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Consumer Advocate

June 16, 1995

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John G. Alford, Secretary
PA Public Utility Commission
Room G-23, North Office Bldg.
Harrisburg, PA 17105-3265

Re: PA Public Utility Commission
v. Pennsylvania Power & Light
Company, Docket No. R-00943271

Dear Secretary Alford:

Enclosed please find for filing an original and nine copies of the Office of Consumer Advocate's Main Brief in the above-captioned proceeding. The OCA's Main Brief is contained in Volumes I and II. A separately bound Volume III contains information alleged to be Proprietary and is being served only on the Administrative Law Judge, the Commission and the Signatory parties to the Proprietary Agreement.

Copies of the OCA's Main Brief, Volumes I and II have been served upon all parties of record as shown on the attached Certificate of Service.

Sincerely,

Mary C. Kenney
Mary C. Kenney
Assistant Consumer Advocate

Enclosures

cc: All parties of record
Hon. Robert A. Christianson, ALJ

30966

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

BTL

PENNSYLVANIA PUBLIC UTILITY
COMMISSION

v.

Docket No. R-00943271

PENNSYLVANIA POWER & LIGHT
COMPANY

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MAIN BRIEF
OF THE
OFFICE OF CONSUMER ADVOCATE
VOLUME I

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Mary C. Kenney
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Assistant Consumer Advocates

For:
Irwin A. Popowsky
Consumer Advocate

DOCKETED
JUN 16 1995

Office of Attorney General
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1425 Strawberry Square
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DATED: June 16, 1995

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I. INTRODUCTION

A. History Of Proceedings

On December 30, 1994, Pennsylvania Power & Light Company ("PP&L" or "Company") filed Tariff Supplement No. 50 to Tariff Electric - Pa. P.U.C. No. 200, proposed to become effective February 28, 1995. The tariff contained proposed changes in rates, rules and regulations calculated to produce an estimated annual increase in base rate operating revenues of \$261,635,000. The increase requested by the Company represents an approximate 11.7% increase in PP&L's annual retail base revenues.

On January 24, 1995, the Office of Consumer Advocate ("OCA") filed a Complaint against the proposed rate increase. Complaints were also filed by the Office of Small Business Advocate ("OSBA"), the PP&L Industrial Customer Alliance ("PPLICA")¹, the Department of Defense and the Federal Executive Agencies ("DOD"), the Central Eastern Pennsylvania Fuel Oil Dealers ("CEPFOD"), the Sierra Club and the Crown American Realty Trust ("Crown"). Petitions to Intervene were filed by Bethlehem Steel Corporation,

¹ The PP&L Industrial Customer Alliance, formerly known as the Lehigh Valley Power Committee, members are: Air Products and Chemicals, Inc., Alumax Mill Products, Inc., Appleton Papers, Inc., Armstrong World Industries, Inc., BOC Gases, CertainTeed Corporation, Chamberlain Manufacturing Corporation, Cressona Aluminum Company, ESSROC Materials Company, Grinnell Corporation, Hercules Cement Company, Hershey Foods Corporation, International Paper Company, Lafarge Whitehall Cement, Liquid Carbonic Industries, M&M/Mars, Inc., Magee Carpet Company, Praxair, Inc., R.R. Donnelly & Sons Company, The Stroh Brewing Company, Thomson Consumer Electronics, Inc. and Victualic Company of America.

the M&M Mars Corporation and the University/College Coalition² ("UCC"). Individual Complaints were filed by approximately 130 customers of PP&L.³ The Office of Trial Staff ("OTS") was directed by the Pennsylvania Public Utility Commission ("PUC" or "Commission") to participate and has taken an active role in this proceeding.

By Order entered January 27, 1995, the Pennsylvania Public Utility Commission suspended PP&L's proposed rates and ordered an investigation to examine the lawfulness, justness and reasonableness of the Company's existing and proposed rates, rules and regulations. The case was assigned to Administrative Law Judge Michael C. Schnierle and a prehearing conference was held on March 7, 1995. Thereafter, the case was transferred to Acting Chief Administrative Law Judge Robert A. Christianson.

In accordance with the schedule established for evidentiary hearings in this proceeding, fourteen days of evidentiary hearings were held in Harrisburg. In addition, public input hearings were held in Harrisburg, Lancaster, Williamsport, Scranton, Wilkes Barre, Hazelton, Pottsville, Allentown and Bethlehem for the purpose of receiving testimony.

The record in this proceeding closed on May 26, 1995. As set forth in detail below, it is the position of the Office of

² The members of the University/College Coalition are: Muhlenberg College, Wilkes College, Kings College, Messiah College, and the University of Scranton.

³ Eric Epstein, an individual Complainant, was an active participant throughout the hearing.

Consumer Advocate that rather than PP&L receiving its rate increase request of \$261 million the Company should decrease its rates by \$66,466,000. See, Appendix A, Table I. A complete set of revised schedules supporting the OCA's recommendation is attached to this Brief as Appendix A. In addition, attached as Appendix B is a list of all Statements and Exhibits submitted by the OCA and admitted into the record of this proceeding. A separate Appendix containing relevant portions of unpublished Commission Orders is submitted as Appendix C to this Main Brief.

It should be noted that the OCA's Main Brief has been bound in three volumes. Volume I and II contain the OCA's Main Brief. Volume III contains a proprietary version of Section III on Excess Capacity. The material alleged to be proprietary by PP&L is marked in bold. Volume I of the OCA's Main Brief contains the non-proprietary version of the OCA's Excess Capacity argument.

The OCA now submits this Main Brief in support of the positions set forth in the testimony of its witnesses in this case.

B. Burden Of Proof

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

Reasonableness of rates. -- In any proceeding upon the motion of the Commission, involving any proposed or existing rate of any public utility, or in any proceeding upon complaint

involving any proposed increase in rates, the burden of proof to show that the rate involved is just and reasonable shall be upon the public utility.

66 Pa.C.S. Section 315(a).

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

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

Lower Frederick Twp. v. Pa. Public Utility Commission, 48 Pa. Commonwealth 222, 226-227, 409 A.2d 505, 507 (1980) (emphasis added). See also, Brockway Glass v. Pa. Public Utility Commission, 63 Pa. Commonwealth 238, 437 A. 2d 1067 (1981).

In rate proceedings, it is well established at the Commission, and in the Courts, that the burden of proof does not shift to parties challenging a requested rate increase. Rather, the utility's burden of establishing the justness and reasonableness of every component of its rate request is an affirmative one and that burden remains with the public utility throughout the course of the rate proceeding. The Courts have held that there is no similar burden placed on other parties to justify a proposed adjustment to the Company's filing. See e.g., Berner v. Pa. Public Utility Commission, 382 Pa. 622, 116 A.2d 738 (1955), where the Pennsylvania Supreme Court stated:

[T]he appellants did not have the burden of proving that the plant additions were improper, unnecessary or too costly; on the contrary, that burden is, by statute, on the utility to demonstrate the reasonable necessity and cost of the installations and that is the burden which the utility patently failed to carry.

Berner, 382 Pa. at 631, 116 A. 2d at 744.

The Commission has addressed this standard in its rate determinations:

The Respondent, Equitable has the burden of persuasion on the issue of the reasonableness of an expense level. Respondent must affirmatively establish, on the record, that the test year claim is a reasonable and appropriate amount.

Pa. P.U.C. v. Equitable Gas Co., 57 Pa. PUC 423, 471 (1983) (emphasis added); accord, University of Pennsylvania v. Pa. Public Utility Commission, 86 Pa. Commonwealth 410, 485 A.2d 1217 (1984).

The Commission has continued to affirm the utilities' burden of proof in base rate proceedings, most recently in Pa. P.U.C. v. Roaring Creek Water Company, Docket No. R-00943177 (May 31, 1995) ("Roaring Creek 1994"), where the Commission held: "It is well settled in the law, as the OCA points out (OCA Exc. at 33-38), that the burden of proof in a rate case remains with the utility." Id. slip op. at 112. See also, Pa. P.U.C. v. National Fuel Gas Distribution Corporation, Docket No. R-00942991, slip op. at 5 (December 6, 1994) ("NFGD 1994").

The OCA submits that it is incumbent upon PP&L to affirmatively prove the reasonableness of every element of its claim, and that it has failed to do so in many respects. The OCA

submits that a number of PP&L's claims must fail based on the Company's failure to sustain its burden of proof. Moreover, the OCA submits that its adjustments to PP&L's claims are reasonable and should be adopted by the Commission.

II. SUMMARY OF ARGUMENT

In this proceeding, Pennsylvania Power & Light Company has requested a rate increase from its retail customers of \$261 million in base rate revenues, or an average increase of 11.7%. The OCA submits that the Company's claim substantially overstates the level of revenues which is necessary to provide a fair return on its investment. The OCA recommends instead that the Company reduce its rates by \$66,464,000.

In particular, the OCA submits that the Company's claimed cost of capital of 10.22%, including a 13.00% return on equity, substantially overstates its cost of capital. The OCA submits that a fair return on equity for PP&L based on the current market data is no more than 11.1%.

While cost of capital is clearly one of the largest factors in the Company's rate increase request⁴, the Company's other large claim relates to its request to earn, for the first time, a return on common equity associated with its investment in the Susquehanna 2 nuclear unit. The Company has previously been disallowed recovery of this return by the Commission when the Commission found that the unit constituted excess capacity. As set forth fully herein, the OCA submits that the equity return disallowance established by the Commission should be continued.

⁴ The revenue requirement associated with each 100 basis points of the Company's return on equity claim is \$40 million. Tr. 405.

PP&L has failed to show that the unit will provide reliability and economic benefits to its ratepayers.⁵

The Company has also proposed, in this proceeding, an extraordinary ratemaking mechanism to automatically recover, through its ECR, the capacity costs associated with its expiring off-system sales. The Company's proposal has the effect of raising its total rate increase request in this case to approximately \$440 million since it is seeking authority, in this case, to include an additional \$177 million in rates--automatically--between now and the year 2000. The OCA submits that the Company's proposal constitutes unsound and improper ratemaking and should be rejected.

The Company has also sought other significant increases in this case. For example, the Company has sought an unprecedented recovery of expenses for the "decommissioning" its fossil fueled power plants. In addition, the Company has included a request for a significant increase in fossil plant depreciation expense, even though it has no real plans to accelerate the retirement of these units. The OCA has challenged these requests to the extent the requests are inconsistent with existing case law, Commission precedent or sound ratemaking policy. These claims, in particular, amounting to approximately \$60 million between them, on a Pennsylvania jurisdictional basis, represent nothing more than an attempt by the Company to extract excess charges from current

⁵ A non-proprietary version of the OCA's argument on excess capacity is bound with this Main Brief, Volume I. A separately bound proprietary version, marked as Main Brief Volume III, has been provided to the Administrative Law Judge, the Commission, and the signatory parties to the Proprietary Agreement.

ratepayers in order to provide the utility with a cushion against future changes in the utility industry. Current ratepayers should not have to pay more than their fair share of current costs for the use of these fossil units. As set forth below, the Company's claims should be rejected.

Additionally, the Company has forwarded several claims that the OCA submits are improper for ratemaking purposes. The Company has included several claims that seek to reach back to recover costs incurred prior to the test year utilized in this case. The Company has not filed a rate case in ten years and seeks to recover expenses in rates occurred during and prior to this period in its current claim. These expense claims include costs related to deferred SFAS 106 costs, and the deferred early window costs related to the Susquehanna Nuclear Power Plants that were placed in service in 1983 and 1985. These costs are clearly retroactive in nature and should not be allowed for ratemaking purposes.

In addition to the revenue requirements issues, the Company has requested an increase in the residential customer charge for residential ("RS") customers, from \$4.80 per month to \$7.20 per month and an increase in the Residential Thermal Storage ("RTS") rate customer charge from \$10.95 to \$15.00 a month. The OCA submits that the Company's requested customer charge increases are not supported by the record or Commission precedent. Consequently, PP&L's requested increase should be denied and the

customer charge should remain at \$4.80 per month for RS customers and \$10.95 per month for RTS customers.

The record in this proceeding has also established various concerns regarding the Company's RTS, or Residential Thermal Storage rate. The record demonstrates that the RTS rate has not achieved the results contemplated by the Company when it initiated the service. The OCA has made several recommendations for addressing the problems raised by the RTS rate. Specifically, the OCA has recommended that the rate be closed prospectively, with current customer locations grandfathered under the existing rate schedule. In addition, the OCA has recommended that the differential between these two rates, that the RTS customers relied upon, be maintained by either giving both classes the same percentage increase, if one is granted, or alternatively, maintaining the cents/kwh difference between the classes. In substantial part, the Company has adopted the OCA's recommendations. The OCA submits that its proposal regarding the RTS rate should be approved.

The OCA has addressed many issues in this proceeding not specifically enumerated above. Each of the OCA's proposed adjustments in this proceeding is well supported, and in accordance with the Public Utility Code and sound ratemaking policy. As such, the OCA submits that its recommendations should be adopted.

NON-PROPRIETARY

III. EXCESS CAPACITY

A. Introduction

In this case, PP&L is seeking to earn, for the first time, a return on common equity associated with its investment in the Susquehanna Steam Electric Station Unit 2 (Susquehanna 2). Previously, the Commission has denied PP&L recovery of the return on equity associated with Susquehanna 2 upon finding that the Unit constituted excess capacity. PP&L now seeks to reverse this Commission decision and recover a return on equity in rates for Susquehanna 2 for the first time.

The OCA submits that the Company's request in this case raises two fundamental questions: (1) is the capacity from Susquehanna 2 needed in order for PP&L to provide reliable service to its ratepayers (referred to herein as physical excess capacity), and (2) will Susquehanna 2 provide an economic benefit to PP&L's ratepayers within a reasonable time (referred to herein as economic excess capacity). These questions are set forth in Section 1323 of the Public Utility Code, 66 Pa.C.S. § 1323, which the OCA submits applies to PP&L's claim in this case.

Even if the Commission determines that Section 1323 is not directly applicable to PP&L's claim in this case, the OCA submits that the Commission's long-standing principle that ratepayers should only pay for investment that is "used and useful" in service to the public requires that the Commission examine the Company's request to assure that both physical and economic

benefits are provided to PP&L's ratepayers. Investment in generating plant that does not provide reliability benefits and economic benefits to ratepayers cannot be considered used and useful in service to the public.

The OCA submits that based upon the record in this case, PP&L has both physical and economic excess capacity related to Susquehanna 2. Through the testimony of Matthew I. Kahal,⁶ the OCA has demonstrated that PP&L continues to have physical excess capacity on the order of 400 to 800 MW. In addition, Mr. Kahal's testimony has demonstrated that Susquehanna 2 does not provide economic benefits in excess of its revenue requirement cost to ratepayers. Moreover, the Company's own study indicates that the revenue requirement cost of Susquehanna will exceed the cost of alternative power during at least the next ten years. See, OCA Cross Examination Exhibits 7 and 21.

The OCA submits that Susquehanna 2 fails both tests of usefulness established by Commission precedent and embodied in Section 1323 of the Public Utility Code. As such, the OCA submits that the Commission's previous disallowance of an equity return on Susquehanna 2 should be continued. The continuation of the Commission's disallowance of the equity return on Susquehanna 2

⁶ Mr. Kahal is a Senior Economist and Principal at Exeter Associates, Inc., a consulting firm specializing in public utility regulation and energy studies. His fields of expertise include energy economics, public utility regulation and financial analysis. Much of Mr. Kahal's work has involved generation planning and need-for-power assessments of electric utilities. Mr. Kahal has testified on more than 100 occasions before state and federal regulatory commissions. Mr. Kahal's qualifications are set forth fully in OCA St. 1 at 1-4, Appendix A.

totals approximately \$62 million, excluding revenue taxes, on a Pennsylvania jurisdictional basis.

B. Legal Standards For Determining Excess Capacity.

1. Introduction.

The determination of whether a utility's generating units are excess capacity is based upon the long-standing principle that utility assets which are not "used and useful" in providing electric service to the public shall not be included in rates. The Courts have long held that the used and useful principle may be applied to exclude the cost of utility assets from rates even if those assets were prudent investments at the time made. See, e.g., Duquesne Light Company v. Barasch, 488 U.S. 299 (1989); Pennsylvania Electric Company v. Pennsylvania Public Utility Commission, 509 Pa. 324, 502 A.2d 130 (1985), appeal dismissed sub nom., Metropolitan Edison Co. v. Pennsylvania Public Utility Commission, 476 U.S. 1137 (1986).

In a concurring opinion in Jersey Central Power & Light Company v. FERC, 810 F.2d 1168 (D.C. Circuit 1987), Judge Starr provided an instructive analysis of the necessity of the prudence standard and the "used and useful" principle to coexist in regulation. As Judge Starr noted:

Prudence is, of course, relevant to the process of striking a reasonable balance in rate-setting for public utilities. Requiring an investment to be prudent when made is one safeguard imposed by regulatory authorities upon the regulated business for benefit of ratepayers. As I see it, the "used and useful" rule is another such safeguard. The prudence rule looks to the time of investment, whereas the "used and useful" rule looks

toward a later time. The two principles are designed to assure that the ratepayers whose property might otherwise be "taken" by regulatory authorities, will not necessarily be saddled with the results of management's defalcations or mistakes, or as a matter of simple justice, be required to pay for that which provides ratepayers with no discernible benefit.

Jersey Central, 810 F.2d at 1190 (footnote omitted). Judge Starr further noted that:

the obvious danger in not examining both ends of the continuum--both the prudence of the investment and whether the end result of the investment was used and useful--is to build in pressures for building excess generating capacity. The "used and useful" rule operates as a restraining principle, reminding utility managers of economic forces working against an investment which is prudent at the time it is made.

Jersey Central, Id. at 1190 n.1.

The Pennsylvania Commission and the Courts have recognized that a prudent investment may be excluded from rates if it is not currently "used and useful" in serving ratepayers. See, e.g., Philadelphia Electric Company v. Pennsylvania Public Utility Commission, 54 Pa. PUC 220, 37 PUR4th 381 (1980), aff'd., 61 Pa. Commonwealth 325, 433 A.2d 620 (1980) (PECO 1980). The Commission, in PECO 1980, made an excess capacity adjustment and denied the Company a return on several existing power plants that had previously been included in rate base. In upholding the Commission's adjustment, the Commonwealth Court stated:

PECO contends that because its decisions to construct the eliminated units as well as its decision to construct every other of its generating units, when made, were prudent, the PUC may not now remove any of these properties

from rate base because there is presently excess capacity. This argument, however, missed the point of the determination. The PUC's order specifically states that the PUC was "not questioning PECO's management decisions made when these units were constructed." The basis for the order is the finding that to the degree there is excess capacity, there are generating properties which are not used and useful in rendering service to ratepayers.

PECO 1980, 61 Pa. Commonwealth at 328, 433 A.2d at 622-23.

The Pennsylvania Supreme Court has also upheld the Commission's application of the used and useful principle. Pennsylvania Public Utility Commission v. Pennsylvania Electric Company, 509 Pa. 324, 502 A.2d 130 (1985) (Penelec). In Penelec, the Pennsylvania Supreme Court upheld the Commission's decision to exclude from rates Pennsylvania Electric Company's and Metropolitan Edison Company's investment in Three Mile Island. In commenting on the used and useful principle, the Court stated:

The "used and useful" principle is soundly based, for it serves to protect consumers from exploitation, and it comports with the view that, in fairness, consumers should not be required to, in effect, provide public subsidies for utility properties that are not useful in the public service.

Penelec, 509 Pa. at 32, 502 A.2d at 135 (1985).

These long-standing principles have been codified in the Pennsylvania Public Utility Code in Sections 1315 and 1323. Section 1323, enacted in 1986, deals specifically with the legal standards for an excess capacity adjustment for baseload generating units. These legal standards codified previous Commission decisions regarding excess capacity.

2. The Commission's Pre-1986 Decisions Regarding Excess Capacity.

The Commission made an excess capacity adjustment as early as 1978 in a case involving Pennsylvania Power Company. Pennsylvania Public Utility Commission v. Pennsylvania Power Company, 52 Pa. PUC 459, 27 PUR4th 426 (1978) (Penn Power I). In Penn Power I, the ALJ, using a 20% reserve capacity figure as a benchmark, found that Penn Power's capacity over and above that amount was excessive. Penn Power I, 52 Pa. PUC at 471, 27 PUR4th at 437. The Commission agreed, stating that it shared the ALJ's "concern over the impact upon ratepayers of the sudden doubling of the investment of the Company ... and the large amounts of capacity generated thereby that is not now needed." Id. In addition, the Commission expressed its concern that there must be a sharing of the adverse effects of bringing large units on line. The Commission stated:

[W]e agree with the judge that the sudden burden of this new plant investment on the company's customers was no fault of Penn Power or its investors; but neither was it the fault of the ratepayers. Under these circumstances there must be some sharing of the risk associated with bringing large plants on line.

Penn Power I, 52 Pa. PUC at 471 (emphasis added).

The Commission continued to make excess capacity adjustments in subsequent cases, applying the principles of sharing in fashioning its remedies when excess capacity was found. See, e.g., Pennsylvania Public Utility Commission v. Philadelphia Electric Company, 54 Pa. PUC 459, 37 PUR4th 381 (1980), affirmed

Philadelphia Electric Company v. Pennsylvania Public Utility Commission, 61 Pa. Commonwealth 325, 433 A.2d 620 (1981) (Commission excluded the capacity of particular units from the return on investment).

In 1983, the Commission found that excess capacity existed on the PP&L system with the addition of Susquehanna Unit 1. Pennsylvania Public Utility Commission v. Pennsylvania Power & Light Company, 57 Pa. PUC 559, 55 PUR4th 185 (1983) (PP&L 1). After reviewing the Penn Power I and PECO 1980 decisions, the Commission applied the standards established in those cases to the facts before it and found that Susquehanna Unit 1 represented excess capacity. PP&L 1, Id. at 576, 55 PUR 4th at 200. As a result of this finding, the Commission disallowed the costs associated with a slice of the system equal to PP&L's ownership share of Susquehanna Unit 1. PP&L 1, Id. at 577-578, 55 PUR4th at 201-202.

Two years later, the Commission addressed the issue of excess capacity on PP&L's system as it regarded the addition of Susquehanna Unit 2 by PP&L.⁷ Pennsylvania Public Utility Commission v. Pennsylvania Power & Light Company, 59 Pa. PUC 332, 67 PUR4th 30 (1985) (PP&L 2). In PP&L 2, the Commission found that Susquehanna 2 constituted excess capacity and as a result, the

⁷ In PP&L 2, PP&L voluntarily moved the costs associated with a 945 MW slice of the system--the size of PP&L's ownership share of Susquehanna 1--below the line since it had sold the capacity to Jersey Central Power and Light Co. (JCP&L). In the case at bar, that sale continues, and the associated 945 MW of capacity associated with the sale was not included in the determination of physical excess capacity by OCA witness Kahal.

Commission disallowed the equity return on Susquehanna Unit 2. In reaching its conclusion, the Commission affirmed the principles regarding excess capacity that had been established in its prior decisions. PP&L 2, 59 Pa. PUC at 345, 67 PUR4th at 41.

In a 1987 case involving Duquesne Light Company, the Commission summarized the principles established in its pre-1986 precedent regarding excess capacity adjustments as follows:

These adjustments were made to balance the risks associated with bringing new generating plant on line between the utility's shareholders and ratepayers. The test used by the Commission in making these adjustments were whether: a) the investments in the plants were prudent when made, and (b) would the plants be used and useful during the period when rates will be in effect. In addition, the Commission also considered evidence as to whether the plants would produce net economic benefits. *PECO, PP&L, I, and PP&L, II.*

Pennsylvania Public Utility Commission v. Duquesne Light Company, 66 Pa. PUC 518, 623, 91 PUR4th 546 (1988).

3. Enactment of Section 1323 And Commission Decisions Applying Section 1323.

In July 1986, the Public Utility Code was amended to add, among other sections, Section 1323. 66 Pa.C.S. §1323. Section 1323 relied upon the used and useful doctrine, as did the prior Commission precedent, in setting forth the legal standards for an excess capacity determination. Section 1323 provides:

(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 reserves;
- (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 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.

66 Pa.C.S. §1323.

Section 1323 requires that a baseload plant, the costs of which are not yet included in a utility's rates, meet a two part test. First, the utility must show that the plant is needed to meet the utility's customer demand plus a reasonable reserve margin in the test year or the year following the test year. 66 Pa.C.S. §1323(a). Second, the utility must show that the plant will provide a net annual economic benefit to ratepayers during the test year or within a reasonable period following the test year. If the utility fails to meet either test, the statute creates a rebuttable presumption of excess capacity. If the utility is unable to overcome that presumption, the Commission must make an adjustment

as provided for in the statute. Duquesne, 66 Pa. PUC at 624. See also, Pennsylvania Public Utility Commission v. Philadelphia Electric Co., 74 Pa. PUC 1, 130-131, 143 (1990).

In the Pennsylvania Public Utility Commission v. Duquesne Light Co., 63 Pa. PUC 337 (1987), the Commission explained the analysis to be performed as follows:

It is clear that for a baseload plant, both the "physical" and the "economic" forms of excess capacity must be negated to prevent the presumption of excess capacity (in the broad sense) from arising. The physical test comes first in the statute, and if the utility fails that test, the economic test need not be reached, and an excess capacity adjustment must be made. An analysis would involve the following: (1) determine a reasonable reserve margin; (2) specify which plants or parts of plants are to be counted in computing installed or available capacity; (3) determine whether all the installed or available capacity is needed to meet the utility's (peak) customer demand plus a reasonable reserve margin in the test year or the year following the test year; and (4) if not, determine if the utility has presented sufficient evidence to overcome the rebuttable presumption, and, if so, move on to the economic test.

Duquesne, 63 Pa. PUC at 364-65.

The Commission has applied Section 1323 in several cases following its enactment. See, e.g., Pennsylvania Public Utility Commission v. Duquesne Light Company, 63 Pa. PUC 337 (1987) (The Commission considered the applicability of Section 1323(b) when Perry I fails to meet the standards for commercial operation by the end of the test year.); Pennsylvania Public Utility Commission v. West Penn Power Company, 63 Pa. PUC 295, 84 PUR4th 198 (1987) (Commission directs a rehearing on excess capacity pursuant

to Section 1323, even though the Company had previously claimed the costs of the Bath County Project.); Pennsylvania Public Utility Commission v. Duquesne Light Company, 66 Pa. PUC 518 (1988) (Commission finds that Duquesne has successfully rebutted the presumption that the addition of Perry I constituted physical excess capacity, but failed to rebut the presumption that the unit was economic excess capacity.); Pennsylvania Public Utility Commission v. Pennsylvania Power Company, 67 Pa. PUC 91 (1988) (Commission finds that Penn Power's addition of Perry 1 does not constitute either physical or economic excess capacity.) and Pennsylvania Public Utility Commission v. Philadelphia Electric Company, 74 Pa. PUC 1 (1990) (Commission finds that PECO failed to rebut the presumption that the addition of the 1055 MW of Limerick 2 will result in both physical and economic excess capacity.)

4. Section 1323 Applies to PP&L's Request For A Return On Common Equity Associated With Susquehanna 2.

The Company has claimed in this proceeding that Section 1323 does not apply to its request for a return on common equity associated with Susquehanna 2. The OCA submits, however, that Section 1323 does apply to the Company's claim in this case since the Company has not previously received ratemaking recognition of the equity return associated with Susquehanna 2. As such, the OCA submits that the Company's claim must be analyzed pursuant to the legal standards set forth in Section 1323.

Section 1323 was enacted in 1986, subsequent to PP&L's base rate case in which the Commission denied PP&L an equity return

on the Company's investment in Susquehanna 2. In pertinent part, Section 1323 states that "[w]henver a public utility claims the costs of an electric generating unit in rates for the first time and the commission finds that the unit results in the utility having excess capacity, the commission shall disallow . . ." 66 Pa.C.S. §1323(a). PP&L apparently assumes that its claim for an equity return on Susquehanna 2 is not a claim made "for the first time." However, the Commission has previously interpreted this language to relate to generating facilities that have not previously been recognized in rates. Pennsylvania Public Utility Commission v. West Penn Power Company, 61 Pa. PUC 711, 736-38, 77 PUR4th 220, 244-246 (1986). Since the return on common equity associated with the Company's investment in Susquehanna 2 has not previously been recognized in rates, Section 1323 is directly applicable to PP&L's claim.

In West Penn, the Commission considered the application of Section 1323 to West Penn's request for ratemaking recognition of the Bath County Pumped Storage Project. West Penn had first sought rate recognition of the Bath County Project in its base rate case filed in 1984. In that case, the Commission analyzed the Company's claim as to whether the investment was prudent when made, and whether the property will be used and useful during the time rates will be in effect. Pennsylvania Public Utility Commission v. West Penn Power Company, 59 Pa. PUC 552, 570-74, 69 PUR4TH 470, 485-489 (1985). The Commission found that the unit would represent needed capacity, and that it would be cost effective and otherwise

beneficial. Id. at 572. However, due to delays in the project, the project did not enter commercial service during the test year, and the Commission denied the Company's request for rate recognition. Id.

In its 1985 rate case, decided in 1986 after the enactment of Section 1323, West Penn again sought ratemaking recognition of the costs of the Bath County Project. In determining whether Section 1323 would apply to the Company's claim, the Commission determined:

It is clear that §1323 applies to our instant consideration of Bath County. Bath is an electric generating unit; its costs are being claimed for the first time, in the sense that its costs have not been included in any prior Commission-made rates (*Cheltenham & A. Sewerage Co. v. Pennsylvania Pub. Utility Commission*, 344 Pa. 366, 43 PUR NS 477, 25 A.2d 334 [1942], cert. denied, 317 U.S. 588, 87 L.Ed. 482, 63 S.Ct. 38; and the instant case was pending at the time §1323 became law.

West Penn, 61 Pa. PUC at 736-37, 77 PUR4th at 245 (underline emphasis added). Various Petitions for Reconsideration were filed regarding the Commission's Order in that case. In its Response to these Petitions, West Penn argued that its preceding rate case, at Docket No. R-842632, was the occasion on which the Company claimed the costs of Bath County "for the first time." Pennsylvania Public Utility Commission v. West Penn Power Company, 63 Pa. PUC 295, 303 (1987). The Commission, however, determined that Section 1323 should apply and remanded the matter to the Administrative Law Judge for a determination with respect to excess capacity as set forth in Section 1323. Id. at 304. In setting the matter for

hearing, the Commission noted that although it had previously determined "that Bath County does not represent excess capacity . . . we certainly recognize that the facts bearing on excess capacity are subject to change." Id.

The Commission has applied Section 1323 in two other proceedings despite the fact that the utilities involved had claimed the costs associated with the generating facility at issue in a previous proceeding. Pennsylvania Public Utility Commission v. Duquesne Light Company, 66 Pa. PUC 518, 91 PUR4th 546 (1987) and Pennsylvania Public Utility Commission v. Pennsylvania Power Company, 67 Pa. PUC 91, 93 PUR4th 189 (1988). Both of these cases concerned the Companies' second request for ratemaking recognition of the investment in the Perry 1 nuclear unit. Both Companies had requested ratemaking recognition of the Perry 1 costs in the preceding base rate case, but were denied such recovery when the unit did not achieve commercial operation during the test year. Pennsylvania Public Utility Commission v. Duquesne Light Company, 63 Pa. PUC 337 (1987) and Pennsylvania Public Utility Commission v. Pennsylvania Power Company, 64 Pa. PUC 308, 85 PUR4th 323 (1987). In the subsequent case, however, the Commission applied the provisions of Section 1323(a) to the Company's claim.

The OCA submits that the Commission's interpretation of the applicability of Section 1323 as set forth in these cases is reasonable, and these principles should be applied to the case at bar. In the case at bar, the Company has never received ratemaking recognition of the return on common equity associated with

Susquehanna 2. As such, the OCA submits that the Company must meet the tests set forth in Section 1323 to receive such ratemaking treatment. Any other interpretation of the language contained in Section 1323 would produce an absurd result.

For example, if Section 1323 was intended to only apply to the first time that a utility claimed the costs of generating plant, a utility could reverse an excess capacity disallowance by merely filing another base rate case one day after the Commission's Order was entered in its first case. Under that interpretation, regardless of the extent of physical or economic excess capacity, the utility could avoid the legal standards set forth in Section 1323 by filing a second case immediately following the first case. Such an interpretation would produce an absurd result, and one that does not favor the public interest. As the Commission has previously recognized:

[T]he General Assembly would: (1) not intend an absurd result, and (2) would intend to favor the public interest as opposed to the private interest. 1 Pa.C.S. § 1922.

PECO, 74 Pa. PUC at 131.

Moreover, the legislative history of Section 1323 confirms that the General Assembly believed that Section 1323 would apply to Pennsylvania Power & Light Company. When the Report of the Committee of Conference on HB 1639, PN 3778 was called for consideration in the House, Representative Laughlin discussed various amendments to the bill that were added to resolve concerns raised by the Senate. One of these amendments dealt specifically with the issue of cogeneration projects on a utility's system, and

was subsequently embodied in Section 1323(c). In discussing what the bill would accomplish, Representative Laughlin stated:

Mr. Speaker, the last thing that this particular legislation does that was not previously there is that it gives a window for a cogeneration project of culm banks in the PP&L (Pennsylvania Power & Light Company) area of northeastern and central Pennsylvania.

Legislative Journal of Pennsylvania House of Representatives, Report to the General Assembly on June 25, 1986, at 1554 (Vol. II, 1986).

The OCA submits that this legislative history indicates the Legislature's belief that the bill it was considering applied to PP&L. Indeed, a review of Section 1323(c) reveals that it clearly applies to units that were in commercial operation before the law was enacted, such as Susquehanna 2. Section 1323(c), in relevant part, provides:

. . . in determining whether a base load unit, which was in commercial operation for at least one year prior to the effective date of this section, results in a public utility having excess capacity. . .

66 Pa.C.S. §1323(c).

In the case at bar, it is particularly important for the Commission to apply the standards set forth in Section 1323 to its consideration of the Company's request for an equity return on its investment in Susquehanna Unit 2. In a 1985 West Penn case, the Commission discussed its decision to make an excess capacity adjustment for Susquehanna 2 as follows:

We are mindful that we rejected a similar argument in the recent *PP&L* case (*Pennsylvania Pub. Utility Commission v. Pennsylvania Power*

& Light Co., 67 PUR4th 30 [Pa.P.U.C. 1985]). However, the actual size and duration of the excess there makes this case distinguishable from the present one. That case involved an excess that was so large it would persist until the end of the century. Accordingly, we stated (67 PUR4th at p. 44):

The sheer magnitude of the present excess capacity and the number of years that it will persist render meaningless the Company's arguments about the temporary effect or adding large baseload plants.

West Penn, 59 Pa. PUC 552, 574, 69 PUR4th 470, 489 (1985).

The OCA submits that to allow the Company to overcome this concern about the magnitude of the excess capacity and its persistence until the end of this century, merely by filing a second case to overcome the applicability of Section 1323, is not in the public interest. It is clear that Section 1323 must apply to the Company's claim in this case to recover an equity return on Susquehanna 2--a claim which was previously denied by the Commission. Even though the Commission's prior Order regarding Susquehanna 2 was entered prior to the enactment of Section 1323, Section 1323 must now control the Commission's consideration of this issue as it regards the return on common equity associated with Susquehanna 2 in this proceeding.

As such, the OCA submits that the Commission must apply Section 1323 in this case to the Company's request for a return on common equity associated with its investment in Susquehanna 2.

5. Even If 1323 Does Not Apply, The Same Principles Should Guide The Commission's Consideration Of PP&L's Request For An Equity Return On Susquehanna 2.

Even if the Commission finds that Section 1323 is not directly applicable to the Company's claim for a return on common equity for Susquehanna 2, the OCA submits that the Commission should consider both physical and economic excess capacity considerations in reviewing the Company's claim. In PP&L's last base rate case, prior to the enactment of Section 1323, the Company itself encouraged the Commission to consider the economic benefits of Susquehanna 2. The Commission summarized the Company's argument:

In addition to the primary reliability sense of usefulness, the Company proposed a second one, consisting of present value economic benefits. From a broader perspective, this present value approach is one aspect of the Company's general argument that long range generation planning cannot be judged on a short term basis.

PP&L 2, 59 Pa. PUC at 347, 67 PUR4th at 43. Based on the evidence adduced in that case, the Commission held:

Second, and even more important, we hold that even on the Company's best case, future economic benefits will not accrue until the next decade. The sheer magnitude of the delay combined with the uncertainty of the projections render the net present value approach meaningless on the record before us.

Id. at 348, 67 PUR4th at 44.

The Commission, based on these findings, disallowed the Company a return on common equity associated with the unit. In discussing this disallowance, the Commission stated:

Fourth, we have made continuation of our excess capacity adjustment contingent on either one of two alternatives: if the Company can show that SSES 2's net economic benefits have begun to outweigh the its net costs, or that its capacity is no longer excess relative to system reliability, then the Company may take appropriate steps to seek modification of this adjustment.

Id. at 351 (emphasis added).

The OCA submits that this language does not establish the standards by which the Company's request for modification of the adjustment will be granted. It merely sets forth a prerequisite that the Company must meet before the Commission will even consider a modification of its previous adjustment. In considering whether to modify this adjustment, the OCA submits that the Commission should be guided by the well-established principles that were codified in Section 1323. As discussed above, the Commission has considered the "used and useful" nature of both existing and new baseload generating plants for nearly two decades. In conducting this review, the Commission has often considered both the economic and physical impacts of generating facilities on a utility's ratepayers. See, PECO 1980, 54 Pa. PUC at 224-27, 37 PUR4th at 386-389; PP&L 1, 57 Pa. PUC 559, 55 PUR4th 185; PP&L 2, 59 Pa. PUC at 343-346, 67 PUR4th at 40-42. The Company has provided no reason as to why its claim for a return on Susquehanna 2 in this case should be exempt from this review.

As such, the OCA submits that even if Section 1323 is not directly applicable to PP&L's claim, the Commission should review both the physical and economic benefits of the unit in determining

whether the unit is "used and useful" in service to the public. As set forth fully below, the OCA submits that the Company has not met either standard.

C. Physical Excess Capacity

1. Introduction

As noted above, in making an excess capacity determination, the Commission first analyzes the issue of whether a utility has physical excess capacity. In making this analysis, the Commission determines the reasonable reserve margin; determines which plants should be counted in computing the installed or available capacity; and then determines whether all of this available capacity is needed to meet the utility's peak customer demand. Duquesne, 63 Pa. PUC at 364-65. If not, the Commission determines whether the utility has presented sufficient evidence to rebut the presumption of excess capacity. Id.

In this case, the OCA has demonstrated that, based on a reasonable reserve margin in the range of 12%-15%, which is consistent with PP&L's obligation to PJM, between 400 to 800 MW of PP&L's generating capacity is not needed for system reliability purposes in the test year or the year following the test year. As such, the OCA submits that Susquehanna Unit 2 constitutes physical excess capacity pursuant to Section 1323(a) of the Public Utility Code.

PP&L, however, has argued that it should not be considered to have physical excess capacity for two reasons. First, PP&L argues that a reasonable reserve margin for ratemaking

purposes should be something in excess of the 12% reserve obligation that PP&L is assigned by PJM, although no PP&L witness provided an exact figure or range above the PJM obligation. Tr. 278-279; Tr. 2337-2338.

Second, the Company argues that in the consideration of its capacity resources, the Commission should disregard the 500 MW of Qualifying Facility (QF or NUG) resources that ratepayers are paying for through the ECR when it determines PP&L's installed or available resources. PP&L St. 9 at 11-12.

For the reasons set forth below, the OCA submits that these arguments must fail. The OCA submits that the Company has provided no justification for utilizing a reserve margin substantially higher than PP&L's obligation to PJM. To do so, would deprive ratepayers of the resource planning benefits that arise from PP&L's participation in the PJM system. Moreover, the OCA submits that it would not be proper for the Commission to ignore 500 MW of system resources that ratepayers are fully funding.

2. A Reasonable Reserve Margin For PP&L, Based On Its PJM Obligation, Is Between 12% and 15%.

PP&L is a member of the Pennsylvania-New Jersey-Maryland (PJM) Interconnection which provides for coordinated planning and operation of a combined electric system. As a member of PJM, PP&L's reliability criterion is determined by PJM, and PJM sets the required reserve margins for PP&L and other system members. In setting these reserve margins, PJM considers various factors,

including the time of the utility's peak in relation to the PJM system peak. PP&L St. 9 at 7. Since PP&L is a winter peaking utility in a summer peaking pool, PP&L's reserve margin has been set at 12% by PJM, while the reserve margin established for the pool is 22%. PP&L St. 9 at 10. As PP&L witness Sipics testified, as of June 1, 1995, the reserve margin for the PJM pool will be reduced to 21.5%. Tr. 2386. PP&L utilizes this 12% reserve margin as its target reserve margin for reliability planning purposes. OCA St. 2A at 9.

The OCA submits that the 12% reserve margin assigned by PJM to PP&L, and utilized by PP&L in its capacity planning, is an appropriate minimum reserve margin to utilize in addressing the issue of physical excess capacity. As OCA witness Kahal explained, some cushion above this minimum reserve margin is appropriate for both planning and ratemaking purposes to account for temporary situations that may result from the addition of new resources. Mr. Kahal testified:

Both Mr. Sipics and I agree that the PJM standard of 12 percent provides a reasonable lower bound for excess capacity measurement purposes. Moreover, I can accept his argument that as a conceptual matter some cushion above this minimum should be considered. Unfortunately, his testimony does not identify what that cushion is.

I can accept the argument that a prudent utility might plan its system to target reserves which in some years exceed the minimum reserve margin due to "lumpiness." This suggests that when large generating units are added, temporary capacity amounts above the reserve margin standard should not be regarded as excess. Alternatively, a utility might add new capacity purely for the fuel

savings even though the capacity is not immediately needed to meet the reliability standard.

OCA St. 2 at 14.

In light of these considerations, OCA witness Kahal recommended that a range of 12% to 15% be used a reasonable reserve margin for purposes of this proceeding. Mr. Kahal explained:

[I]n recognizing the imperfections of capacity planning (i.e., the lumpiness problem), I recommend consideration of a range from 12 to 15 percent. The extra 3 percentage points translate into approximately 200 MW and provides a generous cushion.

OCA St. 2 at 15-16.

The Company, through the testimony of its witnesses on direct and rebuttal, has argued that the reserve margin for ratemaking purposes should significantly exceed the Company's PJM obligation and its own planning criteria. Neither PP&L witness Sipics, nor PP&L witness Hieronymus identified a specific reserve margin or upper bound of a reserve margin range to be used for ratemaking purposes in this proceeding. Tr. 2337-38. However, Dr. Hieronymus noted that the Commission had adopted a 22% reserve margin in PP&L's last case;⁸ (PP&L St. 16-R at 17) and, both PP&L witnesses on this issue concluded that the Company did not have excess capacity. The OCA submits that the Company's position that

⁸ No witness has specifically argued for the continuation of the 22% reserve margin utilized by the Commission in PP&L's last case. The OCA submits that the determination of an appropriate reserve margin is a fact-based question that will vary from utility to utility and may change over time. Moreover, as OCA witness Kahal noted, in PP&L's last case, even at a 22% reserve margin, all of Susquehanna Unit 2 was found to be excess capacity. OCA St. 2A at 23-24.

the reserve margin for ratemaking purposes should significantly exceed the reserve margin for planning purposes is unreasonable and should be rejected.

The gravamen of the Company's argument is that it is inherently uncertain and risky to bring baseload generating units on line, so the "lumpiness" that results from these capacity additions should be considered for ratemaking purposes. OCA witness Kahal agreed that the temporary effect of adding baseload units, or "lumpiness," is an appropriate consideration for ratemaking purposes. As noted above, Mr. Kahal has reflected this consideration by appropriately quantifying a cushion above the planning reserve margin to account for this problem. As Mr. Kahal testified:

I agree that lumpiness is a consideration. As a general matter, it is impractical for utilities to precisely match capacity resource additions with load growth. Thus, when a new generating unit is added, capacity reserves may slightly exceed desired levels. It therefore may take the utility a period of time to absorb fully the capacity from the new resource (e.g., one to three years). For that reason, I have suggested that allowance of a 3 percentage point cushion over planning reserve margin may be justified.

OCA St. 2A at 17.

The Company witnesses, however, seem to favor an allowance for "lumpiness" that approaches the size of the last resource being added, rather than the 3% cushion quantified by OCA witness Kahal. OCA St. 2A at 17. In this case, the "lump" is

Susquehanna 2, or about 1,000 MW.⁹ The OCA submits that the use of a reserve margin that exceeds the planning reserve margin by such a significant amount is unreasonable for ratemaking purposes for several reasons.

Notably, the use of an unreasonably high reserve margin to account for the temporary problem of "lumpiness" associated with capacity additions has little to do with PP&L's current circumstances. As OCA witness Kahal explained:

Recall that lumpiness arises as a temporary problem because unit size exceeds annual load growth. Given that Susquehanna 2 entered service ten years ago in 1985, his [PP&L witness Hieronymus] 1,000 MW lumpiness allowance no longer applies. This is obviously not a matter of PP&L requiring a couple of years to "grow in" to Susquehanna Unit 2.

More importantly, it was PP&L management which made the decision to add new units in the size of 1,000 MW increments. Dr. Hieronymus would shift the risk of that decision away from PP&L and to ratepayers.

OCA St. 2A at 17 (emphasis in original).

Moreover, the "lumpiness" argument loses much of its relevance as utility resource planning develops. As Mr. Kahal explained:

⁹ The Commission, in PP&L's last rate case, explicitly rejected PP&L's argument as it regarded the addition of Susquehanna 2 at that time. The Commission stated:

The sheer magnitude of the present excess capacity and the number of years it will persist render meaningless the Company's arguments about the temporary effect of adding large base load plants.

PP&L 2, 59 Pa. PUC at 348.

In the current planning environment, the "lumpiness" argument is no longer quantitatively important, nor has it been for a number of years. Utilities no longer plan for large (e.g., 600 to 1,000 MW) generating units. Capacity is normally added in relatively small increments, i.e., 100 to 300 MW or smaller, so that capacity additions can follow the utility's load growth pattern, keeping surplus capacity above the planning reserve margin standard to a minimum. In addition, utilities today are able to economize on excess reserves through flexible short-to-medium term purchases. While the lumpiness argument may have been important at one time, it can no longer be used as an explanation for large departures from the planning reserve margin.

OCA St. 2 at 14.

The OCA submits that the Company's argument that the reserve margin for ratemaking purposes should significantly exceed its PJM capacity obligation to account for the effects of the addition of new base load units--or the "lumpiness" problem--is flawed and should be rejected.

PP&L witness Sipics has also argued that PP&L should maintain a reserve margin in excess of what PJM requires due to reliability concerns. PP&L St. 9 at 12-13 and PP&L St. 9-R at 2. The OCA submits, however, that the Company has not demonstrated that it either plans to maintain reserves in excess of PJM obligation for these reasons, or that maintaining a higher reserve margin than the PJM obligation benefits ratepayers in any way. Moreover, The Company has not demonstrated that the factors listed by PP&L witness Sipics are not already accounted for in PJM's determination of reliability, or adequately accounted for in Mr. Kahal's 3% cushion.

The reliability concerns identified by Mr. Sipics are largely accounted for by PJM in its determination of a reserve margin and need not be added to the determination of a reserve margin for ratemaking purposes. OCA St. 2 at 14-15. As OCA witness Kahal explained:

[T]here is no evidence that PJM fails to consider the reliability concerns cited in Mr. Sipics' testimony when it assigns PP&L a reserve margin obligation. In his testimony, he notes that PJM adopts a one-day-in-ten-years standard of reliability. Moreover, on cross-examination, he generally acknowledged that PJM takes into account the same factors as he cites as being reliability concerns. (Tr.. 269-273). Hence, his reliability concerns cannot serve as the basis for a planning reserve margin greater than 12 percent unless PP&L wishes to argue that PJM fails to adequately address utility reliability needs, i.e., PJM reliability planners are imprudent.

OCA St. 2 at 14-15.

In rebuttal, PP&L witness Sipics noted several additional factors, such as the 1993/94 extreme winter conditions, PP&L's long term ability to rely on interruptible load, the PJM after-the-fact capacity deficiency accounting, emerging competitive environments, and PP&L's history with loss of load, as reasons to maintain a reserve margin in excess of the PJM obligation. PP&L St. 9-R at 2. The OCA submits, however, that these factors are already considered in PP&L's reliability planning. As PP&L's 1995 ARPR makes clear, the ARPR is based on maintaining the current level of system reliability. OCA St. 2A at 13. The 1995 ARPR clearly indicates that PP&L is projected to be surplus for the next twelve years. Id. Additionally, the PP&L ARPR does not project capacity

additions until after 2007, and reserve margins with these capacity additions, are in the 11.5% to 12.5% range. OCA St. 2A at 13-14, Sch. MIK-1.

As to the after-the-fact capacity deficiency accounting, the Company has again failed to demonstrate that this concern is not captured in its own planning process, or that Mr. Kahal's 3% cushion is inadequate to account for this effect. Mr. Kahal testified:

First, to the extent this is a realistic concern to PP&L, it would be fully captured in PP&L's decision to plan for a 12 percent reserve margin target. Thus, PP&L itself does not see this as a reason for altering its planning process. Second, there is no evidence that PP&L realistically faces any exposure to a PJM-imposed capacity deficiency penalty in either the test year or the near term. Consequently, this is not a basis for setting aside an excess capacity test.

OCA St. 2A at 14-15.

Moreover, the Company has not even attempted to demonstrate that there is a benefit to PP&L's ratepayers of maintaining reserves in excess of its PJM obligation. As OCA witness Kahal explained, reliability is a PJM Pool-level concept for those participating in the PJM pool. Although there may be some pool benefits to a member Company maintaining reserves in excess of assigned obligations, only a small fraction of that benefit would go to the utility's own customers. Mr. Kahal explained the operation of the Pool as follows:

If PP&L were to maintain reserves at the required 12 percent level but due to unexpected forced outages it experiences a capacity shortage, it has the right to draw

upon available PJM capacity reserves to meet its needs. If the PJM as a whole experiences a capacity shortage, PP&L is obligated to participate in the emergency procedures established under the PJM Agreement even though PP&L has adequate reserves for its own customers. For example, if the PJM is capacity short, PP&L is obligated to participate in voltage reductions, incurring the costs of operating its units at emergency levels or customer curtailments regardless of its practice of maintaining surplus capacity above its PJM obligation.

OCA St. 2 at 15. Thus, the OCA submits that PP&L has not demonstrated any ratepayer benefit from maintaining a reserve margin far in excess of its PJM obligation.

The OCA submits that the appropriate reserve margin to utilize in this proceeding for determining excess capacity is a range of between 12% and 15%. This reserve margin range properly reflects PP&L's reserve margin obligation to the PJM pool, and it provides a reasonable cushion of about 200 MW to account for uncertainties that arise in the planning and operation process. A range that exceeds three percentage points has not been demonstrated to be reasonable, or cost beneficial to ratepayers. The use of a reserve margin for ratemaking purposes that significantly differs from the level the utility would seek to achieve for its own planning purposes would only serve to negate the purpose of an excess capacity review--that of equitably sharing the burden of excess capacity between shareholders and ratepayers.

3. NUG Capacity should Be Included In The Determination Of PP&L's Installed And Available Capacity Resources.

In the second step of the analysis of excess capacity, the Commission must determine which resources are to be included in the determination of a utility's installed or available capacity resources. In Exh. JFS-1, attached to PP&L St. 9, where PP&L compares its peak load to the resources available to PP&L to meet its peak load requirement and to satisfy its installed capacity obligation over a ten year period (PP&L St. 9 at 5) PP&L has shown 504 MW of NUG capacity and 345 MW of interruptible load along with its owned and leased generating facilities. PP&L, however, argues in this proceeding that the 504 MW of NUG capacity should not be included in the determination of excess capacity. PP&L St. 9 at 12; PP&L St. 16-R at 29-33. In addition, the Company, through the rebuttal testimony of its witness Hieronymus, seems to question the inclusion of interruptible load in this determination. PP&L St. 16-R at 34-36. However, the Company has not specifically recommended that interruptible load be excluded from the analysis.

The OCA submits that the 504 MW of NUG capacity on the PP&L system must be included in the determination of excess capacity in this proceeding. As OCA witness Kahal explained, and PP&L witness Sipics agreed, the NUG capacity is recognized by both PJM and PP&L for planning purposes. OCA St. 2 at 11; Tr. 257. In fact, the Company receives PJM installed capacity credits for the 504 MW of NUG capacity. Tr. 257. In addition, ratepayers are paying the full costs of these purchases through the ECR.

The Company, however, believes that there should be a distinction for the NUG capacity because the utility was compelled to purchase the power under federal law. PP&L St. 9 at 12, PP&L St. 16-R at 30. These arguments, however, ignore Section 1323(c) of the Public Utility Code and misconstrue the nature of an excess capacity adjustment.

Section 1323(c) of the Public Utility Code addresses the treatment of NUG capacity in excess capacity determinations. Section 1323(c), in relevant part provides:

in determining whether a base load unit, which was in commercial operation for at least one year prior to the effective date of this section, results in a public utility having excess capacity, cogeneration, for which an agreement has been entered into by the public utility within three years after the in-service date of the base load unit, shall not be considered by the commission in determining the reserve margins or economic benefits resulting from the base load unit for the first five years after the date of the cogeneration agreement.

66 Pa.C.S. §1323(c).

The OCA submits that Section 1323(c) provides appropriate guidance in resolving this matter. The statute establishes an eight year "window" (three years after the base load unit enters service and a five-year period thereafter) during which the NUG capacity cannot be considered in the determination of excess capacity. The 504 MW of NUG capacity on the PP&L system falls outside of this eight year window. As OCA witness Kahal testified:

In light of this standard, I requested information on contract executions for PP&L's 504 MW of QF capacity (OCA Cross Exhibit 6). A copy is attached as Schedule MIK-11, page 2

of 2. This indicates that all of the QF power supply was contracted for between 1985 and 1988, and hence, the five-year waiting period before the capacity could be counted expired during the time period 1990 to 1993.

OCA St. 2 at 13. As such, the OCA submits that the 504 MW of NUG capacity should be included in the reserve margin calculation.

The OCA submits that Section 1323(c) establishes appropriate policy with regard to the inclusion of NUG capacity in the excess capacity determination. Although Section 1323(c) does not provide a specific reason for the eight year window, OCA witness Kahal explained that the provision of such a "window" is appropriate. Mr. Kahal testified:

QF capacity is sometimes viewed as not necessarily subject to the same degree of planning control as a utility's own construction, therefore warranting special consideration in evaluating excess capacity. Permanent exclusion, however, would be extreme and would not serve to properly balance shareholder and ratepayer interests. The utility should be given a reasonable opportunity to adapt its capacity resource profile to the NUG capacity addition, and eight years is judged to be a reasonable outer bound of time for doing so. PP&L witnesses do not argue that eight years is an inadequate period of adjustment and that a longer window is needed.

OCA St. 2A at 22.

The OCA submits that PP&L has had ample opportunity to adjust its capacity resource profile through such measures as off-system capacity sales, engaging in buyouts or buydowns of NUG capacity, or marketing at the retail level. Tr. 2371, OCA St. 2A at 22. The fact of excess capacity remains, however, on the PP&L system. Therefore, to properly balance the interests of

shareholders and ratepayers, this capacity must be included in the excess capacity determination.

The Company has argued in rebuttal, and on direct, that the NUG capacity should not be counted in the excess capacity determination because the Company was compelled to purchase this power under federal law.¹⁰ This argument, however misconstrues the nature of an excess capacity adjustment, and ignores the fact that ratepayers are paying all costs associated with these NUG purchases.

OCA witness Kahal explained the flaw in the Company's argument:

Mr. Sipics' point seems to be that since PP&L did not actively seek to add the QF capacity, but did so only due to regulatory requirements, PP&L is not responsible for the excess capacity which factually results. In other words, the excess capacity due to the QF contracts is not the result of PP&L planning errors.

Mr. Sipics' argument misconstrues the nature of an excess capacity adjustment. The adjustment deals with the fact of excess capacity, not with whether the utility has acted imprudently. For example, excess capacity can just as easily result from a loss of load due to an economic downturn or self generation, also events arguably beyond the utility's control. In neither instance does this eliminate the "used and useful" standard for excess capacity disallowances.

¹⁰ It must be noted that PP&L entered into these contracts based on its own projections of avoided energy costs at the time the contracts were entered into. Tr. 282. These avoided energy cost rates, based on PP&L's projections, had to cover the entire operating cost, both capacity and energy costs, of the NUG facility. Otherwise, it made no economic sense for the NUG to enter the contract. Tr. 282-283.

OCA St. 2 at 12 (emphasis in original).

The OCA submits that PP&L has provided no justification for ignoring the guidance provided in Section 1323(c). The NUG capacity, which has existed on the PP&L system for over eight years, should be included in the determination of excess capacity. It is clear from the record that PP&L receives installed capacity credits for this capacity from PJM and that PP&L recognizes the NUGS as capacity resources in its own capacity planning. Tr. 257-258. As such, there is no reason to exclude the 504 MW of NUG capacity resources when evaluating PP&L's level of excess capacity.

4. Based On The OCA's Analysis, PP&L Has Physical Excess Capacity Of About 400 MW to 800 MW.

After determining the appropriate reserve margin and the installed and available resources, Mr. Kahal completed the physical excess capacity analysis by comparing the installed and available capacity resources to the utility's peak customer demand plus a reasonable reserve margin in the test year and the year following the test year. Using the 12%-15% reserve margin range determined by Mr. Kahal to be reasonable for PP&L for the purposes of this proceeding, and utilizing PP&L's own determination of its resources, including the NUG capacity, Mr. Kahal determined that PP&L has physical excess capacity of between 400-800 MW.

Mr. Kahal described his comparison as follows:

I show this on Schedule MIK-11, page 1 of 2, for the test year (i.e., winter of 1994/1995) and the following year (i.e., winter of 1995/1996). I am utilizing PP&L's own load forecast, its estimate of interruptible load and capacity resources (including QF

capacity). (footnote omitted) Consistent with Mr. Sipics' procedure on Exhibit JFS-1, I net out from capacity the firm off-system sales.

OCA St. 2 at 16.

In reaching his conclusion that between 400 to 800 MW of PP&L's capacity is excess, Mr. Kahal determined the required capacity by using both the 12% reserve margin as the lower bound and the 15% reserve margin as the upper bound. Id. The excess reserves are the difference between the actual capacity and the required capacity. Id.

As Mr. Kahal noted, his analysis finds that the physical excess capacity is somewhat less than the 850 MW of Susquehanna 2 that serves native load customers. Mr. Kahal explained:

A portion of Susquehanna 2 is allocated off-system to JCP&L and BGE, and therefore approximately 850 MW or so of Susquehanna 2 serves native load customers and is therefore "on system." Thus, my excess capacity range of 400 to 800 MW is somewhat less than the "native load" portion of Susquehanna Unit 2.

OCA St. 2 at 17.

The OCA submits, however, that as set forth below, Susquehanna 2 also constitutes significant economic excess capacity. As such, the equity return disallowance on the Pennsylvania Jurisdictional share of the entire unit should continue to apply.

D. Economic Excess Capacity

1. Introduction

Not only does Susquehanna 2 constitute physical excess capacity, it constitutes economic excess capacity. As OCA witness Kahal testified:

Based on my review of the evidence, I conclude that Susquehanna 2 is economic excess capacity. The Susquehanna plant does not provide economic benefits in excess of its current revenue requirement to ratepayers. The Company's own study indicates that Susquehanna's revenue requirement cost will exceed the market cost of power during at least the next ten years, and on a cumulative present value basis would result in a net economic detriment of ~~XXXXXXXXXXXX~~. (See OCA Cross Exhibit 7.)

OCA St. 2 at 4. The OCA submits that the economic excess capacity problem at Susquehanna 2 is even more compelling today than it was when the Commission first considered this issue in 1984. OCA witness Kahal explained:

At the time of the last rate case, the Company argued Susquehanna would be an economically attractive resource on a life cycle basis. It is clear from my review of the discovery documents that this is no longer PP&L's assessment--absent a substantial improvement in the plant's performance and cost control. Whether PP&L can attain such improvements is uncertain and, more importantly, these cost savings are not reflected in PP&L's request in this case.

OCA St. 2 at 5.

The OCA submits that it is clear from the record that Susquehanna 2 constitutes economic excess capacity as well as physical excess capacity. As such, the OCA submits that the Commission should continue its excess capacity disallowance--a

disallowance of the equity return on Susquehanna 2--in this proceeding.

2. The OCA's Analysis Of Economic Excess Capacity Is Reasonable And Should Be Adopted.

The economic test for excess capacity has been set forth in Section 1323 as follows:

For purposes of this section, a rebuttable presumption is created that a unit or units or portion thereof shall be determined to be excess unless . . . 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.

66 Pa.C.S. § 1323(c).

The Commission, in prior cases, has found that utilities have been unable to rebut the presumption of economic excess capacity. In particular, the Commission has rejected efforts by utilities to show an economic benefit through the use of a life cycle analysis that calculates a net present value benefit of the unit. See, e.g., PP&L 1, 57 Pa. PUC at 576); PP&L 2, 59 Pa. PUC at 348; Duquesne, 66 Pa. PUC at 651. The Commission, however, has found these analyses to be too speculative and uncertain to provide meaningful information on whether a unit will provide net economic benefits to ratepayers within a reasonable period of time. Id.

The OCA submits that as competition in the generation market increases, timely and reliable information is now available to the Commission for assessing whether a baseload unit will provide net economic benefits to ratepayers within a reasonable

period of time. In this case, OCA witness Kahal presented an analysis of whether Susquehanna 2 produces economic benefits for ratepayers utilizing this market information. In conducting this analysis, Mr. Kahal compared the full revenue requirement cost of Susquehanna 2 with the market price of power supply. OCA St. 2 at 17. In addition, Mr. Kahal examined evidence regarding life cycle comparisons, and the Company's own analysis, the Strategy 2000 Report, in reaching his conclusions. As Mr. Kahal testified, his examination of this additional evidence "only serves to reinforce my conclusions concerning the need for an economic excess capacity adjustment." OCA St. 2 at 18.

The OCA submits that the developing market for generation provides a means to now directly measure the economic benefits of capacity such as Susquehanna 2. OCA St. 2 at 17. Moreover, the use of market information in assessing the benefits of a capacity resource is consistent with the Commission's recent adoption of competitive bidding as the means of acquiring capacity by Pennsylvania utilities. Id.

The Company, in the rebuttal testimony of Dr. Hieronymus, argued that this creates a new standard for judging economic excess capacity and that by applying a market test to Susquehanna 2, the OCA is seeking to impose a "'50-50 sharing' of its estimate of SSES 2 stranded costs under the guise of a Section 1323 examination. PP&L St. 16-R at 44. In addition, Dr. Hieronymus claims that if employing a market test for Susquehanna 2, the OCA must give recognition to PP&L's assets that are below market price.

The OCA submits that these arguments are red herrings. Initially, it must be noted that this Commission has been analyzing economic excess capacity for nearly a decade and has made disallowances of equity returns on generating units in accordance with its analysis. The OCA's adjustment in this case is merely a continuation of the Commission's previous disallowance of Susquehanna 2, albeit at a lower disallowance level. Moreover, Mr. Kahal has employed precisely the same procedure for calculating the disallowances as employed by the Commission in its previous rate order on Susquehanna 2. The OCA's adjustment in this case is not a "prejudging" of the stranded cost issue.

Secondly, the OCA's approach does not impose market prices on PP&L, nor is the OCA recommending that any of PP&L's assets be priced at market in this rate case. In fact, as the OCA's witness noted, even with the OCA's proposed adjustment, the price of Susquehanna 2 to ratepayers remains above market. OCA St. 2A at 31.

Finally, Dr. Hieronymus' argument that transmission and distribution assets are examples of assets whose market value exceeds book value fails to recognize that there is no feasible market for these assets. As OCA witness Kahal explained:

Further, while it is feasible to compare market value versus regulatory value for generation assets, such a comparison is utterly meaningless in this context for transmission and distribution (T&D). Those are monopoly functions, and there is no competitive T&D market which could fairly evaluate those assets.

OCA St. 2A at 32.

The OCA submits that the use of market information in the analysis of economic excess capacity is reasonable in this proceeding. As will be set forth below, there is reasonable agreement on market prices within the relevant time period, long range speculative and uncertain assumptions that dominate the life cycle analyses can be eliminated, and the market information provides a method of directly assessing the benefits, or the costs, of the baseload generating facility at issue. The Company's theoretical criticisms of this method are unfounded and should be disregarded.

3. Based On The OCA's Analysis, Susquehanna 2 Constitutes Economic Excess Capacity.

In conducting this analysis, Mr. Kahal followed three, straight-forward steps. First, he estimated the cost to ratepayers of the power from Susquehanna 2, and the entire plant, on a revenue requirements basis assuming no disallowances. Second, Mr. Kahal assessed the probable market cost of base load power over the next five to ten years. Finally, Mr. Kahal recomputed the cost of power assuming the continuation of the Commission's equity return disallowance. OCA St. 2 at 19.

When estimating the cost of power from Susquehanna on a revenue requirements basis, Mr. Kahal used a range of parameters for possible disputed items such as the rate of return, decommissioning and depreciation. Within these parameters, Mr. Kahal's analysis, summarized on Schedule MIK-12, produces a revenue requirement range of \$766 to \$860 million per year. OCA St. 2 at

20. Assuming, then, that the plant operates at a capacity factor of 75% to 80%, the average cost is 5.67¢/kwh to 6.37¢/kwh. OCA St. 2 at 20. In order to simplify the comparison, Mr. Kahal utilized an average cost of 6.0¢/kwh. Id. The Company has not disputed Mr. Kahal's determination of the revenue requirements cost of Susquehanna, and Mr. Kahal's estimate is conservative compared with the estimate of 6.7¢/kwh for 1995 utilized by PP&L witness Hieronymus in his analysis. Tr. 2352.

In the next step, Mr. Kahal assessed the probable market cost of power over the next five to ten years. In making this assessment, Mr. Kahal examined several sources, both confidential and non-confidential, supplied by PP&L. One source examined by Mr. Kahal was PP&L's avoided cost filing for 1994. In that filing, PP&L projected that its "all hours" marginal energy cost ranges from 2.4¢/kwh in 1994 to 3.4¢/kwh in 2003, with a levelized value of 2.8¢/kwh. OCA St. 2 at 20. Since this is an energy only cost, Mr. Kahal found it reasonable to add about 0.5¢/kwh to these costs to account for capacity, producing a range of 2.9¢/kwh to 3.9¢/kwh. Id. On cross examination, PP&L witness Sipics testified that the Company has estimated a market price of 2.7¢/kwh in 1995 increasing to 4.0¢/kwh by the year 2000. Tr. 255.

These estimates are consistent with the PP&L confidential sources. Mr. Kahal explained: **PROPRIETARY BEGINS**

PROPRIETARY ENDS

OCA St. 2 at 19.

Based on a review of this evidence, Mr. Kahal determined that a reasonable range of probable market costs of "all hours" base load power is in the range of 2.5¢/kwh to 5.0¢/kwh over the next ten years, with a five- to ten-year average of 3¢/kwh to 4¢/kwh. OCA St. 2 at 20. The OCA submits that this is a reasonable range of probable market costs, consistent with PP&L's own estimates, and should be utilized in the analysis.

By comparing the 6¢/kwh cost of Susquehanna to the market cost of 3¢ to 4¢/kwh, it is clear that Susquehanna 2 does not produce net economic benefits to ratepayers within a reasonable time frame. Using a five year perspective, Mr. Kahal determined that the revenue requirement cost of Susquehanna 2 is about \$150 to \$200 million per year above market.¹¹ OCA St. 2 at 6. The OCA

¹¹ The OCA has utilized a five to ten year perspective for the analysis of the economic benefits of Susquehanna 2. Section 1323 provides that the benefits must be produced within a "reasonable" time period. The OCA submits that the five to ten year time frame is reasonable for the purposes of this proceeding. As OCA witness Kahal testified, projections that extend beyond ten years are highly uncertain, as the Commission has previously noted, and of limited usefulness for ratemaking purposes. OCA St. 2 at 18. See also, PP&L 2, 59 Pa. PUC at 354.

Additionally, as OCA witness Kahal noted, cost comparisons beyond a ten year horizon may not matter if greater deregulation is introduced. If generation is deregulated, any
(continued...)

submits that given these facts, the Commission must continue the equity return disallowance established in the last case. PP&L is simply not able to demonstrate that Susquehanna 2 will provide net economic benefits to ratepayers within a reasonable time.

4. The OCA's Analysis Is Consistent With The Company's Own Report On Susquehanna--Strategy 2000

In the last case, PP&L argued that Susquehanna 2 would produce net economic benefits to ratepayers over its useful life. As the Commission noted in its Order in that proceeding, the life cycle analysis presented by the Company was a heavily litigated issue. As the Commission described it in its Order:

Next the Company argued at length that SSES 2 is useful in contributing a net economic benefit over its lifetime, amounting to about \$5 billion in net present value to ratepayers. (reference omitted). In fact, the various projections of the plant's future and present value economic benefits were one of the most heavily litigated parts of the case, particularly between the Company and OCA. Specifically, the witnesses disputed one another on SSES 2's anticipated operating and maintenance expenses, capital additions, capacity factor, and operating life. In addition, they differed over the appropriate present value discount rate and the cost of alternative fuels. (reference omitted) In view of our disposition of the case, it is unnecessary to describe these disputes in detail.

PP&L 2, 59 Pa. PUC at 339, 67 PUR4th at 36.

In this case, however, there is no dispute between the OCA and the Company about the net present value impact of

¹¹(...continued)
benefits that may result in the out years may never be realized by PP&L's ratepayers. OCA St. 2 at 18.

Susquehanna on ratepayers. As the Company's own study--Strategy 2000--documents, Susquehanna is **PROPRIETARY BEGINS**

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OCA St. 2 at 24, OCA Cross Examination Exhibit 21 at p.2.

Although the OCA does not recommend the use of a remaining life analysis for the determination of excess capacity in this proceeding, the Strategy 2000 report supports the necessity of an economic excess capacity disallowance in this proceeding. OCA witness Kahal explained:

The problem is that the Report makes it very clear that Susquehanna will be highly uneconomic (i.e., a ~~XXXXXXXXXXXXXXXXXXXX~~ cost penalty) absent achieving large cost savings and productivity gains. Unfortunately, these improvements and cost savings are not part of this rate case. In this rate case, PP&L is seeking cost recovery for Susquehanna consistent with its economically infeasible Base Case, i.e., a charge to ratepayers of 6 to 6.5¢/kwh.

OCA St. 2 at 25-26. Moreover, as PP&L witnesses Sipics and Jones testified on cross-examination, the Company has not committed to pursuing any of the efficiency initiatives identified in the

Strategy 2000 Report at this time. Tr. 251, 2258. At this juncture, the Company has assigned these recommendations to its managers for further cost benefit analysis, but no further decisions have been made. Tr. 2258. Importantly, **PROPRIETARY BEGINS**

PROPRIETARY ENDS

OCA St. 2 at

24-25; OCA Cross Examination Exhibit 21 at 2.

The Company has tried to minimize the findings of the Strategy 2000 report, even calling it a "hypothetical solution to a hypothetical problem." (PP&L St. 15-R at 6). The OCA submits that the report itself, and the evidence in this case, makes clear that this is no "hypothetical problem" to PP&L's ratepayers. PP&L's ratepayers are being penalized in the amount of \$XXXXXXXXXXXX over the remaining life of this plant. This, unfortunately, is all too real of a problem for PP&L's ratepayers.

5. PP&L's Rebuttal On Economic Excess Capacity Does Not Overcome The Presumption Of Economic Excess Capacity.

PP&L did not present a direct case on the issue of whether Susquehanna 2 constituted economic excess capacity. PP&L's entire case on this issue was presented in Rebuttal through the testimony of its witness, Dr. Hieronymus. PP&L St. 16-R at 42 to 60. Essentially, after expressing disagreement with the theoretical basis of excess capacity adjustments, Dr. Hieronymus presents a "coal proxy" type analysis in that he compares the year

by year revenue requirements of Susquehanna 2 to the year by year revenue requirements of a new coal plant that enters service in 1995. PP&L St. 16-R at 55-56; OCA St. 2A at 25. Based on the assumed lead time for a coal plant utilized by PP&L and Dr. Hieronymus, this means that construction of this resource would have had to begin in 1987. OCA St. 2A at 25. Dr. Hieronymus concludes that Susquehanna 2 is less costly than a new coal plant by 0.6¢/kwh, i.e. roughly a 10% cost advantage. OCA St. 2A at 28.

The OCA submits that Dr. Hieronymus' use of a "coal proxy" in this proceeding does not provide a meaningful method of analyzing the issue of whether Susquehanna 2 constitutes economic excess capacity. Importantly, Dr. Hieronymus has made no attempt to determine if a new coal plant would be the least cost resource for PP&L either in this time frame, or at the time he must assume that construction began. OCA Cross Examination Exhibit 22; Tr. 2330-2331. As Mr. Kahal explained, it simply is erroneous to make such a comparison. Mr. Kahal stated:

Dr. Hieronymus does not even attempt to address the question as to whether the new coal plant, which he uses for economic benchmarking purposes is cost effective. If the new coal plant is not least cost (or approximately so), then all Dr. Hieronymus has done is compare one uneconomic resource (Susquehanna Unit 2) with a resource that is even more uneconomic (a new coal plant). Any conclusion concerning net economic benefits to customers from such a comparison is obviously erroneous.

OCA St. 2A at 26. As PP&L's own planning witness testified, if PP&L were to lose Susquehanna 2 today, he would expect that it

would be replaced with a combined cycle facility, not a base load coal plant. Tr. 2319-2320.

The use of a coal plant for cost comparison purposes is also inconsistent with PP&L's 1995 Annual Resource Planning Reports (ARPR). PP&L's 1995 ARPR does not include any new coal capacity in its 20 year plan. In fact, according to PP&L's 1995 ARPR, the coal unit provides customers with a benefit-to-cost ratio of only 0.3, indicating that it is not a cost-effective resource. OCA St. 2A at 27. This means that the costs of such a plant exceeds PP&L's avoided cost by about 300%. Tr. 2317. In terms of dollars, the net economic penalty (present value) for ratepayers from a 300 MW pulverized coal plant is estimated to be a \$604 million loss. OCA St. 2A at 27. Clearly, PP&L does not view the addition of a coal plant as an economically viable resource option.

The only perspective from which a coal plant analysis may be useful would be in the context of a prudence analysis, the type of analysis that Dr. Hieronymus seemingly favors. PP&L St. 16-R at 9-12. Such an analysis would compare Susquehanna 2 to the cost of a coal plant entering service contemporaneously in 1985. OCA witness Kahal explained that Susquehanna 2 fails even this test:

Had Dr. Hieronymus' proxy coal plant been built to enter service in 1985--rather than 1995--its ten year rate base value would be dramatically lower than the cost figures used in his study. This would be due to (1) the avoidance of ten years of inflation in the plant's original cost; and (2) the build up of ten years of accumulated depreciation and deferred taxes. These rate base reducing effects would be much larger than the 0.6 cent per kWh cost advantage identified by Dr. Hieronymus. Had he used a 1985 rather than a

1995 vintage coal plant, the cost would be perhaps 1.5 to 2.0 cents per kWh lower, offsetting the claimed 0.6 cent cost advantage for Susquehanna Unit 2. While I take no position on the prudence of Susquehanna, for the period 1995 to 2004, the plant is much more expensive per kWh than a 1985 vintage coal plant.

OCA St. 2A at 28-29.¹²

The OCA submits that Dr. Hieronymus' coal plant comparison analysis is without merit and in fact, only serves to further demonstrate that Susquehanna 2 will not provide net economic benefits. Dr. Hieronymus made no attempt to determine a least cost resource plan for PP&L for a 1995 capacity addition, nor has he made any attempt to determine whether the coal plant utilized in his analysis is a cost-effective resource. As demonstrated by PP&L's 1995 ARPR, the coal plant resource assumed by Dr. Hieronymus is not a least cost resource for PP&L, and it is not even considered as an economically viable resource in PP&L's own planning documents for the next twenty years. There is simply no justification for utilizing an uneconomic resource as a benchmark when making a determination of excess capacity for

¹² Dr. Hieronymus' analysis resembles an analysis prepared by Penn Power in its 1987 rate case at 67 Pa. PUC 125-126, 93 PUR4th 225-226. Under that test, the Commission compared Perry I to a coal plant which began construction after the completion of Perry I. This same type of analysis was used in PECO's 1989 base rate case at 74 Pa. PUC 1. Importantly, the Commission in those cases used the construction of a new unit to determine the "reasonable time period" for the excess capacity determination. In addition, the Commission, in PECO, noted that construction of the unit had to begin "now." In this case, if one looks at "now" or PP&L's present circumstances, it is clear that PP&L would not build a coal-fired baseload unit even if its had to replace Susquehanna 2. OCA St. 2A at 28-29.

ratemaking purposes. To do so, would be to saddle ratepayers with uneconomic costs resulting in rates that are unjust and unreasonable.

E. The Commission Should Continue The Disallowance Of The Equity Return On Susquehanna 2 That Was Established In PP&L's Previous Rate Case.

As set forth above, the record in this case establishes that PP&L has both physical and economic excess capacity warranting an excess capacity adjustment. In previous cases, the Commission has recognized that an excess capacity adjustment should represent a fair sharing of the costs of the excess between ratepayers and shareholders. In an early excess capacity decision involving Penn Power, the Commission held as follows:

[W]e agree . . . that the sudden burden of this new plant investment on the company's customers was no fault of Penn Power or of its investors; but neither was it the fault of ratepayers. Under these circumstances there must be some sharing of the risk associated with bringing large plants on line.

Penn Power 1, 52 Pa. PUC at 471.

This risk sharing principle has continued to guide this Commission's excess capacity adjustments. In PP&L's last rate case, where the Commission implemented the equity disallowance on Susquehanna 2, the Commission discussed why this disallowance constituted a fair sharing of the costs of excess capacity:

The common shareholders assumed the risk that the investment in SSES 2 would succeed, and this risk has presumably been reflected in their authorized rate of return. Even though there has been no finding of imprudence, that risk remains on the shareholders. This is not a penalty, but rather a proper allocation of risk and its consequences.

On the other hand, disallowance of a total return would, in the present context, amount to a penalty. Dividends on preferred stock and interest on debt must be paid in any case. disallowance from rates of these components of return would mean that the common equity holders would have to pay them. Under the particular circumstances of this case, that would not constitute a fair sharing of the burden.

PP&L 2, 59 Pa. PUC at 351, 67 PUR4th at 46.

In upholding the Commission's order, the Commonwealth Court found that the Commission's disallowance of an equity return represented an appropriate balancing of shareholder and ratepayer interests. The Court held as follows:

Indeed, our conclusion is buttressed by the fact that we consider the Commission's allocation of excess capacity in this case to be an appropriate discharge of its duty to balance the interests of PP&L's customers against those of its investors. Pennsylvania Electric Company v. Pennsylvania Public Utility Commission, --- Pa. ---, 502 A.2d 130 (1985). As our Supreme Court noted in Pennsylvania Electric Company, the "focus of inquiry is properly upon the 'total effect' of the rate order, rather than upon the rate-setting method employed." Id. at ____, 502 A.2d at 133. In the case at bar, the Commission's order allows PP&L to recover from its ratepayers the expenses of operating and maintaining Susquehanna 2, which PP&L was properly entitled to recover. [citations omitted] The Commission denied, however, a return on PP&L's common equity investment in Susquehanna 2, until such time as PP&L can show that the capacity produced by Susquehanna 2 is used and useful. Despite PP&L's contention that such allocation of the excess capacity burden falls unfairly on its investors, the Commission determined that such balancing of competing interests was fair, in that the risk of excess capacity is properly laid more heavily on PP&L's shareholders, who voluntarily assumed that risk in the first instance by investing in Susquehanna 2.

Because this determination was made within the broad boundaries of the Commission's discretion and is supported by substantial evidence of record, this Court may not indulge in the process of reweighing the evidence and must uphold the Commission decision on this matter.

Pennsylvania Power and Light Co. v. Pennsylvania Public Utility Commission, 101 Pa. Commonwealth 370, 516 A.2d at 431-32 (1986).

In this case, OCA witness Kahal has recommended a continuation of the common equity disallowance implemented by the Commission in PP&L's last base rate case. Based on the OCA's return on equity recommendation of 11.1% and 45.0% equity ratio, the disallowance is \$61.85 million on a Pennsylvania jurisdictional basis, assuming a 78.5% jurisdictional allocation factor. OCA St. 2 at 21. The final disallowance, however, must be consistent with the Commission's rulings on return on equity, rate base adjustments, and the jurisdictional allocation percentage.

Mr. Kahal assessed the effect of his recommended disallowance on the cost of power from Susquehanna 2. Mr. Kahal explained the effect of his disallowance as follows:

As a result of this recommended disallowance, the cost of power at Susquehanna Unit 2 declines from the 6.0 cents per kWh figure to approximately 4.8 cents per kWh, i.e., a 1.2 cent per kWh reduction.

* * *

The disallowance has a beneficial effect of bringing PP&L's cost to ratepayers for Susquehanna Unit 2 closer to market, but it remains significantly above it using a five-to ten-year time frame. I show this comparison on Schedule MIK-14. Using a benchmark market price of 3 to 4 cents per

kWh, Susquehanna Unit 2 becomes 20 to 40 percent above market.

OCA St. 2 at 22.

Mr. Kahal also analyzed his recommended disallowance by comparing the amount of uneconomic costs absorbed by shareholders and the amount absorbed by ratepayers. Mr. Kahal concluded:

Thus, with the common equity return disallowance, there is roughly a 50/50 sharing between ratepayers and investors of the uneconomic costs for Unit 2. However, following that perspective implies that ratepayers absorb 100 percent of the Unit 1 uneconomic costs. Alternatively, spreading the \$62 million disallowance over both units, ratepayers absorb 75 percent and shareholders only 25 percent of the uneconomic costs.

OCA St. 2 at 23.

Finally, Mr. Kahal compared his excess capacity disallowance to the Strategy 2000 report. Mr. Kahal concluded:

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OCA St. 2 at 26.

The OCA submits that the continuation of the equity disallowance on Susquehanna 2 is reasonable given the facts of this case. Such disallowance results in a revenue disallowance of \$62 million, and effects a 50/50 sharing of the uneconomic costs of

Susquehanna 2. As such, the OCA urges the Commission to continue its equity disallowance on Susquehanna 2.

F. Conclusion

For the reasons set forth above, the OCA submits that the Company has failed to rebut the presumption that Susquehanna 2 constitutes both physical and economic excess capacity. Accordingly, the OCA submits that the Commission should continue the return on equity associated with Susquehanna 2 that was established in PP&L's last base rate case. In this proceeding, the disallowance is approximately \$62 million on a Pennsylvania jurisdictional basis. The OCA's recommended disallowance is reflected on Sch. TSC-1, p. 2.

IV. RATE BASE

A. Introduction

The OCA through the expert testimony of its accounting witness, Thomas S. Catlin,¹³ recommends several adjustments to PP&L's proposed rate base claim. Mr. Catlin's testimony and schedules are contained in OCA Statements 6 and 6A. His final schedules are attached to this Brief in Appendix A. The schedules consist of tables reflecting a final OCA recommended test year rate base of \$4,937,249,000, a summary of which is depicted in Sch. TSC-2 (Updated 5/19/95). The OCA recommends a total reduction of \$80,459,000 in PP&L's proposed future test year rate base claim of \$5,017,178,000. OCA St. 6A, Sch. TSC-2 (Updated 5/19/95).

Specifically, the OCA recommends adjustments in three areas: (1) accrued pensions; (2) prepayments in the Company' Cash Working Capital requirement; and (4) the Company's cash working capital allowance.¹⁴ OCA St. 6, Schs. 3, 5 & 6.

¹³OCA witness Thomas S. Catlin is a principal with Exeter Associates, Inc., a firm specializing in issues pertaining to public utilities. He has over fifteen years of experience in utility rate regulation. Mr. Catlin has testified before this Commission on numerous occasions, including three of the last four West Penn rate cases. Tr. 752. Mr. Catlin, who was previously employed by Camp Dresser & McKee, Inc. and Arthur Beard Engineers, has a Masters of Science Degree in Water Resources Engineering and Management from Arizona State University. A complete description of Mr. Catlin's qualifications is provided in OCA St. 6 at 1-3.

¹⁴ The OCA originally included as an adjustment to PP&L's rate base an adjustment to recognize the balance of accumulated deferred income tax ("ADIT") which is deducted from rate base to reflect the balance of accumulated deferred income taxes associated with the loss on reacquired debt. As set forth in detail in Section IX, the OCA has incorporated this adjustment into the cost of debt. OCA St. 6A, Sch. TSC-2. However, the OCA submits that should the
(continued...)

B. PP&L's Balance Of Accrued Pension Liability Should Be Deducted From Rate Base.

The accrued pension liability which is reflected on PP&L's books represents the difference between the pension costs which have been reflected on PP&L's books and the Company's contributions to its pension fund since the implementation of Statement of Financial Accounting Standard ("SFAS") No. 87 in 1987.

OCA St. 6 at 5. As OCA witness Catlin explained:

Since 1987, the pension costs recorded on the Company's books have either already been recovered from ratepayers as an expense in the year in which they were recorded or are being recovered as a component of the capitalized overheads included in the cost of plant in service. Therefore, the accrued pension liability represents funds that have been recovered from ratepayers,¹⁵ but which have not been contributed to the pension fund by the Company.

Id. The OCA submits that the balance of the accrued pension liability should be deducted from rate base. As shown on OCA St. 6, Sch. TSC-3, this adjustment reduces total Company rate base by \$85,537,000 and Pennsylvania jurisdictional rate base by \$74,034,000.¹⁶

¹⁴(...continued)

Commission adopt the capital structure recommended by PP&L witness Moul than the Commission must consider Mr. Catlin's rate base adjustment.

¹⁵ Mr. Catlin noted that although capitalized pension costs have not yet been fully recovered, PP&L is separately recovering these amounts through depreciation expense and the undepreciated balance is part of rate base. As a result, the effect is the same as though they had already been recovered. OCA St. 6 at 5.

¹⁶ In calculating the balance of accrued pensions to be deducted from rate base as of September 30, 1995, Mr. Catlin
(continued...)

In rebuttal, PP&L witness Berish testified that Mr. Catlin's adjustment was inappropriate and set forth two reasons why he believed Mr. Catlin's adjustment to be flawed. PP&L St. 2R at 13-14. Mr. Catlin responded to both of these arguments in his surrebuttal testimony:

First, he argues that the accrued liability represents the amount by which the pension plan is underfunded not overfunded. This is the very reason why it is appropriate to deduct the accrued pension liability from rate base. The underfunding to which Mr. Berish refers represents the pension costs which have been recorded on the books as an expense and, hence, recovered from ratepayers, but not contributed to the pension trust.

Mr. Berish's second argument is that the ratepayers have not paid the pension costs recorded on the books under SFAS No. 87 because SFAS No. 87 was not adopted by the Company until after its last rate case. This argument, however, is inconsistent with the basic ratemaking presumption that a utility's revenues are adequate to recover its costs. If they are not adequate, the utility will file for rate relief. During the period from 1987 until the present, the Company has recorded the costs under SFAS No. 87 as its pension expense per books. During this period, the Company reported its earnings and its earnings were judged on the basis of these pension costs. Therefore, it is reasonable and proper to recognize those costs as having been recovered from ratepayers.

OCA St. 6A at 4. As Mr. Berish stated, in PP&L's last rate case, the pension expense allowed by the Commission was \$19.1 million on

¹⁶(...continued)
reflected his recommendation that the test year pension accrual be set at zero dollars. Mr. Catlin also reflected the test year amortization of the pension supplement associated with the Voluntary Early Retirement Program ("VERP"). OCA St. 6 at 6.

a Pennsylvania jurisdictional basis. PP&L St. 2R at 15. As shown on PP&L Exh. MJB-14, this amount exceeds the Company's pension expense per books in every year under SFAS No. 87.

The OCA submits that the Company cannot argue that the adoption of SFAS No. 87 resulted in a level of pension expense which was in excess of the amount provided for in rates. In fact, as shown on MJB-14, the adoption of SFAS No. 87 resulted in the amount of expense remaining relatively unchanged from the allowance that was explicitly reflected in rates in Docket No. R-842651. OCA St. 6A at 4-5.

Mr. Berish's argument that it is inappropriate "to examine one change in one item of benefits expense without also considering other components of the Company's benefits" ignores the basic ratemaking presumption that a utility's revenues are adequate to recover its costs. PP&L St. 2R at 15-16, Exh. MJB-15. If the costs of PP&L's other benefits increased during this time period, and PP&L's revenues were not adequate to cover these costs, the Company had the option of seeking rate relief. As shown on OCA St. 6, Sch. TSC-3, adoption of this adjustment reduces total Company rate base by \$85,537,000 and Pennsylvania jurisdictional rate base by \$74,034,000.

C. PP&L's Pro Forma Rate Base Must Be Reduced By \$1,982,000 To Reflect An Appropriate Cash Working Capital Allowance.

1. Introduction

Cash working capital is that element of rate base valuation which measures the funds needed by the utility company to bridge the time interval between the rendition of utility service

and the customers' payment for that service. Pa. P.U.C. v. Pennsylvania-American Water Company, 68 Pa. PUC 343, 356 (1988). PP&L witness Bernini sponsored PP&L's lead/lag study testimony and results in this proceeding.¹⁷ See PP&L St. 3; PP&L Exh. Future 1 (Revised), Sch. C-4. The components of the Company's working capital claim include operation and maintenance expense, average prepayments, accrued taxes, interest payments, preferred dividend payments and cash working capital requirement. Id.

A summary of the Company's pro forma cash working capital claim is set forth at PP&L Exh. Future 1 (Revised), Sch. C-4, at page 1 of 6. As shown in that Exhibit, the Company's own calculation results in a negative cash working capital requirement, although PP&L has chosen to set its cash working capital requirement at zero.¹⁸ PP&L St. 3R at 2. However, as OCA witness Catlin testified:

... when all aspects of working capital are taken into consideration, neither the Company's claimed working capital allowance nor the working capital allowance which I have identified are negative. However, even if one looks at the cash component of working capital in isolation, it is inappropriate to not recognize a negative cash working capital requirement.

¹⁷ A lead lag study measures the differences in time between (1) the time services are rendered until payment of those services are received and (2) the time between when a utility has incurred an expense and the actual payment of the expense. OTS St. 4 at 42.

¹⁸ As OTS witness Weakley explained in his direct testimony: "[T]he total net Company claim for CWC is negative (\$392,000) with a Pennsylvania jurisdictional claim of negative (\$530,000). OTS St. 4 at 42.

OCA St. 6A at 8. Both OTS and OCA witnesses recommended a negative Pennsylvania jurisdictional cash working capital requirement. OCA St. 6 at 9-12; OCA St. 6A at 7-9, Sch. TSC-6 (Updated 5/19/95); OTS St. 4 at 41-55, OTS Exh. 4, Sch.9. The OCA submits that the Commission should treat positive and negative cash working capital requirements in the same manner. Setting the cash working capital requirement at zero ignores the fact that ratepayers are supplying more funds to the Company than is required.

In addition, OCA witness Catlin made four changes to the lead-lag analysis utilized by PP&L to calculate its cash working capital claim. The OCA submits that these adjustments correct errors in the Company's lead/lag analysis and should be adopted. Mr. Catlin explained these adjustments in his direct testimony:

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 at 9. As shown on OCA St. 6A, Sch. TSC-6 (5/19/95 Update), Mr. Catlin determined PP&L's cash working capital requirement on a total Company basis to be negative (\$9,857,000) and on a Pennsylvania jurisdictional basis to be negative (\$12,444,000).

2. PP&L's Working Capital Claim Must Be Reduced To Reflect The Company's Negative Cash Working Capital.

As discussed above, PP&L determined its cash working capital requirement in this proceeding to be a negative (\$837,000). See PP&L St. 3; PP&L Exh. Future 1 (Revised), Sch. C-4. Rather than recognize this adjustment, the Company has chosen to set its cash working capital requirement at zero. As PP&L witness Bernini explained in his rebuttal testimony:

The negative cash working [capital] requirement proposed by these witnesses is caused by the offset for the alleged lag in the payment of bond interest and preferred dividends. Without this adjustment, the Company's claim for cash working capital would be positive. I recognize the Commission has adopted the interest offset adjustment in prior cases based on the hypothetical lag in the payment of bond interest. However, I do not believe that it is appropriate to use this adjustment to drive a utility's cash working capital claim negative.

PP&L St. 3R at 2 (emphasis added). The OCA submits that this argument must fail. Setting a negative cash working capital requirement at zero not only ignores the Company's own study, but it also results in ratepayers, rather than shareholders, supplying funds to the Company in excess of its cash working requirements.

OCA witness Catlin responded to Mr. Bernini's criticism of a negative cash working capital requirement in his surrebuttal testimony. As Mr. Catlin explained:

A negative cash working capital requirement signifies that, on average, the Company is recovering the revenues which it receives for providing service prior to the time that it must pay for the expenses incurred to provide service. A negative cash working capital

requirement indicates that PP&L has the use of ratepayer supplied funds to offset other working capital requirements. Ratepayers are entitled to recognition of this fact just as investors are entitled to a return on the funds they provide when cash working capital requirements are positive.

Id. (emphasis added). The OCA submits that the fact that PP&L ratepayers are entitled to recognition and recovery of the funds supplied in excess of that required by the Company's cash working capital requirement.

As PP&L witness Bernini recognized the Commission has a longstanding policy of deducting the accumulated debt interest and preferred stock dividends from cash working capital as funds available for unrestricted use by respondent. Pa. P.U.C. v. Pennsylvania Power & Light Company, 54 Pa. PUC 645, 655 (1981) ("PP&L 1981"). The Commission set forth its strong support for this adjustment in Pa. P.U.C. v. Pennsylvania Power Company, 55 Pa. PUC 552 (1982), stating:

This subject has been addressed repeatedly by this Commission.¹⁹ In addition to the at

¹⁹Pennsylvania Pub. Utility Commission v. Philadelphia Electric Co. (1981) 55 Pa. PUC 78, 42 PUR4th 475; Pennsylvania Pub. Utility Commission v. Pennsylvania Gas & Water Co. (1981) 55 Pa. PUC 339; Pennsylvania Pub. Utility Commission v. Duquesne Light Co. (1981) 54 Pa. PUC 695, 43 PUR4th 27; Pennsylvania Pub. Utility Commission v. West Penn Power Co. (1981) 54 Pa. PUC 602; Pennsylvania Pub. Utility Commission v. Pennsylvania Power & Light Co. (1981) 54 Pa. PUC 645; Pennsylvania Pub. Utility Commission v. National Fuel Gas Distribution Corp. (1980) 54 Pa. PUC 401, 40 PUR4th 101; Pennsylvania Pub. Utility Commission v. Carnegie Nat. Gas Co. (1980) 54 Pa. PUC 381; Pennsylvania Pub. Utility Commission v. Philadelphia Suburban Water Co., R-79040824, Feb. 1, 1980; Pennsylvania Pub. Utility Commission v. West Penn Power Co. (1979) 53 Pa. PUC 410, 32 PUR4th 245; Pennsylvania Pub. Utility Commission v. Pennsylvania Electric Co. (1978) 52 Pa. PUC 487, 26 PURth 337; (continued...)

least 16 proceedings in which the Commission has approved such an adjustment, the Commission repeatedly has been affirmed by the Commonwealth Court.²⁰

Id. at 564. Even the Company has recognized the Commission's precedent on this matter by including this adjustment in its cash working capital calculation.

Although the Company recognized that the Commission has long held that the accumulated debt interest and preferred stock dividends should be deducted from the cash working capital calculation, it argues that in this proceeding, PP&L should not be required to conform its cash working capital calculation consistent with this precedent because it would result in a negative cash working capital allowance. The OCA recognizes that this Commission has in the past set the cash working capital allowance at zero rather than adopting a negative cash working capital determination. See Pa. P.U.C. v. Equitable Gas Company, 60 Pa. PUC 127, 140-141 (1985); Pa. P.U.C. v. Pennsylvania Power Company, 64 Pa. PUC 308,

¹⁹(...continued)

Pennsylvania Pub. Utility Commission v. Metropolitan Edison Co. (1979) 53 Pa. PUC 225, 28 PUR4th 555; Pennsylvania Pub. Utility Commission v. Pennsylvania Power Co. (1978) 52 Pa. PUC 459, 27 PUR4th 426; Pennsylvania Pub. Utility Commission v. Philadelphia Electric Co. (1977) 51 Pa. PUC 199; Pennsylvania Pub. Utility Commission v. Pennsylvania Electric Co. (1978) 51 Pa. PUC 649; Pennsylvania Pub. Utility Commission v. UGI Corp. (1978) 52 Pa. PUC 383.

²⁰Philadelphia Electric Co. v. Pennsylvania Pub. Utility Commission (1981) 61 (Pa. Cmwlth 325, 433 A.2d 620; UGI Corp. v. Pennsylvania Pub. Utility Commission (1980) 49 Pa. Cmwlth 69, 410 A.2d 923; Peoples Nat. Gas Co. v. Pennsylvania Pub. Utility Commission (1980) 52 Pa. Cmwlth 201, 415 A.2d 937; Penn Electric Co. v. Pennsylvania Pub. Utility Commission (1980) 53 Pa. Cmwlth 186, 417 A.2d 819.

342 (1987); Pa. P.U.C. v. Duquesne Light Company, 66 Pa. PUC 518, 654 (1988); Pa. P.U.C. v. Pennsylvania Power Company, 67 Pa. PUC 91, 342 (1988). However, the Commission has also allowed negative cash working capital allowances. See Pa. P.U.C. v. ALLTELL Pennsylvania, 59 Pa. PUC 447, 457-58 (1985).

The OCA acknowledges that in Barasch v. Pa. Public Utility Commission, 108 Pa. Commonwealth 326, 332, 530 A. 2d 936, 939 (1987), the Commonwealth Court upheld the Commission's refusal to allow a negative cash working capital. However, in that proceeding the courts held that the record lacked sufficient evidence to make such a determination:

Furthermore, we must agree with the Commission that the record lacks sufficient evidence (i.e. a "lead-lag study" supporting negative cash working capital) to establish a negative cash working requirement clearly. Hence the Commission did not commit an error of law in its refusal to adopt a new policy of negative cash working capital, in view of the absence of sufficient evidence to support such a significant change in accounting practices.

Id. 108 Pa. Commonwealth at 332, 530 A.2d at 939. The OCA submits that in this proceeding there is sufficient evidence to support the establishment of a negative cash working requirement.

Although, in Barasch v. Pa. Public Utility Commission, 111 Pa. Commonwealth 339, 352, 533 A.2d 1108, 1114 (1987,) the Court held that the Commission had not established an error of law in setting Continental Telephone Company's cash working capital allowance at zero, its finding was based on the fact that:

... there is nothing that in the Code nor Pennsylvania case law which requires that the

negative cash working capital adjustment be adopted by the Commission.

Id. 111 Pa. Commonwealth at 352, 533 A.2d at 1114. The OCA submits that in this proceeding there is established precedent which supports a of a finding of a negative cash working capital adjustment. See Pa. P.U.C. v. Pennsylvania Power Company, 55 Pa. PUC 552 (1982).

Here, as discussed above, the Company's negative cash working requirement is caused by the offset for the lag in the payment of bond interest and preferred dividends. See PP&L St. 3R at 2. The Commission has long held that these funds should be deducted from cash working capital. However, under the Company's claim ratepayers would not receive the benefits of this adjustment that recognized that the Company has unrestricted use of accumulated debt interest and preferred stock funds dividends because to do so would result in a negative cash working capital requirement. The OCA submits that recognition of the Commission's long standing precedent requiring the deduction of accumulated debt interest and preferred stock funds dividends justifies allowing a negative cash working capital.

The OCA submits that ratepayers would be doubly harmed by setting PP&L's cash working capital requirement at zero. First, it ignores the long standing precedent deducting accumulated debt interest and preferred stock funds dividends from cash working capital. Second, it allows PP&L the use of ratepayer supplied funds to offset other working capital requirements. The Commission's policy of setting cash working capital allowances at

zero should not preclude the allowance of long established cash working capital adjustments. Accordingly, the OCA's adjustment should be adopted.

3. PP&L's Lead Lag Study Should Be Adjusted to Reflect A Correction To The Composite Revenue Lag.

PP&L developed a composite revenue lag based on an analysis of the lag in the receipts of each component of its overall revenues. In response to OTS-RE-19D [OTS Cross Exam Exh. 12], PP&L indicated that the revenue lag associated with accounts for which the payment due date is 20 days (20-day accounts) was inadvertently overstated by two days. Mr. Catlin revised the composite revenue lag to reflect the correction of the 20-day account lag. This correction has the effect of reducing the overall revenue lag from the 35.6 days used by PP&L to 35.0 days. See also OTS St. 4 at 44-45.

In rebuttal, Company witness Bernini reflected this adjustment in his revised schedules. PP&L St. 3R, Attachment 1; PP&L Exhibit Future 1 (Revised), Sch. C-4, p.2.

4. CAAA Permit Fees And Interest On Customer Deposits Should Be Removed From PP&L's O&M Expense Lag.

OCA witness Catlin explained that PP&L treats Clean Air Act Amendment ("CAAA") permit fees and interest on customer deposits in determining its O&M expense lag in the same manner in which it developed a composite revenue lag:

PP&L developed an overall O&M expense payment lag by analyzing the payment patterns for various components of O&M expense. In developing this composite lag, neither CAAA

permit fees nor interest on customer deposits was recognized separately. Instead, both CAAA permit fees and interest on customer deposits were included as a component of "other" O&M and assigned a payment lag of 32 days. In addition, neither item was considered in determining the payment lag of 32 days applied to other O&M.

OCA St. 6 at 10. Mr. Catlin proposed to treat these items as separate expense items in determining the composite O&M expense payment lag.

Mr. Catlin testified that removal of the CAAA permit fees and interest on customer deposits from the expense payment lag was appropriate because:

The CAAA permit fees which PP&L and other utilities pay to the Commonwealth of Pennsylvania for a given calendar year are due prior to September 1 of the following year. For example, on August 26, 1994, PP&L paid approximately \$848,000 of CAAA permit fees applicable to calendar year 1993. As a result, the payment lag for CAAA permit fees is almost 14 months. This is clearly not a typical lag, particularly for such a large expense. Therefore, the expense payment lag of 32 days for other O&M is simply not representative and appropriate for CAAA permit fees...²¹

Interest on customer deposits is paid annually and, as a result, the average payment lag associated with interest on customer deposits is 182.5 days. Although the amount of the interest on customer deposits is relatively small, it is appropriate that ratepayers

²¹ Mr. Catlin recalculated the composite O&M expense payment lag by separately recognizing these permit fees with a lag of 421 days based on the August 26 payment date used in 1994. OCA St. 6 at 10.

receive recognition that interest on their deposits is only paid annually.²²

OCA St. 6 at 10-11. The net effect of these two adjustments to separately recognize CAAA permit fees and interest on customer deposits is to increase the composite expense payment lag calculated on Schedule C-4 of PP&L Exhibit Historic 1 from 30.9 days to 31.1 days. Id. at 11.

In rebuttal PP&L witness Bernini testified that: "... it is inappropriate to 'cherry pick' one item such as CAAA permit fees (or any other item) without considering other individual expenses as well."²³ PP&L St. 3R at 5. In particular, Mr. Bernini argued that Mr. Catlin's adjustment to establish a separate lag for the prepayment of CAAA permit fees is incorrect, asserting that "OCA has confused the calculation of the permit fee with the application period." Id. at 4.

Mr. Catlin responded to Mr. Bernini's criticism of the adjustment to remove CAAA permit fees in his surrebuttal testimony:

Mr. Bernini argues that CAAA permit fees which are paid in September of one year do not apply to the prior calendar year. This is inconsistent with the information provided by the Company in response to OCA IX-9, which is attached to my surrebuttal testimony as Exhibit 1. As shown in that response, PP&L recorded an expense on its books of \$1,618,000 for CAAA permit fees during 1994. The response notes that the expense recorded in

²² Mr. Catlin recalculated the composite O&M expense lag by separately recognizing interest on customer deposits with a 183 (rounded) day lag. OCA St. 6 at 11.

²³ OTS witness Weakley proposed a number of additional adjustments to the Company's O&M expense lag. See OTS St. 4 at 45-49, OTS Exh. 4, Sch. 10.

1994 was increased significantly from prior years to reflect increased 1994 CAAA permit fees to be paid in 1995. The accrual of \$1,618,000 for 1994 is shown as being paid in August 1995.

OCA St. 6A at 9, Catlin Exhibit 1 (emphasis added).

In rejoinder, Mr. Bernini referenced the Company's response to OCA Set IX-9 [Catlin Exhibit 1], to support his argument that the amount of the fee is based on historical data, but the permit fee applies to the current period for which the expense is incurred. PP&L St. 3R at 4; Tr. 2031-2032. As set forth in interrogatory response, the Company stated that:

Amounts paid, accrued and budgeted for Clean Air Act Amendment (CAAA) emission fees are shown below.

PAID

<u>Period</u>	<u>Amount</u>
August 1993 (for 1992)	\$840,546
August 1994 (for 1993)	\$848,442
August 1995 (for 1994)	\$1,618,000

OCA St. 6A, Catlin Exhibit 1. Mr. Bernini testified that instead of the "for 1992", "for 1993", etc., contained in the response, the reference should state "based on the year 1992", "based on the year 1993", etc. Tr. 2032. The OCA submits that this argument is contradicted by a close reading of the entire response provided in of the Exhibit, including the note at the bottom which states:

Pennsylvania CAAA emission fees increased from an interim rate of \$14/ton to a permanent rate of \$37/ton for Phase II units effective for 1994 emissions paid in 1995. ...

OCA St. 6A. Catlin Exhibit 1.

The Commission recently approved this adjustment in Pa. P.U.C. v. West Penn Power Company, Docket No. R-00942986, slip op. at 18 (December 28, 1994), stating:

Consistent with the recommendation of ALJ Corbett, West Penn apparently agreed with his analysis concerning the treatment of CAAA compliance fees as a separate line item in the cash working capital lead-lag analysis. See R.D., pp. 21-22; N.T. 103-104. The permit fees for Pennsylvania for a given calendar year are due in August of the following year. Therefore, the composite payment lag is in excess of 13 months, an atypical lag, particularly for such a large expense.

Id. The CAAA permit fees which PP&L pays to Pennsylvania are paid on the same schedule as those paid by West Penn Power Company and they should be treated in the same manner for cash working capital purposes. OCA St. 6A at 9

The OCA submits that the evidence of record establishes that the lags associated with the CAAA permit fees and interest on customer deposits are atypical and should not be included in the determination of PP&L's expense lag. The recognition of CAAA permit fees and interest on customer deposits as separate line items in the Company's lead/lag analysis increases the composite expense payment lag calculated on Schedule C-4 of PP&L Exhibit Historic 1 from 30.9 days to 31.1 days.

5. The Sunbury Pump Invoice Should Not Be Included In The Calculation Of The Company's O&M Expense Lag.

PP&L developed the 32 day lag for other O&M expenses based on a sample of the invoices paid in the three months ended July 31, 1994. OCA St. 6 at 11. However, as Mr. Catlin testified:

One of the invoices which was included in this sample was a relatively large invoice for a purchase of a pump system for the Sunbury plant which was originally expensed and later corrected and capitalized. Because it was a capital cost and not an O&M expense, this invoice should not be included in determining the O&M expense lag. Therefore, I have removed this invoice from the calculation of the other O&M lag.

Id. at 11. Removal of this invoice has the effect of increasing the other O&M lag from 32 to 33 days and further increasing the composite O&M expense from the 31.1 days discussed above to 31.4 days.

In Pa. P.U.C. v. National Fuel Gas Distribution Corp., 62 Pa. PUC 407, 414-415 (1986), the Commission affirmed the prohibition against including capitalized items in cash working capital requirements holding:

It is well established that a utility may not capitalize an item in rate base and at the same time recover it as an expense from ratepayers (*UGI Corp v. Pennsylvania Pub. Utility Commission*, 49 Pa. Cmwlth 69, 77, 410 A.2d 923, 928 [1980]). These expenses are no exception . . .

Id. at 415. In the above case the Commission denied the Company's claim for recovery of unamortized balances in the cash working capital requirement. The Company did not respond to this adjustment in rebuttal. The OCA submits that the invoice for a purchase of a pump system for Sunbury should be not be included in the determination of the O&M expense lag since it represents a capital cost and not an O&M expense.

6. PP&L's Payment Lags Associated with Interest on Long-Term Debt And Preferred Stock Dividends Should Be Adjusted To Reflect a 365-day Year.

Mr. Catlin's third adjustment to PP&L's lead lag study corrected the payment lag associated with long-term debt and preferred stock dividends. As Mr. Catlin explained:

In its lead-lag study, PP&L assigned a payment lag of 90 days to interest on long-term debt based on the semi-annual payment of that interest and 45 days to preferred dividends based on their quarterly payment. These lags of 90 and 45 days are consistent with a 360-day year.

OCA St. 6 at 12. Mr. Catlin revised the payment lag for interest on long-term debt to 91.25 days (91.3 rounded) and the payment lag for preferred dividends to 45.63 days (45.6 rounded) to reflect a 365-day year. The OCA submits that this adjustment appropriately corrects an error in the Company's payment lag calculation.

7. Conclusion

Mr. Catlin's final adjustment to the Company's cash working capital claim adjusted revenues, expenses and taxes to recognize the OCA's recommended adjustments to the Company's request. OCA St. 6 at 12. As shown on OCA St. 6A, Sch. TSC-6 (Updated 5/19/95), OCA's proposed cash working capital requirement for PP&L is negative (\$9,857,000) and on a Pennsylvania jurisdictional basis negative (\$12,444,000). The OCA submits that in its final Order, the Commission should adjust the Company's cash working capital claim so that it is consistent with the

Commission's findings regarding the Company's final revenue requirements.

D. The Company's Rate Base Should Be Reduced To Reflect The Adjustments To The Balance Of Prepayments In The Company's Cash Working Capital Claim.

The Company's computations of the average investment in cash working capital includes five major components: cash working capital required for operation and maintenance expenses; funds invested in prepayments; adjustment for accrued taxes; adjustment for interest payments; and adjustment for preferred dividend payments. PP&L St. 3 at 10, PP&L Exh. Future 1, Sch. C-4. OCA witness Catlin made two adjustments to one of these components, the balance of prepayments included in rate base by PP&L. OCA St. 6 at 7-9, Sch. TSC-5.²⁴ The adjustments were to eliminate the balance of prepaid insurance and to adjust the balance of other prepayments to exclude the effects of a one-day prepayment of interest and preferred dividends.²⁵ Id. at 7-8.

Mr. Catlin explained the adjustment eliminating the balance for prepaid insurance as follows:

PP&L has included the 13-month average balance of prepaid insurance in rate base in order to recognize the fact that premiums for many of

²⁴ OTS witness Weakley also recommended a number of additional adjustments to the Company's balance of prepayments, including the balances for Insurance, NRC fees, PUC Assessment and Postage. OTS St. 4 at 50-53, OTS Exh. 4, Sch. 11.

²⁵ Mr. Catlin originally proposed three adjustments to the Company's balance of prepayments. See OCA St. 6 at 7-9, Sch. TSC-5. However, in rebuttal, PP&L witness Bernini corrected the average prepayment for the PUC annual assessment to reflect the unamortized balance which existed at the end of each month. PP&L St. 3R, Attachment 1; PP&L Exh. Future 1 (Revised), Sch. C-4, p.3.

its insurance policies must be made at or near the beginning of the time period covered by the policy. The problem with this treatment is that the Company has also reflected the fact that its insurance premiums must be prepaid in its lead-lag cash working capital analysis. That is, in the lead-lag study, the Company has calculated that its insurance premiums are paid 134 days in advance. In calculating this payment lead, PP&L included the same policies which are reflected in the balance of prepayments. Therefore, to avoid this double count, I have removed the balance of prepaid insurance from rate base.

OCA St. 6 at 8.

In rebuttal, PP&L witness Bernini argued that adjustments to eliminate prepayments associated with insurance from rate base were inappropriate since there "is no double counting, because the prepayment balance was not included in the expense balance." PP&L St. 3R at 3. Mr. Catlin responded to this argument in his surrebuttal testimony:

Mr. Bernini argues that there is no double count caused by inclusion of the balance of prepaid insurance in rate base and the inclusion of insurance premiums in the lead lag study. His rationale is that the prepayments only remain on the balance sheet until the premiums are expensed and, therefore, they are different than the expenses included in the lead-lag study. What Mr. Bernini fails to recognize, however, is that the lag assigned to insurance premiums is not based on timing of when the premiums are charged to expense. If it was, the lag would be 15.2 days. Instead PP&L has assigned insurance premiums a 134 day lead based on the timing of when the premiums are paid relative to the policy period. This is exactly what the prepayment balance represents. Therefore, there is a double-count and the balance of prepaid insurance should not be included in rate base.

OCA St. 6A at 8-9 (emphasis added). The OCA submits that the adjustment to eliminate the balance of prepaid insurance from rate base appropriately prevents ratepayers from being double charged for this expense. As shown on OCA St. 6A, Sch. TSC-5 (5/19/95 Update), adoption of this adjustment reduces total Company rate base by \$5,547,000 and Pennsylvania jurisdictional rate base by \$4,543,000.

Mr. Catlin's second adjustment to prepayments was to exclude the effects of a one-day prepayment of interest and preferred dividends. Mr. Catlin explained that this adjustment was necessary because:

As shown on page 3 of Schedule C-4 in Exhibit Historic 1 and Future 1, the balance of "other" prepayments normally ranges from a \$200,000 to \$2.7 million. However, in March 1994, the month end balance jumped to \$68.1 million. This occurred because PP&L made a deposit to its bond interest and preferred dividend payment accounts on March 31, 1994 to cover payments due on April 1, 1994. The deposits had to be made one day ahead of time because of the Good Friday holiday on April 1, 1994. By recording this one-day advance payment as a prepayment and including it in the 13-month average, PP&L has increased the balance of other prepayments by almost \$5.2 million. This is inappropriate because the advance payment only existed for one day and because this one-day advance payment was not a normal event.

OCA St. 6 at 8-9. Mr. Catlin adjusted the balance of "other" prepayments to exclude the effects of this prepayment of interest and preferred dividends. OTS witness Weakley also recommended adoption of this adjustment. OTS St. 4 at 54. The Company did not present rebuttal testimony on this issue. As shown on OCA St. 6A,

Sch. TSC-5 (5/19/95 Update), this adjustment reduces total Company rate base by \$5,164,000 and Pennsylvania jurisdictional rate base by \$4,469,000.

The net effect of Mr. Catlin's adjustments is to reduce the total Company balance of prepayments by \$9,308,000 and to reduce the Pennsylvania jurisdictional balance by \$7,609,000. OCA St. 6A, Sch. TSC-5 (Updated 5/19/95).

V. REVENUES

A. Economic Development Credits

PP&L has offered to its industrial customers, a series of Economic Development Initiatives (EDI) and Industrial Development Initiatives (IDI) since 1987. PP&L St. 8 at 16. In this case, PP&L has sought recovery of \$23,705,606 in EDI costs and \$1,625,464 in IDI costs. OCA St. 5 at 15. These costs represent the revenue shortfall which results from the Company providing discounted rates under the EDI/IDI rate programs.

The Company has sought recovery of this revenue shortfall in its rate increase request in that the credits now provided to customers reduce the current revenue from the customers receiving credits. Id. The Company proposes to recover the revenue shortfalls which result from providing these credits from the customer classes receiving the credits. As OCA witness Johnson explained:

For example, the PP&L cost study sets class revenues for those classes receiving the EDI/IDI credits at the actual revenue level (i.e., incorporating the credit). Thus, the indicated class rates of return for those classes is averaged between customers receiving the credits and customers not receiving the credits. If revenues were to be set at levels to produce equal rates of return for all classes, this would be equivalent to assigning the cost of the EDI/IDI credit to the remaining customers in the same class.

OCA St. 3 at 7.

The OCA has recommended in this proceeding that the revenue shortfall resulting from the provision of these discounted rates be shared equally between ratepayers and shareholders. PP&L

should not be permitted to recover all of this expense from ratepayers. As Commissioner Hanger recently stated:

Permitting a utility to negotiate terms which result in lower revenue to the utility does not mean that the shifting of lost revenues from such contracts to other classes of customers without any shareholder contribution to that cost **should be approved.**

Pennsylvania Electric Company Supplement No. 96 to Tariff Electric-Pa. P.U.C. No. 75, Docket No. R-00943280, FEB-95-OSA-1016, Statement of Commission John Hanger (Revised) (emphasis in original). The OCA submits that its recommended 50% sharing of the revenue shortfall from these programs is an appropriate sharing at this time.

The OCA submits that the Company has not adequately demonstrated in this proceeding that ratepayers benefit from the EDI/IDI programs so as to warrant the recovery of \$25 million in expense from ratepayers. Without a showing that the ratepayers' benefits were as large as the cost of the EDI/IDI program, other ratepayers should not be responsible for bearing the entire burden of these incentive programs. OCA St. 5 at 16.

The OCA submits that the Company's evidence attempting to demonstrate a benefit to other ratepayers is seriously flawed. PP&L witness Kasper argues in both his direct and rebuttal testimony that other ratepayers benefitted from the retention of 300 million kwh of sales that would have been lost without the EDI/IDI program. PP&L St. 8 at 18, PP&L St. 8-R at 39-42. The problem with this analysis, though, is that it assumes that all 300

million kwh would have been lost without the EDI/IDI program. Dr. Johnson explained the problem as follows:

This assumes that every KWH of sales for which EDI/IDI credits were provided would have been lost at the standard rate and that there were no free riders. PP&L has made no attempt to show this is the case. It simply claims that these sales would not have been made absent the EDI/IDI credits.

OCA St. 5 at 16. Even in rebuttal, the Company provided no supporting documentation for this claim. OCA St. 3B at 18.²⁶ The OCA submits that is not proper to simply assume that all of the load would have been lost without the full rate discount.

Additionally, as Dr. Johnson points out, the benefits of retaining these customers came at a cost to other PP&L ratepayers during that period. The additional sales imposed fuel costs on PP&L that were equal to the marginal cost of fuel on the PP&L system. OCA St. 5 at 17. Dr. Johnson discussed the effect of these higher fuel costs as follows:

Because the marginal costs are above the average cost of fuel, the additional sales raised the average costs of fuel to all other ratepayers to recover those additional costs, . . . this new average costs of fuel was passed through the ECR to other ratepayers, so their costs increased as a result of the EDI/IDI programs while shareholders received the benefits from the programs.

OCA St. 5 at 17.

²⁶ It should be noted that during the rejoinder testimony of PP&L witness Hieronymus, he discussed the Company's provision of economic development rates. When questioned on cross examination about this testimony, Dr. Hieronymus stated that ". . .the way it has been characterized to me is that there were some customers for whom retention was an issue, and then a lot of other people for whom retention was not an issue piled in."

The OCA submits that the costs of the EDI/IDI programs should be shared equally between the ratepayers and shareholders of PP&L. OCA St. 5 at 17. As OCA witness Johnson explained, it is possible that shareholders have benefitted from the 300 million kwh of sales that PP&L asserts was retained by these programs. Dr. Johnson stated:

It is possible that shareholders benefitted from the existence of these programs in the period from 1987 up to now, but a portion of any benefits have come from other ratepayers. Assuming that the full 300 million KWH were retained by the existence of the programs and would otherwise have been lost to PP&L, any benefit to shareholders would have been the net revenue produced by these customers.

OCA St. 5 at 17.

Several states have recently adopted a sharing approach for the revenue shortfalls that result from economic development rates, or load retention rates. In a 1994 case, the New York Public Service Commission found it reasonable for shareholders to absorb part of the lost margin resulting from discount rates. Re Competitive Opportunities Available to Customers of Electric and Gas Services, 154 PUR4th 19, 25 (N.Y.P.S.C. 1994). In reaching its conclusion, the New York Commission stated:

When the flexible rates induce a customer to remain on the system or acquire new load, both ratepayers and shareholders benefit, because a revenue stream covering incremental costs and contributing to common costs is maintained and the potential for stranded investment is diminished. Since both ratepayers and shareholders benefit compared to the alternative of lost load and revenue margin, it is proper for both to bear a portion of the reduced margins. This approach is a

reasonable response to the significantly changing landscape of the electric industry.

Id. at 25.

The Michigan Public Service Commission reached a similar result in a 1994 case involving Detroit Edison Company. Re Detroit Edison Co., 149 PUR4th 161 (Mich. P.S.C. 1994). In Detroit Edison, the Michigan Commission was considering whether the revenue shortfall from a tariff discount should be recovered from other ratepayers. The Commission considered whether the tariff provided net economic benefits. Id. at 223. The Commission found that the tariff would not produce a net positive benefit until the year 2000. The Commission also noted:

But the risk of lost revenues is difficult to measure, particularly given the incentives that are created if a customer can qualify for a discount merely by saying that it will cease purchasing electricity from Detroit Edison if it does not get a lower rate. Furthermore, customers on the tariff make no commitment to continue taking service from Detroit Edison if they are placed on the tariff.

Id. at 223.

In light of these considerations, the Commission directed a sharing of the costs between ratepayers and shareholders. The Commission explained its decision as follows:

The result is an equitable sharing of the costs of retaining customers that Detroit Edison says would otherwise leave the system and cease providing a contribution to fixed costs. The sharing that the Commission requires will balance the interests of Detroit Edison, the customers on the R10 tariff, and the customers who pay the cost of the R10 tariff discount.

Id. at 224.

In a more recent Michigan case involving Detroit Edison, the Michigan Commission has determined that the utility must absorb any revenue shortfall associated with the discounts from tariffed rates, unless it can make a compelling showing that a different rate treatment is justified. Re Detroit Edison Company, 160 PUR4th 132 (1995). The Commission set forth a test that the utility must meet before it will be permitted to reallocate the costs to other ratepayers. The Commission's position was summarized as follows:

[T]he utility must present a clear, convincing, and unequivocal demonstration that (1) the contract prices and terms are justified on the basis of cost of service, or (2) the benefits for nonparticipating ratepayers are substantial and outweigh the costs that are not recovered from the contract customers.

Id. at 132, 142.

As can be seen, Commissions in other states have recognized the benefit to shareholders from the retention of load. In addition, the Commission's have sought clear evidence regarding the benefits to ratepayers from the retention of the load.

In addition, Sierra Club witness Biewald identified an additional reason for requiring shareholders to absorb a portion of the revenue shortfall. As Sierra Club witness Biewald testified:

To the extent that utility shareholders absorb some of the revenues that are lost as a result of economic discount rates, the utility will have an incentive to minimize the amount of the discount rate, through negotiations with the customer and cost-effective DSM.

Sierra Club St. 1 at 7. Commissioner Hanger also recognized this principle when he stated:

Unless the shareholders of utilities are potentially at risk for some of the revenue that is lost as a result of the discounts utilities may offer pursuant to the new authority that this Commission may give, utilities will not have a strong incentive to limit as much as possible the amount of lost revenues. To protect both core ratepayers and shareholders, utilities must limit as best it can the amount of revenue lost.

Penelec, Motion of Commissioner Hanger, supra (emphasis in original).

The OCA submits that the cost of the EDI/IDI program should be shared equally between ratepayers and shareholders. In rebuttal, the Company has stated that if shareholders are required to pay for a portion of these costs, the Company will terminate these programs. PP&L St. 8-R at 43. However, the EDI program has already closed, and the Company proposes to leave the IDI program open only through 1997. OCA St. 5 at 17. As Dr. Johnson explained any increased sales or retention of load following this rate case will benefit the shareholders. Dr. Johnson testified:

This means any benefits from additional sales made under the program will flow to shareholders, at the same time existing customers will incur additional costs, as they did before.

OCA St. 5 at 17. The OCA submits that the Company's threat to terminate these programs cannot determine the proper ratemaking treatment of these costs in this case. The Company implemented these programs in 1987, and has not sought rate relief until 1995. The OCA's recommendation increases the Company's revenues by \$12,665,535. As such, the OCA submits that this adjustment to revenues should be adopted.

B. Conclusion

For the foregoing reasons, the OCA submits that the revenue shortfall resulting from the EDI/IDI rate discount programs should be shared between ratepayers and shareholders. The Company has not established that there are ratepayer benefits in proportion to this revenue shortfall to justify its recovery, and as OCA witness Johnson testified, there has been an increase in the average ECR for all customers from the incremental sales. In addition, the OCA submits that a proper incentive is established by requiring shareholders to absorb a portion of these revenue shortfalls. As such, the OCA submits that the Commission should adopt this revenue adjustment which is reflected on Sch. TSC-21.

VI. EXPENSES

A. Introduction

The OCA has proposed a number of adjustments in this proceeding to the Company's expense claims based on the analysis and testimony of Thomas S. Catlin and Dr. Charles E. Johnson. The OCA submits that adjustments to the Company's claims for fossil fuel plant decommissioning costs, deferred SFAS 106 expenses, and Susquehanna early window deferral costs are necessary to comply with the Public Utility Code and case law.

In addition, the OCA submits that adjustments to the Company's depreciation expense claim are necessary to reflect an appropriate test year level of expense. The OCA has made three adjustments to the Company's depreciation expense claim: (1) an adjustment related to the Company's change in depreciation methods for the Susquehanna plant; (2) an adjustment related to the Company's change in deactivation dates for certain fossil fueled plants; and (3) an adjustment related to the Company's proposal to amortize rather than depreciate certain general plant.

Similarly, the Company's claims for expenses associated with employees' benefits, and the Voluntary Early Retirement Program should be adjusted to reflect savings associated with PP&L's employee reduction. Finally, certain of the Company's claims, such as the Susquehanna Refueling Outage Costs and the Company's SFAS 106, SFAS 87 and SFAS 112 claims must be adjusted to reflect a more representative level of expense. The OCA submits that its proposed adjustments are soundly based in the Public

Utility Code, jurisprudence and generally accepted ratemaking principles.

During the course of this proceeding, the parties have made a number of revisions to their positions, reflecting updated information or the adoption of other parties' positions. The OCA has reflected these changes in the revised exhibits appended to this brief as Appendix A.

B. Expense Issues Resolved During The Course Of The Proceeding.

1. Interest On Customer Deposits.

OCA witness Catlin proposed an adjustment to the Company's claim to reflect that, effective April 14, 1995, the 11 percent interest rate on customer deposits is being reduced to 5.77 percent in response to changes to 52 Pa. Code §56.57. Pursuant to Section 56.57 the legal rate of interest to be paid on customer deposits is now equal to the average interest rate on one year treasury bills for September, October and November of the previous year. OCA St. 6 at 20, Sch. TSC-13. In rebuttal, PP&L witness Bernini adopted this adjustment and revised the Company's claim to reflect the decrease in interest rates on customer deposits. PP&L St. 3R, Attachment 1. See also, PP&L Exh. Future 1 (Revised), Sch. D-9. As shown on Schedule TSC-13. This results in a reduction in total Company and jurisdictional expense of \$58,000 and an increase in net income of \$34,000.

C. PP&L's Expense Claim Should Be Reduced By \$197,000 To Reflect The Benefit Savings Associated With The Reduction in Employees.

PP&L adjusted its future test year expenses to reflect the projected year end level of employees and wages. PP&L Exhibit Future 1, Sch. D-5. However, as OCA witness Catlin explained, in developing this adjustment, the Company did not account for the reduction in benefits and payroll taxes which will accompany the reduction in employees and wages. OCA St. 6 at 13. Mr. Catlin testified that:

... in response to OCA IX-29, the Company agreed that it would be appropriate to adjust benefits and payroll taxes for the reduction in employees and wages. Accordingly, I have made this adjustment.²⁷

Id. The Company presented no rebuttal to this adjustment.

The OCA submits that the Company's adjustment to reflect the number of employees and level of wages in effect at the end of the test year should include the cost savings resulting from the reduction in benefits and payroll taxes associated with the reduction in employees. Absent this adjustment, ratepayers would not receive all of the savings resulting from the reduction in employees and wages. As shown on Sch. TSC-8, this adjustment reduces test year expenses by \$197,000 on a total company basis and \$171,000 on a jurisdictional basis. The concomitant increases in net income are \$114,000 and \$99,000, respectively. OCA St. 6 at 13, Sch. TSC-8.

²⁷ Mr. Catlin calculated this adjustment utilizing the 1995 ratio of benefits and payroll taxes to wages. OCA St. 6 at 13.

D. Consistent with Court and Commission Precedent, The Company's Expense Claim For Decommissioning Fossil Fueled Generating Facilities Must Be Denied.

PP&L has included \$55,570,000 in its future test year expenses for the recovery of the costs of decommissioning its fossil fueled generating stations at Martins Creek (Units 1-4), Brunner Island (Units 1-3), Montour (Units 1-2), Sunbury (Units 1-4) and Holtwood (Unit 17). PP&L Exh. Fut. 1 Revised, Sch. D-12. The OCA submits that the Company's claim is contrary to established appellate law and recent Commission precedent, and therefore must be rejected.

The Company's proposal is to recover these future costs from current ratepayers and to establish an annuity, similar to that used for its nuclear decommissioning expense. PP&L St. 3 at 22. The claim is based on an estimate completed by TLG Services, Inc. of the future expected cost of dismantling and demolishing these fossil fueled generating stations. PP&L St. 3 at 22; PP&L St. 13 at 3. The estimate utilized the early deactivation dates proposed in this case for Martins Creek Units 1 and 2, Sunbury, and Holtwood Unit 17, and it also included a contingency factor to cover any costs that could not be predicted. OCA St. 6 at 25, PP&L St. 13 at 21-22.

The Company's claim is most accurately described as one for prospective net negative salvage. Net negative salvage occurs when the costs of removal of a plant exceed the salvage value received from that plant. See, Penn Sheraton Hotel v. Pa. Public Utility Commission, 198 Pa. Super.. 618, 623, 184 A.2d 324, 327

(1962) ("Penn Sheraton"); OCA St. 6 at 26. The Company's claim is prospective in nature because it seeks to recover in advance of actual expenditure the costs it may incur.

Penn Sheraton established the treatment of prospective net negative salvage claims for ratemaking purposes in Pennsylvania. 198 Pa. Super. 618; 184 A.2d 324 (1962). In an appeal from a proceeding involving the proposed increased rates of a steam heating company, the Superior Court held that the estimated negative salvage the Steam Heating Company may incur, if and when its distribution mains are removed at some time in the future, should not be included in determining accrued or annual depreciation. Penn Sheraton Hotel et al. v. Pa. P.U.C., 198 Pa. Super. 618, 623-627; 184 A.2d 324, 327-329 (1962). In denying the claim for prospective negative salvage on existing steam mains, the Court commented:

[N]egative salvage attributed to existing plant is purely prospective; it is a cost which has not yet been incurred; it is uncertain when and if it will be incurred; and it is not a part of the original cost of construction of the facilities when first devoted to public service. To permit recovery of prospective negative salvage is to permit the recovery of something in the nature of future reproduction cost. The established law in this Commonwealth does not permit the recovery by annual depreciation of any such prospective excess. It is therefore the prospective nature of future negative salvage that prevents it from being considered either in accrued depreciation or in the allowance for annual depreciation; they must have a consistent basis under our law.

Penn Sheraton Hotel et al. v. Pa. Public Utility Commission, 198 Pa. Super. at 627; 184 A.2d at 329.

Since the Penn Sheraton case, the Commission has consistently denied claims for prospective net negative salvage. For example, in 1980 West Penn made a claim for prospective net negative salvage with regard to the retirement of fossil fueled plants. Pa. P.U.C. v. West Penn Power Company, 54 Pa. PUC 602 (1981) ("West Penn I"). The Commission denied it on the basis of the Pennsylvania Superior Court's holding in Penn Sheraton. Pa. P.U.C. v. West Penn Power Company, 54 Pa. PUC 602, 629-630 (1981).

Similarly, West Penn Power Company made another such claim in its 1994 rate case. In West Penn 1994, the Company proposed to establish an annuity to recover the future cost of decommissioning four fossil fueled power plants. Pa. P.U.C. v. West Penn Power Company, Docket No. R-942986 (December 28, 1994) ("West Penn II"). The Commission denied the claim and stated:

The Company's alternative approach, in our view, is contrary to that long-standing rule and precedent because it would substitute an uncertain and speculative claim in place of the current cost approach. Further, the Company has failed to present any compelling reasons to revisit that precedent and policy.

* * *

Consequently, we reject the Company's claim because of its uncertain and speculative nature and because this claim is patently counter to existing precedent.

Pa. P.U.C. v. West Penn Power Company, Docket No. R-942986 at 62, 64 (December 28, 1994).

As in Penn Sheraton and the West Penn cases, the Company's claim in the present case involves a claim for estimated negative salvage which may be incurred if and when the plant is

taken out of service at some future point. See, PP&L St. 13 at 3-4. Similarly, no actual decommissioning costs have been incurred and none will be incurred until the coal-fired plants cease commercial operation and are dismantled. PP&L St. 3 at 22. In reference to when this dismantling may occur OCA witness Catlin noted,

[I]t is common for electric utilities to undertake plant life extensions in which the generating facility is overhauled and the life extended. In fact, in its most recent "Five Year Upgrade Plan for Coal Fired Generation," dated May 2, 1994, PP&L concluded that it would be prudent to undertake the investments necessary to continue operation of each of its fossil fueled generating units for at least another 20 years. Moreover, in response to OCA IX-24, the Company has stated that it will continue to consider life extensions at its fossil fueled generating stations in the future. Therefore, it would be premature to include a decommissioning allowance for fossil fueled generating facilities in rates at the present time.

OCA St. 6 at 25-26. Additionally, PP&L witness LaGuardia acknowledged in his rebuttal testimony that it is possible that PP&L's fossil units will be life-extended and/or the sites and structures reused. PP&L St. 13-R at 15. Thus, the OCA submits that PP&L's claim is subject to the same uncertainty as the claim in Penn Sheraton and the West Penn cases that followed it.

PP&L has argued that it believes that "it would be more appropriate to recover these costs from those customers who are enjoying the benefits of the plant's operation." PP&L St. 3-R at 10. PP&L's reason for its claim is not novel to the Commission,

though, and it has already been rejected in West Penn II. As the Commission noted in West Penn II:

We agree with the presiding ALJ. . . . We do so precisely because our precedent sought to separate current and future negative salvage in order to ensure that customers are not required to pay the net expenses associated with retiring plant and equipment before those costs are actually incurred.

West Penn II at 61-62.

The only exception to the prohibition on recovery for prospective net negative salvage is for the decommissioning of nuclear facilities. Because of the extraordinary safety considerations which attach to radioactive contamination, the dismantlement of nuclear facilities presents a health and safety problem for the utility and surrounding community. The Commission noted its concern over these unique and "vital issues of health and safety" in Pa. P.U.C. v. Pennsylvania Electric Co., 51 Pa. PUC 649, 669 (1978) ("Penelec"). Thus, companies have been allowed to recover nuclear decommissioning expense claims in advance of the actual incurring of the expense. Pa. P.U.C. v. Pennsylvania Electric Co., 51 Pa. PUC 649 (1978); Pa. P.U.C. v. West Penn Power Company, 54 Pa. PUC 602 (1981).

Outside of the unique and critical area of decommissioning of nuclear plant, the Commission has denied all claims for prospective recovery of negative salvage claims. Moreover, the Commission has twice decided that the decommissioning of fossil fueled units does not "present any compelling reason[] to revisit that precedent and policy." Pa. P.U.C. v. West Penn Power

Company, Docket No. R-942986 at 62, 64 (December 28, 1994); Pa. P.U.C. v. West Penn Power Company, 54 Pa. PUC 602 (1981). PP&L's claim should not be treated any differently.

Unlike nuclear facilities, there are no requirements that apply to the funding of the decommissioning of fossil fueled generating facilities. OCA St. 6 at 26. Although PP&L witness LaGuardia comments that the Building Official and Code Administrators' (BOCA) National Building Code mandates that "all unsafe structures shall be taken down and removed or made safe and secure," the fact remains that there is no legal requirement that the decommissioning of a fossil plant be funded in advance. PP&L St. 13-R at 14-15; OCA St. 6A at 16.

Furthermore, if and when the Company dismantles its fossil fueled facilities, and if it incurs negative salvage costs associated with their decommissioning, it will be able to make a claim for those costs as incurred. Penn Sheraton provides for just this kind of recovery. Penn Sheraton 198 Pa. Super. at 627-628; 184 A.2d at 329-330. In fact, the Company made a claim for a five year average of negative salvage in this case and neither the OCA nor any other party made an adjustment opposing it.

The OCA submits that the costs represented in the Company's claim are based on projections that are speculative and uncertain. In addition, the Company's claim for prospective net negative salvage for the decommissioning of its fossil fueled plants is inconsistent with prior Commission and Court precedent. As such, the OCA submits that the Company's claim should be wholly

denied and its test year expense claim reduced by \$45,284,000 as shown on schedule TSC-16 (Updated).

E. PP&L's Claim To Recover Its "Early Window" Costs Related To Susquehanna Units 1 & 2 Should Be Denied.

1. Introduction

In 1982 and 1983, respectively, PP&L sought and was granted deferred accounting treatment for the costs related to the operation of Susquehanna Units 1 and 2 prior to the inclusion of those units in rates. Petition of Pennsylvania Power & Light Co. for Declaratory Order, P-820367, (Order Entered July 29, 1982) ("1982 Petition"); Petition of Pennsylvania Power & Light Co. for Declaratory Order, P-830461, (Order Entered November 9, 1983) ("1983 Petition"). Accordingly, the Company deferred net costs totalling \$39,215,000 (consisting of \$39,194,000 of operating expenses, plus \$60,959,000 of deferred carrying costs, plus \$27,223,000 of income taxes, less \$88,161,000 of interchange energy savings). PP&L Exh. Future 1 (Revised), Sch. D-14. PP&L now seeks to amortize these "early window" deferrals over a period of ten years with the net annual amortization being \$3,922,000. PP&L Exh. Future 1 (Revised), Sch. D-14.

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. 1982 Petition at 10; 1983 Petition at 5. In the 1982 Petition, the Commission also stated that: "The burden to show the justness and reasonableness of any proposed rate

change including recovery of deferred costs shall remain squarely with PP&L." 1982 Petition at 5.

The OCA submits that the Company's claim for early window costs must be denied, as a matter of law, as an improper attempt to retroactively recover costs incurred long in the past. As will be addressed below, the OCA submits that recovery of these deferrals is untimely and unreasonable. Moreover, the Company has failed to demonstrate that its circumstances warrant a departure from usual regulatory practice and the rule against retroactive ratemaking.

2. The Company's Claim for Early Window Costs Must Be Denied As A Matter Of Law.

a. The Rule Against Retroactive Ratemaking

Ratemaking is designed to be prospective. Therefore, a general legal prohibition against retroactive ratemaking has evolved. It is this principle which operates to disallow the recovery of costs incurred prior to the test year through prospective rates. Cheltenham & Abington Sewerage Co. v. Pennsylvania Public Utility Commission, 344 Pa. 366, 25 A.2d 334 (1942) ("Cheltenham"); Barasch v. Pennsylvania Public Utility Commission, 507 Pa. 496, 491 A.2d 94 (1985) ("Barasch").

Recently, the Commonwealth Court had the occasion to discuss the importance of this concept. Popowsky v. Pa. Public Utility Commission, 164 Pa.Commonwealth 338, 642 A.2d 648 (1994) ("PP&L 1994"). In PP&L 1994, the Commonwealth Court reversed a Commission Order allowing PP&L not only to record as a regulatory asset PP&L's costs of complying with SFAS 106, but also approving

future retroactive ratemaking recovery for such deferrals. 164 Pa. Commonwealth 338, 642 A.2d 648 (1994). The Court held that such ratemaking treatment was unlawful. The Court stated:

Because of the prospective nature of rates, a rule against retroactive ratemaking has developed. The rule against retroactive ratemaking prohibits a public utility commission from setting future rates to allow a utility to recoup past losses or to refund to customers excess utility profits. (Citation omitted.) The policy reasons behind this rule are that if retroactive ratemaking is allowed, it makes the "test year" method of ratemaking meaningless and the general principle that those customers who use power should pay for its production rather than requiring future ratepayers to pay for past use.

Popowsky v. Pa. P.U.C., 164 Pa. Commonwealth 338, 344, 642 A.2d 648, 651 (1994).

In 1983, the Philadelphia Electric Company sought similar recovery of a three-year amortization of approximately \$41.5 million of deferred costs related to operation of pollution control facilities. Pa. P.U.C. v. Philadelphia Electric Co., 58 Pa. PUC 7, 44 (1983) ("PECO 1983"). In rejecting PECO's claim, the Commission stated:

It is axiomatic that ratemaking is prospective in nature. While there have been instances where the Commission has recognized unusual or extraordinary recorded expenses, the Company herein has failed to establish to our satisfaction that such treatment is warranted.

Id. at 44.

The Commonwealth Court in 1985 affirmed the Commission's denial of rate recovery of these deferred early window costs, agreeing with the Commission that the pollution control equipment

costs at issue in the PECO case were neither extraordinary nor nonrecurring. Philadelphia Electric Co. v. Pa. Public Utility Commission, 93 Pa. Commonwealth 410, 422, 502 A.2d 722, 727-728 (1985). Upon review of legal precedent and the ratemaking principle prohibiting retroactive recovery of costs in setting prospective rates, the Commonwealth Court held:

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 or revenue or expense may not be, without more, the subject of the Commission's order of refund or recovery, respectively, on the occasion of the utility's subsequent rate increase requests.

An exception to this rule in the case of retroactive recovery or unanticipated expenses has been recognized where the expenses are extraordinary and nonrecurring. . . . We agree with the Commission that the pollution control facilities' expenses here at issue are clearly neither extraordinary nor nonrecurring. Indeed, PECO here claimed and was granted the prospective operating, maintenance, and depreciation expenses associated with these facilities.

Id. at 422, 502 A.2d at 727-728 (citations omitted).

The OCA submits that this fundamental principle against inclusion of past costs in future rates, established by the Pennsylvania Supreme Court in the Cheltenham decision, and reaffirmed in subsequent case law, requires that PP&L's early window claim be rejected. As the Pennsylvania Supreme Court stated in Barasch, "current ratepayers should shoulder only actual expenses of providing current utility service." Barasch v. Pennsylvania Public Utility Commission, 507 Pa. 496, 517, 491 A.2d

94, 104 (1985). Only if PP&L can demonstrate that a justified exception to the rule against retroactive ratemaking is warranted, can its claim for deferred Susquehanna costs be included in rates which are set prospectively. To the extent that such claims are legal at all, the Commission has found factual circumstances supporting a departure from the rule against retroactive ratemaking on two recent occasions. Pa. P.U.C. v. Philadelphia Electric Company, 74 Pa. PUC 1 (1990) ("PECO 1990"); Pa. P.U.C. v. Pennsylvania Gas & Water Co., ("PG&W 1993"), 79 Pa. PUC 349, 366 (1993).

b. The Limited Exception -- Cases Where The Commission Has Recognized Factual Circumstances Allowing For An Exception To The Rule Against Retroactive Ratemaking.

The Commission has made clear that the actual recovery of deferred early window costs is not to become part of routine regulatory practice. Re Pennsylvania Power Co., 59 Pa. PUC 541, 545, 68 PUR4th 357, 360 (1985). In addition, the Commission has stated numerous times that simply because it has granted the deferral of such costs, does not mean that it has approved their recovery. See, 1982 Petition at 10; 1983 Petition at 5; Petition of Philadelphia Electric Co. for Declaratory Order, 58 Pa. PUC 522, 528 (1984). Such claims are to be decided on a case-by-case basis particularly focusing on the financial impact on the utility of denying such claims. Id.; Pa. P.U.C. v. Philadelphia Electric Company 74 Pa. PUC 1, 233-35 (1990) (Concurring opinion of Commissioner David W. Rolka).

On two recent occasions the Commission investigated the interplay between the retroactive ratemaking principle and the issue of recovery in rates of deferred accounting costs and found circumstances that supported a departure from traditional regulatory practice. Specifically, in PG&W 1993 and PECO 1990 the Commission allowed rate recovery for deferred early window costs. PG&W 1993; PECO 1990.

The OCA notes that although Commissioner David W. Rolka concurred with the majority's decision to allow the recovery of the early window costs in PECO 1990, he made sure to articulate the following cautionary statements:

[M]y approval should not be construed as a green light for all other utilities' "window" claims. Rather, as this opinion explains, an analysis of each of those claims on a case by case basis, looking at the financial impact of the costs on the particular utility for the period during which the costs were experienced, is appropriate.

74 Pa. PUC at 235.

In PECO 1990, the Commission set forth the criteria a company must meet in order to recover in rates deferred early window costs. The Commission utilized these same criteria in PG&W 1993. Thus, in both cases, the Commission required the Company to show the following:

- (1) The costs are both extraordinary and nonrecurring; and
- (2) The denial of recovery would have a substantial negative financial impact on the utility.

PECO 1990, 74 Pa. PUC at 111; PG&W 1993, 79 Pa. PUC at 369.

Recently, in Pa. P.U.C. v. Pennsylvania American Water Company, the Commission fine tuned the exception. Pa. P.U.C. v. Pennsylvania American Water Company, Docket No. R-932670 (July 26, 1994) ("PAWC 1994"). In that case, the Commission rejected the Company's claim for deferred costs related to a water treatment plant, because the Company had failed to establish that a denial of recovery would have a substantial negative financial impact on the utility. In reaching this determination, the Commission first analyzed if the Company's claim was timely. PAWC 1994, slip op. at 71. The Commission found that the Company's claim was timely because it occurred in the next rate case following the PUC's approval of deferred accounting for the costs in question. Id. The Commission had previously established that it will deny early window claims for costs claimed in the same rate case that the plant they are related to is added to rate base. Pa. P.U.C. v. Duquesne Power Company, 66 Pa. PUC 518 (1988); Pa. P.U.C. v. Pennsylvania Power Company, 67 Pa. PUC 91 (1988). In PAWC 1994, the Company filed a base rate case including its early window claim approximately a year after the base rate case in which the related plant was added to rate base.

After the timeliness of the claim, the Commission examined whether PAWC's costs were both non-recurring and extraordinary. For the criteria of "extraordinary" the Commission broke down the analysis into a qualitative and a quantitative demonstration. PAWC 1994 slip op. at 72. The Commission incorporated the requirement, that the Company show that denial of

its claim would cause substantial negative financial impact, into the quantitative prong of the criterion "extraordinary". As will be further discussed below, the OCA submits that under this analysis PP&L has not demonstrated that its claim qualifies as an exception to the basic ratemaking principle prohibiting retroactive ratemaking.

3. PP&L Has Failed To Demonstrate That Its Early Window Claim Qualifies As An Exception To The Retroactive Ratemaking Principle.

As discussed above, the Commission has found that a Company's factual circumstances warranted a departure from traditional regulatory practice prohibiting actual recovery in rates of costs incurred retrospectively in only limited circumstances. The OCA submits that PP&L has failed to demonstrate that its claim for early window costs qualifies as an exception to the basic ratemaking principle prohibiting retroactive ratemaking.

a. The Company's Claim is Untimely.

As discussed above, in PAWC 1994 the Commission noted that the Company's claim was timely. PAWC 1994 slip op. at 71. As OCA witness Catlin described, PP&L's claim in this case is no longer timely:

I am proposing to disallow recovery of the Susquehanna early window deferrals because recovery of those costs is no longer timely. It has been more than ten years since the last of the early window deferrals occurred and since PP&L last filed a rate case. During that time period, PP&L voluntarily elected not to file for rate relief, presumably because it believed its earnings were at or above what the Commission would deem to be a reasonable

level. Unless PP&L can establish that it was not earning a reasonable return and would not have earned a reasonable return had it amortized the early window costs during the last ten years, it should not now be allowed to recover the early window deferrals.

OCA St. 6 at 28 (emphasis added).

During this time period, PP&L had no constraints regarding its ability to obtain rate relief. This is in contrast to PG&W 1993, where PG&W's management was constrained in its ability to control the timing of filing for rate relief due to its severe service problems. As PG&W argued to the Commission in its claim for the recovery of early window costs:

[T]he Commission had made explicit its intent to deny the Company rate relief until improved water quality had been demonstrated and that could not be done until the four treatment plants were placed in service.

* * *

Because of the Commission's practice of denying rate relief to the Company until its water quality improved, the Company could not obtain rate relief until after the treatment plants were placed in service.

PG&W 1993 at 34 and 43. PP&L, unlike PG&W, could have requested for rate relief earlier if it had required such relief. The decision on when to file a rate case is, and has been, within the sole discretion of PP&L's management.²⁸

²⁸ The OCA notes that PP&L could have sought recovery of the early window deferrals related to Susquehanna Unit 1 in the Unit 2 base rate case, in 1985. Although Company witness Bernini stated that the Company did not seek such recovery in an effort to minimize amount being requested, Mr Bernini did not show that the claim would have had a significant impact on PP&L's overall request in that case.

In PECO 1990, the Company sought recovery for its deferred early window costs in approximately 4 years. 74 Pa PUC 1 (1990). OCA witness Catlin compared PECO 1990 to the present case:

While the Commission did allow PECO to recover the early window deferrals associated with Limerick Unit 1 in that case, there are several important distinctions between the circumstances in that case and this one. First, PECO was seeking recovery of deferrals which took place in 1986 through a rate case filed in 1989. PP&L is seeking recovery in a case filed 11½ years after the Susquehanna Unit 1 deferrals and 9½ years after the Unit 2 deferrals. Second, PECO sought recovery of the Limerick deferrals in its next base rate case. For the Susquehanna Unit 1 deferrals for which PP&L is now seeking recovery, this is not the first rate case after that in which the unit was reflected in rates.

OCA St. 6 at 29. Similarly, in PG&W 1993, the Company deferred the costs related to its four water treatment plants from early summer of 1990, when the plants were placed in service, until July of 1993 when the Company was granted recovery of its early window claim, approximately 3 years. Pa. P.U.C. v. Pennsylvania Gas & Water Co., Docket No. R-00922482, (Order Entered July 23, 1993). Thus, in both the PECO 1990 and PG&W 1993 cases, the Company sought recovery in 3 to 4 years. The OCA submits that to allow recovery for PP&L's claim which is 9.5 to 11.5 years older would improperly reach back in time and would erode the test year concept. As such, allowing PP&L's early window claim would unlawfully result in retroactive ratemaking.

b. The Company Has Not Established That A Denial Of Its Early Window Claim Will Have A Substantial Negative Financial Impact.

PP&L has the burden to sufficiently establish that its claim fits the exception outlined PECO 1990 and clarified in PAWC 1994. In PAWC 1994, the Commission denied PAWC's early window claim because the Company failed to establish that its claim was "quantitatively extraordinary". In other words, PAWC failed to show that a denial of the recovery of its early window costs would have a substantial negative financial impact on PAWC. PAWC 1994. Similarly, PP&L has failed to show that the denial of recovery of its claim would have a substantial negative financial impact on the utility.

Company witness Bernini contends that if these early window costs are not recovered, the Company will be compelled to write-off \$39 million in 1995. PP&L St. 3 at 13. He quantified the impact of this write-off as amounting to: "\$.25/share, as compared to 1994 earnings of \$1.41/share." Id.

The OCA submits that this write-off does not approach the level of loss that PECO and PG&W faced. In PECO 1990, the Company argued that it would have had to have written off in 1990 approximately \$1.14 per share, and the Company's earnings were \$2.33 per share in 1987 and 1988, and \$2.36 per share in 1989. 74 Pa. PUC at 110. Thus, PECO faced a write-off that would have reduced earnings by approximately 50%. Similarly, in PG&W 1993 the Company claimed that to write-off \$5.8 million in 1993 would cut its earnings by nearly half. 79 Pa. PUC at 366.

In contrast, PP&L's claimed reduction is approximately 17.7%. PP&L St. 3 at 13. This is a one-time, one-year reduction. Thus, the OCA submits that PP&L has not proven that its claim is "quantitatively extraordinary." Moreover, the costs it now seeks to recover were not unanticipated. Therefore, the OCA submits that the magnitude of the impact on the financial condition of PP&L simply does not rise to the level of a substantial negative financial impact on PP&L.

In addition, in PG&W 1993 the Company predicted that a denial of its early window claim would depress its interest coverage ratio to 1.95%, below the 2.0% required by its covenants in order to issue additional debt. PG&W 1993 at 366. PP&L has offered no evidence on the effect that a denial of its claim would have on its interest coverage obligations. The OCA submits that PP&L cannot argue that denial of its early window claim will in and of itself generate a substantial negative impact to the Company like that PECO and PG&W faced.

c. The Company Has Failed to Establish That The Lack Of Recovery Of Its Early Window Costs Had A Substantial Negative Impact During The Period The Costs Were Experienced.

It is important to note that PP&L's evidence regarding the financial impact of the early window costs for the period during which the costs were experienced is also unpersuasive. In his concurring opinion in PECO 1990, Commissioner Rolka explained the importance of this evidence:

While the PUC relies on a test year concept for setting rates, it is well known that the ultimate level of rates authorized are

designed to recover prospective costs of operations, due to their fluidness, will probably differ in many respects from the Company's test year predictions. Hence, the general rule against line-by-line examination of the accuracy of a utility's predictions of revenues and expenses is well taken.

To reconcile this basic regulatory maxim in the analysis of this issue, I submit that, in future cases in which a window claim is presented, evidence should be adduced as to the Company's financial operations as a whole for the period in which the window costs were experienced. This evidence should reveal the true financial impact of the lack of recovery of the window costs.

74 Pa. PUC at 235.

Company witness Bernini stated in his surrebuttal that: "Recognition of these costs in 1985 would have reduced earnings by \$.53/share, as compared to 1985 earnings of \$2.68/share." The OCA submits that this statement is incomplete as an attempt to show the financial impact of the lack of recovery of the early window costs during the period in which the costs were experienced. In addition, the reduction would still have only been approximately 20%.

Moreover, it is the lack of recovery of the costs in issue that is important to examine in past periods. As Commissioner Rolka also stated in his concurring opinion in PECO 1990,

The question of whether the window costs are extraordinary should be answered by examining the utility's financial operations during the period that the costs were experienced and determining whether the lack of recovery of those costs had a deleterious effect on the utility. . . . [T]o be truly extraordinary, it must be demonstrated, based on all the

other financial transactions experienced during the same period, the Company was not compensated for these costs.

74 Pa. PUC at 235 (emphasis added). PP&L presented no evidence showing that it was not compensated for its early window costs during the period the costs were experienced. The OCA submits that the Company's failure to seek rate relief to reflect these expenses sooner is evidence of the fact that the Company was satisfied with the rates it obtained in the last rate case and its earnings over the subsequent nearly ten years.

As previously discussed, if the Company had been suffering from financial hardship, it had the ability to seek rate relief and recover these costs. Instead, the Company waited 9 1/2 to 11 1/2 years to finally present these claims. The OCA submits that PP&L has not demonstrated that allowance of these costs would be lawful or appropriate. Rather, to allow recovery of these costs would clearly permit unlawful retroactive ratemaking.

4. Conclusion

The Commission has specifically noted that actual recovery of deferred early window costs is not to become part of routine regulatory practice. Re Pennsylvania Power Co., 59 Pa. PUC 541, 545, 68 PUR4th 357, 360 (1985). This Commission has granted early window claims only in limited situations when factual circumstances warrant a departure from traditional ratemaking. If the Commission allowed PP&L's request, particularly given the lack of record evidence that its circumstances warrant a Commission-determined exception to the retroactive ratemaking principle, then

such a result renders Commission approval of post-in-service claims a part of standard regulatory practice. Such a result, the OCA submits, would be wholly inconsistent with Commission precedent to treat the issue on a case-by-case basis.

PP&L's claim for the recovery of its early window expenses associated with Susquehanna Units 1 & 2 must be denied. The OCA submits that PP&L has failed to demonstrate that its claimed early window costs are timely, non-recurring, and quantitatively and qualitatively extraordinary. PP&L's claim for rate recognition of its early window costs must be denied as violative of the rule against retroactive ratemaking. Popowsky v. Pa. P.U.C., 164 Pa.Commonwealth 338, 642 A.2d 648 (1994); Philadelphia Electric Co. v. Pa. P.U.C., 93 Pa. Commw. 410, 422, 502 A.2d 722, 727-728 (1985); (Cheltenham), 344 Pa. 366, 25 A.2d 334 (1942); Barasch v. Pennsylvania Public Utility Commission, 507 Pa. 496, 491 A.2d 94 (1985). Accordingly, the OCA submits that there should be an adjustment to the Company's net income of \$3,922,000 to account for the elimination of the early window deferrals. OCA St. 6A, Sch. TSC-17(Updated).

F. PP&L's Amortization of Susquehanna Refueling Outage Costs Should Be Decreased To Reflect The Exclusion Of Atypical Refueling Outage Costs.

PP&L normalizes refueling outage costs by amortizing the costs of the outage over the period between refueling outages, which is typically around 18 months.²⁹ PP&L's future test year

²⁹ PP&L witness Berish explained that: "PP&L defers refueling outage costs when incurred and amortizes those costs over the next operating cycle of each Susquehanna unit." P&L St. 2R at 8.

expenses reflect 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. OCA St. 6 at 30.

OCA witness Catlin proposed adjusting the amortization of refueling outage costs to reflect the annualized level of costs based on the level of amortization associated with the most recent outage for each unit as of the end of the test period. Mr. Catlin based his adjustment on the costs of Reload 8 at Susquehanna Unit 1, which was scheduled to take place from March 25 through May 22, 1995, and Reload 7 at Unit 2, which is scheduled to take place from September 16 to November 13, 1995. OCA St. 6 at 30; OCA Cross-Exam Exh. 9. In addition, to reflecting the most recent outage, Mr. Catlin also identified another reason for adopting this adjustment in his direct testimony:

PP&L experienced problems during reload 6 at Susquehanna Unit 2. Because of these problems, the costs associated with reload outage 6 at Unit 2 were higher than normal. In addition, the duration of this outage was almost a month longer than normal. This, in turn, shortened the period over which the outage costs had to be amortized, thereby further increasing the annual amortization expense. As a result, the annual amortization expense associated with reload 6 at Susquehanna 2 is unusually high. Utilizing the annual amortization of the projected costs of reload outage 7 provides a more normal level of refueling outage expense.

OCA St. 6 at 31 (emphasis added). As shown on Schedule TSC-18, this adjustment reduces total company expenses by \$1,416,000 and jurisdictional expenses by \$1,111,000.

In rebuttal, PP&L witness Berish argued that Mr. Catlin's adjustment which substituted Unit 2, Reload 7 for Unit 2, Reload 6 should be rejected because neither the costs nor the amortization period for Unit 2, Reload 6 were atypical.³⁰ In addition, he contended that Mr. Catlin's adjustment would be eliminated if the actual costs of the Unit 1, Reload 7 and Unit 2, Reload 6 were utilized instead of the amounts contained in the Company's claim. Id. at 10.

In surrebuttal, Mr. Catlin responded to both of Mr. Berish's arguments stating:

In his rebuttal testimony, Mr. Berish argues that the costs of Reload 6 at Unit 2 were not atypical by comparing those costs to the costs for Reload 8 at Unit 1. However, this is not an appropriate comparison because the costs of the refueling outages at Unit 1 are normally

³⁰ In response to cross-examination, PP&L witness Berish acknowledged that Reload 6 encountered certain problems:

Q. During Reload 6, would you agree that there were four accidents involving the breaking of refueling masts?

A. I understand that we had problems with refueling masts.

Q. Would you accept subject to check that there was a problem with a jet pump beam which required an unplanned replacement?

A. Subject to check, yes.

Q. In total, is it correct that the shutdown was 23 days longer than planned?

A. I think from the data I had, it was 18 days.

Tr. 2016-2017.

higher than those at Unit 2, as can be seen from the following table. As is also shown in [Table 1]³¹, the costs of Reload 6 are clearly unusually high when compared to the costs of other reloads at Unit 2.

Mr. Berish also claims that in determining its expenses in this case, PP&L used projected costs for Reload 7 at Unit 1 and Reload 6 at Unit 2 which were less than the final actual amounts shown above. As a result, had the actual costs been known, PP&L's claim would have been higher, thereby offsetting my adjustment. This argument is simply in error. The higher costs for the previous outages would not offset my adjustment. Instead, the amount of my adjustment based on the costs of the most recent outages at each unit would have been larger.

OCA St. 6A at 2-3; see also, OCA Cross-Exam Exh. 20.

In rejoinder, in support of his argument that the Unit 2, Reload 6 outage costs were not atypical, Mr. Berish testified that as shown on PP&L Exh. MJB-16, if you match up the costs of the first six refueling outages at Units 1 and 2, three of the Unit 1 outages cost more than Unit 2 outages and vice versa. Tr. 2046; PP&L Exh. MJB-16. The OCA submits that a review of PP&L Exh. MJB-16, reveals that this exhibit does not contradict Mr. Catlin's

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Table 1
COMPARISON OF SUSQUEHANNA
Refueling Outage Costs
(\$000)

<u>Unit 1</u>			<u>Unit 2</u>	
Reload 5	\$21,521	\$14,658	Reload 4	
Reload 6	15,704	13,430	Reload 5	
Reload 7	16,189	18,222	Reload 6	
Reload 8*	17,991	15,960	Reload 7*	

*Indicates projection

Source: Response to OCA IV-46 [OCA Cross-Exam Exh. 20]

adjustment, but in fact supports it. This was established when Mr. Berish testified in response to cross-examination on PP&L Exh. MJB-16:

Q. I would ask you to accept subject to check that the average for Unit No. 1 of the first six outages, the average was \$16,983,000, and that the average for the first six outages at Unit No. 2 was \$13,801,000. Can you accept that subject to check?

A. I'll accept that subject to check. The only quarrel that I had with the statement was the blanket statement that the cost of outages at Unit 1 were generally higher than Unit 2, and that's not quite the case.

Tr. 2051. The OCA submits PP&L Exh. MJB-16 establishes that although the costs of three of the outages at Unit 2 were higher than the matching outages at Unit 1, total costs associated with Unit 2 outages have been lower than the costs at Unit 1.

The Company did not dispute the fact that Mr. Catlin's adjustment reflected the annual costs associated with the most recent outage at each Susquehanna unit. Moreover, including the costs of reload 8 at Susquehanna Unit 1, and the cost of reload 7 at Unit 2 is not unique since PP&L has adjusted other aspects of revenue, expenses and rate base claims to reflect end of test year levels. Thus, reflecting the annualized level of Susquehanna refueling outage costs based on the amortization of the cost of the most recent outages is consistent with the treatment afforded these other items. OCA St. 6A at 3.

The OCA submits that, particularly given the abnormal level of expense associated with Reload 6 at Unit 2, the amortization of refueling outage costs should be based on the costs

of reload 8 at Susquehanna Unit 1, and the cost of reload 7 at Unit 2. Adoption of this adjustment reduces total company expenses by \$1,416,000 and jurisdictional expenses by \$1,111,000. The resulting increases in net income are \$819,000 and \$643,000, respectively. OCA St. 6, Sch. TSC-18.

G. Depreciation

1. PP&L's Proposal To Change Its Depreciation Methodology For Pre-1989 Susquehanna Plant From The Modified Sinking Fund Method Should Be Rejected.

PP&L has proposed to change the manner in which it accrues depreciation on the Susquehanna Steam Electric Station ("SSES") plant for pre-1989 investment for both ratemaking and accounting purposes. PP&L St. 4 at 10-15. Currently, property that was installed at SSES prior to January 1, 1989 is depreciated using the modified sinking fund ("MSF") approach. Tr. at 131. The Company wants to change to a levelized depreciation accrual for the period of September 30, 1995 through December 31, 1998, (39 months) at which time the Company would then switch to the straight-line method of depreciation. Id. at 12-13. The Company's proposed modification increases test year expense by approximately \$30 million. PP&L St. 4 at 13; Tr. at 117. The OCA submits that such a change in the depreciation accrual distorts the relationship of the depreciation accruals to rate base and should therefore be denied.

Under the current MSF method, the annual depreciation accrual will increase each year, from \$142 million in 1995 to \$194

million in 1998. PP&L St. 4-R at 3. Under the Company's proposal, the annual depreciation accrual will remain the same each year. PPLICA witness Kollen described the derivation of the Company's levelization proposal:

[T]he Company simply computed the average annual depreciation over the 39 months remaining between the end of the current test year (September 30, 1995) and the scheduled completion of the MSF depreciation (December 31, 1998).

PPLICA St. 9 at 16. Thus, under the Company's proposal the depreciation accrual would be \$173 million each year through 1998.

The OCA submits that this proposal to increase the test year depreciation accrual is flawed and should not be accepted for the purposes of setting rates in this case. OCA witness Johnson explained why this proposal is flawed:

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 St. 5 at 5-6. The OCA submits that it is this inconsistent treatment of the two components of capital recovery that makes the Company's proposal problematic.

If the Company were to file a rate case each year, rate base would be annually reduced by the depreciation accrued and the return on and the return of capital would be correspondingly smaller each year due to the declining rate base. See, PP&L St. 4-R, Exh. DSH-3 (Note the tables on this exhibit are calculated on a calendar year and not on a test year basis). Thus, the total capital recovered would be approximately the same under either method of depreciation if rates were adjusted annually. OCA St. 5A at 4; Tr. at 1745.

However, if the Company does not file a base rate case every year, the effect will be that revenues will be set to recover: return at current levels of rate base, and a set level of depreciation expense, a test year amount. OCA St. 5A at 4. The corresponding effect this test year amount of depreciation expense will have on rate base and return will not be reflected in rates until the next base rate proceeding. Therefore, the Company may overrecover the revenue requirement associated with the annual depreciation accruals for the interim period between rate cases.

OCA witness Johnson explained the effects of the Company's levelization proposal:

Because the test year is different from the calendar year, these comparisons are not exact, but allowing for that imprecision, return for the test year [under the levelized approach] would be set at about \$296 million and depreciation expense would be set at \$173

million for a total of \$469 million in total capital recovery in rates from Pennsylvania ratepayers. (parenthetical omitted).

OCA St. 5A at 5. Thus, the Company's plan to levelize the SSES depreciation accrual, would allow the Company to recover approximately \$469 million of capital each year until the Company files another base rate case. OCA St. 5A at 5. This amount exceeds what would be recovered in the test year under the MSF method by over \$30 million. OCA St. 5A at 5. In addition, this amount exceeds, by a considerable margin, the amount of capital the levelized approach would require if the Company filed annually and the revenues were set each year to reflect the accompanying changes in rate base. Dr. Johnson explained:

Examining Exhibit DSH-3, it can be seen that the \$469 million in test year capital recovery exceeds the capital recovery under the levelized approach (assuming annual rate proceedings) by the following amounts:

1995	\$24 million
1996	\$19 million
1997	\$36 million
1998	\$54 million

In other words, if the PP&L levelized Susquehanna depreciation proposal is used to set rates, it is likely that rate reductions would be appropriate in each future year.

OCA St. 5A at 5.

In contrast, under the MSF approach, if the Company filed a rate case every year, the Company's recovery of capital would be fairly constant. Dr. Johnson explained:

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 St. 5 at 4-5.

Therefore, if the Company does not file a base rate case in the next four years under the MSF approach, the difference in the total capital recovered by the Company and the capital required to meet the MSF accruals is minimal. See PP&L St. 4-R, Exh. DSH-3. However, if the Company does not file a base rate case in the next four years under the levelization proposal, the Company overrecovers by approximately \$133 million, because the difference in the total capital recovered by the Company and the capital required to meet the levelized accruals is approximately \$133 million. See PP&L St. 4-R, Exh. DSH-3.

As Dr. Johnson described, the Company's levelization plan is problematic because it would levelize the depreciation accrual without correspondingly levelizing the return on capital invested. OCA St. 5 at 5. However, the MSF approach "levelizes capital recovery when both aspects [depreciation accrual and return on capital] are considered." Id. The OCA submits that the Company's proposal distorts the relationship of the depreciation accrual to rate base and should therefore be denied.

The Company offered only the following justifications for its proposal. First, the Company stated that its proposal would not result in the recovery of any additional depreciation over the 39 month period. PP&L St. 4 at 15. Second, the Company advocated that its proposal will eliminate the large annual increases in depreciation expense that arise under the current sinking fund

method; an elimination which, according to the Company, should enable it to minimize future base rate increase requests. Id.

The OCA does not dispute that the depreciation booked and return on investment for pre-1989 plant would be approximately the same under the proposed levelization method or the MSF approach if rates were adjusted annually. OCA St. 5A at 4. However, as discussed above, if rates are not adjusted annually in the next four years, the Company will overrecover. As to the Company's assertion that its proposed method will eliminate large annual increases that would otherwise occur under the sinking fund method, Dr. Johnson, witness for the OCA, explained that these annual increases must be viewed in light of the resulting annual decreases in required return. Dr. Johnson testified:

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

The increase in the depreciation accruals [under the MSF] is almost exactly offset by the decrease in return on rate base. That is exactly what the MSF is calculated to do. The annual accrual is much like the portion of a mortgage payment that is principal, which is small in early years and increases over time. The return on rate base is much like the interest portion of the mortgage payment that decline over time and the sum of the two is a constant amount. Thus the "large annual increases" in the depreciation expense levels associated with Susquehanna are offset by what one must characterize as "large annual decreases" in required return on rate base associated with Susquehanna.

OCA St. 5 at 4-5. Thus, the current MSF approach is a balanced one. The Company believed it was a fair and reasonable method to employ when it was implemented. Tr. 1854. The OCA submits that the MSF method represents a fair balance of ratepayer and shareholder interests and should remain in place.

The Company also argued on rebuttal that the OCA witness arguments in favor of the MSF approach could only be correct if, "one assumes that the Company will not make any new investment in plant after rates are put into effect." PP&L St. 4-R at 5. However, as OCA witness Johnson explained, it would be inappropriate to consider the effect of future investment in Susquehanna in the present depreciation analysis. Dr. Johnson stated:

Depreciation rates are set for the purpose of recovering the capital that has already been invested in utility plant, and to generally attempt to recover the capital over the useful life of the plant. Depreciable plant is that portion of the utility's current investment for which capital recovery is determined. Depreciation concepts do not extend to recovery of future investment. Moreover, the issue under consideration is the MSF method applied to pre-1989 Susquehanna investment. Any future investment would not be subject to the MSF.

OCA St. 5A at 4 (emphasis in original).

The Company's proposed modification to the current capital recovery schedule for Susquehanna SES increases test year expense by \$30 million. OCA St. 5 at 3. In addition, as discussed above, the Company's proposal to change to a levelized depreciation accrual distorts the relationship between depreciation accruals and

rate base. The OCA submits that the extent of this imbalance is unfair to ratepayers. Under the Company's proposal, PP&L would receive approximately \$100 million more from ratepayers in the next four years than it would if rates were set each year. OCA St. 5 at 6.

For these reasons, the OCA submits that the Company's proposal to levelize the depreciation accrual for SSES be denied. Accordingly, the Company's test year expense should be \$152,777,006. On a jurisdictional basis, the Company's claim should be reduced by \$22,864,760. OCA St. 5 at 7. This adjustment has been incorporated with other depreciation adjustments on schedule TSC-20 (Updated).

2. PP&L's Proposal To Increase Depreciation Expense By Advancing The Deactivation Dates On Fossil Fueled Units Should Be Denied.

PP&L has requested in this case that it be allowed to increase depreciation expense by advancing the deactivation dates for several of its generating units. In its filing, PP&L has proposed to advance the deactivation date of the Holtwood 17 steam plant from 2009 to 2003, Martins Creek Units 1 and 2 from 2015 to 2003, and Sunbury 1, 2, 3 and 4 from 2010 to 2003. PP&L St. 5 at 7. In addition, PP&L has proposed to advance the deactivation date for the combustion turbines and diesel units at Sunbury from 2010 to 2003 and at Martins Creek from 2015 to 2010, which is the currently scheduled deactivation date for Martins Creek Steam Units 3 and 4. Id. This advance of deactivation dates increases the

depreciation accruals for these generating units by approximately \$19 million. OCA St. 5 at 8.

The OCA submits that the Company's proposal to advance the deactivation dates of these units for ratemaking purposes is not supported by the record in this proceeding. Indeed, there is no evidence that PP&L actually plans to advance the deactivation of these units for any purpose other than increasing depreciation expense in this case. As such, the OCA submits that the currently existing deactivation dates should be utilized for the determination of depreciation expense in this proceeding. The depreciation accruals under the OCA's proposal will differ by \$18,743,803 on a total company basis and \$15,274,409 on a Pennsylvania jurisdictional basis. OCA St. 5 at 11.

The OCA submits that the Company's proposal to advance the deactivation dates for the units is not supported by record evidence. At a minimum, the Company was unable to show that its reasons for this decision were based on any circumstances that changed since the Company issued its 1994 Five Year Coal Upgrade Plan which had concluded that these units would continue to operate through at least 2013. The Company gave essentially four reasons for its decision. OCA witness Dr. Johnson outlined them in his testimony:

Company witness Krall identified four reasons for advancing the deactivation dates of the steam units. They are:

- (1) The units are old and have in-service dates of from 1949 to 1954,

- (2) These units are relatively less efficient than newer generating stations,
 - (3) the cost of meeting environmental requirement is great, and
 - (4) these generating units are small.
- [Statement 5, page 9]

OCA St. 5 at 10. But as evidenced through cross examination, these factors were not new to the Company. As PP&L witness Krall conceded on cross examination, the Company was aware that all of these factors existed in May of 1994, when the Company produced its Five-Year Coal Upgrade Plan. Tr. 166-169. The 1994 Five-Year Coal Upgrade Plan concludes that it would be prudent to continue operation of the units through the year 2013. Tr. 163-164.

Thus, the Company's proposal is not based on new circumstances. As OCA witness Dr. Johnson explained:

Nothing has been identified by Mr. Krall that was not already known at the time the Five-Year Upgrade Plan was prepared. That these generating units are old, small and less efficient generating units has not changed in the past year. They were old, small and less efficient than other generating plants a year ago. As for environmental costs, some of these were included in the development of the Five-Year Upgrade Plan and the ones that weren't included were and still are too speculative to be able to include in any analysis.

OCA St. 5 at 11. In essence, the reasons the Company identifies for its decision to advance the deactivation dates were all present when the Company made a written analysis favoring continued operation of the units. Therefore, nothing has occurred to cause the Company to depart from the deactivation dates it formerly established. The OCA submits that since the Company's

circumstances have not substantively changed, the Company's proposal is inappropriate at this time and should be denied.

The OCA notes that the corresponding effect of changing the deactivation dates of these plants is that PP&L will recover the undepreciated balance for these plants in this shorter time period. However, at this point in time the Company does not plan to retire the units in 2003. [Tr. 176] OCA witness Dr. Johnson explained:

The Company's witness Krall testified that the Company made a decision to "reflect the possibility that they would be retired earlier in the depreciation schedule" and that the only place that this possibility is set forth is in witness Krall's testimony. [Tr. 188] [Emphasis added.] He also testified that the Company does not plan to retire those units in 2003. [Tr. 176] It seemed clear from his testimony that PP&L has set the earlier deactivation dates solely for the purpose of calculating depreciation accruals in this rate case.

OCA St. 5 at 8. The OCA submits that the Company should not be able to advance the deactivation dates for ratemaking depreciation purposes for the units if they currently do not even plan to retire them on those dates. As OCA witness Dr. Johnson explained:

It is a general principle of depreciation accounting that the capital invested in plant is to be recovered over the useful life of the plant and at the time of its retirement, all

capital is to have been recovered. Exceptions exist, of course, where it doesn't work out that way, but the general objective of performing depreciation studies is to determine appropriate service lives and other parameters so as to be able to accrue the correct amount of depreciation each year that will result in the full and complete recovery of the capital at the time of retirement. If the Company does not intend to retire these units in 2003, it is improper to request capital recovery by that date.

OCA St. 5 at 9.

Again, the OCA submits that the record is clear that the Company at this point does not intend to retire the units in the year 2003. PP&L witness Krall made this fact clear during cross-examination. In response to a question concerning the Company's depreciation schedule Mr. Krall stated:

Q. And you are saying that they are going to consider it, but is the claim now based on earlier retirement dates?

A. Again, we're using the term "retirement date," and I don't want to leave the impression that we have a current plan to retire those plants on 2003.

Q. I'm not trying to get you to say that. I'm asking what the claim is based on.

A. Yes, the depreciation schedule is based on a 2003 deactivation date, that's correct.

Q. Earlier retirement dates?

A. Yes.

Q. Whether you plan to retire them or not, that's what you're asking for in rates?

A. Yes.

Tr. 188-189. Thus, the Company is requesting to change the deactivation dates for depreciation purposes regardless of when it

intends to retire the units. The OCA submits that the Company has simply not provided sufficient evidence to support such a change.

In addition, the OCA submits that the Company has failed to provide any sound engineering or economic analysis supporting its decision to advance the deactivation dates. As PPLICA witness Kollen explained, the Company was asked to do so:

The Company was requested to provide all studies relied upon to revise its projected retirement dates for the generating facilities identified on Exhibit DAK-4 (PP&L Industrial Customer Alliance, Set II, Q. 13 and Office of Consumer Advocate, Set IV, Q. 86). In addition, the Company was requested to provide any studies that examined the cost effectiveness of life extension compared to retirement/replacement (Office of Consumer Advocate, Set IV, Q. 85).

In response to these requests, the Company provided its Five Year Upgrade Plan for Coal-Fired Generation previously filed with the Commission in accordance with Pennsylvania statutory requirements. . . . [that] promote the use of coal.

PPLICA St. 9 at 14. In this response, PP&L witness Krall identified the 1994 Five Year Upgrade Plan as "the starting point for PP&L's proposed retirement dates". OCA St. 5A, Exh. CEJ-5, Sch. 1, p. 1. However, Mr. Krall never identified an additional study as the justification for the Company's decision to advance these deactivation dates. In fact, he testified that no such document exists. OCA witness Johnson explained:

Mr. Krall made it clear during cross examination on March 21, 1995 that at the time his testimony was being prepared in October-November 1994, the Company made a decision to advance the deactivation dates for these generating units and memorialized that decision only in his testimony for this

proceeding. No memorandum or other document was prepared. [Tr. 165]

OCA St. 5A at 2.

Notably, the conclusions of the Five Year Upgrade Plan do not support the Company's proposal to advance the deactivation dates. As discussed above, PP&L witness Krall acknowledged on cross examination that the Five Year Upgrade Plan concluded that it would be prudent to continue the operation of Sunbury, Martins Creek 1 and 2, and Holtwood 17 "through at least 2013." Tr. at 163-64. In fact, nowhere in the 1994 Five Year Upgrade Plan does it discuss advancing the deactivation dates for those units to 2003. Thus, at the time the Company completed the 1994 Five-Year Upgrade Plan in May of 1994, PP&L had no plans to advance the deactivation dates of the units.

Similarly, in October of 1994 the Company produced its 1995-1996 Budget, (PP&L Exh. DAK-2) which contained the statement "PP&L currently has no current plans to retire any other existing generating units for the period 1994-2013, although this could change as the utility industry environment changes." PP&L Exh. DAK-2, Chap.3, Sec. F, p. 3-7. Thus, in October of 1994 the Company still had no plans to change the deactivation dates of the units. While PP&L witness Krall asserted that in the back of this document is a statement about the "potential capital exposure" PP&L could face in relation to Title I and Title III of the Clean Air Act amendments, he did not offer this statement as an analysis or study to justify changing deactivation dates. Tr. at 164-165.

The only analysis for this proposed change the Company had given, was the brief text of the interrogatory responses mentioned above by Mr. Kollen. PPLICA St. 9 at 14. This brief text is attached as an exhibit to OCA St. 5A as Exh. CEJ-5, Sch. 1. PP&L witness Krall referred to this one and a quarter page of text as "appropriate analytical support". PP&L St. 5-R at 5.

The OCA submits the responses are insufficient as a cost/benefit analysis to serve as the basis for the Company's decision to advance the deactivation dates of its facilities, a decision that will impose \$15 million of additional expense on ratepayers. In addition, as OCA witness Johnson noted:

[T]hese responses were prepared after Mr. Krall's testimony was prepared, so the documents could not have served as the basis for the decision to advance the deactivation dates. One is forced to conclude that, at most, PP&L personnel gave thought to the issue prior to receipt of the data requests, but committed nothing to paper.

OCA St. 5A at 3.

The OCA submits that even the documents PP&L offered at the rebuttal stage of the case are insufficient to justify the Company's decision. In response to criticisms of the Company's lack of analysis related to this issue, the Company entered into evidence an expanded version of the text of the interrogatory responses. According to PP&L witness Krall, PP&L Exhibit DAK-5, lays out "the details of the Martins Creek analysis."

Exhibit DAK-5, however, only discusses one location, Martins Creek. In addition, the first 5 pages of this document come directly from the 1994 Five Year Upgrade Plan which concluded

that it would be prudent to continue the operation of Martins Creek 1 and 2, "through at least 2013." PP&L St. 5-R at 7; Tr. at 163-64. The sixth page is simply a spreadsheet utilizing the cost estimates for environmental retrofits the Company mentioned in the interrogatory responses.

Similarly, the usefulness of these cost estimates for environmental retrofits is questionable, since PP&L witness Krall has stated that the requirements for compliance with the Clean Air Act Amendments ("CAAA") are not yet known. Upon cross examination, Mr. Krall stated:

The issue specifically with regard to Title I and Title III is one of uncertainty.

At this point in time, we really can't say what our option is as far as compliance, because we really don't have regulations to comply with.

Tr. at 160.

Furthermore, even with these estimates, Exhibit DAK-5 is premised on the retirement of Martins Creek in 1997. Tr. at 1891. The Company failed to provide a similar exhibit premised on retirement in the year for which it has proposed to change the deactivation date, the year 2003. Thus, the OCA submits that Exhibit DAK-5 provides irrelevant, unsupported information.

The Company also introduced during the rebuttal phase Exhibit DAK-6 "summarizing the most recent results for Martins Creek 1 & 2." PP&L St. 5-R at 9. The OCA submits that this document is also of no value as a basis for the Company's decision. Exhibit DAK-6 has the same flaws that Exhibit DAK-5 has. Exhibit

DAK-6 only concerns Martins Creek, and it is premised on the retirement of Martins Creek in 1998, not 2003, the year the Company is proposing as its deactivation date. Tr. at 1891.

PP&L witness Krall stated that Exhibits DAK-5 and DAK-6 are similar to the Company's 1995 Annual Resource Planning Report ("ARPR") analysis, and represent an "evolution of PP&L's understanding". PP&L St. 5-R at 9. However, the conclusions in the May 1995 ARPR are no different than those in the Company's 1994 Five Year Upgrade Plan. The 1995 ARPR again favors continued operation of the units. As Mr. Krall stated on cross-examination:

Q. Would you agree that one key finding of the 1995 Annual Resource Planning Report's preferred plan is to continue the operation of existing operating units?

A. Yes.

Tr. at 1896. Thus, the Company has offered no document displaying an economic or engineering analysis that supported its decision to advance the deactivation dates of the Sunbury units, Holtwood 17, and Martins Creek Units 1 & 2 in this proceeding.

The OCA submits that the Company's proposal to change the deactivation dates of the Holtwood 17 steam plant, Martins Creek Units 1 and 2, and Sunbury Units 1, 2, 3 and 4 must be denied. The Company has failed to show that circumstances related to this issue have substantively changed. In addition, the Company has failed to provide a sound engineering or economic basis for taking such action. Moreover, the Company does not have any current plan to retire the units on the proposed deactivation date. The OCA submits that for these reasons it would be inappropriate to change

the deactivation dates and shorten the depreciation lives of these units. The Company's depreciation accrual should be reduced by \$18,743,803 on a total company basis, which is \$15,274,409 on a Pennsylvania jurisdictional basis. OCA St. 5 at 11. This adjustment has been incorporated with the other depreciation adjustments shown on TSC-20.

3. The Company's Depreciation Expense Is Overstated Due To The Fact That The Company's Suggested Amortization Periods Are Too Short, And The Company Intends To Fully Depreciate Plant That Is Older Than The Amortization Periods Selected.

a. Introduction

PP&L has proposed to change from depreciation accounting to amortization accounting for its General Plant accounts related to Office Furniture, Tools and Equipment. PP&L St. 4 at 16.³² The Company's reason for this request is to reduce the administrative effort required to record, retire, and track this property which has a relatively low average cost per item. PP&L St. 4 at 15-16.

The OCA does not oppose the Company's suggestion to change to amortization accounting for the above named accounts. As OCA witness Dr. Johnson explained:

I have no reason to doubt that the Company's claim that the recordkeeping required to calculate depreciation for these accounts is

³² Specifically, the Company has proposed amortization periods for accounts 391.2 (furniture), 391.4 (mechanical equipment), 391.6 (computer equipment-general), 393.0 (stores equipment), 394.0 (tools-L&S Line Crews), 394.4 (tools-construction), 394.6 (tools-other), 394.8 (garage equipment), 395.0 (laboratory equipment), and 398.0 (miscellaneous equipment). PP&L Exh.1, Vol. 4, Part V-B-2, p. 10.

an unnecessary burden on the Company and that it is reasonable to establish lives over which the assets in these accounts be amortized.

OCA St. 5 at 11. However, the OCA does oppose the amount of expense that the Company has included in the test year related to this change. The OCA submits that because eight of the Company's ten amortization periods are unreasonably short and not supported by record evidence, the Company's test year level of expense is overstated.

The OCA submits that OCA witness Dr. Johnson's proposed amortization periods for these accounts are more reasonable, more in line with the Company's own analysis, and should be adopted by this Commission. See OCA St. 6A, Sch. TSC-20.

b. The Company's Suggested Amortization Periods Are Inappropriate When Compared With The Company's Own Prior Data and Analysis

The OCA submits that eight of the ten General Plant account amortization periods utilized by the Company are too short and thus unreasonably increase expense.³³ The analysis performed by the Company points to longer amortization periods for these

³³ Specifically, the OCA submits that the proposed amortization periods for accounts 391.2 (furniture), 391.4 (mechanical equipment), 394.0 (tools-L&S Line Crews), 394.4 (tools-construction), 394.6 (tools-other), 394.8 (garage equipment), 395.0 (laboratory equipment), and 398.0 (miscellaneous equipment) are too short. OCA St. 5, Exh. CEJ-2, Sch. 2. The OCA is not opposing the proposed amortization periods for accounts 391.6 (computer equipment-general) and 393.0 (stores equipment).

accounts.³⁴ Indeed, the Company has provided no evidence to support the amortization periods it has used.

For example, the Company's amortization periods are not closely related to the service life of the plant according to the Company's depreciation studies. In fact, the Company's amortization periods are shorter than the service lives of the plant according to the last full service life study. PP&L witness Hoch testified to this fact on cross-examination:

Q: And is it true that a comparison of your proposed amortization periods for these accounts with the last life study, the 1988 study, shows that for only one account, Account No. 391.6, your proposed amortization period is greater than the service life study?

A: That is true.

Q: So for the remaining nine accounts proposed to be amortized, your proposed amortization periods are shorter than the service life study shows?

A: Yes.

Tr. 1863. Similarly, except for account 393.0, an account OCA has not opposed, all the Company's amortization periods are shorter than the service lives in the 1980 service life study, which was used to establish the annual depreciation accruals reflected in the

³⁴ For these accounts, OCA witness Johnson proposed longer amortization periods which are located in OCA St. 5, Exh. CEJ-2, Sch. 2. The OCA notes that OCA witness Johnson has revised two of his proposed amortization periods on this table. Dr. Johnson revised the amortization period for account 394.8 (garage equipment) from 35 years to 25. Tr. 1742. Similarly, for account 395.0 (laboratory equipment), Dr. Johnson revised his proposal from 40 years to 20 years. OCA St. 5A at 7.

Company's existing base rates. See OCA St. 5, Exh. CEJ-2, Schedule 2, column "Current Life".³⁵

Company witness Hoch dismisses this criticism stating that, "As a general rule, a service life study that is over five years old is typically considered outdated for determining annual depreciation accruals for ratemaking purposes." PP&L St. 4-R at 12. However, as Mr. Hoch admitted on cross examination, the Company has not performed a more recent service life study for these accounts other than the one conducted in 1988. Tr. 1863. The Company has also not presented any evidence supporting the amortization periods it utilized.

In response to discovery, the Company provided information about the average age of retirement for the plant in each account, the best fitting Iowa curve indicating average service life for the plant in each account, and information about what percentage of plant will still be in service at various age levels. OCA witness Johnson reviewed this data and determined that for each account the data suggested a longer amortization level than what the Company utilized. OCA St. 5 at 14. Dr. Johnson summarized his findings in OCA St. 5, Exh. CEJ-2, Sch. 3, p.1.

In addition, Dr. Johnson compared the amount of depreciation booked in these accounts during the test year with the amount claimed by PP&L under its proposed amortization. OCA St. 5, Exh. CEJ-2, Sch. 3, p.2. As his schedule demonstrates, for every account but one, the Company's proposed amortization yields a

³⁵ Account 391.6 was established in 1986.

greater amount than the accrual under the current depreciation rates. Thus, under the Company's proposal, it would collect more in rates for these accounts than it would have collected under its existing depreciation method.

As an illustration of how the Company's amortization periods differ from the Company's own data and analysis, OCA witness Dr. Johnson carefully explained his review of the data related to account 391.2 (furniture). He stated:

PP&L has proposed a 20 year amortization for account 391.2 (Furniture). In response to a request for information supporting this proposed amortization period (OCA III, Q. 8), PP&L provided information about the accounts that are to be amortized. There are several features of this data that suggest a longer amortization than 20 years for furniture and nothing on which to base a 20 year amortization.

First, the Company compared the retirement data for this account with several standard curves used in depreciation analysis, known as Iowa curves. The curve that best fit all the data was the Iowa curve designated S1-38.7, being a Symmetric curve with a 38.7 year average service life. With some of the data excluded, the curve of best fit had an average service life of 40.1 years. These analyses suggest that an amortization period of around 40 years is more appropriate than a 20 year amortization period.

A second observation, based on the retirement data provided, is that over half of all the furniture placed in this account was still in use 44 years later. In fact, 98.18 percent of all furniture placed ten years earlier was still in use and 89.44 percent of that placed 20 years earlier was still in use. This observation certainly indicates that the life of assets in this account is greater than 20 years and that the amortization period for the account should be greater than 20 years.

Third, for all retirements during the 20-year period 1972-1991, the average age of plant retired is 30.0 years. This means that during the most recent 20-year period, the average age of plant being retired was 30 years. For a growing account, this suggests a longer life than 30 years.

There is nothing in any of this data to suggest a 20-year amortization period for furniture. According to Company witness Hoch, the derivation of the 20-year amortization period was from discussions with individuals in the PP&L facilities department who gave their best knowledge of "how long furniture should last." [Tr. 141] There is no indication that these individuals were knowledgeable about how long furniture actually had lasted at PP&L or about the dispersion of retirements for this account.

OCA St. 5 at 12-13.

As Dr. Johnson has explained, the Company's data supports a longer amortization period for account 391.2 than the Company has requested. Similarly, the OCA submits that in each instance, the data supports longer amortization periods than that requested by the Company. OCA St. 5, Exh. CEJ-2, Sch. 3, p.1-2. Thus, OCA witness Johnson has proposed longer amortization periods for these accounts based on the Company's data. OCA St. 5, Exh. CEJ-2, Sch. 2. The OCA submits that Dr. Johnson's proposed amortization periods are appropriate and they are more consistent with PP&L's own data than the Company's recommendation.

In his rebuttal testimony, PP&L witness Hoch criticized Dr. Johnson's testimony stating that, Dr. Johnson failed to consider the "age distribution of the property" and "other factors that would directly affect the reserve balance." PP&L St. 4-R at 13-14 (emphasis in original). However, as Dr. Johnson explained

there would be no way to address any problems created by age distribution or existing reserve balances. Dr. Johnson stated:

PP&L has not performed [any recent] life studies on these accounts, so it is not possible to determine if problems arise for these reasons. . . . Absent information that would enable me to determine the potential existence of problems, I have assumed that none exist.

OCA St. 5A at 10. Dr. Johnson also noted:

It should be kept in mind that there may be none. That is, if depreciation recovery in the past was proper, the change to amortizations in the future would be seamless. What I mean by that is that as existing vintages are retired and their depreciation levels decline, the amount of plant being amortized will increase and the amortization will generally offset the reductions in depreciation. Future vintages would be amortized and existing plant would continue to be depreciated, so that the total expense would be roughly at the level included in the test year.

OCA St. 5A at 9.

Therefore, although problems created by age distribution or existing reserve balances are usually addressed when changing from depreciation accounting to amortization accounting, the Company has no data to address this issue. In addition, as Dr. Johnson explained there should not be any such problems if depreciation recovery in the past was proper.

As stated above, the OCA submits that the Company has not provided any evidence to support its proposed amortization periods. Importantly, the test year expense is a function of the amount of plant in each account that should be amortized as well as the amortization period.

In oral rejoinder, the Company put into the record an exhibit to accompany the rebuttal testimony of the Company's witness on this issue. Through this document, Exhibit DSH-4, the Company has indicated that for seven of the accounts scheduled to be amortized, the Company plans to fully depreciate any plant that is older than the amortization period selected by the Company.³⁶ PP&L Exh. DSH-4; Tr. 2232.

The Company plans to treat this plant as retired, even though it is not being taken out of service by the Company. By doing so, the Company will increase the level of expense included in the test year for these accounts. The Company's plan will allow PP&L to recover in rates each year until the next rate case the cost to fully depreciate this plant.³⁷ While the OCA has not made any specific adjustment directly relating to this part of the Company's proposal, the OCA submits that the Company's clarification of its method in rejoinder demonstrates the necessity of setting appropriate amortization periods in this case. The Company will already be receiving full recovery for plant older than the amortization period, and the use of unreasonably short

³⁶ The Company plans to fully depreciate: all pre-1965 plant in account 393.0 (stores equipment); all pre-1970 plant in account 398.0 (miscellaneous equipment); all pre-1975 plant in accounts 391.2 (furniture), and 394.6 (tools-other); all pre-1980 plant in accounts 391.4 (mechanical equipment) and 395.0 (laboratory equipment); and all pre-1985 plant in account 391.6 (computer equipment-general).

³⁷ The OCA notes that this problem is similar to the Company's proposal associated with levelizing the depreciation accrual for Susquehanna Steam Electric Plant as fully discussed in Section ?

amortization periods will unnecessarily burden ratepayers.

c. Conclusion

The OCA submits that the Company's depreciation expense is overstated due to the fact that its amortization periods are too short. The Company has provided no evidence to support the amortization periods it has used and as a result, the amortization periods proposed by the Company should be rejected.

The OCA further submits that OCA witness Dr. Johnson's proposed amortization periods for these accounts, are more reasonable and are consistent with the Company's own analysis. The OCA's proposed amortization periods should be adopted by the Commission. Accordingly, the Company's test year level of expense should be reduced by \$3,028,129 on a total Company basis. (\$3,141,268 - \$113,139 -- this number reflects the Company's correction made during oral rejoinder on May 23, 1995, Tr. 1844-45.) This adjustment has been incorporated, on a Pennsylvania jurisdictional basis, with the other depreciation adjustments shown OCA St. 6, Sch. TSC-20 (Updated).

H. The Discount Rate Used To Determine PP&L's Pension And Postretirement Benefits Costs Should Be Increased

In its filing, PP&L has based its pension expense on an actuarial estimate of the cost under Statement of Financial Accounting Standard No. 87 ("SFAS 87"). PP&L Exh. Future 1 (Revised), Sch. D-6, p. 4. Similarly, PP&L has based its postretirement benefits other than pensions ("OPEBs") expense claim on its actuarial estimate of the costs under Statement of Financial Accounting Standard No. 106 ("SFAS 106"). PP&L St. 14 at 4-11;

PP&L Exh. Future 1 (Revised), Sch. D-6, p. 2. The Company's actuary, Towers Perrin, used a 7.5% discount rate to calculate both of these estimates.³⁸ OCA St. 6 at 14; Tr. at 87-88. The OCA submits that the discount rate used to determine the Company's pension and postretirement benefits costs should be increased to 8.5% in order to reflect current market bond yields.

As PP&L witness Beers testified on cross-examination, the discount rate is intended to reflect the time value of money. Tr. 88. Consequently, the discount rate is normally based on investment-grade bonds. Id. Towers Perrin based the discount rate for its pension and postretirement benefits costs on four different types of investment-grade bonds. OCA St. 6 at 15. After reviewing the yields on these government and corporate bonds as of December 31, 1994, OCA witness Catlin recommended that the Company's discount rate be increased from 7.5% to 8.5%. OCA St. 6 at 16, Schs. TSC-9 & TSC-10. In support of this recommendation Mr. Catlin explained:

At the time at which the Company's 1994 actuarial reports were prepared in early 1994, a discount rate of 7 percent was used. This discount rate was selected after considering the yields on four different types of investment grade bonds as of December 31, 1993. As shown in the following table [see OCA St. 6 at 15], the yield on each type of bond had increased by approximately 1.5% as of December 1994. This data supports an increase in the discount rate of more than the .5% recognized by PP&L. Consistent with the

³⁸ The Company's filed claim used a discount rate of 7.25% for pension expense, however, at the time of hearings on March 21, 1995 the Company submitted an updated Towers Perrin actuarial report for 1995 in which the discount rate was increased to 7.5%.

increase in bond yields, I am proposing to increase the discount rate by 1.5% [from the 1994 rate of 7.0%].

OCA St. 6 at 15. The OCA submits the discount rate used to determine PP&L's pension and postretirement benefits costs should be more reflective of the market rate. As such, the discount rate should be increased to 8.5%.

The reasonableness of Mr. Catlin's recommendation is supported by the fact that PP&L's own actuary, Towers Perrin, recommended to another utility an increase above 8.5% for 1995. In the 1995 actuarial reports for American Water Works Company, Towers Perrin increased the discount rate from the 7.25% used in their 1994 reports to 8.75%. Tr. 91-92. In other words, Towers Perrin increased American Water Works discount rate for 1995 .25% higher than what the OCA is recommending for PP&L. Pa. P.U.C. v. Pennsylvania American Water Company, Docket No. R-943231 (Order pending) ("PAWC").³⁹ In addition, the Towers Perrin report offered in PAWC is two months more recent than the one Towers Perrin prepared for PP&L. Tr. 91. The OCA submits that the recommendation that Towers Perrin made in PAWC is more in line with the market rate than the 7.5% rate utilized in this proceeding.

In his rebuttal testimony PP&L witness Beers contends that the discount rate of its client PAWC is "entirely irrelevant to the reasonableness of the 7.5% figure adopted by PP&L." PP&L St. 14-R at 4. However, he failed to explain why Towers Perrin

³⁹ Pennsylvania-American Water Company, a subsidiary of American Water Works Company, Inc., recently filed a rate case in which it presented as an exhibit the actuarial report for 1995.

recommended different discount rates for PAWC (American Water Works) and PP&L. In addition, PAWC is not the only case where Towers Perrin recommended a discount rate in the range of 8.5%, nor is Towers Perrin the only actuary to recommend such a rate. As OCA witness Catlin explained, three utilities with rate cases pending before this Commission have based their pension and SFAS 106 claims on actuarial reports employing higher discount rates than PP&L:

[I]ncreasing the discount rate to the range of 8.5% is not unique to PAWC. In the pension actuarial report prepared for Philadelphia Suburban Water Company (PSWC) in March 1995, Towers Perrin also increased the discount rate from the 7.0 percent used in 1994 to 8.5 percent in 1995. In its May 1995 actuarial report for UGI Utilities, Inc.'s postretirement welfare plan, Towers Perrin increased the discount rate from 7.0 percent to 8.7 percent. Similarly, in the most recent actuarial report prepared for National Fuel Gas (NFG) Distribution Company and the other members of the NFG system, William M. Mercer, Incorporated increased the discount rate which it used for the postretirement benefit plan in 1995 to 8.5 percent.

OCA St. 6A at 17-18.

Therefore, the adjustments which OCA witness Catlin has proposed to reflect an 8.5 percent discount rate are consistent with those used by Towers Perrin and other actuaries for 1995. The OCA submits that a discount rate of 8.5% should be utilized for PP&L's pension and postretirement benefits expenses. Accordingly, the OCA submits that the postretirement benefits expense charged to O&M should be reduced by \$481,000 on a total company basis and \$416,000 on a Pennsylvania jurisdictional basis as shown on OCA St. 6, Sch. TSC-9. Likewise, the pension expense charged to O&M should

be reduced by \$12,296,000 on a total company basis and \$7,056,000 on a jurisdictional basis as shown on schedule TSC-10 (Updated). This calculation is based on Mr. Catlin's conservative assumption that pension costs will fall to zero and not become negative with an increase in the discount rate. SEE OCA St. 6 at 17.

I. PP&L's Claim For Recovery Of Prior Period OPEB Benefits Should Be Denied

1. Introduction

PP&L has requested that it be allowed to recover \$31.1 million of prior period costs for post-retirement benefit obligations other than pensions under Statement of Financial Accounting Standards No. 106 ("SFAS 106"). PP&L Exh. Future 1 (Revised), Sch. D-6, p. 3. The Company proposed to amortize these costs over 17.3 years. Id. These costs represent the incremental costs incurred under SFAS 106 from the date it became effective, on January 1, 1993, until the end of the future test year in this case. Id. The OCA submits that PP&L's claim for these prior period costs must be denied as the Commonwealth Court has already determined that the rule against retroactive ratemaking prohibits recovery of these costs. To grant this claim would violate the rule against retroactive ratemaking in contravention of both Court and Commission precedent.

2. The History Of The Claim

In December 1990, the Financial Accounting Standards Board ("FASB") issued SFAS 106, generally requiring that, effective for fiscal years beginning after December 15, 1992, employers, for financial accounting purposes, must recognize post-retirement

benefit obligations other than pensions and related costs during the period employees provide the service that may entitle them to future benefits.

In December of 1992, PP&L filed a petition for declaratory order with the PUC requesting permission to defer for accounting purposes, and to recover in future rates, the incremental costs of OPEBs that the Company was required to recognize for accounting purposes beginning on January 1, 1993 under SFAS No. 106. The PUC approved PP&L's petition. Pa. P.U.C. v. Pennsylvania Power & Light Co., Docket No. P-00920635, (Entered May 6, 1993). The OCA opposed this claim and appealed the PUC's decision to the Commonwealth Court arguing that guaranteed future recovery of these costs violates the rule against retroactive ratemaking. See, Popowsky v. Pennsylvania Public Utility Commission, 164 Pa. Commonwealth 338, 345, 642 A.2d 648, 651 (1994) ("PP&L 1994")

On May 26, 1994, the Commonwealth Court reversed the PUC decision granting the Company's petition. PP&L 1994, 164 Pa. Commonwealth 338, 642 A.2d 648 (1994).⁴⁰ The Commonwealth Court concluded that "the incremental costs would be prohibited by the rule against retroactive ratemaking and the PUC's order improperly assures future recovery." Id.

⁴⁰ Petitions for Allowance of Appeal to the Supreme Court of Pennsylvania were filed in that case by the Public Utility Commission and Pennsylvania Power and Light Company at No. 0294 M.D. Allocatur Docket 1994. These Petitions are still pending before the Supreme Court.

The Court in PP&L 1994 summarized PP&L's purpose in filing a petition for declaratory order. It stated:

[T]he purpose of PP&L's filing of a request for declaratory order was to postpone filing a general rate case while getting a determination of how the accrual costs of OPEBs would be handled in a general rate case.

Popowsky v. Pennsylvania Public Utility Commission, 164 Pa. Commonwealth at 344, 642 A.2d at 651. In addition, the Court also recognized that although the case was a declaratory proceeding, an analysis of retroactive ratemaking was mandatory because of the effect of the Commission's Order which granted PP&L future rate recovery of these costs. PP&L 1994, 164 Pa. Commonwealth at 342, 642 A.2d at 650. The Court stated, "The PUC order means that costs incurred now will be rolled into PP&L's next rate case and will be paid by future ratepayers." Id. Thus, the Court recognized that PP&L would be seeking rate recovery of these costs in the future and it found that such a claim would violate the rule against retroactive ratemaking.

3. The Company's Claim Must Be Denied Because It Violates The Rule Against Retroactive Ratemaking.

The OCA submits that the Company's claim must be denied since the rule against retroactive ratemaking prohibits recovery of these costs. In addition, the Commission has recently denied a similar claim for recovery of deferred OPEB costs in a West Penn case based on the Court's holding in PP&L 1994. Pa. P.U.C. v. West Penn Power Company, Docket No. R-00942986 (Order Entered December 28, 1994).

The Commonwealth Court considered the exact cost figures PP&L is now claiming⁴¹ and determined that the rule against retroactive ratemaking prohibited their recovery. The Court explained the rule against retroactive ratemaking as follows:

Because of the prospective nature of rates, a rule against retroactive ratemaking has developed. The rule against retroactive ratemaking prohibits a public utility commission from setting future rates to allow a utility to recoup past losses or to refund to customers excess utility profits. (Citation omitted.) The policy reasons behind this rule are that if retroactive ratemaking is allowed, it makes the "test year" method of ratemaking meaningless and the general principle that those customers who use power should pay for its production rather than requiring future ratepayers to pay for past use.

PP&L 1994, 164 Pa. Commonwealth 338, 344, 642 A.2d 648, 651 (1994).

The Court then analyzed the issue of whether the OPEB costs which PP&L sought to defer and recover in future rates violated this rule. The Court held that the recovery of such costs in future rates would be improper. The Court reasoned:

Because the incremental costs recovered in some future rate case would relate to 1993 and the years up until the next rate case, what PP&L requested and the PUC awarded is retroactive ratemaking.

* * *

[W]e believe that requiring future ratepayers to pay not only the transitional obligation costs of changing to the accrual method but also the incremental costs incurred in 1993

⁴¹ PP&L has stated that this claim represents the costs that would have been deferred under the Commission's order entered May 6, 1993 at Docket No. P-920635 (had the Commonwealth Court not reversed it). PP&L Exh. Future 1 (Revised), Sch. D-6, p. 3.

and beyond until the next rate case unfairly burdens the future ratepayers.

PP&L 1994, 164 Pa. Commonwealth 338, 346-47, 642 A.2d 648, 652 (1994).

Similarly, the Commission denied West Penn Power Company's recent claim for its prior period OPEB costs. Pa. P.U.C. v. West Penn Power Company, Docket No. R-942986 (Order Entered December 28, 1994) ("West Penn 1994"). In West Penn, the Company sought to recover OPEB costs from the period between January 1, 1993 (when SFAS 106 became effective) to May 18, 1993, when West Penn's rates reflecting full SFAS 106 recovery were approved. Id. at 31. The Commission held that West Penn failed to claim these costs in a timely manner, and that the rule against retroactive ratemaking precluded the recovery of these costs in a later period. Id. at 30-35. In addition, the Commission found that these costs do not qualify for an exception to the rule against retroactive ratemaking. The Commission adopted the ALJ's recommendation who stated:

There is no question these costs were anticipated, they are recurring and not extraordinary.

Id. at 31.

The OCA submits that based on the Commonwealth Court's conclusion in PP&L 1994, and the Commission's recent denial of West Penn's prior period SFAS 106 claim, PP&L's claim must be denied as retroactive ratemaking. Accordingly, the Company's net income must be adjusted by \$1,040,000 on a total company basis and \$900,000 on a Pennsylvania jurisdictional basis as shown on TSC-11.

J. PP&L's SFAS 112 Claim Should Be Denied

In this proceeding, PP&L has included \$996,000 in expense for the accrual of costs in the future test year under Statement of Financial Accounting Standard 112 ("SFAS 112"). OCA St. 6 at 19. OCA witness Catlin explained the Company's claim:

The \$996,000 cost which PP&L has recognized represents an accrual for the projected increase in the future liability for long-term disability and survivor income protection and is in addition to the actual benefits the Company will pay for during the future test year.

OCA St. 6 at 19. The OCA submits that the Commission should deny the Company's SFAS 112 claim. The Company intends to pay these costs on a pay-as-you-go basis and the Company has no plan to establish a separate fund for this liability if it recovers these costs prior to incurring them. OCA St. 6 at 19, PP&L St. 2-R at 16.

The Company has proposed to include an accrual of these costs in the future test year for ratemaking purposes, even though PP&L will treat these benefit costs just as it has in the past. In other words, PP&L plans to pay for the benefits covered by the SFAS 112 accrual on a pay-as-you-go basis; however, the Company expects ratepayers to fund these potential costs in advance. The OCA submits that the Company's proposed treatment is an unfair burden on ratepayers. OCA witness Catlin explains:

In response to OTS-RE-105, the Company has indicated that these accruals are relatively short-term liabilities. Therefore, the Company does not intend to fund these costs in the same manner as SFAS No. 106 expenses, but instead intends to pay for the costs as they

become due. Test year expenses already include the annual cost associated with paying post-employment benefits. Ratepayers should not be required to pay for future liabilities which PP&L itself does not intend to pay until they become due.

OCA St. 6 at 19. The OCA submits that for these reasons PP&L's claim for a SFAS 112 accrual should be excluded from rates in this proceeding.

In rebuttal, PP&L witness Berish contended that the reasons supporting the use of SFAS 106 for ratemaking purposes also apply to SFAS 112. PP&L St. 2-R at 16. However, Mr. Berish failed to provide any evidence to demonstrate that these two claims are similar. In fact, as OCA witness Catlin explained, SFAS 112 is significantly different than SFAS 106:

SFAS No. 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. The Company itself has stated that SFAS No. 112 accruals are relatively short-term liabilities which it does not intend to fund but, instead, intends to pay as they become due. Therefore, no reason exists to change the ratemaking treatment of SFAS 112 related expenses from a cash basis to an accrual basis.

OCA St. 6A at 5.

Thus, the OCA submits that the reasons supporting the use of SFAS 106 for ratemaking purposes are not present for the potential liability under SFAS 112. Moreover, the Company should not be allowed to collect funds from ratepayers on an accrual basis while continuing to pay the related claims on a pay-as-you-go basis. The OCA submits that Commission should deny the Company's SFAS 112 claim. Accordingly, the Company's O&M expense claim

should be reduced by \$684,000 on a total company basis and by \$592,000 on a Pennsylvania jurisdictional basis as shown on schedule TSC-12.

K. The Company's Claim For VERP Costs Should Be Adjusted To Account For Savings Resulting From The Early Retirement Program.

PP&L is proposing that it be allowed to defer and amortize the costs associated with the Voluntary Early Retirement Program ("VERP") which it offered in late 1994. The Company is requesting a five year amortization of the \$75,859,000, a cost of \$15,172,000 per year. PP&L St. 2 at 12-14, PP&L Exh. Future 1 (Revised), Sch. D-10. PP&L witness Berish testified that the VERP was designed to encourage early retirements in an overall effort to reduce the number of employees and, as a result, reduce costs. P&L St. 2 at 12.

PPLICA witness Lane Kollen proposed that the amount of the costs which PP&L is allowed to amortize should be adjusted to net out the savings which PP&L will realize from the VERP prior to the time the savings are reflected in rates. PPLICA St. 9 at 26-28. As Mr. Kollen testified:

The Company's request is clearly inequitable. It seeks to recover the gross cost of the VERP despite the fact that it was also the beneficiary of nine months of VERP savings from December 31, 1994 through September 30, 1995. If the Company is allowed recovery of the VERP costs, then recovery should be based on the net cost, not the gross cost.

Id. at 27. Mr. Kollen stated that utilizing the net cost of VERP reduces the Company's claim by \$5,799,000 on a total Company basis

and by \$5,019,000 on a Pennsylvania jurisdictional basis. Id. at 27-28.

In surrebuttal, OCA witness Catlin adopted Mr. Kollen's recommendation, testifying that:

The costs of the VERP represent non-recurring costs which will be incurred prior to the end of the test year and not ongoing costs which will continue to be incurred during the period rates approved in this case will be in effect. Therefore, PP&L has proposed that it be allowed to defer the costs of the VERP and to amortize those costs to ratepayers over five years beginning the date the rates approved in this case go into effect. In developing its adjustment, PP&L has recognized that the VERP will produce ongoing costs savings during the period the rates approved in this case will be in effect. However, the Company has not recognized the VERP will have produced cost savings prior to the time the VERP is reflected in rates just as costs were incurred prior to the time the VERP is reflected in rates.

Id. at 6. Mr. Catlin stated that the Company's actions resulted in a mismatch between the costs and benefits of the program.

In rejoinder, Mr. Berish contended that implementation of the VERP had not produced cost savings, because "we have had to supplement our work force" in response to the VERP. Tr. 2048-2049; PP&L Exh. MJB-17. However, Mr. Berish agreed when asked to explain why, as shown on PP&L Exh. MJB-17, the actual versus budget wage expense was so high in January that "January included a large one-time vacation payment to employees who were departing under VERP." Tr. 2052.⁴²

⁴² The OCA is still waiting for a response to an on-the-record data request relating to the January wage expense.

The OCA submits that PP&L should not be allowed to defer the costs of the program for future rate recovery without also recognizing that the VERP has produced cost savings which were similarly not reflected in rates. Therefore the adjustment proposed by Mr. Kollen to net out the cost savings realized prior to the end of the test year from the VERP costs to be amortized is necessary and appropriate. As shown on OCA St. 6A, Sch. TSC-28, adoption of this adjustment reduces test year expenses by \$5,799,000 on a total company basis and \$5,019,000 on a jurisdictional basis compared to PP&L's revised claim. The corresponding increases in net income are \$3,355,000 and \$2,904,000, respectively.

L. PP&L Should Be Required To Separately Account For And Track Any Funds It Receives Related To Its Social Programs.

In this proceeding, PP&L is requesting Commission approval to implement eight programs that it has developed "to serve customer and community needs, PP&L's corporate objectives, and the public interest." The Programs are: Build-A-Neighborhood; Affordable Housing; Small Business Program; Keep Warm Plan; Payment Protection Plan; Winter Emergency Plan; Operation HELP Contribution Enhancement Plan; and CARES Extension Pilot Program. PP&L St. 11 at 13-31. The Company has projected that the total cost of these programs will run \$6,700,000 per year. Of this total, PP&L is seeking \$3,530,000 in test year expenses as representative of the

portion of the costs which provide ratepayer benefits.⁴³ Id. Based on the descriptions of the programs provided by PP&L, it appears that these social programs will provide some customer benefits in terms of energy efficiency, load management and conservation. OCA St. 6 at 39.

The OCA notes that the OTS has recommended the total disallowance of the costs related to the Build-A-Neighborhood, Affordable Housing and Small Business Programs which results in a \$2,500,000 reduction in the Company's claim. The OCA has not taken a position on the OTS adjustment, but submits that should the Company be allowed to recover all or only a portion of its Social Programs claim, that certain reporting requirements should be implemented to insure that these Programs are being implemented and funded consistent with the plans presented by PP&L in the rebuttal phase of this proceeding.

OCA witness Catlin detailed his concerns regarding the status of these programs in his direct testimony:

I am concerned about the reasonableness of the costs claimed in rates for several reasons. First, the Company has provided no basis or support for either the total program costs or the portion of those costs which provide ratepayer benefits. Second, the Company has not presented an implementation plan or other details of the programs. Finally, it appears that many of the programs will not be fully implemented until after the test year so that

⁴³ The Company is seeking ratepayer contributions for the Build-A-Neighborhood, Affordable Housing, Small Business, Keep Warm, and CARES programs. PP&L St. 11; OTS St. 4 at 32. PP&L has indicated that the Company will implement all of these programs for a period of three years even if rate recovery were not granted in this proceeding. PP&L St. 11R at 14.

the costs of the program will not be incurred in the test year.

OCA St. 6 at 39.

The Company responded to these concerns in rebuttal. PP&L St. 11R at 13-14. PP&L witness Stathos presented a preliminary implementation plan and timeline. Id., Attachment 1. Mr. Stathos testified that:

PP&L recognizes that in the cases of new programs such as these, the Commission and bodies such as the Office of Consumer Advocate will sometimes wish to closely monitor utility activities and expenses. Therefore, PP&L volunteers to submit quarterly reports to the Commission and the OCA on the implementation status and expenditures of these programs.

PP&L St. 11R at 14.

The OCA acknowledges that the Company's voluntary reporting will help the Commission, and interested parties track the status of these programs. However, PP&L should be required to include in these reports detailed information relating to the implementation, expenditures and results of the programs. Absent this information, it will be difficult for any party to assess the effectiveness of the programs. Moreover, due to the preliminary nature of the information provided by the Company relating to these programs it is difficult to develop detailed reporting requirements. The OCA submits that since these programs are all scheduled for implementation by September 30, 1995, that the Commission should require the Company to provide the final implementation plans and an outline of the future reporting requirements along with its compliance filing.

VII. NUCLEAR DECOMMISSIONING RELATED ISSUES

A. Introduction

Decommissioning occurs once a nuclear facility has reached the end of its useful life. It is the process by which a nuclear facility is safely removed from service and radioactive materials are disposed of without incurring unreasonable risk to public health and safety. OCA St. 4 at 8. In this proceeding, PP&L's nuclear decommissioning expense claim is based on an \$804 million (in 1993 dollars) estimate for costs related to the decommissioning of the two nuclear units at Susquehanna Steam Electric Station ("SSES") beginning in the year 2022.⁴⁴ PP&L St. 13 at 3. The Company's revenue requirement includes a request to increase the allowed annual decommissioning accrual for the Susquehanna units by more than four times the previous level. PP&L is requesting an increase from \$7.126 million on a total Company basis to \$30.042 million on a total Company basis, \$23.570 million on a Pennsylvania jurisdictional basis.

As set forth in the TLG study, the Company plans to begin decommissioning upon the shutdown of Unit 1 in 2022, the decommissioning process will take at least ten years for each Unit. PP&L Exh. TSL-2 at 5-8. Under PP&L's plan for decommissioning funds, all the funds required for decommissioning both the

⁴⁴ PP&L is basing its decommissioning claim on a decommissioning cost estimate prepared by TLG Engineering ("TLG Study"). OCA St. 4 at 6. The TLG study assumes that the final shutdown of each of the two units occurs on the expiration date of each unit's operating license. PP&L Exh. TSL-2 at 2-1. The Unit 1 operating license expires in 2022, and the Unit 2 license expires in 2024. Id.

radiological and non-radiological portions of the SSES site must be in the fund prior to the initiation of decommissioning. However, the Company's cost estimate fails to consider the interest that will accrue on these funds during the ten year decommissioning period. The OCA, through its witness Thomas S. Catlin, submits that the Company's claim for decommissioning funds should be reduced to reflect the fact that the Company will continue to earn interest on its decommissioning funds even while SSES is being decommissioned. Adjusting PP&L's claim to account for the continued earnings results in a reduction of \$3,105,000 on a total Company basis and by \$2,436,000 on a Pennsylvania jurisdictional basis. OCA St. 6 at 22.

In this proceeding the Company, in response to a recent change in regulations, is asking the Commission to relax the investment standard requirements related to its decommissioning trust fund. In support of its request, the Company submits that it would expect to achieve higher earnings on the fund under a more aggressive investment strategy. However, the Company has failed to incorporate these higher earnings expectations into its 5.5% rate of return estimate of trust fund earnings. The OCA, through its witnesses Thomas S. Catlin and Matthew I. Kahal, demonstrated that utilization of increased earnings assumptions reduces the ratepayers' funding obligation. The OCA submits that a 7.5% rate of return estimate more accurately reflects current market conditions. Using a 7.5% rate of return reduces the Company's claim by \$11,671,000 on a total Company basis and by \$9,157,000 on

a Pennsylvania jurisdictional basis assuming that the earnings assumptions discussed above are utilized. OCA St. 6, Sch. TSC-14.

The Company is requesting rate recovery of decommissioning costs based on a total decommissioning cost estimate of \$804 million. Included in this estimate is \$127.4 million related to decommissioning the non-radiological facilities and equipment at the SSES site and \$106,569,000 in contingencies related to radiological decommissioning costs to cover unanticipated problems during decommissioning. OCA St. 4, Exh. DGB-12. The OCA, through its witness Dale G. Bridenbaugh,⁴⁵ submits that the Company's claim for decommissioning funds should be reduced to reflect the removal of the costs associated with non-radiological decommissioning and contingencies. As discussed below, excluding non-radiological costs and contingencies from the costs to be funded reduces the required annual contributions by \$6,402,000 on a total company basis and \$5,022,000 on a Pennsylvania jurisdictional basis. This results in increases of \$3,733,000 in total company net income and \$2,928,000 in jurisdictional net income. OCA St. 6, Sch. TSC-15.

⁴⁵ Mr. Bridenbaugh is the president and co-founder of MHB Technical Associates, providing technical consulting services on energy and the environment. Since 1976, Mr. Bridenbaugh has provided technical consulting service on subjects related to the design, operation, and economic aspects of commercial nuclear power plants. Prior to that time, Mr. Bridenbaugh spent twenty three years as an engineer and manager with the General Electric Company, including ten years in the nuclear energy division. A complete description of Mr. Bridenbaugh's qualifications is provided at OCA St. 4 at 1-3 and Exhibit DGB-1.

As discussed below, the OCA submits that PP&L's claim for nuclear decommissioning expense should be revised to reflect all of these adjustments. Adoption of these four adjustments reduces PP&L's decommissioning expense claim by \$21,178,000 from \$30,042,000 on a total Company basis to \$8,864,000 on a total Company basis.⁴⁶

B. PP&L's Nuclear Decommissioning Trust Fund Estimate Should Be Reduced To Include Interest Earned After Decommissioning Begins.

At this time, PP&L estimates that it will begin decommissioning the two units at SSES in 2022. As OCA witness Catlin explained, the Company calculated the annual contribution required to fund the decommissioning of Susquehanna Units 1 and 2, assuming that the full amount of the funds required would have to be available at the time each unit is retired. Mr. Catlin testified that:

This procedure fails to recognize that the decommissioning process and the associated expenditures will take place over 12 years for Unit 1 and 10 years for Unit 2. As a result, monies will remain in the decommissioning trust funds and those funds will continue to realize significant earnings during the period over which the decommissioning activities take place once the units are retired.

OCA St. 6 at 21. In order to recognize the fund earnings during the period over which decommissioning takes place, Mr. Catlin

⁴⁶ On a Pennsylvania jurisdictional basis, adoption of the OCA's adjustments reduces PP&L's decommissioning expense claim by \$16,615,000 from \$23,370,000 to \$6,955,000.

utilized a decommissioning model which takes into consideration the timing of the decommissioning expenditures.⁴⁷

This method for determining decommissioning trust fund requirements has been adopted in other jurisdictions. As OCA witness Catlin testified:

The Federal Energy Regulatory Commission utilizes the procedure which I am recommending in establishing the decommissioning funding requirements for nuclear units subject to its jurisdiction. In addition, in the previous rate cases in which I have been involved where decommissioning funding requirements for nuclear units were established, the utility itself has proposed to establish funding contributions taking into consideration interest earned during the decommissioning period. These cases have involved Louisiana Power & Light Company, System Energy Resources, Inc. and Commonwealth Edison Company, which has 16 nuclear units and is the largest investor-owned nuclear utility in the U.S.A.

OCA St. 1 at 22. The OCA submits that PP&L's trust fund earnings should also consider the timing of decommissioning expenditures.

In rebuttal, PP&L witness LaGuardia argued that current NRC rules require that the nuclear decommissioning fund be fully funded. However he noted that "the NRC has made exceptions on a case by case basis." PP&L St. 13R at 14 (emphasis added).⁴⁸

⁴⁷ In developing this model, Mr. Catlin recognized that inflation will continue to affect decommissioning costs over the 10 and 12 year periods during which decommissioning of the units will take place and that, in turn, this will affect the total decommissioning funds which are required. OCA St. 6 at 22. Mr. Catlin also recognized that the unexpended balances of the trust funds will earn a return during those time periods. Id.

⁴⁸ In response to cross-examination, Mr. LaGuardia acknowledged that the NRC requirement for full funding related only to funds (continued...)

The OCA acknowledges that Mr. LaGuardia is correct when he stated that the NRC rules require full funding of radiological decommissioning costs at the time of decommissioning. However, as, Mr. LaGuardia acknowledged, NRC rules do not preclude the recognition of trust fund earnings during the decommissioning period in determining the contributions required to fund decommissioning costs. As Mr. Catlin testified in surrebuttal:

The licensee for the plant must simply reflect the earnings in the funding plan which it submits to the NRC. This is borne out by the fact the NRC has accepted the funding plans of the other utilities which recognize fund earnings subsequent to the planned termination of operations of their plants in calculating the required funding contribution.

OCA St. 6A at 15. The OCA submits that the NRC has in the past allowed electric utilities to include the funds earned during decommissioning to be included in its decommissioning earnings. PP&L has not provided any evidence that it would be precluded from requesting such an exemption from the NRC.

As shown on Sch. TSC-14, recognizing that the decommissioning trust funds will continue to earn a return after the units are retired, without recognizing any other changes results in funding requirements of \$11,399,000 per year for Unit 1 and \$15,538,000 for Unit 2. Adoption of this adjustment reduces PP&L's decommissioning claim by \$3,105,000 on a total Company basis

⁴⁸ (...continued)
required for the radiological portion of the decommissioning. Tr. 2084. There is no NRC funding requirement for non-radiological decommissioning costs.

and by \$2,436,000 on a Pennsylvania jurisdictional basis. OCA St. 6 at 22.

C. PP&L's Decommissioning Trust Fund Earnings Projections Are Too Low And Should Be Revised.

1. Introduction.

A key element in determining the contributions which must be collected from ratepayers to fund decommissioning costs is the estimate of what the funds invested in the decommissioning trust will earn once they have been collected. To develop its estimate of the returns which the decommissioning funds will earn, PP&L established an investment strategy and projected the rates of return which the various types of investments (e.g., stocks, bonds, treasuries, etc.) will earn. OCA St. 6 at 23. As PPLICA witness Kollen testified:

... the actual return earned directly affects the balance in the trust fund. If the fund earnings are higher than the assumption in the earlier years of the trust fund, then the accrual and funding can be reduced in latter years. Alternatively, if the fund earnings are lower than the assumption in the earlier years, than the accrual and funding would need to be increased in the latter years.

Consequently, under the current regulatory construct, both the historical actual earned return and the projected return affect the annual accrual and, thus, the revenue requirement.

PPLICA St. 9 at 21. In this proceeding, PP&L is requesting to include in its revenue requirements in this case \$30 million on a total company basis for the decommissioning of the Susquehanna nuclear site. The revenue requirements collected from ratepayers

are to be transferred to an external trust fund to be used for the express purpose of decommissioning. OCA St. 1 at 56.

In addition, the Company is requesting that the Commission eliminate the "Black Lung" restrictions on the type of securities that PP&L can invest in its nuclear decommissioning fund. PP&L St. 1 at 8-11. As a result of the change in federal law, PP&L is petitioning the Commission in this case to permit the Company to employ the "prudent person" standard for investing the trust funds.⁴⁹ PP&L witness Hill testified that if the restrictions are removed, "[T]he Company anticipates that a broader investment strategy would produce higher returns than are now realized under the current investment requirements." Id. at 10-11. In its claim, PP&L assumes a net of tax rate of return averaging 5.5 percent over the period 1995 until completion of decommissioning.⁵⁰ The Company's overall investment strategy is set forth in OCA Cross-Exam Exh. 8. The OCA submits that PP&L's estimate of earnings is overly conservative, particularly in light of its request in this proceeding for an easing of earnings restrictions and should be increased.

⁴⁹ As Mr. Hill noted the Commission has already granted requests by several electric utilities to eliminate the "Black Lung" restrictions. PP&L St. 1 at 9.

⁵⁰ As Mr. Kahal explained: "In addition to factoring in the 20 percent tax rate, PP&L bases its return estimates on the historic market returns, 1926-1993, as published by Ibbotson Associates. The historic return data are used both for equity investments and bonds." OCA St. 1 at 57. The derivation of the 5.5 percent rate of return in the Company's trust fund analysis is shown on OCA St. 1, Sch. MIK-10.

2. The Evidence Of Record Supports An Increase In PP&L's Decommissioning Trust Fund Earnings Rate.

The OCA submits that PP&L's estimate of trust fund earnings of a 5.5 percent expected return is an unreasonably low and pessimistic projection. As OCA witness Kahal explained:

The earnings rate assumption has become more complex as a result of recent change in federal law. The 1992 Energy Policy Act (EPAct) relaxed previously federally-mandated restrictions on qualified nuclear decommissioning trust fund investments. Prior to EPAct, the trust funds were required to invest in "Black Lung" securities -- obligations of state and local governments, U.S. Treasury securities and deposits with commercial banks. While such investments generally are viewed as "safe" (i.e., free from default risk), they also provide relatively low returns. By lifting the Black Lung restrictions, the trust funds have the opportunity to invest in more attractive, higher earnings securities such as corporate stocks and bonds.

OCA St. 1 at 56. Understating the return on the Trust Fund results in a significant increase in the decommissioning revenue requirements which PP&L is seeking from its ratepayers in this case.

Moreover, such a return is totally inconsistent with the findings of all four rate of return witnesses in this case. The OCA Submits that the conservative nature of PP&L's estimated rate of return is particularly glaring in light of the 13.0% return on equity made by Mr. Moul in this proceeding.⁵¹ After analyzing

⁵¹ Mr. Moul testified that a risk premium of nearly 5 percentage points over bond yields is a reasonable view of expected equity returns. Given the current corporate bond yields of about 8.5 percent and projected yields of 8 percent, this implies a minimum return on corporate equities of 13 to 14 percent. OCA St. 1 at 59.

PP&L's investment strategy and reviewing market conditions, Mr. Kahal recommended increasing PP&L's 5.5% after tax earnings rate to a 7.5% after tax earnings rate.⁵²

In his direct testimony, Mr. Kahal identified his concerns with PP&L's earnings forecast:

PP&L's assumed rates of returns on stocks and bonds are greatly understated and out of line both with current market conditions, the long-term outlook in financial markets and available authoritative forecasts. Mr. Hill assumes a return on long-term bonds of 5.5 to 6.0 percent and a mere 10 percent rate of return on equities. This latter figure compares to the 13 percent the Company presently insists is the market-required rate of return for PP&L common stock. The return on common stocks for trust fund planning purposes should certainly exceed the PP&L authorized return, and in my opinion, should be no lower than about 12 percent. This is about a percentage point above my 11.1 percent recommendation for PP&L in this case and reflects PP&L's lower than average risk relative to the overall stock market.

OCA St. 1 at 58.⁵³ See also, PPLICA St. 9 at 24-25.

⁵² Mr. Kahal explained that after deducting transaction costs, his return estimate becomes 7.2 percent. OCA St. 1B at 3. OCA witness Catlin employed the 7.2% earnings figure in his calculations. See OCA St. 1, Sch. TSC-15.

⁵³ Mr. Kahal noted that economic forecasters and financial markets also support a higher return on equity assumption:

... Blue Chip Economic Indicator recently published its survey of long-term forecasts of yields on Aaa corporate bonds, extending from 1996 to 2007. The Blue Chip long-term consensus is about 7.9 to 8.0 percent. The yield on long term Treasury bonds would be slightly lower than Aaa corporate bonds, while the yield on average investment grade corporate bonds would be slightly higher. On the basis of this consensus forecast, coupled

(continued...)

In rebuttal, PP&L presented the testimony of John M. Chappellear. PP&L St. 17R. Mr. Chappellear characterized the 7.5% recommendation as "aggressive". In addition, he argued that Mr. Kahal's recommendation was "inconsistent and incomplete" because of the failure to consider the interrelationship between PP&L's proposed earnings rate on the trust fund and the projected cost of decommissioning the Susquehanna plant. He contended that the Company's conservative earnings assumptions on the trust fund were offset by the 4.0% inflation factor used in developing the estimate of the Susquehanna decommissioning costs. PP&L St. 17R at 3-5.

In surrebuttal, Mr. Kahal first addressed the characterization of his 7.5% recommendation as "aggressive" noting that his earnings assumption estimate is "completely supported by market data and authoritative projections." OCA St. 1A at 4. In addition, Mr. Kahal arrived at the 7.5% recommendation utilizing the Company's own 30% equity allocation. As discussed below, the OCA submits that the 30% equity allocation restricts PP&L's investment opportunities and results in lower earnings. Thus, using the 30% equity allocation increases the conservative nature of Mr. Kahal's recommendation.

⁵³(...continued)

with currently prevailing market yields, I believe a reasonable expectation for bond returns would be approximately 8 percent.

OCA St. 1 at 59-60.

Mr. Kahal also responded to Mr. Chappellear's argument that the Commission must limit the estimate of earnings on the trust fund because PP&L has selected a "conservative" cost escalation rate for its decommissioning cost estimate. As Mr. Kahal testified:

PP&L must take responsibility for the realism of its own projections of cost, and not use its misgivings over those projections as the basis for biasing a completely separate aspect of decommissioning, i.e., trust fund earnings. This "two wrongs make a right" logic must be rejected.

OCA St. 1A at 4. Moreover, the Company did not present any evidence that Mr. Kahal's 7.5% was inconsistent with current and projected market conditions.

As discussed in Mr. Kahal's surrebuttal testimony, the earnings assumptions of an 8 percent return on bonds and 12 percent on equity investments, are fully supported:

It is my position that the return expected by investors on the overall stock market should exceed PP&L's cost of equity by at least a small amount. I used a 12 percent stock market return, which compares to PP&L's ROE request of 13 percent and Mr. Moul's projection of (investor expected) stock market returns of 16 percent. Thus, my 12 percent is far more conservative than the return PP&L's own witness claims the market as a whole is expecting.

OCA St. 1B at 5. The OCA submits that the Company should be required to increase its rate of return on its decommissioning trust fund earning from 5.5% to 7.5%.

3. Mr. Kahal's 7.5% Trust Fund Earning Recommendation Is Further Supported By His Use Of PP&L's Conservative 30% Equity Allocation.

Mr. Kahal recommended a 7.5 percent average earnings rate for the trust fund horizon. This is based upon the assumption of an 8 percent average bond yield and a 12 percent return on corporate equities. OCA St. 1 at 58-59, Sch. MIK-10. As shown on Sch. MIK-10, the after-tax rate of return is 7.5 percent using the 30/70 asset allocation and 7.9 percent using the 40/60 portfolio.

OCA witness Kahal criticized the Company's asset allocation:

I believe an asset allocation to equities of 30 percent is too conservative, given the clear advantages of equity investing. These advantages include a substantially higher expected rate of return, diversification benefits and tax savings due to the tax deferral attribute of capital gains.

OCA St. 1 at 58. Recognizing that asset allocation is highly judgmental, Mr. Kahal conducted his own earnings analysis using both a 30 and 40 percent average equity ratio. PPLICCA witness Kollen also addressed the Company's 30% equity allocation. PPLICCA St. 9 at 22-23.

In rebuttal, Mr. Chappellear defended the "conservative approach" that PP&L is utilizing in its 30/70 asset allocation in the fund due to the current market conditions. PP&L St. 17R at 6. However, this argument is contradicted by information supplied by the Company. As PPLICCA witness Kollen testified:

... the Company has proposed to invest only 30% of the funds in equities. Yet equities have historically far outperformed other investments, according to data specifically

cited by the Company in response to discovery.

...

Id. at 23. The OCA submits that the Company's decision to invest only 30% of the trust funds in equities increases the conservative nature of its investment projection of a 5.5% return. Accordingly, Mr. Kahal's 7.5% return recommendation, which incorporates the 30% equity allocation, addresses PP&L's concerns while recognizing current market conditions. The OCA submits that PP&L should be required to utilize a 7.5% return as an earnings standard for the decommissioning trust fund investments. Adoption of a 7.5% return, this adjustment reduces PP&L's decommissioning claim by \$11,671,000 on a total Company basis and by \$9,157,000 on a Pennsylvania jurisdictional basis.⁵⁴ OCA St. 6, Sch. TSC-14.

D. PP&L's Claim For Nuclear Decommissioning Should Be Reduced To Reflect The Removal Of Non-Radiological Decommissioning Costs From PP&L's Cost Estimate.

There are currently four different options available to operators of nuclear generating facilities for decommissioning these facilities. As OCA witness Bridenbaugh explained:

There are three decommissioning options that are commonly considered acceptable by the NRC. They are immediate dismantlement of the reactor, mothballing for later dismantlement while residual radioactive material decays, and entombment in steel and concrete. These options are designated by NRC as DECON, SAFSTOR, and ENTOMB, respectively. Additionally, the NRC leaves an option of conversion of the plant so that it will continue to generate electricity.

⁵⁴ As shown on OCA St. 6, Sch. TSC-14, calculation of this adjustment includes the interest earnings discussed above.

OCA St. 4 at 9. A more detailed explanation of the three major decommissioning options can be found in OCA St. 4 at 10.

In this proceeding, PP&L has based its decommissioning cost estimate on a study prepared by Thomas S. LaGuardia. PP&L St. 13; PP&L Exh. TSL-2. Mr. Laguardia recommended "... that for planning purposes, the decommissioning cost funding be based upon removal of the Susquehanna SES using the DECON alternative." PP&L St. 13 at 29.⁵⁵ The OCA is not challenging PP&L's choice of the DECON alternative in this proceeding.

Included in PP&L's claim for decommissioning funding are the costs associated with decommissioning the radiological and non-radiological facilities and equipment at SSES. These costs (rounded) are listed below:

	<u>Radiological</u>	<u>Non-Radiological</u>	<u>Total</u>
Unit 1	\$304.9 million	\$45.7 million	\$350.5 million
<u>Unit 2</u>	<u>\$372.0 million</u>	<u>\$81.7 million</u>	<u>\$453.7 million</u>
Total	\$676.9 million	\$127.4 million	\$804.3 million

OCA St. 4 at 6. Non-radiological decommissioning costs are associated with the removal of buildings at Susquehanna that have not been subjected to ionizing radiation, such as cooling towers, gatehouses, and administration buildings. The OCA submits that the non-radiological decommissioning costs should not be included in rates at this time. Id. at 18. As OCA witness Bridenbaugh

⁵⁵ Mr. LaGuardia testified that pursuant to NRC regulations, it is not necessary to select a specific decommissioning method at this time. PP&L St. 13 at 42. However, he stated: "for financial planning purposes, the decommissioning cost funding should be based upon the DECON methodology. Id. at 43.

testified, non-radiological decommissioning is not required to protect the health and safety of the public. The OCA, therefore, submits that this portion of PP&L's decommissioning claim does not constitute an appropriate exception to Court and Commission precedent precluding recovery of these costs.

The precedent against early recovery of costs associated with the retirement of generating plants was first established in Penn Sheraton Hotel et al. v. Pa. P.U.C., 198 Pa. Super. 618, 623-627; 184 A.2d 324, 327-329 (1962) ("Penn Sheraton"). In Penn Sheraton, an appeal from a proceeding involving the proposed increased rates of a steam heating company, the Superior Court held that the estimated negative salvage the Steam Heating Company may incur, if and when its distribution mains are removed at some time in the future, should not be included in determining accrued or annual depreciation. The OCA submits that the Penn Sheraton precedent is applicable to the Company's request for recovery of the non-radiological decommissioning costs.

The Commission granted a limited exception to the Penn Sheraton prohibition to allow for recovery of costs associated with radiological decommissioning. However, the Commission initially limited recovery to only the costs associated with decommissioning the radioactive facilities at each unit. See Pa. P.U.C. v. Pennsylvania Electric Company, 51 Pa. PUC 649, 669 (1978) ("Penelec 1978"). In Penelec 1978, specifically excluded non-radiological decommissioning costs:

An analysis of the estimated claim shows that of the \$37.2 million, approximately \$13.6

million is for the dismantling of nonnuclear structures of TMI-1 and include the turbine buildings, cooling towers, river waterpump house, and miscellaneous structures which by their nature, pose no special concern in regard to health and safety. Thus we should consider such expense as the "prospective negative salvage" referred to in the Penn Sheraton case. Penelec's expense in this matter will be limited to an allowance of funds sufficient to accumulate the \$23.6 million now viewed as necessary for the proper containment of the nuclear components upon decommissioning.

Id. Pa. PUC at 669. See also, Pa. P.U.C. v. Philadelphia Electric Company, 55 Pa. PUC 78, 95 (1981). The Commission's limitation on nuclear decommissioning costs to radiological costs was widely accepted. In fact, PP&L's 1983 and 1985 claims for decommissioning cost recovery apparently did not include costs related to non-radiological decommissioning. Pa. P.U.C. v. Pennsylvania Power & Light Company, 57 Pa PUC 559, 606-607 (1983) ("PP&L 1983"); Pa. P.U.C. v. Pennsylvania Power & Light Company, 59 Pa PUC 332, 384 (1985) ("PP&L 1985").

The OCA recognizes that in 1987, the Commission found that non-radiological decommissioning expenses should be included in the decommissioning trusts. Pa. P.U.C. v. Pennsylvania Power Company, 64 Pa. PUC 308 (1987) ("Penn Power"). In Penn Power, the Commission allowed recovery of non-radiological decommissioning costs because it found:

... significant safety considerations were present, and that removal of contaminated facilities will severely damage a large portion of non-contaminated structures.

Id. 64 Pa. PUC at 353. The Commission relied on Penn Power in allowing recovery of non-radiological decommissioning costs in 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).

The OCA submits that the safety concerns presented in Penn Power should be reexamined in light of changing information relating to the NRC requirements and the SSES site. The Commission must consider that a number of issues will impact the Company's decisions regarding the future of the SSES site. These issues include proposed changes in the NRC regulations, potential continual use of the site, and changing technology. Most importantly, the Commission must remember that the burden remains on the Company to prove that these costs are necessary.

In a recent Illinois case, 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.

In addition, this Commission does not have a statutory obligation to return sites to greenfield status. Illinois law mandates that decommissioning trusts be established to fund the costs of decommissioning. However, it does not require that sites be returned to greenfield status. It is also clear from the evidence in the record that the NRC does not mandate greenfield status.

Re Commonwealth Edison, 158 PUR4th 458, 499 (Illinois Commerce Commission 1995). In that proceeding, as here, the electric utility based its decommissioning cost estimate on the DECON option.

The OCA submits that in view of the Commonwealth Edison decision, and the recent proposed changes in NRC regulations, as well as an examination of the facilities and equipment included in the non-radiological decommissioning estimate, the Commission should reevaluate its recent practice of including non-radiological decommissioning costs in the decommissioning estimate.

PP&L witness LaGuardia argued that it is necessary to dismantle the remaining structures at the SSES site because of safety concerns, particularly the concern that removal of contaminated material may damage the remaining structures. PP&L St. 13 at 35-38. The OCA recognizes that there are costs for removing non-contaminated items that should be included in the decommissioning estimate. However, these costs are already included in the estimate for radiological decommissioning costs.

As Mr. Bridenbaugh testified:

TLG refers to these costs as "cascading costs," which are defined as the costs associated with removing non-radioactive releasable materials in support of the decommissioning process. For example, the costs of removing a non-contaminated floor to gain access to a contaminated area is considered a cascading cost. These costs are described in the TLG cost estimate

OCA St. 4 at 22. See PP&L Exh. TSL-1, p. 4-12. As discussed below, the OCA is only requesting that the costs related solely to

non-radiological decommissioning be removed from the decommissioning cost estimate.

The OCA submits that a review of the list of structures that would be included in the non-radiological decommissioning estimate does not reveal a pressing safety concern. As shown on OCA St. 4A, Table 1, Mr. LaGuardia has included the removal of warehouses, roads and a parking lot in the non-radiological decommissioning estimates. OCA St. 4A at 3-6. The OCA submits that decommissioning of these facilities is not required to avoid a public health hazard.

First, there are no regulatory requirements that mandate non-radiological decommissioning. As Mr. Bridenbaugh noted, the Nuclear Regulatory Commission ("NRC") regulations do not require that the decommissioning cost estimates include the task of decommissioning the non-radioactive components of the plant.⁵⁶ OCA St. 4 at 18. Thus, there is no NRC regulation that supports the collection of any funding for non-radiological decommissioning, much less the full funding contained in PP&L's claim. Although Mr. LaGuardia testified that the Building Official and Code

⁵⁶ Mr. Bridenbaugh stated:

The NRC, as reflected in the PNL studies, limits its concerns to health and safety issues regarding the use of radioactive materials, and therefore it does not have regulations or guidance regarding decommissioning of non-radiological portions of the plant.

OCA St. 4 at 18.

Administrators National Building Code ("BOCA Code") could require the removal of all of the non-radiological structures from the site at the time of decommissioning, the OCA submits that there is no evidence to support the assertion that the BOCA Code would require the removal of all structures regardless of condition or possible continued usage. As Mr. Bridenbaugh explained:

The Code only requires that unsafe structures dangerous to the public or being subjected to improper use be removed or made safe and secure. The Susquehanna site is, and no doubt will be, fenced and guarded for the foreseeable future. It is a valuable resource that PP&L will likely continue to use at least as a transmission interconnection, and will probably use in some form as a generating station location. Public access is thereby precluded. Removal of damaged structures is not in question, as that is already in the radiological cost estimate.

Id. Thus, there is very little concern that these sites will be abandoned and a hazard to public safety.

Second, the Company has not yet determined its long range plans for the SSES site. The OCA submits that this plan should be developed before any non-radiological decommissioning costs are collected from ratepayers. Mr. Bridenbaugh testified it is the burden of the Company to demonstrate that existing buildings will

not be of use before complete dismantlement can be justified.⁵⁷ OCA St. 4 at 19. Importantly as Mr. Bridenbaugh testified:

... it is my opinion that most utilities will not choose to abandon sites that have been used for nuclear power. This opinion is based on the economic issues implicit in abandoning real estate that is owned by the utility, abandoning the infrastructure that was built up to support the facility (e.g. roads, housing and transmission facilities), and abandoning the significant investments which have already gone into such structures as cooling towers and cooling water intake structures. [footnote omitted] These sites are valuable resources and will likely be used far into the future.

OCA St. 4 at 19-20. The OCA submits that this consideration is particularly applicable to the SSES site since the Cowanesque water diversion system was built to make the site fully usable to Susquehanna. Id. Moreover, as noted in Mr. Bridenbaugh's testimony, new proposed regulations on site release criteria actually redefine decommissioning to allow for restricted use of a facility. Id. at 19. Thus, in the future, under these proposed regulations, utilities could be encouraged to use the non-radiological portions of the facilities as industrial sites or for power generation purposes. Id.

⁵⁷ Mr. Bridenbaugh testified that converting a nuclear station to another power generation facility is an option that has been or is being used by a number of utilities, to make use of the infrastructure, water facilities and transmission capabilities. OCA St. 4 at 21. For example, the Pathfinder research reactor, which was owned and operated by Northern States Power, was converted from nuclear generation to fossil-fuel fired generation after decontamination and separation of several of the nuclear components. Id.

Further, as Mr. Bridenbaugh testified, the NRC has not shown an active interest in regulating non-radiological decommissioning:

There has not been an expression of regulatory interest in removing non-radioactive structures. When the NRC responded to comments on the draft regulations for decommissioning, it specifically stated that, "[T]he use made of the facility after termination of the NRC license is independent of the alternative used to decommission the facility. With regard to reuse of the site for nuclear purposes, there is nothing in this rule preventing such reuse." [footnote omitted]

OCA St. 4 at 19. Since decommissioning only extends to contaminated structures, it implicitly allows the reuse of remaining buildings. The OCA submits that PP&L has failed to demonstrate that the non-contaminated facilities at SSES could not continue to be utilized.

In rebuttal, PP&L witness LaGuardia contends that Mr. Bridenbaugh's recommendations regarding the disallowance of non-radiological decommissioning costs do not "justify" the disallowance of these costs. PP&L St. 13R at 3-5. Although, Mr. LaGuardia agrees that NRC regulations do not require the removal of non-radiological structures and equipment, he argues that the NRC has in the past dictated site restoration activities as part of the nuclear delicensing process. PP&L St. 13R at 3. However, in response to cross-examination, after identifying the locations where the NRC dictated site restoration activities, Mr. LaGuardia was asked:

Q. And all of these involved cancellation of a second or in North Anna, a third and fourth unit at multiple-unit sites; is that correct?

A. That's correct, to return the site to a preconstruction condition.

Tr. 2086. The OCA submits that these sites can easily be distinguished from SSES site, which is not the location of a canceled plant. In the cases cited by Mr. LaGuardia, site restoration was required at multiple unit sites where one unit was placed into operation and the other units under construction were canceled.

In surrebuttal, Mr. Bridenbaugh responded to Mr. LaGuardia's argument that the SSES site will be a public danger, absent non-radiological decommissioning:

I believe that if PP&L does in fact totally abandon the Susquehanna site as a working generating facility, it may be advantageous in the long run to tear down all structures and restore the site as assumed by the TLG Study. However, as I state in my original direct testimony, I do not believe that is what the ultimate use will be of this valuable property. It was selected, after a lengthy decision process, as an optimal location for generation and transmission of electrical energy, and it will continue to be suitable for that purpose long after SSES ceases operation.

It may be that there will be a transition period between cessation of SSES operation and the development of a new PP&L facility. Until it is determined what that new facility will be, and which of the existing structures may be useable, it is my opinion that the existing protective fencing with protective guard personnel in place would suitably protect the public at a minimal cost.

OCA St. 4A at 2. In addition, Mr. LaGuardia's argument against waiting for the Company to determine its plans at the site assumes that PP&L will not be able to recover these costs in a timely fashion. The OCA submits that just because PP&L does not recover the non-radiological decommissioning costs at this time does not mean that the Company is precluded from ever recovering these costs. As discussed above in Penelec 1978 the Commission allows recovery of these costs when at the time incurred through net negative salvage. See also, Penn Sheraton Hotel et al. v. Pa. P.U.C., 198 Pa. Super. 618, 623-627; 184 A.2d 324, 327-329 (1962).

Mr. LaGuardia also disputed Mr. Bridenbaugh's observations regarding the future use of the SSES site, arguing that he has limited the decommissioning estimate to the "structures and equipment located within the restricted areas of the site." PP&L St. 13R at 4. However, as shown on Table 1 and Schedule 1 of Mr. Bridenbaugh's surrebuttal testimony:

All of the major structures identified thereon, and many minor structures not identified, are listed in the TLG study as being slated for removal, even though some of them are not within the "restricted area" as it is commonly defined by the NRC. Attached as Table 1 is a listing of the buildings identified in the TLG backup papers scheduled for removal and included in the cost estimate. [footnote omitted] It seems to include all structures associated with the SSES plant, many of which would not be expected to be radioactive nor to contain radioactive materials. Even the warehouse, roads and parking lot, some of which arguably could be said to be outside of the "restricted area," are scheduled for removal or for "cover with fill." ...

OCA St. 4A at 2-3 (emphasis added). As Mr. LaGuardia testified in response to cross-examination, his study even removed the warehouses built for decommissioning work at the site. Tr. 2085.

Finally, Mr. Bridenbaugh responded to Mr. LaGuardia's claims that "any attempt to quantify the costs and benefits of specific site plans thirty to forty years into the future would be a meaningless exercise", as follows:

I find it somewhat ironic that Mr. LaGuardia makes such a statement when the subject he testifies to is a very similar study, namely the decommissioning of the SSES plant which will not be completed, under the most optimistic of circumstances, until 2033, some 38 years in the future. Even though it is a long time into the future, it is incumbent on the utility to attempt to develop a plan and quantify the effects of that plan so that the current and future ratepayers are fairly treated.

PP&L St. 13R at 5; OCA St. 4A at 7. In view of the proposed NRC regulation changes and recognizing that the SSES site will still be a viable site for siting future electric generation, after radiological decommissioning is complete, the Commission should reevaluate its policy of including non-radiological decommissioning costs in decommissioning cost estimates. The OCA submits that PP&L's decommissioning cost estimate should continue to be based solely on radiological decommissioning costs. Removal of the non-radiological costs from PP&L's decommissioning claim results in a reduction of \$3,195,000 on a total Company basis and by \$2,506,000 on a Pennsylvania jurisdictional basis.

E. PP&L's Decommissioning Estimates Should Be Reduced To Reflect The Removal Of Contingencies.

In its estimate for radiological decommissioning costs, the Company included \$106,569,000 for contingencies.⁵⁸ Mr. LaGuardia testified that "[A]n average contingency was added to allow for the effect of unpredictable program problems on costs." PP&L St. 13 at 21. OCA witness Bridenbaugh testified that:

The estimate includes a range of contingency factors to the different tasks which results in a total contingency of approximately 18% based on the overall estimate. Contingencies range by decommissioning task from 15% to 75%. [footnote omitted] The radiological portion of the estimate includes an overall contingency of approximately 19%.

OCA St. 4 at 23; Exh. DGB-5. As shown on OCA St. 4, Exh. DGB-12, Mr. Bridenbaugh adjusted the TLG estimate to remove all of the Period 3 non-radiological costs, as well as the contingency factors for Periods 1 and 2.⁵⁹ The specific costs (in millions) removed are as follows:

⁵⁸ As discussed above, the OCA submits that the Commission should remove the contingencies associated with the radiological decommissioning. However, should the Commission fail to adopt the OCA's adjustment removing non-radiological costs from PP&L's decommissioning estimate, the Commission should still remove any contingencies included in the non-radiological cost estimate. As Mr. Bridenbaugh testified the Company included a contingency of \$16.235 million in its non-radiological cost estimate. OCA St. 4 at 31.

⁵⁹ Mr. Bridenbaugh explained that the TLG cost estimate is segregated into three distinct periods. Period 1 covers the initial planning and preparation work. Period 2 covers the work of removal of the radiological equipment and materials, and Period 3 covers the removal of the non-radiological facilities.

	<u>Contingency</u>	<u>Total</u>	<u>% Contingency</u>
Period 1 (Planning)	\$9.074	\$68.704	15.2
Period 2 (Rad Removal)	\$97.495	\$610.877	19.3
Period 3 (Normal Removal)	\$16.235	\$124.679	15.0

OCA St. 4 at 31. As discussed below, the OCA submits that the Company should not include these additional contingencies in its decommissioning cost estimates.

The Commission has in the past, removed contingency costs from decommissioning cost estimates. In PP&L's 1983 and 1985 cases the Commission disallowed the 25% contingency factor contained in the decommissioning costs estimates. 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 which is too speculative in nature and which is as likely to fluctuate downward as upward as the state of the art develops.

Id. 57 Pa. PUC at 607. Similarly, in the recent Commonwealth Edison Order, the Illinois Commerce Commission rejected a 25% contingency factor stating:

Based upon the evidence of record, the Commission is of the opinion that a contingency factor should be excluded. The Commission is persuaded by the evidence that the use of site specific studies reduces the need for inclusion of a contingency factor.

Re Commonwealth Edison, 158 PUR4th 458, 505 (Illinois Commerce Commission 1995). The OCA submits that the Commission's concern over the speculative and fluctuating nature of contingencies in those proceedings is equally applicable to PP&L's decommissioning cost estimate which contains significant contingencies in this proceeding.

OCA witness Bridenbaugh testified that there is no justification for using a contingency factor in the decommissioning estimate:

contingency factors are used in construction and decommissioning cost estimates, they are intended to cover all uncertainties which the estimator cannot anticipate. Said another way, using a contingency factor implies that the risks of potential uncertainties will increase the ultimate cost of decommissioning. However, assumptions embedded within the decommissioning cost estimates, and additional assumptions concerning inflation and earnings rate assumptions, could change the direction of the risks. In effect, the costs could be lower than estimated.

OCA St. 4 at 24. Mr. Bridenbaugh identified a number of reasons that the contingencies should not be included in the radiological decommissioning cost estimates. OCA St. 4 at 24-30. First, Mr. Bridenbaugh testified that low-level radioactive waste ("LLRW") disposal costs accounts for almost 27% of the Susquehanna decommissioning cost estimate. OCA St. 4 at 25. Mr. Bridenbaugh testified that the wide range of uncertainties regarding LLRW did not "justify the use of a fictitious disposal cost that is further inflated by contingency adders." OCA St. 4 at 25.

In addition, PP&L will not begin to decommission the SSES site for until 2022, the OCA submits that experienced gained in decommissioning other nuclear plants during these 27 years may well reduce costs. OCA St. 4 at 29. Further as Mr. Bridenbaugh testified: "[T]here has been much discussion in the nuclear industry of extending the life of plants for twenty or more years beyond their existing licenses (present licenses are 30-40 years)." Id. Although, the Company currently has no plans to extend the Susquehanna license, a life extension would have the effect of spreading payments out over a longer period of time, thus reducing the annual payments.

Finally, one of the most compelling reasons for reducing the contingency rate is that most states and the NRC require that cost estimates be periodically updated and thus new versions should be able to capture much of the technical and economic uncertainties. OCA St. 4 at 30. PP&L has indicated that it plans to internally update its cost estimate every two years. OCA St. 4 at 13; OCA Cross Exam Exh. 15. The OCA submits that all costs related to contingencies should be removed from the radiological cost estimates. See also OTS St. 2 at 19-23.

In rebuttal, Mr. LaGuardia argued that because of TLG's experience, particularly its experience in decommissioning Shippingport, its contingency estimates should be accepted. However, as Mr. Bridenbaugh testified in surrebuttal:

Although Mr. LaGuardia's Rebuttal Testimony is silent on the numerical amount of contingency used at Shippingport, as reported by the U.S. DOE, decommissioning costs there came in some

8% below budget, when the contingency is included.

The contingency amount included in the Shippingport decommissioning cost estimate was \$11.6 million of the total \$98.3 million estimate. This equates to a 13 percent contingency factor. Since the actual cost of Shippingport decommissioning was \$91 million, only \$4.3 million of the contingency was used. Therefore, the actual contingency used was 5% of the base estimate. [footnote omitted] This can be compared to the overall contingency of approximately 18% that has been applied in the TLG estimate of the SSES costs.

OCA St. 4A at 8, Exh. DGB-13. Moreover, as Mr. Bridenbaugh testified, Mr. Laguardia's reliance on the decommissioning activities at Yankee Rowe and Rancho Seco is either inapplicable or "premature" since these facilities are only in the initial phases of decommissioning.⁶⁰

The OCA submits that the Commission should continue the policy established 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) and remove the contingencies included in PP&L's decommissioning estimate. Removal of the contingencies costs from PP&L's radiological decommissioning

⁶⁰ Mr. Bridenbaugh testified:

Of the four plants listed, only one, Pathfinder, has been completely decommissioned, and that plant was small and of an atypical design, as was implied by Mr. Gadsden in his cross-examination of me. As to the other three plants, the actual decommissioning is not nearly complete or is not relevant to the decommissioning of the SSES.

OCA St. 4A at 8-9.

claim results in a reduction of \$3,207,000 on a total Company basis and by \$2,516,000 on a Pennsylvania jurisdictional basis.

F. Conclusion

The OCA submits that PP&L's \$30.042 million claim for SSES decommissioning costs in this proceeding is significantly overstated and must be reduced by \$21.780 million to more accurately reflect the Company's decommissioning costs. As discussed above, the Company's trust fund estimates failed to include the interest earned on the trust funds during the ten to twelve year time period over which decommissioning is scheduled to occur. Recognition of the interest earnings reduces PP&L's decommissioning claim by \$3,105,000 on a total Company basis and by \$2,436,000 on a Pennsylvania jurisdictional basis. In addition, the OCA submits that PP&L underestimated the rate of return that the trust fund will earn over the period 1995 until completion of decommissioning, adopting the 7.5% rate of return recommended by the OCA in this proceeding results in a reduction to PP&L's decommissioning claim by \$11,671,000 on a total Company basis and by \$9,157,000 on a Pennsylvania jurisdictional basis.

Moreover, PP&L's decommissioning costs estimates should be adjusted to remove costs associated with non-radiological decommissioning. The OCA submits that non-radiological decommissioning is not required to protect the public health or safety. Removing the non-radiological costs from PP&L's decommissioning claim results in a reduction of \$3,195,000 on a total Company basis and by \$2,506,000 on a Pennsylvania

jurisdictional basis. Finally, PP&L has included contingencies ranging from 15% to 75% in its decommissioning cost estimate, the OCA submits that ratepayers should not be required to pay for these speculative costs. Eliminating the contingencies costs from PP&L's radiological decommissioning claim results in a reduction of \$3,207,000 on a total Company basis and by \$2,516,000 on a Pennsylvania jurisdictional basis.