Pennsylvania

PENNSYLVANIA P.U.C.
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STATEMENT OF COMMISSIONER JOHN HANGER

Polling Issue No. 13.

Social Programs

At the outset, PP&L should be commended for its willingness to develop programs which address the needs of its customers and the community it serves. PP&L has proposed six new programs and funding for two existing programs which serve a variety of health and safety, housing, economic development and emergency needs. PP&L has proposed total funding of \$6.7 million for these programs and has proposed that shareholders provide \$3.17 million of such funds, while ratepayers provide the remaining \$3.53 million.

A "social program" is not to be excluded from rates simply because it is labeled as such. As our society and economy have matured, it has become increasingly clear that a "social program" designed to clean up the environment can become a cost-effective utility program to provide demand-side management services. A "social program" designed to subsidize a factory so that it can stay in business can become a competitive rate discount which maintains system load, benefitting both shareholders and ratepayers. A "social program" which helps low-income customers pay their bills can become a cost-effective collection strategy which maintains service to those who need it while reducing uncollectible expenses. The Commission has long encouraged or approved these and similar programs.

In short, a so-called social program is only as appropriate for inclusion in rates as it is effective in addressing a utility and ratepayer impacted problem. If a utility can articulate a situation which impacts the utility and its ratepayers adversely, and can design and implement a program which effectively addresses the problem in a way which benefits the utility and its ratepayers, then inclusion of funding for such programs in rates is appropriate.

Admittedly, PP&L has not articulated all of its proposals particularly well or in a way which clearly meets such standards. However, PP&L has agreed to commit substantial resources of its own to these programs, and it would not likely do so if it did not believe that benefits would ensue. Furthermore, it is impossible to prove in advance that a program without a history will accomplish its goals. Even OTS has proposed funding the "Keep Warm

Program" and the "Cares Extension Program" as pilots with future evaluation of costs and benefits. Some opportunity to gain a track record must be provided if any program, whether "social" or "economic" is to be proven effective. PP&L should be given an opportunity to develop and implement these programs and demonstrate that ratepayer funds should support them in the future.

August 20, 1995

DATED

John Hanger

JOHN HANGER, COMMISSIONER

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, Pennsylvania

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STATEMENT OF COMMISSIONER JOHN HANGER

Polling Issue No. 21.
Capital Structure

In its capital structure, PP&L assumes the completion of a \$100 million equity issuance in August, 1995, prior to issuance of the final Commission Order in this case. Despite the fact that OCA raised this issue directly throughout the case, PP&L has not yet responded by updating the Commission and the other parties on the status of this issuance. OCA is correct that absent firm evidence that the equity has been issued, PP&L should not be allowed to include it in its capital structure in this rate proceeding. It would be inappropriate to grant a return on equity that does not exist. It is important to note that OCA's recommendation gives PP&L until issuance of the Final Order in this case to indicate that the equity in fact has been issued.

While no one seriously doubts PP&L's intent to issue the equity as scheduled, I remain concerned that some utilities may use last minute capital infusions to improve their debt/equity ratio and increase earnings. For this reason, it is appropriate that this Commission diligently demand proof that all equity approved in the capital structure for ratemaking purposes in fact be issued.

August 30, 1995
DATED

John Hanger
JOHN HANGER, COMMISSIONER

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, Pennsylvania

PENNSYLVANIA P.U.C.
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& LIGHT COMPANY

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STATEMENT OF COMMISSIONER JOHN HANGER
Polling Issues 23, 28
Interruptible Service

PP&L's proposals in this case continue its efforts to phase out the use of interruptible service, arguing that times have changed such that competitive rate riders and other flexible tariff provisions for large industrial customers can replace the rate discounts previously offered as interruptible rates. In so doing, PP&L has failed to recognize that interruptible service can provide a distinct benefit to the company that cannot be replaced completely by competitive rate programs.

It is true that in the past, interruptible service has been related to economic development and similar discounts for large industrial customers. These other goals are to prevent load loss or increase load through programs designed to retain customers who have competitive alternatives, prevent plant closures, and to promote new plant development and increased production. The fact that a new generation of economic development or competitive tariffs has been developed, however, does not mean that the original goal of interruptible service-- to increase reliability by shedding load during peak usage-- has disappeared. Quite to the contrary, the power emergency during January, 1994 and the record-shattering use during July, 1995, clearly indicate that emergency load shedding remains a potential fact of life within the PJM power pool.

Thus, interruptible service can and should still be defined as a distinct service for load management purposes, and as a separate class of service. While PP&L's value of service approach to pricing of interruptible service is an appropriate change, it remains true that interruptible service is a lower quality of service which can be provided at a lower cost of service. This is because interruptible customers have agreed to be the first to lose service when peaking capacity is needed. As such, they are not considered in PP&L's generation planning, and they do not contribute to the cost of peak generation as do other customers.

It also remains true that the existing customers on PP&L's interruptible service began that service when economic development and cost of service considerations were used in pricing the service. Movement towards value of service pricing for

interruptible service is appropriate, but it must continue to recognize cost of service and the original economic development considerations. It cannot be done by eliminating interruptible service or without reasonable gradualism.

PP&L's proposed pricing of interruptible customers as if they were firm customers, while granting a credit for the amount of interruptible service taken, will on its own, even without any general rate increase from this case, raise rates for LP-5 customers by approximately 22%. Bethlehem has projected that the rate increase for LP-4 and LP-5 interruptible customers would be 34% and 27% respectively if PP&L were to receive the entire increase requested. No class should have to absorb the extreme, non-gradual rate increases proposed for interruptible customers in this proceeding. The interruptible customers who would be harmed are major businesses and major employers in this state. It simply would be bad public policy to send such a jolt through the Pennsylvania economy, perhaps encouraging job losses or other business setbacks. Even if the rate structure and rates for interruptible customers must be changed, it must be done more gradually over time.

Lastly, this issue demonstrates why many business customers are saying that it is time to give them "customer choice." How can Pennsylvania's businesses compete successfully if they do not have access to least cost electricity? It is time for this Commission to resolve that fundamental issue.

August 5, 1995
DATED

John Hanger
JOHN HANGER, COMMISSIONER

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, Pennsylvania

PENNSYLVANIA P.U.C.
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STATEMENT OF COMMISSIONER JOHN HANGER

Polling Issue No. 31
Economic and Industrial Development Credits

I have long supported the appropriate use of economic and industrial development incentive rates as well as flexible rate programs for customers with competitive options. It is important to note that all such programs cannot be lumped together. One valid purpose of such programs is to prevent a customer from leaving the system because of a more competitive energy source. A related, but different, goal is to avoid a plant shutdown or move to another state or country because of the economic conditions facing the customer. A third goal is to expand economic development within a service territory generally.

There can be no doubt than ratepayers may benefit from such programs if the marginal contribution to utility costs can be made higher than it otherwise might have been. Similarly, there can be no doubt that shareholders may benefit to the extent that sales are maintained or increased over what they otherwise would be.

However, the simple fact that such a program exists does not mean that it is an effective program and that ratepayer net benefits have been obtained. It may be difficult precisely to assess the benefits of such programs because it is not possible to know what would have happened if the discount had been provided at a different level or had not been provided at all.

Shareholders of a utility utilizing such programs must bear part of the risk that the programs will be successful. They must have a strong incentive to design the programs well and operate them wisely. They must have a strong incentive to limit as much as possible the amount of lost revenues that result from any discounts. This approach protects shareholders as well as ratepayers.

As I indicated in my Statement concerning Penelec Supplement No. 96 to Tariff- Electric Pa. P.U.C. No. 75, Docket No. R-00943280, March 16, 1995, I support the 1994 New York Public Service Commission approach for shareholders and ratepayers to share the costs of such programs, Re Competitive Opportunities Available to Customers of Electric and Gas Services, 154 PUR 4th 19, 25 (N.Y.P.S.C. 1994). Given the nature of the economic and

industrial development programs in this case, the apparent benefits to ratepayers and shareholders, and the lack of any documentation of specific ratepayer benefits, the 50/50 sharing of costs recommended by OCA in this case is reasonable.

August 30, 1995
DATED

John Hanger
JOHN HANGER, COMMISSIONER

**PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, Pennsylvania**

**PENNSYLVANIA P.U.C.
ET AL.**

v.

**PENNSYLVANIA POWER
& LIGHT COMPANY**

**PUBLIC MEETING-
AUGUST 31, 1995
AUG-95-ALJ-123*
DOCKET NO. R-943271**

STATEMENT OF COMMISSIONER JOHN HANGER

**Polling Issue No. 32
Demand Side Management**

Since this Commission has rendered its decision concerning DSM incentives and cost recovery, and that decision remains in the appeals process, it is inappropriate for this Commission at this time to amend its position on any issues subject to the appeal.

However, the Sierra Club has offered a useful proposal concerning DSM certification as a condition for securing an economic development rate. Since this proposal addresses changes to economic development tariffs, and not the DSM regulations, there is no reason why it cannot be addressed in this proceeding. The proposal is not part of the DSM process previously decided, it is a separate proposal which applies DSM concerns to a separate issue which was an important component of this proceeding.

Even economic development rates which clearly are cost-effective and beneficial to other ratepayers provide a discount to one customer which is borne by other customers. The discount rate is intended to provide a way to keep the customer's bills lower so that the economic development goal can be accomplished. As such, it is reasonable to require the customer receiving the discount to do what it can to ensure that it is minimizing its bills. The proposal requires only those DSM treatments that are cost-effective for the customer, thereby lowering the the customer's bills and making it that much more competitive. It is reasonable to link receipt of this benefit to its own reasonable efforts to minimize its cost to other ratepayers and/or the utility.

This proposal, as offered by Sierra Club, is not novel or extreme. New York requires industrial DSM audits as a condition for receiving a flexible rate. Both the Board of Public Utilities and the Senate in New Jersey are presently considering such a requirement. Pennsylvania should, too.

August 30, 1995
DATED

John Hanger
JOHN HANGER, COMMISSIONER

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, Pennsylvania 17105-3265

PA.PUC et al. v. PENNSYLVANIA
POWER & LIGHT COMPANY

PUBLIC MEETING - AUGUST 31, 1995
AUG-95-ALJ-123*
DOCKET NO. R-943271

STATEMENT OF COMMISSIONER DAVID W. ROLKA

Issue # 1 - Excess Capacity

On first evaluation of the positions of the parties on this issue, the argument advanced by the Office of Trial Staff appears to make sense. However, we are responsible for insuring that the Company's customers have adequate service. Recent experience with load, coupled with uncertainty due to Clean Air Act compliance requirements, convinces me that the low reserve margin proposed by OTS is not reasonable. Therefore, I agree with the Company's Exceptions and find that the 564 MW excluded from rate base by the ALJ are used and useful.

Aug 30, 1995
DATE



DAVID W. ROLKA, COMMISSIONER

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, Pennsylvania 17105-3265

PENNSYLVANIA PUBLIC UTILITY
COMMISSION, *et al.*

v.

PENNSYLVANIA POWER AND LIGHT
COMPANY

PUBLIC MEETING-
AUGUST 31, 1995

AUG-95-ALJ-123*

DOCKET NOS. R-943271 *et seq.*

STATEMENT OF COMMISSIONER DAVID W. ROLKA
Issue No. 5--Post Retirement Benefits (SFAS 106)

I support the allowance of this claim to the extent that our discretion has not been limited by applicable court precedent. It is my understanding that the Commonwealth Court has ruled that PP&L cannot recover pre-future test year SFAS 106 deferred costs associated with the transfer from cash to accrual accounting. In this proceeding, the future test year is for the twelve month period ending September 30, 1995. Accordingly, the deferred costs of \$10.8 million for the 1993 period as well as the cost claimed for a nine month period in 1994, or \$8.7 million must be disallowed. The future test year claim for deferred costs, of \$11.6 million, may be recovered. Using PP&L's amortization period of 17.3 years, the recalculated claim for deferred costs which I would allow in rates is \$671,000. As for the other component of PP&L's claim relating to the current, ongoing SFAS costs, court precedent does not constitute a bar to base rate recognition of these costs. For this portion of the claim, \$25.85 million, I would allow full recovery.

Aug 30, 1995
DATED

David W. Rolka
DAVID W. ROLKA, COMMISSIONER

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, Pennsylvania 17105-3265

PA.PUC et al. v. PENNSYLVANIA
POWER & LIGHT COMPANY

PUBLIC MEETING - AUGUST 31, 1995
AUG-95-ALJ-123*
DOCKET NO. R-943271

STATEMENT OF COMMISSIONER DAVID W. ROLKA

Issue # 33 - Energy Cost Rate

Although this issue is presented in the context of the ECR, it is really a second "excess capacity" matter. The Company's primary proposal results in prospective rate increases and I cannot accept that approach. The Company's alternative proposal seem reasonable to me and is consistent with this Commission's handling of similar excess capacity conditions. Keeping the successive slices of system capacity out of rates will force the Company to aggressively market an eventual total of 945 MW of capacity. I'm sure this will be a useful exercise in preparing for the future.

My support for the PP&L alternative is based on the expectation that any attempt to make customers responsible for this capacity in the future will be a subject for resolution under our recently approved Competitive Bidding Regulations. In other words, once this alternative is approved, the capacity in question is subject to the market, now and forever.

Aug 30, 1995
DATE



DAVID W. ROLKA, COMMISSIONER

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, Pennsylvania 17105-3265

PA.PUC et al. v. PENNSYLVANIA
POWER & LIGHT COMPANY

PUBLIC MEETING - AUGUST 31, 1995
AUG-95-ALJ-123* (Revised)
DOCKET NO. R-943271

STATEMENT OF COMMISSIONER DAVID W. ROLKA

Issue # 36 - Energy Cost Rate

Although this issue is presented in the context of the ECR, it is really a second "excess capacity" matter. The Company's primary proposal results in prospective rate increases and I cannot accept that approach. The Company's alternative proposal seem reasonable to me and is consistent with this Commission's handling of similar excess capacity conditions. Keeping the successive slices of system capacity out of rates will force the Company to aggressively market an eventual total of 945 MW of capacity. I'm sure this will be a useful exercise in preparing for the future.

My support for the PP&L alternative is based on the expectation that any attempt to make customers responsible for this capacity in the future will be a subject for resolution under our recently approved Competitive Bidding Regulations. In other words, once this alternative is approved, the capacity in question is subject to the market, now and forever.

Aug 30 1995
DATE



DAVID W. ROLKA, COMMISSIONER

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, Pennsylvania 17105-3265

**PENNSYLVANIA PUBLIC UTILITY
 COMMISSION, ET. AL.**

V.

**PENNSYLVANIA POWER & LIGHT
 COMPANY**

**PUBLIC MEETING
 AUGUST 31, 1995
 AUG-95-ALJ-123*
 DOCKET NOS.
 R-00943271;
 R-00943271C0001-C0145**

STATEMENT OF COMMISSIONER ROBERT K. BLOOM

Polling Issue #13 - Social Programs

PP&L proposes to introduce six new social programs and funding for two existing programs. PP&L requests \$3.5 million from ratepayers. PP&L's shareholders will contribute \$3.2 million to the cost of the programs. The ALJ made no adjustment to PP&L's proposal.

The OTS excepts to the ALJ's recommendation stating that the Commission should disallow all the costs relating to three of the new social programs. The OTS opines that any conservation, efficiency, load management and rate incentive costs will be minimal at best.

While I believe that it is the shareholder's role, if they so choose, to fund all social programs, I concur with OTS's position that there is no identifiable cost benefit to PP&L's customers. As the OTS succinctly stated:

"Based upon PP&L's own description of the programs, 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 Exceptions, at p. 4.

OTS's analysis applies to all social programs. Socio-economic decisions concerning the kind and extent of subsidies for needy customers should be left to the legislative branch of government. It is not the appropriate role for this Commission.

8/31/95
 DATE

Robert K. Bloom
 ROBERT K. BLOOM, COMMISSIONER

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Uniform Cover and Calendar Sheet

1. REPORT DATE:	:	2. BUREAU AGENDA NO.
September 22, 1995	:	
	:	SEP-95-OSA-219*
3. BUREAU: Office of Special Assistants	:	
	:	
4. SECTION(S):	:	5. PUBLIC MEETING DATE
	:	
6. APPROVED BY:	:	
Director: C.W. Davis 7-1827	:	September 27, 1995
Supervisor:	:	
	:	
7. PERSON IN CHARGE:	:	
R. Albert/A. Arnold 7-1827	:	
	:	
8. DOCKET NO.:	:	
R-00943271, et al.	:	

DOCKETED
OCT 10 1995
DOCUMENT FOLDER

9. (a) CAPTION (abbreviate if more than 4 lines)
 (b) Short summary of history & facts, documents & briefs
 (c) Recommendation
 (a) Pennsylvania Public Utility Commission, et al. v. Pennsylvania Power & Light Company

(b) On December 30, 1994, Pennsylvania Power & Light Company ("PP&L") filed Supplement No. 50 to Tariff Electric - Pa.P.U.C. No. 200, to become effective February 28, 1995, containing changes calculated to produce \$261.6 million in additional annual revenues based upon a test year ending September 30, 1995. The filing was, thereupon, suspended by operation of law and assigned to the Office of Administrative Law Judge for hearings and the issuance of a Recommended Decision ("R.D."). One-hundred and forty-five individual complaints were filed against the supplement, three interventions were granted and the Commission's Office of Trial Staff, the Office of Consumer Advocate, and the Office of Small Business Advocate participated. On July 31, 1995, the R.D. of presiding Administrative Law Judge ("ALJ") Robert A. Christianson issued. The ALJ recommended, inter alia, an increase of \$61.7 million in additional annual revenues. On August 31, 1995, the Commission conducted a non-binding polling of the contested issues.

CONTINUED

MOTION BY: Commissioner Chm. Quain
 SECONDED: Commissioner Crutchfield
 Commissioner Hanger - Concurring
 & Dissenting in part
 Commissioner Rolka - Yes
 Commissioner Bloom - Yes

CONTENT OF MOTION: Staff recommendation adopted.

Statement of Commissioner John Hanger attached.

R-943271, et al

(c) The Office of Special Assistants recommends that the Commission adopt the attached draft Opinion and Order prepared consistent with the August 31, 1995 polling.

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, Pennsylvania

PENNSYLVANIA P.U.C.
ET AL.

v.
PENNSYLVANIA POWER
& LIGHT COMPANY

PUBLIC MEETING-
SEPTEMBER 27, 1995
SEP-95-OSA-219*
DOCKET NO. R-943271

STATEMENT OF COMMISSIONER JOHN HANGER

Today's majority decision provides an overall rate increase of approximately \$ 107 million, averaging 4.8%. This is considerably below the \$261 million requested by PP&L which would have increased base rates for the first time since 1985 by an average of 11.7%. While I support the majority position on most issues, as indicated in the polling of the issues on August 31, I would reach a different result on several issues. I am especially delighted to see that the final result concerning industrial customers who receive interruptible service is dramatically different than as polled originally.

Not all customers receive the same percentage increase, depending primarily on their class of service and levels of usage. As originally polled, industrial customers on interruptible rates would have received a whopping increase of 22%, even if no general rate increase were granted. This is because the company proposed to eliminate interruptible service as a distinct class of service and to switch interruptible pricing entirely to a "value of service" approach. All other customer classes have their rates determined based primarily on "cost of service".

The final result today revises the result on this issue as originally polled to recognize that interruptible service is a distinct class of service that is inferior to firm service. As a result, the entire rate increase for interruptible customers will be reduced to about 5-7%, as opposed to an increase of more than 25% based on the August 31 polling.

Interruptibility remains a fact of life. It is not just a theoretical possibility. As recently as the heat wave this summer, with record-shattering usage, PP&L's interruptible customers had service curtailed from July 31 through August 4, 1995 so that other customers could continue to receive service reliably. Interruptible service remains a valuable tool for utilities to manage peak load. It also remains a desirable option for customers who can take advantage of lower prices by agreeing to be interrupted in the event that it is necessary.

Since PP&L does not take into account the need to provide service to interruptible customers in its generation planning, it is appropriate to exclude generation from cost of service allocations for interruptible customers. Thus, interruptible service is a distinct class of service that has a much lower cost

of service, and interruptible customers should receive recognition of these facts in ratemaking. The final decision today does just that.

The value of service principles proposed by the company are appropriate considerations in ratemaking as well, but should not be adopted in this case. To do so would yield exorbitant rate increases which contradict cost of service principles as well as the important principle of gradualism. The rate increase for all other classes of services has been limited to 1.5 times the system average increase, and there is no reason to impose an increase that is as much as ten times the average increase on this one class of customers. Imposing rate shock on the largest employers in Pennsylvania would be an insane result. It can only result in stifled economic development and the loss of existing jobs.

Moreover, it would be especially counterproductive since the affected customers are precisely those most able and willing to seek alternative electric service in an increasingly competitive electric industry. Forcing the largest customers off the system or giving them more and more competitive discounts only serves to impose the existing fixed costs of operating PP&L on the smaller and smaller class of core customers who do not have competitive alternatives. Permitting competition to benefit only a small group of customers leaves everyone else worse off. Consequently, it is imperative that a fair and orderly transition that gives all customers choice be started as soon as possible. Only when all customers have the power of choice can competition benefit all ratepayers.

Finally, this case and the proposed merger of PP&L and Peco Energy indicate the urgency of moving forward to address the increasing role of competition in the electric industry. In particular, the issues of excess capacity, rate of return, interruptible service, and economic development/competitive rates clearly indicate the pervasiveness of impending competition. If Pennsylvania does not address these issues now, they will not disappear. To the contrary, it is far more likely that competitive pressures will expand even further, making a reasonable transition to customer choice more difficult. We must take the reins to guide these developments. The sooner that we do so the better it will be for Pennsylvania's consumers, and the utilities and their shareholders and employees.

September 26, 1995
Dated

John Hanger
JOHN HANGER, COMMISSIONER



COMMONWEALTH OF PENNSYLVANIA
PENNSYLVANIA PUBLIC UTILITY COMMISSION
P.O. BOX 3265, HARRISBURG, PA 17105-3265
SEPTEMBER 27, 1995

KJR

IN REPLY PLEASE
REFER TO OUR FILE

R-00943271

■
PAUL E RUSSELL ESQUIRE
PENNSYLVANIA POWER & LIGHT COMPANY
TWO NORTH NINTH STREET
ALLENTON PA 18101-1179
■

DOCUMENT
FOLDER

Pennsylvania Public Utility Commission, et al.

v.

Pennsylvania Power & Light Company

DOCKETED
OCT 11 1995

To Whom It May Concern:

This is to advise you that an Opinion and Order has been adopted by the Commission in Public Meeting on September 27, 1995 in the above entitled proceeding.

An Opinion and Order has been enclosed for your records.

Very truly yours,

John G. Alford
Secretary

Enclosure
Certified Mail
JEP

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Public Meeting held September 27, 1995

Commissioners Present:

John M. Quain, Chairman
Lisa Crutchfield, Vice Chairman
John Hanger - Concurring & Dissenting in part-Statement attached
David W. Rolka
Robert K. Bloom

Pennsylvania Public
Utility Commission, et al.

Docket Nos.
R-00943271C001-
C0145

M&M/Mars, Inc.

Intervenor

Bethlehem Steel Corporation

Intervenor

University/College Coalition

Intervenor

v.

Pennsylvania Power & Light Co.

OPINION AND ORDER

DOCUMENT
FOLDER

DOCKETED
OCT 11 1995

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OPINION AND ORDER

I. INTRODUCTION

On December 30, 1994, Pennsylvania Power & Light Company ("PP&L" or "Company") filed Supplement No. 50 to Tariff Electric-Pa. P.U.C. No. 200, to become effective February 28, 1995. This filing contained changes calculated to produce \$261,635,000 in additional annual revenues, based on the projected level of operations for the 12 months ending September 30, 1995. This amount represents an average increase of approximately 11.7 percent of PP&L's annual retail base revenues.

The filing was suspended by operation of law until September 28, 1995. By order adopted January 26, 1995 and entered January 27, 1995, the Commission instituted an investigation into the lawfulness, justness and reasonableness of the proposed rates, as well as the Company's present rates. The matter was thereupon referred to the Office of Administrative Law Judge and subsequently assigned to Administrative Law Judge ("ALJ") Robert A. Christianson.

A prehearing conference concerning the matter was held in Harrisburg on March 7, 1995, before ALJ Michael C. Schnierle. However, before hearings were held the case was reassigned to ALJ Robert A. Christianson. A litigation schedule was established at the prehearing conference and approximately 16 days of evidentiary hearings were conducted at the North Office Building in Harrisburg. In addition, Public Input hearings were held in Harrisburg, Lancaster, Williamsport, Scranton, Wilkes-Barre, Hazleton, Pottsville, Allentown and Bethlehem, for the purpose of receiving testimony from the public.

A total of 145 formal complaints were submitted by various parties, in response to the Company's general rate increase filing. Three petitions to intervene were granted. In addition, the Commission's Office of Trial Staff ("OTS") participated actively in the proceeding. The various associated complaints were consolidated with the underlying Commission proceeding, for purpose of hearing and decision.

Main briefs were filed on or about June 16, 1995 by the following: the OTS; PP&L; the Office of Consumer Advocate ("OCA"); the Office of Small Business Advocate ("OSBA"); the PP&L Industrial Customer Alliance ("PPLICA" hereafter); the Department of Defense and the Federal Executive Agencies ("DOD"); Bethlehem Steel Corporation ("Beth Steel"); the Central Eastern Pennsylvania Fuel Oil Dealers ("CEPFOD"); the Crown American Realty Trust ("Crown"); the University/College Coalition ("UCC"); the Commission on Economic Opportunity ("CEO"); the Sierra Club; and Eric Epstein.

By motion dated July 3, 1995, PP&L sought to strike portions of Mr. Epstein's main brief. Also, the OTS, by motion dated July 3, 1995, moved to strike portions of the reply brief of the Sierra Club. In an interlocutory ruling, ALJ Christianson granted the motion to strike the testimony of Mr. Bruce Biewald of the Tellus Institute.¹ Further, ALJ Christianson declined to strike certain portions of the brief of Mr. Epstein. (See Recommended Decision, p. 95).

The record in this proceeding was closed, subject to certain provisions, at the last hearing, held on May 26, 1995. Before then, PP&L had submitted a request for transcript corrections, dated April 24, 1995. PP&L also submitted another

¹ This proffered testimony addressed Demand Side Management ("DSM") design and initiatives and lost revenue recovery.

such request, dated June 13, 1995. No opposition to them was indicated and both requests were, therefore, granted.

Additionally, PP&L, by letter dated June 7, 1995, requested that a portion of OCA witness Kahal's testimony in another proceeding be made part of this proceeding. The Kahal testimony relates to cross-examination by PP&L of Mr. Kahal late in this proceeding. The reference is to another proceeding wherein ALJ Christianson presided. No indications of opposition to this PP&L request were received and the motion was granted. ALJ Christianson designated the cross-referenced testimony as PP&L Cross-Examination Exhibit No. 1 and it was made a part of the record. A copy was provided for inclusion in the main file and the parties were served with the PP&L request which contains the passage in question.²

On July 31, 1995, the Recommended Decision ("R.D." hereafter) of ALJ Christianson issued in this matter. Upon consideration of the evidence, the main and reply briefs of the parties, ALJ Christianson concluded as follows:

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;

Further, the R.D. contained the following Ordering Paragraphs:

² This exhibit relates generally to avoided cost calculations. This other proceeding involves Pennsylvania Electric Company and carries the lead docket number of P-870235.

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.

Various Exceptions and Replies were filed by the Company, the OTS, the OCA, the OSBA, PPLICCA, UCC, DOD, Bethlehem Steel, CEPFOD, the Sierra Club and Mr. Eric Epstein.

Also, by letter dated August 23, 1995, we were informed by the Company that the Exceptions of Mr. Epstein were not properly addressed. As a consequence, the copy of Mr. Epstein's Exceptions served upon PP&L was not received until on or about August 21, 1995. The August 23, 1995 letter requests that it be treated as a letter-reply to the Exceptions of Mr. Epstein. Finding good cause, we shall, hereby, consider the August 23, 1995 letter of PP&L in the nature of Replies to the Exceptions of Mr. Epstein.

II. DESCRIPTION OF THE COMPANY

PP&L is an investor owned utility with its headquarters in Allentown, Pennsylvania. It was founded in 1920 upon the consolidation of eight electric companies. PP&L provides service to 1.2 million customers throughout a 10,000 square mile area in 29 counties of Central Eastern Pennsylvania. (PP&L Stmt. 9)

The Company's total owned and leased generation resources as of September 30, 1994, were 8542 MW (winter ratings). These resources include the following generation mix: 49% coal fired; 23% nuclear; 19% oil-fired; 6% combustion turbine and diesels; and 3% hydroelectric. Additionally, PP&L purchases output from 504 MW of non-utility generation ("NUG" generation). (Id.) These figures reflect PP&L's ownership of approximately 12% of the Keystone coal-fired plant and approximately 11% of the Conemaugh coal-fired plant. Also, the Company owns one-third of the Safe Harbor Hydro Station, and ninety (90) percent of the Susquehanna Electric Station nuclear unit.³

At Docket No. A-110500, F.206, (Order entered February 10, 1995), PP&L received permission to form a holding company structure which has been placed into effect. The new company, PP&L Resources, Inc., is the parent of PP&L.

PP&L's system also includes transmission facilities with more than 1,100 miles of transmission lines operating at 230,000 volts or higher plus more than 50,000 miles of distribution lines operating at less than 230,000 volts.

PP&L operates its generation and transmission facilities as part of the Pennsylvania-New Jersey-Maryland

³ The Allegheny Electric Cooperative, Inc ("AEC") owns the remaining 10% of the Susquehanna Electric Station nuclear unit.

("PJM") interconnection. The PJM interconnection consists of PP&L and other electric utility systems in the states of Pennsylvania, New Jersey, Maryland, Delaware and Virginia as well as the District of Columbia. The PJM companies coordinate the operation of their generating systems and bulk power transmission systems, in the interest of economy. PJM operations and other wholesale services are subject to the regulatory jurisdiction of the Federal Energy Regulatory Commission (FERC).

III. THE PUBLIC INPUT HEARINGS

We, hereby, set forth the ALJ's description of the substance of the Public Input hearings conducted in this proceeding as summarized at pages 8-10 of the R.D.

Various parties refer to the testimony provided at the 11 public input hearings which were held between March 30 and April 6, 1995. These hearings were held at nine cities, with two hearings being held at Lancaster and at Harrisburg.

OTS, in the context of its arguments concerning street lighting, refers to testimony provided at Scranton, Wilkes-Barre and Hazleton. See OTS main brief, page 146. PP&L, starting at page 296 of its main brief, provides a brief response and review relating to these public input hearings. OCA, commencing at page 297 of its main brief, provides various references to public input testimony relating to a residential heating rate, rate RTS. In addition, OCA, with its reply brief, provides a 37 page summary of public input testimony.

Most notable was testimony provided by residential customers concerning the residential heating rate, rate RTS, and testimony from industrial customers concerning an interruptible industrial rate. Of course, various other customers provided testimony about their own problems or viewpoints.

The first witness at the first public input hearing was Arthur Taylor, president of Muhlenberg College. Seven witnesses testified at this first hearing, which was held in Harrisburg during the afternoon of March 30, 1995 at the Pennsylvania State Museum. An evening hearing was held that day, at the same location, the Pennsylvania State Museum. Only three witnesses testified at this evening hearing. Similar hearings were held in Lancaster on March 31, 1995, afternoon and evening, at the Southern Market Center. Sixteen witnesses testified at this

afternoon hearing while four witnesses testified at the evening hearing. One witness, Daniel C. Witmer, also testified at a subsequent Harrisburg hearing. See Tr. page 1074.

A fifth public input hearing was held at Williamsport, in the First Ward Fire Hall, during the evening of April 3, 1995. Eighteen witnesses testified at this hearing. The next hearing was held at Scranton during the afternoon of April 4, 1995, in the Municipal Building. Eleven witnesses testified at this hearing. That evening, a hearing was held in Wilkes-Barre at the Coughlin High School Auditorium. Eleven witnesses testified at this hearing.

On April 5, 1995, an afternoon hearing was held in the Hazleton City Hall and an evening hearing was held in Pottsville, at the Schuylkill County Courthouse. Thirteen witnesses testified at Hazleton while ten witnesses testified at Pottsville. The last two hearings were held on April 6, 1995, in the afternoon at the Bethlehem Town Hall and in the evening at the Allentown City Hall. These two sessions were probably the longest public input hearings for this proceeding, with 28 witnesses testifying at Bethlehem and 31 witnesses testifying at Allentown. Two state senators, Joseph Uliana and Roy C. Afflerbach, participated at the Bethlehem hearing.

The transcripts of the public input hearings include more than 800 numbered pages. Not all of this is testimony because the presiding officer and various lawyers also offered comments on the record. However, considerable testimony was provided. The OCA summary can be consulted for details and, of course, the transcripts are available, as they are for the so-called "expert" testimony offered in the North Office Building at Harrisburg.

IV. RATE BASE

PP&L's final claim for the value of its rate base is \$5,017,708,000. The claim consists of the depreciated original cost of its plant in service at September 30, 1995, together with certain additions and deductions that, according to the Company, were made in accordance with accepted ratemaking procedures. (PP&L M.B., p. 14). Several issues related to the claimed rate base were raised on the record by various parties. These issues will be considered and resolved seriatim hereinbelow.

A. Excess Capacity

Included in the Company's claimed rate base is an amount of \$5,719,584,000 for net utility plant in service. PP&L contends that all of its claimed plant in service is "used and useful", and that its claim contains no facilities which could be considered excess capacity. (Id., pp. 14-59, Appendix B).

Both the OTS and the OCA contend that a portion of the Company's generating facilities represent excess capacity.

The OTS has taken the position that PP&L has excess generating capacity in the amount of 564 megawatts ("MW"), and that a corresponding reduction to the Company's claimed rate base, in the amount of \$239,474,000, should be adopted to recognize and adjust for this capacity. (OTS M.B., p. 35). The OTS' proposal is based upon a 16 percent capacity reserve margin over peak demand, which the OTS considers appropriate, and a nine year average of the Company's available generating capacity. In its calculation of PP&L's average available capacity, the OTS has included non-utility generator ("NUG") capacity, plus the incremental return of 945 MW of capacity associated with the five year

phase-out of an agreement with Jersey Central Power & Light ("JCP&L"). (Id., pp. 30-35).

The OCA contends that PP&L has physical excess generating capacity of between 400 and 800 MW, based upon its determination of a reasonable reserve margin range of 12 percent to 15 percent plus its calculation of the Company's available capacity and peak demand. (OCA M.B., pp. 44-46). However, the OCA's primary position on this issue is that the Company's Susquehanna Steam Electric Station Unit 2 ("Susquehanna 2") represents economic excess capacity under the requirements set forth in Section 1323 of the Public Utility Code, 66 Pa. C.S. §1323.⁴

⁴ Section 1323 provides, in pertinent part, as follows:

§1323. Procedures for new electric generating capacity

(a) Excess capacity costs.-Whenever a public utility claims the costs of an electric generating unit in its rates for the first time and the commission finds that the unit results in the utility having excess capacity, the commission shall disallow from the utility's rates, in the same proportion as found to be excess capacity:

- (1) the return on specific unit or units of any excess generating reserve;
- (2) the return on the average net original cost per megawatt of the utility's generating capacity; or
- (3) the equity investment in the new unit.

In addition to the disallowances set forth in this subsection, the commission may disallow any other costs of the unit or units which the commission deems appropriate. For the purposes of this section, a rebuttable presumption is created that a unit or units or portion thereof shall be determined to be excess unless found to be needed to meet the utility's customer demand plus a reasonable

According to the OCA, the Company's Susquehanna 2 fails both the physical usefulness test established by Commission precedent and the economic benefit test embodied in Section 1323 of the Code. The OCA observes that in PP&L's last rate proceeding the Commission disallowed any equity return on Susquehanna 2, based upon a finding of excess capacity. Pennsylvania Public Utility Commission v. Pennsylvania Power & Light Company 59 Pa. PUC 332, 67 PUR4th 30 (1985) ("PP&L 1985").⁵ The OCA asserts that this disallowance should be continued in the present case. (Id., p. 12).

ALJ Christianson agreed with both the OTS and the OCA that there is excess generating capacity on the PP&L system. However, the ALJ recommended the rejection of the disallowance proposed by the OCA stating that:

[I] would be very reluctant to support an adjustment related entirely to Susquehanna 2. I prefer the approach I suggested in the last case, a "slice of system" approach, whereby all capacity is considered in making the adjustment. This seems to be allowed for in some of the language included in Section 1323. However, I do not agree with OCA that Section 1323 applies here.

I recognize that OCA can provide some basis for use here of Section 1323. However, my reading is that PP&L is not claiming the cost of Susquehanna 2 for the first time in this

reserve margin in the test year or the year following the test year, or, if it is a base load unit, it is also found to produce annual economic benefits which will exceed the total annual cost of the plant during the test year or within a reasonable period following the test year.

⁵ Affirmed 101 Pa. Commonwealth Ct. 370, 516 A.2d 426 (1986).

proceeding. It is not even receiving recognition of Susquehanna 2 for the first time in this proceeding. It received partial recognition in the last case. Moreover, some of the details of Section 1323 really do not work when we are dealing with a time frame 10 years after the completion of the plant.

(R.D., pp. 26-27)

While he was not convinced of the appropriateness of every element of the OTS position on this issue, the ALJ did recommend approval of the OTS' proposed adjustment for excess capacity. The ALJ concluded that:

Rather than producing alternative calculation which would result in approximately the same disallowance, I am accepting the OTS approach and its calculations. I am not entirely sure about the nine year period but I accept the result, based partly on the recognition that some of the capacity coming back to the system is associated with the Susquehanna plant.

To summarize, I agree with the use of a "used and useful" adjustment here, based on the physical excess capacity analysis. I am in fundamental agreement with the results produced by both OCA and OTS, although I would not go to the higher end of the OCA range. I also accept the OTS result, based on a disallowance of approximately \$239 million of rate base.

(Id., pp. 29-30)

Both the OCA and the Company have filed Exceptions to the ALJ's recommendation on this issue.

The OCA, in its Exceptions, agrees with ALJ Christianson's determination that PP&L has excess generating capacity. However, the OCA objects to the ALJ's finding that Section 1323 of the Public Utility Code does not apply to PP&L's

claim for Susquehanna 2 in this case. The OCA further objects to his "failure to consider the issue of economic excess capacity". (OCA Exc., p. 1). The OCA insists that Section 1323 applies to the Company's claim in this proceeding because it is in this case that PP&L claims, for the first time, an equity return associated with Susquehanna 2. (Id., p. 4).

Premised on our review of the record as developed in this proceeding, we find that we are in complete agreement with the ALJ's reasoning on the question of the applicability of Section 1323 to the Company's claim. Not only is this case not the first time that the Company has sought to earn an equity return on Susquehanna 2 (the claim was, in fact, first made in PP&L 1985), there has been partial recognition of that unit in the Company's rates for approximately ten years. It is clear that Section 1323 does not apply in this instance. The OCA's Exception on this point is, therefore, denied.

The OCA also contends that, even if the provisions of Section 1323 do not apply to the Company's claim in this case, economic excess capacity is still a relevant consideration under the traditional "used and useful" standard. The OCA asserts that the ALJ should have considered the issue of economic excess capacity, that he should have approved the economic analysis performed by and testified to by the OCA's witness, and, finally, that he should have recommended adoption of the OCA's proposed remedy of continuing the equity disallowance on Susquehanna 2. (OCA Exc., pp. 3-14).

We would agree with the OCA to the extent that we determine that the inapplicability of the provisions of Section 1323 do not preclude the consideration of economic excess capacity in the context of a "used and useful" analysis. Indeed, as PP&L points out in its Reply Exceptions:

[A] finding that Section 1323 did not apply would simply eliminate the "rebuttable presumption" that a utility would otherwise have to overcome in the event that it could not establish the need for and economics of the new base load unit.

(PP&L R. Exc., p. 3)

As to the OCA's contention that the ALJ erred by not approving its economic excess capacity analysis and by not recommending the adoption of its proposed excess capacity adjustment, we do not agree. In this regard, we concur with the Company's assessment of the value of the OCA's economic analysis.

PP&L points out in its Reply Exceptions that the OCA's "economic benefits" test for Susquehanna 2 attempts to measure that unit, which was completed approximately ten years ago, against a hypothetical future cost of "deregulated" power as projected for the early part of the next century. (PP&L R. Exc., p. 4). The Company points to serious flaws in the OCA's analysis which include the following:

1. The assumption of a set of market conditions which are inconsistent with the OCA's own analysis of PP&L's reliability requirements. (Id., pp. 4-5)
2. The selective application of its market-based test. (Id., pp. 5-6)
3. The highly speculative nature of the OCA's market price projections. (Id., pp. 7-8)

According to PP&L, these flaws and others render the OCA's economic excess capacity analysis unreliable and unreasonable.

PP&L did perform its own evaluation of Susquehanna 2 from an economic standpoint and describes its efforts and results as follows:

Rather than rely on highly uncertain estimates of future market-based prices, Dr. Hieronymus evaluated the economics of SSES 2 in light of the conditions PP&L would have faced in a world in which SSES 2 did not exist. Under these circumstances, the Company would not have simply waited to see what capacity might be available and at what price. Indeed, its statutory obligation to serve would have precluded such complacency. Rather, the Company would have had no choice but to proceed with a logical baseload alternative (PP&L Initial Brief, p. 55).

* * *

Unlike Mr. Kahal's market-based approach, Dr. Hieronymus' analysis is not dependent upon speculation regarding the possible deregulation of the electric utility industry. To the contrary, his calculations are straight-forward and verifiable. Perhaps for this reason, Mr. Kahal did not contest any of Dr. Hieronymus' input assumptions, and, accordingly, his findings were not seriously challenged. The results of Dr. Hieronymus' base case analysis shows that SSES 2 provides annual net economics benefits to PP&L ratepayers in the test year and in virtually all years thereafter. The analysis also shows that, under the most conservative assumptions, PP&L's rates are \$4 million to \$93 million lower per year with SSES 2 than with the alternative coal plant (PP&L St. 16-R, p. 58; PP&L Ex. WHH-4).

(Id., pp. 8-10)

We are persuaded that the Company's economic analysis of Susquehanna 2 represents the most reasonable and reliable "benefits test" of that unit on the record in this proceeding. We find that PP&L has demonstrated that Susquehanna 2 should produce annual benefits when compared to the cost of a logical

baseload alternative. As noted earlier herein, we agree with the Company's assessment of the OCA's economic excess capacity analysis. The OCA's Exception on this issue is, accordingly, denied.

The Company, in its Exceptions to ALJ Christianson's recommendation on this issue, objects to his determination that there is physical excess generating capacity on the Company's system. PP&L contends that the ALJ's recommendation to adopt the OTS' proposed 564 MW adjustment to plant with a corresponding disallowance of approximately \$239.5 million in claimed rate base is seriously flawed in a number of ways.

Initially, the Company asserts that the OTS' proposal and, therefore, the ALJ's recommendation, are based upon a 16 percent generating capacity reserve margin which is wholly inadequate. The Company points out that the OTS' proposed reserve margin was not based on any meaningful evaluation of its load and resources. Rather, the 16 percent margin was designed to provide what the OTS considered to be a sufficient "contingency" or "padding" factor over and above the Company's capacity obligation to the PJM. (PP&L Exc., pp. 12-13). According to PP&L, the OTS' position fails to take into account such important considerations as planning uncertainties and generating unit availability during the winter peak, which make it incumbent upon the Company to maintain reserves substantially above its designated PJM minimum requirement. (*Id.*, pp. 13-15). PP&L notes that in its last base rate proceeding:

[T]he Commission determined that 22% was a reasonable reserve margin for ratemaking purposes and, armed with that finding, denied the Company a return on 945 Mw of SSES 2 capacity. See Pa. P.U.V. v. Pennsylvania Power & Light Co., 59 Pa. P.U.C. 332 (1985) (the "Unit 2 Case"). In the intervening ten years, PP&L's peak demand has increased

by approximately 1555 Mw, or 610 Mw more than the amount found excess in the Unit 2 Case. This is significant because, apart from an extremely cost-effective 90 Mw (jurisdictional) uprate of SSES 2 PP&L has not added to the capacity which it owns and operates since SSES 2 was placed in service.

(Id., p. 12)

PP&L also observes that the 16 percent reserve margin is less than the margins which we have allowed for other electric utilities. (Id., p. 17).

The Company contends that the ALJ's recommendation is in error because the 564 MW, which he determined to be excess generating capacity, contains facilities which are not properly included in the computation of its available capacity. Specifically, PP&L asserts that the disallowed capacity, for the most part, represents NUG or qualifying facility ("QF") capacity and capacity which will return to PP&L over future years under the terms of an agreement with JCP&L. (Id., pp. 17-23). With regard to the inclusion of NUG or QF capacity, the Company argues that,

[I]t would be patently unreasonable and confiscatory to deny it a return on pre-existing plant investment solely because it was required, by PURPA and the Commission's regulations, to purchase output from QFs. This is not a case where a utility continued to add capacity long after the availability of QF output became known. Rather, as previously noted, PP&L's contracts with QFs were not executed until after SSES 2 was virtually completed. Consequently, if PP&L has any excess capacity, the QFs are unquestionably the cause of that excess. (Emphasis in original)

(Id., p. 18)

As for factoring in the return of the JCP&L capacity to the Company's available reserves, PP&L contends that:

As previously pointed out, the 564 Mw figure developed by Mr. Metro is based, in part, on projections that reach out as far as the winter of 2003-2004 (OTS Ex. 5). There are several problems with this approach... Future customer demands may exceed expectations, available resources may not be present in the amounts assumed. Consequently, and in view of the foregoing factors, the practical effect of the ALJ's recommended adjustment is to penalize PP&L today for capacity which it is not claiming in rates and/or which the OTS merely speculates may become "excess" years from now.

(Id., p. 23)

On consideration of the positions of the parties on this issue, we begin with the axiom that "[T]he touchstone for determining whether or not a prudently constructed unit should be included in a utility's rate base is whether or not, during the test year involved, the unit will be used and useful in rendering service to the public". See PP&L v. PUC, supra, citing Philadelphia Electric Company v. Pennsylvania Public Utility Commission, 61 Pa. Commonwealth Ct. 325, 433 A.2d 620 (1981).

Based on the record herein, we would agree with the Company that there is no excess generating capacity on its system. Therefore, we shall reject the ALJ recommendation concerning this issue.

Our finding in this regard is based upon a determination that the reserve margin range established in this proceeding is within the 16% to 22% range for PP&L. As was pointed out by the Company, we determined in its last base rate proceeding (PP&L 1985) that 22 percent was a reasonable reserve margin for ratemaking purposes. We have found no evidence or arguments on the record here which would persuade us to alter the determination that a reserve not exceeding 22% is unreasonable. We find persuasive the Company's citation of the fact that in the

intervening ten years, PP&L's peak demand has increased by approximately 1555 Mw, or 610 Mw more than the amount found excess in the Unit 2 Case. This is significant as, apart from an extremely cost-effective 90 Mw (jurisdictional) uprate of SSES 2, PP&L has not added to the capacity which it owns and operates.

We find the lower reserve margins proposed by the OTS and the OCA to be grounded in the perception that PP&L's membership in the PJM for interstate power pooling concerns should be dispositive of a Pennsylvania jurisdictional reserve. This result is somewhat arbitrary.

We specifically find the ALJ's reliance on the OTS calculations to be flawed. Most importantly, PP&L points out in its Exceptions that the rejection of the OTS recommendation concerning the Company's proposed ECR treatment of the returning JCP&L capacity renders the OTS proposal concerning excess capacity unreliable. The OTS acknowledges this in its Replies to Exceptions:

Consequently, PP&L's argument has merit in that there is a nexus between [sic] OTS's excess capacity adjustment and PP&L's ECR proposal in this proceeding. In essence, OTS submits that it would be entirely inappropriate to base an excess capacity adjustment on capacity that has not been paid by Pennsylvania jurisdictional customers. Simply put, if Pennsylvania jurisdiction customers do not pay for the capacity, then obviously there is no excess capacity adjustment.

(OTS R. Exc., pp. 3-4)

We also find the OCA's calculations to be lacking in merit here, as well. The economic analysis of the OCA is not material here, and we agree with ALJ Christianson's determination to not utilize it. Additionally, we take notice of the recent

severe weather in PP&L's service territory in the winter of 1994 and the summer of 1995, which we believe serves to reinforce the argument to leave our previous determination of a 22 percent reserve margin undisturbed.

The Company notes in its Exceptions that, "[i]f the 22% reserve margin standard employed in the Unit 2 Case were utilized here, there would be no basis for concluding that PP&L has 'excess capacity -- even if all of the other flaws in the Recommended Decision were ignored." (Id., p. 13). We would agree. Since we, hereby, find that 22 percent, as the upper range of a reasonable reserve, continues to be an appropriate reserve margin for the Company, we conclude that it is unnecessary to address the questions of whether the NUG capacity⁶ should be considered part of PP&L's resources in the context of this excess capacity issue.

In light of the above discussion, we find that there is currently no excess generating capacity on the PP&L system. The recommendation of the ALJ on this issue is, therefore, rejected, and the Exceptions of the Company are granted to the extent that they are consistent with the foregoing reasoning.

Prior to leaving this issue of excess capacity, we note that, in its Exceptions, PP&L also contends that the ALJ's recommendation is inconsistent with his rejection of the Company's energy cost rate ("ECR") proposal. Specific issues relating to the PP&L's ECR proposal are considered in a subsequent section of this Opinion and Order.

⁶ Our disposition of the JCP&L capacity is consistent with our finding of no excess capacity of PP&L's system and our rejection of the OTS position in this regard.

B. Accrued Pensions

The OCA proposes that the Company's rate base claim be reduced by \$74,034,000, on a Pennsylvania jurisdictional basis, to reflect its accrued pension liability. The proposed adjustment represents the difference between pension costs reflected on PP&L's books and its contribution to the pension funds since the implementation of Statement of Financial Accounting Standard ("SFAS") No. 87 in 1987. (OCA M.B., p. 65). The OCA contends that the accrued pension liability are costs which PP&L has either already recovered from its ratepayers as an expense, or they are currently being recovered as a component of capitalized overheads which are included in plant in service, and should, therefore, be deducted from the Company's rate base. (Id.).

PP&L argues that the OCA's position is unfair and unreasonable because it focuses on a change in but one element of the Company's benefits cost. The Company points out that other components of that expense have risen significantly in the years since its last base rate case. (PP&L R.B., pp. 21-22).

ALJ Christianson agreed with the Company's position on this issue and recommended the rejection of the OCA proposal, based upon the following reasoning:

I admit to some difficulty in merely understanding the OCA argument in this instance. However, my result is governed by fundamental agreement with the PP&L point that we should not engage in a line-by-line examination of revenues and expenses associated with the last rate proceeding. Rates are set as a general matter, based on many individual elements. The revenue requirement should be examined as a whole or not examined at all.

(R.D., p. 32)

The OCA filed an Exception to the ALJ's recommendation, repeating its contention that the accrued pension liability should be deducted from the claimed rate base in order "to reflect the fact that ratepayers have paid these pension costs although they have not yet been contributed to the Company's pension fund." (OCA Exc., p. 14).

In its Reply Exceptions, PP&L again asserts that the OCA's proposal is improperly focused on pensions to the exclusion of other expenses which have increased. The Company rejoins that the OCA's position is also incorrect for other reasons, including the following:

It erroneously assumes that a mere change in pension accounting rules brought about by Statement of Financial Accounting Standards No. 87 ("SFAS 87") -- without an accompanying increase in rates -- could generate additional "customer-supplied" funds.

It overlooks the fact that the "accrued pension liability" represents the amount by which the Company's pension plan is underfunded on an actuarial basis, not overfunded as the OCA suggests (OCA Exc., pp. 14-15). Thus, the OCA is proposing a rate base deduction because the Company, in effect, owes \$74 million to the pension trust.

(PP&L R. Exc., p. 11)

We are persuaded by the Company's reasoning on this issue. In particular, we would agree with the Company that there is no basis for a conclusion that the difference between pension costs reflected on PP&L's books and its contribution to the pension fund properly denote customer supplied funds which should be considered available to the Company. In fact, the amount represented thereby is an amount by which the Company's pension plan is underfunded on an actuarial basis as opposed to an overfunding suggested by OCA witness Catlin.

Further, we concur with the ALJ, that the OCA was incorrect and unfair to single out pension costs and ignore other costs which have been escalating. We will, accordingly, adopt the recommendation of the ALJ on this issue. The Exception of the OCA is, therefore, denied.

C. Cash Working Capital

The Company has made no claim for a cash working capital requirement in rate base in this proceeding. However, in compliance with our rate case filing requirements, PP&L did include a detailed cash working capital study with its supporting data. That study employed the lead/lag method to determine the amount of funds necessary to pay monthly operating and maintenance expenses prior to the receipt of revenues from customers. (PP&L M.B., p. 62). The Company's study indicates a negative cash working capital requirement. (PP&L Exh. Future 1 (revised) Sch. C-4). As noted above, however, the Company made no claim, either positive or negative, for cash working capital in this case.

Both the OCA and the OTS contend that a negative cash working requirement should be recognized in this proceeding, and both parties submit that a corresponding reduction should be made to PP&L's rate base claim.

The OCA asserts that allowing the Company to set its cash working capital requirement at zero would not only ignore PP&L's own lead/lag study, "but it also results in ratepayers, rather than shareholders, supplying funds to the Company in excess of its cash working requirements." (OCA M.B., p. 70). The calculation of the OCA's proposed adjustment is summarized by its witness on this issue, as follows:

First, I have revised the composite revenue lag to correct the lag utilized for 20-day accounts. Second, I have revised the O&M expense lag to account for the effects of recognizing Clean Air Act Amendment (CAAA) permit fees and interest on customer deposits as separate expense items and to exclude an invoice for a capitalized expense from the calculation of the lag. Third, I have revised the payment lags for interest on long-term debt and preferred dividends to be consistent with a 365-day year. Finally, I have revised the amounts of expenses and taxes incorporated in the study to reflect the OCA's adjustments to PP&L's claimed expenses and taxes.

(OCA St. 6, p. 9)

The OCA determined, based upon the foregoing, that the Company's jurisdictional cash working capital requirement is a negative (\$12,444,000). The OCA contends that our resolution of this issue should be consistent with its analysis, but recognizes that our adjustment must also comport with our findings regarding PP&L's final revenue requirement. (OCA M.B., pp. 81-82).

The OTS proposed a number of adjustments to two components of the Company's lead/lag study; the computation of various revenue and expense lag periods, and the level of funds invested in prepayments. (OTS M.B., pp. 16-21). The end result of the OTS' adjustments is a recommendation that PP&L be found to have a negative cash working capital requirement in the amount of (\$12,279,000) on a Pennsylvania jurisdictional basis. (Id., p.23). The OTS contends that a finding of a negative cash working capital requirement is appropriate in this case since the Company's original rate filing included a negative allowance for this item, though admittedly, PP&L's original claim was significantly smaller than the OTS' proposed adjustment. (Id., p. 22).

The Company argues that the OTS' and the OCA's proposal to adopt a negative cash working capital allowance in this case goes against "a long line of Commission and Pennsylvania Appellate Court decisions rejecting that position." (PP&L R.B., p. 16). The Company also notes that a significant element of both the OTS' and the OCA's proposals is an "offset" for interest and preferred stock dividends which have accrued prior to pay-out. PP&L points out that it has made no cash working capital claim in this case. It asserts that the interest and dividend "offset" should only be applied to a positive claim and should not be used as "a stand-alone deduction to a utility's rate base." (Id., p. 17). As for the OTS' position that PP&L left itself open to a negative cash working capital adjustment through its initial filing in this case, the Company contends that the fact that it showed a small negative balance in its filing "can hardly be viewed as tacit acceptance of the \$12.3 million adjustment proposed by OTS." (Id., p. 18).

ALJ Christianson agreed with PP&L that a negative cash working capital adjustment should not be imposed in this proceeding. The ALJ's reasoning on this issue is as follows:

I accept the fundamental PP&L position that the interest/dividend offset should only be used against a positive cash working capital balance. This adjustment should not be used to drive cash working capital into negative numbers. Therefore, I am setting cash working capital at zero.

(R.D., p. 35)

The OCA has excepted to the ALJ's recommendation. The OCA recognizes that we have, in the past, set cash working capital allowances at zero rather than adopting a negative determination. (OCA Exc., p. 16). The OCA argues, however, that our past practice "should not preclude the allowance of long estab-

lished cash working capital adjustments", such as the adjustment to offset accrued interest and dividends against the Company's claim. (Id., pp. 16-17). The OCA also asserts that there is Commission precedent for making a negative cash working capital allowance, citing Pa. P.U.C. v. ALLTEL Pennsylvania, 59 Pa. PUC 447, 457-58 (1985). Finally, the OCA contends that the ALJ failed to consider various other adjustments which it had proposed to correct "errors" in PP&L's study. (Id., p. 17).

In its response to the OCA's Exceptions, the Company correctly points out that the case precedent cited by the OCA, ALLTEL supra., has no meaningful application to this proceeding because the issue of negative cash working capital was not litigated, or even raised, in that case. PP&L repeats its argument that there are numerous Commission and Pennsylvania Appellate Court decisions which support the ALJ's recommended rejection of the OCA's proposal. The Company concludes by noting that, "the Commission has repeatedly held that the debt interest and preferred dividend adjustment is an 'offset' to cash working capital requirements and should not be used to drive working capital requirements below zero." (PP&L R. Exc., p. 12).

We are not persuaded by the OCA's arguments to abandon our usual practice of setting cash working capital requirements at zero rather than approving negative adjustments when no positive claim has been made by the Company. We, therefore, accept the ALJ's reasoning and recommendation on this issue, as supported by the Company's Reply Exceptions. As for the OCA's charge that the ALJ should have considered certain other adjustments which it had proposed to PP&L's study, our review of those adjustments indicates a level of complication and "fine tuning" which we are not convinced is necessary in the computation of a cash working capital allowance. In addition, acceptance of those adjustments would result in setting a negative cash working

capital allowance which, as noted earlier, we are not disposed to do in this case.

Accordingly, the Exceptions of the OCA on this issue are denied, and the recommendation of the ALJ is adopted.

D. Land Held for Future Use

PP&L has not included any land held for future use in its rate base claim for this proceeding. The Company has asked, however, that we approve the accrual of an allowance for funds used during construction ("AFUDC") on its future use property investments. (PP&L M.B., pp. 75-76).

ALJ Christianson, recognizing that PP&L's request is for accounting purposes only, recommends its approval. The ALJ emphasizes that, "the ultimate decision concerning acceptance of the property in question into rate base will occur in the future, when PP&L asserts that the land is actually used and useful." (R.D., pp. 35-36).

We agree with the ALJ, and, as none of the parties have excepted to his recommendation, it is adopted.

E. Other Rate Base Matters

The Company has included in its rate base claim certain other adjustments for which no opposition has been proffered. Having reviewed the Company's claim for accrued depreciation pollution control projects, fuel stocks and materials and supplies, accumulated deferred taxes, customer advances and customer deposits, we find those claims to be reasonable and we adopt the ALJ's recommendation to include them in our ratemaking determination herein.

V. REVENUES

No issues were presented with respect to the Company's pro forma revenues. We, hereby, adopt the ALJ comments on same, recognizing that to the extent material, revenue related issues are considered elsewhere in this Opinion and Order.

VI. EXPENSES

A. Reduction in Employees

The OCA proposed a reduction in expenses to reflect benefit savings associated with PP&L's projected reduction in its complement of employees. (OCA M. B., p. 96, R. B., p. 44). PP&L has not contested this adjustment. The ALJ recommended that the OCA's proposal be adopted.

Based on our review of the record as developed, we conclude that the OCA's adjustment is reasonable and appropriate. We note that neither PP&L or any other party to the proceeding excepted to the ALJ's adjustment relative to reduction in the number of employees. Accordingly, we shall accept the adjustment as proposed by the OCA and, therefore, reduce PP&L's expenses by \$171,000 on a jurisdictional basis.

B. Early Retirement Program

PP&L implemented a Voluntary Early Retirement Program ("VERP"), on September 25, 1994. (PP&L M.B., p. 79). The VERP allowed eligible employees to select early retirement without a substantial reduction in retirement benefits. (*Id.*).

PP&L's initial filing included a net reduction in operating expenses of \$13.9 million as a result of the VERP program. The PP&L proposal was a net figure based on anticipated savings and anticipated costs.

The DOD, through its witness Prisco, had proposed to increase the PP&L adjustment by an additional \$3.2, but the adjustment was, apparently, abandoned after explanation from the Company. (R.D., p. 41).

PPLICA and the OCA⁷ raised concerns about this matter.

PPLICA proposed two specific adjustments. First, PPLICA proposed that the amortization cost be reduced by the amount of savings enjoyed before the end of the test year. Generally, the end of the future test year is approximately the same as the end of litigation and the commencement of new rates. The other PPLICA adjustment was to change the amortization period from five years to ten years, mainly because this parallels the length of time during which actual payment would be made under the retirement program. This adjustment, of course, reduces the annual revenue requirement associated with this amortization. PPLICA arrives at a total adjustment of \$9.6 million annually.

PP&L, in its Main Brief, responded that the VERP program has not produced cost savings and that it has already reflected a full year of savings in its rate filing. It acknowledges that there might be some modest level of savings realized later in the future test year, but it also asserts that it will experience increased expenses and plant additions during the same time period. PP&L further argues that the 10 year amortization period is inconsistent with the general Commission treatment of similar costs, pointing out that Pennsylvania does not allow a return on these amortizations. The Company argues that a five year period for amortization is consistent with precedent.

ALJ Christianson, on review of the positions of the parties, agreed with PP&L to reject both adjustments. He stated that he does not discern evidence of cost decreases sufficient to justify the PPLICA adjustment. He further reasoned that, while he could agree that some of the cost increases associated with

⁷ The OCA proposed to adopt, essentially, the PPLICA adjustment to this Company claim. (OCA R. B., p. 73).

the recent months might not be continued over the long term, he found no good basis for adding in short-term information for the creation of an adjustment. Concerning the amortization period, the ALJ also agrees with PP&L. The ALJ opined that, while the total program might last longer, in the sense indicated by PPLICA, there is no return allowed on the amortizations and he would not string out the cost recovery to be allowed PP&L. A five year period is more consistent with past practice and with the facts. While reasonable minds could differ, concluded the ALJ, he viewed the PP&L proposal as better than the alternatives proposed by the two other parties.

(R.D., pp. 44-45).

PPLICA and the OCA filed Exceptions to the recommendation.

In its Exceptions, PPLICA again argues that the Company must be required to adjust its proposal in two specific ways. First, PPLICA argues that the Company should be required to reduce the total cost of its Early Retirement program by the amount of savings that it would have obtained by the end of the test year. Second, recovery of the program costs should be amortized over a ten year period, consistent with the length of the plan.

In support of its first contention, PPLICA points out that the Company has achieved savings as a result of this program, and that it is not fair that the Company should be allowed to recover the gross costs of the program when the Company was the beneficiary of nine months of program-related savings. (PPLICA M.B., pp. 43-44) In support of its second contention, PPLICA argues that the ALJ's recommendation unreasonably disregarded PPLICA's argument that a ten-year straight-line amortization period for net program cost is more equitable than a five-year period since it more closely parallels

the length of time during which actual payment will be made under the program. (PPLICA M.B., p. 44) Therefore, PPLICA submits that the ALJ's recommendation should be reversed and the Company's revenue requirement should be reduced by an additional \$4 million to recognize an extension of the amortization period from five to ten years for recovery of the program costs.

(PPLICA Exc., pp. 32-34)

In its Exceptions, the OCA points out that it supports the adjustment to this item which was proposed by the PPLICA witness, to reduce the amount of the costs which the Company is allowed to amortize by netting out the savings which the Company will realize from the early retirement program prior to the time the savings are reflected in rates. The OCA submits that the ALJ's recommended denial of this adjustment fails to recognize that the Company seeks to recover the gross cost of the program from December of 1994 to September of 1995, despite the fact that it is also the beneficiary of nine months of program savings in this time period. The OCA further submits that adoption of the ALJ's recommendation would result in a mismatch between the costs and the benefits of the program. (OCA Exc., pp. 18-19)

In response to the Exceptions of PPLICA and the OCA, the Company states that, as recognized by the ALJ, the Company's filing already incorporates a full year of annualized savings. PPLICA and the OCA seek an additional adjustment for savings during the future test year, but do not mention that these alleged savings did not materialize. As to PPLICA's proposal that the program savings be amortized over ten years, rather than five years, the Company argues that the five year amortization period which it proposes is consistent with Commission practice, particularly since the Company did not claim any return on the unamortized portion of the adjustment. PP&L asserts that most of the costs will be incurred over the next five years. (PP&L R. Exc., pp. 24-25)

On review of this issue, we agree with the recommendation of the ALJ, and we shall, hereby, accept the Company's position. Based on our review of the record, we do not discern evidence of additional cost decreases sufficient to justify the proposed adjustment. While some of the cost increases associated with recent months might not be continued over the long term, there is no sufficient rationale for using the short term information for creation of an adjustment. As recognized by the ALJ, the Company's filing already incorporates a full year of annualized savings. (PP&L M.B., p. 82) The OCA and PPLICA seek an additional adjustment for savings during the future test year. However, these savings have failed to materialize. The original PP&L proposal is a better measure of the impact of this program.

Concerning the amortization period, we also agree with the Company. There is no good basis to unduly extend the cost recovery to be allowed PP&L. A five year period is more consistent with past practice, particularly since the Company did not claim any return on the unamortized portion of the adjustment. (PP&L M.B., pp. 83-84, PP&L R.B., pp. 28-29)

The Exceptions of the OCA and PPLICA on the issue of PP&L's VERP are, therefore, denied.

C. Post-Retirement Benefits (SFAS 106)

PP&L requested the recovery of \$31.095 million in deferred costs resulting from compliance with Statement of Financial Accounting Standard No. 106 ("SFAS 106") amortized over 17.3 years.⁸ (PP&L M.B., p. 91). This constitutes an annual cost

⁸ The Company also claimed \$25.8 million in current SFAS 106 costs. This claim had no controversy.

of service of \$1.797 million (\$1.55 million on a Pennsylvania jurisdictional basis) and a revenue requirement of \$1.894 million.⁹

Consistent with SFAS 106, companies subject to generally accepted accounting principles shifted to use of an accrual method of accounting, rather than a cash method, for post-retirement benefits other than pensions. Adoption of this standard served to increase the level of benefits reflected in financial statements and produce significant transition costs from the former methods. This situation is not unique to PP&L but is a familiar topic of litigation recently.

The fundamental challenge against the deferred costs is essentially that it violates the prohibition against "retroactive ratemaking". See Pike County Light and Power Company v. Pennsylvania Public Utility Commission, 87 Pa. Commonwealth Ct. 451, 456, 487 A.2d 118, 121 (1985) - "[t]he Commission clearly may not establish rates which are calculated to retroactively recover surpluses or refund deficits created by inaccuracies in its prior rate authorizations."; and Philadelphia Electric Company v. Pennsylvania Public Utility Commission, 93 Pa. Commonwealth Ct. 410, 422, 502 A.2d 722, 727-728 (1985) :

"The general rule is that there may be no line by line examination of the relative success or failure of the utility to have accurately projected its particular items of expense or revenue and an excess over the projection of an isolated item of revenue or expense may not be, without more, the subject of the

⁹ In December 1990, the Financial Accounting Standards Board ("FASB"), the body responsible for establishing generally accepted accounting principles ("GAAP") issued SFAS No. 106 requiring employers to adopt accrual accounting for benefits other than pensions to retired employees ("OPEBs"), i.e. health care and life insurance benefits and dental benefits. See Pennsylvania Public Utility Commission v. Philadelphia Electric Company, et al. Docket No. P-920588 (Order entered November 4, 1992).

Commission's order of refund or recovery, respectively, on the occasion of the utility's subsequent rate increase requests."

The OTS, the OCA and PPLICA provided arguments against the recovery of the PP&L expense. The argument against recognition of the claim is that it relates to compensation of employees for past services and, therefore, is a matter of past history which should not be a matter of prospective ratemaking.¹⁰

The OTS specifically argued that the matter was raised during 1992 when PP&L filed a petition requesting permission to defer costs. The OTS refers to Popowsky v. Pennsylvania Public Utility Commission, 164 Pa. Commonwealth Court 338, 642 A.2d 648 (1994) ("SFAS 106 - PP&L") involving PP&L and asserts that allowance of the deferred expense is barred therein by the doctrine of retroactive ratemaking.

In the opinion of the OTS, Commonwealth Court explained that the exception to retroactive ratemaking for "extraordinary" expenses did not apply to PP&L's situation. The OTS argues that the Company could have elected to come in for a general rate proceeding earlier since the SFAS 106 ruling was not unanticipated. The OTS would characterize an extraordinary expense as: (1) a one-time expense for a substantial item that would not appear as a continuing expense and (2) one which comes "out of the blue" and would never be recovered if ratemaking were strictly prospective.

The OTS continues its SFAS 106 discussion in its Reply Brief. It characterizes its differences with PP&L as differences in interpretation of court precedent. The OTS states that the

¹⁰ The issue of the proposed discount rate treated herein by the OCA will be addressed in Section VI.E of this Opinion and Order.

Commission's treatment of the PP&L transition obligation was not appealed to Commonwealth Court, and that Commonwealth Court dismissed the fundamental PP&L position on the basis that incremental costs were anticipated at an earlier time and could have been recovered in an earlier proceeding. It would apply the same ruling to this PP&L request for incremental costs. The OTS refers to the Pennsylvania-American case in Commonwealth Court, Popowsky v. Pennsylvania Public Utility Commission, 164 Pa. Commonwealth Ct. 600, 643 A.2d 1146 (1994), ("SFAS 106 - PAWC") where it was found that there was no retroactive ratemaking because Pennsylvania-American was merely requesting a timing change and not attempting to correct an incorrect projection. The OTS argues that the Pennsylvania-American situation does not shield PP&L here.

The OCA also argues that the claim must be denied because it is retroactive ratemaking. It refers to court precedent, which it views as controlling, and to a Commission decision in a West Penn case in which the Commission held that the Company had failed to claim costs in a timely manner and that the rule against retroactive ratemaking should preclude recovery. The OCA sees no distinction in claiming this cost in a general rate increase proceeding as opposed to some other type of proceeding. The OCA refers to both the PP&L court precedent and the SFAS 106 -PAWC court precedent. The OCA proposes an adjustment of approximately \$1 million.

PPLICA, relying upon Commonwealth Court interpretation of SFAS 106 - PP&L and SFAS 106 - PAWC, is of the opinion that the Commission is legally precluded from approving the PP&L proposal. PPLICA concludes that this PP&L claim should be denied, to make the result consistent with the recent Commission action in a West Penn case.

PP&L begins its position in support of this expense with the general proposition that utilities are prohibited from recovering past costs through future rates, but that there is an exception to this rule for extraordinary and non-recurring expenses. As an example, PP&L refers to an amortization of prior period tax losses, and goes on to claim that, in this instance, its SFAS 106 claim does not reflect surpluses or deficits created by a prior inaccurate rate authorization. PP&L asserts that the SFAS 106 change only altered the timing of recovery of cost and not the total amount of recovery. PP&L concludes that this SFAS 106 claim does not violate the general rule against retroactive ratemaking. PP&L then refers to the PP&L and the Pennsylvania-American decisions by Commonwealth Court. PP&L makes the same fundamental arguments in its Reply Brief.

ALJ Christianson, upon consideration of the positions of the parties, concluded that PP&L should be permitted recovery of the amount for SFAS 106 costs. He viewed the SFAS 106 change as an extraordinary and one time event, which occurred outside the test year but should be recognized. He stated that, in his decision on this issue, he did not consider himself to be controlled by case law which could be subject to varying interpretations, and in addition, is on appeal.

The ALJ further asserted that he agreed with PP&L that this sort of adjustment can be considered in a base rate proceeding better than in a non-base rate proceeding. The ALJ, therefore, concluded that lack of recognition in this instance would be unfair to the utility.

The OTS, the OCA, and PPLICA all filed Exceptions to the recommendation of the ALJ on this issue.

In its Exceptions, the OTS refers to the statement of the ALJ, found on page 50 of his Recommended Decision, that he is

not "controlled by case law which could be read either way and is, in addition, on appeal". The OTS argues that the ALJ is controlled by case law, and that, in addition, whether the case at issue is on appeal has no bearing on the holding of the case. The OTS then states that the Commonwealth Court decision in SFAS 106 - PP&L provides sufficient rationale as to why PP&L's request to recover an expense associated with the amortization of the regulatory asset of accumulated deferred OPEB (other post-employment benefits) expenses is barred by the doctrine of retroactive ratemaking.

The OTS further asserts that most of the arguments advanced by the Company were rejected by the Commonwealth Court in the SFAS 106 - PP&L, supra, on the premise that the costs were anticipated at an earlier time and could have been recovered in an earlier proceeding. In addition, the OTS argues that the Company cannot support its claim that the SFAS 106 cost is extraordinary because the Company did not produce any evidence to suggest that the SFAS 106 ruling was not unanticipated. The OTS concludes therefore, that PP&L's recovery of \$1,797,000 for the 17.3 amortization of the deferred expense of \$31,095,000 should be denied. (OTS Exc., pp. 11-12).

In its Exceptions, the OCA argues that the ALJ erred in his assertion that SFAS 106 - PP&L, supra, could be read either way. The OCA argues again that the case law is clear that these costs are prohibited from recovery in a base rate case, and, further, that recovery of these costs herein would violate the rule against retroactive ratemaking. The OCA further argues that the Commonwealth Court was quite clear that these costs are not "extraordinary" so as to fit within an exception to the rule against retroactive ratemaking. The OCA concludes that, for these reasons, the ALJ's recommendation should be rejected and the Company's net income should be adjusted by \$900,000 on a

Pennsylvania jurisdictional basis as shown on Schedule TSC-11.
(OCA Exc., pp. 19-22)

PPLICA also argues in its Exceptions that, given that the legality of SFAS 106 cost recovery is currently pending before the Courts, the Company's proposal must be rejected, and PP&L's expenses must be adjusted downward by \$1.797 million. (PPLICA Exc., p. 35).

In its replies to Exceptions, the Company again emphasizes that these claimed costs do not fall within the scope of the rule against retroactive ratemaking. The Company asserts that the amount it claims for costs accrued under SFAS 106 is identical over time to the amount that would be paid under a cash-based accounting method. The switch to SFAS 106 merely modified the timing of the Company's recovery of OPEBs, not the total amount of such costs. (PP&L St. 3-R, pp. 7-8). The Company also argues that, even if the rule against retroactive ratemaking were to apply, the Company's claim falls within the well-established exception for extraordinary and non-recurring costs.

The Company then refers to the case of PAPUC v. Pennsylvania-American Water Co., 79 Pa. P.U.C. 25, 42-51 (1993), aff'd, Popowsky v. Pa. P.U.C., supra, in which, according to the Company, the utility requested and received Commission permission to recover its past SFAS 106 expenses in the context of a base rate proceeding. The Court affirmed the Commission's order, rejecting arguments that such order violated the general rule against retroactive ratemaking. SFAS 106 - PAWC, 164 Pa. Commonwealth Ct. at 608. The Company concludes that these costs are extraordinary and non-recurring, and thus fall within the exception to the general rule against retroactive ratemaking. (PP&L R. Exc., pp. 20-21)

On review of this issue in light of the record as developed, we find that there is merit to the position advanced by the Company. We shall, therefore, adopt the recommendation of ALJ Christianson and permit the claim. Our determination that the claim should be permitted is grounded in the observation that the Company has acted expeditiously in seeking the recovery of SFAS 106 costs at the earliest opportunity in light of the legal uncertainty created by the Commonwealth Court's ruling in SFAS 106 - PP&L. Consistent with the Commonwealth Court's discussion of UGI Corp. v. Pennsylvania Public Utility Commission, 49 Pa. Commonwealth Ct. 69, 410 A.2d 923 (1980) in Columbia Gas of Pennsylvania, Inc. v. Pennsylvania Public Utility Commission, 149 Pa. Commonwealth Ct. 247, 613 A.2d 74 (1992), PP&L has taken steps to immediately seek recovery of the expenses created by SFAS 106.

Notwithstanding that the language in SFAS 106 - PP&L strongly suggests that the Company could have anticipated certain costs associated with implementation of SFAS 106, the change in financial accounting methodology and the legal uncertainty surrounding compliance with same is of an extraordinary, substantial and non-recurring nature which should be recognized outside the test year. Although this is the type of Company claim that should be approached with caution, our "bottom line" is that the lack of recognition of this claim would be fundamentally unfair to the Company.

Therefore, the Exceptions filed on this issue by the OTS, the OCA, and PPLICA, are all denied.

D. Pension Expense

PP&L bases its pension cost claim on an accrual method. It states that both the OTS and the OCA propose complete disallowance of this claim. The OTS theory is that PP&L will not

be making any cash contributions to the fund during the future test year. The OCA bases its disallowance proposal on its view of the appropriate discount rate involved.

The OTS discussion begins at page 86 of its Main Brief, where it recommends a \$10,224,000 reduction to operating expenses and a \$5,273,000 reduction to rate base. It refers to SFAS 87 and also to alternative computations made to comply with the Employer Retirement Income Security Act ("ERISA") and IRS rules. The OTS further states that, in this instance, there is no cash contribution required and it would treat pension expense on a cash only basis. The OTS refers to PP&L testimony that cash contributions are projected for 1996, but it views this as speculation and states that, in any event, payment will not occur until even later. With the lack of cash contributions, the OTS concludes, it would find no basis for a claim. The OTS again addresses this matter in its Reply Brief, commencing at page 38, wherein it responds to the PP&L argument in favor of an accrual basis. The OTS refers to its witness' testimony about payments not occurring until 1998. The OTS concludes that it would disregard PP&L's arguments relating to potential future payments because PP&L may have another base rate case within two years.

The OCA argument concerning this topic is based on a difference of opinion relating to discount rates. The same argument applies to the SFAS 106 matter. The OCA discusses these arguments together, commencing at page 147 of its Main Brief. The ALJ elected to follow the OCA format to discuss them together, under a separate heading. The ALJ first discussed the OTS proposed adjustment to the PP&L claim.

The PP&L discussion of the OTS adjustment commences at page 85 of its Main Brief. It provides several reasons why the OTS adjustment should be rejected. The Company first argues that pension expense is an extremely variable cost. It further views

the OTS adjustment as inconsistent with the Commission adoption of SFAS 106, relating to other forms of post-retirement benefits. PP&L takes the position that it makes no sense to calculate pension expense on a cash basis yet calculate retirement benefits other than pensions on an accrual basis. PP&L addresses this issue again in its Reply Brief, commencing at page 29, wherein it refers to both the argument of the OTS and of the OCA.

The ALJ stated that, although the OTS presents a good, coherent argument, he found himself in agreement with PP&L. He further stated that, although precedent provides mixed guidance, he finally agreed with the fundamental principle that an accrual method is better than a cash method. The ALJ added that use of the accrual method should be fair to both ratepayers and stockholders, if this method is used consistently, and that use of this method would seem to provide for a more consistent and less variable expense element. The ALJ also opined that what is really at issue is a timing difference, which should work out over time. He concluded that he accepts the argument that this issue should be decided the same way as the SFAS 106 issue, and he rejected the OTS adjustment for this item. (R.D., pp. 52-53).

The OTS takes Exception to the recommendation of the ALJ on this issue.

In its Exceptions, the OTS argues that the ALJ erred in rejecting the OTS' proposed adjustment for this item. The OTS notes 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. The OTS asserts that SFAS 87 does not address funding requirements of pension plans or the ratemaking treatment of the expense. Accordingly, the ALJ's adoption of the Company's 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).

In addition, the OTS argues that its position on this issue is consistent with prior Commission rulings on this issue. The OTS further argues that, in the instant proceeding, the future test year ends on September 30, 1995, and that there is no record evidence that the Company will be making a cash contribution to its pension fund during the test year. Therefore, the OTS submits that the Company's claim for pension expense should be limited to the annual pension contribution computed in compliance with ERISA and IRS rules. Since the Company has failed to satisfy these requirements, the OTS urges that the total claim of \$10,224,000 be disallowed. (OTS Exc., pp. 7-10).

In its response to the OTS' Exception, the Company points out that its claim for pension expense is based on SFAS 87. The Company maintains that this approach is appropriate because it is consistent with the accrual basis upon which all other major expense claims are established, and also it avoids the arbitrary variability of annual cash contributions. The Company further asserts that this approach is wholly consistent with relevant Commission precedent. Also, the Company states that it will make substantial cash contributions to its pension plan in each of the next three years, and that these cash contributions will exceed its SFAS accrual claim. Thus, the adoption of the Company's claim should result in lower rates to customers over time. (PP&L R. Exc., pp. 22-23).

On review of this issue, we find the recommendation of the ALJ that the Company's claim for this item be accepted to be in accord with the evidence as developed in this proceeding. We note that pension expense tends to be an extremely variable cost, from year to year. As noted by the ALJ, consistent use of the accrual method should be fair to both ratepayers and stockholders, over the long term. Further, consistent use of the accrual method will, over time, provide for a more consistent and

less variable expense element. We agree with the Company's position that it makes no sense to calculate pension expense on a cash basis, but to calculate retirement benefits other than pensions on an accrual basis.

For these reasons, the Exception filed by the OTS on this issue is denied.

E. The OCA Discount Rate Argument

The OCA addresses this matter, commencing at page 147 of its Main Brief. PP&L presents its main argument, commencing at page 89, with a reference, within the SFAS 106 discussion, at page 96 of its Main Brief. It presents a related argument, commencing at page 31 of its Reply Brief. The corresponding OCA Reply Brief argument commences at page 64.

The OCA would increase the discount rate for both pension and post-retirement benefits costs from 7.5 percent to 8.5 percent, in order to reflect current market bond yields. The OCA's position is that the relevant yield has increased. The OCA refers to use of an 8.75 rate by the PP&L actuary in another proceeding, and also to other uses of a higher discount rate. The OCA repeats its fundamental arguments in its Reply Brief, taking the position that PP&L has not provided the appropriate underlying basis for its choice of 7.5 percent.

PP&L states that, in the exercise of its informed judgment, the use of 7.5 percent is appropriate. The discussion of this matter in PP&L's Reply Brief begins at page 31. PP&L states that it would not merely rely on the choices of other utilities, and it refers to the possibility of 7.9 percent as a reasonable choice. It also refers to rate of return testimony as indicating a decline in rates. PP&L states that its burden of

proof is not to disprove other possibilities but to provide reasonable support for its own position.

The ALJ stated that he can agree with PP&L that it has met the fundamental burden of proof. On the other hand, continued the ALJ, the OCA has also provided a substantial case concerning this discount rate matter. The ALJ recognized that the OCA provides numbers above 7.5 percent and its argument is rather persuasive, but then he stated that the OCA's numbers could be wrong and that PP&L's could be right. While the OCA's approach is not particularly systematic, he stated, PP&L could have provided a better defense of its choice.

The ALJ concluded that this topic is rather like the topic of the proper equity return, where various numbers can be supplied and reasonable minds can differ. The ALJ finally accepted PP&L's 7.5 percent, largely based on the arguments contained at page 32 of its Reply Brief. The ALJ added that rates may have been up but appear to be declining at the moment, and that, with regard to future prospects, PP&L's number appears to be correct. (R.D., p. 54).

The OCA excepts to the recommendation of the ALJ on this issue.

The OCA argues that the Company fails to provide sufficient evidence to support its proposed 7.5% discount rate. The Company's witness testified on cross-examination that the discount rate is normally based on investment grade bonds and it is intended to reflect the time value of money. However, the OCA contends that the Company's witness offered no explanation as to how the Company selected its proposed rate other than to state that its proposed rate "was determined based on a detailed analysis of a variety of factors". The Company failed to enumerate or discuss these factors. Furthermore, the OCA argues

that the Company has failed to differentiate its case from the case of those companies that have utilized a rate in the range of 8.5%. On the other hand, the OCA has established a record that supports its recommended 8.5% discount rate. (OCA Exc., pp. 22-24).

In response to the OCA's Exceptions on this issue, the Company states that the OCA's proposed rate should be rejected. The Company states that it has submitted substantial evidence supporting its proposed 7.5% rate, including the testimony of its actuary that the Company's pension obligations could be settled at a rate of 25 to 50 basis points below long-term government bonds, which were then trading at 7.9%. The OCA ignores this evidence and argues that the Company's discount rate should be increased because other utilities have employed higher discount rates. The Company argues that the circumstances affecting the choice of discount rates can vary from company to company and the fact that other companies at other points in time selected higher discount rates does not support any adjustment to the Company's claim. (PP&L R. Exc., pp. 23-24).

Based on our review of the record as developed, we conclude that the position espoused by PP&L on the issue of the discount rate is the most tenable. As noted by the ALJ, this is an issue on which reasonable minds may differ. However, in the final analysis, PP&L has met its burden of proof on this issue. The Company has submitted substantial evidence supporting its proposed 7.5% rate, including the testimony of its actuary that the Company's pension obligations could be settled at a rate of 25 to 50 basis points below long-term government bonds, which were then trading at 7.9%. (PP&L M.B., p. 90, PP&L R.B., p. 32). While the OCA argued that the Company's discount rate should be increased because other utilities have employed higher discount rates, we are cognizant that the circumstances affecting the choice of discount rates can vary from company to company.

F. The SFAS 112 Claim

SFAS 112 concerns accounting treatment of long-term disability and other benefits provided to employees and their families. PP&L's claim reflects an accrual for the anticipated increase in future liabilities for these long-term benefits. The OCA would retain a cash basis, thereby reducing the Company's expense claim by \$592,000 on a jurisdictional basis.

The OCA argues that the PP&L claim is a projection and is in addition to the actual benefits which PP&L will pay during the future test year. The OCA states that PP&L intends to pay these costs on a pay-as-you-go basis and has no plan to establish a separate fund for this liability. The OCA indicates that the Company plans no changes in actual payment methods, and it would draw a distinction between SFAS 106 and SFAS 112. (OCA M.B., pp. 156-158. OCA R.B., pp. 71-73).

PP&L argues that it keeps its books and records on an accrual basis. The accrual method of SFAS 112 is fully consistent with generally accepted accounting principles and well-established ratemaking principles, argues the Company. PP&L strives for a consistency with other types of benefit expenses, and it refers to SFAS 106. It asserts that the OCA offered no reasoned basis for continuing the cash method. (PP&L M.B., pp. 96-98, PP&L R.B., p. 37).

The ALJ stated that reference to the record indicates that these liabilities are relatively short-term, and he found no valid argument that the claim should be denied as too speculative. The ALJ also asserted that the OCA argues that there is no particular fund for these amounts and that PP&L should not be allowed to collect revenues before it actually pays out the funds in question. The ALJ further noted PP&L's argument that an accrual basis is reasonable and consistent with other

accruals. PP&L would have revenue collection occur when the fundamental liability is incurred, not when funds are ultimately paid out. The ALJ stated that he would be more comfortable if there were a separate fund, with monitoring of income and expenditures. However, the ALJ concluded that such monitoring, or lack of monitoring, is not a significant problem. PP&L's handling of these funds can be readily tracked and reviewed. The ALJ concluded by accepting PP&L's fundamental argument that this item should be treated like other similar items, and he rejected this proposed OCA adjustment.

(R.D., p. 56).

The OCA filed Exceptions to the ALJ's recommendation on this issue.

The OCA argues in its Exceptions that there is no point in switching to an accrual basis if the Company plans to pay for these benefits on a pay-as-you-go basis, as the Company has admitted that it does. In addition, the ALJ's recommendation fails to consider that the Company has stated that it will not establish a separate fund for this liability if it recovers these costs prior to incurring them. The OCA continues that the reasons supporting the accrual method for ratemaking purposes for other benefit expenses under SFAS 106 are not present for the potential liability under SFAS 112. SFAS 112 does not create a significant, long-term difference between cash and accrual expenses for which FASB has determined a regulatory asset will not be allowed. Therefore, concludes the OCA, the expenses under SFAS 112 and SFAS 106 should not be treated the same for ratemaking purposes. (OCA Exc., pp. 24-25).

In response, the Company states simply that the ALJ has properly rejected this OCA proposed adjustment, for the reasons it set forth in its Initial Brief, at pages 96-98.

On review of this issue, we are in agreement with the recommendation of the ALJ, to adopt the position of the Company. The record indicates that the liabilities involved in this item are relatively short-term, and we find no basis to the claim that they should be denied as too speculative. We, on the other hand, agree with the Company that accounting for this item on an accrual basis is reasonable and consistent with other accruals. In addition, as pointed out by the ALJ, the Company's handling of these funds can be readily tracked and reviewed. In our view, this item should be treated the same as other similar items.

Therefore, the OCA's Exception on this issue is denied.

G. The Susquehanna Early Window Deferrals

As PP&L explains, the early window deferrals involve operating and maintenance expenses incurred between the date a new generating unit enters commercial operation and the date it is recognized in rates.

The OTS provides various relevant dates. Susquehanna 1 ("Susquehanna 1", "Unit 1", or "SSES 1") went into service on June 8, 1983 and was recognized in rates effective August 22, 1983, pursuant to the Commission Order entered on August 22, 1983 at Docket No. R-822169. (OTS St. 4, p. 16). Susquehanna 2 ("Susquehanna 2", "Unit 2", or "SSES 2") went into service 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 No. R-842651. (OTS St. 4, p. 16). The Commission had, during 1982 and again during 1983, authorized these two deferrals, for accounting purposes only. (Orders at Docket Nos. P-820367, entered July 29, 1982, and at P-830461, entered November 9, 1983). Those authorizing orders left the question of the justness and reasonableness of costs and rates for a later proceeding.

The OTS takes the position that the claims should be disallowed because PP&L failed to claim any recovery of these expenses at the first opportunity available and because recovery constitutes impermissible retroactive ratemaking. It argues that, in the case of Susquehanna 1, the Company had the Susquehanna 2 base rate proceeding available shortly thereafter and did not claim the Susquehanna 1 deferrals at that time. PP&L takes the position, on the other hand, that it did not make a claim in this 1984-1985 Susquehanna 2 case because it wanted to minimize the amount being requested in that case.

The OTS takes the position that PP&L could have filed an earlier rate case and not waited 10 years to seek recovery. The OTS further argues that retroactive ratemaking is not to be favored. In its Reply Brief, commencing at page 45, the OTS responds to PP&L. The OTS refers to Commonwealth Court decisions which support its position, including 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), and Irwin A. Popowsky, Consumer Advocate v. Pennsylvania Public Utility Commission, 642 A.2d 648 (1994). The OTS contends that these rulings changed the manner in which the Commission must view deferred claims by utility companies in Pennsylvania.

The OCA introduces the background of this matter at page 103 of its Main Brief. It outlines the general rule against retroactive ratemaking, with reference to limited exceptions it recognizes. It further states that the Commission has made it clear that recovery of deferred early window costs is not to become part of routine regulatory practice. It also points out that the mere granting of accounting accrual does not mean that there will be subsequent approval of the expense. The OCA refers to two instances where the Commission allowed this recovery.

There are indications in these decisions that there is no green light for these deferrals and that the costs, to be recognized, should be extraordinary and nonrecurring.

The OCA Reply Brief discussion commences at page 48. It again refers to the rule against retroactive ratemaking. The OCA states that PP&L has not shown that there should be departure from the basic rule, in this instance. It also discusses the element of negative financial impact. The dollar amount involved here is approximately \$40 million. The OCA views this amount, as a write-off, as relatively minor, compared to amounts allowed by the Commission previously. The OCA refers to the fact that the Company did not seek these reimbursements sooner. While the OCA agrees that the previous Commission orders did not set a time limit on recovery, it asserts that PP&L still must present a timely claim in order to recover these costs.

PP&L discusses this matter in terms of timeliness and the general rule against retroactive ratemaking. It states that it is seeking a 10 year amortization of the amount of approximately \$40 million. PP&L refers to the lack of a time limit in the Commission "early window" orders. It also makes the policy argument that a strict time limit requirement would encourage frequent rate cases. It refers to the magnitude of the Susquehanna 2 rate filing and its own desire to avoid additional expenses at that point. It is not seeking to violate the general rule against retroactive ratemaking, and the construction of a new nuclear plant is obviously extraordinary and non-recurring. PP&L again addresses this matter in its Reply Brief, starting at page 38, wherein it asserts that denial of this claim now would have a substantial adverse impact on PP&L earnings. It refers to a drop of close to 18 percent for 1995.

The ALJ stated that he found no assertion that the costs in question were imprudent. The arguments were that any

allowance now would involve retroactive ratemaking, and that PP&L has simply waited too long for recovery of these costs. The ALJ then stated that he was not convinced by the retroactive ratemaking arguments. He pointed out that PP&L carefully asked for Commission allowance of these accruals, and he agreed with PP&L's position that the event in question was unusual and not of the sort that would reoccur frequently. The ALJ also stated that bringing the two plants into service was certainly anticipated.

The ALJ concluded that, given the total picture, and the significant impact on PP&L's finances, he was inclined to allow the two recognitions. A factor in his decision was the fact that the Commission had indicated to PP&L that, absent imprudence or some other similar problem, it could recover these costs later. Moreover, added the ALJ, this is the sort of major event which can reasonably be handled with such special treatment. He further noted that the financial impact on the Company is significant.

However, the ALJ then noted that he was more troubled by the delay in seeking recognition of these costs. He stated that he could accept the Susquehanna 2 delay, because there had been no base rate case since 1985. He would not require a special rate case just to recognize these costs. However, he added, the Susquehanna 2 case came shortly after the Susquehanna 1 case and PP&L could well have claimed the Susquehanna 1 costs in the Susquehanna 2 case. PP&L argues, noted the ALJ, that it sought to keep the Susquehanna 2 increase as low as it could. The ALJ declared that he does not accept this answer, given the significant revenue request in the 1985 case and the minimal impact on total cost. Given the early chance PP&L had to seek recognition of the Susquehanna 1 costs, the ALJ concluded that the claim for Susquehanna 1 early window amortization should be denied, reducing annual O&M expense by \$2,035,000. He accepted

the Susquehanna 2 amortization cost of \$1,886,000 per year. (R.D., pp. 60-62).

The Company and the OCA filed Exceptions to the recommendation of the ALJ on this issue.

In its Exceptions, PP&L claims that the ALJ's recommendation that the Susquehanna 1 "early window" costs be denied is inappropriate for several reasons. First, the Commission authorized the Company to defer its claim for Susquehanna 1 early window costs in Petition of Pennsylvania Power & Light Co., Docket No. R-820367, Docket No. P-820367, Pa. PUC LEXIS 75 (Order entered July 29, 1982). This order did not establish any time limit on PP&L's ability to claim and recover its Susquehanna 1 early window deferrals, and certainly it did not require PP&L to claim these costs in its next base rate proceeding. Second, argues the Company, the recommended adjustment is inequitable. Third, as the Company has previously explained, it did not claim its Susquehanna 1 early window costs in its Unit 2 Case because it sought to minimize its requested rate increase and the concomitant impact on its customers. The Company argues that its efforts to reduce the requested rate increase in 1985 should be recognized as appropriate, and it should not be penalized for its decision. (PP&L Exc., pp. 46-48).

In response to PP&L's Exceptions on this issue, the OCA notes that the rule against retroactive ratemaking prohibits the inclusion of a utility's past costs in future rates. The OCA argues that the Company's claim is barred as a matter of law. To the extent that "early window" claims are legal at all, they must meet the three pronged test established by prior Commission rulings. The ALJ, argues the OCA, correctly determined that the Company's claim for recovery of Susquehanna 1 "early window" costs could not meet the standards set forth by the Commission.

Finally, argues the OCA, the Company has failed to demonstrate that denial of its claim would have a substantial negative impact on the utility. (OCA R. Exc., pp. 19-21).

The OTS also responds to the Company's argument on this issue, stating that the early window claim for Susquehanna 1 should be disallowed because the Company failed to claim any recovery of the expense at the first opportunity. The OTS further argues that to allow recovery now would constitute impermissible retroactive ratemaking. Finally, the OTS refers to the Commonwealth Court decisions which have been cited above. (OTS R. Exc., pp. 36-38).

The OCA, on the other hand, excepts to the ALJ's recommendation to permit PP&L to recover its deferred "early window" costs for Susquehanna 2. Initially, the OCA notes that it disagrees with the ALJ's reading of the Commission's Declaratory Orders regarding the accounting treatment for these deferred costs. The OCA states that, when the Commission granted PP&L's petitions for permission to defer the Susquehanna early window costs for accounting purposes, it specifically stated in each case that the issuance of the Order was not a determination that the Company may recover the deferred costs.

In addition, the OCA asserts that the Commission, in numerous cases where it has considered a utility's request for recovery of deferred costs, has made it clear that actual recovery of deferred costs is not to become a part of routine regulatory practice. Rather, cautions the OCA, each request must be considered to determine if an exception to the rule against retroactive ratemaking is warranted.

The OCA also points out that the Company has waited over nine years to file for recovery of the Susquehanna 2 early window costs. During this time period, PP&L suffered no

constraints on its ability to seek rate relief, but it voluntarily elected not to file. In addition, argues the OCA, the Company has not demonstrated that denial of recovery of its early window costs would have a substantial negative impact on the company. Finally, the OCA submits that current ratepayers should not be asked to bear these past costs, as this would constitute improper retroactive ratemaking. (OCA Exc., pp. 26-31).

In response to the OCA's Exceptions, the Company refers to the Declaratory Orders mentioned by the OCA. The Company states that, while it is true that these Declaratory Orders do not guarantee recovery of early window costs, this is irrelevant given that the Commission in several base rate orders has approved recovery of early window costs for other utilities. In response to the OCA's assertion that the Company did not file a claim for these costs until several years after they were deferred, the Company states that, again, this claim is correct but irrelevant.

The Company argues that it has engaged in a number of aggressive and extraordinary measures to control costs, increase sales, and maintain its earnings without raising base rates. The Company argues that it should be rewarded for its efforts, not penalized by having valid cost claims rejected. Therefore, PP&L contends that the OCA's claim that almost \$40 million, representing approximately 20% of the Company's earnings, is not "significant" should be rejected. (PP&L R. Exc., pp. 14-15).

Based on our review of the record, we find the recommendation proposed by the ALJ, that the "early window" costs for Susquehanna Unit 1 be disallowed, but that the "early window" costs for Susquehanna Unit 2 be allowed, to be in accord with the evidence and the law. The costs for Susquehanna 1 were incurred by the Company in 1983, and were not claimed by the Company in

its subsequent base rate case in 1984. The Company voluntarily elected not to seek recovery at that time. It is not that these costs, for Susquehanna 1 and 2, were imprudently incurred, but, as pointed out by the ALJ, the Company has waited too long to claim recognition of the Susquehanna 1 costs. We have previously made clear our position that the recovery of deferred "early window" costs is not to become part of routine regulatory practice.

Therefore, the Exceptions filed by PP&L on the recommendation of the ALJ with regard to the treatment of the Susquehanna 1 costs, are denied. The Exceptions of the OCA are denied consistent with our discussion herein.

H. Susquehanna Refueling Outage Expense

The OCA observes that PP&L normalizes refueling outage costs by, typically, amortizing over 18 months, the period between refueling outages. PP&L proposes that we look at the most recent outage for each unit as a measure. It also states that the annual amortization associated with reload six at Susquehanna 2, reflected in the future test year, was unusually high. The OCA reviews the PP&L rebuttal testimony and relies on its own surrebuttal testimony. This involves, in part, a comparison between Unit 1 and Unit 2.

The parties differ about the relative costs of the units. The OCA would base an amortization on the costs of reload eight at Susquehanna Unit 1 and of reload seven at Unit 2. The jurisdictional adjustment is slightly more than \$1 million. In its Reply Brief, the OCA responds to PP&L's assertion that its adjustment is arbitrary and unsupported, again referring to the problems experienced with reload six at Unit 2. The OCA would have the cost reflect the most recent outages at the units.

PP&L, in its Main Brief, refers to the OCA's avoidance of the Unit 2 reload six costs. It compares these costs to those for Unit 1 reload eight projected costs, and would have Unit 2 reload six found to be reasonable. PP&L characterizes the OCA's adjustment as arbitrary and unsupported. In its Reply Brief, PP&L argues that it is more appropriate to determine the refueling outage expenses based on the most recent actual costs (Unit 1 reload seven and Unit 2 reload six) rather than the estimated data relied upon by the OCA.

The ALJ noted that the OCA's fundamental argument is that costs for reload six at Unit 2 were abnormally high and should not be used as a measure for ratemaking purposes. The ALJ stated that the OCA approach seems to be arbitrary and that he would strive for consistency in ratemaking, rather than jumping from one measure to another, depending on the result, or depending upon particular details of the data. The ALJ concluded that he does not find reload six at Unit 2 to be so out of line that it should not be used as an appropriate measure for this ratemaking calculation. He accepted the PP&L position and rejected the proposed adjustment. (R.D., p. 63).

The OCA excepts to the ALJ's recommendation on this issue.

The OCA notes that the Company normalizes refueling outage costs by amortizing the costs of the outage over the period between refueling outages, which is typically around 18 months. The OCA argues that the ALJ erred in accepting PP&L's determination of future test year refueling outage expense, which was based on the completion of the amortization of Reload Outage 7 and the initiation of Reload Outage 8 at Susquehanna Unit 1 and the amortization of Reload Outage 6 at Unit 2.

The OCA also argues that, due to the unusually high level of expense associated with Reload Outage 6 at Unit 2, the OCA witness adjusted the amortization of refueling outage costs to reflect the annualized level of costs based on the most recent outage for each unit as of the end of the test period. The OCA further asserts that the ALJ's finding that the costs for Reload 6 at Unit 2 were not "so out of line that it should not be used as an appropriate measure for this ratemaking calculation" fails to consider the many problems that occurred during Reload 6. (OCA Exc., pp. 31-33).

In response to these Exceptions, the Company counters that, despite repeated assertions to the contrary, the OCA did not, in fact, utilize data for the "most recent" Susquehanna refueling outages to develop its claim. For example, continues the Company, the OCA proposes to utilize the cost of Reload 7 at Susquehanna 2, even though this outage has not even begun and will not be completed until several months after the end of the future test year. Moreover, the OCA's contention that the cost of Reload 6 for Unit 2 was abnormally high is wrong. Most of the increases in cost which occurred during this outage were capital costs, not operating and maintenance expenses. The Company presented extensive evidence that the operating and maintenance expenses incurred for this outage were not abnormal. These costs were virtually the same as other outage costs, which the OCA accepted without objection. (PP&L R. Exc., pp. 19-20).

On review of this issue, we conclude that the recommendation of the ALJ is in accord with the evidence as developed in this proceeding. The basic argument of the OCA is that costs for Reload six at Unit 2 were abnormally high and should not be used as a measure for ratemaking purposes. We find the OCA's position on this issue to be arbitrary. As we stated earlier, we believe that it is in the public interest that we strive for consistency in ratemaking, where appropriate, rather

than switching from one measure to another, depending on the result, or depending on the particular details of the data. The costs for Reload six at Unit 2 were not so out of line that it would be inappropriate to use these results for this ratemaking calculation.

For these reasons, the Exceptions of the OCA on this issue are denied.

I. Environmental Remediation Costs

The OTS discusses this topic, commencing at page 84 of its Main Brief. PP&L's discussion commences at page 105 of its Main Brief. PP&L refers to the OTS' adjustment and to the OCA's adjustment. The OTS pursued a challenge to this claim.

The OTS criticizes the PP&L claim as speculative in nature and based primarily on potential future costs. It points out that, between the filing of the OTS direct testimony and the filing of rebuttal testimony, PP&L and the Department of Environmental Resources (DER) reached an agreement concerning cleanup efforts. The agreement provides for a 10 year program which will have an impact on 134 sites. In recognition of this agreement, the OTS reduced its disallowance recommendation by a considerable amount. The OTS points out that the agreement calls for PP&L to spend up to \$5 million a year.

The OTS points out that PP&L's claim had been based on \$5.4 million a year. The OTS focuses on this \$400,000 difference and recommends a slightly smaller disallowance. Commencing at page 32 of its Reply Brief, the OTS points out that its final adjustment was based on PP&L information. The OTS notes the proposal of \$5.4 million and the apparent final agreement at \$5 million or, perhaps, less. It proposes a \$326,000 reduction.

PP&L first describes the situation with regard to the originally proposed adjustments. It refers to the April 27, 1995 agreement between PP&L and DER. PP&L points out that the OCA's witness withdrew his proposed adjustment. In its Reply Brief, starting at page 47, PP&L provides a jurisdictional adjustment, based on the final OTS position. The Company appears to agree that the adjustment is based on the difference between the \$5.4 million as originally estimated and the maximum amount which appears to be provided for in the agreement with DER. It notes that the agreement does not prohibit the Company from spending additional amounts. PP&L concludes by asserting that its original claim of \$5.4 million is reasonable.

Under the circumstances, stated the ALJ, he found that the OTS final adjustment was appropriate. The agreement apparently calls for PP&L to spend up to \$5 million. It could spend more but it could also spend less. The ALJ asserted that he would base the projection on the agreement and would focus on the \$5 million, which is apparently the OTS position. The ALJ further opined that this modest adjustment appears to be quite proper, and an improvement upon the original PP&L projection. The ALJ observed, in conclusion, that this adjustment was based on information which became available during litigation. (R.D., p. 65).

The Company and the Sierra Club filed Exceptions to the recommendation of the ALJ on this issue.

The Company argues that, as it explained in its Initial and Reply Briefs, its recent agreement with DER requires it to investigate and, if necessary, to clean up 134 potentially contaminated sites. Given the large number of sites and the broad scope of work encompassed by the agreement, asserts the Company, its claim of \$5.4 million is a more accurate projection of the costs it will likely incur on an ongoing basis than the

reduced amount proposed by the ALJ. Therefore, the ALJ's proposed adjustment should be rejected. (PP&L Exc., p. 55).

The Sierra Club in its Exceptions states that the ALJ should have recommended full recovery for the costs of environmental remediation because cleaning up or avoiding pollution is a cost of providing power. The Sierra Club also asserts that, while the adjustment proposed by the OTS herein seems to track the settlement, it also provides the wrong signals to management, and it may not track the realities of environmental cleanup costs. The Sierra Club further suggests that the environmental remediation be treated as a fund for ratemaking purposes. (Sierra Club Exc., pp. 18-20).

In response to the Exceptions of the Company and the Sierra Club, the OTS refers to PP&L Exh. MJB-9, which provides as follows:

...This agreement states, during the next 10 years, PP&L will investigate all 134 sites and spend up to \$5 million a year on investigation and clean up operations.
(Emphasis Added)

The OTS further asserts that the Company was given ample opportunity to provide evidence as to whether PP&L Exh. MJB-9 did not accurately reflect the agreement between PP&L and DER. In the absence of a contrary answer by the Company, the parties and the Commission must assume that the agreement obligates the Company to pay at least \$5 million for "environmental remediation expenses". The OTS asserts finally that the plain language of the agreement must be recognized in this proceeding, which provides only for a maximum payment of \$5 million for this item. (OTS R. Exc., pp. 35-36).

On review of this issue, we agree with the position of the ALJ, which is that the final adjustment as proposed by the OTS is the appropriate adjustment. The agreement between the Company and DER calls for PP&L to spend up to \$5 million for environmental remediation, and it is appropriate to base the adjustment herein on the agreement. The Company was given ample opportunity to provide evidence as to whether the relevant Company exhibit (MJB-9) did not reflect the agreement between the Company and DER, and it failed to do so. On cross-examination, PP&L witness Berish acknowledged that PP&L exhibit MJB-9 did not differ in any respect from the agreement between the Company and DER. Our adjustment to this item will reduce the Company's claim on this item by \$326,000.

Therefore, the Exceptions of the Company and the Sierra Club on this issue will be denied.

J. Uncollectible Accounts

The PP&L discussion sets forth, at page 97 and at page 101 of its main brief, essentially two claims. The first claim is one of approximately \$17 million for normal uncollectible accounts expenses and the second claim is slightly less than \$1 million for costs associated with PP&L's customer assistance program, referred to as the OnTrack Payment Program (OTPP). (R.D., p. 66). After a brief discussion of the parties' positions, the ALJ recommended adoption of OTS' position on one part of the claim i.e., reducing operating expenses by \$1,234,000, and with PP&L's position on the OTPP i.e., reducing that expense by \$130,000. (R.D., pp. 69-70).

There were no exceptions filed to this determination. Finding it otherwise reasonable and supported by the evidentiary record, we adopt the recommendation of the ALJ.

K. Rate Case Expense

PP&L seeks to normalize its rate case expense over a two-year period although the OTS seeks a four-year period and DOD seeks a three-year period. (R.D., pp. 70-71). After noting the admittedly unusual length of time since PP&L's last rate case i.e., ten years, the ALJ opted for the OTS' four year period. (R.D., pp. 72).

PP&L takes exception to the recommendation that PP&L's rate case expense claim be reduced by \$373,000 to reflect a four-year normalization period. PP&L claims that the level of rate relief proposed by the Recommended Decision makes it inconceivable that the Company will wait another ten years before seeking an increase in base rates. (PP&L Exc., pp. 6).

PP&L objects that the OTS' proposal was based on a review of PP&L base rate cases over a twenty-year period, including the abnormally long ten-year period since the filing of its last base rate proceeding, and that the ALJ thus wrongfully refused to exclude this ten-year filing period from his analysis. (PP&L Exc., pp. 54-55).

PP&L objects to the ALJ's conclusion that a four-year normalization period was appropriate. PP&L cites its Initial (M.B., pp. 111-113) and Reply (R.B., pp. 49-50) Briefs for the proposition that the record evidence demonstrates that the abnormally long stay-out period preceding this case is not likely to recur. (PP&L Exc., pp. 54). If this unusual period is disregarded, PP&L's average rate case filing period is 2.3 years. (PP&L Exc., pp. 54 citing PP&L St. 3-R, pp. 5-6). PP&L claims that its two-year proposal, therefore, is clearly reasonable.

Moreover, given the level of revenue increase proposed by the ALJ and the ALJ's recommended denial of the Company's

proposal for ECR recovery of returning capacity, PP&L claims that it is simply not credible to expect that the Company will stay out for four years before filing another base rate case. PP&L concludes that a four-year normalization provides no reasonable chance to recover its reasonable rate case expense and must be rejected as inconsistent with recent Commission precedent.¹¹

The OTS rejoins that PP&L's claim overlooks the fact that the purpose of averaging historical filing intervals is to mitigate the aberrations of long and short periods occurring during an historical period. (OTS R. Exc., pp. 33-34, Emphasis supplied). The OTS cites PP&L's testimony to the effect that the two-year period was used, not for purposes related to the long period since the last filing, but because that was used in the last case and there was no better choice. (OTS R. Exc., pp. 34 citing Tr. 536).

After consideration, we shall adopt the ALJ's recommendation and deny the parties' exceptions to the extent they are inconsistent with this Opinion and Order. We do so because, notwithstanding the fact that there has been an exceptionally long period since PP&L's last rate case, the record shows that PP&L picked the two-year period based on its last rate case. That choice, in our view, makes this case different from recent cases in which we endorsed a four-year normalization for this expense. We also take this action because, unlike those

¹¹ Moreover, while each company's circumstances are unique, PP&L would note that a four-year normalization is out of line with other recent Commission decisions. See, e.g., Pa. P.U.C. v. West Penn Power Co., Docket No. R-00942986, 1994 Pa. PUC LEXIS 144 (Order entered December 29, 1994) (24 months); Pa. P.U.C. v. UGI Utilities, Inc. (Elec. Div.), Docket No. R-00932862, 1994 Pa. PUC LEXIS 1137 (Order entered July 27, 1994) (16 months); Pa. P.U.C. v. Pennsylvania-American Water Co., Docket No. R-00932670, 1994 Pa. PUC LEXIS 120 (Order entered July 16, 1994) (12 months); Pa. P.U.C. v. Roaring Creek Water Co., Docket No. R-00932665, 1994 Pa. PUC LEXIS 41 (Order entered February 3, 1994) (12 months).

cases, PP&L has not filed a base rate case for several years. Finally, the lapse in time since the last rate case reinforces the validity of using the averaged historical filing period for its intended purpose as presented by the OTS.

L. Social Programs

PP&L's proposal consists of two existing programs and six new programs aimed at addressing customer and community needs. These include the following:

- Build-A-Neighborhood Program
- Affordable Housing Program
- Small Business Program
- Keep Warm Plan
- Payment Protection Plan
- Winter Emergency Plan
- Operation HELP Contribution Enhancement Program
- CARES Extension Pilot Program

PP&L claims that these programs are designed to promote the effective usage of electricity and economic development while providing utility support services in PP&L's service territory. (R.D., pp. 72-73). PP&L further states that the total annual projected cost of these programs is \$6.7 million, of which only \$3.5 million is sought for recovery herein (conservation, efficiency, load management and rate incentive programs). The remaining \$3.2 million (other program costs including charitable contributions, neighborhood improvements, closing and real estate costs, grants for small businesses) will be funded entirely by shareholders. (R.D., p. 73).

The other parties, especially OTS and CEO, took strong positions on PP&L's proposal. (R.D., pp. 73-79). The ALJ recommended that, although some of the considerations herein were beyond the scope of this ratemaking proceeding and might be considered elsewhere (R.D., p. 80), no adjustments be made.

(R.D., p. 80). PP&L's subsequent Reply Exceptions noted that they were seeking \$3.5 million for several social programs which the ALJ apparently supports. (PP&L R. Exc., p. 26; R.D., p. 80).

The parties filed several Exceptions and Reply Exceptions on this issue.

The OCA did not object to the proposed claim but seeks to have the Commission require more detailed filings on the programs in the Company's compliance filings and thereafter. (OCA Exc., pp. 32-33).

The OTS objects to the recommendation on the grounds that rate proceedings are not the place to foster social programs -- especially in light of the fact that the Company has not proposed to segregate ratepayer contributions from stockholder contributions and thereby avoid commingling (OTS Exc., pp. 2-5). The OTS further objects to PP&L's proposal because it goes well beyond the Commission's policy of assisting ratepayers with payment problems to funding programs to solve the socio-economic problems of their urban service territories. (OTS Exc., pp. 5-7). Finally, the OTS cites United States Steel Corporation v. Pennsylvania Public Utility Commission, 37 Pa. Commonwealth Ct. 173, 185, 390 A.2d 865 (1978) for the proposition that social program funding is best left to the legislature. (OTS Exc., pp. 6-7). The OTS recommends disallowing \$2,500,000 from the Company's proposal.

The Sierra Club places emphasis on the fact that the social programs proposed by PP&L represent reasonable and prudently incurred utility costs. (Sierra Club Exc., pp. 22-25). The Sierra Club also supports PP&L's rate recovery of \$3.5 million for their conservation, efficiency, and load management programs. The Sierra Club does so because the programs enhance

PP&L's ability to deliver cost-effective energy services to all their customers. (Sierra Club Exc., pp. 23).

The Sierra Club claims these programs are traditionally recognized as compensable through rates -- especially in light of the small amount represented by the \$3.5 million cost for a utility the size of PP&L. (Sierra Club Exc., pp. 23-24). The Sierra Club also claims that CEO is correct in opposing the spreading of limited funds to still more customers. However, the Sierra Club goes on to further recommend that PP&L "ramp up" their funding on these programs. (Sierra Club Exc., pp. 24-25). The Sierra Club further claims that OTS' concern about social program funding is misplaced. The Sierra Club reaches this conclusion by alleging that the claim ignores the fact that both the Company and the Company's ratepayers are "stuck" with each other and that, as a consequence, denying the Company an opportunity to fund such endeavors denies it an opportunity to earn a return on their investment. (Sierra Club Exc., pp. 24-25).

The Sierra Club goes on to suggest that PP&L not limit their programs to peak-shaving because such a limitation overlooks the fact that attacking baseload inefficiencies benefits all customers. For example, helping low income customers cut baseload, as with the type of refrigerator change-outs recently announced between PASNY and the New York Housing Authority,¹² also helps cut bad debts.

Finally, the Sierra Club recommends that these programs be monitored by CEEP and that they do not constitute unreasonable

¹² The Sierra Club cites recent media articles to make their point i.e., "Public Housing Efficiency Plan, Step One: Get New Refrigerators", New York Times, Jun. 20, 1995, p. B-1.

discrimination in violation of the Public Utility Code. (Sierra Club Exc., pp. 24-25).

In their exceptions, CEO claims that the July 1995 Commission report and other data support the fact that energy conservation and baseload demand reductions through Demand Side Management make good public policy and are appropriately considered in a base rate proceeding. (CEO Exc., pp. 2-3).

After consideration of the exceptions, we agree with the OTS that a \$2,500,000 reduction is appropriate reflecting total disallowance of costs associated with "Build-A-Neighborhood"; "Affordable Housing"; and "Small Business Programs." (OTS Exc., pp. 2-7). We do so for several reasons.

PP&L proposes to fund six new programs and continue two existing programs. The OTS, in our view, rightly argues that funding for three programs should be disallowed because any conservation, efficiency, load management, and rate incentive costs will be minimal at best. While we believe the shareholders, if they so choose, can fund any and all social programs of their choice, we believe that Commission-sanctioned funding is not appropriate when there is no demonstrable benefit to PP&L's customers. We further note, in relevant part, OTS' argument in that regard:

Based upon PP&L's own description of the programs, 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 Exc., p. 4).

After applying the OTS' analysis to these programs in light of our discussion above, we will disallow any funding for

"Build-A-Neighborhood"; "Affordable Housing"; and "Small Business Programs." These socio-economic programs, to the extent they do not provide demonstrable benefits in light of costs to PP&L's customers, are socio-economic decisions concerning the kind and extent of subsidies for needy customers in service territories that should be left to the legislative branch of the government. Such purely socio-economic decisions, devoid of any demonstrable cost benefit to a utility's customers, are not the appropriate role for this Commission.

Therefore, we shall disallow \$2,500,000 in funding consistent with the ALJ's endorsement of the OTS' position.

M. Nuclear Decommissioning Costs

There are four major components of decommissioning-related cost claims that have significant financial impact in this case. These are the nuclear decommissioning cost, the fossil fuel plant decommissioning cost, nuclear plant depreciation, and fossil fuel plant depreciation. (R.D., p. 81). The positions of the parties on these topics is discussed in length in the R.D. (R.D., pp. 81-106).

The ALJ initially presents PP&L's position. PP&L seeks an operating expense that includes \$30 million for an annual annuity accrual to fund decommissioning for SSES 1 and SSES 2. (R.D., pp. 81-82 citing PP&L Exhibit Future 1, Sch. D-11). PP&L's claim contains a four percent (4%) annual escalation of cost i.e., inflation, and a five and one-half percent (5.5%) after-tax earnings rate. (R.D., pp. 81-82).

PP&L claims that the 1993 decommissioning cost estimate was based on the results of a site-specific study. The interested reader is referred to the testimony of Mr. Thomas LaGuardia. (R.D., pp. 82-83). PP&L also claims that

non-radiological structures should be included because they may not necessarily be safe under applicable codes (R.D., pp. 83-84). PP&L also claims that a contingency factor is appropriate based on experience. PP&L further claims that a conservative earnings rate of 5.5 for earnings on monies reserved for decommissioning is appropriate. (R.D., pp. 83-90).

The ALJ then presents the OTS' position. The OTS starts by recommending a total allowance of \$18 million rather than the \$30 million claimed by PP&L. (R.D., pp. 84). The OTS bases their figure on Mr. LaGuardia's 1993 cost estimate devoid of \$122.8 million for contingencies, an inflation factor cost estimate of four percent per year, and an estimated 5.5 percent per year earnings rate on the trust. (R.D., pp. 84-85). The OTS position references the Commission's last rate case wherein the Commission rejected use of a contingency factor as too speculative. (R.D., p. 85).

The ALJ then presents the OCA's position. (R.D., pp. 85-90). The OCA seeks use of an interest rate of 7.5 percent, elimination of the \$127.4 decommissioning cost for non-radiological facilities, and \$106.6 million for contingencies related to that cost. (R.D., p. 86). The OCA's approach is premised on a reduction that takes into account the earned interest during the 10 to 12 year decommissioning, criticism of PP&L's overly pessimistic earnings assumption, prior Commission precedent allegedly excluding non-radiological decommissioning costs, and references to the Penn Sheraton Hotel Co. v. Pa. P.U.C., 198 Pa. Super. Ct. 618, 184 A.2d 324 (1962) ("Penn Sheraton") case for the proposition that net negative salvage is appropriate for non-nuclear decommissioning. (R.D., pp. 85-88).

The ALJ then presents the PPLICA position. PPLICA is concerned about the four-fold increase in accruals for decommissioning the Susquehanna units because of the nearly

\$20 million increase in the Company's revenue requirement. (R.D., pp. 90-91). PPLICA believes the 5.5 percent rate of return is well below the Company's own rate and it suggests a rate of return equal to that of the Company i.e., 10.23 percent. (R.D., p. 91).

The ALJ next addresses DOD's position. DOD recommends (1) that the Commission continue its current allowance for PP&L, and (2) refers to non-nuclear decontamination, and the possibility of a life extension at the plant. (R.D., pp. 91-92).

Finally, the ALJ discusses Mr. Epstein's position on nuclear issues. Mr. Epstein's basic position is that the fundamentally uncertain nature of nuclear decommissioning, and the resulting costs, should be borne by shareholders and not ratepayers. (R.D., pp. 91-92). In particular, Mr. Epstein decries the fact that AEC, PP&L's partner, is contributing but 10% to the nuclear costs. (R.D., pp. 92-93). Mr. Epstein agrees with the OCA that cost estimates for non-radiological decommissioning are not mandated by the NRC.

After considering the parties' positions, the ALJ agreed with PP&L's position and included both radiological and non-radiological costs. The ALJ took that approach on the belief that, given the nature of the cost, it was better to be approximately correct than exactly wrong. The ALJ rejected loading the decommissioning cost on net negative salvage at the end of the lifetime of the plant. The ALJ did so because that approach imposed an "intergenerational" cost on ratepayers who did not share in the benefit -- especially with regard to nuclear plants. (R.D., pp. 95-97).

The ALJ made several recommendations. The ALJ first recommended the use of annual annuity accrual over the life of the plant. (R.D., pp. 96-97). The ALJ next recommended

elimination of the "black lung" restrictions and imposition of ERISA standards to broaden investments in the fund. (R.D., p. 97).

The ALJ then recommended inclusion of the non-radiological expenses in the allowance, notwithstanding Penn Sheraton, on the ground that one should err on the side of caution. (R.D., p. 98). The ALJ also recommended elimination of the contingency factor, notwithstanding the Sierra Club's claims that funding was inadequate, because the contingency represented overkill on the issue. (R.D., pp. 98-99). The ALJ further recommended PP&L's position for use of an annual annuity accrual for the expense. (R.D., p. 99). In addition, the ALJ recommended use of PP&L's 5.5 percent factor on trust fund earnings. (R.D., p. 99). Finally, the ALJ recommended an adjustment to account for earnings on post-shutdown monies. (R.D., p. 100).

The ALJ's recommendations, beginning with acceptance of PP&L's proposal, rejection of the contingency allowance, and allowance of an adjustment for post-shutdown earnings, results in expense reductions of \$2,436,000 for post-shutdown earnings and \$2,516,000 for contingencies. (R.D., p. 100).

1. The Contingency Factor.

PP&L excepts to the ALJ's recommendations with regard to the elimination of contingencies. (PP&L Exc., pp. 39-44; PP&L R. Exc., pp. 15-19). PP&L disputes the contingency recommendation because it reduces PP&L's decommissioning cost claim by \$2.5 million. (PP&L Exc., p. 4 citing R.D., p. 100).

PP&L alleges that its proposed contingency cost estimate is reasonable, fully supported by the evidence and that inclusion of this contingency consideration is consistent with

prior regulatory decisions from this and other jurisdictions. PP&L claims that their cost was based on the results of a site-specific study of SSES 1 and 2, prepared by Mr. Thomas S. LaGuardia, President of TLG Services, Inc., and that it was consistent with well-accepted analytic methods. (PP&L Exc., p. 39). PP&L goes on to claim that Mr. LaGuardia's use of an experience-based contingency factor, derived from actual decommissioning projects, is widely used and approved by FERC and other state commissions. (PP&L Exc., pp. 39-40). PP&L also claims that the Commission has itself twice approved decommissioning expense claims which included "contingency" factors. (PP&L Exc., p. 39 citing PP&L Initial Brief, pp. 129-137).

PP&L urges the Commission to reject the ALJ's disallowance because it rests on the mistaken belief that the contingency was a simple "safety factor" tacked on to the Company's best estimate of decommissioning costs. (PP&L Exc., p. 40 citing R.D., pp. 99). PP&L disputes that view based on the fact that contingencies play an integral role in estimating and are not mere addendums to basic suppositions. (PP&L Exc., pp. 40-41).

In this case, the Company's "contingency" component represents the costs of program problems that have a high probability of occurrence but which have not been reflected in the basic estimate. Examples include schedule slippage (leading to overtime or project extensions), weather delays, labor strikes, worker injuries, material shipping problems, equipment breakdowns, regulatory inspections and hazardous materials handling. (PP&L Exc., pp. 40-41 citing PP&L St. 13, pp. 22-23. Emphasis supplied).

Furthermore, PP&L claims that inclusion of a contingency in the cost estimation process for the construction

and dismantling of projects is a well accepted practice. PP&L cites the practice of the American Association of Cost Engineers on the need for such a contingency allowance in engineering cost estimates as proof. PP&L also cites the Atomic Industrial Forum's Guidelines Study ("Guidelines Study") for nuclear decommissioning which explicitly validate inclusion of a contingency in decommissioning cost estimates. (PP&L Exc., pp. 40-41).

In fact, PP&L notes that, in the Guidelines Study, individual contingencies ranging from 10% to 75% were judged proper for various tasks, depending on their degree of difficulty. Those contingencies, when applied to the appropriate components of nuclear plant decommissioning costs, average upwards of 25% overall. (PP&L Exc., p. 40 citing PP&L St. 13, pp. 22-23). By contrast, the Company used a conservative contingency of about 17%. (PP&L Exc., pp. 41-42).

PP&L next cites the regulatory practice of other commissions and the FERC for precedent sustaining use of contingencies. Other commissions have approved contingencies of up to 25% in nuclear decommissioning cost estimates. PP&L also references the use of a 25% contingency for nuclear power plant decommissioning in the Middle South Energy/Grand Gulf Case. (See Grand Gulf Proceeding, FERC Docket No. ER82-616). PP&L also cites numerous other state commissions that have adopted a 25% contingency for nuclear plant decommissioning with specific reference to an AGA-EEI Depreciation Committee Survey showing that two-thirds of all survey respondents had approved contingencies. (PP&L Exc., pp. 40-41 citing PP&L St. 13, p. 24).

PP&L then references prior Commission practice. PP&L notes that the Commission has approved decommissioning claims that included a 25% contingency, based on studies submitted by

Mr. LaGuardia himself. See Pa. P.U.C. v. Pennsylvania Power Co., 85 PUR4th 323 (1987); Pa. P.U.C. v. Pennsylvania Power Co., 67 Pa. P.U.C. 91 (1983).¹³

PP&L criticizes attempts to justify exclusion of contingencies that rest on the Commission's rejection of a contingency in the Company's last rate case. In the last rate case, PP&L used a generic decommissioning study for estimating a contingency the Commission rejected. In this case, PP&L is using site-specific decommissioning studies that include areas with a high probability for problems, delays or additional costs, and has determined an appropriate contingency factor based on the actual experience of dismantling and decontaminating nuclear plants. Furthermore, the issue was novel at that time and has since evolved into one where commissions did recognize contingencies in decommissioning costs. (PP&L Exc., p. 41, in particular n. 10).

PP&L concludes that the Recommended Decision's exclusion of this adjustment must be rejected. (PP&L Exc., p. 41).

¹³ Although given no weight by the ALJ, opposing parties attempted to justify their proposed adjustment by reference to the Commission's rejection of a contingency in the Company's Unit 2 Case. That decision, however, is clearly distinguishable. At that time, the Company employed a judgment-based contingency factor, which it applied to a cost estimate derived from a "generic" decommissioning study. In contrast, for his site-specific SSES study, Mr. LaGuardia has analyzed each area having a high probability for problems, delays or additional costs, and has determined an appropriate contingency factor based on the actual experience of dismantling and decontaminating nuclear plants (PP&L St. 13, pp. 21-25). Moreover, in 1985, this issue had been addressed in relatively few jurisdictions, and the Commission relied upon a single decision from Massachusetts that purported to disallow a contingency. Since 1985, the weight of precedent from Federal and State regulatory agencies supports the use of a contingency factor. (PP&L Exc., p. 41, n. 10).

The Sierra Club joins PP&L in opposing elimination of the contingency. Unlike PP&L or the OCA and OTS, however, the Sierra Club also contends that many costs have been underestimated. (Sierra Exc., pp. 25-26). The Sierra Club concedes the validity of the ALJ's concern with overkill. However, the Sierra Club strongly believes that shareholders must take responsibility for their management's selection of the nuclear energy option. (Sierra Club Exc., pp. 25-26). Consequently, the Sierra Club opposes the elimination of the contingency as decision that simply exacerbates the undercollection situation. (Sierra Club Exc., p. 26).

The Sierra Club believes that it is simply not in the Commonwealth's interest to underfund the treatment of radioactive poisons that have lives of tens of thousands of years. Given the unlikelihood of PP&L's returning for a general rate case until the next century, and the absence of any other mechanism for collecting for nuclear decommissioning costs, this is the last opportunity for this Commission to adjust PP&L's nuclear decommissioning rates for some time. Consequently, the Sierra Club supports inclusion of the contingency in PP&L's cost estimates. (Sierra Club Exc., pp. 25-30).

Both OTS and OCA support the ALJ's recommendation. The OCA cites their Main and Reply Briefs to reiterate their position that PP&L's decommissioning cost estimate includes a range of contingencies. The contingencies vary for the different tasks, ranging from 15% to 75%, and result in an overall estimate of approximately 18%.

The OCA notes that the radiological portion of the estimate includes an overall contingency of approximately 19%, or \$106,569,000, for contingencies. The OCA also notes that the Company included a contingency of \$16.235 million in its non-radiological cost estimate. (OCA R. Exc., pp. 14-17 citing

OCA St. 4, p. 31;¹⁴ OCA M.B., pp. 189-195; OCA R.B., pp. 81-84).

The OCA challenges PP&L's claim that the "contingency component" of its decommissioning cost estimate represents costs "that have a high probability of occurrence." (OCA R. Exc., pp. 14-15 citing PP&L Exc., p. 40). The OCA claims that the ALJ correctly recognized that contingencies represent cost overkill. (OCA R. Exc. pp. 15-16 citing R.D., p. 99).

The OCA references the testimony of their witness, Bridenbaugh, to the effect that the NRC requires that cost estimates be periodically updated. The OCA concludes from this that updated cost information will capture the technical and economic uncertainties PP&L is attempting to cover with contingencies.¹⁵ (OCA R. Exc., pp. 14-15 citing OCA M.B., p. 192).

The OCA next challenges PP&L's claim that the Commission has in the past approved decommissioning claims that included a 25% contingency. (OCA R. Exc., p. 15 citing Pa. P.U.C. v. Pennsylvania Power Company, 64 Pa. PUC 308, 85 Pa. PUR4th 323 (1987) and Pa. P.U.C. v. Pennsylvania Power Company, 67 Pa. PUC 91 (1988) in PP&L Exc., p. 41). The OCA notes that in reviewing both the Recommended Decisions and the Commission Orders in those cases, the issue of contingencies is not addressed by the Commission. (OCA R. Exc., p. 15 citing OCA R.B., pp. 83-89).

¹⁴ The OCA has excepted to the ALJ's recommendation to allow PP&L to recover the costs associated with non-radiological decommissioning. (OCA Exc. at 34-36). However, if the Commission allows PP&L to recover non-radiological decommissioning costs, the OCA submits that, consistent with the ALJ's recommendation, both radiological and non-radiological contingency costs should be removed from PP&L's claim. (OCA Exc. at 34-36).

¹⁵ PP&L has indicated that it plans to internally update its cost estimate every two years.

The OCA challenges the Company's claim that, although the Commission has in the past rejected the use of contingency factors in decommissioning cost estimates, contingencies were disallowed largely because the decommissioning costs were based on a generic study rather than the site specific study in this case. (OCA R. Exc., p. 15 citing PP&L Exc., p. 41).

The OCA claims that the Commission has previously removed contingency costs from decommissioning cost estimates because of their speculative and uncertain nature. Pa. P.U.C. v. Pennsylvania Power & Light Company, 57 Pa PUC 559, 606-607 (1983); Pa. P.U.C. v. Pennsylvania Power & Light Company, 59 Pa PUC 332, 384 (1985). In PP&L 1983, the Commission disallowed the 25% contingency factor stating:

The Company has failed, in this case, to demonstrate that the 25% is anything but conjecture on its part. We cannot permit ratepayers to be subject to a contingency factor and which is as likely to fluctuate downwards as upwards as the state of the art develops.

PP&L, 57 Pa. PUC at 607.

The OCA concludes that the concerns the Commission expressed in 1983 regarding the speculative nature of PP&L's contingency factors are still relevant today. (OCA R. Exc., pp. 15-16 citing OCA M.B., pp. 190-193).

The OCA also dismisses PP&L's claim, that precedent supports disallowing contingencies only when they are premised on generic studies, as one that overlooks recent commission decisions in which contingencies were rejected in decommissioning cost estimates based on site-specific studies. The OCA cites a recent Illinois Commerce Commission decision in which the Illinois Commission rejected a 25% contingency factor because the use of a site specific study in fact "reduces the need for

inclusion of a contingency factor". See, Re Commonwealth Edison, 158 PUR4th 458, 505 (Illinois Commerce Commission 1995) ("Commonwealth Edison"). The OCA submits that these considerations are applicable to this case. (OCA R. Exc., pp. 15-16).

The OTS reiterates many of the OCA's claims in this regard. In addition, the OTS supports the ALJ's recommendation. (OTS R. Exc., pp. 21-26).

The OTS disputes the claim that the contingency is a safety factor well accepted by engineering associations. The OTS supports denying the contingency because of its speculative and uncertain nature. (OTS R. Exc., p. 23). The OTS claims that, because contingencies are essentially estimates of what may occur in estimates of decommissioning costs, it is far better to require periodic cost updates based on what has actually occurred in those costs. (OTS R. Exc., pp. 24-26). After rejecting a Massachusetts case as purely speculative in regard to contingencies, the OTS urges the Commission to reject PP&L's contingency factor in decommissioning costs. (OTS R. Exc., p. 26).

After consideration of the positions of the parties, we will disallow the contingency expense and thereby sustain the ALJ's recommendation for an expense reduction of \$2,516,000. (R.D., p. 100). We do so for several reasons.

First, the parties have correctly cited our precedent for the proposition that speculative estimates, based on estimated totals of future costs, are not a preferred method for handling future expenses. In our view, the changes encompassed within PP&L's contingency factor can, as suggested by the OTS, be reflected in periodic cost updates based on what is actually

occurring to these costs. That way, a more certain measure of those costs can be attained.

In addition, PP&L's references to the practices of the FERC and the other jurisdictions overlook the recent Illinois decision that eliminated contingencies even though a site-specific decommissioning study was used in that case. Furthermore, the Sierra Club's concern about cost underestimation can be addressed through the periodic cost updates suggested by the OTS.

Also, we recognize that, in most engineering cost estimation practices, a contingency is a routinely accepted practice. We also recognize that such a consideration may be critical to the nuclear decommissioning process given the potential health and safety risks. However, in this case, unlike many engineering cost scenarios, these contingencies are little more than estimates of what may occur in estimates of decommissioning cost claims. We believe it is far better to approximate those evolving costs with periodic cost updates rather than using a one-time contingency factor.

We see no reason to conclude, for all time, that speculative future costs necessitate a large contingency factor which rests, in itself, on total estimated costs which are themselves far from certain.

2. Post-Shutdown Earnings from Trust.

PP&L excepts to the ALJ's recommendations with regard to inclusion of post-shutdown earnings. (PP&L Exc., pp. 42-44). PP&L excepts to the recommendation that their claim for nuclear decommissioning costs be reduced by \$2.4 million to reflect earnings that purportedly would accrue on decommissioning trust

fund assets subsequent to the actual shutdown of SSES 1 and SSES 2. (PP&L Exc., pp. 42-44 citing R.D., p. 100).

PP&L alleges that this proposal is contrary to the rules of the Nuclear Regulatory Commission which require that a nuclear decommissioning trust be fully funded in the amount necessary to terminate the license at the time of plant shutdown. (PP&L Exc., p. 6, Emphasis supplied).

PP&L calculated an annual decommissioning annuity sufficient to provide all needed decommissioning funds by the time SSES 1 and 2 are shut down at the end of their NRC licensed lives. PP&L notes that OCA's witness Catlin proposed an adjustment to reduce the Company's annual expense claim by treating post-shutdown earnings on trust assets as funds available to meet PP&L's decommissioning commitment. (PP&L Exc., pp. 42-43).

PP&L claims that the central issue here is whether Mr. Catlin's proposal to recognize post-shutdown earnings violates NRC rules. PP&L claims that the OCA's conclusion, that such an earnings approach does not violate NRC rules, is based on a single telephone call to the NRC which PP&L claims is based on a misunderstanding of the NRC rules. PP&L then cites their witness, a nationally-recognized expert on nuclear decommissioning, for the proposition that, because the NRC requires full funding of radiological decommissioning costs as of the time a nuclear unit is shut down, consideration of earnings from an external trust would be in violation of NRC rules. (PP&L Exc., pp. 42-44 citing PP&L St. 13-R, p. 14).

PP&L cites NRC several regulations and policies governing nuclear power plant decommissioning funds. PP&L cites the 10 CFR § 50.75's requirement that licensees provide financial assurance of an amount sufficient to cover the estimated costs of

decommissioning. PP&L claims that one permitted method of providing financial assurance -- and the one chosen by PP&L -- is an external trust fund. (PP&L Exc., p. 43).

With respect to that option, NRC regulations (10 CFR §50.75(e)(1)(ii)) mandate that periodic payments into the fund must be "sufficient to pay decommissioning costs at the time termination of operation is expected" (PP&L Exc., pp. 41-42, Emphasis Supplied). In short, the fund balance must equal the estimated decommissioning costs by the time the plant is shut down. Similarly, in the Statement of Considerations accompanying this regulation, the NRC stated that its objective was to assure that "at the time of permanent end of operations sufficient funds are available to decommission the facility in a manner which protects public health and safety" (emphasis added). 53 Fed. Reg. 24018, 24031 (June 27, 1988). (PP&L Exc., pp. 43-44, Emphasis Supplied).

NRC guidance documents also drive this point home. In particular, Regulatory Guide 1.159, "Assuring the Availability of Funds for Decommissioning Nuclear Reactors" (August 1990), contains the following provisions:

- Section C.1.1.1 states that licensees should have "a viable plan to accumulate funds in the certification amount, adjusted for inflation, by the projected time of permanent cessation of operations" (Emphasis Supplied).
- Section C.2.1.2 states that the "licensee should indicate that the method used [to establish financial assurance] provides, or will provide at the projected cessation of operations, an amount at least equal to the estimated or certified decommissioning cost for the facility" (Emphasis Supplied).
- Section C.2.2.5 states that the "[a]nnual deposits in an external

sinking fund, including projected earnings, should attempt to approximate the total amount remaining to be accumulated, divided by the remaining years of the license, as determined by the initial and updated certification amount" (Emphasis Supplied).

(PP&L Exc., pp. 43-44).

The ALJ recommended adoption of the OCA's proposed adjustment for the following reason:

The money which remains unused during the decommissioning operation will be available to provide some return, contributing some money to the total pot [...] (R.D., p. 100).

Of course, PP&L did not dispute that post-shutdown earnings will accrue in some amount. Rather, as previously discussed, the real issue is whether those earnings can be recognized without violating NRC guidelines. That issue was not addressed by the ALJ except for a single reference suggesting that the NRC's position on this issue was not clear. (R.D., p. 100). In fact, the NRC's regulations and guidance documents could not be clearer that, in their view, such a practice violates NRC rules. (PP&L Exc., pp. 43-45).

PP&L believes the ALJ's confusion may have been caused by a nuance that Mr. Catlin stumbled over. As Mr. LaGuardia pointed out, the NRC has granted case-by-case waivers from the guidelines cited above, but only where a nuclear unit was retired prematurely (PP&L Exc., p. 44 citing Tr. 2075-76, Emphasis Supplied). PP&L could not qualify for such a waiver for SSES and, therefore, it must abide by the NRC's generally applicable requirements. The ALJ's recommendation is inconsistent with those requirements and should be rejected. (PP&L Exc., pp. 44-45).

After examination of the positions of the parties, we shall adopt the ALJ's recommendation. Contrary to PP&L's claim, there is nothing in the cited regulations and policies which strictly prohibit recognition of earnings from PP&L's external trust to partially fund the obligation underwritten by that trust i.e., nuclear decommissioning. In our view, the regulations and policies require a party to demonstrate that they have the financial wherewithal to meet the decommissioning expense. There is nothing in those same regulations which prohibit factoring in earnings from principal on such an external trust as a factor to be used in setting aside the required monies to meet the decommissioning expense. Consequently, we reject PP&L's argument.

3. Non-Radiological Expenses

The fundamental issue here is the cost for dismantling and removing non-radiological structures in conjunction with any nuclear decommissioning. (R.D., p. 82). The OCA's claims generally include the claims of all parties opposed to including non-radiological costs in decommissioning costs. The OCA initially claimed that, because the NRC does not require removal of non-radiological structures (which site PP&L would probably not completely abandon anyway), inclusion of non-radiological costs was inappropriate. (R.D., p. 82). PP&L countered with the claim that such structures, even if not radiological, would probably be unsafe under the Building Officials and Code Administrators ("BOCA") National Building Code and that, even if not unsafe, should be included in decommissioning as part of site restoration and removal. (R.D., p. 82). The Sierra Club, to the extent they would claim that costs are underestimated, would generally support inclusion of those costs in nuclear decommissioning costs.

After considering these claims, the ALJ recommended including the non-radiological costs in decommissioning costs.

(R.D., p. 96). Notwithstanding the uncertainty and speculative nature of these costs, the ALJ recommends inclusion of these costs in order to be approximately right than exactly wrong.

PP&L claims that the OCA was the only party that contested the Company's claim for dismantling and removing non-radiological structures. The ALJ rejected the OCA's proposed disallowance of these costs and the OCA has excepted. (PP&L R. Exc., pp. 15-17).

PP&L notes that precedent strongly supports pre-funding the expense of removing non-radiological structures and rejects the OCA's contention that the Commission should reexamine its position in light of a recent decision involving Commonwealth Edison Company. Commonwealth Edison, 158 PUR4th at 499. In that case, the Illinois Commerce Commission rejected the claim of Commonwealth Edison that the sites of all thirteen of its nuclear units would be returned to "greenfield" status and none of the non-radiological structures would be re-used. (PP&L R. Exc., pp. 15-17).

In contrast to Commonwealth Edison, the site-specific study for SSES did not include any decommissioning costs for non-radiological structures that are reasonably subject to future re-use (PP&L R. Exc., pp. 15-16 citing Tr. 2065 and PP&L Reply Brief, p. 58). PP&L claims their study does not contain the defect that lead to rejection of Commonwealth Edison's claim in Illinois. PP&L further maintains that the OCA is demonstratively incorrect in contending that the SSES study failed to consider possible re-use of non-radiological structures. (PP&L R. Exc., pp. 14-16 citing PP&L Initial Brief, pp. 128-129).

PP&L also contests the OCA's claim that, because non-radiological structures do not pose the same level of health and safety risks as radioactively contaminated facilities, there

is insufficient justification to carve out an exception from the general rule of Penn Sheraton. (PP&L R. Exc., pp. 14-16 citing OCA Exc., p. 34). PP&L claims that the record evidence contradicts that claim and that the Commission has previously approved recovery of non-radiological costs. (PP&L R. Exc., pp. 14-16 citing PP&L Initial Brief, pp. 126-127 and Pa. P.U.C. v. Pennsylvania Power Co., 67 Pa. P.U.C. 91, 140 (1988)).

The OCA challenges PP&L's claims. (OCA Exc., pp. 34-36). The OCA notes that PP&L's nuclear decommissioning expense claim in this case is based on an \$804 million estimate (in 1993 dollars) for costs related to the decommissioning of SESS 1 and SESS 2. PP&L's claimed annual decommissioning expense is \$30.042 million on a total Company basis, \$23.570 million on a Pennsylvania jurisdictional basis. (OCA Exc., pp. 34-36). The OCA proposes to remove \$127.4 million in non-radiological decommissioning costs from this \$804.3 million decommissioning estimate. (OCA Exc., pp. 34-36 citing OCA M.B., pp. 176-188; OCA R.B., pp. 77-81).

The OCA claims that the cost of non-radiological decommissioning should not be included in rates at this time. The OCA reiterates their claim that there are no federal or state regulations requiring the decommissioning of non-radiological structures and that the public safety concerns associated with non-radiological structures do not rise to the same level as those for radiologically contaminated areas. (OCA Exc., pp. 34-36). The OCA challenges the ALJ's determination that the limited nuclear exception of Penn Sheraton is applicable to

non-radiological decommissioning costs.¹⁶ (OCA Exc., pp. 34-36 citing R.D., p. 98).

The OCA then discusses the recent Commonwealth Edison¹⁷ decision to sustain that view. The OCA cited Commonwealth Edison for the proper exclusion of non-radiological decommissioning costs by citing language from that decision on the issue:

The burden is on the Company to prove that it will not re-use old structures. The Company has failed to convince the Commission that nonradioactive structures will not be used in the future. The Commission cannot allow ratepayers to pay for returning facilities to greenfield status when, in fact, some facilities may be re-used.

¹⁶ In 1978, the Commission granted a limited exception to the Penn Sheraton prohibition to allow for recovery of costs associated with radiological decommissioning. See Pa. P.U.C. v. Pennsylvania Electric Company, 51 Pa. PUC 649, 669 (1978); Pa. P.U.C. v. Philadelphia Electric Company, 55 Pa. PUC 78, 95 (1981). Nine years later, in Pa. P.U.C. v. Pennsylvania Power Company, 64 Pa. PUC 308 (1988) ("Penn Power"), the Commission allowed recovery of non-radiological decommissioning costs because of safety concerns related to damage to non-contaminated facilities during the removal of contaminated facilities. See also, Pa. P.U.C. v. Duquesne Light Company, 66 Pa. PUC 518, 679-680 (1988); Pa. P.U.C. v. Pennsylvania Power Company, 67 Pa. PUC 91, 139-140 (1988). (OCA Exc., pp. 34-36).

¹⁷ In Re Commonwealth Edison, 158 PUR4th 458, 499 (Illinois Commerce Commission 1995), the Illinois Commerce Commission denied Commonwealth Edison Company's request for non-radiological decommissioning costs finding that:

The burden is on the Company to prove that it will not re-use old structures. The Company has failed to convince the Commission that nonradioactive structures will not be used in the future. The Commission cannot allow ratepayers to pay for returning facilities to greenfield status when, in fact, some facilities may be re-used.

Id. 158 PUR4th at 499. (OCA Exc., pp. 34-36).

(OCA Exc., pp. 34-36 citing Commonwealth Edison, 158 PUR4th at 499).

The OCA also discusses recent Commission practice in regard to non-radiological decommissioning cost estimates. (OCA Exc., pp. 34-36). The OCA claims that, in 1978, the Commission granted a limited exception to the Penn Sheraton prohibition to allow for recovery of costs associated with radiological decommissioning. See Pa. P.U.C. v. Pennsylvania Electric Company, 51 Pa. PUC 649, 669 (1978); Pa. P.U.C. v. Philadelphia Electric Company, 55 Pa. PUC 78, 95 (1981). The OCA then claims that, nine years later, in Pa. P.U.C. v. Pennsylvania Power Company, 64 Pa. PUC 308 (1988) ("Penn Power"), the Commission allowed recovery of non-radiological decommissioning costs because of safety concerns related to damage to non-contaminated facilities during the removal of contaminated facilities. See also, Pa. P.U. C. v. Duquesne Light Company, 66 Pa. PUC 518, 679-680 (1988); Pa. P.U.C. v. Pennsylvania Power Company, 67 Pa. PUC 91, 139-140 (1988). (OCA Exc., pp. 34-36). The OCA urges the Commission, in light of proposed changes in NRC regulations, to re-evaluate their recent practice and precedent regarding the inclusion of non-radiological decommissioning costs in the decommissioning estimate. (OCA Exc., pp. 34-36).

The OCA also requests that costs related solely to non-radiological decommissioning be removed from the decommissioning cost estimate. (OCA Exc., pp. 34-36 citing OCA M.B., pp. 181-188). The OCA makes a distinction between "cascading non-radiological costs" i.e., non-radiological costs related to radiological costs and "non-cascading non-radiological" costs i.e., non-radiological costs unrelated to radiological costs. The OCA claims that cascading costs may be appropriate for inclusion but that non-cascading costs are not. (OCA Exc., pp. 34-36 citing OCA M.B., pp. 180-182). The OCA criticizes the ALJ's recommendation because of the fact that the

SSES site will still be viable for future electric generation use after radiological decommissioning is complete. (OCA Exc., pp. 34-37).

The OCA concludes that PP&L's cost estimate should be based solely on radiological decommissioning costs and that non-radiological costs must be removed from PP&L's decommissioning claim. (OCA Exc., pp. 34-36). The OCA claims this will result in a reduction of \$3,195,000 on a total Company basis and \$2,506,000 on a Pennsylvania jurisdictional basis.¹⁸ (OCA Exc., p. 36).

After consideration of the positions of the parties, we shall adopt the ALJ's recommendation to include non-radiological costs in PP&L's decommissioning cost estimates. We do so because we believe that non-radiological costs should be included in decommissioning cost estimates even if the components of that cost will vary based on time and experience.

4. Amortization in Lieu of Annuity

The ALJ recommended use of PP&L's annual annuity accrual instead of the amortization put forth by the OTS. (R.D., p. 99). The ALJ did so by rejecting the OTS proposal because it appeared to short-change the fund. (R.D., p. 99).

PP&L notes that the OTS was the only party to disagree with the use of the annuity method to calculate PP&L's nuclear decommissioning expense. The OTS' proposal is premised on the

¹⁸ The OCA submits that should the Commission adopt the ALJ's recommendation to include non-radiological costs in PP&L's decommissioning claim, that the Commission must also remove the contingency associated with these non-radiological costs. The OTS recommendation on contingencies reflects the removal of the contingency component from both radiological and non-radiological cost estimates. OTS M.B. at 46-53.

fact that such a method was approved in PP&L's last rate case and because it avoids the need to make projections of future inflation¹⁹ and trust fund earnings rates. (PP&L R. Exc., pp. 18-19).

PP&L claims that the last rate case determination significantly undercuts the OTS' proposal. That is because, if that approach were taken here, PP&L would be permitted to recover its deficiencies over a one-year period and that would result in a substantially higher result in this case.²⁰ (PP&L R. Exc., p. 18).

PP&L faults the OTS methodology as one which does not require projections of future inflation²¹ or trust fund earnings rates in that it assumes that trust fund earnings will always equal the future escalation in the cost of decommissioning. PP&L views that assumption as unrealistic and contrary to real experience. (PP&L R. Exc., pp. 18-19). As a result, and as noted by the ALJ (R.D., pp. 96 and 98), the OTS' method will "back-end load" expense recovery and, thereby, unfairly burden

¹⁹ Contrary to the OTS' contention (OTS Exc., p. 16), the Commission did not "determine that it is inappropriate to recognize inflation" in Pa. P.U.C. v. Pennsylvania Power Co., 64 Pa. P.U.C. 308, 351 (1987). Rather, in that case, Penn Power did not request an allowance for future inflation.

²⁰The OTS responded to this point by suggesting that a one-year amortization had been employed in PP&L's last case because that was as long as SSES 1 had been in operation at the time and, therefore, represented the period over which the deficiency had occurred and not, as PP&L suggests, an absolute one-year period.

²¹ PP&L claims, however, that the accrual method does, require recognition of prior period inflation not reflected in the decommissioning estimate. PP&L alleges that its nuclear decommissioning cost estimate is stated in 1993 dollars. The trust fund balance used by the OTS' witness is stated as of September 30, 1995 (OTS Ex. 2, Sch. 2, p. 2). At a minimum, the 1993 cost estimate should be escalated to September 1995 and thereby increased by approximately 8%. (See PP&L Exc. and PP&L R. Exc.).

customers in the future with ever-increasing revenue requirements. (PP&L R. Exc., pp. 18-19).

The OTS observes that PP&L's request in this case is based on a site-specific study performed by their witness for decommissioning costs that consist of \$315.5 million for Unit 1 and \$408.4 million for Unit 2 in 1993 dollars. (OTS Exc., p. 13). After factoring in a 4% escalation rate and a 5.5% earnings rate, PP&L now seeks \$12.6 million for Unit 1 and \$17.4 million for Unit 2 or a total increase of \$22.9 million in decommissioning costs. (OTS Exc., p. 13).

The OTS dismisses PP&L's claim, that use of the methodology from the 1985 rate case in this case will result in a substantially higher claim, by noting that PP&L's argument is premised on an assumption that a multi-year accrual should be recovered in one year. In the OTS' view, the 1985 rate case stands for the proposition that an amortized accrual over multiple years is appropriate for a multiple year accrual. Furthermore, in the OTS' view, the 1985 rate case would not permit a multiple year accrual to be amortized over one year. Hence, the OTS urges the Commission to reject PP&L's method and eliminate the inflation factor in favor of a methodology employed in previous cases. (OTS Exc., p. 13).

The OTS challenges PP&L's misrepresentation of an appropriate allowance for recovery of the decommissioning expense of the life of the property since, contrary to PP&L's claim, OTS rejects recovery of prior accruals from an 11 to 12 year period in one year. (OTS Exc., pp. 14-15). The OTS also opposes the ALJ's refusal to eliminate the inflation factor because that approach is contrary to precedent and because the resulting additional earnings should be offset against cost increases. (OTS Exc., pp. 15-17).

Consequently, the OTS concludes that the proper approach is to allow for recovery of prior accruals over the life of the plant and to remove the inflation factor from PP&L's decommissioning expense claim. (OTS Exc., p. 17). This, in OTS' view, would result in a \$18,297,000 decommissioning expense, as opposed to \$30,042,000, which, in Pennsylvania, would translate into a \$8,581,000 adjustment and a \$9,040,000 revenue requirement. (OTS Exc., p. 17, n. 8).

After examination of the parties' position, we affirm the ALJ's recommendation that the decommissioning expense be recovered using PP&L's annual annuity accrual method. (R.D. p. 99; PP&L M.B., p. 124). We do so here for several reasons.

First, the use of the OTS' truncated amortization recovery period, unlike PP&L's annual annuity accrual method, would result in significant cost increases if either a one year period, consistent with the approach taken in the 1985 rate case, or a multiple year period approach were taken. In addition, PP&L's approach reasonably tries to mitigate "back-end load" expense recovery that could unfairly burden customers in the future with ever-increasing revenue requirements for decommissioning prior plants. Finally, we share PP&L's fundamental concern that cost escalation is a significant consideration, which PP&L accounts for in its inflation estimate, precisely because future earnings may not necessarily keep pace with the general inflation rate or, even more importantly, industry-specific decommissioning costs. Taken in toto, we conclude that affirming the ALJ's recommendation is in the public interest in this case.

5. Nuclear Trust Fund Earnings Rate.

The last issue concerns the appropriate earnings rate

imputed to the nuclear decommissioning trust created by virtue of this Opinion and Order. (R.D., pp. 81-107).

PP&L proposes a four percent (4%) annual escalation of cost offset by estimated earnings of five and one-half (5 1/2%) percent to derive a sum of money PP&L must accrue by the time the Susquehanna plants are retired. (R.D., pp. 81-82). PP&L claims that their trust fund earnings estimate is premised on an interrelationship between its proposed earnings rate on trust fund assets and the projected cost of decommissioning the nuclear plants. PP&L also claims that their 5.5 percent trust fund earnings rate represents its attempt to make sure that sufficient funds are available to decommission the plants, at retirement, using a cautious and conservative investment strategy. PP&L bases this approach on the fact that funds will be needed over a relatively brief period of time, when decommissioning occurs, and that the funds must be adequate. (R.D., pp. 83-84, 94). PP&L disagrees with the OCA's proposal of a 7.5 percent trust fund earnings rate as a consequence of the OCA's investment strategy which assumes an eight percent return on bonds and 12 percent on equities. PP&L claims that the ratios and returns will evolve over time. (R.D., pp. 81-106).

The OCA presses for an earnings rate of 7.5 percent on the funds set aside to meet the total decommissioning cost estimate of \$804 million. (R.D., p. 86). The OCA notes that it will take 10 to 12 years to decommission the units, that interest will accrue on those funds in the interim and during decommissioning, and that PP&L's proposal is not overly aggressive. (R.D., pp. 86-87). In particular, the OCA counters PP&L's claims concerning an investment strategy by noting the conservative 30% equity premise in the OCA's earnings analysis. (R.D., p. 90).

The OTS would support a 5.5 percent earnings figure but, unlike PP&L, the OTS would also begin with a lower \$18 million allowance (as opposed to PP&L's \$30 million allowance) by factoring out contingencies. (R.D., pp. 84-85). The OTS prefers to use the Commission methodology used in the last PP&L rate case proceeding. (R.D., p. 85).

PPLICA states that the 5.5 percent figure is well below the return the Company claims on its own rate base. PPLICA would increase the estimate. PPLICA suggests a rate of return equal to that requested by the Company, 10.23 percent. (R.D., pp. 90-91). The DOD and Mr. Epstein briefly discuss the issues generically without proposing a specific trust fund earnings rate. (R.D., pp. 90-106).

The ALJ, based on the earlier recommendation on eliminating the contingency factor, recommended a cautious approach to the earnings estimate. While noting that PP&L might well do better than their proposed 5.5 percent earnings rate, the ALJ went on to recommend retention of PP&L's reasonable, if conservative, 5.5 percent proposal. (R.D., pp. 99-100).

PP&L dismisses the parties challenges to the recommendation. (PP&L R. Exc., p. 17). PP&L claims that the OCA's and PPLICA's proposals to increase the earnings rate above 5.5 percent are not sustainable because it is inappropriate to equate the earnings rate on a trust fund with claimed returns on equity. (PP&L R. Exc., p. 17). PP&L further claims that the OCA and PPLICA ignore the complex interrelationship between the inflation and earnings rates in the annuity calculation. (PP&L R. Exc., p. 17).

The OCA contests the ALJ's recommendation for a 5.5 percent earnings rate on the trust fund. (OCA Exc., pp. 36-37). The OCA explains that PP&L will be placing the decommissioning

funds collected from ratepayers into an external Nuclear Decommissioning Trust Fund. This Fund will then generate earnings which will be incorporated into the fund. The OCA reiterates their claim that PP&L's estimate of trust fund earnings is too low, particularly in light of PP&L's request to utilize a prudent person standard for fund investment as a result of a change in federal law. (OCA Exc., pp. 36-37 citing OCA M.B., pp. 169-176; OCA R.B., pp. 85-86). The OCA further claims that use of PP&L's "conservative" estimate is inappropriate -- especially in light of the additional recommendation to remove the "black lung" restrictions on investments. The OCA further claims that allowing PP&L to understate the return on the Trust Fund results in a significant increase in the decommissioning revenue requirements sought from ratepayers in this case. (OCA Exc., pp. 36-37 citing OCA M.B., pp. 169-176).

PPLICA supports an increase in trust fund earnings rates for several reasons. (PPLICA Exc., pp. 30-32). PPLICA claims that PP&L should be required to manage their trust fund investments, at levels comparable to those approaches taken to manage their own rate base investments. From an investor's perspective, PPLICA claims that the ratepayers are essentially providing advance funding for this known expense and that, as advance investors of these funds, they are entitled to a return on their investment similar to that which PP&L proposes for PP&L's investments. PPLICA, unlike the OCA, proposes an even higher rate of 9.26% based on the fact that this figure is the rate of return recommended by the ALJ for PP&L's own investment. (PPLICA Exc., pp. 30-32).

After due consideration of the positions, we determine that the 7.5% figure proposed by the OCA is an appropriate earnings rate for the decommissioning trust fund that will be funded as a result of today's decision. We do so for several reasons. First, we agree with the parties that this known

expense also contains components whose exact costs may not exactly be established at this time. Consequently, the holder of the funds expected to meet this known and measurable, but not precisely quantifiable, expense should be encouraged to exercise their market sophistication in order to generate an adequate return to meet this expense. By holding PP&L to 7.5%, we underscore the importance attached to generating returns adequate to help meet this obligation. This figure also strikes a balance between the higher 9.26% proposed by PPLICA and the overly cautious 5.5 percent rate proposed by PP&L. Furthermore, we have also approved removal of the black lung restrictions even as we hold PP&L to ERISA standards. This additional flexibility will provide PP&L with more opportunities to meet this 7.5% rate notwithstanding our approval of the ALJ's recommendation that PP&L be held to ERISA standards on these funds.

N. Fossil Decommissioning Expense

PP&L proposes to establish an annuity, similar to the one used for nuclear decommissioning, to recover the cost of dismantling and demolishing its fossil-fired generating plants, following their retirement from service. (R.D., p. 100). This would include 14 units in service and two units that are now deactivated. (R.D., pp. 100). The jurisdictional expense claim would be \$45 million and payments to a fossil decommissioning trust are not deductible for federal income tax purposes. (R.D., pp. 100-101).

PP&L's estimate was developed by Mr. LaGuardia. PP&L concedes this approach represents a departure from the conventional method of de-commissioning non-nuclear units. Absent Commission approval of the proposal, the costs would continue to be recoverable as a form of net negative salvage. (R.D., pp. 100-102).

PP&L reviews the background behind net negative salvage. This would involve a recovery of cost over five years, after it has been incurred. PP&L states that this method is adequate for relatively small costs but states that, for large units and large amounts of cost, this method would result in an inequitable distribution of cost among different generations of customers. (R.D., pp. 100-102).

PP&L concedes that their approach may result in a rate spike but suggests that this concern must be balanced against mounting public health and safety concerns for fossil plants, as well as problems with the BOCA code. PP&L believes this newer method ensures that public health and safety risks are adequately addressed upon retirement of the plant. (R.D., pp. 100-102).

PP&L's balances Commission precedent in that regard, however, against the impact on future customers. PP&L addresses the net negative salvage method and earnings rate allowance position of the other parties by noting the health and safety problems with fossil plants and, furthermore, the intergenerational problem of burdening future customers with decommissioning plants serving today's customers. PP&L prefers to have those customers using a plant pay for that plant's decommissioning as the needed power is produced for their use. PP&L also claims that there will be larger expenditures for decommissioning than are currently anticipated. PP&L further claims that numerous ratemaking allowances are based on long-term assumptions. (R.D., pp. 100-102).

For example, PP&L states that the cost of decommissioning two of PP&L's large coal-fired plants is estimated to be \$698 million. With net negative salvage, they would recover this at up to \$140 million per year over five years. PP&L would, under this proposal, recover this amount in annual installments of approximately \$18 million over the

remaining lives of the plants. (R.D., p. 106). PP&L urges the Commission to develop an appropriate regulatory response that addresses the underlying obligation instead of pretending it does not exist. (R.D., pp. 100-102).

OTS supports net negative salvage precedent and explains how it works. The OTS refers to PP&L testimony relating to dismantling of 16 fossil fuel generating units at five different locations. The OTS then reviews technology assumptions, the earnings rate (5.5 percent) and the inflation factor (4 percent). The OTS clearly recognizes that PP&L is seeking to depart from the Commission's traditional treatment of salvage, by providing for prospective negative salvage of non-nuclear generating plants, by expanding the Penn Sheraton precedent. The OTS reminds the Commission of the speculative nature of decommissioning cost estimates. The OTS also refers to the testimony of its witness, Mr. Sivulich. The OTS argues that the record in this proceeding demonstrates that PP&L's claim is filled with uncertainty, that retirement dates are uncertain, that fossil plants do not have the special circumstances of nuclear plants, and that the traditional approach should be used because it avoids customer payments for uncertain costs that are not actually incurred. (R.D., pp. 102-103).

The OCA also addresses this proposal. The OCA notes that this proposal is similar to the accepted method for nuclear decommissioning expense. The OCA views the Company's claim as nothing more than prospective net negative salvage. The OCA urges the Commission to deny that request consistent with Penn Sheraton. (R.D., pp. 103-104).

PPLICA dismisses the proposal as one that unjustifiably inflates the revenue requirement. PPLICA considers the claim little more than prospective negative net salvage. PPLICA urges

the Commission to reject the proposal under Penn Sheraton. (R.D., pp. 104-105).

The ALJ noted that there is an element of speculation built into PP&L's proposal. The ALJ also noted that, while PP&L's approach improves upon the present practice, the precedent reflected in Penn Sheraton and other cases mitigates against adopting it here. The ALJ urged the Commission to give the matter a long look. (R.D., pp. 106-107). The ALJ recommended against departing from precedent. The ALJ accepted the parties' proposed adjustment which eliminated the jurisdictional claim of \$45,284,000 without reaching the return rate of 5.5 percent. (R.D., p. 107).

PP&L excepts to the ALJ's recommendation. (PP&L Exc., pp. 44-46). PP&L proposes to establish an annuity, similar to the one used to fund nuclear decommissioning expense, for recovery of the cost of dismantling and demolishing its fossil-fired generating plants following their retirement from service.²² The Company's proposal would provide for the recovery of decommissioning costs over the remaining operating lives of its fossil plants. The Company proposed this so that customers actually receiving service from those plants would bear the attendant decommissioning expense. PP&L claims that rejection of their proposal will defer decommissioning costs until after the plants are retired. At that point, those costs would be recovered as a component of net negative salvage by means of a five-year amortization. (PP&L Exc., pp. 44-46 citing PP&L Initial Brief, pp. 147-148).

²² Like its nuclear decommissioning expense claim, the Company's fossil decommissioning cost estimate was based on site-specific studies prepared by Mr. LaGuardia (PP&L Initial Brief, p. 147).

PP&L objects to the ALJ's refusal to adopt its proposal because the ALJ felt "constrained" to follow the Commission's decision in Pa. P.U.C. v. West Penn Power Co., Docket No. R-00942986 (December 29, 1994) (PP&L Exc., pp. 44-46 citing R.D., p. 106). PP&L urges the Commission to also note the observation that PP&L's proposal has merit.

PP&L acknowledges that net negative salvage will be a source of funding but stresses the customer impact and inter-generational equity issues. It states that the cost of decommissioning two of PP&L's large coal-fired plants is estimated to be \$698 million. With net negative salvage, they would recover this at up to \$140 million per year over five years. It would, under its proposal, recover this amount in annual installments of approximately \$18 million over the remaining lives of the plants.

I strongly sympathize with PP&L's proposal. There is an element of speculation built into this depreciation method of recovering decommissioning costs but, to my view, the PP&L approach improves upon the present practice. However, I am not so supportive of the PP&L approach as to disregard precedent.

* * *

Adherence to precedent will have a significant (and, I feel, adverse) impact on the "inter-generational" problem. I would rather see an orderly provision for decommissioning cost and again suggest that it is better to be approximately correct than precisely wrong. . . .

I suggest that the Commission give this matter a hard look and entertain some thought of movement away from the Penn Sheraton precedent. (Emphasis added.)

PP&L does not believe the Commission should endorse the ALJ's rejection of its proposal. PP&L proposes use of an annuity for fossil decommissioning costs to promote inter-generational equity, as the ALJ concluded, but also to ensure that public

health and safety risks are adequately addressed upon the retirement of these plants. (PP&L Exc., pp. 44-46).

PP&L reiterates their belief that there are significant health and safety concerns associated with the hazardous materials and chemicals present in fossil-fired generating plants.²³ The hazardous nature of the work required to dismantle those plants, and the risks to the public of not performing that work properly, clearly justify extending to fossil plant decommissioning the same "health and safety" exception to Penn Sheraton²⁴ permitted for nuclear facilities. PP&L does not view Penn Sheraton as a legal bar to their claim. PP&L concludes that their proposal to pre-fund fossil decommissioning costs should be granted. (PP&L Exc., pp. 44-46).

Both the OTS and the OCA support the ALJ's recommendation. The ALJ, in accordance with controlling precedent, recommended that PP&L's fossil decommissioning expense claim be denied. The OCA believes that the ALJ properly made his recommendation because he was "concerned about the speculative nature of the PP&L approach." Moreover, the Company's claim is

²³ As Mr. LaGuardia explained, virtually all older fossil-fueled plants are loaded with asbestos, lead-painted surfaces, acids and caustics. All work in abating and removing these materials is extremely hazardous. Federal and State regulations pertaining to the safety of workers exposed to such materials and dealing with the removal, transportation and disposal of those substances are rigorous, complex and costly. (PP&L Initial Brief, pp. 152-152).

²⁴ Penn Sheraton Hotel Co. v. Pa. P.U.C., 198 Pa. Super. 618, 184 A.2d 324 (1962), is typically cited for the proposition that current recovery of prospective net negative salvage is not permitted. However, a notable exception has been recognized to permit the accrual of decommissioning costs for nuclear generating facilities because the significant health and safety risks associated with the closure of nuclear facilities justifies pre-funding such expenses. See Pa. P.U.C. v. West Penn Power Co., 54 Pa. P.U.C. 602 (1980).

prohibited by appellate law and agency precedent. (OCA R. Exc., pp. 17-19).

The OCA supports the ALJ's conformance with precedent. The OCA submits that it is the "speculative nature" involved with all prospective net salvage claims that makes them problematic. In Penn Sheraton Hotel et al. v. Pa. P.U.C., the Superior Court, in discussing prospective net salvage, stated: "[I]t is a cost which has not yet been incurred; [and] it is uncertain when and if it will be incurred. . . ." 198 Pa.Super. 618, 623-627, 184 A.2d 324, 327-329 (1962) ("Penn Sheraton").

Similarly, in Pa. P.U.C. v. West Penn Power Company, the Commission denied the Company's second attempt to make a prospective net negative salvage claim and stated that the Company's approach, "would substitute an uncertain and speculative claim in place of the current cost approach." Docket No. R-942986, p. 62, 64 (December 28, 1994). As in Penn Sheraton and the West Penn cases, PP&L's claim is one for prospective net salvage which may be incurred when the plant is taken out of service at some future point. (OCA R. Exc., pp. 17-19).

The OCA disputes the Company's concerns for health and safety. The OCA notes that the Commission has decided twice before that the unique "health and safety problems" associated with nuclear decommissioning are not present in fossil fuel decommissioning. Pa. P.U.C. v. West Penn Power Co., 54 Pa. PUC 602, 630 (1981); Pa. P.U.C. v. West Penn Power Co., Docket No. R-942986 (December 28, 1994). The OCA rejects the Company's claim that the hazardous nature of the work required to dismantle fossil-fueled plants justifies extending the "health and safety" exception permitted for nuclear facilities to fossil plant decommissioning. (OCA R. Exc., pp. 17-19). The OCA concludes that PP&L has not presented any new reasons for the Commission to abandon precedent.

The OTS also urges rejection of PP&L's position. (OTS R. Exc., pp. 26-33). The OTS urges the Commission to follow the Penn Sheraton and West Penn precedent clearly supporting use of net negative salvage for fossil plant decommissioning costs.

The OTS also dismisses PP&L's intergenerational claim by noting that today's customers are undoubtedly paying for prior plant they did not benefit from and that this can reasonably be expected to continue into the future. This is especially true given PP&L's questionable use of "past" and "present" and "future" customers when many customers have been, or will be, customers so long that they fall into all these categories. (OTS R. Exc., pp. 26-33).

The OTS next dismisses the Company's reliance on public health and safety by noting that the special circumstances of nuclear plants are not present here, that the health and safety considerations governing fossil plants are more generic, and that the precedent of Penn Sheraton rejects "speculative" costs in favor of net negative salvage. The OTS also notes that the costs for fossil units can be recovered on an after-the-fact basis so the hard look recommended here warrants rejection of PP&L's proposal for prospective net negative salvage value. (OTS R. Exc., pp. 26-33).

After consideration of the positions of the parties, we shall adopt the ALJ's recommendation. We believe that continued adherence to the Penn Sheraton precedent, notwithstanding the Company's arguments concerning impending expenses associated with fossil fuel plants, is appropriate. We also believe that avoidance of approaches other than net negative salvage for fossil plant costs warrants rejection of PP&L's proposal based on today's circumstances. We also believe the intergenerational problem is addressed by the fact that many customers currently bear the costs of prior retirements in the same way that future

customers, many of whom are current customers, can be expected to bear the costs for units retired in the past. We do not believe the health and safety considerations governing nuclear plants are so identical to those for fossil plants that the same costing methodology is appropriate at this time. Consequently, we consider PP&L's claim closer to prospective net negative salvage, under today's circumstances, and for that reason we reject the proposal.

O. Depreciation Expense

PP&L proposes three major revisions to its depreciation practices. Each was challenged at hearing. PP&L claims an annual depreciation and amortization expense allowance of \$320,797,000 based on calculations performed by its witness Mr. Hoch. (R.D., pp. 107-108). PP&L proposes "levelizing", with respect to the modified sinking fund (MSF) depreciation expense for pre-1989 vintage Susquehanna property. It characterizes this proposal as a modification only of timing, not of the amount, of the depreciation to be charged during an approximately three year period. PP&L also proposes adoption of amortization accounting for certain general property accounts, which consist of numerous small value items. These are discussed in more detail below.

P. Susquehanna Depreciation

PP&L first states that its present modified sinking fund method was used in the two Susquehanna proceedings as a means of moderating rate increases associated with putting those plants into rate base. Under the existing approach, the depreciation expense begins well below the straight-line amount and increases each year until the end of 1998 when (1) annual MSF depreciation expense will substantially exceed the straight-line amount and (2) total accrued depreciation on pre-1989 investment will equal the amount that would have accrued if straight-line

depreciation had been used since Susquehanna 1 and Susquehanna 2 were first placed into service. (R.D., p. 109).

PP&L states that it is requesting permission to set depreciation expense for pre-1989 Susquehanna investment at a levelized annual total company amount of approximately \$173 million. This proposal is calculated to recover the same amount of depreciation that would have been recovered by the MSF method from September 30, 1995 to December 31, 1998. At January 1, 1999, there would be a switch to straight-line depreciation and the annual expense would fall to \$102 million. (R.D., pp. 109-110).

PP&L agrees to automatically adjust retail rates as of January 1, 1999, to reflect this switch. PP&L states that this proposal will result in a more equitable distribution of depreciation expense during the remaining MSF period. It stresses that only the timing is changed from the existing plan. PP&L suggests that this method will smooth the transition from MSF to straight-line depreciation and avoid more rate filings. (R.D., pp. 109-110).

The OTS discussion of Susquehanna depreciation refers to the MSF method. The OTS states that this proposal would result in a higher level of depreciation expense for this rate proceeding and that denial of that approach will result in a lower revenue requirements for PP&L customers in this case. (R.D., p. 110).

The OTS indicates that PP&L would not have to file annual proceedings to collect the amounts contemplated. OTS also indicates that PP&L would not normally file a rate case based solely on the need to change its depreciation rates. OTS would deny the PP&L proposal. The OTS further states that PP&L's proposal should be denied because it might distort the

depreciation-rate base relationship and thereby lead to annual rate filings with the constant recovery of capital. (R.D., pp. 110-112).

The OCA claims that it is inappropriate to consider the effect of future investment in Susquehanna, in the present depreciation analysis. The OCA points to the \$30 million difference involved in the PP&L proposal and views the proposal as a distortion of the relationship between depreciation accruals and rate base. The OCA would deny the change. (R.D., pp. 112-113).

PPLICA also opposes the change. PPLICA refers to the \$30.6 million annual change and claims that the proposal reaches beyond the test year, that it does not include the offsetting carrying charge benefit, that concerns about recovery problems are speculative, and that the original MSF proposal was intended to match economic benefits of the plant, over its life cycle, to the ratepayers.

PPLICA states that PP&L should not now be entitled to modify its MSF treatment of the Susquehanna plants, thereby increasing the revenue requirement for ratepayers in this case. It refers to a need for a reduction of the revenue requirement by \$19.927 million. (R.D., pp. 112-113).

PPLICA stresses the linkage between return on investment and depreciation. It would view the later straight-line depreciation as irrelevant to this discussion. It views the PP&L change as improper. It states that PP&L chose the MSF method and indicates that it should stay with it, as originally projected. PPLICA views the proposal as one of improper acceleration and premature collection of depreciation. (R.D., pp. 112-113). DOD supports the other parties. (R.D., pp. 113).

The ALJ noted that the reasons for use of MSF were related to the circumstances of the Susquehanna plants and, notwithstanding, recommended movement toward the more traditional straight-line depreciation method. (R.D., pp. 114-115).

PP&L claims that they only seek to "levelize" the Modified Sinking Fund ("MSF") depreciation²⁵ expense, related to pre-1989 vintage SSES property, that will accrue between September 30, 1995 (the effective date of rates in this case) and December 31, 1998, when SSES depreciation will switch from MSF to straight-line. PP&L's proposal only modifies the timing, not the amount, of the depreciation to be charged during that approximate three-year period. PP&L's proposal provides a fairer and more gradual transition from MSF to the straight-line method.²⁶ (PP&L R. Exc., pp. 12-14). PP&L claims that a levelized depreciation amount of \$173 million for pre-1989 Susquehanna investment, and at January 1, 1999, the method would switch to straight-line and

²⁵ As PP&L explained earlier, they believe that MSF depreciation was approved in PP&L's last two rate cases to moderate the rate increases for SSES 1 and 2. The Commission mandate for use of a modified MSF method resulted in annual depreciation expenses that began well below the straight-line amount and would increase each year until December 31, 1998. At that time, annual MSF depreciation expense would substantially exceed the straight-line amount and total accrued depreciation on pre-1989 investment would equal the amount that would have accrued under the straight-line method.

²⁶ As explained in PP&L's Initial Brief (pp. 160-161), the Company's proposal will provide a more equitable distribution of depreciation expense during the remaining period that the MSF method is in effect because depreciation expense will be charged in equal annual installments. This equal distribution of expense replicates the straight-line method, which is universally accepted as a fair and reasonable method of capital recovery. The Company's proposal also will smooth the transition from MSF to straight-line depreciation. Without levelization, annual accruals would increase to \$194 million on a total Company basis in 1998, before dropping to approximately \$102 million in 1999 -- a one-year change of \$92 million (PP&L Ex. DSH-4).

the annual expense would fall to \$102 million. (PP&L R. Exc., pp. 12-14).

The OCA notes that the Company's proposal increases the Company's claimed depreciation expense by \$22,864,760 on a Pennsylvania jurisdictional basis. The OCA opposes the recommendation that PP&L be permitted to move to the straight-line method instead of the modified sinking fund method. (OCA Exc., pp. 37-39).

The OCA submits that the ALJ erred in adopting this claim. The Company has failed to justify its proposed change in methodology that will increase expense by over \$22.8 million. The OCA claims that the Company's proposal to change from the modified sinking fund method to a straight-line method is flawed in that it distorts the relationship between depreciation accruals and rate base, and results in the Company securing a larger recover from ratepayers than would otherwise be the case. The OCA cites witness Johnson to support their claim:

The major objection I have to the Company's proposal is that it only levelizes one aspect of capital recovery--the depreciation accrual--and does not levelize the other aspect of capital recovery--return on capital invested.

In normal ratemaking practice, there is a connection between depreciation accruals and rate base through the mechanism of providing a return on rate base (i.e., on adjusted net plant), which is gross plant less accumulated depreciation. The greater the accumulated depreciation over time, the lower the rate base and its return. This relationship is time dependent. . .[E]very time a rate case is filed, the amount of test year rate base is dependent on the depreciation accrued up to that time. A significant change in the size of the depreciation accrual would distort that relationship, at least for a period of time after the change.

(OCA Exc., pp. 37-39 citing OCA St. 5, pp. 5-6).

Thus, what PP&L has proposed is that its depreciation accrual be levelized at a higher rate, but it has failed to recognize the reduced return requirements on its rate base that will result from this accelerated depreciation. The OCA is concerned that the reduced return requirement can be significant, ranging from \$19 million to \$54 million per year. By contrast, if the Company remained with the modified sinking fund approach, the recovery of capital would be fairly constant. Dr. Johnson explained:

The increase in annual depreciation accrual from one year to the next never exceeds \$20 million. Moreover, because net plant is declining each year, this \$20 million is largely offset by reduction in return on investment that is required. . .

Note that the total recovery of capital would be relatively constant under the modified sinking fund. The increase in the depreciation accruals is almost exactly offset by the decrease in return on rate base. That is exactly what the MSF is calculated to do.

(OCA Exc., pp. 37-39 citing OCA St. 5, pp. 4-5).

The OCA claims that continuation of the MSF method represents a fair balance of ratepayer and shareholder interests. This is especially true, in OCA's view, because PP&L has not justified a levelization proposal that increases depreciation expense by \$22.8 million and results in overrecovery. OCA urges the Commission to reject the recommendation. (OCA Exc., pp. 37-39).

The OTS fundamentally opposes a change to straight line method depreciation for the three year period because it will result in a higher level of depreciation in this case. (OTS

Exc., pp. 18-21). The OTS notes PP&L's admission that continuation of MSF in this case will not act to prevent recovery of the depreciation expense although, if MSF is continued, it will act to reduce the revenue requirement in this case. (OTS Exc., p. 19).

PPLICA, for its part, also claims the ALJ erred in approving PP&L's proposal to modify their sinking fund depreciation method. (PPLICA Exc., pp. 27-29). PPLICA claims that the Company wrongfully attempts to reach beyond the test year to secure a cost increase without any offsetting cost reductions or revenue increases, that the proposal fails to include any charge benefit to levelize the effect of the increase, and that the Company will over-recover when their SSES depreciation expenses are reduced to straight-line in January 1999. (PPLICA Exc., p. 28). Finally, PPLICA claims that modification of the MSF method for straight-line erodes the rate stability sought by the Commission when they approved use of MSF in the prior proceeding. (PPLICA Exc., p. 29).

After due consideration of the positions of the parties, we shall affirm the ALJ's recommendation. While we note that the basis for use of MSF was to reduce the impact of SESS related-expenses, this is a three year period which, while it does adjust the timing of the depreciation, will not adjust the amount of the depreciation. This proposal attempts to migrate PP&L's depreciation approach away from the novel use of MSF toward the more traditional straight-line depreciation method.

The opposition's main point is that the modified MSF method should continue in its present form simply because it provides a lower revenue requirement in this case. The fact that MSF will realize an annual depreciation expense well above the levelized amount by 1998, before abruptly falling to the straight-line level on January 1, 1999, is simply ignored by the

parties. We believe that PP&L makes a convincing argument that, without filing an annual rate case between September 30, 1995 and December 31, 1998, acceptance of MSF would result in PP&L running the risk of a substantial underrecovery. By accepting the ALJ's recommendation on this point, we avoid that problem and conserve resources that could have been devoted to annual rate cases for more productive purposes.

Q. Fossil Plant Depreciation

PP&L's proposal concerns projected plant life which, in turn, will impact depreciation rates. PP&L states that their depreciation claims for Sunbury, Martins Creek 1 and 2 and Holtwood reflect a deactivation date of 2003. This results in life spans that are, respectively, 6, 12 and 7 years shorter than those being now used to depreciate these units. PP&L points out that the proposed life spans are actually somewhat longer than those approved in the Company's last rate proceeding. PP&L states that, in the last case, the deactivation dates used to calculate depreciation expense claims were 1994 for Holtwood, 1995 for Martins Creek 1 and 2 and 2000 for Sunbury. (R.D., pp. 115-126).

PP&L claims that, in conjunction with other changes, the Commission approved PP&L's proposed extension of the depreciable lives of these older fossil-fired units to reflect deactivation dates of 2009 for Holtwood, 2015 for Martins Creek 1 and 2 and 2010 for Sunbury. The Company adds that, when these changes were made in 1988, it could not have foreseen the substantial cost that would be required to comply with the 1990 Clean Air Act Amendments (CAAA). It states that these costs dramatically alter the economics of life extension for the older fossil-fired units. It further states that the projected CAAA compliance costs would almost double the depreciated original

cost of these units, as shown by a PP&L witness. (R.D., pp. 115-126).

PP&L argues that 2003 is a watershed year because, by that time, it will have to achieve final compliance with stringent nitrogen oxide limitations imposed under Title I of the CAAA and expects to make significant reductions in emissions of "air toxics" as mandated by Title III of the CAAA. PP&L argues that, by the year 2003, it must either have deactivated these older plants or have made significant investments to achieve environmental compliance. It states that operation of these plants beyond 2003 is highly uncertain because of the various factors. (R.D., pp. 115-126).

PP&L states that the new dates and the new depreciation calculations are justified because of the uncertainty that these plants will run beyond 2003. PP&L adds that this change is consistent with the concept of having current customers bear prudent costs incurred on their behalf. PP&L suggests that the lack of a change now will result in recovery of these funds from future customers, after deactivation of the plants. (R.D., pp. 115-126).

The OTS reviews the revisions made to the expected lives of the plants. The OTS takes the position that these reductions in life expectancy projections are clearly improper. The OTS suggests that the changes were made only to generate a higher revenue requirement in this case. The OTS points out that there are no management plans to retire these units early. The OTS is also concerned that PP&L is not appropriately planning for the future in regard to its utility plant, indications that 2003 retirements are not really expected, and an apparent management plans to run these plants as long as they are viable. (R.D., pp. 115-126).

The OCA claims that these adjustments are not supported by the record in this proceeding. The OCA claims that the currently existing deactivation dates should be used for the depreciation expense in this proceeding. The OCA believes that circumstances have not changed and refers to witness testimony to make that claim. The OCA notes that PP&L does not plan to retire these units until 2013 and alleges that PP&L has failed to provide any sound engineering or economic analysis supporting their changes. (R.D., pp. 115-126)

The PPLICA refers to testimony of PP&L witnesses and argues that PP&L has no plan to retire any steam electric system during the next 20 years. PPLICA views the burden of proof as a major problem for PP&L and one which PP&L has failed to meet. PPLICA claims that PP&L has not committed to the earlier retirement indicated in its depreciation analysis. DOD notes that PP&L had no immediate plans to retire these valuable power plants. DOD then refers to the testimony of its own witness. (R.D., pp. 115-126).

The ALJ concluded that denial of PP&L's claim was appropriate, in part, because PP&L lacked any plan to alter the lifeline of the plants in question -- notwithstanding the potential impacts of the Clean Air Act Amendments and changes in the field which might, but has yet to, result in an altered retirement date. (R.D., pp. 125-126).

PP&L excepts to rejection of their proposed depreciable lives for these older fossil-fired generating units. PP&L claims that their depreciation expense claim properly reflects the significant uncertainties regarding the prospective operational and economic viability of the units in question and is in full accord with the Commission's prior refusal to recognize the possibility of life-extension until the necessary investment to extend lives has been made. (PP&L Exc., pp. 32-39).

The OCA supports the ALJ's rejection of PP&L's proposal to accelerate depreciation for several of its generating units. The OCA claims that acceptance of this claim that would have increased the Company's depreciation expense by approximately \$15 million on a Pennsylvania jurisdictional basis. The OCA further claims that no evidence exists that the Company actually intends to retire these units in the year 2003, the year used for accelerated depreciation. (OCA R. Exc., pp. 12-14 citing Tr. 188-189 and OCA M.B., p. 133). PP&L just wants to "reflect the possibility that they would be retired earlier in the depreciation schedule." (OCA R. Exc., pp. 12-14 citing OCA M.B. at 132). PP&L witness Krall further testified that the only place in which the Company memorialized its decision to advance the deactivation dates of these units was his testimony. (OCA R. Exc., pp. 12-14 citing OCA M.B., p. 134).

The OCA further claims that no study documents the Company's conclusion. The OCA submits that the Company should not be permitted to advance the deactivation dates for ratemaking depreciation purposes. The OCA also rejects the PP&L assertion that the "projected" costs for compliance with the Clean Air Act Amendments ("CAAA") "has dramatically altered the economics" of these plants remaining operative, (PP&L Exc. at 33) and that it has "prepared detailed analyses of the economic feasibility" of these units related to compliance with CAAA. (OCA R. Exc., pp. 12-13).

The OCA points to the testimony of PP&L witness Krall that PP&L's requirements for compliance with CAAA are not yet known. (OCA R. Exc., pp. 12-13 citing OCA M.B. at 137). The ALJ aptly recognized this when he stated that "we cannot now know the exact investment required for these plants. . . ." (R.D. at 124) and it was this "uncertainty" that caused him to reject the Company's argument. The OCA further claims that the Company has failed to provide any engineering or economic analysis as support

for its decision to accelerate the depreciation of these units. (OCA R. Exc. at 13 citing OCA M.B., pp. 134-139). The only analysis for this proposed change PP&L offered, what PP&L asserts as "detailed analyses," was one and a quarter pages of text given in response to an interrogatory that requested all studies relied upon to revise the deactivation dates. In contrast, both the Company's 1994 Five Year Coal Upgrade Plan and its 1995 Annual Resource Planning Report favor continued operation of these units well beyond 2003. (OCA R. Exc. at 13 citing Tr. 163-164, 1896).

After careful consideration of the positions of the parties, we shall affirm the ALJ's recommendation. We agree with the ALJ that the facts underlying this claim are devoid of any clear commitment to retiring the plants in the year in question. We also agree with the OTS and the OCA that the record evidence strongly suggests that the impact of the Clean Air Act Amendments is more conjectural than real, at this time, based on PP&L's own testimony. We see no reason to alter PP&L's depreciation timetable under these circumstances.

R. General Plant Amortization Accounting

PP&L proposes to adopt amortization for those plant accounts which record certain general plant expenses such as office furniture, general tools and equipment. PP&L claims that these are only a small fraction of total investment in plant and service. PP&L rejects the "whole life" proposal of the OCA witness by relying on the West Penn and UGI precedent. PP&L also rejects the going-forward recommendation of the OCA witness and the proposed amortization periods because they will increase record keeping and thus frustrate the purpose of the proposed adjustment. (R.D., pp. 126-127).

The OCA opposes the proposal as to the amount in the case although the OCA does not oppose amortization per se. (R.D., pp. 126-127). The OCA agrees with PP&L that on amortization although it believes that eight of the periods are unreasonably short. The OCA suggests longer amortization periods and more details on the lives in service for the items in question. The OCA states that, for these eight categories, the PP&L periods are shorter than the service lives in its 1980 service life study which, even if outdated, represent the most reliable data on the items. The OCA further claims that the Company could collect more in rates than under the existing depreciation method and also increase the level of expense included in the test year. (R.D., pp. 127-128).

After consideration of the claims, the ALJ recommends PP&L's position. PP&L presents a basis for the OCA amortization periods, states that their witness had prepared a retirement rate analysis in 1994, and further states that its witness applied engineering judgment and a practical understanding of how PP&L uses its property. Given these considerations, the ALJ found support for PP&L's proposal and very little for the OCA alternative. The ALJ recommended no adjustment. (R.D., p. 128-129).

Neither the OCA nor PP&L filed any exceptions in regard to this item. We therefore approve the item as recommended.

VII. TAXES

The ALJ noted that the OCA addressed several issues within this general heading: (A) Gross Receipts Tax; (B) Consolidated Tax Savings; and (C) Additions to Taxable Income. The ALJ observed that the other parties do not address taxes specifically. The ALJ reviewed the arguments of the OCA and the responses of PP&L.

A. Gross Receipts Tax

The OCA recommended a reduction to Gross Receipts Tax ("GRT") by \$745,000 to recognize that revenues which are not received (uncollectibles) are not subject to the tax. PP&L argues that the ALJ's recommendation that we adopt the OCA adjustment is inappropriate. PP&L counters that the OCA's argument that PP&L is compensated for uncollectibles through an expense allowance is wrong for two reasons. First, the issue is revenues -- not expenses. PP&L asserts that lack of earnings is no basis for further reducing the revenue by disallowing the tax. Second, PP&L argues that it did not claim any additional uncollectible accounts expense associated with the revenue increase requested in this proceeding. PP&L indicates that this should be an offset against the OCA adjustment. PP&L further states that it is not aware of any proceeding in which the Commission has approved this sort of adjustment.

The OCA states that the PP&L criticism is without merit. The OCA observes that PP&L does not dispute that uncollectibles are not subject to gross receipts tax. The OCA continues that the situation is already being addressed through the PP&L claim for recovery of uncollectibles. The OCA argues that the Commission adopted a similar adjustment in Pa. P.U.C. v. West Penn Power Company, Docket No. R-00942986, slip op. at 80 (December 28, 1994). ("West Penn 1994"). The OCA maintains that

PP&L is already seeking to recover any deficiency in its revenue due to uncollectibles from ratepayers, in its uncollectibles claim. Therefore, the OCA argues that PP&L's argument about an offset is not an excuse to deny the uncollectibles adjustment. The OCA again refers to the West Penn 1994, supra.

PP&L argued that it views West Penn 1994 precedent as the only case in which the recommendation of the OCA has been adopted and indicates that the matter was not seriously contested there. PP&L repeated its position that the adjustment is unwarranted.

The ALJ proffered the following resolution of this issue:

In this instance, I am not quite clear about the exact arguments being presented. However, I fundamentally agree with OCA. If there is no revenue, then there should be no tax and if there is compensating uncollectibles revenue, the tax could be included. What I am not clear on is whether the Company claim for recovery of uncollectibles includes recovery of the gross receipts tax which would have been included if the revenue had been collected. What I am saying is that the revenue necessary to pay gross receipts tax on uncollectibles might be collected another way, making this claim double counting. The gross receipts tax factor should not be collected twice, once by imputing the revenue as if it had been collected and again by collecting the tax on the provision for uncollectibles. Given the uncertainty, I conclude that I should allow the OCA adjustment. I recommend that this adjustment be accepted, unless PP&L can show that I am wrong about this problem of double receipt of the tax amount.

(R.D. at 131-132).

In its Exceptions, PP&L submits that the adjustment is wholly inappropriate and should be rejected. PP&L contends that

the ALJ's concern over "double recovery" was not raised by any party to the proceeding, and thus it had no notice that this was an issue and had no opportunity to respond. PP&L continues that there is absolutely no record evidence to support a "double recovery" conclusion. PP&L proffers that had it known that this was an issue, it would have presented expert testimony demonstrating there is no double recovery. PP&L argues that it should not be penalized for failing to anticipate arguments not made on the record. (PP&L Exceptions at 50-51).

PP&L posits that the argument that was presented on the record was that the it improperly calculated GRT on its total revenue request, and thereby failed to reflect the fact that a portion of its requested revenue increase will not actually be collected (due to bad debts). PP&L argues that this argument is completely without merit, and if adopted, would simply assure that PP&L does not earn its allowed rate of return. (Id.).

According to PP&L, the OCA's argument that the Company is fully compensated for the effect of uncollectible accounts through an expense allowance is equally unavailing. First, says PP&L, the issue here is revenues, not expenses. According to PP&L, all of the revenues requested are required to permit the Company to earn its requested return. PP&L contends that the fact that the Company will not actually collect all of this revenue and will not actually earn its requested return provides no basis for further reducing the Company's rates (and its return) by disallowing GRT on revenues which will not be collected. (PP&L Exceptions at 51).

Second, PP&L submits that the OCA is factually wrong. PP&L posits that in order to be conservative and to keep the total amount of its requested increase reasonable, it did not claim any additional uncollectible accounts expense associated

with the revenue increase requested in this proceeding. This, PP&L contends, reduced it's claim by \$1.6 million, more than twice the OCA's proposed GRT adjustment. Thus, PP&L concludes that the OCA's contention that the Company is fully compensated through uncollectible accounts expense, even if theoretically correct, is factually in error in this case and urges rejection of the OCA-proposed adjustment. (PP&L Exceptions at 52).

In its Reply Exceptions, the OCA argues that PP&L's argument totally ignores the fact that as a result of non-payment of uncollectibles, it will not receive all of the revenues that it has claimed. As a result, says the OCA, PP&L will not have to pay gross receipts tax on all of the revenues that it has claimed. The OCA contends that its adjustment recognizes that in this proceeding, PP&L is already seeking to recover any deficiency in its revenues due to uncollectibles from ratepayers in its uncollectible claim. Gross receipts taxes do not apply to uncollectible revenues. (OCA Reply Exceptions at 23).

The OCA further argues that PP&L's contention that although it did not claim any additional uncollectibles expense, if it had claimed these costs it would have offset the OCA's adjustment, is without support. The OCA rejoins that the PP&L's failure to present a request for future test year uncollectible costs cannot be used as an excuse to deny an adjustment to the PP&L's claim as filed. The OCA based its adjustment on the uncollectibles claimed by PP&L in this proceeding. (OCA Reply Exceptions at 23-24)

The OCA submits that the ALJ's recommendation is both factually and theoretically correct. Moreover, the OCA submits that it is consistent with Commission precedent. The OCA urges that the ALJ's recommendation adjusting PP&L's gross receipts tax claim to remove uncollectibles be adopted. (OCA Reply Exceptions at 23-24).

Upon review of this issue, based on the record as developed, we found PP&L's Exceptions to be persuasive. Specifically, we find that PP&L effectively refuted the OCA's argument that the Gross Receipts Tax was improperly computed due to the fact that a portion of PP&L's requested revenue increase would not actually be collected due to bad debts. We agree with PP&L that such an adjustment would only serve to assure that PP&L will not earn its allowed rate of return.

We agree further with PP&L's comment that the issue before us is revenues. The issue is not expenses. We adopt PP&L's argument that the fact that the Company will not actually collect all of its revenue and will not actually earn its requested return provides no basis to further reduce PP&L's rates by disallowing Gross Receipts Tax on revenues which will not be collected.

Accordingly, we will grant the Exceptions of PP&L and reverse the ALJ on this issue.

B. Additions to Taxable Income

The OCA eliminated three items which the Company included as additions to taxable income, for purposes of calculating future test year income tax expense. The OCA states that these three eliminations, of the additions to taxable income for ECR/FAC overrecoveries, refueling outage costs and bad debt accruals, reduces income taxes and increases net income by approximately \$6 million, on a total Company basis. The OCA argues that the record indicates that uncollectibles reflect future test year estimates of write-offs. It states that these items should be eliminated.

PP&L views the OCA's recommendation as arbitrary and defends its total level as reasonable. PP&L states that its

uncollectible accounts expense claim is based on accruals not the actual level of bad debt write-offs. PP&L urges a finding that its own income tax is reasonable.

In response, the OCA asserts that the record supports its adjustments. The OCA states that PP&L does not dispute the accuracy of two of its adjustments. Concerning the third, bad debt accrual, the OCA states that the Company's argument is contradicted by the evidence of record.

The ALJ's resolution of the matter is as follows:

I sympathize with PP&L in its concern about unfairness by OCA and "cherry picking". However, these adjustments seem to be correct and PP&L could always have provided counter-adjustments earlier in the proceeding. I accept and recommend the OCA adjustments.

(R.D. at 136).

In its Exceptions, PP&L notes that book/tax timing adjustments can both increase and decrease tax expense for ratemaking purposes. However, PP&L asserts that the OCA improperly focussed on those items that increased tax expense and ignored those adjustments which decreased tax expense. PP&L argues that it demonstrated this "cherry picking" approach in its rebuttal testimony of a book/tax timing difference in the treatment of power plant inventory which decreased tax expense. PP&L observed that the ALJ accepted this concept by reducing the OCA adjustment to reflect the effect of this offset. PP&L submits that the ALJ should have gone further and rejected the OCA's adjustment in its entirety. (PP&L Exceptions at 49).

In the alternative says PP&L, the adjustment adopted by the ALJ, at a minimum, must be recalculated to be consistent with his proposed treatment of uncollectible accounts expense. PP&L's

claim for uncollectible accounts expense in this case was based on the estimated accrual to its uncollectible reserve. For tax purposes, however, uncollectible accounts are deducted when actually written off. This difference in the book and tax treatment of bad debts is one component of the OCA's adjustment to taxable income. (PP&L Exceptions at 49-50).

PP&L notes that the OTS proposed to calculate uncollectible accounts expense based on the actual write-off and not on the accrual to the uncollectible reserve. The ALJ agreed and reduced PP&L's claim by \$1,234,000 (R.D., pp. 69-70). However, PP&L contends that this adjustment also eliminates the book/tax timing difference for bad debts and eliminates the OCA's corresponding tax adjustment. Therefore, PP&L states that if the OTS's adjustment for uncollectible accounts expense is adopted and PP&L adds parenthetically that has not excepted to that recommendation, then the bad debt portion of the OCA's adjustment to taxable income also must be eliminated. PP&L adds that the OCA's witness specifically agreed with this analysis on cross-examination, stating that the bad debt portion of the book/tax timing adjustment would "go away" if the OTS' uncollectible accounts expense adjustment were adopted (Tr. 2043). PP&L notes that the effect of this correction is to increase federal income tax expense by \$610,000 and state income tax expense by \$215,000. (PP&L Exceptions at 50).

In its Reply Exceptions, the OCA states that PP&L does not dispute the accuracy of the OCA's adjustment but contends that the adjustment is "cherry picking". The OCA submits that the ALJ correctly recognized that these adjustments were supported by the evidence of record. The OCA continued that its witness recognized that items included in the additions to the Company's taxable income will fluctuate up and down, and thus, properly eliminated all inappropriate items, including the adjustment suggested by PP&L's witness.

The OCA acknowledges that PP&L correctly noted that should the Commission adopt the OTS' adjustment for uncollectibles accounts expense, the OCA's adjustment for bad debt accruals (\$1,959,000) would be eliminated. PP&L Exc. at 50; OCA St. 6A, Sch. TSC-23. The remaining two adjustments for ECR/FAC overrecovery (\$9,690,000) and Refueling Outage Costs (\$2,138,000) remain. (OCA Reply Exceptions at 22).

The OCA concludes that PP&L's arguments do not overcome the fact that the OCA's adjustment appropriately eliminates items from the Company's claim for income tax expense. The OCA submits that the ALJ's recommendation adopting the OCA's adjustment to eliminate certain additions to taxable income is well supported by the evidence of record and should be approved. (Id.).

Based upon the positions of the parties as described above, we will adopt the position of PP&L that since the OTS adjustment for uncollectible accounts expense was adopted, the bad debt portion of the OCA's adjustment to taxable income also must be eliminated. Accordingly, we will not adopt the ALJ's recommendation and thus eliminate the adjustment of \$1,959,000. The Exceptions of PP&L are granted to the extent consistent with our resolution of this issue.

C. Consolidated Tax Savings

The ALJ observed that this a commonly litigated matter and that reference is frequently made to court precedent. The OCA sets up the background and does refer to court precedent. The OCA provides the fundamental legal standard involved in resolving this issue. This is based on the "actual taxes paid" idea whereby savings associated with tax losses of other companies can be imputed to the utility in question. The OCA argues that the Commission has approved the modified effective tax rate method for this calculation.

PP&L refers to two mining companies which are no longer in operation. The OCA refers to the testimony of its witness, who indicated that there will still be tax losses. The OCA suggests that losses will continue into the future and, therefore, an adjustment reducing federal income tax expense by \$2,161,000 on a jurisdictional basis is appropriate. The OCA also addressed PP&L's argument that ratepayers have already received the tax savings through the ECR. The OCA views this contention as unsupported by the record. The OCA argues that PP&L's witness had only stated that these savings may have occurred because costs which were incurred when the mines were in operation may not have been tax deductible until paid.

PP&L opposed the OCA's adjustment. PP&L voiced its general opposition to this sort of adjustment but it recognized that there is Commission precedent for the position espoused by the OCA. PP&L then provided three reasons why the adjustment proposed by the OCA should not be allowed in this instance.

First, PP&L argued that ratemaking is forward-looking and that we should examine the period in which new rates will be in effect. PP&L refers back to an early precedent relating to this matter, from 1956. PP&L also refers to the differences between temporary effects and ongoing situations. PP&L continues with a view of precedent and emphasizes the prospective nature of this adjustment. PP&L then states that the OCA adjustment is incorrect because it does not reflect a reasonable estimate for the future. PP&L points out that the vast majority of this adjustment is based on Pennsylvania Mines Corporation and Rushton Mining Company. According to PP&L, neither of these companies are in operation and, thus, will not generate any tax losses in the future. PP&L posits that past tax losses are non-recurring.

Second, PP&L argues that these companies were never intended to operate at a profit or a loss. It refers to mere timing differences.

Third, PP&L argues that the benefit to customers has been realized through the ECR. It states that expenses by these companies were recorded on PP&L's books. Furthermore, PP&L states that the deferred credit for taxes would be reflected as a reduction in the cost of coal to PP&L which, in turn, was flowed through to PP&L's customers through the ECR. Therefore, PP&L asserts that the tax savings identified by the OCA have already been passed through to the PP&L customers in the cost of fuel.

The OCA rejoins that its witness requested prospective tax information about the two mining companies but that PP&L did not respond. The OCA asserts that the historic information is the most recent data provided. The OCA also states that these companies indicate losses for the future test year. The OCA claims that PP&L presented no evidence to support its position that losses will not continue into the future.

The OCA then responded to the argument related to lack of profit or loss. The OCA argues that PP&L has provided no evidence that ratepayers have received the tax benefits and argues that the burden of proof to substantiate each element of its claim rests on PP&L. The OCA concludes with the fundamental argument that PP&L should be required to pass on the tax savings associated with consolidated tax filings.

PP&L rejoins that it is self-evident that the two mining companies will not continue to incur tax losses or produce taxable revenue on a going forward basis. PP&L points out that the losses were attributable to timing differences created under the tax laws. PP&L asserts that such timing differences are not properly considered in establishing rates. PP&L states that the

two mining companies were operated on a non-profit basis and asserts that OCA has recognized that this should work an exclusion. Concerning its argument about the ECR, PP&L points to its rebuttal testimony. PP&L states that the OCA did not elect to challenge this rebuttal.

The ALJ's resolution of this issue is as follows:

I do not find the arguments of the parties to be particularly clear on the various points. However, upon review, I agree with PP&L. This sort of adjustment is obvious but OCA seems to be saying that the adjustment should be made here because it is an obvious adjustment in general. However, I do not agree with the mechanism for making the adjustment.

In this instance, the discontinuance of mining operations would make the future quite unlike the past yet OCA depends on the past for its adjustment. I realize that it argues for lack of information from PP&L but, still, I find no basis for projecting the general situation of the past into the future, at all. Moreover, my understanding is that these two mining are essentially captured mines by PP&L and I fundamentally agree with the ECR argument of PP&L.

There might be some basis for a consolidated tax adjustment but I do not find one here. This could be just because I am misunderstanding the OCA arguments but I cannot go with an argument that I do not understand. I do not see how these past (and unusual) tax losses can be imputed to future rates for PP&L.

(R.D. at 131-132).

In its Exceptions, the OCA submits that the ALJ erred in finding that there was no basis for a consolidated tax adjustment in this proceeding. In particular, the OCA excepts to the ALJ's conclusion that the OCA's adjustment is an attempt to impute "past tax losses" related to PP&L's mining operations to

future rates for PP&L. The OCA excepts to this recommendation since it fails to recognize that the OCA's consolidated tax savings adjustment relies on the future test year projections provided by PP&L. (OCA Exceptions at 39-40).

The OCA submits that in this proceeding, consistent with Commission precedent, it calculated the consolidated tax savings allocable to the Company utilizing what has become known as the modified effective tax rate method. In calculating this adjustment, the OCA relied on the most recent data provided by the Company. The OCA continues that the ALJ's finding that there is "no basis for projecting the general situation of the past into the future" ignores the evidence in this proceeding, that PP&L projected losses for the future test year is of over \$5.75 million. (Id.)

The OCA maintains that despite its request for additional data, the Company presented no evidence to support its position that these losses will not continue into the future. Thus, the OCA posits that it is appropriate to include these future test year losses in the consolidated tax calculation.

In addition, the OCA submits that the ALJ erred in his acceptance of the "ECR argument of PP&L." According to the OCA, PP&L failed to provide any evidence to support its claim that tax savings have already been passed through to customers through the ECR. The OCA submits that PP&L retains the burden of proof to establish each element of its claim. Thus, the OCA urges that the ALJ's recommendation to reject the OCA's consolidated tax savings adjustment be rejected. According to the ALJ, adoption of this adjustment reduces federal income tax expense by \$2,548,000 on a total company basis and \$2,161,000 on a Pennsylvania jurisdictional basis. (OCA Exceptions at 40).

In its Reply Exceptions, PP&L opines that the ALJ correctly rejected the OCA's proposed consolidated tax savings adjustment for three reasons. First, as the ALJ recognized, the bulk of the OCA's adjustment (86%) relates to losses from the discontinued operation of certain mining companies. According to PP&L, the Commission has repeatedly held, and the OCA itself has agreed in other cases, that discontinued operations will not generate ongoing tax losses and, therefore, should not be included in the calculation of a consolidated tax savings adjustment. Second, PP&L states that the mining companies at issue were never intended to operate at a profit or loss. Indeed, according to the OCA, any small profit or loss in a particular year is due solely to temporary book/tax timing differences. Third, the OCA states that customers have already received the full benefit of any temporary tax losses through lower fuel costs.

PP&L labels as false, the OCA assertion that the Company presented no evidence to support this position. PP&L counters that it presented unrebutted expert testimony on this issue, and that the OCA failed to cross-examine PP&L's witness on this issue and did not file any responsive testimony. (Id.)

Upon our careful consideration of this issue, we will adopt the position espoused by the OCA. We find that PP&L did not establish that the losses from the mining operations will not continue into the future. In our consideration of this matter, we gave weight to the OCA's statement in its Exceptions that the data provided by PP&L demonstrated that the mining companies that produced the majority of the taxable losses had continued to generate tax losses in the years following their closing, including projected losses during the future test year. (OCA Exceptions at 40; Footnote 20).

Accordingly, we will grant the OCA's Exceptions, and not adopt the ALJ's recommendation.

D. Tax Deficiency Accruals

In this proceeding, the OCA proposed an adjustment of to reduce state tax expense by \$213,000 and federal income tax expense by \$804,000 on a jurisdictional basis. The adjustment is based upon OCA's contention that the accruals of potential state and federal income tax deficiencies should be removed. The ALJ found no response by PP&L. The ALJ recommended that the adjustment be adopted. PP&L did not except to the ALJ's resolution of the issue. We adopt the ALJ's adjustment without further comment.

E. Synchronization Adjustment

The ALJ proffered the following resolution of this issue:

OCA addresses this topic, commencing at page 209 of its main brief and at page 95 of its reply brief. It observes that PP&L presented no rebuttal on this subject. It characterizes this as an accepted ratemaking adjustment. It indicates that this adjustment is well supported by precedent. I agree and accept the adjustment. I find no PP&L response.

(R.D. at 138)

No party excepted to the ALJ's resolution. Accordingly, the ALJ's resolution is adopted.

F. State Income Tax Rate

The ALJ framed the issue as follows:

On June 30, 1995, after the close of the record in this proceeding, legislation was signed which reduced the corporate net income tax rate from 10.99 percent to 9.99 percent, effective January 1, 1995. Because the state income tax expense claimed in this proceeding is based on 10.99 percent (PP&L Exhibit Future 1, Revised, Sch. D19, page 2, Revised), it is noted that PP&L will be required to reflect the lower rate of 9.99 percent in a recomputation of its State Tax Adjustment Surcharge (STAS) filed pursuant to Commission regulations at 52 Pa. Code §69.51, et seq.

(R.D. at 138).

No party excepted to the above resolution. Accordingly, the ALJ's resolution is adopted without further discussion.

VIII. RATE OF RETURN

The calculation of the appropriate rate of return, particularly the determination of the common equity element, was a major issue in this proceeding. Although the quantification of rate of return is subject to various methodologies and interpretations of financial data, the definition of rate of return is not disputed. As explained in P. Garfield and W. Lovejoy, Public Utility Economics 116 (1964),

[t]he rate of return is the amount of money a utility earns, over and above operating expenses, depreciation expense and taxes, expressed as a percentage of the legally established net valuation of utility property, the rate base. Included in the 'return' are interest on long-term debt, dividends on preferred stock, and earnings on common stock equity. In other words, the return is that money earned from operations which is available for distribution among the capital. In the case of common stockholders, part of their share may be retained as surplus. The rate-of-return concept merely converts the dollars earned on the rate base into a percentage figure, thus making the item more easily comparable with that in other companies or industries.

(Emphasis in original.)

A public utility, whose facilities and assets have been dedicated to public service, is entitled to an opportunity to earn a fair rate of return on its investment. The standards to be used by the Commission in determining what is a fair rate of return are well established and were set forth more than six decades ago by the United States Supreme Court in Bluefield Water Works and Improvement Co. v. Public Service Commission of West Virginia, 262 U.S. 679, 690-93 (1923) ("Bluefield"):

Rates which are not sufficient to yield a reasonable return on the value of the

property used at the time it is being used to render the service are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility of its property in violation of the Fourteenth Amendment. . .

. . . .

. . . 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.

These principles have been adopted and applied by Pennsylvania's appellate courts in numerous circumstances. See, e.g., Lower Paxton Township v. Pennsylvania Public Utility Commission, 13 Pa. Commonwealth Ct. 135, 317 A.2d 917 (1974) ("Lower Paxton"); Riverton Consolidated Water Co. v. Pennsylvania Public Utility Commission, 186 Pa. Superior Ct. 1, 140 A.2d 114 (1958) ("Riverton").

As the United States Supreme Court stated in three landmark opinions, the return allowed to investors must be commensurate with the risk assumed. The Bluefield decision requires that the rate of return reflect "a return on the value of the [utility's] property which it employs for the convenience of the public equal to that generally being made at the same time on investments in other business undertakings which are attended by corresponding risk and uncertainties." Id. at 692. The decision in Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591 (1944) ("Hope") states:

From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include

A. Capital Structure

The following table summarizes the capital structure proposals of the parties:

<u>Capital Structure</u>	PP&L	OCA	PPLICA	DOD	OTS
	<u>Percent1</u>	<u>Percent2</u>	<u>Percent3</u>	<u>Percent4</u>	<u>Percent5</u>
Long-Term Debt	46.53	47.56	47.13	46.53	46.53
Preferred Stock	7.59	7.44	7.91	7.59	7.59
Common Equity	<u>45.88</u>	<u>45.00</u>	<u>44.96</u>	<u>45.88</u>	<u>45.88</u>
	100.00	100.00	100.00	100.00	100.00

- 1 PP&L main brief, page 200.
- 2 OCA main brief, page 213.
- 3 PPLICA Statement 8, page 37, Table 4.
- 4 DOD main brief, page 10.
- 5 OTS main brief, page 109.

PP&L proposes a future test year end pro forma capital structure as of September 30, 1995 (PP&L St. 12, page 2). PP&L contends that the approach used in this proceeding is identical to that approved by the Commission in numerous recent decisions. See, e.g., Pa. P.U.C. v. Pennsylvania-American Water Co., 79 Pa. P.U.C. 25, 80 (1993); Pa. P.U.C. v. Pennsylvania-American Water Co., Docket No. 901652 (December 14, 1990) (Order, page 105). According to PP&L, all elements of the ratemaking formula, i.e., revenues, expenses, rate base and return, have been annualized and normalized to reflect anticipated conditions at the end of the future test year (PP&L St. 3, pages 3-4; Ex. Future 1 - Revised). PP&L argues that rejection of the future test year data for a single item, i.e., capital structure ratios, would create a mismatch between capital structure and all other elements of the ratemaking formula.

PPLICA opposes PP&L's utilization of future test year data. PPLICA's argument was that PP&L had not adequately

explained and defended its future test year financing plans. PPLICA recommends the use of historical test year data. Specifically, PPLICA points out that the proposed capital structure incorporates the effects of an equity issuance of \$100 million in August 1995 which it states that PP&L may pursue. PPLICA estimates that, with all other factors held constant, this increase in the Common Equity ratio results in an additional revenue requirement of \$5 million. PPLICA states that no PP&L witness testified to the benefits gained from such an increase to common equity (PPLICA St. 8, page 38).

PP&L addressed PPLICA's concerns concerning the reasonableness of PP&L's future test year end capital ratios. PP&L argues that it moved its capital structure toward less debt and higher common equity ratios in reaction to bond rating agencies comments regarding business risk increases.

The OCA capital structure proposal accepts PP&L's future test year capital structure except for a proposed common stock issuance which had not as yet been sold (OCA St. 1, page 13).

PP&L maintains that most of the elements of a rate case are based, at least in part, on projections including revenues, expenses, rate base, proposed capital structure and capital costs. PP&L continues that these projections are based upon the best information available at the time the case is decided. The use of projections is a standard part of ratemaking. PP&L contends it would be unfair and unreasonable to abandon this standard ratemaking practice for one issue, i.e., the Company's proposed issuance of new common equity.

PP&L contends that evidence demonstrates that it will probably issue common stock in the near future. PP&L states that the issuance of new common equity is necessary. According to

PP&L, its current equity ratio is too low compared to other electric utilities (PP&L St. 12-R, pages 11-12). PP&L contends that the bond rating agencies have specifically criticized its equity ratio as being too low (PP&L St. 12-R, page 9). PP&L believes it must issue additional common equity to improve its common equity ratio and avoid a further downgrading of its bonds. Specifically, PP&L argued as follows:

Additional equity is necessary to respond to the more stringent financial criteria now required by the bond rating agencies. Moreover, the rating agencies have expressed a concern over the Company's high debt use in the past. The Company's financing plan is required to alleviate those concerns and represents a prudent course of action to help prevent further bond downgradings.

(PP&L St. 12-R, page 12).

Further, PP&L asserts that the new equity issuance is part of a two-step financing plan. The first step in this plan involves the virtually completed repurchase of high-cost debt. PP&L continues that the second step of the financing plan, the issuance of new common equity, is now ready to move forward (PP&L St. 12-R, pages 11-12). PP&L indicates that it has already undertaken a number of specific steps to issue the new common equity, including Board of Directors authorization, selection of lead underwriters and preparation of the SEC Registration Statement (PP&L St. 12-R, page 11).

Although the exact timing of the common equity issuance is not certain, PP&L states that it has a definite need to issue new equity, has a specific plan to do so and has taken specific steps to implement that plan.

According to PP&L, its refinancing high-cost debt and preferred stock has reduced PP&L's cost of senior capital (PP&L

St. 1, page 5). PP&L cites P.U.C. v. National Fuel Gas Distribution Corp., 73 Pa. P.U.C. 552, 607 (1990) ("NFG 1990"), for the proposition that the Commission has recognized that refinancing high-cost debt produces direct benefits to ratepayers and should be encouraged (PP&L St. 12, pages 29-30). PP&L argues that NFG 1990 also stands for the proposition that the Commission also has held that a utility should be allowed to fully recover all costs associated with the reacquisition of high-cost debt and that the utility's capital structure and capital costs should not be adversely affected by such reacquisitions. PP&L cites Administrative Law Judge ("ALJ") Herbert S. Cohen from his Recommended Decision (page 154) in NFG 1990 as follows:

In the early 1980s, the Commission sent letters to NFGDC and other utilities, encouraging the utilities to reacquire high cost debt and replace it with lower cost of debt for the purpose of reducing the overall embedded cost of debt to be charged to ratepayers. The letter from the Commission to NFGDC is dated July 24, 1986. The letter provides as follows:

The Commission is aware that current bond market conditions provide opportunities for utilities to refund outstanding issues of high coupon debt. The Commission encourages such refunding if the utility can demonstrate that it is in the public interest. The Commission will favorably consider ratemaking treatment which allows recovery of and a return on the call or tender premium which must be paid to accomplish such transactions if there is a showing that the transactions were prudently undertaken and result in significant and measurable savings to ratepayers (Exh. No. 212-A, Sch. 1).

PP&L maintains that in order to reacquire high-cost debt and preferred stock, the Company, in most instances, had to pay a premium to existing bondholders and preferred stockholders (PP&L St. 12, page 28). PP&L continues that it followed standard Commission practice in this proceeding and adjusted both its capital cost rates and capital structure to reflect the effect of these premiums.

The OCA, according to PP&L, recognizes and accepts the change in the cost of debt and preferred stock associated with these refinancings, but opposes any adjustment to capital structure (OCA St. 1, page 14). PP&L contends that the OCA proposal would create a mismatch between the establishment of capital cost rates and capital structure.

According to PP&L, the premiums paid to reacquire high-cost debt and preferred stock were financed with newly issued long-term debt,²⁷ and the issuance of additional long-term debt to finance the premiums increased the amount of long-term debt outstanding and obviously affected both the cost of long-term debt and the Company's capital structure. PP&L states that for the OCA to recognize one effect of these refinancings (cost of capital effect) and not the other (capital structure effect) is a mismatch and should be rejected.

Finally, PP&L indicates that the same adjustment proposed by the OCA has been repeatedly rejected in a series of National Fuel Gas rate cases. Pa. P.U.C. v. National Fuel Gas Distribution Corp., 62 Pa. P.U.C. 407, 435 (1986), ("NFG 1986");

²⁷ PP&L pointed out that OCA witness Kahal assumed that the premiums were paid out of general Company funds and therefore did not affect the Company's capital structure (OCA St. 1A, page 7). According to PP&L, this is not the case. Mr. Moul specifically testified that the premiums were paid out of the proceeds of new long-term debt (Tr. 1834-1835).

Pa. P.U.C. v. National Fuel Gas Distribution Corp., 67 Pa. P.U.C. 264, 324-326 (1988) ("NFG 1988"). PP&L cites NFG 1988 as follows:

We conclude that NFGD has properly accounted for these unamortized refinancing premium costs. The OCA's proposal to include the unamortized refinancing premium costs in the principal amount of debt used in computing the effective debt cost rate is incorrect since the premiums were paid to former debenture owners and therefore are no longer available to the Company. We adopt the recommendation of the ALJ and deny the OCA Exceptions. 67 Pa.P.U.C. at 326.

The OCA would also remove \$5 million of tender and call premiums from NFGD's long-term debt to compute its long-term debt ratio and increase its long-term debt cost rate. OCA maintains that NFGD cannot both recover its call and tender premiums through amortization and simultaneously earn a return on its unamortized expense balance. The OCA further maintains that NFGD should only be allowed an amortization of these call and tender premiums (R.D. at 150).

We agree with the Company that our letter to NFGD dated July 24, 1986, makes it clear that the Commission intended to allow full recovery of the Company's expenses and a return on such expenses in order to provide an incentive to reduce the embedded cost of debt associates with prudent refinancing to high cost debt. We, therefore, deny the OCA's exceptions to the Company's procedure to recover the costs associated with refinancing high cost debt. Accordingly, we adopt the ALJ's recommendation on the proper capital structure to be allowed NFGD in this proceeding.

The OCA adjustment, according to PP&L would create a mismatch between capital structure and senior capital cost rates.

The OCA, through the testimony of witness Catlin, also proposes a \$40 million reduction to PP&L's rate base to reflect deferred taxes associated with the reacquisition premiums (OCA St. 6, page 6). PP&L urges rejection of this adjustment. First, argues PP&L, there is no basis for any rate base adjustment because PP&L has not sought to include the premiums in rate base. If any adjustment were to be made, says PP&L, it should be made to capital structure ratios, not to rate base (PP&L St. 12-R1, pages 1-4). The ALJ noted that on surrebuttal, OCA witness Kahal agreed (R.D. at 148).

The ALJ observed that the reacquisition premiums were tax deductible at the time they were paid. The ALJ opined that the issue is how those tax savings should be credited to customers. The ALJ noted that, under PP&L's method, the tax savings generated by the reacquisition premiums will be flowed through to customers as those customers pay the underlying cost of the premium (PP&L St. 12-R1, pages 1-2). PP&L submits that it financed the premiums initially and will recover them from ratepayers over the life of the new debt. It is the position of PP&L that since customers will pay the cost of the premium over the life of the debt, therefore they should receive the associated tax savings over the same period. To do otherwise, according to PP&L, would create a mismatch between the tax savings and the underlying cost which generated the tax savings. PP&L stated that research has found no case in which the Commission has made any adjustment of the type. Therefore, it should, according to PP&L being rejected.

The OCA contends that it employs PP&L's actual capital structured projections and not the modified capital structure ratios PP&L uses (OCA St. 1, pages 13-17).

OCA witness Kahal explained the modification to PP&L's actual capitalization data as follows:

Witness Moul's treatment provides the Company both a return of and a return on these expenditures in three ways. First the annual amortization of the losses (net of some minor gains) is added to interest expense. This totals about \$7.2 million. Second, the unamortized balance of \$115.9 million is subtracted from the long term debt balance when computing the embedded cost of debt. The combination of these two actions increases the embedded cost of debt from 7.40% to 7.97%. Third, Mr. Moul also subtracts the \$115.9 million of unamortized losses from the debt balance for capital structure purposes.

(OCA St. 1, pages 13-14).

The OCA contends that it is this third adjustment that serves to inflate the equity portion of capital structure and the overall pre-tax rate of return (OCA St. 1, page 14). The OCA states it does not object to PP&L receiving a return of and a return on the call premiums and that cost recovery should take place through rate of return (OCA St. 1, page 14). The OCA does object to PP&L's adjustment to its actual capital structure to reduce the debt balance by approximately \$116 million. The OCA submits that the \$115.9 million of unamortized losses should not be subtracted from the debt balance for capital structure purposes.

PP&L's adjustment to the capitalization provides it with approximately \$24 million of cost recovery on a total company basis. (OCA St. 1, Sch. MIK-1 at 2). The OCA states that this adjustment overcharges ratepayers by about \$8 million (\$24 million minus \$16 million). (OCA St. 1, page 16).

The OCA recognizes that the Commission in the past has allowed utilities to adjust their capital structures to allow recovery of the call premium expense through an amortization and to earn a return on that unamortized balance of that expense. See

(NFG 1988); Pa. P.U.C. v. National Fuel Gas Distribution Corporation 73 Pa. PUC 552, 606-607 (1990) ("NFG 1990"). In NFG 1990, says the OCA, the Commission allowed the utility "full recovery of the Company's expenses and a return on such expenses in order to provide an incentive to reduce the embedded cost of debt." (NFG 1990 at 607).

However, the OCA asserts that, because these refinancings occurred during the ten years between rate cases shareholders benefitted. Specifically, the OCA proffered the following argument:

PP&L shareholders have been able to enjoy many years of savings from these refinancings since PP&L has not had a rate case since 1985. These substantial interest expenses savings due to refinancings undoubtedly increased PP&L's profits and higher profits translate into higher retained earning and thus common equity. Unless one makes the unrealistic assumption that every dollar of profits translates into an additional dollar of common dividends, the refinancings very likely have resulted in a higher per books common equity balance than would exist absent the refinancings.

(OCA St. 1, page 15).

The OCA submits that PP&L should not be given an additional \$8 million in incentives for refinancing. The OCA submits that its adjustment provides PP&L with full cost recovery of \$16 million, including a debt return on the unamortized balance of call premiums. The OCA contends, therefore, that the Commission's findings in the NFG decisions should be reconsidered in this proceeding.

PP&L's witness Hill testified in response to cross-examination that PP&L does not subtract the \$115.9 million

from debt balance for financial reporting purposes (Tr. 414).
Further, OCA witness Kahal testified:

It is also not the case that this adjustment is needed in order to keep the PP&L capital structure in some sense "neutral" with respect to the refinancings. The call premiums when incurred were expenses to PP&L, expenses incurred in order to reduce interest costs by an even larger amount. The call premiums, however, did not reduce common equity when incurred the way an incremental expense normally would. This is because PP&L has created a "regulatory asset" on its books, reflecting the unamortized balance of the reacquisition losses (call premiums).

(OCA St. 1, pages 14-15).

Accordingly, according to the OCA, because the call premiums are a regulatory asset on the PP&L balance sheet, the common equity balance is unaffected by the refinancings.

In rebuttal, PP&L witness Moul objected to OCA witness Kahal's capital structure adjustment testifying that:

Although Mr. Kahal recognizes that recovery of the annual cost should be reflected in the Company's cost of debt, he unfairly lowers the Company's equity ratio by failing to recognize the Company's adjustment.

(PP&L St. 12R, page 8).

Witness Kahal responded to witness Moul in his surrebuttal testimony, noting that:

Contrary to the impression in Mr. Moul's testimony, I am not lowering PP&L's equity ratio. Rather, I propose to use in this case PP&L's projected actual capital structure ratios at 9/30/95. It is Mr. Moul who seeks

to alter the actual, per books capital structure ratios. This is an adjustment which investor analysts (e.g., credit rating agencies) do not make.

(OCA St. 1A, page 6).

Moreover, as Kahal explained:

... no reduction to common equity occurred from the losses on reacquisition, except as amortization takes place. However, since annual interest expense savings from refinancings greatly exceeds the annual amortization, the probable net effect is an increase in PP&L's common equity. This increase to profits and hence equity could take place because PP&L has not had a rate case during the intervening period, and therefore the net interest expense savings (i.e., net of the amortizations) have flowed 100 percent to shareholders. From this perspective, an adjustment to even further increase the equity ratio above its actual level -- as Mr. Moul argues -- makes no sense.

(OCA St. 1A, page 7).

The OCA proposes that the Commission should reject PP&L's adjustment to its projected common equity ratio. The OCA, based upon PP&L's capital structure adjustment, recommends that PP&L's rate base be adjusted to recognize the accumulated deferred income taxes (ADIT) balances associated with the loss on reacquired debt (OCA St. 6, page 6).

OCA witness Kahal explained the basis for this adjustment:

... PP&L incurred call premiums (losses on debt reacquisition) over a period of years, principally between 1986 and 1993, when refinancing its high cost debt. In addition to receiving large net interest expense savings in those years (which went to shareholders), PP&L also received immediate tax write-offs.

Those losses could be expensed for tax purposes in the year incurred. For accounting purposes, those losses are treated as a regulatory asset on a pre-tax basis and amortized over a very long period of time. Per Mr. Moul's proposal, PP&L recovers the amortizations and a return on the unamortized balance in rates through higher interest expense, i.e., a higher embedded cost of debt. With interest synchronization, the dollar amount of PP&L's original tax savings is returned to ratepayers very gradually over time. (Emphasis in original).

(OCA St. 1B at 6).

In rebuttal, PP&L opposed adoption of OCA's rate base adjustment, but suggested as an alternative that recognizing:

... deferred income taxes related to the call of high cost debt would require a modification to the Company's capital structure ratios and embedded cost of debt.

(PP&L St. 12R1, Exh. PRM-4)

As shown on that exhibit, recognizing the deferred tax provisions results in the following capital structures:

<u>Type of Capital</u> ¹	<u>Ratios</u> %	<u>Cost Rate</u> %	<u>Weighted Cost</u> %
Long Term Debt	46.96	7.84	3.68
Preferred Stock	7.53	7.31	0.55
Common Equity	<u>45.51</u>	13.00	<u>5.92</u>
Total Capital	<u>100.00</u>		<u>10.15</u>

¹ PP&L St. 12R1, Exh. PRM-4, Sch. 2.²⁸

²⁸ The OCA notes that witness Moul's proposed capital structure adjustment utilized the capital structure that he recommended in this proceeding.

PP&L witness Moul testified that he was not recommending adoption of this revised capital structure since it was his position that the deferred taxes associated with call premiums should be completely disregarded (Tr. 1794-1795).

In surrebuttal, OCA witness Kahal testified that PP&L's alternative which results in a modification to the Company's capital structure was acceptable. The OCA conditioned adoption of this adjustment on the use of PP&L's actual capital structure, not the adjusted capital structure presented witness Moul in this proceeding (OCA St. 1B, pages 1-2). Thus, if the Commission accepts his recommendation to utilize PP&L's actual capital structure, OCA witness stated:

I find acceptable Mr. Moul's recognition of deferred taxes in the cost of debt in lieu of rate base. The deferred tax recognition lowers the embedded cost of debt from 7.97 to 7.84 percent, and lowers my overall rate of return from 9.33 to 9.27 percent. My capital structure ratios are not altered by this adjustment.

(OCA St. 1B, page 9).

Accordingly, the OCA submits that the Commission should utilize the Company's actual capital structure with a modification to the embedded cost of debt to recognize the accumulated deferred taxes associated with the loss on reacquired debt.

The OCA submits that PP&L's suggestion to "disregard" the balance of ADIT on reacquired debt results in PP&L's failure to recognize a source of non-investor supplied capital. The OCA submits that the Commission should adopt either; a) the 7.84 percent cost of debt with the PP&L's actual capital structure; or b) if PP&L's modified capital structure is accepted, OCA's rate base adjustment. Adoption of one of these two options is

according to the OCA, essential in order to give proper ratemaking treatment of these funds.

The OCA states that if PP&L adjusted capital structure is used, then rate base must be adjusted to reflect the ADIT associated with the loss on reacquired debt. The OCA contends that PP&L's proposed handling of this issue results in the shareholders having received the tax savings but ratepayers will only see the tax savings gradually over the next 10 to 15 years. OCA witness Catlin testified that the Company accomplished this by:

... both including the amortization of the loss as an interest cost and deducting the unamortized balance of the loss from the balance of outstanding debt used to calculate the weighted cost. However, nowhere in its calculations has PP&L recognized that it received an immediate tax benefit for the loss which served as a source of cost-free capital. Therefore, deducting the balance of ADIT on reacquired debt from rate base is necessary to recognize this balance as a source of non-investor supplied capital.

(OCA St. 6, page 7).

Adoption of the OCA adjustment would reduce total PP&L rate base by \$47,863,000 and reduces Pennsylvania jurisdictional rate base by \$40,838,000 (OCA St. 6, TSC-4).

In rebuttal, PP&L witness Moul argued that the OCA adjustment should be rejected because ratepayers:

will begin to bear the costs of amortizing the remaining call premiums and will receive the benefit of the associated tax deduction in the Company's pro forma income tax calculation.

(PP&L St. 12R1, page 1-3).

PP&L further argues that the OCA adjustment is inappropriate because "there were no customer funds utilized to undertake the call of the Company's high cost debt ..." and that customers will receive the tax benefit through "an interest synchronization technique" (PP&L St. 12R1, pages 1-2). OCA witness Kahal noted in his surrebuttal testimony that this assertion is only partly true:

The call premiums were financed partly by investors (i.e., about 60 to 65 percent) and partly by the U.S. Treasury due to the tax write-off. PP&L should only receive a return on the portion of the unamortized balance financed by investors. That is why deferred taxes must be recognized. Mr. Moul's other argument that ratepayers receive their appropriate share of the tax savings through interest synchronization misses the essential point. The issue with the deferred taxes is not whether the tax benefit dollars will be passed on to ratepayers but when. (Emphasis supplied by the OCA).

(OCA St. 1B, page 7).

The OCA submits that PP&L agrees that the deferred taxes exist, the issue is whether the timing difference should be flowed through to ratepayers as is the normal practice for deferred taxes.

PP&L argues against the OCA rate base because it "would give customers the benefit of the tax deduction up front.." (PP&L St. 12R1, pages 2-3). In response, OCA witness Kahal testified:

Mr. Catlin's recognition of deferred taxes does not front load the tax benefit for ratepayers, as Mr. Moul asserts. Rather, its purpose -- as is always the case with deferred tax recognition -- is to ensure that the Company only receives a return on the investor-financed portion of the asset, not on

the portion financed by the taxing authority or ratepayers.

(OCA St. 1B, page 8).

The OCA submits that limiting PP&L's return to the shareholder financed portion is an appropriate ratemaking treatment of these funds. The OCA states that PP&L seems to be arguing that since unamortized call premiums are not given rate base recognition, then witness Catlin's adjustment should be rejected. However, OCA witness Kahal testified that because PP&L witness Moul "subtracts the unamortized balance from debt balance for capital structure purposes he is in effect giving that balance a combined debt plus equity return, i.e., the dollar equivalent of putting it in rate base" (OCA St. 1B, page 8). As witness Kahal explained:

... Mr. Moul's proposed rate of return treatment gives PP&L the same dollar amount as if it received rate base treatment on the unamortized balance. By including the call premium adjustment in rate of return, PP&L hides the fact that it is seeking a rate base equivalent rate of return (including income tax gross up) for an expense item.

(Id. pages 8-9).

Thus, the OCA submits that should Mr. Moul's adjustment be adopted, the OCA's recommended adjustment to rate base should be adopted.

The ALJ found that PP&L's capital structure proposal of 57.48 percent long-term debt, 7.59 percent preferred stock and 45.88 percent common equity best reflected the manner in which PP&L will be financed during the life of the proposed rate increase. (R.D. at 159).

The ALJ found that the common stock issuance in the second part of a two part financing plan is reasonable. The ALJ found that the repurchase of high cost debt is nearly complete. Further, the ALJ found that PP&L has begun the process of issuing new common equity. The ALJ also commented that it should be noted that PPLICCA's witness has proposed to use PP&L's future test year end embedded cost rates. The ALJ continued that these rates are, of course, a function of the very future test year financings that he would ignore for capital structure purposes. (R.D. at 143; Footnote 1).

The ALJ agreed with PP&L's argument that use of projected fixed capital costs as of September 30, 1995 which only reflects in part PP&L's financing plan would create a mismatch of capital costs and capital structure ratios. The ALJ also considered PP&L's contention that the issuance of common stock is necessary because if PP&L does not improve its common equity ratio, its bonds could be downgraded. (R.D. at 159).

With regard to the issue of adjusting capital structures to allow recovery of the call premium expense through an amortization and to earn a return on that unamortized balance of that expense, the ALJ cited NFG 1988 and NFG 1990 for the proposition that the Commission in the past has allowed such an adjustment. The ALJ found nothing in the evidence of this proceeding that would persuade him that the Commission position should be reconsidered. (R.D. at 159-160).

Finally, the ALJ agreed with PP&L that it is reasonable to match recovery of the cost of the premiums and the associated tax savings. The ALJ observed that PP&L would accomplish this by recovering the cost of the premiums over the life of the new debt and by returning the deferred tax savings over the same time. (R.D. at 160).

In its Exceptions, PPLICA argues that the ALJ has approved a capital structure that is based upon conjecture and speculation. PPLICA continues that during the evidentiary phase of the hearing, PP&L neither committed to the August equity issuance upon which its capital structure was based nor provided evidence of any numerical study evaluating whether the issuance would be a prudent financing effort. (PPLICA Exceptions at 27).

PPLICA asserts that NFG 1990 stands for the proposition that a capital structure based upon a possible issuance of equity must be denied as being too speculative. PPLICA maintains that the ALJ erred in adopting a speculative capital structure. PPLICA asserts that the only reasonable alternative is to utilize PP&L's actual capital structure as of September 30, 1994. (Id.)

In its Exceptions, the OCA points out that this proceeding, PP&L's projected capital structure relies, in part, on a \$100 million equity issuance scheduled to take place in August 1995, prior to the issuance of the Commission's Final Order. The OCA continues that it did not object to using the projected capital structure, as long as the Company updated the Commission on the status and amount of the planned equity infusion, and utilized only the actual amount of equity issued in the capital structure. However, the OCA maintains that if the equity infusion did not occur prior to the entry of the Commission's Final Order in this proceeding, the OCA recommended that PP&L's capital structure should be revised to exclude the projected equity infusion. (OCA Exceptions at 41).

To date, says the OCA, PP&L has provided no additional information on the status of the equity issuance, even though PP&L's witnesses agreed that it would be reasonable to use the actual amount of equity issuance in the Company's capital structure. OCA M.B. at 213-214; OCA R.B. at 99. The OCA cites NFG 1990 for the proposition that absent firm evidence that the

equity has been issued, PP&L should not be allowed to include it in its capital structure in this rate proceeding. (Id.)

Thus, the OCA excepts to the ALJ's finding that PP&L's projected capital structure is "reasonable," absent any evidence that the equity infusion in the amount projected by PP&L is proceeding as scheduled. The OCA submits that PP&L retains the burden to establish that the equity issuance has actually taken place prior to the entry of a final Order. Accordingly, the OCA submits that prior to the entry of a Final Order in this proceeding, PP&L should be required to update the Commission and the active parties of record on the status and amount of the planned equity infusion. Moreover, insists the OCA, should the equity infusion not occur prior to the entry of the Commission's Final Order in this proceeding, PP&L's capital structure should be revised to exclude the projected equity infusion. (OCA Exceptions at 42).

The OCA then addressed the ALJ's rejection of the OCA's primary capital structure recommendation finding that Commission precedent allowed utilities to adjust their capital structures for the recovery of call premium expense. (R.D. at 159-160). The OCA does not except to this recommendation. In the alternative, if the Commission did not accept this adjustment, the OCA recommended that PP&L's rate base be adjusted to recognize the balance of accumulated deferred income taxes (ADIT) associated with the Company's loss on reacquired debt. However, the ALJ also rejected the OCA's rate base adjustment associated with ADIT. The OCA urges that its (ADIT) adjustment must be adopted if the OCA's primary recommendation is rejected. Thus, the OCA excepts to the rejection of its alternative adjustment. (OCA Exceptions at 42)

The OCA submits that the ALJ's finding that it is reasonable to "match recovery of the cost of the premiums and the

associated tax savings", in fact creates a mismatch. The OCA continues that its rate base adjustment recognized that the Company's practice of reacquiring debt gave rise to a tax timing difference, and hence, deferred taxes. In other words, according to the OCA, shareholders have already received the tax savings but ratepayers will only see the tax savings gradually over the next 10 to 15 years. However, the OCA presents the testimony of its witness Mr. Catlin as follows:

... nowhere in its calculations has PP&L recognized that it received an immediate tax benefit for the loss which served as a source of cost-free capital. Therefore, deducting the balance of ADIT on reacquired debt from rate base is necessary to recognize this balance as a source of non-investor supplied capital.

(OCA Exceptions at 43).

The OCA continued that the issue with the deferred taxes is not whether the tax benefit dollars will be passed on to ratepayers but when. The OCA submits that the ALJ's recommendation fails to recognize that the rate base adjustment for the accumulated deferred income taxes associated with the loss on reacquired debt ensures that the Company only receives a return on the investor-financed portion of the asset, not on the portion financed by the taxing authority or ratepayers. Thus, the OCA submits that if the Commission adopts the ALJ's recommendation to allow PP&L to adjust its capital structure by the amount of the losses on reacquired debt, then the Commission must also adopt the OCA's adjustment to rate base in order to reflect the associated accumulated deferred income taxes. The OCA concludes that absent this adjustment, ratepayers will be denied timely recovery of the deferred taxes associated with PP&L's call premiums. The OCA refers to its Statement Schedule TSC-4 to illustrate that adoption of this adjustment reduces

total Company rate base by \$47,863,000 and reduces Pennsylvania jurisdictional rate base by \$40,838,000.

(OCA Exceptions at 44).

In its Reply Exceptions, PP&L contends that the un rebutted record evidence demonstrates that the new issuance of common equity is necessary and appropriate. It is the position of PP&L that the ALJ properly rejected the OCA/PPLICA attempt to establish a rigid and artificial deadline for reflection of new common equity in the Company's capital structure. PP&L maintains that all other elements of the ratemaking formula are based on best available estimates in the record. The common equity ratio should be no different.

Regarding the deferred tax adjustment associated with premiums paid to reacquire high cost debt and preferred stock, PP&L asserts that the adjustment was correctly rejected by the ALJ. PP&L continues that its aggressive refinancing efforts have dramatically lowered the Company's cost of capital. PP&L contends that the Commission has repeatedly recognized that such refinancing efforts are in the public interest and has held that utilities should be allowed to fully recover all costs associated with such reacquisitions (PP&L Reply Exceptions at p. 29).

PP&L maintains that in order to reacquire high cost debt and preferred stock, the Company, in most instances, had to pay a premium to existing investors. PP&L continues that this premium was paid in full by stockholders at the time of the reacquisition and was tax deductible at that time. PP&L argues that for ratemaking purposes, the Company will recover the premium from customers over the life of the new bonds issued to pay the premium. According to PP&L, under the its proposal, the associated tax savings will be flowed through to customers as they pay the associated premiums. It is the position of PP&L that the OCA's adjustment would give customers all of the tax

savings now, even though they will not pay the associated costs until many years in the future. The Company submits that this is unfair and inequitable and would discourage utilities from taking aggressive measures to reacquire high cost debt. PP&L counters that the OCA fails to cite a single case in which an adjustment of this type has been adopted. PP&L urges rejection of what it terms as OCA's unprecedented and inequitable adjustment.

Upon consideration of the positions of the parties, we will adopt the recommendation of the ALJ to use the PP&L-proposed capital structure. We found the argument advanced by PP&L, that an a matching of all elements of the capital structure is essential, to be persuasive. As noted previously by ALJ Christianson, use of projected fixed capital costs as of September 30, 1995 which only reflects in part PP&L's financing plan by excluding the planned equity issuance, would create a mismatch of capital costs and capital structure ratios. Moreover, we are mindful, along with the ALJ, of the necessity for PP&L to increase the equity component of its capital structure to avoid a downgrading of its bonds. We are convinced that an equity issuance is imminent, despite the fact that it had not occurred prior to August 31, 1995. Accordingly, we will deny the Exceptions of the OCA and PPLICA, and adopt the reasoning and recommendation of the ALJ.

With regard to the issue of the recovery of the call premium expense, we agree with the ALJ's resolution of this issue for several reasons. First, this issue has been considered in NFG 1988 and NFG 1990, and the ALJ's disposition of the issue is consistent with precedent, and that the record herein contains no reason to act contrary to the two aforesaid cases. Second, it is in the interest of PP&L and its ratepayers for the Company to recall high cost debt. We were convinced by PP&L's argument in its Reply Exceptions that to adopt the OCA's adjustment would give customers all of the tax savings now, even though the

ratepayers will not pay the associated costs until many years in the future. We agree with the Company's assertion that this action may discourage utilities from reacquiring high cost debt in the future. Thus, the Exception of the OCA that deals with this issue is denied.

B. Long-Term Debt Cost

PP&L is claiming a pro forma September 30, 1995 debt cost rate of 7.97 percent (PP&L main brief, pages 200 and 209). The ALJ noted that the OTS, PPLICA, and DOD accept PP&L's debt cost claim.

(R.D. at 160).

The OCA proposed a reduction in PP&L's debt cost claim of 7.97 percent to 7.84 percent to reflect recognition of accumulated deferred income taxes associated with reacquired debt in the cost of debt (OCA St. 1B, page 9).

The ALJ recommended adoption PP&L's debt cost claim of 7.97 percent because it rejects OCA's claim on capital structure. The ALJ reasoned that use of OCA's debt cost would create a mismatch between the capital structure and the debt cost.

No party filed exceptions to the ALJ's recommendation. Accordingly, we will adopt the ALJ's recommendation.

C. Preferred Stock Cost

PP&L is claiming a pro forma September 30, 1995 preferred stock cost rate of 7.31 percent. The ALJ noted that OCA, OTS, PPLICA and DOD accept PP&L's preferred stock cost claim (Id.). There is no disagreement over this claim. The ALJ recommends adoption of the claim. We will adopt the ALJ's recommendation.

D. Common Equity Cost

The ALJ proffered the following summary of the Common Equity Cost recommendation of the parties:

<u>Methodology</u>	<u>PP&L</u>	<u>OCA</u>	<u>PPLICA</u>	<u>DOD</u> ¹	<u>OTS</u>
	%	%	%	%	%
Discounted Cash Flow (DCF)	12.46	11.1	10.85		10.63
Risk Premium (RP)	13.25				
Capital Asset Pricing Model (CAPM)	12.79-13.92				
Comparable Earnings (CE)	13.55				
Recommendation	13.0	11.1	10.85	11.5	10.63

1 DOD's cost of common equity is based upon the cost of common equity in Pennsylvania Public Utility Commission v. West Penn Power Company, Docket No. R-00942986. DOD witness Prisco did not conduct any independent study of current capital markets (DOD main brief, pages 8-9). This Opinion and Order will contain no further discussion of the DOD recommendation.

Generally, observed the ALJ, the Commission has criticized the Risk Premium and CAPM methodologies. In rejecting Risk Premium and CAPM analyses, the Commission has explained:

[F]irst, we [i.e., the Commission] cannot accept that historic experienced earnings reflect the cost of capital. We know of no reputable analyst who would seriously argue that experienced earnings represent the cost of capital, except by pure happenstance. But, such is the inherent assumption of each methodology [Risk Premium and CAPM]. Second, we cannot accept, even assuming that historic experience earnings represented the cost of capital that the average premium of an equity investment over a fixed income investment

over a period as long as 50 years, represents the investor required premium in today's and tomorrow's market.

Accordingly, we conclude that we can place little credence in the results of these methodologies.

Pennsylvania Public Utility Commission v. Pennsylvania Power Co., 67 Pa. P.U.C. 91, 164 (1988) (emphasis in original); see also Pennsylvania Public Utility Commission v. Peoples Natural Gas Co., 69 Pa. P.U.C. 138, 165-68 (1989); Pennsylvania Public Utility Commission v. Pennsylvania-American Water Co., 68 Pa. P.U.C. 343, 377-78 (1988); Pennsylvania Public Utility Commission v. National Fuel Gas Distribution Corp., 67 Pa. P.U.C. 264, 331-32 (1988); Pennsylvania Public Utility Commission v. York Water Co., 62 Pa. P.U.C. 459 (1986).

The ALJ noted that in Pennsylvania Public Utility Commission v. Duquesne Light Co., 66 Pa. P.U.C. 518 (1988), the Commission declared "that the economic environment over lengthy time frames is not representative of current economic conditions and therefore does not produce realistic risk premium results." (R.D. at 163).

The ALJ stated that his equity return recommendation in this proceeding is based primarily upon the DCF method and judgement. (Id.).

The ALJ noted that PP&L's common stock was publicly traded during this proceeding. The ALJ continued that, at its annual meeting in May, 1995, PP&L's stockholders approved the creation of a holding company. PP&L Resources, the holding company, operations are dominated by PP&L electric operations and its common stock is publicly traded. (Id.)

The ALJ stated that his recommendation would consider the financial market data for PP&L and the barometer groups set forth by the parties. The ALJ continued that barometer group data is given slightly less weight because no two utilities are ever complete replications of each other and therefore, no barometer group of companies however well chosen is ever universally comparable to the subject utility. The ALJ continued that, understanding this truth, he would consider data for all proposed utility groups. The ALJ observed that each of the barometer groups consists of utilities which the sponsoring party argues are as similar to PP&L in terms of risks as it is possible to be. The ALJ found that PP&L is not faced by business risks that are not faced by the barometer group companies and as such the risks are reflected in the market price of their stocks. The ALJ opined that in the world of corporate finance and utility regulation, the existence of risk rate imperfections between a specific utility and a barometer group is inevitable. (R.D. at pp. 163-164).

At page 164 of the R.D., the ALJ proffered the following summary of the dividend yield and growth rate recommendations of the parties:

<u>DCF</u>	<u>PP&L</u> %	<u>OCA</u> %	<u>PPLICCA</u> %	<u>OTS</u> %
Dividend Yield	8.29	7.50	7.8	7.45
Growth Rate	4.00	3.45	2.8	2.88
Recommendation	12.46	11.1	10.85	10.63

A very simplified explanation of the DCF method is that it is expressed mathematically as $K=(D/P)+G$, where K represents the cost of capital, D represents the dividends paid, P represents the price of the stock, and G represents the growth

rate. Stated another way, the DCF recommendation is the dividend yield (D/P) plus the growth rate.

1. PP&L

PP&L chose a barometer group of 8 electric companies. The barometer group of 8 electric companies consist of the following electric utilities:

Allegheny Power System
American Electric Power
Atlantic Energy, Inc.
Baltimore Gas and Electric Company
Delmarva Power & Light Company
DPL, Inc. (Dayton Power & Light)
Potomac Electric Power Company
Public Service Enterprise Group

See PP&L Exhibit PRM-1; Schedule 2, Page 2.

PP&L computed the dividend yield component or "D" of the DCF formula by taking an average dividends for the twelve months ended October, 1994, for PP&L and the Barometer Group identified above. The price of the stock, or "P" in the formula was determined by the month-end price of the stock, adjusted to reflect the build-up of the dividend price which has occurred since the last ex-dividend date dividend, or, the date upon which a shareholder must own the shares to be entitled to the dividend payment, usually about two to three weeks prior to the actual payment. The results of the calculation was a dividend yield of 7.48% for PP&L and 7.28% for the barometer group. The Company continued that comparing dividend yields for three and six-month periods for the Company produces results of 8.26% and 8.37% for PP&L, and 7.80% for the barometer group for both time frames. PP&L used an average dividend yield of 8.25% for PP&L and 7.75% for the Barometer Group. (PP&L Statement No. 12, pp. 39-41).

Then PP&L, through its witness Mr. Moul, incorporated an adjustment to the dividend yields as follows:

For the purpose of a DCF calculation, the average dividend yield must be adjusted to reflect the prospective nature of the dividend payments, i.e., the higher expected dividend for the future. Recall that the DCF is an expectational model which must reflect investor anticipated future cash flows. For PP&L, I have adjusted the 8.25% dividend yield in three different but generally acceptable manners, and used the average of the three of 8.49% as calculated in Appendix C. Similarly, Appendix C provides the basis for the 7.97% adjusted dividend yield which I have calculated for the Barometer Group.

(PP&L Statement No. 12 at 41).

First, the dividend yields were adjusted for the expected increase in dividends at the level of one-half the growth component of 4.00% or 1.02%, which results in an adjusted dividend yield of 8.42% for PP&L, and 7.91% for the Barometer Group. (PP&L Statement No. 12, Appendix C at C-7). The second adjustment is for the discrete growth in the quarterly dividend, by a factor of 1.02488%. This adjustment results in dividend yields for PP&L of 8.46% and 7.94% for the Barometer Group. (PP&L Statement No. 12, Appendix C at C7-8). The third adjustment provided for the compounding of the annual quarterly dividends. This adjustment was to multiply the unadjusted dividend yield 8.25% by the factor of 1.020625%, which results in a yield of 8.60% for PP&L and 8.06% for the Barometer Group. Thus the average of the three adjusted dividend yields is 8.49% for PP&L and 7.97% for the Barometer Group. (Id.). For its dividend yield recommendation, PP&L used 8.25%.

For the growth rate component, or "G", PP&L used 4.0%. Its growth rate recommendation was based an analysis of five-year

projected growth rates and historical growth rates for PP&L and the Barometer Group by Value Line and Institutional Brokers Estimate System ("I/B/E/S"). PP&L noted that the historical growth rates in earnings per share contain instances of negative growth. PP&L continues that negative growth rates provide no reliable guide to gauge investor expected growth for the future, and should not be given significant weight in formulating a composite investors' growth expectations for the future. PP&L noted that its historical growth for dividends was approximately 3.50%. The analysis for the Barometer group produced a range of from 2.25% to 3.31%. (PP&L Statement No. 12, Appendix C at C12-13).

The five-year growth rates from Value Line and I/B/E/S show projected earnings per share rates of 1.00% to 1.55% for PP&L, and 2.28 to 3.56% for the Barometer Group. PP&L witness Moul explains the difference as follows:

This situation indicates that the forecast show [sic] a repositioning of growth for PP&L relative to the Barometer Group. So while PP&L historically had higher growth than the Barometer Group, the forecasts now suggest that PP&L's growth will lag the Barometer Group. This situation is understandable given the extended length of time since the Company's last rate case. When the Company's earnings are restored to more normal levels after this rate case, PP&L will be able to begin a new cycle of earnings growth after the recent periods where growth has showed from previously higher levels.

(PP&L Statement No. 12; Appendix C; Page C-14).

PP&L asserts that historical performance and published forecasts support the reasonableness of a growth rate, "G", recommendation of 3.5%. PP&L continues that for purposes of this case a .5% adjustment to the growth rate for market-wide factors is warranted. The reasoning is as follows:

While the DCF growth rate cannot be established solely with a mathematical formulation, the growth rates for PP&L and Barometer Group are within the array of growth rates shown by company-specific accounting values (earnings per share, dividends per share, book value per share, retention growth, and cash flow per share). However, as previously noted, market-wide factors also influence the capital gains yield expected by investors. In my opinion, the DCF growth rate must represent the capital gains expectations of investors given the growth prospects for the economy and the new business environment of electric industry. Moreover, the DCF growth rate must be representative of the relative proportion that the capital gains yield provides within investors' total return expectations.

(PP&L Statement No. 12 at 43).

Accordingly, PP&L recommends a "D" of 8.49% and a "G" of 4.00% for a DCF-based equity return of 12.49%

The OCA considers PP&L's common equity cost rate claim to be overstated for five reasons (OCA main brief, pages 251-263).

1. PP&L employs an unsupported growth rate which includes a 50 basis point adjustment for "non-company specific" market factors;
2. PP&L also adjusts the DCF calculation to reflect an ex-dividend adjustment and quarterly compounding of the dividend;
3. PP&L's use of a RP method consistently rejected by the Commission;
4. PP&L's use of the CAPM method consistently rejected by this Commission; and
5. PP&L's comparable earnings approach should be rejected because its an accounting

ratio and not a financial market related ratio.

(OCA main brief, pages 251-263).

The OTS considers PP&L's common equity cost rate claim to be overstated for four reasons:

1. PP&L's use of ex-dividend adjustment;
2. PP&L's 50 basis point adjustment for market factors;
3. PP&L's use of CAPM and RP methods that contend that historical conditions are the same as current conditions; and
4. PP&L's use of comparable earnings method, since it merely computes historical book returns for unregulated companies.

(OTS main brief, pages 127-132).

PPLICA considers PP&L's common equity cost rate claim to

be overstated for five reasons:

1. PP&L's DCF growth rate claim is overstated;
2. PP&L's DCF growth rate claim further includes 50 basis point adjustment for market factors;
3. PP&L's use of the comparable earnings approach should be rejected as an accounting based ratio rather than a market based ratio;
4. PP&L's RP should be rejected because its based historical data that has no relevance; and
5. PP&L's CAPM approach should be rejected because this Commission has previously rejected this approach.

2. The OCA

The OCA used a "primary proxy group" which consists of the following utilities:

Atlantic Energy
Baltimore Gas & Electric
Carolina Power & Light
Delmarva Power & Light
Detroit Edison
Dominion Resources
IES Industries
Kansas City Power & Light
Midwest Resources
New England Electric System
Pacific Gas & Electric
Public Service Enterprise
San Diego Gas & Electric
SCANA
Southern Company
Union Electric
Western Resources

(OCA Statement No. 1; Schedule MIK-4)

For the price or "P" component of the formula, the OCA by computing the average stock price obtained from the Standard and Poor's ("S&P") Stock Guide for the six-month period ending February 1995 for the barometer group listed above. The OCA obtained from the S&P stock guide, the average quarterly dividend annualized and divided by the stock price, for the end of the six-month period ended February 1995. The OCA analysis produced an average dividend yield for the said six-month period of 7.66%. The OCA added that the average dividend yield for the most recent three-month period was 7.48%. The OCA chose to use the six-month average of 7.66%. The OCA adjusted the six-month dividend average by 1.02% to reflect half of the growth in dividends which results in a dividend yield of 7.8% for the barometer group.

For PP&L, alone, the OCA utilized, as a check, the dividend yield for the six month period ending February 1995 of

8.39%. Adjustment for the one-half year's growth, resulted in a dividend yield of 8.5%.

For the "G" component, the OCA used historical and projected growth rates, as well as an application of the earnings retention method. The earnings retention method is defined as the future retention rate "b" multiplied by the future expected return on book equity "r" in order to obtain a sustainable growth rate. For the "r" portion of the formula, the OCA found that the average return on equity for the barometer group was 11.8% during the last 5 years, and 13.2% over the last 10 years. The retention rate, or "b", for the past five and ten year periods were 11.8% to 20.1%. In combination, the (b x r) calculation produces a historical growth rate of 1.4%.

The OCA's analysis for future performance indicates a projected equity return of 12.0%, and an average retention rate of approximately 20%. The OCA noted that the Value Line Investment Survey currently projects a future return on book equity of 12.0% for the period 1997-1999. Thus, the OCA submits that b x r rate suggests a growth rate 2.4%, for the barometer group, based upon analysts projections.

The OCA continued that the growth rate evidence suggests a lower growth rate for PP&L than for the barometer group. The OCA found a growth rate range of 2.5% to 3.0% for PP&L.

The OCA's calculation for its PP&L-exclusive calculation results a DCF-based return of between 11.0% and 11.5%. The OCA states that the PP&L-specific analysis is used as only as a check on its other studies, and as such should not be given much weight in the deliberation. (OCA Statement No. 1, Page 37).

Based on the foregoing analysis, the OCA recommends a DCF-based rate of return ranging from 10.5% to 11.5%, with a midpoint of 11.1%.

PP&L criticized the OCA's proposed DCF growth rate because it specifically assumed returns on equity in a 12 percent to 12.5 percent range (PP&L St. 12-R, pages 17-18). PP&L contends that the OCA did not explain how PP&L can achieve these anticipated growth rates under the OCA-proposed 11.1 percent return on equity.

3. PPLICA

PPLICA used two barometer groups of electric companies plus PP&L. One of the barometer groups used by PPLICA was the barometer group used by PP&L. The other barometer group is as follows:

Atlantic Energy, Inc.
Carolina Power & Light Co.
Delmarva Power & Light Co.
Dominion Resources, Inc.
Kansas City Power & Light Co.
New England Electric System
Oklahoma Gas & Electric Co.
St. Joseph Light & Power Co.

(PPLICA Statement 8 at 23).

PPLICA first calculated the dividend yield or "d" for PP&L for the six month period from September 1994 through February 1995, using the data which appears in the S&P Stock Guide. The result of this analysis is an average dividend yield of 8.39%. (PPLICA Statement 8 at 24).

For the growth rate component or "g" PPLICA computes what it refers to as the "Expected" growth rate. PPLICA used the

Value Line and I/B/E/S surveys. The Value Line growth estimates are based on forecasts for the next five to six years. The I/B/E/S/ estimates are based on forecasts for the next five years. PPLICA also applied the retention ratio method used by the OCA. The forecasted compound growth rates from the Value Line survey ranged from 1.00% to 2.05%. Historical growth rates ranged from 2.75% to 3.42%. (PPLICA Statement 8 at 28).

Based upon the analysis, PPLICA calculates a dividend yield adjusted for growth from 8.48% to 8.52%, and a growth rate range from 2.05% to 3.05%. Therefore, a range of 10.53% to 11.57% exists in the calculation. PPLICA arrives at a mid-point 11.05%.

For the barometer group, PPLICA performed a similar calculation to arrive at a six-month average dividend yield of 7.35%. (PPLICA Statement 8 at 30). The growth component was calculated in the same manner as for PP&L. The forecasted growth rates ranged from 1.45% to 2.80%. Historical averages ranged from 3.02% to 3.38%. Thus, for the barometer group, PPLICA's analysis results in a growth-adjusted dividend yield of 7.45% to 7.48%. The growth rate ranged from 2.60% to 3.40%. PPLICA's calculation ranges from 10.05% to 10.88% or a mid-point of 10.47% (PPLICA Statement 8 at 32)

For PP&L's Barometer Group, PPLICA performed the same calculation that it performed for PP&L and its own Barometer Group. The result of the dividend yield calculation was a six-month average dividend yield of 7.66%. The forecasted growth rates ranged from 1.44% to 3.15%. The historical growth rates ranged from 2.10% to 2.73%. For PP&L's Barometer Group, PPLICA's analysis results in a growth adjusted dividend yield of 7.78%, and a growth rate range from 2.70% to 3.20%. The final calculation results in a range of between 10.26% to 10.98%. (PPLICA Statement 8 at 32).

For purposes of this case, PPLICA recommends a DCF-based equity return of 10.85%. The 10.85% figure represents the average of the range of mid-points of the PP&L and Barometer Group analyses. PPLICA comments that its recommended equity return is near the upper range of its Barometer Group. (PPLICA Statement 8 at 36).

4. The OTS

The OTS provided equal weight to the financial results of PP&L and the Barometer Group used by PP&L in this proceeding.

For the dividend yield component, the OTS' analysis resulted in a for the 52-week period ending with February, 1995 of 7.68% for PP&L and 7.5% for the Barometer Group, and a Spot dividend yield as of February 22, 1995²⁹ of 7.30% for the Barometer Group and for 8.15% PP&L. (OTS Statement No. 1; Schedule No. 1, pages 1-2).

For the growth rate component the OTS used both projected and historical growth rates. The OTS based its estimates upon Value Line estimates, S&P consensus estimates, retention rate analysis and 10-year log linear growth rates. Based upon this analysis, the OTS found that a growth rate estimate ranging 2.75% to 3.25% represented the growth that investors could reasonably expect, for the barometer group and from 2.50% to 3.00% for PP&L.

Based upon the foregoing analysis, the OTS finds an equity return of 10.63% to be appropriate.

²⁹The OTS notes that Value Line reports the spot price as of the last Wednesday of the month.

According to PP&L, OTS' mechanical application of the DCF model produced unreasonable results for both PP&L, and its barometer group companies. PP&L observes that the OTS' analysis of the Value Line barometer group determined that the cost of equity for its individual companies produced DCF calculations as low as 9.25 percent for a barometer group and 9.4 percent for PP&L while some of the barometer group companies had individual DCF calculations as low as 8.2 percent to 8.5 percent (PP&L St. 12-R, pages 19-20). PP&L asserts that if one accepts the standard regulatory version of DCF, these results must show the expected cost of common equity. The simple answer, according to PP&L, is that the DCF method cannot be used in isolation and without careful exercise of informed judgment.

The ALJ recommended an unadjusted dividend yield of 7.63 % because it is the mid point of the ranges of the OCA, the OTS, and PPLICIA. The ALJ reasoned as follows:

1. The dividend yields represent longer term trends and short-term trends with the result that the dividend yields are not stale nor are they biased by short-term aberrations;
2. The dividend yields include data for PP&L and groups of barometer companies;
3. The use of three expert witnesses and the mid-point of their proposals would decrease expert witness bias; and
4. The use of the dividend yield range of three expert witnesses would decrease barometer group selection bias.

(R.D. at 171).

The ALJ recommended adjustment of the dividend yield and for the next period growth as follows:

The 7.63 percent unadjusted dividend yield adjusted for next period growth is 7.75 percent (unadjusted dividend yield of 7.63 percent times half of the growth rate of 3.15 percent equals 7.75 percent).

(R.D. at 171).

For the growth rate, the ALJ found as follows:

This recommendation finds a growth rate of 3.15 percent. I do not find the growth rate evidence of any party to be totally persuasive. The evidence of record indicates a growth rate range of 2.8-3.5 percent. The range is premised upon all four parties' proposed growth rates. The PP&L claim of 4 percent overstates the growth by at least 50 basis points. The 50 basis points adjustment reflects an adjustment for other market factors (PP&L main brief, pages 219-220). I find the arguments proposed by OTS, OCA and PPLICA on the adjustment to be reasonable. The three parties argue that PP&L produced no evidence to support it and that it appears to be only an adder (OCA St. 1A, page 14; PPLICA St. 8, page 42; and OTS main brief, pages 127-128).

The 3.15 percent growth recommendation is the mid-point of the 2.8-3.5 percent range. The use of the mid point offsets aberrations and biases in the data and any bias the expert witness may have.

Therefore, the ALJ recommended a DCF common equity cost rate of 10.9 percent (adjusted dividend yield of 7.75 percent plus a growth rate of 3.15 percent). (R.D. at 171-172).

Summary of Recommendation

<u>Capital Structure</u>	<u>Ratio</u> %	<u>Cost Rate</u> %	<u>Weighted Cost</u> %
Long-Term Debt	46.53	7.97	3.71
Preferred Stock	7.59	7.31	.55
Common Equity	<u>45.88</u>	<u>10.90</u>	<u>5.00</u>
	<u>100.00</u>		<u>9.26</u>

(R.D. at 179).

In its Exceptions, PP&L argued that as a threshold matter, the ALJ's proposed 10.9% equity allowance cannot be reconciled with recent Commission cost of capital findings. For example, within the past month the Commission determined that the cost of equity for a water utility was 11.25%. Pa. P.U.C. v. Pennsylvania-American Water Co., Docket No. R-00943231 (July 24, 1995), ("PAWC"); see also Pa. P.U.C. v. Roaring Creek Water Co., Docket No. R-00943177 (May 31, 1995), ("Roaring Creek") (11.0%). And, last December, the Commission awarded West Penn Power Company -- a utility with an A+ bond rating and no nuclear investment exposure -- an equity return rate of 11.5%. (PP&L Exceptions at 26).

PP&L continued that the ALJ's recommendation is far too low is also confirmed by recent regulatory decisions from other jurisdictions. See, e.g., Re Portland General Electric Co., 160 PUR4th 201, 271 (1995) (11.6%); Re Hawaii Electric Light Co., 159 PUR4th 290, 325 (1995) (11.5% prior to upward adjustment for company-specific risk factors); Re Sierra Pacific Power Co., 158 PUR4th 217, 241-242 (1995) (setting authorized equity returns for California's electric utilities ranging from 11.3% to 12.1%); Re Commonwealth Edison Co., 158 PUR4th 458, 521 (1994) (12.28%); Re Madison Gas & Electric Co., 158 PUR4th 168, 178 (1994) (11.7%); Re Wisconsin Power & Light Co., 158 PUR4th 80, 93 (1994) (11.5%). (PP&L Exceptions at 26-27).

According to PP&L, the principal flaw in the ALJ's analysis rests in his averaging of results. PP&L cites Pa. P.U.C. v. Columbia Gas of Pa., Docket No.. R-891468 (September 20, 1990) (Order, pp. 118-119) ("Columbia 1990") for the proposition that the Commission has properly held in the past, this technique [averaging] only invites abuse. Specifically, PP&L cites Columbia 1990 as follows:

"[c]ost of equity recommendations should be based upon specific market based costs, rather than by a method which averages the recommendations of the various parties."

(Columbia 1990 at 118-119).

Even in the most extreme situation, argues PP&L, the averaging of results is a poor substitute for informed judgment and thoughtful analysis. In this proceeding, asserts PP&L, the use of such an approach is especially egregious. As noted earlier by PP&L, the ALJ chose to average the findings of the OTS, OCA and PPLICA witnesses and, in so doing, gave no weight whatsoever to the evidence submitted by the Company. Consequently, it is the position of PP&L that the Recommended Decision does not act to "decrease expert witness bias", as suggested (R.D., p. 171), but instead tilted the scales decisively toward those who, from the outset, have aggressively opposed PP&L's requested rate increase. (PP&L Exceptions at 30-31).

Moreover, and wholly apart from the issue of witness bias, PP&L argues that the ALJ's averaging of results is at odds with his stated purpose. PP&L notes that at page 163 of the Recommended Decision, the ALJ indicates that he believes barometer group data should be given "slightly less weight" than data for PP&L itself. However, PP&L posits that his use of the midpoint of the average dividend yields proposed by the opposing

party witnesses has exactly the opposite effect. This according to PP&L is because the OCA and PPLICCA produced dividend yields for two different barometer groups. Accordingly, PP&L maintains that an average of their respective dividend yield findings accords two-thirds weight to barometer group data and only one-third weight to PP&L data. (PP&L Exceptions at 30).

Compounding this problem, according to PP&L, is the fact that the 7.5% OCA dividend yield set forth on page 164 of the Recommended Decision appears to be the rounded average of the OCA's two barometer group findings and, as such, completely disregards his recommended DCF yield for PP&L. PP&L argues that if only equal weight had been given to the OCA's 8.46% yield for PP&L, the midpoint of the ALJ's dividend yield range would have approximated 7.96%, or 33 basis points higher than his 7.63% recommendation. PP&L contends that if "slightly less weight" were accorded the barometer group data, as the ALJ implies would be appropriate, the figure obviously would be even higher.

PP&L argues further that the final flaw in the ALJ's averaging of results is attributable to the fact that all three opposing party witnesses developed proposed yields for PP&L and PP&L's barometer group. PP&L argues that rather than inputting multiple (i.e. initial and updated) dividend yield values for PP&L and the same group of utilities, the ALJ should have considered only the most current yield data presented by the close of the record as follows:

Baudino Barometer Group (PPLICCA St. 8, p. 32)	7.35%
Kahal Barometer Group (OCA St. 1A, Sch. MIK-6, p. 1 Update)	7.41%
Moul Barometer Group (OCA St. 1A, Sch. MIK-4, p. 1 Update)	7.52%

PP&L
(OCA St. 1A, Sch, MIK-7, p. 1 Update) 8.46%

(PP&L Exceptions at 31).

PP&L counters that utilizing the midpoint of the range of values, which also has the effect of giving equal weight to PP&L and barometer group data, produces an unadjusted dividend yield of 7.91%.

PP&L next argues that the ALJ's recommended 3.15% growth rate, which similarly is based on an averaging or midpoint approach, is deficient for many of the same reasons that undermine his dividend yield finding. More importantly, says PP&L, his proposed 10.9% equity allowance, even if achieved, would not generate anything near the level of growth which he concluded investors could reasonably expect.

This is confirmed by the following table, which is comparable in format to that developed by Mr. Moul in his rebuttal testimony (PP&L St. 12-R, p. 6) and reproduced in the PP&L's Initial Brief (p. 229):

Recommended ROE	PP&L Book Value	Earnings Per Share	Amount Retained Per Share	Calculated Growth Rate
10.9%	\$15.79	\$1.72	\$1.67	0.32%

(PP&L Exceptions at 32).

In its Reply Exceptions, the OCA responds to PP&L's Exception wherein PP&L criticizes the ALJ's return on equity recommendation as being "woefully inadequate" and compares it to recent return on equity determinations made by this Commission and Commission's in other jurisdictions. Specifically, the OCA cites the testimony of its witness as follows:

I would note that a recent Edison Electric Institute (EEI) survey finds that electric utility ROE awards for 1994 averaged about 11.5 percent. (See Electric Utility Week, page 11, March 20, 1995.) While this is slightly higher than my present recommendation, capital costs have declined considerably from 1994, particularly compared to late 1994 levels.

OCA St. 1A at 9.

The OCA submits that any comparison to other Commission decisions, including those in other jurisdictions, must also consider the changes in the capital market. (OCA Reply Exceptions at 9).

The OCA addresses the PP&L Exception that the ALJ's recommendation is flawed because his analysis utilized the averaging of results. The OCA notes that PP&L contends that the ALJ's exclusion of the dividend yield data and growth rate supplied by PP&L witness Moul was in error. However, argues the OCA, the exclusion of the particular data because of "quarterly compounding and the ex-dividend adjustment" was appropriate. In addition, the OCA maintains that the ALJ's finding that PP&L's 4.0% growth rate was overstated "by at least 50 basis points" is also supported by the evidence. (OCA Reply Exceptions at 10).

Next the OCA addresses the PP&L Exception wherein PP&L asserts that the data relied upon by the ALJ was biased because it utilized both barometer group and PP&L specific data. PP&L Exc. at 30-31. The OCA submits, however, that PP&L stock is not the only source of data for a DCF analysis. The OCA cites the testimony of its witness as follows:

In conducting a single company DCF analysis, there is always the risk that the historical and market data for that firm may be atypical of what investors could reasonably expect in

the future. Employing a group of firms has the advantage of averaging out the unusually high and low observations.

OCA St. 1 at 24.

The OCA again cites the testimony of its witness as follows:

I believe that proxy groups--if correctly selected--should produce more reliable, stable estimates than single company DCF studies. In addition, it should be noted that PP&L is in the process of reorganizing in order to facilitate investments in non-utility ventures. While this activity is nominal at present, it could become significant in the future.

OCA St. 1 at 35.

Accordingly, the OCA maintains that the ALJ's reliance on the DCF analyses of the proxy groups, as well as for PP&L, produced a reliable DCF result. (OCA Reply Exceptions at 11).

In its Exceptions, the OTS notes that PP&L relied on cost of capital findings in recent Commission decisions. The OTS continues that, aside from the fact that the Commission, on numerous occasions, has chastised parties for comparing the Commission's cost of capital findings in other proceedings, the following is additional evidence as to why the Commission's cost of capital finding in other proceedings is not applicable to the circumstances surrounding PP&L:

The information provided in OTS Surrebuttal Exhibit No. 1, indicates that the 30-year Treasury Bond Yield peaked during the week ending November 11, 1994 at about 8.16[%]. The 30-year Treasury bond when PP&L filed its rebuttal testimony was 7.02%. Therefore, the 30-year Treasury bond yield has declined by 114 basis points.

(OTS Reply Exceptions at 13).

Therefore, the OTS points out that the above passage indicates that the 30-year Treasury bond yield has significantly declined since the Commission made cost of capital findings in the cases cited by PP&L in its Reply Exceptions.

The OTS continues that the Commission is reluctant to compare cost of capital findings in its own cases, and is even more reluctant to compare such findings with those of other jurisdictions. The OTS continued that notably absent from PP&L's comparison list of cost of capital findings from other jurisdictions was Potomac Edison Company, docketed at NO. 94-0027-E-42T, issued March 17, 1995. In that proceeding, the West Virginia Public Service Commission allowed a cost of capital of 10.85% for the Monongahela Power Company. (Id.)

The OTS then addressed PP&L's criticism of the averaging of results. The OTS opined that the ALJ acted reasonably by only considering reasonable numbers.

In its Reply Exceptions, PPLICA argues that the cases cited by PP&L for the proposition that the equity return recommendation in the case is too low, actually confirm the reasonableness of the recommended equity allowance. PPLICA notes that in PAWC, supra, the Commission made a common equity allowance of 11.25%, 35 basis points above the recommended allowance herein. PPLICA notes further that in PAWC, the Commission rejected both the risk premium and CAPM methodologies and relied exclusively on DCF. (PPLICA Reply Exceptions at 2-3). PPLICA notes that in Roaring Creek, supra, the Commission allowed an equity return of 11.0%. (PPLICA Reply Exceptions at 2-3).

PPLICA notes that in West Penn, supra, the Commission approved an equity return allowance of 11.5%. However, PPLICA points out that the 11.5% equity return included an adjustment

for good performance. PPLICA argues that without the performance adjustment, the return in West Penn is comparable to the recommended equity return herein. (PPLICA Exceptions at 3).

Upon our review of the positions of the parties, we agree with the ALJ's decision not to consider PP&L's proposals in his averaging of the parties positions for several reasons. First, we find that the use of "ex-dividend" prices in its computation of the dividend yield serves to unrealistically inflate the dividend yield data. We note that this approach to the dividend yield computation is not regularly used in rate of return proceedings before us.

Second, we believe that the ALJ was correct in rejecting PP&L's proposal to increase the growth rate recommendation by an additional 50 basis points for what PP&L terms "market-wide factors." We find that the evidence of record in the instant proceeding does not support the adjustment proposed by PP&L.

We observe that the dividend yield analysis submitted by the four parties who actively participated in the litigation of the issue of equity return, demonstrates that the dividend yield for the PP&L-specific calculation exceeds the average yield for each of the barometer groups employed by the parties. Further, we note, that the most recent six-month and spot dividends for PP&L exceed 8%. For the different barometer groups, the highest dividend yield is approximately 7.86% unadjusted for growth. We find the PP&L stand-alone position can be used as a check, on the reasonableness of our final recommendation but should not be used as the final determinant of our final allowance. Without endorsing a particular method, we will adopt an unadjusted dividend yield of 7.86%

For the growth rate percentage, we observe that the range of recommendations from the particular parties is from 2.8% to 3.5%. We agree with the ALJ that none of the parties growth rate recommendations are particularly persuasive. We do find that for purposes of a growth rate determination in this proceeding, PP&L's argument cited previously herein, that forecasts suggest that PP&L's growth will lag behind the barometer due to the extended length of time since the Company's last rate case, is supportive of a growth rate determination of 3.5%.

Thus, for purposes of this proceeding we will adopt a dividend yield of 7.66% adjusted for the next period growth of 8.0%. We will adopt a growth rate of 3.5%. The combination of the dividend yield and growth rate result in a DCF-based equity return allowance of 11.5%.

The following table summarizes our equity return conclusions:

<u>Capital Structure</u>	<u>Summary of Recommendation</u>		
	<u>Ratio</u> %	<u>Cost Rate</u> %	<u>Weighted Cost</u> %
Long-Term Debt	46.53	7.97	3.71
Preferred Stock	7.59	7.31	.55
Common Equity	<u>45.88</u>	<u>11.50</u>	<u>5.28</u>
	<u>100.00</u>		<u>9.54</u>

5. RP and CAPM Methods

PP&L was the only party in the matter before us to file an equity return recommendation based upon the RP and CAPM methods. The ALJ did not consider these methods and based his equity return recommendation on his DCF calculation and judgement. (R.D. at 163).

In its Exceptions, PP&L notes that the Commission has in recent years based its rate of return allowances on the DCF method. PP&L urges the Commission to "keep an open mind" on the various methods of calculating an equity return allowance. (PP&L Exceptions at 29). In Reply Exceptions, the OCA and support the ALJ's determination to rely exclusively on the DCF method.

On the basis of the record before us herein, we conclude that there is no reason for us to divert from our practice of considering the DCF method exclusively for equity rate of return determinations. Accordingly, PP&L's Exceptions regarding this issue are denied.

Finally, in its Exceptions, PP&L criticizes the ALJ's determination that managerial performance, and particularly its unparalleled efforts to maintain rate stability over the past ten years, may be ignored because the Company did not include "a quantified request for an equity bonus" in its initial filing (R.D., p. 176). PP&L counters that it has not sought a specific "equity bonus." According to PP&L, it has merely asked that the Commission consider its accomplishments and grant it an equity allowance at the upper end of the zone of reasonableness. PP&L continues that Section 523 of the Public Utility Code does not obligate a utility to quantify a potential "reward". Instead, says PP&L, it directs the Commission to consider evidence regarding "the efficiency, effectiveness and adequacy of service" and to make appropriate rate adjustments in response thereto. PP&L argues that such evidence was presented by PP&L. (PP&L Exceptions at 32).

In its Reply Exceptions, the OCA notes that although PP&L does not ask for a specific "equity bonus," the Company does seek a higher return on equity in recognition of efficient management. The OCA submits that the ALJ's recommendation to reject an "equity bonus" is well supported by the evidence of

record and case law. See generally, Pa. P.U.C. v. Metropolitan Edison Company, 141 PUR 4th 336, 406 (1993) (Performance adjustment denied, no evidence that Company's performance had been exemplary); Pa. P.U.C. v. National Fuel Gas Distribution Corp., 73 Pa. PUC 552, 611-612, 121 PUR4th 434 (1990) (Performance award unwarranted, NFGD is obligated to provide adequate, efficient and reasonable service).

The OCA continued that the ALJ recognized that PP&L had not, prior to its Main Brief, asked for an adjustment related to management performance. The OCA submits that for the reasons discussed above, PP&L is not entitled to receive a "reward" of a 13.00% return on equity for quality of service. (OCA Reply Exceptions at 10).

Upon our consideration of the position of the parties, we find that this discussion deals with what is essentially a non-issue. In our view, the position of PP&L presented in their Exceptions is essentially evidence that PP&L should be given an equity return at or near the top of a reasonable range because of what it perceives to be its excellent management practices. We find this discussion to be moot in this matter because the rate of return allowance does come from the high end of the reasonable range for DCF calculations. Moreover, we are of the opinion that we should not consider the RP or CAPM methods to produce a higher rate of return for "good management." Accordingly, PP&L's Exceptions are denied.

IX. RATE STRUCTURE

A. Cost of Service

In this proceeding, PP&L proposed to utilize the 12 coincident peak (12 CP) cost methodology to allocate generating and transmission plant costs. This is, essentially, the same cost allocation proposed in the Company's immediately preceding base rate case. (PP&L Stmt. No. 7, p. 5). This approach assigns production and transmission demand costs on the basis of the average of the twelve monthly coincident class demands occurring at the system average peak. The Company pointed out that the 12 CP method recognizes not only that generating costs are incurred to meet peak demand requirements but also that these demand requirements continue throughout the year.

The Company's cost of service study also accounts for the existence of interruptible load by first allocating costs to the classes having an interruptible option (ISA, LP-4 and LP-5) according to their coincident peak demands, and then providing credit equal to the value of interruptible load on PP&L system. The Company proposed that this value be based on the cost of a peaking unit, a natural gas fired combustion turbine, at \$300/kwh (PP&L St. 9, pp. 13-14; PP&L St. 9-R, pp. 24-25). The Company also proposed that the resulting credit in the amount of \$86 million be subtracted from the cost of generating facilities assigned proportionally to the classes with the interruptible option. (PP&L St. 7, pp. 9-10).

The Company explained that, for a variety of reasons, primarily for economic development reasons and gradualism, it proposed an interruptible credit above the level reflected in the cost of service study. While conceding that its applied value of \$300/kw may overstate the value of the interruptible capacity, the Company emphasized that interruptible load is not as reliable a resource as generating capacity controlled by the Company. The Company added that because it has had adequate generating

capacity, interruptible customers have in fact received service that is essentially firm service. (R.D., pp. 192-193).

With respect to its distribution plant cost allocations, the Company classified its distribution plant investment and operating expenses by means of a minimum size system method calculation. See Ex. JMK-3. Under the Company's proposal, a "minimum size" system capable of providing reliable electrical service to customers is used to identify the applicable customer and demand-related cost components. (PP&L Stmt. 7, p. 11). The Company proposed that this data be used, along with other non-cost factors, to determine an appropriate customer charge. The Company maintained that its approach is supported by the minimum system guidelines of the National Association of Regulatory Utility Commissioners ("NARUC") manual and devised to determine the current cost of its minimum system (PP&L St. 7-R., p. 20).

Several parties objected to the Company's cost of service study and offered alternative methodologies or revisions to the Company's proposal. At page 265 of its Main Brief, the OCA outlined its position with respect to the Company's cost of study as follows:

The OCA recommends three modifications to the Company's class cost of service study. First, the OCA proposes that production and transmission related costs be allocated using the Peak and Average methodology. Second, the OCA proposes that the distribution demand allocators be adjusted to account for the load-carrying capability of the minimum distribution system. Third, the OCA proposes that the value of interruptible credits to other ratepayers in the cost study be the current value of peaking capacity to the system. OCA St. 3 at 4.

In addition, the OCA recommends that the Company's proposed customer charge increase

for Rates RS and RTS be rejected. The Company has not established that an increase in the customer charge is justified. Dr. Johnson has also recommended that the Commission reject PP&L's proposal to increase the number of energy blocks for the residential classes from two to three. The Company has presented no valid reason for this increase in energy blocks.

Lastly, the OCA has recommended that the RTS rate schedule be closed prospectively with current customer locations being grandfathered under the existing rate schedule. Additionally, the OCA recommends that the RTS class be given no greater a percentage increase than the RS class, or in the alternative, the 2.3¢/kwh rate differential that currently exists between the two rate schedules be maintained.

In its cost of service study, the OCA utilized the peak and average methodology. The OCA argued that peak and average methodology properly accounts for the both the energy and demand components of power production investment. (OCA M.B., p. 267). The OCA further asserted that classification of the production and transmission investment should be based upon an understanding of the generation planning process in order to understand the reasons for the incurrence of the capacity costs. The OCA explained that the generation planning process must be reflected to the fullest extent possible in the cost of service study in order to make a determination of the reasonable relationship between cost incurrence and cost responsibility. (OCA M.B., p. 268). In the OCA's view, the peak and average methodology provides a solid balance of both the amount of capacity required to meet system coincident peak requirements and the energy requirements of the classes. (OCA M. B., p. 269).

The OCA also argued that the Company's minimum distribution system study is flawed. The OCA maintained that the Company's method overstates the amount of costs that are

considered to be customer related. The OCA offered an adjustment which, in its view, would reduce the overstatement. The OCA proposed the adoption of its witness Johnson's alternative distribution demand allocator, as reflected in the OCA's cost of service study.

The OCA also challenged the Company's interruptible rate component of its cost of service study. The OCA expressed concern that the value of peaking capacity is relatively low. The OCA proposed that interruptible customers be assigned a portion of the production investment. The OCA attempted to discredit the proposals of PPLICA and Beth Steel regarding the treatment of production investment for interruptible customers, arguing that the arguments are flawed and should be rejected. (R.D., p. 197).

The OCA concluded that its cost of service study which incorporates the peak and average methodology should be utilized as a guide for allocating any revenue increase, or revenue decrease. Additionally, the OCA proposed that the D10 allocator taken from the OCA's cost of service study should be used to allocate the capacity related costs which are demand allocated in the Company's ECR. (OCA M.B., pp. 288-289; See Exh. CEJ-1, Sch. 4).

The PPLICA proposed that the Company's 12 CP coincident peak allocation methodology be utilized, as modified by PPLICA's suggested adjustments, for the purpose of revenue increase allocation. While the PPLICA is of the opinion that a single coincident winter peak is the ideal cost of service study, it would accept the Company's methodology, with certain proposed modifications. The PPLICA offered three specific adjustments to the Company's cost of service study. First, the PPLICA disagreed with the Company's treatment of its interruptible load in its cost of service study. The PPLICA argued that the value of interruptible load as a capacity credit is undervalued in the

Company's cost of service study analysis. The PPLICA argued that the Company's study should include a revenue credit relating to interruptible load which is equal to the revenue credits actually being proposed, as embodied in the rate proposals. The PPLICA also proposed that the cost of paying these revenues credits be allocated to all customers classes, on the basis of the 12 CP production demand allocation factor. This measure, in the PPLICA's view, would remedy the mismatch contained in the Company's analysis.

In addition, the PPLICA proposed to adjust the demand/energy basis for allocation of the NUG output payments in the roll-in of the ECR. The PPLICA pointed out that the Company has included and allocated on a 100% energy basis approximately \$220 million of NUG purchased power expenses in its retail cost of service analysis. The PPLICA argued that in recovering NUG expenses within the ECR on an assigned demand and energy basis, the Company failed to provide a consistent allocation of these expenses relative to the treatment of the revenues associated with the recovery of these costs from customers within the ECR. (PPLICA M.B., p. 50).

The PPLICA proffered that the above cited mismatch could be corrected by adopting the following the adjustment:

An appropriate cost of service study analysis must classify the same portion of NUG expenses as demand related as are classified as demand related by the Company in its ECR revenue analysis contained in Schedule D-3 of this proceeding. PP&L Exhibit Future 1. To correct the Company's cost of service study, the retail portion of NUG purchased power expenses of approximately \$200 million should be classified as 16.38% demand-related and 83.62% energy related. With this adjustment, the allocation of NUG expenses in the cost-of-service study consistent with PP&L's treatment of NUG expenses within its ECR.

PPLICA Statement No, 7, p. 31. Otherwise, in ignoring the demand/energy classification of NUG payments in the cost of service analysis and allocating 100% of the retail NUG payment cost in the rate classes on an energy basis, a greater than proportionate share of NUG expenses are allocated to high load factor customer classes such as Rate Schedule LP-5. Thus, the cost of service assigns revenues associated with NUG payments on a less than proportionate basis, and it results in a lower rate of return on rate base being identified for rate schedule LP-5. In order to produce a reasonable estimate of each class' cost of service, this mismatch must be corrected. Id. at 32. PP&L is in agreement with the need to incorporate this correction. See PP&L Statement No. 7-R, p. 19.

(PPLICA M.B., p. 51).

The PPLICA also proposed an adjustment of the Company's treatment and allocation of Economic Development Initiative ("EDI") and Industrial Development Initiatives ("IDI") revenue credits in the cost of service study. The PPLICA proffered that because the intent of EDI/IDI programs was to benefit to all PP&L customers, a reasonable cost of service treatment of the EDI/IDI credits would assign the cost for those credits to all rate classes, rather than assign the cost of the credits only to the rate classes of the customers receiving the credits. The PPLICA added that the flaw in the Company's allocation of these costs is evidenced by the fact that Rate ISA contains only one customer who is receiving approximately \$872,000.00 in EDI/IDI credits. (PPLICA M.B., p. 53). The PPLICA concluded that its proposal is consistent with the Company's allocation of costs associated with customer assistance programs designed primarily for residential load. (PPLICA M.B. at 54).

Other parties generally supporting the use of the 12 CP method were Beth Steel and the OSBA. The UCC supported the 1 CP

method stating the view that this method was more cost based. (R.D., pp. 200-203).

In the R.D., ALJ Christianson recommended the adoption of the Company's 12 CP method as the acceptable cost of service study. The ALJ concluded that the 12 CP method is reasonable and represents, as argued by the Company, a middle of the road approach. (R.D., p. 204-205).

On the issue of interruptible service, the ALJ reasoned as follows:

I agree with PP&L that interruptible service does not act like additional generation plant and that we are dealing with a peaking situation when we deal with interruptible load. Moreover, PP&L does not fully control interruptible customers for purposes of load reduction and these customers do enjoy rather good service, especially considering the rather adequate capacity enjoyed by PP&L currently.... For allocation purposes, PP&L appears to do a proper "peak" analysis. PP&L uses a combustion turbine as a measure of cost saved. I agree with that approach. I also tend to agree with OCA criticism and note that OCA seems to fundamentally agree with the PP&L approach. However, I reject the calculation variance offered by OCA.

The PP&L analysis seems to be fundamentally realistic and based on the PP&L system. I also agree with PP&L about its choices, for ratemaking purposes. I view the interruptible customers as members of their normal classes, members who have been, for a few years, given a particular break, based on both the theoretical interruptible considerations and the more practical considerations of meeting competition and industrial development.

I do have one more comment concerning interruptible industrial customers. This relates to the cost of paying the revenue credits associated with interruptible service. PPLICA would allocate these costs

(or, more correctly, revenue shortfalls) to all customer classes, on the basis of the 12 CP production demand allocation factor. It views this adjustment as a correction of the mismatch contained in the Company analysis. PPLICA appears to have additional disagreements with the PP&L analysis but, on this one point, I find myself in agreement with PPLICA. Various programs benefit one class of customers directly, and only the participating customers within that class. However, the theory seems to be that all customers in the system benefit because of sales which would otherwise be lost, or for other similar reasons.

I am talking about such programs as residential conservation programs, commercial and industrial development programs and these interruptible rates. Unless we are dealing with an overtly eleemosynary situation, the theory must be that the program somehow benefits the utility's customers generally. Unless there is some particular reason why benefits are limited only to the particular class in question, normally benefits would be spread over the entire customer base because revenue realized benefits all customers. There is no proper way of distinguishing only those customers who happen to be in the particular class, along with the customer enjoying the direct benefits of the program.

Based on these considerations, I agree with PPLICA. This agreement will be touched on later, in the discussion of rate design. Whatever the cost of service merits of the various parties' arguments, I repeat my view that, for me, interruptible service rate considerations are more a matter of ratemaking than cost of service theory.

(R.D, pp. 206-207)

With respect to the minimum system proposed by the Company, the ALJ accepted the PP&L method as well as the Company approach relating to the CEPFOD argument concerning certain operating and operating and maintenance costs.

In considering the PPLICA's proposed adjustment to the Company's NUG capacity allocation, the ALJ explained:

As PPLICA argues at pages 50-51 of its main brief, PP&L has recognized a demand component for NUG payments, for purposes of the ECR calculation. PPLICA asserts that PP&L is being consistent when it allocates NUG capacity, on a strictly energy basis, for base rate purposes. The PPLICA argument appears to be logical, even though PP&L has stated that its NUG payments are on an energy basis. Clearly, there is some capacity value involved here, for both native load and PJM purposes. I agree with the PPLICA argument and recommend that its energy/demand allocation method be utilized.

(R.D., p. 208)

In addition, the ALJ recommended that we reject the proposal offered by the PPLICA that a new rate category for interruptible industrial customers be created.

The ALJ also recommended that we accept the PPLICA's proposal that EDI/IDI revenue credits be assigned to all customer classes and not just to those rate classes in which customers receiving credits reside. Specifically, the ALJ stated:

On one more issue, I agree with PPLICA. This concerns the EDI/IDI credits, as discussed commencing at page 52 of the PPLICA main brief. Once again, I agree in theory and practice that the program benefits all PP&L customers. I see no good reason to view secondary benefits as limited only to industrial or commercial customers. In fact, no matter what the theory, I agree with the argument that cost of this activity be spread over all customers.

Either they all benefit from the situation or they should all share in the tax to raise revenue for the EDI/IDI program. I also agree with the argument that the broader

spreading of this cost (revenue lack) helps avoid the spreading of the cost on the customer given the cost benefit, or cost break. As PPLICA points out, this situation becomes especially acute with respect to Schedule ISA, which now contains only one customer, Beth Steel.

(R.D., p. 209)

Exceptions to the ALJ's Recommended Decision were filed by the OCA, Bethlehem, the PPLICA, and UCC.

The OCA objects to the ALJ's recommendation arguing that its peak and average method is the proper method to be utilized in this proceeding. The OCA contends that the peak and average methodology is the only methodology proposed in this proceeding that properly recognizes both the amount of capacity required to meet the system peak demands and the energy demands of the class. (OCA Exc., p. 45). The OCA also avers that the importance of these energy demands in classifying and allocating production investment has been recognized by us in previous Commission decisions. The OCA further asserts that its proposed peak and average method was adopted by us in Pennsylvania Public Utility Commission v. West Penn Power, 73 Pa. P.U.C. 454 (1990). The OCA submits that the peak and average method should be adopted as a reasonable and appropriate guide in determining revenue allocation in this proceeding because it reflects the cost responsibility of the classes for the PP&L system. (OCA Exc., p. 46).

The OCA also challenges the ALJ's recommendation that the Company's minimum system study be adopted. The OCA is of the opinion that the Company's method overstates the amount of costs that are considered to be customer related. The OCA submits that its proposed adjustment to the Company's minimum system study as reflected in Dr. Johnson's cost of service study reduces the

Company's overstatement. The OCA summarizes that its proposal to adjust the demand allocator to account for the load carrying capability of the system so that the customer related component could be more accurately identified is reasonable and should be adopted. (OCA Exc., p. 48).

The UCC urges us to reject the ALJ's recommendation to adopt the Company's 12 CP method arguing that the 1 CP method, advanced by its witness, accurately reflects the cost of service responsibility (UCC Exc., p. 5). The UCC further asserts that the ALJ's reliance on PP&L's argument regarding the impact of off-peak scheduled maintenance on its available capacity is unsupported in the record. The UCC also argues that maximum capacity requirement occurs more in the winter peak period than it does during spring or fall months. (UCC Exc., p. 9-10).

Beth Steel excepted to the ALJ's recommendation to accept the Company's allocation of generation costs to interruptible customers and the Company's adjustment to rate base to reflect the value of interruptible load. (Beth Steel Exc., p. 3). Beth Steel reiterates the position as stated in its Main Brief that because the Company does not plan generation facilities to serve its interruptible load and that load does not cause the Company to incur any generation-related capital costs, it is inappropriate to assign capacity costs to the interruptible load customers. (Beth Steel Exc., p. 3).

In its Exceptions, the PPLICA questions the ALJ's recommendation to accept the Company's \$3.00/kw per month "value" for interruptible load for cost of service study. The PPLICA points out that while it opposed the Company's "resource value approach" for rate design purposes, it maintained that if the approach was deemed appropriate for cost of service study purposes, the \$3.00/kw per month credit utilized by the Company was an understatement which should be adjusted. The PPLICA adds

that it proposed that the \$6.00 and \$8.00/kW credits proposed by PP&L in its rate design for interruptible customers should be reflected in the Company's cost of service study. The PPLICA submits that the Company's cost of service study should be further adjusted to reflect an interruptible credit of \$6.00/kW (two hour notice interruptible load) and \$8.00/kW (30 minute notice interruptible load). The PPLICA concludes that the ALJ erred in approving the Company's cost of service study without recommending the implementation of the aforementioned adjustment which reflects the true value of interruptible load as proposed by the Company in its rate design. (PPLICA Exc., p. 22).

On consideration of the positions of the parties, we shall adopt the ALJ recommendation to use the Company's 12 CP method as the basic cost of service model herein. This method has served to accurately reflect the allocation of generation and transmission costs for PP&L. However, we find the modifications to PP&L's cost of service study as advocated by PPLICA to be persuasive for purposes of the revenue increase allocation. We shall adopt the PPLICA recommendations to the extent delineated, below, in the body of this Opinion and Order.

The ALJ's recommendation concerning issues relating to the Company's NUG capacity allocation³⁰ and the Company's minimum system study are adopted and PP&L is so directed to implement these revisions. We do not, however, adopt the ALJ's recommendation to accept PPLICA's EDI/IDI credit proposal.³¹

³⁰ We note that the Company recommended an adjustment in its final accounting exhibits to exclude from the ECR revenue adjustment credit on line 4 of pages 83-84 of Ex. JMK-2 the effect of the NUG output payment demand/energy allocation. (PP&L M.B., p 247; PP&L St. 7-R, p. 19).

³¹ See discussion on Economic Development Credits, Section IX, H, infra.

Accordingly, the respective Exceptions of the OCA, the UCC, PPLICA and Beth Steel are granted and denied consistent with our following determinations.

Finally, we observe that PPLICA proposed a rate design which would treat the LP-5 and LP-6 interruptible customers as a separate class. (See PPLICA Exc., p. 7 citing PPLICA Stmt. No. 7, pp. 59-64). Its arguments supportive of this position are that: (a) such customers receive a service that is decidedly inferior in quality as a result of the prospect of interruptibility; and (b) as a result of a customers' selection of interruptible service, explicit demand/energy charges are imposed which differ from the LP-5 firm demand and energy charge; therefore, the Company's existing rate design implicitly recognizes that interruptible customers are a separate class. (PPLICA Exc., p. 8).

Again, we find the PPLICA position that the interruptible customers be treated as a separate class to be persuasive.

B. Revenue Distribution

The Commission here faces the task of deciding, based on the major customer classes, how to distribute the revenue increase we approve today. One approach is to impose an across-the-board similar to that in the PP&L case involving the Susquehanna 1 plant. Another approach would be to utilize the cost-of-service study. The standard approach is a mix of these two with a view to avoiding major impacts on customer classes via the practice of gradualism. (R.D., p. 210).

There is considerable interest given to the distribution problem in this proceeding. The parties addressed

the matter in differing degrees although only the OTS opted to not specifically address this problem by submitting a recommendation on off-peak treatment for rate schedule SE, street lighting. (R.D., p. 211).

The question of distributing a reduced increase (below the increase requested by the company) is always a difficult question. The usual practice is to allow the different classes different rates of return under existing rates with the basic goal of moving all classes toward the same overall rate of return. Few parties differ over this basic goal but many recommendations are provided concerning limitations on movement toward system rate of return, often based on concerns about gradualism, and avoiding too great an increase, or even decrease, to a particular class of customers. (R.D., pp. 211-212).

Beth Steel provides a detailed and strenuous defense of its ISA contract and rate. Beth Steel claims that it is responding to results produced by the PPLICA development. Before reaching the difference of opinion with PPLICA, Beth Steel refers to the PPLICA main brief, at pages 2-3 of the Beth Steel reply brief. Beth Steel endorses the views set forth in the preamble to the main brief of PPLICA. In particular, Beth Steel concurs with the PPLICA sentiment regarding the competitive arena in which all companies operate today. (R.D., p. 213).

PPLICA's main focus is on the competitive problems of business customers and related considerations. PPLICA's members are PP&L's larger customers whose competitive vitality is critical to the health of the local and state economies. PPLICA is of the view that PP&L is attempting to gain what revenues they can under the existing "monopoly" regulatory model before competition makes such revenue difficult or impossible to secure. PPLICA references the overall increase sought by PP&L and

indicates its opposition, for various reasons, to these elements of the overall increase. (R.D., p. 213).

PPLICA also takes considerable exception to some of PP&L's revenue elements. One of these is interruptible power. After noting that the interruptible service rate would even increase 22 percent if there is no overall increase, PPLICA views any other proposed results to be extreme and argues against them. (R.D., p. 214). Another variable to PPLICA is real world considerations, as opposed to theoretical concerns, as reflected in the cost-of-service studies. PPLICA raises what it views as broad philosophical concerns, as opposed to detailed ratemaking choices, in the proceeding. (R.D., pp. 214-215).

PPLICA rate increase allocation by proposing a 50 percent reduction in existing subsidies for each rate class provided that no rate schedule receives an increase in excess of 1.5 times the average increase. PPLICA proposes this approach as a systematic movement toward cost of service-based rates consistent with the gradualism principle. PPLICA also notes that their proposal for rate schedule increases capped at 1.5 times the average increase is consistent with PP&L's proposal. (R.D., pp. 217-218).

However, PPLICA also opposes PP&L's rate increase -- in particular that of the interruptible customers of rate schedules LP-4 and LP-5. PPLICA claims that such an increase i.e., nearly three times the system average, would result in a 22% rate increase for those large customers even if there is no overall increase in this proceeding. (R.D., pp. 218-219).

PPLICA next discusses competitive trends and gradualism, with a particular emphasis on jobs, and rejects any comparison with PP&L's rates prior to 1992. PPLICA claims that PP&L's proposal fails to move toward an average rate of return

for all classes and claims that every party has sought to minimize their own rates at the expense of other types of customers. (R.D., pp. 218-219).

PP&L also claims that the parties have provided sharply contrasting proposals for allocation of the increase among the various rate classes. PP&L then invokes gradualism and the basic principles of moving all classes closer to system average return, limiting increases to one and a half times the system average increase, and allocating some rate increase to all classes to correct what PP&L views as the overstated discount in rate design for interruptible customers. (R.D., p. 215).

PP&L opposes the positions of other parties on the ground that their positions will shift substantial costs to one class or another. PP&L gives various examples of the impact of the parties' positions although those results would vary depending on the cost of service study. PP&L alternatively seeks a proportional setback or scaleback in the event the proposed increases are reduced by the Commission. (R.D., pp. 215-216).

The OTS does not devote particular sections of its briefs to this topic although OTS does discuss various rate design issues. The OCA provides a table comparing rates of return of major classes and generally agrees with PP&L's attempt to move each class closer to the system average. The OCA notes, however, that it uses a different cost of service study which starts with different rates of return at present rates. The OCA would restrict the increase to any one class to 1.33 times the overall increase. (R.D., pp. 216-217).

After this, there follows a discussion of the RTS problem. The OCA would resolve the problem with a proposed revenue allocation for RTS and RS equal to the system average increase. The OCA supports a 16 percent increase for the ISA

class and notes PPLICA's support for that approach. (R.D., p. 216).

In the alternative, the OCA proposes a lesser overall increase spread in proportion to the increase in total revenues consistent with the OCA's general recommendation. The OCA would give first priority to a reduced revenue from the classes with the highest current rates of return. The OCA views the ISA class situation as one not approved by the Commission as just and reasonable given the 1989 Commission Order and a recent 1990 Roaring Creek decision. The OCA then criticizes the allocations of other parties. The OCA claims that OSBA's proposal for the ISA class is not reasonable nor is PP&L's proposal to hold down their rates supported by the record. (R.D., pp. 216-217).

The OSBA views small business rates as historically high, very much above their cost of service. The OSBA views PP&L's proposals as resulting in improved relative rates of return for the GS-1 and GS-3 classes. The OSBA firmly believes that their cost of service would support substantial decreases for GS-1 customers and minimal increases for GS-3 customers consistent with the gradualism principle. The OSBA fails to present an alternative distribution proposal but notes that GS-1 rates are far out of line and suggests an automatic adjustment mechanism for reducing rates each year. (R.D., pp. 219-220).

The OSBA resumes with a critical review of the OCA and PPLICA proposals with details on the resulting rate shifts and increases. The OSBA's focus on GS customers results in considerable disagreement with OCA but less disagreement with PPLICA. (R.D., pp. 219-220).

The OSBA next discusses the problem of allocating a reduced revenue deficiency. The OSBA, after noting that a proportional scaleback is the traditional method of managing

reduced revenue increases, opts for a weighted method as a means of moving the rate classes closer to cost-base rates. The OSBA has an interesting automatic rate reduction proposal although that departs from traditional ratemaking. (R.D., pp. 221).

The DOD then discusses cost of service and revenue allocation. The DOD, after considering the potential for discrimination, argues for a separate industrial interruptible rate class. The DOD supports PP&L's proposal in that regard but takes no position relating to CEPFOD's arguments on RS and RTS rates. However, the DOD supports moving toward an overall rate of return using the gradualism principle. (R.D., p. 221).

The U/CC discusses this topic under the heading of interclass subsidies and concludes that subsidies for residential are already too high and that PP&L's proposed revenue distribution only aggravates the problem. The USS proposes a reduction in interclass subsidies by limiting the range to three times the relationship between any class increase and the overall increase. (R.D., pp. 222-223).

Beth Steel addresses the revenue allocation for LP-4 and LP-5 interruptible customers and the increase for rate schedule ISA. Beth Steel views the interruptible increase as inconsistent with cost of service studies and competitive conditions. Beth Steel claims that the LP-4 and LP-5 classes are showing above average rate of return and suggest that this should result in a lesser increase in the interruptible rates or, in the alternative, rates that are not competitive. (R.D., pp. 222-234).

Beth Steel then addresses the interruptible service problem given PP&L's proposal for interruptible service. Beth Steel urges the Commission to reject PP&L's proposal or, in the alternative, to develop an interruptible tariff to avoid the

problem of creating an inferior interruptible service within the LP-5 and LP-6 categories. (R.D., pp. 222-234).

CEPFOD provides some contributions to allocation discussion although its main focus is on rate schedule RTS. It also provides some input relating to schedule RS although consideration of their issues are deferred until rate design is discussed below. (R.D., pp. 224-225).

The ALJ, after a considerable commentary on the problems of utility regulation in light of the OSBA's innovative proposal, opted for PP&L's general proposal with some modifications based on the cost of service study consistent with the principle of gradualism. In the alternative, the ALJ recommended that the Commission consider the OSBA's proposal to proportionally allocate any less-than-requested increase approved by the Commission. (R.D., pp. 225-227).

PP&L supports the ALJ's adoption, with some minor changes, of their cost of service study and rate design proposals. PP&L claims that the opposing parties take issue with many of those findings in order to secure beneficial results for their rate class by imposing substantial costs on other parties. PP&L alleges that the ALJ properly recognized that PP&L's proposals steer a reasonable, middle course among the competing rate classes. PP&L urges the Commission to adopt the ALJ's findings in that regard and endorse the reasoned and well-balanced resolution. (PP&L R. Exc., pp. 32-33).

The OCA excepts to the ALJ's recommendations. (Exc., pp. 48-49; OCA R. Exc., pp. 26-27). The OCA claims that the ALJ failed to provide a specific revenue distribution but, instead, apparently opted for PP&L's proposal with some modifications. The OCA also claims that the ALJ's acceptance of the OCA's proposal for their RTS class will change PP&L's proposal for that class. The OCA particularly notes that the increase for the RTS rate class under PP&L's proposal will be substantially the same as increase for the RS rate class. The OCA believes their proposal is more reasonable. That is because there would only be an increase of between 5.93% and 15.56%, with most increases around 11% to 11.7%, or near the system average even if the entire rate increase were adopted. (OCA Exc., pp. 48-49 citing OCA M.B., p. 291).

The OCA also comments on the OSBA's proposal to reduce GS rates. The OCA opposes that idea and urges the Commission to adopt proportional scaleback.³² The OCA is concerned that the OSBA's proposal, which appears to utilize the subtraction methodology of a "constant differential," will result in decreases for some classes i.e., the GS classes, while other classes i.e., the residential classes, will experience above-average increases. The OCA claims that this subtraction methodology, as opposed to the traditional multiplication methodology of proportional scaleback, distorts the relationship to the system average increase, violates the principle of gradualism, and results in disproportionate increases for some classes -- particularly the residential class.

The OCA's Reply Exceptions expand on that claim. The OCA claims that their review of Appendix A to the OSBA's

³² Under a proportional scaleback, if the Company received one-half of its request, then each class' increase would be cut in half.

Exceptions, which presents an example of the scaleback methods, demonstrates that the proposal distorts relationships to the system average with disproportionate increases.³³ In particular, the OCA claims that the preference for a relatively uniform system average rate of increase for some classes i.e., the GS classes, is being accomplished, at the cost of other rate design principles such as rate continuity and gradualism for other classes i.e., the residential classes. (OCA R. Exc., pp. 26-27).

The OCA concludes that it is simply unfair to displace the principles of rate continuity and gradualism with system average rate increases given the disproportionate results. The OCA urges the Commission to utilize a proportional scaleback. (OCA Exc., pp. 48-49; OCA R. Exc., pp. 26-27).

The OSBA supports PP&L's conceptual approach for several reasons. First, the OSBA claims that the Company's approach attempts to address the fact that the Company's business customers, in particular those paying GS-1 and GS-3 rates, are paying substantially higher electric rates than warranted by their cost of service. The OSBA cites the GS-1 rate class return, which is nearly twice the system average, as proof of that fact. The OSBA also cites the GS-3 rate class return, which is roughly 1.36 times the system average and the second highest return of the major classes, as further proof of that fact. (OSBA R. Exc., pp. 5-8 citing OSBA M.B., pp. 13-14). The OSBA further cites the Company's November 1994 report of PP&L's Social

³³ For example, the Company had proposed that the RS class be capped to effect the principle of gradualism. As shown on OSBA Appendix A, the RS class would have received an increase 1.3 times the system average under the Company's original proposal. Looking at Appendix A, however, one can see that under the constant differential method, the RS class receives an increase that is 2.34 times the system average increase, while under the weighted method, the increase is 1.57 times. On the other hand, under both of the OSBA's methods, the GS-1 class receives a rate reduction while the residential classes receive significant rate increases.

Initiatives Task Force to support that fact. The report concludes as follows:

The small business customer (e.g., mom-and-pop stores) is the forgotten customer at PP&L. There are nearly 120,000 small general service customers, and as a group, they pay the highest electric rates. In addition, they receive the least amount of customer service and support from the company. These customers often play a role in maintaining the viability of the neighborhoods where they are located.

(OSBA R. Exc., p. 6 citing OTS Cross Examination Exhibit No. 16, Attachment 1, page 10).

The OSBA concludes that the Company's conceptual approach is warranted because it begins to address the historic problem of rate disparity vis a vis the business customer in utility rate policy. (OSBA R. Exc., p. 6).

However, the OSBA excepts to the ALJ's use of the "traditional scaleback approach" if the overall increase is below the one sought. (OSBA Exc., p. 3 citing R.D., p. 226). The OSBA claims that the ALJ's recommended adoption of the weighted scaleback approach for small increases and calls for improved scalebacks with any level of increase should be extended to use of a weighted scaleback for higher revenue awards. (OSBA Exc., pp. 3-4 citing R.D., p. 226).

The OSBA believes the ALJ's concern with any disproportionate rate impacts, resulting from the OSBA's weighted scaleback approach, is ameliorated by their witness' testimony that use of the OSBA's methodology at varying levels of rate relief can mitigate that result. (OSBA Exc., p. 4 citing Robert D. Knecht and OSBA Exhibit 4). The OSBA's proposal evaluates the rate increase using the proportional scaleback and the constant

differential scaleback³⁴ which are then combined to produce a weighted average of the two methods. (OSBA Exc., pp. 4-5 citing OSBA Main Brief, pp. 23-28). Of course, the relative impact of the two different methods depends largely upon the final increase. (OSBA Exc., p. 4-5 citing OSBA Stmt. No. 1 at 11; OSBA Stmt. No. R1, pp. 30-32).³⁵ The OSBA claims that this weighted scaleback approach provides greater progress toward cost-based rates than PP&L's proportional scaleback method.³⁶ (OSBA Exc., p. 5 citing OSBA Stmt. No. 1, p. 9).

The OSBA's Appendix A in its Exceptions provide us with more detail on their weighted scaleback approach. The OSBA claims that their comparison table shows the actual dollar and percentage increases that result from use of the proportional scaleback, constant differential scaleback and weighted scaleback approaches with a revenue deficiency of \$61.744 million. (OSBA Exc., pp. 6-8).

The OSBA used the method and formulae thoroughly described in Mr. Knecht's direct and rebuttal testimony. (OSBA Exc., p. 5 citing OSBA Stmt. No. 1, pp. 11-12; OSBA Exhibit 4; OSBA Stmt. No. R1, pp. 30-32). In particular, the OSBA notes

³⁴ The constant differential method is described in the OSBA's Main Brief at 22-23, with reference to OSBA Stmt. No. 1 at 9. Under that approach, the difference between the class increase and the system increase in the approved revenue allocation is maintained at whatever increase is ultimately adopted.

³⁵ In the case of an increase on the order of the ALJ's recommendation, substantially more weight (75%) is afforded the results of a proportional scaleback, with less weight (25%) being given to the results of the constant differential scaleback. (OSBA Exc., p. 8).

³⁶ As explained by the OSBA's witness, "the constant differential method produces progress toward cost-based rates that is more similar to the original proposal than the proportional scaleback approach." (OSBA Exc., pp. 4-5 citing OSBA Stmt. No. 1, p. 9).

that Exhibit 4 of their witness' testimony furnishes the same information for hypothetical revenue deficiencies of \$64.5 million, \$129 million and \$193.5 million. (OSBA Exc., p. 5 citing OSBA Stmt. No. 1).³⁷

The OSBA notes that there would be a minimal reduction of .7% in the GS-1 revenues using the weighted scaleback approach. The OSBA claims that PP&L's cost of service study, which shows that the GS-1 class is contributing twice the system average at present rates, and the ALJ's rejection of the OSBA's proposal, which calls for an annual automatic adjustment mechanism for the GS-1 class, support such a modest decrease in GS-1 rates. (OSBA Exc., p. 6 citing PP&L Exhibit OGK-3 and R.D., p. 261).³⁸ The OSBA claims that the weighted scaleback approach is better than the proportional scaleback because it makes greater progress toward cost-based rates by decreasing the contribution of those classes whose rate of return contribution is greater than those classes whose rate of return contribution is lesser. (OSBA Exc., p. 7).

³⁷ For example, Appendix A shows a \$61.744 million revenue deficiency. This would result in an increase of 3.4% to the Residential class using proportional scaleback, an increase of 6.1% if the constant differential scaleback is employed. Using weighted scaleback, however, the Residential class is 4.1%. For a GS-3 customer, the proportional scaleback increase is 1.5%, a negative 2.4% using the constant differential scaleback, and a .5% increase using weighted scaleback. (OSBA Exc., p. 8 citing Appendix A).

³⁸ For example, if the Commission were to award PP&L one-half of its requested revenue increase, the Residential increase would be 7.6% using a proportional scaleback, but would be 8.5% if a weighted scaleback were employed. By contrast, the GS-3 class would experience a 3.4% increase using proportional scaleback and a 2.1% increase using weighted scaleback. At a rate level granting PP&L one-half of their requested rate relief, the GS-1 rates would increase by 1.9% under proportional scaleback and would remain unchanged using a weighted scaleback approach. (OSBA Exc., p. 8 citing OSBA Exhibit 4).

Finally, the OSBA claims that the OCA's proposed revenue distribution would result in a significant shifting of revenue responsibility from the residential class to the Company's small business classes. In view of the facts that PP&L's small businesses are already providing substantial subsidies to the residential customers and have been recently identified by the Company's internal task force as the "forgotten customer at PP&L," the OSBA claims that such a shift is unreasonably and unfairly perpetuating the existing imbalances in PP&L's rate structure. (OSBA R. Exc., pp. 6-7 citing OSBA M.B., pp. 17-19).

The OSBA concludes that the hypothetical examples using weighted scaleback, which vary depending upon the revenue deficiency ultimately determined by the Commission, establish that their approach imposes no unusual increases on any customer class. The OSBA urges the Commission to direct PP&L to implement their weighted scaleback approach depending on the level of rate relief ultimately determined in this proceeding. (OSBA R. Exc., pp. 8-9).

PPLICA claims that the ALJ erred in failing to adjust the recommended increase in operating revenues to reflect any actual increase in annual operating revenues requested by PP&L. (PPLICA Ex., pp. 24-26; PP&L R. Exc., pp. 25-26). PPLICA points out that PP&L agreed to offset their proposed \$261 million rate increase to reflect a credit of \$21 million in revenues for off-system sales provided PP&L were permitted to recover the costs for these off-system sales. (PPLICA Ex., p. 24). However, PPLICA points out that the off-system sales revenue should be reflected in the ALJ's calculations for PP&L's overall rate increase even though the ALJ has recommended against recovery of the costs for those sales. (PPLICA Ex., pp. 24-25).

PPLICA urges the Commission amend the ALJ's Recommended Decision concerning "pro forma present rates" to reflect the ALJ's approval of PP&L's alternative proposal at page 275 of the R.D. (PPLICA Exc., p. 26).

PPLICA also urges the Commission to allocate their ultimate revenue deficiency determination consistent with PPLICA's proposals to limit increases to the interruptible class to 1.5 times the system and limit interclass subsidies to 50%. (PPLICA R. Exc., p. 25). Finally, PPLICA argues against the OSBA's proposal for weighted scaleback in favor of traditional scaleback because it, unlike the OSBA's proposal, better achieves removal of interclass subsidy consistent with the principle of gradualism. (PPLICA R. Exc., p. 26).

U/CC excepts to the ALJ's attempts to reduce interclass subsidization. (U/CC Exc., pp. 11-15). U/CC excepts to current business class subsidies which U/CC claims amount to \$227.5 million per year from the GS-1, GS-3, LP-4 and LP-5 classes and which U/CC claims constitute almost 88.2% of PP&L's jurisdictional increase or about 18.2 cents per dollar paid by these classes. U/CC claims that PP&L's proposed revenue allocation based on rates of return has the perverse effect of moving rates further away from costs and exacerbating interclass subsidies. (U/CC Exc., pp. 12-14).

U/CC urges the Commission to reduce subsidies by 50% although limit the resulting increases to no more than 300% of PP&L's overall jurisdictional increase of 11.7%. U/CC also urges the Commission to reduce subsidies by a uniform percentage and to keep the Rate ISA as it exists because of the special nature of the underlying contract. (U/CC Exc., pp. 13-14).

On consideration of this issue, we shall affirm the ALJ's recommendation with the proviso that the position of

PPLICA, (and Beth Steel to the extent consistent) that the increase to the interruptible class be limited to 1.5 times the system average and limit interclass subsidies to 50% is granted. (See R.D., pp. 225-228). In particular, we agree with the ALJ that the complexity of the issue and avoidance of unintended results from novel innovations support use of a safe, as opposed to innovative, approach. We conclude that the ALJ's use of the straight scaleback as capped by the PPLICA proposal is in the public interest because it does move the rate classes closer toward the established overall rate of return than would otherwise be the case with novel innovations. While we recognize the possibility that movement of all classes toward a uniform rate of return contribution could have adverse consequence as proposed by U/CC, our review of the record in light of the impending changes in the electric industry caution for a more traditional approach at this time.

C. Rate Schedule RS

PP&L proposes an RS customer charge of \$7.20, a 50 percent increase over the present charge. It states that its cost study shows the relevant cost as \$17.51 per customer per month. It also refers to billing and metering costs per customer as \$10.18 per month. It considers this charge it proposes to be a reasonable balance. It mentions that the increase is only \$2.40 which, in the PP&L view, would not impose undue hardships on rate RS customers, particularly since costs shifted from the customer charge should be recovered in the first billing block of usage charges. (R.D., pp. 227-228). PP&L points out that the customer charge was set at \$4.80 over 10 years ago and argues that it is now outdated. It refers to other proposals concerning this charge. It notes that OTS proposed an increase of \$1.10 and that CEPFOD proposed a similar increase. PP&L notes the OCA's opposition. (R.D., pp. 227-231).

PP&L defends its third billing block for rate schedule RS. It states that it has sought to ensure a more equitable recovery of both unrecovered customer-related costs and demand-related costs in the early blocks of the rate, rather than the trailing block. PP&L notes CEPFOD's and OCA's opposition.

The OTS addresses the residential customer charge. It reviews the background and provides its recommendation of an increase of \$1.10, to \$5.90 per month, at the overall requested increase. The OTS views their approach as consistent with Pennsylvania practice and reviews the support for their claim before concluding that a much lower increase is warranted. The OTS continues by addressing various other PP&L positions in support. OTS suggests that even a \$2.40 per month increase could be a hardship. (R.D., pp. 227-229).

The OCA discusses both the RS charge and the RTS customer charge of \$15 per month. The OCA claims that PP&L has failed to justify these substantial increases. The OCA associates these charges with metering and billing costs. The OCA suggests that PP&L is seeking to recover more than this amount. It suggests that PP&L cost figures include too much and should be reduced. It finds a basic cost of \$4.73 monthly. It also finds an RTS cost below the current charge. (R.D., pp. 227-229).

The Sierra Club next addresses the residential customer charge. Sierra Club discusses the charge in connection with monopolistic services and apparently supports a charge based on one's level of consumption. (R.D., pp. 227-229).

PP&L responds to the parties' positions. PP&L cursorily discussed the Sierra Club position in a footnote at page 109. PP&L views the OCA's position as one pertaining largely to basic customer costs.

The ALJ viewed the proposed customer charges as supported by cost studies and as reasonable -- at least in theory. The ALJ recommended limiting the increase to 35 percent and PP&L's third block proposal. The ALJ did so because the increase is based on the inflation rate over the past 10 years which, if accepted as recommended, would be approximately three times PP&L's proposed overall increase. The ALJ did not recommend such a limitation on the RTS customer charge which, as indicated below, is much more modest. (R.D., pp. 230-231).

PP&L supports the ALJ's recommendation for a 35% increase but further opposes the ALJ's recommendation that the change be scaled back to reflect any lesser increase. (PP&L Exc., pp. 57-58; PP&L R. Exc., pp. 35-36). The OCA opposes the recommendation on the ground that the current customer charge should remain at the current levels and that the third block declining rate should be rejected. (OCA Exc., pp. 50-53; OCA R. Exc., p. 24). Sierra Club vigorously objects to the recommendation on the ground that increasing the customer charge while decreasing the third block charge will send customers the wrong message on energy conservation. (Sierra Club Exc., pp. 30-33). CEPFOD argues that the ALJ's recommendation on a third block is unjustified and the OTS recommends denial of Respondent's exceptions. (CEPFOD Exc., pp. 3-7; OTS R. Exc., p. 39).

After careful deliberation on the issue, we believe that a 35% increase in the customer charge is appropriate. We also believe that a declining rate third block charge is appropriate as recommended by the ALJ. We do so because the customer charge is approximately that of the inflation rate over the past ten years and, as such, represents an attempt to move class charges closer together consistent with the principles of gradualism and rate continuity. Furthermore, we also conclude that the third block rate is appropriate because imposition of

charges for such a block makes customers aware of their increased consumption even if that consumption rate may be priced at a lesser rate.

D. Rate Schedule RTS

PP&L's position is that this rate schedule is only available to customers who install certain electric thermal storage systems equipped with timing devices that permit PP&L to pre-set the time during which electric heat and/or hot water heating occurs. This rate, in comparison to rate schedule RS, has a lower per kwh charge in a single billing block, a higher monthly demand rate and additional demand charges for usage over 2 kw during peak periods. PP&L makes the following claim in that regard:

Rate Schedule RTS was developed as a load management tool during the early 1980s, when the Company sought to reduce peak load growth. The thermal storage technology offered the opportunity to shift heating load from the peak period of the day through the use of timing devices. Thermal storage provided significant advantages over other load management tools (PP&L St. 8-R, pp. 13-15). In particular, the Company's peak load growth in the mid- to late-1970s and early 1980s displayed a growing morning peak problem. Thermal storage would allow the Company to shift heating load to the evening, alleviating the morning peak

(R.D., pp. 231 to 241 citing PP&L St. 6-R, pp. 10-11; Exh. JJS-10 and JJS-11; Tr. 2123).

PP&L notes that Rate Schedule RTS was introduced in 1984 and attracted approximately 14,000 customers by early 1995. By the late 1980s, the Company became aware that a general shift in peak usage towards the evening by non-RTS customers would, over the long term (after 1995), create an evening peak on PP&L's system, which would reduce the benefits of the RTS rate. (R.D., pp. 231-241 citing PP&L St. 6-R, pp. 3-7). Consequently, the

Company began phasing out advertising promotions and grants for thermal storage customers in 1991 and by 1995 it had entirely discontinued them. As a result, fewer and fewer customers have subscribed to the RTS service in recent years: 806 in 1993, 549 in 1994, and only 145 in the first quarter of 1995. (R.D., pp. 231-241 citing PP&L St. 6-R, p. 8; Ex. JJS-9). PP&L also commenced a pilot program to study the effect and feasibility of installing direct dispatch controls on RTS units, permitting the Company to use real-time pricing and improve the relative revenue contribution from RTS units. (R.D., pp. 231-241 citing Tr. 723-27; PP&L St. 8-R, pp. 17-18).

PP&L proposes to modify the rate schedule by accepting new customers only until December 31, 1995, (2) thereafter allowing eligible persons to use the new rate schedule to incorporate newer technology and appropriate terms, conditions and rates, (3) providing service to existing RTS locations through the life of the existing thermal storage units, and (4) proposing no reduction in the existing 2.3¢ per kilowatt hour differential between RTS and RS customers before December 31, 1999. (R.D., p. 232).

PP&L claims that this proposal is broadly similar to the OCA's and was favorably received by the OCA's witness. PP&L claims the proposal is based on changing load patterns and changes in technology. PP&L views the proposal as a good balance of all customer interests, despite the RTS low rate of return, and concludes that no investigation is warranted. PP&L notes that the RTS rate does contribute to fixed cost and does improve the Company peak load profile even though the negative return of the RTS class on a fully-allocated basis is a matter of concern for PP&L. (R.D., pp. 232-234).

PP&L's dismisses most of CEPFOD's claims as irrelevant to the issue. PP&L claims that RTS was a load management tool,

that it did have some success, and that RTS helps achieve important load management objectives. PP&L further claims that the program's failure was not discerned until 1987 and denies that it ignored the problem until today. (R.D., pp. 239-240).

The OTS' position, described through their witness, is that any increase must first be recovered from the RTS rate class. The OTS also proposes an investigation of the RTS rate schedule -- partly from the concern that some customers were induced to go to this service with overly optimistic promises. (R.D., p. 234).

The OCA has significant concerns about this RTS rate schedule. The OCA is concerned that the cost study shows a negative rate of return for this class and that PP&L has proposed a 17.39 percent increase for these customers. The OCA is concerned that this is higher than the increase proposed for RS customers. The OCA further points out that some RTS customers may experience an improper increase under the circumstances. (R.D., pp. 234-236).

The OCA further points out that this rate did not produce the results intended by PP&L. OCA would not unduly emphasize the cost of service results, considering the nature of this service. It proposes modifications, providing details. The OCA comments favorably on the fact that PP&L has since adopted many of the OCA's recommendations. (R.D., p. 235).

The OCA discusses two further points of disagreement. First, the OCA declines to endorse a date certain for terminating entry i.e., December 31, 1999. Second, the OCA disagrees with a closing date. The OCA prefers to have the rate close with the issuance of the Commission Order. PP&L seeks some time for customer response. It states that, in the alternative, PP&L be directed to fully inform applicants of the conditions relating to

this rate, prior to their signing up for service. The OCA disagrees with the CEPFOD proposals and views them as unduly burdensome. (R.D., pp. 234-236).

CEPFOD also has a position with regard to residential rate design. CEPFOD's primary recommendation is to abolish the RTS rate and to require credits by PP&L to RTS ratepayers. CEPFOD views the matter as blatantly market expansive by providing these high user customers with relatively cheap electric service. (R.D., pp. 236-239).

CEPFOD further claims that PP&L is seeking to maximize sales. CEPFOD details alleged promotional efforts and massive subsidies before suggesting that PP&L be prohibited from harming current ratepayers to compensate for their policy miscalculations. CEPFOD claims that it has been unfairly hurt by subsidization and that PP&L has long been aware of the peaking problem. (R.D., pp. 237-239).

CEPFOD reviews the positions taken by the parties, including its own positions. It suggests that PP&L should not be rewarded for its imprudence, by allowing it to shift the RTS subsidy to other customers. It characterizes its position as being based on several undisputed facts. It first states that PP&L knew that the RTS rate was a load management failure during 1987. It further asserts that rate RTS is a subsidized service. It states that rate RTS increases the evening peak for PP&L. (R.D., pp. 238-239).

CEPFOD goes on to discuss the competition aspect with oil and gas suppliers. It refers especially to price competition. It refers to the negative rate of return and characterizes this as not a recent development. It also refers to incremental cost. It suggests that rate RTS does not contribute to fixed cost recovery. It also suggests that the

rate does not recover fuel costs. It goes on to refer to timers and various developments. It regards PP&L modifications as too late. It also characterizes its own recommendations as fair to all customers. (R.D., pp. 238-239).

CEPFOD then refers to the third RS block and to the RS customer charge increase. It indicates that demand charges should be paid by heating customers. It provides additional numbers relating to blocking and the customer charge. It takes the position that they are not cost-supported. (R.D., pp. 239-240).

The ALJ recommended adoption of the PP&L/OCA proposal with some modification. The ALJ modifications are to accept the PP&L delay time but recommend that the customer notice be required as outlined by OCA. The ALJ noted CEPFOD concerns, particularly with regard to policy failure and competitive impact, but concluded that CEPFOD's position was overstated notwithstanding the record evidence of negative rates of return and pricing differentials. (R.D., pp. 240-241).

PP&L and the OCA support the ALJ's recommendation by claiming that the ALJ properly rejected CEPFOD's misplaced arguments and properly refused to endorse OTS' proposals for rate investigations. (PP&L R. Exc., pp. 34-35; OCA R. Exc., p. 25). Both OTS and CEPFOD except to the recommendation by decrying the ALJ's refusal to recommend an investigation or a determination that PP&L was refusing to eliminate a subsidy with anti-competitive impacts. (OTS Exc., pp. 20-22; CEPFOD Exc., pp. 7-10).

After consideration of the positions of the parties, we shall affirm the ALJ. We agree with the ALJ that the facts in this case do not warrant the investigation requested by the OTS. In addition, we do not believe the facts warrant the conclusion

drawn by CEPFOD that PP&L's approach to rates constitutes anti-competitive behavior. We draw this conclusion, in part, because PP&L has presented sufficient credible testimony explaining their approach and, in addition, has presented several reasonable proposals for managing any shortcomings with this rate that underscore, in our opinion, the absence of any deliberately anti-competitive behavior.

E. Interruptible Service

In this proceeding, PP&L proposed to significantly alter the interruptible rate option under schedules, LP-4 and L-5³⁹. (See PP&L discussion under this topic heading, rate schedules LP-4 and LP-5 and LP-6, interruptible option, at page 270 of PP&L's main brief).

Under the current rate structure, customers whose loads are interruptible pay reduced demand and energy charges as compared to firm customers. The exact level of savings, or discount, from the firm rate, is dependent upon the customer's classification, size, relative firm and interruptible load, on-peak load factor, and total hours use of demand. (PP&L Stmt. 8, pp. 12-13).

In addition to the benefit to be received by the utility of load retention (a response of the utility to economic concerns of customers, some of whom were at risk of closure, and contraction or relocation of operations), interruptible load enabled the utility to avoid the need for generation capacity

³⁹ Rate Schedule IS-1 in the interruptible option for greenhouse lighting. Interruptible Service by Agreement ("ISA") provides for interruptible rates and service by individual contract to large customers who take service at 66,000 volts or higher. LP-6 -- Large Power Service at Transmission Voltage (High Load Factor) Rate, is a new rate representing the Company's response to prevent load loss from energy intensive industrial users with multi-plant locations. (PP&L Stmt. 8, pp. 8-9).

designed to meet short duration peak. The avoided generation capacity designed to meet such peaks was argued by PP&L to be comparable to a combustion turbine unit. Id.; 10.

The interruptible rate options at issue in this proceeding would replace the reduced demand and energy charges with an interruptible load credit. The interruptible load credit would be deducted from the billing amount the customer would pay on the appropriate firm service rate. It is available for customers with at least 1,000 KW of interruptible load on firm rate schedules LP-4, LP-5, and the new LP-6⁴⁰. The credit is derived as follows:

$$\begin{aligned} & (\text{Billing KW} - \text{Firm KW}) \times (\text{On-peak Load factor}) \times \\ & (\$6/\text{KW}) \end{aligned}$$

As noted above, PP&L's approach to valuation of interruptible load is to view such as a capacity equivalent resource. That is to say, PP&L would equate the value of interruptible load to the annual carrying cost of a combustion turbine peaking unit. Under this theory, the load which can be interrupted avoids the necessity for the utility to make a comparable investment in such a peaking unit generating addition. (See PP&L Stmt. No. 9). Consequently, the former interruptible service option rates have been replaced with an interruptible credit which is applied to firm rates. This credit is based on the cost of a new combustion turbine peaking unit. The proposed credit is \$6 per kilowatt per month and \$8 per kilowatt per month, depending on notice requirements.

⁴⁰ PP&L also proposed for customers on LP-6 with at least 10,000 KW of interruptible load and who can reach firm power levels within 1.2 hour, will receive an additional monthly credit of \$2 per KW.

A recent analysis prepared by the Company indicated that combustion turbines can be installed at a cost of approximately \$300 per kilowatt, with a resulting carrying charge of \$45/KW per year. Id.

PPLICA and Beth Steel, primarily, oppose the PP&L revision to the interruptible rate.⁴¹

PP&L argues in support of its interruptible rate that such rates are not out of line. Also, PP&L argues that the rate levels it proposes are just and reasonable. Here, it refers to the rate decreases for interruptible customers in 1992. PP&L states that, relative to 1984, the interruptible customers will receive a 5 percent rate decrease in the instant case. Therefore, PP&L characterizes the rates for interruptible service option customers as still far lower than rates available to firm large power customers.

By way of historical development, PP&L states that the interruptible credit was set at a higher level than was justified by cost, in the hope of encouraging economic development and preventing load loss. It states that it filed to close the rate during 1994. (See Commission Order at Docket No. R-00943081, et al.). It emphasizes that the current proposal represents a return to the status quo and further argues against the allegation that this filing would impose a rate shock on these interruptible customers. According to the Company, PPLICA and the industrial customers opposing the revisions would prefer, in PP&L's view, to freeze in place a mistaken interruptible credit, as a permanent rate benefit.

⁴¹ These, and other parties, in certain overlapping discussion also oppose PP&L's treatment of interruptible capacity for rate design purposes as well. (See discussion at Section A;B, supra.).

PPLICA vigorously opposed the PP&L revisions. We shall focus on the points raised in its contentions, finding overlap in PPLICA's position and those of the other parties who disagreed with the Company's proposals.

PPLICA explained that the proposed design is essentially a flat kilowatt rate with an adjustment for load factor. Under the current tariff, a demand charge is applicable to the billing kilowatts and then two energy blocks (plus the ECR) apply. PPLICA then proceeded to compare the two rate designs. It stated that PP&L had also proposed a 500 megawatt cap on interruptible load. PPLICA argued that, given that the effective amount of interruptible load for the cap has been identified as 460 megawatts, only 40 megawatts of interruptible load are available. By means of a footnote, it requests that the matter of adding incremental load beyond the cap should be clarified. It references transcript pages 810-811, which provided some clarification.

PPLICA observed that the overall LP-5 revenue increase is shown as 15.45 percent, as compared to the overall system average increase of 11.7 percent. It further observed that this includes a 27 percent increase for interruptible customers.

PPLICA stated that it is adamantly opposed to PP&L's interruptible rate design changes. It states that PP&L has effectively transformed the interruptible service into a firm service rate with a load insensitive credit. It views this as a dramatic change in rate design philosophy, causing an unprecedented increase in rates without any meaningful justification. It views the change as going against current competitive trends, the principle of gradualism and the recognized sensitivity of this state's economy.

PPLICA, therefore, recommended three schedules, LP-5 firm, LP-6 firm and LP-5/L-6 interruptible. It states that the basic PP&L design for the two proposed firm rate schedules is reasonable but that the PPLICA recommended revenue increase should be used. PPLICA also proposes to apply the 1.5 times system average increase for the interruptible rate. This would be an overall increase to the interruptible customers of 17.55 percent, based on the entire revenue requirement being met. It characterizes this as a substantial increase. It provides a schedule detailing information. It states that the overall LP-5 revenue class (including LP-5 and LP-6 plus the proposed LP-5/LP-6 interruptible) would receive a 10.9 percent increase. PPLICA also indicates that it recommends, for rate design, an interruptible credit that is approximately the same as that proposed by PP&L.

PPLICA also addressed the PP&L "resource value approach" to interruptible rates. This assumes that interruptible service is a substitute for peaking capacity. The rates are based on value while other customers have their rates, presumably, based on embedded cost, in accordance with standard cost of service studies. PPLICA would view this as making interruptible load a resource to be purchased by PP&L rather than a low reliability service offered by PP&L. PPLICA opposes this treatment of interruptible service. It would prefer rates based on cost of service. Presumably, this would be cost of service without the capacity element included.

PPLICA continues with the view that interruptible service is lower quality service. It also characterizes the situation proposed by PP&L as the selling back of interruptible service capacity by the customers to PP&L. PPLICA views this approach as faulty. It discusses active load management, the value of capacity and other related matters. It again refers to

its proposal that the increase be limited to 1.5 times system average. It further argues for cost of service ratemaking.

In addition to responding to PP&L proposals, PPLICA refers to the OCA resource value approach. Its criticisms of the OCA alternative are similar to the criticisms of PP&L's approach. It is also opposed to the market-based valuation method.

The main PPLICA response concerning interruptible rates begins at page 3 of its reply brief. It indicates disagreement with PP&L's view of its leadership relating to economic development initiatives. It focuses attention on the proposed rate increases for interruptible customers. It would not look back 10 years to the last case where there was no interruptible service, as is presently structured. It views the PP&L initiative as an inappropriate manner in which to meet competition.

PPLICA views its own proposal as one which reduces cross-subsidization and which moves all rates toward the system average. It also discusses the possibility of self-generation of electricity by customers. Additionally, PPLICA discusses the valuation method of ratemaking for interruptible service. (See PPLICA Reply Brief, p. 6). It does not agree with PP&L that the PP&L proposal is a reasonable, middle-of-the-road position. It draws a distinction between cost allocation and valuation ratemaking. It views PP&L as confused concerning these matters. It further discusses its 1.5 times cap proposal. It indicates its view that the PP&L proposal is out of balance, unjust and unreasonable. It discusses competition and competitive threats. It views the PP&L position as not striking the proper balance. It discusses the PP&L theory and impacts on PPLICA members.

PPLICA further discusses the PP&L EDI/IDI credits and alternatives to the existing interruptible rates. PPLICA would

prefer the interruptible rate option to various possibilities of alternatives. It also states that PP&L has mischaracterized the PPLICA proposal. It states that it is not recommending lower rates but only rates lower than those proposed by PP&L. It further discusses the Commission action to close the interruptible offering. It distinguishes this from the current proposal to increase rates. It would further distinguish rates for 1984 or even 1992. It views the interruptible program as a good program still and disagrees with the PP&L argument that the interruptible proposal was flawed even in 1992.

PPLICA states that the interruptible program has worked. It closes with a reference to its 1.5 times increase cap proposal and movement toward a system average rate of return. It also refers to the principle of gradualism.

Beth Steel, in discussions under the headings of cost of service study and revenue allocation, also disagreed with the proposed change in the interruptible service option.

ALJ Christianson, as a general matter accepted the PP&L proposals. He accurately noted that PP&L appeared to be phasing out this interruptible service under the favorable, existing terms, indicating a preference for more carefully structured and limited rate reductions. The PP&L proposal which indicated a preference for "value of service" ratemaking rather than "cost of service" ratemaking was viewed as entirely appropriate, given the context.

ALJ Christianson reasoned as follows:

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.

(R.D., pp. 250-251).

The PPLICA filed extensive Exceptions to the ALJ recommendation to adopt PP&L's proposal regarding revisions to interruptible rates. (PPLICA Exc., pp. 3-23).

First, the PPLICA argues that the recommendation violates principles of gradualism. It would emphasize that the increase to the interruptible rates constitute, on average, a 22% increase (assuming no revenue increase for the Company) and a 28% increase (assuming the full rate increase request is granted). (PPLICA Exc., p. 4; 5-6.). This is objectionable according to the PPLICA argument, especially in light of the fact that the ALJ recommendations result in an average increase, systemwide, of 2.7%.

Supportive of its reliance on the view that the R.D. impermissibly violates principles of gradualism as a consideration in ratemaking, PPLICA cites Pennsylvania Public Utility Commission v. Philadelphia Electric Company, 74 Pa. P.U.C. 1, 211-212 (1990); Pennsylvania Public Utility Commission v. National Fuel gas Distribution Corporation, 73 Pa. P.U.C. 552, 621 (1990); Pennsylvania Public Utility Commission v. Western Pennsylvania Water Company, 95 PUR4th 470, 515-516 (1988); and Pennsylvania Public Utility Commission v. Pennsylvania-American Water Company, 97 PUR4th 469, 507-508 (1988).

PPLICA also presses its view that interruptible service constitutes a separate class.⁴²

Bethlehem Steel also filed Exceptions to the R.D. repeating many of the concerns articulated by PPLICA.

⁴² As noted above, under PPLICA's proposal, its rate design would treat the LP-5 and LP-6 interruptible customers as a separate class. See PPLICA Exc., p. 7, n. 1.

On consideration of the positions of the parties, we find merit in the Exceptions of PPLICA and Beth Steel. Therefore, we shall grant the PP&L proposed revisions to the interruptible rate option with the following modifications principally articulated by PPLICA.

We conclude that the interruptible rate option customers should be treated as a separate class, and we shall so direct PP&L to develop tariffs accomplishing this revision. Further, arguments which are grounded in principles of gradualism, when viewed in the proper context, are persuasive that the rate increase for the interruptible rate option class be limited to 1.5 times the system average as developed in the presentation of PPLICA.

The approach used by PP&L, in valuing interruptible load as related to a combustion peaking unit is a dramatic departure from the design of the interruptible rate option currently in use on its system. Interruptible customers do, in fact, receive an inferior quality of service than firm customers. Further, we accept PPLICA's criticisms of the flaws in the determination of the credit resulting from subjective assessments of value to interruptible option customers. (PPLICA Exc., pp. 25-26). Therefore, the approach taken by the Company which is grounded on value of service considerations may be acceptable as a matter of theory. Yet, it overlooks the economic realities faced by this class of customer and violates principles of gradualism in rates.

Based on the foregoing, we shall grant the Exceptions of PPLICA and Beth Steel, to the extent consistent with PPLICA. We, hereby, reject PP&L's proposed rate design which would eliminate the separate interruptible tariff and replace this with an interruptible credit. We direct the Company to retain the rate design consistent with the recommendations contained herein.

Exceptions and replies to the contrary are, hereby, denied.

F. Rate Schedule SE, Street Lighting

The OTS, through its witness Mr. Yarolin has recommended that Rate Schedule SE be considered an off-peak service. The service, used by 58 customers, is not used during peak hours for seven of the twelve months of the year. The OTS reasoned was 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 responded that Rate Schedule SE has consistently contributed to monthly system peaks since the rate was established in 1982. It found no change of circumstances sufficient to support the OTS revision. 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.

ALJ Christianson recommended against adoption of the OTS proposal, stating that:

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.

ALJ Christianson observed that some work could be done about providing added notice to municipal customers, considering their budget problems. However, that idea was not before him in this proceeding and went beyond the scope of an individual rate proceeding. Therefore, he recommended the rejection of this OTS initiative.

The OTS pressed its proposal in its Exceptions. It would emphasize that the ability to shift load is not the sole criterion for whether a service is off-peak. Additionally, the OTS stresses the financial impact on affected municipalities of its proposal.

On consideration of the Exceptions of the OTS, we are not persuaded that the contribution of the rate to PP&L's system necessitates a change in the rate's classification. We will, therefore, deny the OTS Exceptions.

G. Rate Schedule ISA

The topic of Rate Schedule ISA has also been discussed under the context of cost of service and allocation. Beth Steel

addressed this subject in 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.

The presiding ALJ accepted the PP&L theory of meeting competition and retaining load. He would not, therefore, disturb the contract. He concluded that the Roaring Creek precedent does not really apply here.

On consideration of this issue, we shall adopt the reasoning and recommendation of the ALJ.

H. Economic Development Credits (EDI/IDI)

Since 1987, the Company has offered to its industrial customers a series of economic development initiatives ("EDI") and industrial Development initiatives ("IDI"). EDI was made available in 1987 and IDI was implemented in 1992. To receive EDI credits, customers must have signed contracts agreeing to expand production or expand physical facilities. The program provides credits of 1 cent per kWh and \$2 per kWh to encourage the expansion of use of existing commercial. Under the program, credits were only provided to customers who were able to submit data demonstrating an intent to expand physical plant and add production capacity. Absent such a showing, EDI/IDI credits were not made available to the customers.

The Company maintained that the program has provided substantial benefits to the participants and helped to retain 20 plants in the Company's service territory. (PP&L St. 8-R, p. 39). The Company also asserted that the program has deterred a number of industrial customers from constructing substantial on-site cogeneration capacity over the past ten years which would have resulted in major losses of the incremental sales produced by the EDI/IDI participants. (PP&L St. 8-R).

In this proceeding, the Company proposed to allocate the cost of these programs to the beneficiary rate classes. The Company also indicated that its shareholders have funded these programs for several years. The Company further advocated that if the program, as modified and proposed in this proceeding, is not approved by the Commission, the program should be terminated and the shareholders should not be required to fund the program.

The Company opposed the OCA's proposal that the cost of the programs be shared with the shareholders and that the Company be required to continue the programs. The Company further

refuted the OCA's assertion that it is seeking economic development costs to captive residential or commercial customers.

The Company also stated that it would have no objection to the Sierra Club's proposal to require companies to perform or present DSM audits, as part of the program requirements.

The PPLICA argued that because the initiatives benefit all customers classes, the costs should be allocated among all customer classes. The PPLICA further maintained that the Company's program places a disproportionate burden on industrial customers. The PPLICA also asserted that a more reasonable approach would be to allow the credits on a system wide basis.

The ALJ recommended the adoption of the PPLICA's proposal to spread the cost of the EDI/IDI credits among all rate classes. The ALJ further stated:

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.

(R.D., p. 260).

The OCA excepted to the ALJ's recommendation arguing that its proposal represents an appropriate sharing of costs of the EDI/IDI program which benefits the ratepayers as well as the shareholders. (OCA Exc., p. 55). The OCA disputes the Company's contention that all of the load would have been lost without the full rate discounts. The OCA further avers that the Company failed to present real evidence to support this assumption. The OCA summates that its revenue adjustment of \$12,665,535 reflecting a 50/50 sharing of revenue shortfalls from the provision of discounted rates under the program should adopted.

In its Exceptions, the Company urges us to reject the ALJ's recommendation. Specifically, the Company states that:

The proposed adjustment should be rejected. While all customers, both participants and non-participants, may benefit from these programs. those benefits are not shared equally. Participants receive much greater benefits, and the cost of these programs should be allocated accordingly. Cost should be allocated on those factors which cause a cost to be incurred. The "cause" of the cost here is the rate discount to industrial customers receiving the EDI/IDI discounts. The "cost" of these discounts therefore should be allocated to the industrial customer classes which receive those discounts.

Finally, the recommended adjustment is inconsistent with the Commission's treatment of similar costs and lost revenues produced by Demand-Side Management (DSM) programs (PP&L St. 8-R, p. 38). The Commission's current DSM Order (Docket No. I-900005) requires recovery of cost and lost revenues

from the classes receiving direct benefits from the programs (Id.). The ALJ's recommendation, therefore, is inappropriate and should be rejected.

(PP&L Exc., pp. 56-57) (Footnote deleted).

Upon careful review of the record and the arguments of the Parties, we conclude that it is reasonable and appropriate to allocate the costs of the EDI/IDI programs among the industrial customer classes, as proposed by the Company. Accordingly, we will grant the Company's Exceptions.

I. GS-1 Rate Adjustments

We find no indication of exceptions filed with respect to the ALJ recommendation to reject the OSBA proposal for a gradual reduction in allocated class revenues over a number of years. We, hereby accept the resolution of this issue consistent therewith.

J. Demand Side Management⁴³

We note that ALJ Christianson considered the various alternatives to the current PP&L demand-side management ("DSM") program. He opined that many of the ideas "might be good," but he concluded that "much of the development [was] beyond the scope

⁴³ On December 13, 1993, we entered a Corrected Opinion and Order ("1993 Order") in Investigation into Demand Side Management by Electric Utilities UNIFORM COST RECOVERY MECHANISM at Docket No. I-00900005 ("DSM Investigation"). The 1993 Order authorized jurisdictional electric utilities to implement a Demand Side Cost Rate ("DSCR") surcharge to recover direct and collateral DSM program costs, subject to annual review for four years. Further, the Office of Administrative Law Judge was directed to address demand-side management and integrated resource planning as issues in future utility rate cases.

On April 8, 1994, we entered another Opinion and Order ("1994 Order") in DSM Investigation. The 1994 Order clarified our 1993 Order and denied a Petition for Stay or Supersedeas Pending Appeal. We stated at page 26 of the 1994 Order that "[w]e are convinced that it is in the public interest to aggressively and without delay implement the DSM programs as set forth in our" 1993 Order.

An appeal of our 1993 and 1994 Orders was taken to the Commonwealth Court. On January 9, 1995, the Commonwealth Court affirmed our 1993 Order in all respects except to that part allowing the recovery of incentives and costs of physical facilities through the surcharge mechanism and adopting the calculation for incentives. That part was reversed, and the case was remanded to us on the lost revenue issue. Our 1994 Order was vacated. (Pa. Industrial Energy Coalition v. Pa. P.U.C., 653 A.2d 1336 (Commonwealth Court, 1995). ("PIEC"))

The Pennsylvania Supreme Court has accepted our appeal of the Commonwealth Court decision in PIEC. The appeal is docketed at No. 75 M.D. Appeal Docket 1995. The issues are whether the Commonwealth Court properly determined that Section 523 incentives cannot be used in a Section 1307 cost recovery mechanism and whether the Commonwealth Court properly remanded to us the issue of our legal authority to award recovery of lost revenues. Oral arguments are anticipated in Spring 1996.

of this ratemaking proceeding." He recommended no modifications. (R.D., p. 265.)

In taking exception to the Recommended Decision on the DSM issue, the Sierra Club raises two Exceptions concerning DSM:

Sierra Club Exception 1: The ALJ should not have excluded the proffered Sierra Club direct testimony as to its proposal regarding DSM, incentives, and lost revenues in setting PP&L's rates.

(Sierra Club Exceptions, pp. 14-18.)

Sierra Club Exception 7: The ALJ should have adopted the Sierra Club proposal to require maximum cost-effective DSM, verified by third-party audits, as a prerequisite to DSM certification and economic discount rates.

(Sierra Club Exceptions, pp. 33-39.)

In support of its first Exception, the Sierra Club characterizes its proposal as "the appropriate method for addressing these matters while the DSM Order of the Commonwealth Court" is before the Supreme Court. (Sierra Club Exc., p.17.) The Sierra Club argues that if we do not address DSM cost recovery in this case, the opportunity to address PP&L incentives and lost revenue issues may not come again until PP&L's next general base rate case, which PP&L predicts will not be until the next century. (Sierra Exc., pp. 16-17.)

In support of its seventh Exception, the Sierra Club characterizes its proposal as "flexible," affordable," "less of a burden," and "simple to administer." (Sierra Exc., pp. 35-36.) The Sierra Club further asserts that our failure to adopt its proposal will place us in a reactive, negative mode of responding to changes in the electric utility industry. The Sierra Club argues that under its proposal other customers would benefit from

increased local economic activity as industrial customers invest in DSM measures and increase production. (Sierra Exc., pp. 37 & 39.)

The Sierra Club also dealt with DSM matters in its Main Brief, asking the ALJ to reconsider his decision to exclude consideration of incentives and lost revenues relating to DSM from this proceeding. (Sierra M.B., pp. 13-14.) The Sierra Club further recommended cost-effective DSM programs relating to all customers and having shareholders absorb some lost revenues. The Sierra Club sought creation of a system benefits charge based on electric sales by the utility; referred to stranded benefits and other emerging matters such as peak reduction measures and performance-based incentives; recommended a non-bypassable system benefits charge for recovering DSM costs; and advocated future public input hearings for PP&L customers. The Sierra Club referred to the experience in New York and other states, as well as to the Federal Energy Regulatory Commission and the "freedom" allowed to the states concerning this matter. (Sierra M.B., pp. 18-25.)

In its Reply Exceptions, PPLICA asserts that the Sierra Club's DSM Exceptions should be summarily denied as an untimely resurrection of an issue which should have been the subject of a petition for interlocutory review. (PPLICA's R.E., pp. 17-20.) Substantively, PPLICA challenges the Sierra Club for failing to provide a rationale for energy audits of industrial customers but not for other customers. Further, PPLICA asserts that the Sierra Club's witness was uninformed as to important facts and that, as a result, the Sierra Club proposal is "poorly developed" and without foundation. (PPLICA R.E., pp. 21-22.)

PP&L discussed DSM issues starting at page 288 of its Main Brief, arguing that it had justified the scope and focus of its DSM programs. PP&L maintained that it has adequate capacity

for the immediate future and that accelerated investment in DSM would not reduce its capital costs. It also stated that it spends more than other major jurisdictional utilities, despite the continued uncertainty over recovery mechanisms. PP&L further discussed these matters starting at page 128 of its Reply Brief, stating that it did not object to a non-binding audit but did not favor the broad recommendations made by the Sierra Club. PP&L described the Sierra Club proposal as poorly defined and premature. PP&L suggested that the DSM issues were a matter best addressed in DSM Investigation at Docket No. I-00900005.

Initially, we must determine whether the Sierra Club is properly raising the DSM issue via its Exceptions, after having raised the issue at the Hearing and in its Briefs. We note that the threshold for interlocutory review is a high one. The standards for interlocutory review are found in Section 331(e) of the Public Utility Code, 66 Pa. C.S. §331(e), and in Sections 5.302 and 5.303 of our Regulations, 52 Pa. Code §§5.302 & 5.303. We interpreted these standards in Application of Knights Limousine Service, Inc., 59 PaPUC 538 (1985) (Knights). As we said in Knights, we do not routinely grant interlocutory review except upon a showing by a petitioner of extraordinary circumstances or compelling reasons. Such showing may be accomplished, for example, by a petitioner proving that without interlocutory review some harm would result that would not be reparable through normal avenues, that the relief sought should be granted now rather than later, or that granting interlocutory review would prevent substantial prejudice or expedite the proceeding.

Additionally, Section 5.404 of our Regulations, 52 Pa. Code §5.404, provides that:

At any stage of the hearing or thereafter the Commission or the presiding officer may call for

further admissible evidence upon an issue and require that the evidence be presented by the participants concerned, either at the hearing or at the adjournment thereof.

In light of the threshold for interlocutory review and our ability to call for evidence, we cannot conclude that a party's sole recourse to challenge a ruling of an ALJ relative to the exclusion of evidence should be predicated upon a petition for interlocutory review. Having reviewed the record as developed in this proceeding, we conclude that the Sierra Club has properly requested that we reconsider herein ALJ Christianson's prior decision to exclude evidence relating to DSM issues.

Turning now to whether the evidence should have been excluded, we recognize that the proposal offered by the Sierra Club is arguably neither novel nor extreme. For example, New York requires DSM audits as a condition for receiving a flexible rate. The New Jersey Senate is considering enacting legislation to impose a similar requirement. We cannot ignore, however, the fact that certain DSM issues are presently pending before the Pennsylvania Supreme Court with oral arguments anticipated in Spring 1996.

In our opinion, whether Pennsylvania should adopt the Sierra Club's proposal is not a question for a specific rate case involving only one utility. Additionally, to attempt to fashion DSM proposals in anticipation of the decision of the Pennsylvania Supreme Court would be tantamount to trying to hit an invisible, moving target. In our opinion, the issues raised by the Sierra Club should be raised in DSM Investigation, Docket No. I-00900005, after the Pennsylvania Supreme Court renders its opinion.

We further note in passing that PPLICA's challenge to the Sierra Club's proposal and assertion that it should be rejected for a failure to require energy audits for all customers is without merit. In our opinion and without addressing the merits of the Sierra Club's proposal, we believe that the proposal is clear that any customer, regardless of customer class, for whom a utility seeks a DSM rate would be subject to an audit under the proposal.

Accordingly, the Sierra Club's first and seventh Exceptions are denied.