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BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

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APPENDIX C

Tanya J. McCloskey  
Mary C. Kenney  
Gicine P. Brignola  
Assistant Consumer Advocates

**DOCKETED**  
JUN 16 1995

For:  
Irwin A. Popowsky  
Consumer Advocate

Office of Attorney General  
Office of Consumer Advocate  
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Harrisburg, PA 17120  
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DATED: June 16, 1995

**DOCUMENT  
FOLDER**

INDEX TO UNPUBLISHED DECISIONS

Pa. P.U.C. v. Pennsylvania American Water Company, Docket No. R-00932670 (July 26, 1994).

Pa. P.U.C. v. Pennsylvania Gas & Water Company, Docket No. R-00922482 (July 23, 1993).

Pa. P.U.C. v. Pennsylvania Power & Light Company, Docket No. R-881170 (January 27, 1989).

Pa. P.U.C. v. Roaring Creek Water Company, Docket No. R-00943177 (May 31, 1995).

Pa. P.U.C. v. West Penn Power Company, Docket No. R-00942986 (December 28, 1994).

Pennsylvania Electric Company Supplement No. 96 to Tariff Electric-Pa. P.U.C. No. 75, Docket No. R-00943280 (February 24, 1995).  
Statement of Commissioner John Hanger.

Petition of Pennsylvania Power & Light Company for Declaratory Order, Docket No. P-820367 (July 29, 1982).

Petition of Pennsylvania Power & Light Company for Declaratory Order, Docket No. P-830461 (November 9, 1983).

PENNSYLVANIA  
PUBLIC UTILITY COMMISSION  
Harrisburg, PA 17105-3265

Public Meeting held July 21, 1994

Commissioners Present:

David W. Rolka, Chairman, Concurring & Dissenting in part  
Joseph Rhodes, Jr., Vice-Chairman  
John M. Quain, Concurring & Dissenting in part  
Lisa Crutchfield, Concurring & Dissenting in part  
John Hanger

Pennsylvania Public Utility Commission  
Office of Consumer Advocate  
Louise Bernick  
Armco Advanced Materials Company  
Office of Small Business Advocate  
Terry Beane  
Pennsylvania-American Water  
Large User Group  
Ronald A. Coddling  
Mark E. Bartas

R-00932670  
R-00932670C0001  
R-00932670C0002  
R-00932670C0003  
R-00932670C0004  
R-00932670C0005  
  
R-00932670C0006  
R-00932670C0007  
R-00932670C0008

v.

Pennsylvania-American Water Company

Affiliated Interest Agreement between  
Pennsylvania American Water Company  
and American Water Works Service Company,  
Inc.

G-00940374

OPINION AND ORDER

In its Replies, PAWC disagrees with the OCA's characterization and position (PAWC Reply Exceptions at 22-23). The Company urges the Commission to adopt the ALJ's well-reasoned recommendation regarding the inapplicability of Section 2102 to Service Company provision of property and equipment to PAWC through Occoquan based, in part, on the OCA's mischaracterization of these leases as previously hidden when, in fact, they had been closely scrutinized in PAWC 1992 and in an earlier Commission-sponsored Management Audit.

On consideration of the issue, we agree with the ALJ's conclusion that review of the particular contractual relationships encompassed in this proceeding do not need further review under Section 2102(a). We conclude that any necessary review of these contractual arrangements have clearly been satisfied by our prior approval of the Service Contract between the Service Company and PAWC, our close scrutiny and determination in the PAWC 1992 proceeding that these contractual arrangements were reasonable, and our prior review in the earlier Management Audit. Consequently, we see no need to conduct the additional review of these particular contractual arrangements advocated by the OCA in this proceeding.

**L. Hershey Treatment Plant "Early Window" Costs**

On August 14, 1992, the Company filed a Petition for Declaratory Order requesting that the Commission approve certain accounting procedures in order to permit the synchronization of the commercial operation and rate recognition of its new Hershey Treatment Plant, which was placed in service on November 1, 1992. The Petition sought permission to defer the capital costs (i.e., carrying charges and depreciation) associated with the Hershey Treatment Plant from the date of commercial operation to the date the plant would be reflected in rates. The Petition also sought

approval of a ten-year amortization period for these interim expenses so that they would commence with the rates established at the conclusion of its prior rate case, which was then pending as PAWC 1992.

On October 22, 1992, the Commission entered an Order at Docket No. P-00920603 which authorized, and in fact required, PAWC to utilize deferred accounting for the interim expenses that would be incurred during the period from the date of commercial operation to the date the plant would be reflected in rates. However, the Commission did not approve PAWC's recovery of the deferred costs but instead concluded that rate recovery of these such would be addressed in a future rate proceeding following PAWC 1992. The Company now seeks to recover \$92,461 consisting of a portion of the 10-year amortization of the deferred costs that were deferred by the October 1992 order. R.D. at 75-76.

The R.D. recommended allowance of that expense even though the normal recovery of these deferred expenses would be prohibited as retroactive ratemaking. R.D. at 76-77. The R.D. did so based on the conclusion that these deferred expenses were excepted from the general ban because they were nonrecurring and extraordinary expenses. R.D. at 76-77.

The OCA and OTS filed Exceptions to this recommendation (OCA Exceptions at 10-17; OTS Exceptions at 8-10; OTS Reply Exceptions at 12). The OCA excepted on the grounds that their recovery contravenes the ban on retroactive ratemaking, that the Company has failed to establish the expense as an exception to the ban, and that the Company has failed to establish either the rate recovery treatment or reasonableness of the claimed expense (OCA Exceptions at 11-12, 13-16, 13). OTS excepts on the grounds that

the ALJ wrongfully permitted recovery of the post-in-service AFUDC expense represented by the deferred expenses, PAWC should bear the impact of the fact that these AFUDC expenses fell outside the applicable test years given their annual rate case filings, and that Commission practice and recent Commonwealth Court precedent prohibit recovery (OTS Exceptions at 8-10).

The Company challenges the OCA and OTS position in several respects (PAWC Reply Exceptions at 12-18). The Company claims that the current consideration of rate treatment for this expense based on the Commission prior approval of deferred treatment does not constitute retroactive ratemaking (PAWC Reply Exceptions at 15). The Company further claims that the earlier denial of amortized recovery was without prejudice to a substantive determination on the merits in the later proceeding (PAWC Reply Exceptions at 15). The Company also claims that prior Commission precedent permits amortization of such early window costs given the practical inability to precisely time the placement of plant in service with rate case filings and that inclusion of such expenses would not constitute retroactive ratemaking (PAWC Reply Exceptions at 14-16). In addition, the Company claims that the OCA's reliance on the May 1994 PP&L decision of the Commonwealth Court is misplaced because that decision is not the final word on the matter, may be subject to Supreme Court appeal, and is distinguishable from this case on the facts (PAWC Reply Exceptions at 17-18). Finally, the Company claims that the recovery period for such unusual capital expenses occurring outside the test year is a determination within the Commission's expertise and that denial of the expenses subject to the October 1992 order will adversely impact the Company's financial condition given the \$20 million dollar nature of the expense in question. PAWC R.E. at 17-18.

We reject the OCA and OTS claim that rate recovery of the "early window" deferred accounting costs would constitute impermissible retroactive ratemaking. However, the Company's claim must fail given their failure to provide sufficient evidence to meet the threshold showing of adverse financial impact.

The OCA cites the recent Commonwealth Court decision of May 1994 involving PP&L's recovery of FAS 106 costs. Popowsky v. Pa.P.U.C., No. 1315 C.D. 1993 (May 26, 1994) (hereinafter "PP&L"). The OCA cites PP&L for the proposition that rate recovery of the early window Hershey Plan costs constitutes retroactive ratemaking. We obviously disagree with the Court's decision, in part, because the effect of that decision would be to overturn our prior approval for deferred accounting and deferred ratemaking treatment of the FAS 106 expense at issue in that case. In this case, our earlier decision limited our approval of the Hershey Plant costs for accounting purposes only. Even more to the point, the Commonwealth Court's approval of the base rate recognition of PAWC's FAS 106 costs is more squarely on point. In that decision, the Commonwealth Court ruled:

Furthermore, in both Pike and Philadelphia Electric "[a]n exception to this rule in the case of retroactive recovery of unanticipated expenses has been recognized where the expenses are extraordinary and nonrecurring." [citations omitted]. In Pike, this Court rejected the company's argument that the Commission could not order the company to account for loss carryovers occurring in the past, available as deductions for federal income tax purposes, since they were extraordinary losses to be amortized over a period of years.

In Philadelphia Electric, this Court declined to permit the utility to recover part of the cost of deferred pollution control facilities' expense amortized over a three year period, because they were past expenses that could have been anticipated and requested in a prior

rate case proceeding and they were neither extraordinary nor non-recurring.

In this case also, PAWC had no opportunity to seek recovery of its OPEBs until the issuance and acceptance of SFAS 106 and the Commission approval of accrued accounting treatment of such obligations. We, therefore, hold that PAWC's application is timely; that the transitional obligation arises from an extraordinary and non-recurring one-time event -- the change from cash to accrual accounting -- and the allowance of the recovery of that obligation amortized over a period of twenty years is not retroactive ratemaking.

PP&L, Slip Op. at 6-8. With regard to the Hershey Plant costs, there is no question that the Company's ratemaking claim is timely given that the claim was initially made in its prior base rate case which was the first case following the PUC's approval of deferred accounting for these costs. The Commission deferred the claim to a subsequent proceeding. The present case is the next base rate case following the Commission's deferral of the ratemaking treatment of these costs. There is also no question that these cost are non-recurring in the sense that the costs relate to a one-time event of this large project being operational. Nonetheless, it is appropriate to evaluate these costs according to the rules governing amortizations of extraordinary and non-recurring costs because the Company's claim represents a request for recovery of costs in addition to an ongoing level of rate recovery associated with the operation of the Hershey Plant.

As to whether these costs are extraordinary, we are guided by the appellate precedents as well as prior Commission precedent addressing ratemaking claims for deferral costs pursuant to window petitions. The PUC decision in the 1990 PECO base rate case required the utility to show that window costs are both extraordinary and non-recurring, and that the denial of recovery

would have a substantial negative financial impact on the utility. We view the first evidentiary prong as requiring a qualitative demonstration and the second prong as requiring a quantitative demonstration that the costs are extraordinary. The concurring opinion in the 1990 PECO case clearly advised that this evaluation must proceed on a case by case basis, looking at the financial impact of the utility during the period that the costs were experienced.

PAWC has satisfied the qualitative evidentiary showing that the Hershey Plant costs were extraordinary, relying on the 1992 PG&W case. With regard to the quantitative evaluation, however, PAWC's evidence is insufficient. As OCA pointed out in Exceptions, there was no comparison of the potential effect on PAWC's earnings with and without rate recovery of these window costs. Simply because the Company may not have earned its authorized rate of return during the period in question that the costs were experienced does not meet its burden of showing substantial negative financial impact. For these reasons, we reject PAWC's ratemaking claim for the Hershey window costs.

#### **M. Purchased Power**

OTS's witness Mr. Laudenslager recommended a disallowance of \$94,863 of PAWC's originally claimed increase in purchased power (electricity) costs. This amount represents a portion of the estimated increase in charges for electrical service attributed to a rate increase anticipated by West Penn Power (R.D. at 77)

PAWC witness Balmer indicated in her rebuttal testimony that the Company adopted this proposed adjustment and eliminated the estimated West Penn Power increase from its claim for purchased

The stipulation reserves for litigation the issue of whether and to what extent the customer charge should be increased for residential customers having 5/8 - inch and 3/4 - inch meters.

#### **B. Customer Charges**

Under PAWC's Rate Zone 1 proposal, customer charges for all classes of customers and all meter sizes were increased by an amount approximately equal, on a percentage basis to the proposed system average increase. (PAWC Ex. 10 - A. Sch. F) Thus, a residential or commercial customer with a standard 5/8 - inch meter would experience a monthly increase from \$8.40 to \$9.00 or 60 cents. If the Commission grants less than PAWC's total requested increase the proposed customer charge would be scaled-back uniformly.

The OTS contends that total customer charge revenues exceed the cost allocated to the customer functions. (OTS St. 5, p. 5) The OCA contends that customer charge revenues exceed customer costs even for the residential class. (OCA St. 4, p. 14 and Sch. TSC - 3)<sup>16</sup>

PAWC witness Stout explained:

Although the revenues under proposed rates from customer charges exceed the allocated customer costs; this is only true with respect to the commercial, industrial public and other water utilities classes. The proposed customer charge revenue for residential customers is less than the customer costs that I have allocated to the class. Thus, for over 90 percent of the Company's customers, the unpro-

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<sup>16</sup> The Stipulation also provides that customer charges for commercial customers with 5/8 - inch and 3/4 - inch meters will be equal to the residential customer charges for similarly sized meters.

posed customer charges are less than the allocated customer costs.<sup>17</sup>

(PAWC St. 10-R, p. 24)

PAWC argues that OTS witness Rodrock has accepted that customer charges should be designed to recover customer costs and has accepted its witness' allocation of costs to the customer function. Therefore, OTS position that customer charges not be increased is not applicable to the residential class. (PAWC Main Brief, p. 131)

The OCA did its own computation of customer costs which shows that customer charge revenues exceed customer costs even for the residential class. (OCA St. 4, p. 14 and Sch. TSC-3) The OCA calculation excluded all so-called "indirect" costs, because the OCA determined that the Commission "in various rate proceedings has found that customer service charges need only be high enough to recover direct customer costs." (OCA St. 4, p. 14)

PAWC witness states that the costs labelled "indirect" by the OCA are, in fact, cost that should be properly allocated to the customer function. Witness Stout explained:

Mr. Catlin has excluded an allocation portion of administrative and general expenses, as well as the depreciation expense and rate base for an allocable portion of general plant. The administrative and general costs and the related plant are required to support all functions of the Company including the customer accounting and collecting function. Such costs should be prorated to all cost functions

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<sup>17</sup>

The magnitude of the revenue deficiency is also significant. For the residential class, customer costs exceed customer charge revenue by over \$1.5 million at the Company's proposed rate level.

including the customer cost function. It is inappropriate to exclude such indirect costs from any function whether it be the provision of treatment, transmission, distribution or customer services.

(PAWC St. 10-A, pp. 25-26)

On cross-examination OCA witness Catlin, according to PAWC, admit that "indirect" costs should be allocated to the customer function as done by PAWC witness Stout:

Q. Just to summarize and, for purposes of clarity, then, under the application of the base extra capacity method, some portion of administrative and general costs would be allocated to the customer cost function. Is that correct?

A. [Mr. Catlin] Yes. Some costs are allocated to the customer function because they are allocated there in proportion to other directly assignable costs. (Tr. 756)

PAWC contends that there is no Commission policy precluding the recovery of "indirect" costs in the customer cost. In Pennsylvania Public Utility Commission v. Philadelphia Suburban Water Company, Docket No. R-911892 (October 18, 1991), pp. 130, 136, the PAWC states that the Commission rejected an OCA argument that ". . . indirect costs . . . should not be used in the calculation of customer costs."

The OCA argues that the utility can recover only basic customer costs" in customer charges. Pennsylvania Public Utility Commission v. Metropolitan Edison, 60 Pa. PUC 349 (1985). In Pennsylvania Public Utility Commission v. West Penn Power Company, 59 Pa. PUC 552, 612, 69 PUR 4th 470, 521 (1985), the Commission

defined the "basic customer cost" method for developing customer charges. The Commission stated:

He [OTS witness Strausbaugh] defined "basic customer cost" as those expenses for items the Company must have in place each month for each customer. This includes the costs for the meter and service drop, meter reading and billings. It excludes consideration of asserted "customer-related" costs of transformation and distribution plant.

\* \* \* \* \*

We have adopted the "basic customer cost" method for several major Pennsylvania electric utilities (cite omitted), and we now conclude that it is likewise appropriate for WPP.

This analysis of customer costs has also been adopted by the Commission for water utilities. See, Pennsylvania Public Utility Commission v. Mechanicsburg Water Co., Docket No. R-00922502, Order entered July 22, 1993; see also, Pennsylvania Public Utility Commission v. Pennsylvania Gas and Water Company, Docket No. R-00922482, Order entered June 23, 1993 (PG&W). In PG&W, the Commission adopted ALJ Solomon's recommendation regarding the appropriate costs to be included in a customer charge:

. . . a true customer charge should only include costs that are directly related to metering, billing, meters, and services. . .

Id. at 119-120.

The OCA contends that the residential customer charges are adequate to recover allowable basic customer costs. (OCA St. 4 at 14) OCA witness Catlin included only the basic customer costs in his calculation of the customer charge as allowed by the Commission. Id. Witness Catlin identified the items as follows:

The direct costs to be included in a customer service charge include: the depreciation, return and income taxes associated with meter

and services investment; the O&M costs for meters and services; and the expenses associated with meter reading and billing. The revenues from the existing Zone 1 service charges are more than sufficient to recover these direct customer costs. Therefore, I am recommending that the existing service charges applicable to customers in Zone 1 not be increased.

(OCA St. 4 at 14)

From PAWC figures, the residential class should recover \$20,601,354 for the customer charge. (OCA St. 4, Sch. TSC-3) PAWC actually receives revenues, with its existing residential customer charges of \$34,895,978. Id. This calculation is consistent with Commission precedent. (OCA St. 4A at 5)

About PAWC's "additional costs", witness Catlin said:

The measurement of direct customer costs which I utilized is consistent with the definition of direct customer costs which the Commission has found to be appropriate in various rate proceedings of Pennsylvania utilities. Moreover, as shown on Schedule TSC-4, customer charge revenues still far exceed direct customer costs, even if all of the additional direct costs which Mr. Stout has identified on 25 of PAWC Statement 100-R (sic) are included. Therefore, no increase in the current Zone 1 customer charge is necessary or appropriate.

(OCA St. 4A at 5)

With the "additional direct" costs included, the customer costs would total \$28,676,820; four million dollars less than the Company currently recovers through its customer charge. (OCA St. 4A, Sch. TSC-4)

The OCA submits that if the residential class recover the basic customer costs for that class, whether the "additional direct" costs claimed by the Company are included or not, there

should be no increase in the residential customer charges in this case.

The OCA argues that only those costs which this Commission has found acceptable to include in the customer charge should be recovered through the customer charge. Therefore, any uniform increase not tied directly to an increase in direct customer charge-related expenses is inappropriate.

The ALJ recognized that PAWC's position, simply stated, is that because its overall costs have increased, the customer charge should be increased proportionately. This Commission has consistently rejected such proposed increase in the absence of evidentiary support.

In Pennsylvania Public Utility Commission v. West Penn Power, Docket No. R-00922378, Order entered May 14, 1993, this Commission was faced with a similar argument. In that case, the ALJ rejected a proposed 20% increase in the customer charge. A lesser increase, which would have served the principles of gradualism, was also rejected because it was not based upon any increase in basic customer costs. In regard to the full increase requested by the Company the ALJ reasoned:

I am inclined to agree with OCA on this issue. I believe the evidence shows that WPP's proposed residential customer charge includes costs that go beyond the definition of true customer costs as set forth by the Commission in West Penn 1985. There is no doubt that WPP included costs in its analysis that are not properly considered to be customer costs. Furthermore, I agree with OTS that the proposed 20% increase in the residential customer charge violates the principle of gradualism.

WPP, supra, at 217 (emphasis added).

Regarding the lesser proposed increase the ALJ stated:

the proposed charge is not based upon any analysis of WPP's customer costs and thus, should not be accepted. Therefore, I recommended that WPP's residential customer charge remain at its current level. . .

Id. at 217 (emphasis added).

The OCA opposed the Company's inclusion of these "additional direct" and "indirect" costs in the customer charge. These indirect costs are not basic customer costs as the Commission defines those costs in previous cases. The expense amount attributed to each of these accounts does not increase or decrease with the addition or loss of each residential customer. For these reasons, the Commission should reject PAWC's attempt to include these additional costs in the customer charge and only allow recovery of appropriate amounts in the volumetric charge.

Not only does the company include improper costs in its customer charge expense calculation, but it erroneously concludes that even with those costs included, the proposed increase in the customer charge under-recovers the customer charge expense for the residential class.

The Company is currently over collecting customer charge revenues from the residential class. (OCA St. 4A at 5) If the Company is permitted to implement its customer charge allocation, this over-collection will be exacerbated. OCA submits, therefore, that the customer charge for the 5/8" and 3/4" meter should remain at their present levels.

OTS witness Mr. Rodrock recommended that customer charges remain at present rates. OTS argues that all metered customers are

subject to a monthly customer charge, based on the meter size serving the customers. Customer charges should recover customer costs which are incurred regardless of consumption. In response to an interrogatory of the OTS, OTS-RS-3, PAWC indicated that annualized customer charge revenues are \$44,131,000 under present rates. PAWC indicated that customer charge revenues will be \$47,283,000 (OTS-RS-1). Thus, after PAWC's rate increase proposal, customer charge revenues would be \$3,960,000 higher than related customer costs. (OTS St. 5, pp. 5, 6)

The purpose of a customer charge is to recover costs up front each month before a customer is charged for consumption. Customer charges do not recover demand costs.

Customer charges appropriately recover billing and collection costs, meter reading costs and costs of meters and services. Because PAWC's current customer charge revenues recover more than related customer costs, the Commission should reject PAWC's proposed increase to customer charges for 5/8" and 3/4" service to residential and commercial customers.

Therefore, for the current customer charge for 5/8" and 3/4" meters, the ALJ accepted the OCA and OTS positions that since customer costs are more than covered by the current customer charge, no additional amount should be added to the current customer charge.

#### **1. PAWC Exceptions**

PAWC filed Exceptions to the above recommendation. On consideration of the R.D., and the Exceptions, we find that PAWC has raised no issues overlooked in the R.D. We are, therefore, in agreement with the reasoning and conclusion therein. We find the

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PENNSYLVANIA  
PUBLIC UTILITY COMMISSION  
Harrisburg, PA 17105-3265

Public Meeting held July 22, 1993

Commissioners Present:

David W. Rolka, Chairman  
Joseph Rhodes, Jr. Vice-Chairman  
John M. Quain  
Lisa Crutchfield  
John Hanger

JUL 23 1993

Office of Attorney General  
OCA

Pennsylvania Public Utility Commission  
v.  
Pennsylvania Gas & Water Company

R-00922482

OPINION AND ORDER

BY THE COMMISSION:

On June 25, 1993, Pennsylvania Gas & Water Company filed Supplement No. 119 to Water-Pa. P.U.C. No. 4 to become effective June 23, 1993. The aforementioned tariff supplement implements the rate structure and rate design as permitted in the ALJ's Recommended Decision and adopted by our Order entered June 23, 1993.

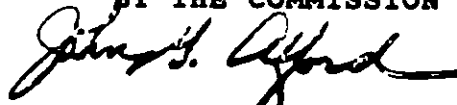
The proposed rates, rules and regulations as contained in this tariff supplement are consistent with the ALJ's Recommended Decision and our Opinion and Order entered June 23, 1993. Rates have been increased by \$4,968,995, resulting in annual jurisdictional operating revenues of \$33,421,704; **THEREFORE,**

IT IS ORDERED:

1. That Supplement No. 119 to Tariff Water-Pa. P.U.C. No. 4 be, and hereby is, permitted to become effective for service rendered on and after June 23, 1993.

2. That our investigation at Docket No. R-00922482, be and hereby is, terminated and the record be marked closed.

BY THE COMMISSION



John G. Alford  
Secretary

(SEAL)

ORDER ADOPTED: July 22, 1993

ORDER ENTERED: JUL 23 1993

## VI. EXPENSES

### A. Deferred Treatment Plant Costs

On June 5, 1990, the Company petitioned the Commission for a declaratory order allowing PG&W early window accounting treatment whereby the utility would defer the costs of the four water treatment plants nearing completion in the Scranton Water Rate Area. Approval of deferral accounting would provide for the recognition of certain costs associated with the operation of these plants prior to their recognition in base rates. PG&W has listed deferred plant start-up costs of \$666,842 and operating expenses and carrying charges of \$5,146,698 as having been incurred between the time these plants were placed in service and their recognition in rates on March 23, 1991. Thus, the Company seeks to recover in rates, through a ten-year amortization, \$5.8 million of deferred costs, or \$581,354 annually. (PG&W M.B., pp. 50-51)

By its approval of deferred accounting,<sup>1/</sup> the Commission recognized that the plant investment in question constituted an extraordinary amount relative to the Company's revenues, stated PG&W. Moreover, the record evidence relating to the Company's current financial status does not, in PG&W's estimation, justify a different result today. (*Id.* at 53-54) PG&W argued that if it is not permitted to amortize the deferred costs and recover them in rates, it would have to write off \$5.8 million in 1993.

Because the Company's earnings are relatively low, PG&W contended, a write-off of that magnitude would cut its earnings for the 12 months ended June, 1993 by nearly half. (*Id.* at 54) PG&W claimed that additional consequences of such a write-off

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<sup>1/</sup> Order entered September 5, 1990 at Docket No. P-900454.

would likely include the need to write off the deferred costs relating to the Crystal Lake Plant (reducing earnings by another \$800,000) and render unrecoverable such costs related to the Ceasetown and Watres Water Treatment Plants now under construction. (Id.) PG&W predicted that so large a write-off would have a severe impact on its ability to raise the additional capital needed to maintain quality of service and continue with ongoing improvements to its system. Specifically, the Company's interest coverage ratio would fall from an expected 2.10 for the end of the future test year to a projected 1.95, precluding issuance of additional debt under the terms of a certain letter of credit agreement. (Id. at 54-55)

PG&W pointed to a relatively recent decision allowing the recovery of similar costs related to the startup of the Limerick 1 nuclear power plant. In Pennsylvania Public Utility Commission v. Pennsylvania Electric Company, 74 Pa. P.U.C. 1 (1990), the Commission set forth criteria for recovery of such costs, requirements which the Company said it satisfied. PG&W contended that the costs at issue herein are extraordinary and nonrecurring and the financial impact of denial of recovery would be virtually identical to that in the PECO case, if not greater. (Id. at 55-56)

The Company argued that the cost recovery it sought does not constitute retroactive ratemaking. That contention has been raised before in deferred costs cases and rejected by the Commission. (Id. at 57) PG&W stated it is not seeking the rate recovery of costs on the basis it should have charged higher rates previously; the 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. (Id.)

As for the inclusion in the deferred costs claim of carrying charges antedating June, 1990 and certain depreciation expense, the Company contended that these items were consistent with the Commission's Declaratory Order of September 5, 1990 and with Commission precedent. (Id. at 58) PG&W explained that a portion of the costs at issue pertained to two storage tanks which were "related facilities" as that term was used in the Commission's September 5, 1990 Order. The tanks were an integral part of the water treatment project that commenced commercial operation before the water treatment plants. (Id. t 59) Most of the rest of the start-up costs were for training PG&W's people to test and operate the treatment plants and ancillary facilities. This was felt by the Company to be more cost-effective than having the construction contractor perform test and start-up activities. (Id. at 59-60) Lastly, stated PG&W, a relatively small amount of pre-June, 1990 carrying costs were for public utility realty taxes assessed upon the commencement of construction of the treatment plants. PG&W argued that such taxes are analogous to carrying charges on land held for future use. (Id. at 60)

PG&W attacked the OCA's effort to distinguish the 1990 PECO case on the basis of nuclear safety concerns. Pointing to 74 Pa. P.U.C. at 111, the Company contended that the Commission nowhere suggested that its decision allowing amortization of deferred costs for Limerick 1 was motivated by nuclear-related safety concerns. (PG&W R.B., p. 33)

With respect to the financial impact of a PG&W write-off of deferred costs, the Company emphasized the importance of the financial covenants between the utility and its present lenders and urged disregard of the OCA's focus on the coverage calculations of the rating agencies. Of greater importance is whether PG&W would be precluded from issuing more debt should it have to write off its deferred costs. (Id.)

The OCA urged total denial of recovery of the deferred costs at issue as being retroactive ratemaking. The OCA quoted the testimony of its witness, Mr. Cotton, to the effect that it is not the function of ratemaking to charge ratepayers for past costs or even true-up the past. (OCA M.B., p. 75) The deferred costs were expenses incurred during normal commercial operation of four treatment plants over a nine-month period three years ago, observed the OCA. (Id. at 76)

In support of its argument concerning impermissible retroactive ratemaking, the OCA cited Pennsylvania Public Utility Commission v. Philadelphia Electric Co., 58 Pa. P.U.C. 7 (1983). In that case, the Commission denied amortization of deferred costs related to the operation of recently installed pollution control equipment. (58 Pa. P.U.C. at 42-44) The OCA quoted the Commonwealth Court opinion<sup>2/</sup> affirming the foregoing denial of cost recovery, agreeing with the Commission that the pollution control facility expenses at issue were clearly neither extraordinary nor nonrecurring. (OCA M.B., pp. 77-78) The OCA reasoned that, just as with PECO's claim for the recovery of deferred costs related to pollution control equipment, the costs in PG&W's claim are typical costs for providing water service, to include taxes, depreciation expense, O&M expense and carrying charges. (Id. at 78).

The OCA analyzed the single specific instance wherein the Commission allowed recovery of deferred costs, Philadelphia Electric's 1990 case, quoting 74 Pa. P.U.C. at 111. The OCA contended that the Commission's comparison of the operation of pollution control equipment to the construction of an entire nuclear power plant is applicable to PG&W's start-up of water

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<sup>2/</sup> Philadelphia Electric Co. v. Pennsylvania Public Utility Commission, 93 Pa. Cmwlth. 410, 422, 502 A.2d 722, 727-728 (1985).

treatment plants. (Id.) In the first place, the Company spent millions for its facilities, not billions. (Id.) Secondly, the safety concerns inherent in bringing a nuclear plant on line are not comparable to safety issues pertaining to water filtration plants. (Id. at 78-79) Finally, the OCA disputed the claim that any potential write-off of the deferred costs would have a severe financial impact on PG&W. (Id. at 79)

The OCA attacked the Company's claim as a one-sided attempt to retroactively recover costs without related recognition of past cost decreases and revenue increases. The OCA claimed that the areas in which PG&W might have done better than expected include growth by customers, decrease in injuries and damages expense and other fluctuating cost items. (Id.)

Beyond the fundamental issue of the allowability of the claimed amortization, stated the OCA, is the overstatement of the amount by PG&W. The Commission Order allowed deferred accounting treatment for the period June, 1990 to March, 1991, an interval which encompasses the start-up dates for the four filtration plants. (Id. at 79-80) The OCA observed that the Company's claim included costs which occurred prior to those start-up dates, specifically depreciation and carrying costs from 1988. (Id. at 80) The OCA quoted the testimony of PG&W witness Robert J. McBride in which he conceded that the Company had not sought the deferral of start-up costs in its petition and it had not specifically included in its petition the depreciation expense (\$24,258) incurred in 1988 and 1989 for the Dunmore and Williams Bridge storage tanks and the Oakmont pump station. (Id.) Likewise, the OCA condemned the PG&W's use of pre-tax AFUDC rates. The post-tax AFUDC rate reflects the actual cash expense during the period due to the deductibility of a portion of the carrying cost as an interest expense from the utility's taxes. (Id. at 81)

While it agreed that the Company would have to write off the deferred costs if not allowed into rates by the Commission, the OCA insisted that this would not have the severe impact claimed by PG&W. (Id.) The OCA argued that the write-off, \$3.4 million after taxes, would reduce common equity by about 0.5%. Also, this would be considered an extraordinary event and would not influence the coverage ratio computations of rating agencies. Lastly, these deferred charges have been booked without any cash flow impact and, like AFUDC, have been already excluded by rating agencies. (Id. at 81-82)

The OCA pointed out that the Commonwealth Court, in its 1985 opinion affirming Commission denial of rate recovery of deferred costs by PECO for pollution control equipment, noted that installation of that equipment was required by a consent decree issued in the course of litigation. The OCA saw this situation as being similar to the DER requirement that PG&W construct its water treatment plants. (OCA R.B., pp. 28-29)

Each of the parties who have locked horns on this issue have found a Philadelphia Electric Company case to support its position. The ALJ stated that he had carefully considered the pollution control equipment deferral cited by the OCA and the nuclear plant start-up deferral cited by PG&W. He found that the situation in the instant case is best analogized to the Limerick 1 proceeding reported at 74 Pa. P.U.C. 1 (1990). First, both PG&W and PECO were involved with the initiation of service through a new production facility, one being water (consisting of four water treatment plants) and the other electricity. The facility involved in PECO's 1990 case was a utility service production facility. In the 1983 case cited by the OCA, the pollution control equipment was ancillary to the principal utility plant and did not directly contribute to creating the product delivered to the customer's premises. That PG&W was required to construct its treatment plants by government edict,

in the same way that the pollution control facilities installation was the product of a court order, the ALJ found not to be controlling.

The ALJ continued as follows on this issue, on pages 48-53 of his R.D.:

By definitively allowing into rates an amortization of deferred costs pertaining to bringing new plant on line, the Commission has, in the 1990 PECO case, put to rest any contention that such an amortization is impermissible retroactive rate-making as a matter of law. We reject OCA's position on this facet. PG&W is simply seeking to recover through prospective rates certain costs which were incurred prior to the test year. The Commission has repeatedly approved the amortization of a wide range of historic costs.

For the Commission to allow the deferral of costs and then summarily deny recovery in a future rate proceeding as being retroactive ratemaking would be a sham and we cannot believe such a result was the Commission's intent. The question at this point is, has the Company brought itself within the requirements of PECO's 1990 rate order and to what extent are the various components of its claim allowable in the requested amortization?

From a reading of the 1990 PECO order, we glean the following criteria for allowing the recovery by amortization of deferred costs:

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

(74 Pa. P.U.C. at 111)

With due allowance for the fact that a new nuclear power plant involves an investment in the billions of dollars and that four new water treatment plants involve an investment in the tens of millions of dollars, and with appropriate consideration to the proportionality of the amount of

these investments to the size of the utilities involved, we have no hesitancy in finding that the deferred costs relating to the start-up of PG&W's new filtration plants are properly described as extraordinary. That is to say, such initial operation occurs infrequently and clearly represents a nonrecurring event.

The Company pointed out that the negative impact on its earnings and interest coverage obligations would be quite substantial if it had to write off the deferred costs. OCA admitted that such a write-off would be the normal consequence of adoption of its view but minimized the expected impact on PG&W. We think the Company has adequately proven its point. A write-off of the magnitude of \$5.8 million (\$3.4 million net of taxes) in June of 1993 would reduce PG&W's earnings for the 12 months then ended by nearly 50%. This compares to the potential impact claimed by PECO in its 1990 case with respect to Limerick 1. We do not see the OCA calculation relating the write-off to common equity as relevant. It is the impact on earnings which concerned the Commission in the PECO case.

The Company contended that a further effect of a write-off of such size would be a failure on its part to meet the interest coverage ratio requirements contained in certain debt covenants with its lender. PG&W predicted that disallowance of its deferred costs amortization claim would depress its forecasted ratio to 1.95. Its covenants prohibit the issuance of additional debt should the interest coverage ratio fall below 2.00.

\* \* \* \* \*

It is our conclusion that PG&W should be permitted to include in rates certain of its deferred cost related to the four new filtration plants in the Scranton Rate Area. We say "certain" because OCA has raised a question with respect to cost items claimed by PG&W but allegedly not embraced within the Commission's Declaratory Order of September 5, 1990. These items are depreciation expenses incurred in 1988 and 1989 in connection with three facilities related to the treatment plants and the start-up expense pertaining to the training of the Company's treatment plant personnel. OCA also questioned the Company's use of a pre-tax AFUDC rate.

The 1990 Declaratory Order directed PG&W to use the following accounting procedure for those filtration plants placed in service prior to the conclusion of its last base rate case (R-901726):

(i) PG&W will identify and record as hereinafter provided, all costs associated with the Scranton rate area water treatment plants and related facilities from the date of their respective commercial operation until the Commission acts on the initial rate increase application in which PG&W seeks to recover costs associated with the plants and related facilities, as listed on Appendix A.

Petition of Pennsylvania Gas & Water Company, Water Division, for Declaratory Order, Docket No. P-900454, p. 6 (Order entered September 5, 1990). The "Appendix A" referred to in the Order is Appendix A to PG&W's petition. That petition appendix lists the following Scranton Area Plant Auxiliary Facilities, among others:

Oakmont Pump Station  
Williams Bridge Storage Tank  
Dunmore No. 1 Storage Tank

Accordingly, it is proper for the Company to include within its deferred costs claim depreciation expense incurred in the 1988-89 time frame for the foregoing related facilities, in the amount of \$24,258.

With respect to the start-up training cost, we observe that such expense was not included in the Company's petition and PG&W did not receive approval for deferral accounting for the same from the Commission. Therefore, this training cost is not properly includable in PG&W's claim herein. We cannot make an adjustment on this score as there is no quantification in the record. We will, by separate order, direct PG&W to submit the requisite quantification as part of its Exceptions to this Recommended Decision.

As for the OCA objection to the Company's choice of AFUDC rate, we need only state that use of the post-tax rate as recommended by OCA would negate much of the benefit of permitting AFUDC. This

makes no sense to us. We do not find distressing the fact that use of the pre-tax AFUDC rate results in passing the tax advantage on to rate-payers gradually over ten years for that is the normal process. Thus, we reject OCA's proposal as to AFUDC rates.

The OCA filed an exception on this issue, stating that the ALJ had erred in allowing the Company to recover \$5.8 million of deferred treatment plant costs. The OCA contends that the ALJ has misinterpreted the law and the Commission's decision in a number of respects. First, as in the instant case, in 1983, Philadelphia Electric Company (PECO) had sought recovery of a three-year amortization of approximately \$41.5 million of deferred costs related to the operation of recently installed pollution control facilities. Adopting the OCA's, and Trial Staff's, view that the Company's claim constituted inappropriate retroactive ratemaking, the Commission denied the Company's claim. This rule of law was upheld by the Commonwealth Court and is still valid law. Philadelphia Electric Company v. Pa. PUC, 93 Pa. Commw. 410, 419, 502 A.2d 722, 727-28 (1985).

In upholding the Commission's finding relative to the deferred pollution control device costs claimed by PECO, the Commonwealth Court reviewed applicable legal precedent and determined that the Commission correctly applied "basic regulatory tenets" to deny the claim.

Secondly, argued the OCA, the ALJ's application of the Commission's later PECO decision to the facts here is wrong. The Commission set forth the criteria for allowing the recovery by amortization of deferred costs: 1) that the costs be extraordinary and non-recurring, and 2) that the denial of recovery would have a substantial negative financial impact on the utility.

The OCA continued that these treatment plant costs are neither extraordinary nor non-recurring. PG&W placed water treatment plants on line in 1989, 1990, and 1992, and anticipates two more commencing operation in the near future. These costs cannot be said to be unanticipated. Now, years after it knew it would have to budget for these capital costs and four and one-half years after it filed the first of its now six post treatment plant construction rate cases, the Commission must not permit the claim that these costs are extraordinary.

The OCA next argued that the Company did not put forth the required proof that denial would have the substantial negative financial impact on the utility required by the 1990 PECO decision. As noted by the ALJ, if unrecovered, the Company will write off \$3.5 million of Early Window costs after taxes. Finally, the OCA argued that the ALJ's acceptance of PG&W's view of the financial impact ignores the prospective nature of this rate case. The OCA concluded that the Commission must adhere to the law and deny the Company Early Window Cost recovery. OCA Exc., pp. 27-30

The Company responded that the OCA had raised the same arguments in its Exceptions that were argued in its Briefs and were subsequently rejected by the ALJ. The Company has addressed and effectively refuted the OCA's contention that the approval of the Company's claim constituted impermissible retroactive rate-making in its Main Brief at pp. 57-58, and the ALJ has rejected the OCA's contention as constituting a sham. 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. To deny recovery of the deferred treatment plant costs under these circumstances would not only be a sham, it would be unjust and contrary to established Commission precedent.

The Company next contended that the case of Pa. PUC v. Philadelphia Electric Company, 74 Pa. PUC 1, 99-111 (1990) is applicable to this case. The OCA's argument that the treatment plant costs are neither extraordinary nor non-recurring defies logic. The fact that the subject costs were anticipated does not make them "not extraordinary". The fact that the Company constructed six plants prior to 1993, and will complete construction of two more in 1993, does not make those costs "recurring". Each plant serves a different section of the Company's service territory.

The Company continued that the OCA's argument that the Company did not prove that denial of its claim would have a substantial negative financial impact on the utility, as required by the 1990 PECO case, appears to have been made without the benefit of a review of the record. The ALJ, on pages 49-50 of the R.D., referred to the substantial evidence of record which proves that there would be a negative financial impact on the Company if the claim is denied. If the costs were to be written off, the Company would be precluded from issuing any new debt. P.G. & W. R. Exc., pp. 8-11

We find the ALJ's conclusion on this issue to be correct, and we adopt it. The ALJ's discussion of the issue of deferred treatment plant costs, quoted above, we find to be most persuasive and comprehensive. In particular, we would note that by definitively allowing into rates an amortization of defined costs pertaining to bringing new plant on line, we have, in the 1990 PECO case, put to rest any contention that such an amortization is impermissible retroactive ratemaking as a matter of law. The Company is seeking to recover through prospective rates certain costs which were incurred prior to the test year.

We also agree with the ALJ's analysis and conclusion with regard to the criteria set up by the 1990 PECO order, i.e.,

(1) that the costs must be both extraordinary and non recurring; and (2) the denial of recovery would have a substantial negative financial impact on the utility. As concluded by the ALJ, PG&W has met these criteria. The OCA's argument that the treatment plant costs are neither extraordinary nor non-recurring defies logic. In addition, there is substantial record evidence that there would be a negative financial impact on the Company were this claim to be denied.

**B. Other Post-Employment Benefits**

PG&W traditionally paid for Other Post-Employment Benefits (OPEBs)<sup>3/</sup> on a pay-as-you-go, or cash method, basis. In December of 1990, the Financial Accounting Standards Board, or FASB, issued SFAS 106, an accounting guideline effective January 1, 1993, requiring the treatment of OPEBs as a form of deferred compensation and mandating the use of accrual accounting to record OPEB costs for financial accounting reporting purposes. In its rate filing for this proceeding, PG&W included a claim reflecting implementation of SFAS 106. That is, the Company sought Commission permission to record its OPEB expense on an accrual basis pursuant to SFAS 106. (PG&W M.B., p. 61)

Due to amendment of its OPEB plan, the Company was able to reduce its 1993 OPEB expense level to \$2.6 million, such that the allocation of this increase to the Scranton Water Rate Area is \$319,240.<sup>4/</sup> PG&W plans to use a 20-year amortization period

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<sup>3/</sup> Other Post-Employment Benefits are benefits other than pensions provided by employers to retirees. Two examples are life insurance and medical insurance. (PG&W Statement No. JJM-, p. 3)

<sup>4/</sup> PG&W's original claim for the Scranton Water Rate Area was \$845,282. OTS proposed a claim reduction of \$551,732, presumably to \$293,550 (OTS Main Brief, p. 13) and OCA proposed a reduction to \$313,120 (OCA Main Brief, pp. 86-87)

PENNSYLVANIA  
PUBLIC UTILITY COMMISSION  
Harrisburg, PA. 17120

Public Meeting held January 26, 1989

Commissioners Present:

Bill Shane, Chairman  
William H. Smith, Vice Chairman  
Joseph Rhodes, Jr.  
Frank Fischl

JAN 27 1989  
Office of the General  
Clerk

Pennsylvania Public Utility Commission  
v.  
Pennsylvania Power and Light Company

R-881170

OPINION AND ORDER

BY THE COMMISSION:

On December 7, 1988, Pennsylvania Power and Light Company ("PP&L") filed interruptible rate service agreements for North Star Steel Corporation and Bethlehem Steel Corporation, and Supplement No. 21 to Tariff-Electric Pa. P.U.C. No. 200 to become effective February 6, 1989. The supplement specifically reflects the existence of agreements for interruptible service to qualifying customers.

The Company claims this filing will provide an improved economic climate in PP&L's service area, including indirect benefits such as the creation of jobs associated with increased economic activity at North Star and Bethlehem Steel, and additional capacity and operating flexibility for PP&L made possible by the large interruptible load associated with these agreements.

After investigation and analysis of the tariff filing and supporting data, it does not appear that the proposed supplement and the related rate service agreements are unlawful, unjust, unreasonable, or contrary to the public interest. This does not constitute a determination of the lawful, just and reasonable rates to be charged by Respondent. Rather, this is a determination that suspension or further investigation of the tariff filing is not warranted at this time; **THEREFORE,**

IT IS ORDERED:

1. That the proposed Supplement No. 21 to Tariff-Electric Pa. P.U.C. No. 200 and the related agreements are permitted to become effective February 6, 1989.

2. That this Opinion and Order is without prejudice to any formal complaints timely filed against Respondent's proposed supplement.

3. That a copy of this Opinion and Order shall be served upon the Respondent and any formal complainants.

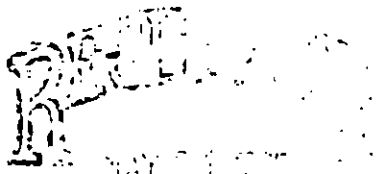
BY THE COMMISSION,

  
Jerry Rich  
Secretary

(SEAL)

ORDER ADOPTED: January 26, 1989

ORDER ENTERED: **JAN 27 1989**



**PENNSYLVANIA  
PUBLIC UTILITY COMMISSION  
Harrisburg, PA 17105-3265**

OFFICE OF  
CONSUMER ADVOCATE

Public Meeting held May 11, 1995

**Commissioners Present:**

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

**Pennsylvania Public Utility  
Commission**

Irwin A. Popowsky, Consumer  
Advocate

Richard J. Thomas

John K. Kieisnowski

Mr. and Mrs. Anthony S. Wasilewski

Robert T. Morgan

Sandra Shillingford

Dianne Bordner

Catherine Santelli

Lyman Weaver

Vincent P. Chesney

Mrs. John Lamb

Marilyn Simmons

Carl J. Stillo

Marcella Reidinger

Albert Augustine

Mr. and Mrs. Alfred J. Lazarski

Keith and Cindy Foote

R. Pauline McCoy

Veronica and Thomas Kenney

Dennis J. Reiprish

William B. Otto

Mr. and Mrs. Frank J. Alba

Joseph Warner

Debra Evans Shipe

Betty Hartman

Francis Rossi

Walter Earl Delbaugh

Lorraine Lenhart

Marylou Purin

George K. Boos

Basil and Sue Yeannakis

Agnes Adams

Barry W. Cooper

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Ronald C. Anderson	R-00943177C0034
Lois Little	R-00943177C0035
Marlin W. Snyder	R-00943177C0036
John and Theana Marshall	R-00943177C0037
Kathleen G. Kissinger	R-00943177C0038
Rachel E. Smith	R-00943177C0039
Edwin G. Smith	R-00943177C0040
Rozella Morgan	R-00943177C0041
Leon F. Nark	R-00943177C0042
John A. Gudonis	R-00943177C0043
Mary Ann Bartosic	R-00943177C0044
Marlin L. and Margaret D. Moore	R-00943177C0045
Mr. and Mrs. Arthur Kopyscianski	R-00943177C0046
Elsie DiRienzo	R-00943177C0047
Leon D. Nark	R-00943177C0048
Virginia T. Nark	R-00943177C0049
Joseph C. Michetti, Jr.	R-00943177C0050
Julia Cherneskie	R-00943177C0051
Mr. and Mrs. Frank Buraczeski	R-00943177C0052
Jeffrey and Trudy Persavage	R-00943177C0053
Mary Baigis	R-00943177C0054
Mildred Whitmer	R-00943177C0055
Albert A. and Florence Witkoski	R-00943177C0056
Mary Kolody	R-00943177C0057
Bernard A. Ryan, Jr., Small Business Advocate	R-00943177C0058
James A. and Mary L. Chiavaroli	R-00943177C0059
Cheryl Sincavage	R-00943177C0060
Bartol's Market	R-00943177C0061
Shirley V. Mertz	R-00943177C0062
Mary F. Novey	R-00943177C0063
Mr. and Mrs. James Holland	R-00943177C0064
Robert A. Francis	R-00943177C0065
Gloria Bohr	R-00943177C0066
Walter A. Novey	R-00943177C0067
Erma M. Latshaw	R-00943177C0068
Jean Burns and Family	R-00943177C0069
Andrew Sincavage	R-00943177C0070
Kathleen M. Malloy, et al.	R-00943177C0071
Richard A. Engert	R-00943177C0072
Richard M. Shierant	R-00943177C0073
Theresa Auman, et al.	R-00943177C0074
Marlene Shipe	R-00943177C0075
August and Bernadine Witowski, Sr.	R-00943177C0076
George W. Zimmerman	R-00943177C0077
Lucy A. Zimmerman	R-00943177C0078
Peggy A. Cawthern	R-00943177C0079
Harry A. Cawthern	R-00943177C0080
George B. Pensyl	R-00943177C0081
Edward C. Novak	R-00943177C0082
William Janovich, Jr.	R-00943177C0083
Brian E. Hubler	R-00943177C0084
Arthur and Edna Ehret	R-00943177C0085
Norman E. Appel	R-00943177C0086

Kathy Hoopengardner	R-00943177C0087
Robert and Joan Kidron	R-00943177C0089
Elva R. Carroll	R-00943177C0090
Mrs. Joseph Kaplafka	R-00943177C0091
Royce J. Surak	R-00943177C0092
Gary M. Surak	R-00943177C0093
Dennis Mall, et al.	R-00943177C0094
Raymond M. Redding, et al.	R-00943177C0095
John Smolock	R-00943177C0096
Foster Wheeler Mt. Carmel, Inc.	R-00943177C0097
Fhurman and Marybelle Appel	R-00943177C0098
Frank M. Vandevender	R-00943177C0099
David Hoopengardner	R-00943177C0100
Margaret L. Karlovich	R-00943177C0101
UAE Coal Corp. Associates	R-00943177C0102
Wendy Lenig	R-00943177C0103
Mrs. Yutta DeGennaro	R-00943177C0104
Emilio A. Rosini	R-00943177C0106
Marie Crawford	R-00943177C0107
Maria Handerhan	R-00943177C0108
Housing Authority of The City of Shamokin	R-00943177C0109
Leona Karwacki	R-00943177C0110
Michael J. Sassani, et al.	R-00943177C0111
Rosemarie T. Bednar	R-00943177C0112
Charlene J. Kalinoski	R-00943177C0113
Connie Harper	R-00943177C0114
Corrine M. Getchey	R-00943177C0115
Mr. and Mrs. George D. Hack	R-00943177C0116
Wanda B. Tobias	R-00943177C0117
Roy W. Sanders	R-00943177C0118
Leo J. Kukkola	R-00943177C0119
Donna E. Todd	R-00943177C0120
Mrs. William Cox	R-00943177C0121
Ralph Richards, et al.	R-00943177C0122
Jeneen Pickering	R-00943177C0123
Laura Marcheskie	R-00943177C0124
Warren Howerter	R-00943177C0125
George J. Zanella	R-00943177C0126

v.

Roaring Creek Water Company

since the prior determination. The Company argues that in Pa. P.U.C. v. National Fuel Gas Distribution Corp., Docket No. R-00942991 (Order entered December 6, 1994), the Commission acknowledged that there is some positive correlation between the cost of debt and the cost of equity. (RCWC R.E., p. 8).

RCWC also contends that both the OTS and the OCA used stale and outdated data for the same time frame as the Company's prior case, and this needs to be updated. RCWC refers to the testimony of its expert, Mr. Mulle, who testified that, in order to maintain its level of credit, the Company must get "some 200 basis points more in terms of equity." RCWC submits that, if more recent data were used, the cost rate for common equity, even using the OTS' methodology, is in the range of 11.70-12.64 percent. This, according to the Company, shows to what degree the ALJ's recommended return on common equity of 11.00 percent actually understates the cost of equity, rather than overstating it, as argued by both the OCA and OTS. (RCWC R.E., pp. 8-9).

RCWC further asserts that, contrary to the OTS contention that the record in this proceeding lacks evidence supporting a funding of the Company's business risk, the record in this proceeding contains ample evidence of these risks, referring to RCWC Statement 6, pp. 20-27, RCWC Statement 3, p. 4, RCWC Statement 6R, pp. 4-7 and the Transcript, pp. 789-792. The Company contends that Mr. Mulle's testimony at RCWC Statement 6R, p. 4, very specifically addressed the factors which Standard & Poor's assesses to arrive at the relative business risk position of a company.

Mr. Mulle demonstrated, according to RCWC, that the quantification of the difference between "average" and "below average" business risk is approximately 97.5 basis points at the A level of credit. While RCWC concedes that this is not a "finite" measurement, nevertheless, argues the Company, it clear-

ly demonstrates that such an adjustment would be in excess of 50 basis points, and possibly as high as 100 basis points. (RCWC R.E., pp. 9-11).

Regarding the OTS' argument that the relevant business risk factor to be determined in this proceeding is that of Consumers, RCWC's parent, the Company argues that what is being established in this proceeding is RCWC's cost of common equity, and that even the OTS testimony on rate of return was based on a comparison of companies similar to RCWC, not Consumers. The Company further contends that RCWC Exhibit 6A, Schedule 4, clearly demonstrates that the cost of common equity for Consumers is actually higher than that of the barometer groups which were employed to determine RCWC's common equity. Finally, regarding financial risk, RCWC contends that its common equity ratio indicates higher, rather than lower, financial risk. (RCWC R.E., pp. 11-12).

#### 4. Commission's Determinations

In considering the issues and arguments raised regarding the appropriate return on common equity for RCWC, we note the following. We have, in recent years, relied primarily on the DCF methodology in arriving at our authorized return on common equity. As correctly observed by the ALJ, we rejected the use of the risk premium and the CAPM methods in the Company's last rate case at Roaring Creek 1994, supra, as well as in Pennsylvania Power Company, supra. There is no evidence of record in the proceeding before us which convinces us that such methodologies should be used in this proceeding. Accordingly, we will continue to rely primarily on the DCF methodology and informed judgement. Pa. PUC v. West Penn Power Company, 73 Pa. PUC 454, at 502-503 (1990).

As support for his recommendation of 11.00 percent as the authorized return on common equity, the ALJ used the high end of the OTS' recommendation, 10.75 percent, having found the OTS' methodology to have produced the best DCF calculation of the cost of capital to the Company. To that he added 25 basis points to account for the increased risk to the Company because of his recommendations regarding the Foster Wheeler rate, and as a reward to the Company for its efforts in acquiring small, troubled water companies, consistent with Commission policy. This results in a recommended authorized return on common equity of 11.00 percent.

As discussed above, all three parties which disputed the rate of return on common equity in this proceeding before the ALJ filed exceptions to the ALJ's recommendations. The OCA and OTS argued that the ALJ's recommendation was too high, and the Company contended that it was too low.

In adopting the high end of the OTS range, the ALJ rejected that portion of the OTS range from 10.25 to 10.48 percent, since that portion is below 10.48 percent, which was the authorized return on common equity in RCWC's last rate case at Roaring Creek 1994, supra. As discussed above, the OTS excepted (OTS Exc., p. 1) to this use of the authorized return for the last rate case, arguing that each proceeding is independent of the other and must stand on its own merits, except for the methodologies used. We concur that it is not proper to use the last case's result as the low point in this proceeding.

The ALJ rejected RCWC's use, in its DCF methodology, of price appreciation in the calculation of the growth rate of the stock. We also reject its use in this proceeding, as we did in RCWC's last rate proceeding at Roaring Creek 1994, supra at pages 483-484.

Both the OTS and the OCA except to the ALJ's recommendation to grant the Company an additional 25 basis points in its return on common equity to reflect the Company's increased risk and as a reward for its performance in acquiring troubled water companies. The Company argues that such an additional 25 basis points is warranted in light of the recent increases in such indicators as the prime lending rate and the federal fund rate.

The record in this proceeding demonstrates that the financial markets have experienced rising interest rates. We do not concur with RCWC that this can be translated directly into an increase of approximately 250 basis points in its cost of capital, as the Company argues in its Exceptions and Reply Exceptions. RCWC acknowledges that there may not be an exact point for point correlation, but that there is some positive correlation, as we recognized in our decision at Pa. P.U.C. v. National Fuel Gas Distribution Corp., Docket No. R-00942991 (Order entered December 6, 1994). We will lend some credence to this correlation in arriving at the authorized return on common equity.

In further support of his recommended return on common equity of 11.00 percent, the ALJ relied on the fact that, with the 11.00 percent return, the interest coverage, after taxes, would be 2.26 percent. (R.D., p. 50). We concur that this is an important consideration and lends support for the ALJ's recommended return on common equity. In this proceeding, RCWC's first mortgage indentures require an after-tax coverage of 2.0 times. Without this coverage, the Company would be unable to continue its capital improvement plan.

The OCA proposed to mitigate the impact of the rate increase authorized in this proceeding on the affordability of those rates for RCWC's customers by, in part, reducing RCWC's authorized return on common equity in this proceeding to the

lower portion of the recommended range. We will discuss the issue of affordability in a separate section below. However, we will say here that, with respect to the return on common equity of 11.00 percent which we are authorizing in this proceeding, we conclude, based on the record in this proceeding, that such a reduction is unwarranted. Reducing the return on common equity to the lower end of the recommended range would lower RCWC's after-tax interest coverage to below 2 times. This would endanger RCWC's ability to raise capital in the financial markets for continuation of its capital improvement program. We are persuaded, by the evidence of record in this proceeding, that RCWC's ability to raise capital outweighs the issues of affordability raised by the OCA.

For the reasons presented above, we determine that the return on common equity of 11.00 percent as recommended by the ALJ is the appropriate return for RCWC in light of the evidence presented in this proceeding. Accordingly, we grant, in part, and deny, in part, the Exceptions of the parties regarding the return on common equity, consistent with the discussion above. The following table summarizes our findings with regard to return on common equity, as well as capital structure and the relevant costs of debt:

<u>Type of Capital</u>	<u>Ratios</u>	<u>Cost Rate</u>	<u>Weighted Cost Rate</u>
Long-Term Debt	54.13%	7.40%	4.01%
Common Equity	45.87%	11.00%	5.05%
<hr/>			
Overall Cost of Capital	100.00%		9.06%

PENNSYLVANIA PUBLIC UTILITY COMMISSION  
Harrisburg, PA 17105-3265

Public Meeting of December 15, 1994

Commissioners Present:

David W. Rolka, Chairman, Concurring & Dissenting in part-Opinion attached  
Joseph Rhodes, Jr., Vice Chairman, Concurring & Dissenting in part  
John M. Quain  
Lisa Crutchfield  
John Hanger, Statement attached

Pennsylvania Public Utility Commission, <u>et al.</u>	:	Docket Nos.
	:	R-00942986
	:	R-00942986C0001-C0052
v.	:	
West Penn Power Company	:	
Application of West Penn Power Company pursuant to 66 Pa. C.S. §2102 for prior written approval of contracts between or among West Penn Power Company and its affiliated interests.	:	Docket No. G-00940382
Pennsylvania Public Utility Commission	:	
v.	:	Docket No. M-00940523
West Penn Power Company	:	
Relating to Energy Cost Rate Statement No. 18 to become effective April 1, 1994.	:	
Petition of West Penn Power Company for Declaratory Order to Return to Operation Mitchell Power Station Unit No. 1 and Associated Boilers.	:	Docket No. P-00940788
Petition of West Penn Power Company for Declaratory Order for Recovery of Revenue Requirements for Environmental Projects.	:	Docket No. P-00910512
Allegheny Ludlum Corporation	:	Docket No.
v.	:	P-00910512C001
West Penn Power Company	:	

2. CAAA Permit Fees

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 OCA pointed out that West Penn pays CAAA permit fees to two states: Pennsylvania and West Virginia. The permit fees for Pennsylvania for a given calendar year are due in August of the following year. For West Virginia, the permit fees for a given calendar year are due July 1 of the following year. Therefore, the composite payment lag is in excess of 13 months, an atypical lag, particularly for such a large expense.

West Penn reflects this adjustment in its Final Claim (WPP M.B. at 4, App. B at 6). The claim for the payment of said permit fees are assigned a payment lag of 409 days. *Id.*, OCA M.S., pp. 20-21; OCA St. 2, pp. 7-8.

3. Budget Plus Plan Customers

West Penn claimed a revenue lag associated with sales to regular customers of 42 days. The overall revenue lag was calculated as 41 days. Included in the revenue lag for sales to regular customers were arrearages from Budget Plus Plan customers (WPP M.B. at 4; WPP St. 3A at 1-2).

The OCA, relying upon Pennsylvania Public Utility Commission v. National Fuel Gas Distribution Corp., 62 Pa. P.U.C. 407, 414-415 (1986) for the proposition that the unamortized balance of an expense is not properly included in rate base, contended that Budget Plus Plan customers should be excluded from the sales to regular customers category to calculate the payment lag. Due to the difficulty in collecting revenues from many payment agreement customers, the OCA argues that the payment lag for these customers is typically longer than the average payment lag. In this case, the OCA observed that West Penn proposed treating the past due receivables for Budget Plus Plan customers as

Docket No. R-00842632, with an effective date of August 28, 1985, in the calculation of the appropriate interval between rate cases is not decisive. He stated that:

If this latter case is excluded from the calculation, the interval becomes 25.5 months as opposed to the Company's calculation of 22.6 months. More importantly, 25.5 months is only 1.5 months greater than West Penn's claim of 24 months. This difference is not significant.

Also, with respect to the significance of West Penn being in substantial compliance for CAAA expenditures upon the conclusion of the instant proceeding, he stated:

While CAAA expenditures may be substantially recovered with the conclusion of this proceeding, no one can predict when West Penn may need to file a base rate case. The history of filings for this Company over the last ten years, which do not include CAAA expenditure requirements in every case, discloses an interval of 22.6 months, which is less than the 24 months that West Penn claims here.

Consequently, ALJ Corbett recommended that we reject the OTS' adjustment to rate case expense of \$120,000.

We concur with the ALJ's resolution of this issue.

**B. Postretirement Benefits (SFAS 106)**

In December 1990, the Financial Accounting Systems Board issued Statement of Financial Accounting Standard No. 106 ("SFAS 106" or "FASB 106"), "Employers' Accounting for Postretirement Benefits Other Than Pensions". SFAS 106 provides that, effective for financial statements for fiscal years beginning after December 15, 1992, employers must recognize postretirement benefit obligations other than pensions ("OPEBS") and related costs during the period employees provide the service that may entitle them to future benefits. Essentially, under SFAS 106, large companies are

required to change their form of accounting for OPEBS and move from the pay-as-go or cash basis OPEBS to an accrual method of accounting. The transformation creates transitional obligations or accumulated liability for OPEB expenses for both present employees and current retirees during the period up to date of conversion to an accrual method which had been deferred for future periods under the pay-as-you-go basis.

Addressing the issue of FASB 106 in Pennsylvania Public Utility Commission v. Philadelphia Electric Company, ("PECO"), 77 Pa. P.U.C. 222 (1992), we said:

The foundation of FASB 106 is the premise that postretirement benefits are a form of deferred compensation, whereby an employer promises to exchange future benefits for employees' current services. The pronouncement requires companies to switch to the accrual method of accounting for OPEBs. After a complex series of calculations, based in part upon an actuarial study, a company must now record an amount that represents an estimate of a portion of the past, present and future cost of OPEBs. In almost all cases, the FASB 106 amount will be much larger than the pay-as-you-go amount.

It is important to mention the current status of OPEBs with regard to the Internal Revenue Code ("IRC"). Simply stated, at the present time, the FASB 106 amount of OPEBs would not be entirely tax deductible. Depending upon the funding mechanism chosen, varying amounts of OPEBs would be allowed as tax deductions. The situation is analogous to nuclear decommissioning costs at their inception. Given the current federal budget deficit, however, it is questionable to assume any future increased deductibility of OPEBs.

77 Pa. P.U.C. at 226. (Emphasis in original)

Rather than issue a declaratory order or policy statement as requested by the parties in PECO, we determined that the

appropriate amount of OPEBs would be decided on a case by case basis. PECO, at 228.

In this proceeding, the Company proposed to collect over a four year amortization period, that part of its OPEBs expenses it did not collect in rates between January 1, 1993 and May 17, 1993 in the amount of \$1,962,972. The Company's annual amortization claim is \$491,000. In support of its claim, the Company argued that the claim is only an accounting problem and does not represent recovery of a single item from a historical period. The claim, West Penn asserted, does not constitute retroactive ratemaking because the claim is a nonrecurring, extraordinary, one-time item that is being normalized out of the test year through an amortization process. The Company also alleged that disallowance of the recovery of expenses, over which it had no discretionary control, would mean that these costs will never be recovered. West Penn further took the position that to ask it to forego recovery of a federally-mandated SFAS 106 expense for the reason that it did not timely file a base rate case to recover such costs in a jurisdiction which limits the timing of rate cases, 66 Pa. C.S. §1308(d), borders on unconstitutional confiscation.

The OTS opposed West Penn's request on the basis that the claim constituted retroactive ratemaking. The OTS further argued that although the Company was aware of the effective date of SFAS 106, West Penn failed to recover these expenses in the first instance. The OTS also challenged the Company's attempt to categorize the claim as an accounting problem noting that the claim does not represent recovery of a single line item from a historical period. The OTS added that the Company was not prohibited by a stay-out provision or other restriction from filing an earlier base rate proceeding to collect the costs.

The OTS further asserted that the effect of the SFAS 106 ruling was not unanticipated. Because the Company failed to

demonstrate that the claim was unanticipated, extraordinary and a nonrecurring one-time event, the OTS took the position that the claim should be denied for failure to collect the costs at the first opportunity.

The OCA presented similar objections to the Company's claim. The OCA argued that the recovery of the costs requested by the Company is essentially retroactive ratemaking which has been expressly prohibited by the courts in numerous cases. The OCA further added the exceptions to the principle of retroactive ratemaking have been clearly defined by the courts. Popowsky v. Pennsylvania Public Utility Commission, \_\_\_ Pa. Commonwealth Ct. \_\_\_, 642 A. 2d 648 (1994) ("PP&L"), Pennsylvania Public Utility Commission v. Philadelphia Electric Company, 58 Pa. P.U.C. 7 (1983), upheld on appeal, Philadelphia Electric Company v. Pennsylvania Public Utility Commission, ("PECO"), 93 Pa. Commonwealth Ct. 410, 502 A.2d 722 (1985). The costs claimed by the Company, the OCA maintained, were anticipated by the Company and were not extraordinary and nonrecurring expenses. The OCA asserted that the Company is now precluded from recovery of this expense by having failed to collect the costs at the appropriate opportunity or establishing that the claim is an exception to the principle of retroactive ratemaking.

Additionally, the OCA repeated the argument advanced by it in the Company's prior rate case at Docket No. R-00922378. That is, OPEBs should be included in rates on a pay-as-you-go basis. The OCA argued that because the Commission's determination to allow recovery of SFAS 106 level of expense in Popowsky v. Pennsylvania Public Utility Commission, \_\_\_ Pa. Commonwealth Ct. \_\_\_, 643 A.2d 1146 (1994) ("PANC") is still subject to appeal<sup>6</sup>, the Commission

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<sup>6</sup> On July 7, 1994, the OCA filed a Petition for Allowance of Appeal with the Supreme Court of Pennsylvania at Allocatur Docket No. 309 of 1994.

should determine that the Company's entire claim for SFAS expense is subject to refund pending the outcome of the appeals.

The DOD observed that the courts have issued two decisions this year involving the recovery of FASB 106 expenses. PAWC, supra, PP&L, supra. The DOD maintained that the PP&L decision makes it clear that the Commission may not establish rates which result in a retroactive recovery of surpluses or refund deficits not properly accounted for or allocated for in prior rate cases. The DOD argued the prohibition against retroactive ratemaking established by the courts precludes West Penn from recovery of this claim.

#### ALJ Recommendation

The ALJ's recommendation at pages 39-40 of the R.D. on this issue is clear and succinct. We shall set forth his reasoning in its entirety, below:

The rule against retroactive ratemaking is clear. The courts have held "[t]he Commission clearly may not establish rates which are calculated to retroactively recover surpluses or refund deficits created by inaccuracies in its prior rate authorizations." Pike County,<sup>7</sup> 87 Pa. Commonwealth Ct. at 457. "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." PP&L, 642 A.2d at 651. Exceptions to this rule are permitted only where there are extraordinary and nonrecurring expenses, which could not have been reasonably anticipated. Philadelphia Electric Co., supra; Pike County, supra.

In this case, West Penn seeks to recover SFAS 106 costs that were not captured in the expenses allowed in its previous rate case,

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<sup>7</sup> Pike County Light and Power Company v. Pennsylvania Public Utility Commission, 87 Pa. Commonwealth Ct. 451, 487 A.2d 118 (1985).

because of the time frame from West Penn chose to include within its test year in the prior case. West Penn has not adequately explained how its failure to capture these expenses in the previous case was unavoidable. Failure to file for recovery of a deficit at the earliest opportunity has been found to result in the loss of a claim. Columbia Gas,<sup>8</sup> supra. There is no question these costs were anticipated, they are recurring and not extraordinary. Since West Penn failed to claim these costs in a timely manner, its claim should be denied.

Therefore, I recommend disallowance of the Company's claim for four year amortization of \$1,962,972 in SFAS 106 costs accrued from January 1, 1993, when West Penn adopted SFAS 106, to May 18, 1993, when the new rates recognizing these costs went into effect. This adjustment reduces expenses by \$491,000 annually. For the reasons West Penn cites, I urge the Commission to reject the OCA's proposal to make all SFAS 106 recoveries subject to refund pending certain decisions upon appeal. (Footnote added).

#### Exceptions of West Penn

West Penn excepted to this recommendation. The Company maintains that the ALJ's recommendation evinces a narrow view of the facts and of Pennsylvania regulation. In response to the ALJ's suggestion that it could have included the SFAS 106 expense sought in the instant proceeding in its last rate case, the Company asserts there was no assurance that the Commission would have allowed FAS 106 recovery in that rate case proceeding. The Company observes that the Commission denied similar recovery to another utility. See Pennsylvania Public Utility Commission v. Metropolitan Edison Company, Docket No. R-00922314, et al. (Order entered January 21, 1993), 141 P.U.R. 4th 336 (1993).

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<sup>8</sup> Columbia Gas of Pennsylvania v. Pennsylvania Public Utility Commission, 149 Pa. Commonwealth Ct. 247, 613 A.2d 74 (1992), affirmed, \_\_\_ Pa. \_\_\_, 636 A.2d 627 (1994).

The Company further argues that although the SFAS 106 costs are now recurring, they did not exist at all on December 31, 1992. Also, West Penn contends that its claim falls within the definition of extraordinary expense because FAS 106 was a major change in generally accepted principles having an enormous impact on both regulated and unregulated enterprises. West Penn further opines that the concept of retroactive ratemaking is not at issue in this proceeding. The Company maintains that regulatory equity is at stake in the instant proceeding. The regulatory equity argument is based on the observation by the Company, that if it filed a rate case five months earlier than the case at Docket No. R-00922378, its claim for the amount of the Harrison scrubber investment allowable in rate base would have been compromised. The Company adds that under 66 Pa. C.S. §1308(d), it would have been impossible to increase the recovery of carrying costs until the instant rate case.

West Penn, therefore, disputes the ALJ's contention that it was not diligent and missed its opportunity to recover SFAS 106 expenses in a timely manner. The Company reiterates its earlier argument that a constitutional dilemma may be at issue if the it is compelled to make a choice between the federally-mandated SFAS 106 expenses and CAAA investment with respect to ratemaking recovery and barred recovery of both.

#### Reply Exceptions

In their respective Reply Exceptions, the OCA and the OTS support the ALJ's recommendation to reject the Company's claim to recover a four year amortization of \$1,962,972 for OPEBs not collected in rates between January 1, 1993 and May 18, 1993. The OCA and OTS argue that the ALJ's conclusion that recovery of the claim violates the prohibition against retroactive ratemaking is properly founded in the record and caselaw precedent. Columbia Gas of Pennsylvania Company v. Pennsylvania Public Utility Commission, 149 Pa. Commonwealth Ct. 247. 613 A.2d 74 (1992). affirmed, \_\_\_ Pa.

\_\_\_, 636 A.2d 627 (1994); PP&L, supra; PECO, supra; also Pennsylvania Public Utility Commission v. T.W. Phillips Gas and Oil Company, Docket No. R-811615 (Order entered May 30, 1984), Slip. Op., pp. 3-4. Specifically, the OTS maintains that the Company's contention that it had no assurance that the Commission would have allowed FASB 106 recovery in a rate case filed five months earlier is without merit. The OTS argues that there are never any guarantees in any ratemaking process that an utility will recover certain requested expenses and costs. With respect to the Company's allegation that the subject costs were not recurring because they did not exist on December 31, 1992, the OTS points out that West Penn's witness acknowledged on the record that the Company had notice two years prior to the January 1, 1993 effective date of FASB 106. The OTS further adds that the record evinces that the FASB 106 effective date was not unanticipated as the Company argues. The OTS also argues that the Company's meaning of extraordinary is contrary to the Commonwealth Court's definition of the term in PP&L, supra. In PP&L, the Court defined the term as not only an unanticipated item expense but as " a substantial, one-time expense or a substantial item that will not appear as a continuing expense and could never be recovered in rates because, like weather related expenses, it would be normalized out of the test year as abnormal." Id., at 652. The Company's argument, the OTS opines, is flawed because OPEBs are clearly a recurring expense and are not extraordinary as interpreted by the Commonwealth Court.

Finally, the OTS asserts that the Company's contention that its recovery of its Harrison scrubber investment would have been diminished had it filed its case at Docket No. R-00922378 five month earlier is conclusionary and lacking any demonstrated evidentiary support. Simply put, the OTS states the Company merely miscalculated its original claim and failed to properly time its rate case at Docket No. R-00922378 in such manner which would have incorporated all of the Company's costs attributable to SFAS 106. The OTS concludes that the Company's error should result in a

determination consistent with the courts and recommended by the ALJ in the instant proceeding. That is, the conclusion that West Penn has lost the claim. Columbia Gas of Pennsylvania, supra.

The OCA makes arguments similar to those of the OTS in support of the ALJ's recommendation. The OCA also argues that the Company's attempt to distinguish PP&L from the instant proceeding is misplaced. The OCA submits that the court in PP&L determined that the principle of retroactive ratemaking applied to deferred OPEBS expenses and that case is controlling in the instant proceeding.

#### Conclusion

We have carefully examined the record of the prior rate base proceeding of the Company. Pennsylvania Public Utility Commission et al. v. West Penn Power Company Docket No. R-000922378 (Order entered May 14, 1993). We note that in West Penn's prior rate case, the Company failed to request an amortization of expenses associated with the timing difference of converting to FASB 106. The timing difference involved is to cover the period of time the accruals were booked (January 1, 1993) to the time effective date of the prior, approved rates (May 18, 1993). On this basis, the claim of West Penn must fail.

First, we are not presented with any substantial reason for the failure to include this claim in the prior case. Consideration of the timing difference in the manner proposed by the Company would violate the test year concept and "reach back" to a prior time period to recover alleged deficiencies. Absent proof that such expense is extraordinary or non-recurring, we conclude that the utility has not met its burden on this issue.

Additionally, we point out that several other similarly situated utilities, in their initial SFAS 106 expense claims, sought requests for recognition of the timing difference. Even

assuming the Company's focus was myopic toward the need to bring on line the Harrison scrubbers, we agree with ALJ Corbett's observation that such a rationale for the failure to prosecute the claim in an earlier period is not sufficient. It would appear, therefore, that West Penn failed to make such a request at the proper time. We conclude that first time recognition in this case of such a regulatory asset is precluded by the doctrine of retroactive ratemaking.

On consideration of the Exceptions and the Replies, we will adopt the ALJ's recommendation. Our review of the record reveals that the ALJ's recommendation is amply supported by the record. Additionally, we are convinced that the caselaw of this jurisdiction supports the rejection of the Company's claim. As stated by the ALJ, the prohibition against retroactive ratemaking is clear in this jurisdiction. Moreover, the Company has failed to demonstrate that its claim should be considered an exception to principle of retroactive ratemaking. Accordingly, the Exception of West Penn is denied.

**C. Pension Expenses (SFAS 87)**

West Penn requested an increase in operating expenses for pension costs stated on a SFAS 87 basis in the amount of \$1,797,533. (WPP St. 1 at 19-23, Exh. WPP-2, D-16). In support of its claim, the Company offered a letter from its actuary dated July 29, 1994, purporting to project the need for a pension payment for the period July 1, 1994 through June 30, 1995. (WPP St. 1B at 6; Exh. CVB-9). West Penn proposed to amortize over a period of four years the regulatory asset, which it has recorded to account for the difference between pension contributed and pension accruals under SFAS 87 since its 1990 rate case. The annualized regulatory asset is \$759,763 which represents \$3,039,051 amortized over a four year period. Additionally, the Company requested recovery of its SFAS 87 pension expense of \$1,037,770 for 1994. These amounts

Given these factors, we believe the better approach is the adjustment proposed by the OCA. We agree with the OCA that the Company's 1994 budgeted level of expenses of \$66,129,000 is not a normal portrayal of the ongoing level of maintenance expenses during the period the rates approved in this rate case will be in effect. OCA St. 2A, pp. 4-5. The 1994 budgeted expense requested by the Company in the instant proceeding include the delayed overhaul of Mitchell Unit No. 3. But for the expense of \$5,645,000 of the delayed overhaul, the 1994 budget would be \$60,484,000. We believe that the 1995 forecasted expense is more representative of the normalized maintenance expenses because it does not include the Mitchell Unit No.3 overhaul costs. Inasmuch as the 1995 forecasted power station maintenance expense is an estimate formulated by the Company, the estimate encompasses the ongoing level of maintenance costs necessary to meet changing regulatory requirements.

Accordingly, the normalized power station maintenance expense for 1994 test year is \$60,484,000. The Company's test year power station maintenance expenses will be adjusted downwardly in the amount of \$5,445,000. Accordingly, the Company's Exception is denied, in part, consistent with the above discussion.

**G. Negative Net Salvage Annuity**

West Penn proposes to establish a sinking fund annuity to provide for the cost of decommissioning four power plants within its system. West Penn proposes a future test year depreciation expense claim of \$1,464,000 representing the Company's share of the decommissioning costs. See R.D., p. 68 citing WPP St. 5 at 6. The claim is based on the estimated costs West Penn expects to incur when the coal plants are retired. See R.D. at 68 citing WPP St. 6 at 11. West Penn would create this annuity, based upon decommission cost, and include a 13.6% contingency allowance for "the effect of unpredictable program problems on costs". Id.

On consideration of the positions of the parties, ALJ Corbett rejected this proposed expense. R.D. at 82. ALJ Corbett concluded, inter alia, that the rationale for the instant claim was indistinguishable from that previously rejected by this Commission in West Penn Power Company v. Pennsylvania Public Utility Commission, 54 Pa. P.U.C. 602 (1981) where we denied negative salvage for fossil-fuel plant decommissioning, while preserving as an exception to this principle, the decommissioning of nuclear generating units. R.D., p. 81-82. Thus, the presiding ALJ was able to reconcile Penn Sheraton Hotel v. Pennsylvania Public Utility Commission, 198 Pa. Superior Ct. 618, 184 A.2d 324 (1962) ("Penn-Sheraton") with Popowsky v. Pennsylvania Public Utility Commission, \_\_\_ Pa. Commonwealth Ct.\_\_\_\_\_, 645 A.2d 912 (1994), ("Met-Ed" hereafter).

#### Exceptions

West Penn filed Exceptions to the ALJ recommendation. The Company repeats its claim that our current practice, based on the Penn Sheraton decision and when read conjunctively with the Met Ed decision, leaves little room for recovery. West Penn Exc., p. 23. The Company also repeats the claim that our practice is "unique" among American regulatory approaches and that customers not receiving service from plants should not pay the cost of their retirement. West Penn Exc., pp. 23-24. However, the Company concedes that decommissioning funds are not required by law. Id.

The OCA supports the recommendation because recovery of prospective net negative salvage is not allowed under Pennsylvania Court and Commission precedent and because the Company has presented no compelling reason to depart from precedent. OCA R.E., pp. 16-17. The OCA notes that the Company is seeking to recover the actual costs associated with retiring plant and that this approach, as opposed to the uncertain and speculative nature of the Company's proposal is consistent with Commission precedent. OCA Exc., pp. 18-19.

Both WPPII and the OTS support the ALJ's conclusion that recovery of net negative salvage value on a current basis, other than in the nuclear decommissioning area due to the unique nature of those facilities, is consistent with precedent and that departure from that precedent for this Company's facilities is unwarranted. OTS R.E., pp. at 15-16; WPPII R.E., pp. 17-19. ARMCO also claims that the ALJ correctly determined that a coal plant decommissioning annuity is inappropriate because no alternatives were seriously studied and because the Commission should reject the invitation to create novel policy. ARMCO R.E., pp. 14-15.

The OTS also claims that the separation of current and future negative net salvage is necessary to ensure that the customers are not required to pay the expense of retiring plant and equipment before these costs are actually incurred. OTS R.E., p. 17. Finally, the OTS claims that the Company is not placed in a conundrum by virtue of the Penn Sheraton and Med-Ed decisions because the plant at issue in Med Ed is, by the Company's own admission, unique and not one that could be used and useful either currently or in the future. OTS R.E., p. 18.

As noted above, the ALJ recommended rejection because the claim was speculative and contravened precedent. R.D., p. at 82. ALJ Corbett observed that, beyond the decision to permit anticipated decommissioning costs in the nuclear generation area, which are based upon exceptional and unique circumstances presented thereby, recovery of net negative salvage on a current basis was consistent with Commission and court precedent. R.D., pp. 78-82.

On consideration of the position of the Company, we agree with the presiding ALJ. We reject the Company's assertions that "Pennsylvania has [a] unique regulatory practice" and that our policy is "out-of-step with the rest of the world". R.D., p. 80 citing WPP M.B. at 13-14. We so do precisely because our precedent sought to separate current and future negative salvage in order to

ensure that customers are not required to pay the net expenses associated with retiring plant and equipment before those costs are actually incurred. The Company's alternative approach, in our view, is contrary to that long-standing rule and precedent because it would substitute an uncertain and speculative claim in place of the current cost approach. Further, the Company has failed to present any compelling reasons to revisit that precedent and policy. R.D.. pp. 80-82.<sup>9</sup>

We also reject the Company's claim that the recent decision in Met-Ed "creates a very serious tension" with the rule enunciated in Penn Sheraton. R.D. at 80-81 citing WPP M.B. at 14. We share the view of ALJ Corbett, that the Met-Ed case is easily reconciled Penn Sheraton. In Met-Ed, we had a special, unusual situation, in contrast to Penn Sheraton. West Penn concedes Met-Ed is easily distinguishable on its facts from the issue presented here, in which costs were recovered prior to their expenditure given the special nature of the facility in question (R.D. at 80-81 citing WPP M.B. at 14). Also, the Penn Sheraton case and our precedent permit the Company to submit, as they have, claims for actual negative net salvage which, in this case, consists of a five year average of actual costs incurred at the end of the service life of an otherwise used and useful investment. R.D., p. 81.

Thus, there is no inconsistency created by the Penn Sheraton and Met-Ed holdings. That is because, in part, the rationale sustaining our precedent is as valid in this case as it was in 1980 when we rejected this Company's attempt to recover a

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<sup>9</sup> We duly note that West Penn has, in this proceeding, made a claim for actual negative net salvage, representing a five year average of actual costs incurred at the end of the service life of otherwise used and useful investment which was not opposed by any party. See R.D., p. 81.

Natural Gas Company, 61 Pa. Commonwealth Ct. 436, 433 A.2d 938 (1981) (OCA M.B. at 53-54).

The OCA is correct; therefore, as is our usual practice, the tables appended to this decision reflect an interest synchronization adjustment.

C. Pennsylvania Corporate Net Income Tax Rate

The Company's original claim in this proceeding included Pennsylvania corporate net income (CNI) tax expense based on an annual rate of 12.25% (Exh. WPP-2, D-24). Its final claim includes CNI tax expense based on an annual rate of 11.99%, effective for the calendar year 1994 (WPP M.B., Exh. B. at 3).

The corporate net income tax rate has been reduced from 12.25% to 11.99% retroactive to January 1, 1994, and will be further reduced to 10.99% effective January 1, 1995 (OCA St. 2 at 22-23; OCA St. 2A at 15). OCA witness Catlin recalculates West Penn's CNI tax expense to show rate reductions totaling 1.26%, reflecting the January 1, 1995 tax rate of 10.99%. This recalculation produces an expense reduction of \$1,291,000 at present rates. Id., Sch. TSC-19 (Updated 9/15/94).

The OCA addressed this issue at page 24 of its Main Brief, under the heading "Update to STAS" (State Tax Adjustment Surcharge), as a part of its discussion of "Expense Issues Resolved During The Course of This Proceeding." (The Company did not address this issue in either its Main Brief or its Reply Brief.) Despite the OCA's placement of this issue in its "resolved" category, West Penn and the OCA appear not to be in agreement as to the correct CNI tax rate.

Because the reduced CNI tax rate of 10.99% takes effect just one day after the close of the test year, and because the Commission has previously allowed known and measurable adjustments

beyond the future test year, we will accept the ALJ recommendation that West Penn's tax expense claim be recalculated to reflect this lower rate. Based on Pennsylvania taxable income at present rates of \$95,332,000 (WPP M.B, Tables at 3), the January 1, 1995 one percent tax rate reduction results in a recommended expense reduction of \$953,000 to the Company's final CNI tax expense claim.

The Company's December 31, 1994 pro forma capital structure was accepted by the OCA, DOD and the OTS<sup>16</sup> (OCA St. 1A, Sch. MIK-1 (August 1994 update); DOD M.B. at 11; OTS M.B. at 46). ALJ Corbett recommended accepting West Penn's proposed capital structure. We shall, based in part on this recommendation, adopt the capital structure proposed by the Company in this proceeding.

**B. Debt and Preferred Stock Costs**

The following table summarizes the debt and preferred stock cost rate proposals of the Company:

<u>Type of Capital</u>	<u>Cost</u> %
Debt	7.47
Preferred Stock	5.67

(WPP M.B. at 26).

The Company's proposed debt and preferred stock cost rates are accepted by the OCA, DOD and the OTS (OCA St. 1A, Sch. MIK-1 (August 1994 update); DOD M.B. at 11; OTS M.B. at 47). WPPII, Allegheny Ludlum, Armco and OSBA did not address West Penn's capital structure ratio. Consequently, there is no preferred stock cost rates.

**C. Common Equity**

The derivation of an reasonable return on common equity engendered the major controversy here. The following table summarizes the common equity methodologies and claims of the parties:

<u>Methodology</u>	<u>WPP<sup>1</sup></u>	<u>OCA<sup>2</sup></u>	<u>WPPII/Armco<sup>3</sup></u>	<u>Allegheny<sup>4</sup></u>	<u>OTS<sup>5</sup></u>
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<sup>16</sup> The following parties did not address West Penn's capital structure ratios: WPPII, Allegheny, Armco and OSBA.

Discounted Cash Flow (DCF)	11-11.5	10.3-10.6	10.3-10.72	10.31-10.63	10-11
Risk Premium (RP)	11.75-12.75				
Capital Asset Pricing Model (CAPM)			10.95	10.01	
Recommendation	11.5-12.50	10.75	10.5	10.63	10.5

1. West Penn's common equity cost rates are found at WPP St. 9 at 50, 69. It adjusts its cost of common equity to reflect flotation costs and FERC AGC risk (WPP St. 9 at 72, 76, 77).
2. OCA's common equity cost rates are found at OCA St. 1, Sch. MIK-5, 6, 7 (August 1994 update). OCA adjusts its common equity cost rate to reflect AGC adjustment (OCA M.B. at 64 and 70).
3. WPPII/Armco's cost of common equity rates are found at WPPII M.B. at 18, 20 and 21 and Armco M.B. at 8 and 9.
4. Allegheny's cost of common equity rates are found at Allegheny Ludlum M.B. at 12, 13 and 15.
5. OTS' cost of common equity rates are found at OTS St. 1 at 24 and OTS Exh. Sch. 3 at 1 and 2.<sup>17</sup>

The presiding ALJ, citing recent Commission decisions, noted that we have determined the cost of common equity for our jurisdictional utilities primarily based upon the DCF method and informed judgment. See Pa. P.U.C. v. Philadelphia Suburban Water Co., 71 Pa. P.U.C. 593, 623-632 (1989); Pa. P.U.C. v. Western Pennsylvania Water Co., 67 Pa. P.U.C. 529, 559-570 (1988). Observing that we have, in recent past, criticized the RP and CAPM methodologies, the presiding ALJ saw no basis in the instant record to give consideration to the alternative methodologies:

In Pa. P.U.C. v. Pa. American Water Co., 68 Pa. P.U.C. 343, 377-378 (1988) the Commission did not give any weight to the RP analysis.

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<sup>17</sup> The DOD accepts and recommends OTS' cost of common equity and performance bonus recommendations (DOD M.B. at 11). The OSBA, WPPII, Armco and Allegheny Ludlum do not address the Company's debt and preferred stock cost rates.

See also Pa. P.U.C. v. Peoples Natural Gas Co., 69 Pa. P.U.C. 138, 165-168 (1989); Pa. P.U.C. v. National Fuel Gas Distribution Corp., 67 Pa. P.U.C. 264, 331-332 (1988); Pa. P.U.C. v. York Water Co., 62 Pa. P.U.C. 459, 79 P.U.R. 4th 332 (1986). In Pa. P.U.C. v. Duquesne Light Co., 66 Pa. P.U.C. 518, 91 P.U.R. 4th 546 (1988), the Commission stated: We continue to believe that the economic environment over lengthy time frames is not representative of current economic conditions and therefore does not produce realistic risk premium results.

66 Pa. P.U.C. at 696.

In rejecting Risk Premium and CAPM analyses in Pa. P.U.C. v. Pennsylvania Power Co., 67 Pa. P.U.C. 91 (1988), the Commission ruled:

[F]irst, we cannot accept that historic experienced earnings reflect the cost of capital. We know of no reputable analyst who would seriously argue that experienced earnings represent the cost of capital, except by pure happenstance. But, such is the inherent assumption of each methodology [Risk Premium and CAPM]. Second, we cannot accept, even assuming that historic experience earnings represented the cost of capital that the average premium of an equity investment over a fixed income investment over a period as long as 50 years, represents the investor required premium in today's and tomorrow's market.

Accordingly, we conclude that we can place little credence in the results of these methodologies.

67 Pa. P.U.C. at 164.

The Commission has rejected the RP and CAPM results in general. I see nothing in this record that causes me to find differently.

R.D., pp. 114-115.

On the basis of the various implementations of DCF, the ALJ determined the cost of equity for West Penn to be 10.71 percent, consisting of an adjusted divided yield of 7.13 percent plus a growth rate of 3.58 percent:

This recommendation finds an unadjusted dividend yield of 7.0 percent. The 7.0

percent unadjusted dividend yield is premised upon OTS' claim. The OTS calculation, using 52 weekend and spot market prices, generates a dividend yield that both represents the stabilization of the longer term with the current position, while offsetting any current market aberrations. Additionally, the 7.0 percent unadjusted dividend yield is within the range of all parties, except for Allegheny Ludlum which recommends 7.52 percent and West Penn which claims 6.62-6.83 percent.

The 7.0 percent unadjusted dividend yield is then adjusted for the next period to 7.13 percent. (The unadjusted dividend yield of 7.0 percent times half the growth of 1.018 equals 7.13 percent).

I find the midpoint of the proposed growth rate range proposed by all the parties to be 3.58 percent. The use of this average may eliminate expert witness bias and presents a growth, at least in this proceeding, that investors may expect in the future. The 3.58 percent is within 20 basis points of the rate proposed by every party, but West Penn and Allegheny Ludlum. Therefore, I recommend a DCF common equity cost rate based upon an adjusted dividend yield of 7.13 percent plus a growth rate of 3.58 percent totalling 10.71 percent.

R.D., pp. 118-119.

The following table summarizes the dividend yield and growth rate recommendations of the parties:

<u>DCF</u>	<u>WPP</u> <sup>1</sup>	<u>OCA</u> <sup>1</sup>	<u>WPII/Armco</u> <sup>1</sup>	<u>Allegheny</u> <sup>1</sup>	<u>OTS</u> <sup>1</sup>
Dividend Yield	6.62-6.83	6.61-7.28	6.27-7.07	7.52	7.0
Growth Rate	4.0-4.75	3.0-3.5	3.41-3.85	3.0	3.38
DCF	11.5-12.50	10.75	10.5	10.63	10.5

1. West Penn's adjusted dividends are 6.75-7.0 percent (WPP St. 9 at 48-49). The unadjusted dividend yield calculated by the Judge is 6.62-6.83 percent (6.75 times .98 percent = 6.62 and 7.0 times 97.625 percent = 6.83 percent). The growth rates are found at WPP St. 9 at 48-49.

2. OCA's adjusted dividends are 7.0 percent for West Penn proxy group, 6.7 percent for OCA proxy group and 7.40 percent for APS stand alone. (Unadjusted dividends are 6.89 and 7.28 percent respectively) (OCA St. 1A, Sch. 5-7). The growth rates of West Penn proxy average range is 3.5 percent, OCA proxy is 3.5 percent and APS stand alone is 3 percent (OCA St. 1A, Sch. MIK 5-7). OCA adjusts additionally for AGC risk of .1 or ten basis points. Id. A DCF finding of 10.5 is adjusted to recommend 10.75 percent. Id.
3. WPPII/Armco adjusted dividend yields are 7.31 percent for APS and 6.42 percent for WPPII/Armco comparison group (WPPII M.B. at 16-18). The unadjusted dividend yields are 6.27-7.07 percent respectively. Id. Growth rate claims are 3.41-3.85 percent respectively. The cost of common equity recommendation is 10.5 percent. Id.
4. Allegheny Ludlum's adjusted dividend claims are 7.63 percent for the barometer group and 7.81 percent for APS (Allegheny Ludlum M.B. at 11-16). The unadjusted dividend yield are 7.52-7.71 percent respectively. Id. Growth rate claims are 2.50 and 3 respectively. Id. The cost of common equity recommendation is 10.63 percent. Id.
5. OTS' adjusted dividend yield claims are 7.41 percent for APS and 6.82 percent for OTS' barometer group (OTS M.B. at 52-57). The unadjusted dividend yields are 7.3 percent and 6.7 percent respectively. Id. The growth rate range for APS is 2.5-3.5 percent and 3.25-4.25 percent for the OTS barometer group. Id. OTS recommendation is 10.5. Id.

#### Exceptions and Replies

West Penn filed Exceptions to the ALJ recommendation on its common equity (and overall) rate of return. In its Exceptions, the Company initially criticizes the ALJ for his use of the DCF methodology and his rejection of other approaches. West Penn states that ALJ Corbett, in "boiler plate" fashion, rejected consideration of the variations of RP proposed by its witness in recommending a common equity return. West Penn points out that such a conclusory dismissal of RP and the CAPM approach assumes that there is only one approach, when, in fact, its witness, Dr. Avera performed eight other RP analyses.

More important is the Company's observation that the end result of the ALJ recommendation is inadequate when compared to other Commission decisions and is an improper application of the DCF model, the model most commonly used by regulators at present. On consideration of the Exceptions of the Company, it is with respect to the latter contention that we are constrained to grant the Company's Exceptions, in part, consistent with our discussion herein.

The Company objects to the ALJ recommended return on equity by essentially arguing that the decision simply struck an average of eight numbers (three "ranges" and two single figures) found on the Growth Rate line in the tables. See West Penn. Exc., p. 5 referencing page 116 of the R.D. This, argues the Company, is an approach that was rejected in Pennsylvania Public Utility Commission v. West Penn Power Company, Docket No. R-00901609, 119 PUR 4th 165.

Further, the Company states that the ALJ recommendation contains another fundamental flaw. That is, the key to the application of the so called "steady state" DCF formula is the assumption that dividends will grow at a constant rate, in perpetuity.<sup>18</sup> The DCF theory and the DCF model, according to the Company, assume long term expectations. Here it is argued, is where the ALJ committed his principal error. That error is the reliance on short term data. As argued by West Penn, all of the parties, with the exception of its witness Dr. Avera, used short term forecasts in developing their growth numbers. By using short term numbers, one assumes the present, sluggish state of the economy

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<sup>18</sup> The steady state DCF formula can be expressed in the following terms:  $K = Y + G$ . Where K is the Required Return; Y is the dividend yield; and G is Growth.

will continue forever (or that the investor makes that assumption).<sup>19</sup>

Significantly, the Company posits the following:

If the Commission intends to base its judgment exclusively on the DCF model, the model should be used correctly. Accepting for the moment the ALJ's unadjusted yield of 7.0% and using his method of adjusting it for next period dividend growth, the long-term DCF analysis produces an indicated bare bones cost of equity to APS of 11.9% before any adjustments or updates. (Footnote omitted)

The ALJ's 7.0% yield, however, is quite wrong and the table at R.D. 116 is very misleading. It shows WPP's yield recommendation as 6.62-6.83% (implying that the Company's recommendation was about the same as those of the other parties or even lower) but, as the ALJ's reference shows, these were the numbers presented in Dr. Avera's original direct testimony, filed March 31, 1994. he updated that yield to 7.45% (Tr. 932) and that is the most current yield reflected in the record. (Footnote omitted). If we accept the ALJ's "average" growth rate of 3.58% (which we do not), the indicated APS bare bones cost of equity at a yield of 7.45% is 11.03% and at the current yield of about 8.0%, is 11.58%. (Footnote omitted).

West Penn Exc., pp. 7-8.

The OTS, in its Replies, defends the use of the DCF methodology by ALJ Corbett in this proceeding. The OTS criticizes the Company for its claim that the DCF methodology understates the required rate of return on common equity by proposing that ten different methods pursuant to RP be examined in computing the cost of equity in this proceeding. Further, the results of all ten RP methods are, in addition to their native complexity, adjusted by

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<sup>19</sup> In connection with this argument, West Penn laments the ALJ's failure to discuss Ozark Gas Transmission System, FERC Docket No. RP94-105-002, 688 FERC Para. 51,032 (July 7, 1994). As noted, the OTS and others, argue that the Ozark decision should not be given any weight, herein.

proposed increments of flotation costs, AGC risk and management performance. OTS Exc., pp. 3-4.<sup>20</sup>

As a "check" on the reasonableness of the ALJ recommendation, the OTS observes that if one were to examine changes in bond yield, the current return on equity would be in the area of 9.93% (subtracting the 557 basis point difference between Treasury bond yields from the 15.50% rate of return allowed in the Company's 1984 rate case.

Finally, the OTS states that its witness should not be criticized for a perceived failure to look at long-range growth rates as Mr. O'Donnell based his recommendation upon 15 different historic five-year growth rate computations and forecasted five-year growth rates for the years ending 1994, 1995, and 1999.

In its Replies, the OCA notes that this Commission has placed primary reliance on the results of validly conducted DCF studies in determining the return on common equity element for utilities. Further, as rebuttal to the West Penn's injection of the common equity returns permitted in prior cases, it attaches as an appendix, a Risk Premium analysis of West Penn Decisions. The OCA concluded that the ALJ result in this matter is consistent with said analysis.

With respect to the criticism of the use of only short term data, the OCA refers us to the testimony of Mr. Kahal which purports to add an additional .5 percent to the Value Line long-run estimate to account for possible growth through stock issuance.

On consideration of the record herein, we conclude that the proper range of return on common equity should be based upon

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<sup>20</sup> The OTS also chides West Penn for its heavy reliance of Ozark which is, outside the record of this proceeding. Id.

the standard DCF methodology employed by the Company witness, Dr. Avera. We find the ALJ's overall use of a midpoint, between the various positions of the parties concerning growth to be unacceptable given the recent indicators testified to by West Penn.

The DCF model uses the dividend yield of the firm as the first component in arriving at a market derived return on equity. The dividend yield that is employed for ratemaking purposes, is often based upon current spot yields, twelve-month average yields, or some combination of the two. The record in this case clearly sets forth the recent yields of the parent APS, upon which we shall rely.<sup>21</sup> West Penn, as a subsidiary of APS, does not have publicly traded common stock. See West Penn Stmt. No. 9, p. 12. APS is publicly traded on the New York Stock Exchange. The cost of common equity for APS and the proposed barometer groups was considered in the recommendation but, in our view, no distinction between the risks of the proxy group and West Penn was adequately reflected in the common equity return results. While we agree, as a generally principle with the ALJ, that West Penn does not face any business risks that are not faced by the barometer group companies or APS, we disagree that such risks are reflected in the market price of their stocks and resultant dividend yield.

This Commission often relies heavily upon average yields in ratemaking. We do this in an attempt to account for certain short-term market fluctuations and temporary uncertainties. When,

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<sup>21</sup> We agree with the Company in its Exceptions, that the updated yield, the most current yield reflected in the record, indicates a an APS bare bones cost of equity of 11.03%. APS, as a proxy for WPP, is, as noted by the Company, subject to less risk. APS is a multi-jurisdictional utility as compared to WPP, which operates primarily in Pennsylvania. In addition, we observe that certain structural changes in the electric utility industry, renders the perception of risk on the part of investors more acute than is reflected in the DCF methods of the other parties.

however, we observe a major move in the market, or a change in industry or macroeconomic fundamentals during a rate case, past averages of the dividend yield may become less indicative of the future.

Since the time that this case was filed, we have observed a trend of deterioration in the market for utility stocks, the increased potential in the industry for business risk due to competition and continuing increases to interest rates. The Company witness Avera testified to such observations and was cross-examined on these issues. These trends do not appear to be abating. As such, when determining a fair dividend yield to be employed in setting rates, we are compelled to rely heavily upon the most recent information that is available.

We note that OTS Witness O'Donnell provides the record with current dividend yields at June 1, 1994. OTS Exhibit No.1, Schedule 3, p. 3. Mr. O'Donnell testified that the current dividend yield for APS was 7.8%. Upon cross examination in August, Mr. O'Donnell updated the current APS yield to 8.0%.

In updating his written Direct Testimony, West Penn witness Avera testified to an 8.0% dividend yield for APS, on June 21, 1994. See Tr. 157. These updates were also subject to extensive cross examination.

We believe that the parent utility may be the basis for the rate of return analysis in the instant case. The parent adequately encompasses the elements of risk found in the subsidiary utilities. Therefore, in light of the updates to the current yields of APS, we shall adopt a dividend yield of 8.0% for our DCF analysis.

The second segment of the DCF model is the growth rate that is expected by investors over the period that they hold the

stock. The selection of a growth rate must reflect systematic analysis derived from market data and estimates that are available and known to investors. A competent analysis of growth rates would not entail taking a simple average of every measure of growth that is set before us. We stated in our Order to West Penn at R-00901609:

Although the ALJ based his recommendation for WPP on the DCF method plus a regulatory risk adjustment, he did not systematically analyze the DCF nor the remainder of the common equity cost rate methodologies set forth by the witnesses. On the contrary, the ALJ based his DCF recommendation on an averaging of the dividend yields and growth rates set forth by the parties. Although averaging may offset possible risk differences among the barometer groups plus possible aberrations in the witnesses' judgments, averaging also dilutes any witness's judgment that is based upon sound financial and economic analysis of the prevailing evidence.

As such, we reject the ALJ's averaging technique for arriving at a growth rate.

The DCF model, as it is used for ratemaking, assumes an infinite future time horizon. When reliable, widely-published estimates of future growth are known, we consider them to be superior to estimates based upon past performance. This is particularly valid when fundamental changes are occurring in the industry, the market or the economy, such as those that we have observed and discussed, above. Further, where long-term growth can be estimated upon a reasonable basis, they too should be given consideration in arriving at a DCF-based return on equity. As a result, we shall heavily weight the projected growth rates set forth in the record, in arriving at the growth element to be employed in our DCF calculation.

In calculating our growth rate, we have given primary consideration to the projected growth in earnings. It can be argued

that over the infinite horizon of DCF, all other legitimate measures of growth (dividends, book value, internal growth) are directly dependent upon the growth in a firm's earnings. This factor is either an intuitive or acquired knowledge of investors. The future earnings growth for APS is estimated by Value Line to be 3.5%, on July 17, 1994. See West Penn Cross Examination Exhibit No. 12, August 12, 1994. The IBES near-term estimate is 3.0% per the updated testimony of Mr Avera of June 21, 1994 at Tr. 157.

West Penn witness Avera also introduced the concept of using long term growth rates into the case. We agree that, in theory, investors instinctively incorporate such rates into the price they are willing to pay for a stock. Developing highly accurate long-term forecasts would be difficult for even the most competent economist or financial analyst. This is especially true for an individual market segment, such as electric utilities. But the issue in financial analysis is not necessarily the accuracy of short and long term estimates but more importantly their very existence, their availability to investors, and whether they are relied upon by investors in their making financial decisions.

Specifically, Dr. Avera points to the DRI/McGraw-Hill (DRI) Review of the U.S. Economy- Long Range Focus (Winter 1993-94). DRI estimates that the long-term (1999-2018) GDP rate of growth will be 5.3%. Avera contends that in the long run, all firms' growth rates will converge with the GDP growth, because GDP is the aggregate of all firms (Tr 229). Other parties in this case dispute whether long-term GDP growth is a reasonable proxy for growth in the electric industry. No empirical data was proffered by the Company in support of its contention with regard to the relationship between GDP growth and the industry. While we do not directly use the DRI GDP growth rate directly in our calculation, it is a factor to which we have given some consideration in arriving at our final return on equity. We can think of no other industry that is more closely and inexorably linked to the long-

term growth of our economy, and therefore GDP, as is the electric utility industry.

In our DCF calculation, therefore, we shall employ the 8.0% current dividend yield of APS, and 3.25% growth rate, which is an average of the projected earnings growth rates of IBES, 3.0% and Value Line, 3.5%. The resultant return on equity is 11.25%.

To this return, however, we are adding .25% to compensate the Company for its management performance. See Section 523 of the Public Utility Code, 66 Pa. C.S. §523. We, therefore, fail to adopt the ALJ recommendation at R.D., p. 120, which characterized the Company and "simply doing its job". The firm has promoted and accomplished cost efficiencies in several operational aspects, particularly its management of the necessity to meet CAAA compliance.<sup>22</sup> We believe that stockholders who install such managers should be rewarded. Consequently, we conclude that the record supports an allowed return on equity of 11.5%.

We have not, recently, employed Risk Premium methods in arriving at an allowed return, due to the current volatile climate in the financial markets and the economy. We take administrative notice, however, that our final allowance is not inconsistent with the results produced by those methodologies.

While we shall establish the return on equity consistent with the derivation of Company witness Avera, we shall adopt the ALJ conclusion regarding a floatation cost increment. We, hereby,

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<sup>22</sup> Our management performance adjustment has as its basis Section 523(a) of the Public Utility Code, 66 Pa. C.S. §523(a). We have duly balanced the customer input received from the Public Input hearings, *supra*, with the other specific findings of record which lead to our decision regarding a performance factor adjustment.

deny the Company's Exceptions with regard to the necessity for a flotation cost adjustment.

Based on the above, we shall permit the Company the opportunity to earn an overall return based on 11.5% for common equity.

he recommended the Commission accept the settlement agreement relating to these two rate structure issues.

On consideration of the R.D., we shall adopt ALJ Corbett's recommendation.

**B. Residential Customer Charge**

West Penn proposes raising its residential customer charge from \$5.00 to \$5.50 per month in this proceeding (WPP M.B. at 49). It asserts that, theoretically, a customer charge should recover all customer-related costs, including those relating to a portion of the distribution system. Accordingly, an analysis of such costs supports a customer charge of \$13.89/month (WPP M.B. at 49-50; WPP Exh. CAM-6). However, West Penn recognizes the Commission's policy of allowing only basic customer costs in a customer charge, as set forth in a prior Company rate case at R-00842632. Id. at 50. In that case, we stated basic customer costs include the costs for the meter and service drop, meter reading and billings, and exclude customer-related costs of transformation and distribution plant. Pa. P.U.C. v. West Penn Power Co., 59 Pa. P.U.C. 552, 612, 69 P.U.R. 4th 470, 521 (1985).

Thus, West Penn presented what it referred to as a "bare bones" analysis of residential customer costs, under which all distribution plant except meters and service drops were classified on a demand basis (WPP St. 8-A at 12). According to the Company, this analysis determines only basic customer costs as defined by the Commission and supports a customer charge of \$7.08/month (WPP M.B. at 52). West Penn concludes its proposed increase to the residential customer charge is justified in light of both the fully-allocated cost approach and the "bare bones" analysis, and in light of a comparison to the residential customer charges of other Pennsylvania electric companies. Id.

The OCA objected to West Penn's proposed increase to the residential customer charge. The OCA contended that both of the Company's customer cost analyses include costs, which are not contained in the Commission's definition of basic customer costs (OCA M.B. at 93). OCA asserts the Company's "bare bones" analysis improperly includes administrative and general expense, certain allocated portions of customer accounts expense, distribution O&M expense, customer service expense, and general plant costs which are not direct customer costs. Id. at 94-96. Citing a number of past rate cases, the OCA argued that increases including such costs have been consistently denied by the Commission based on its established guidelines regarding basic customer costs. Id. at 96.

In contrast to West Penn's numbers, OCA witness Johnson calculates the Company's residential customer cost to be \$3.56/month (OCA M.B. at 91; WPP Cross-Exam. Exh. 10).<sup>23</sup> OCA claims this figure includes basic costs associated with meter drops and reading, customer records and collection (OCA M.B. at 91). Based on this figure, the OCA contended West Penn's current residential customer charge of \$5.00/month is more than adequate and no increase is warranted.

West Penn, in reply, stated that OCA witness Johnson, in his position and calculation, attempted to narrow the scope of what the Commission intended in its definition of basic customer costs. In this regard, the Company argues:

Surely, for instance, we should pick up the rate base component of a meter and a service drop (as OCA does), but, logically, under the Commission's language, we should also pick up all the directly associated "costs for the meter and service drop, meter reading and

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<sup>23</sup> Dr. Johnson's original method of calculating the residential customer cost differed from that shown in West Penn Cross Examination Exhibit 10. There is a one cent difference between the results of the two different calculations, which Dr. Johnson attributes to rounding (N.T. 652-654, 895-897).

billings." Inconsistently, OCA would pick up O&M expense for the meter, but not for the service drop (Tr. 898). OCA would include the costs of meter readers, but not the costs of the customer assistance personnel who resolve customer billing complaints (Tr. 904). OCA would exclude completely the costs associated with maintaining an inventory of spare meters, as well as any portion of the costs of the buildings used to house them and the vehicles used to transport and install them (Tr. 904).

(WPP M.B. at 51-52). With regard to Commission policy, West Penn argues OCA witness Johnson has no greater insight than anyone else (WPP M.B. at 50, fn. 36; WPP R.B. at 39).

After examining the evidence in this case, including West Penn Exhibit CAM-12, ALJ Corbett concluded that the Company's residential customer cost analysis includes costs which go beyond the Commission's definition of basic customer costs. As an example, the ALJ observed that it is not appropriate to include costs relating to customer billing complaints or to maintaining an inventory of spare meters. Nor is it appropriate to include costs relating to the building used to house meters or relating to the transport of meters. He also did not find it proper to include administrative and general expense in the determination of basic customer costs. Although many of these costs may be customer-related, they are not direct costs of meters, service drops, meter reading and customer billing.

For the above reasons, ALJ Corbett concluded that West Penn's residential customer cost analysis does not provide valid support for its proposed customer charge increase. Therefore, he recommended the proposed increase be rejected and the residential customer charge remain at its current level of \$5.00/month.

On consideration of the R.D. we shall, hereby, adopt the ALJ's reasoning and conclusion.

**PENNSYLVANIA PUBLIC UTILITY COMMISSION  
Harrisburg, Pennsylvania**

**PENNSYLVANIA ELECTRIC COMPANY  
SUPPLEMENT No. 96 to TARIFF  
ELECTRIC-PA. P.U.C. No. 75**

**PUBLIC MEETING-  
FEBRUARY 24, 1995  
FEB-95-OSA-1016\*  
DOCKET NO. R-00943280  
REVISED**

**STATEMENT OF COMMISSIONER JOHN HANGER**

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. Such revenue losses could hurt other customers or shareholders if the cost of maintaining a fixed infrastructure can be spread only over a smaller number of customers.

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. Approval of discount tariffs must not be assumed to merely pass on all lost revenues from those tariffs to consumers in the next rate case.

Those who are concerned with possible cost shifting in retail wheeling must recognize that we are facing these issues right now, even if we continue to defer formal decisions. Just opposing industry restructuring that gives all customers more choice, without more, does not stop the cost shifting that is now under way. By itself, all it does is to stop utility shareholders from getting a reasonable transition to a new industry structure; to prevent more customers from getting the power of choice; and to guarantee that the captive ratepayers, the shareholders, or probably both will pay for the costs shifted as a result of these discounts.

I increasingly believe that the existing structure of the industry where some parts are competitive but most are not and where some customers have choice but most do not is unsustainable. I also believe that the existing structure will harm all core ratepayers and shareholders.

PENNSYLVANIA  
PUBLIC UTILITY COMMISSION  
Harrisburg, PA 17120

Public Meeting held July 1, 1982

Commissioners Present:

Susan M. Shanaman, Chairman, concurring and dissenting  
Michael Johnson, dissenting  
James H. Cawley  
Linda C. Taliaferro  
Clifford L. Jones

Petition of Pennsylvania Power &  
Light Company for a Declaratory Order

P-820367

OPINION AND ORDER

BY THE COMMISSION:

BACKGROUND

On May 13, 1982, Pennsylvania Power and Light Company (PP&L, Company or Petitioner) filed with this Commission a Petition for Declaratory Order (Petition), requesting permission to establish several accounting changes relative to the anticipated operation of the Susquehanna Steam Electric Station (Susquehanna) - Unit 1.

Susquehanna is a nuclear power plant consisting of two units, each with a maximum design capacity of 1050 megawatts. PP&L owns a ninety percent (90%) share of each unit and the remaining capacity is owned by Allegheny Electric Cooperative. PP&L anticipates that Susquehanna Unit 1 will receive an operating license from the Nuclear Regulatory Commission (NRC) and commence test operations in July 1982. Commercial operation is forecasted to begin in the second quarter of 1983. The Petitioner also alleges that the cost of Unit 1 will be approximately \$2 billion - effectively doubling PP&L's current net electric plant in service.

Under traditional regulatory practice, the coincidence of the recognition in rates of a new generating facility plant and the plant's actual operation is sheer happenstance, owing to the impossibility of precisely pinpointing the in-service date of a unit. This is especially true of a nuclear powered generator, which is subject to thorough scrutiny by the NRC. Normally, a utility must attempt to predict the in-service date of the new facility and file a request for a rate change necessitated by the plant being included in rate base such that, if all proceeds as anticipated, the end of suspension and/or the test year will coincide with the date the plant becomes commercial. If the plant comes on line subsequent to the end of the suspension period and the rate change occasioned by inclusion of the plant in rate base is already effectuated,

then consumers would be burdened with the cost of a non-producing plant or, in the alternative, if the rate change is not approved then the company must re-file and re-litigate its case. If actual operation occurs prior to the rate change, then the utility's shareholders must absorb the<sup>1/</sup> interim costs of operating the plant without recourse to ratepayers<sup>2/</sup>, while directly flowing through to customers any energy savings resulting from the more efficient operation of the plant or the lower cost of fuel.<sup>2/</sup>

### THE PETITION

PP&L proposes that we establish, by declaratory order, a procedure by which to synchronize rate recognition of Susquehanna Unit 1 with that facility's actual operation. Specifically, Petitioner requests:

1. A declaration that, in the event that the commercial operation of Unit 1 is delayed beyond the end of the test year period, the Commission will make findings in its rate order concerning the revenue requirement associated with Unit 1 and subsequently allow rate recognition of such revenue requirement when Unit 1 is actually placed in commercial operation (See, Petition at 13-14); and

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1/ Under our Uniform System of Accounts, the company must cease accruing Allowance for Funds Used During Construction (AFUDC), a construction period deferred accounting method, upon commercial operation of the unit. These carrying costs would, therefore, be underwritten by the stockholders. Nor would the utility be permitted to recoup from ratepayers any other costs, including operating and maintenance expenses or depreciation expenses.

2/ PP&L's existing fuel clause, the Energy Cost Rate (ECR), requires that:

In projecting the Company's energy costs for the computation year, the estimated cost of energy generated and sold to other utilities on a firm basis and the estimated net effect on the Company's energy costs of generation forecast for the computation year from a base load unit expected to begin commercial operation, shall be excluded. When the in-service date of such a base load unit can be estimated with reasonable certainty, the Company shall file with the Commission no later than 30 days prior to the unit's expected in-service date for an interim revision of the ECR then in effect to reflect the estimated effect of the unit's operation on the Company's energy costs.

2. A declaration that, in the event that the commercial operation of Unit 1 occurs prior to the end of suspension, the Commission will allow PP&L to separately account, as a deferred item, for costs associated with Unit 1 from the date of commercial operation until the date of rate recognition of the costs associated with Unit 1 (See, Petition at 9-12).

In the event that the declaration stated in paragraph 2 above is granted, PP&L further requests:

1. A declaration that the Commission will allow the separately accounted for deferred costs be amortized and collected from customers over a five year period (Id.); and
2. A declaration that the energy savings and interchange sales of power associated with Unit 1 may be separately accounted for from the date of commercial operation until Unit 1 is recognized in base rates and not be immediately passed through to consumers in the ECR, but rather, be used to offset the deferred costs (Id.).

The Office of Consumer Advocate (OCA) in its Answer and Response, opposes PP&L's Petition on three basic grounds: (1) the matters raised by PP&L are not properly the subject of a Declaratory Order; (2) the issuance of the requested Declaratory Order would deprive OCA as well as other PP&L ratepayers of their due process rights in view of the absence of notice, a hearing on factual issues, and an opportunity to be heard on the legal questions presented; and (3) the requested relief is contrary to the Public Utility Code and sound public and regulatory policy.

#### DISCUSSION AND CONCLUSION

The threshold question to be addressed is whether the issuance of a declaratory order is appropriate under the circumstances presented here. The Public Utility Code provides that: "The Commission, with like effect as in the case of other orders, and in its sound discretion, may issue a declaratory order to terminate a controversy or remove uncertainty." 66 Pa. C.S. §331(f). While Petitioner's concern with synchronization of rate recognition of a new power plant with the plant's commercial operation is not new or unique, the problem presents a significant regulatory dilemma. This is especially true where, as here, the estimated investment in Unit 1 at time of commercial operation will approximately double PP&L's rate base. The large magnitude of this investment and its attendant impact upon PP&L's customers and the financial health of the Company, fully warrants Commission consideration of the request for a declaratory order.

Considering the substance of PP&L's request, we find that the public interest and sound regulatory policy require us to grant the Petition to the extent of approving the first two declarations outlined above. In the event that the commercial operation of Unit 1 is delayed beyond the end of the future test year in PP&L's rate proceeding in which Unit 1 costs are claimed, we will enter an order resolving all of the issues in the case, including the rate value of Unit 1, but will allow only the reasonable non-Susquehanna related costs to be recovered, pending the declaration of commercial operation at that unit. In the event that Unit 1 begins commercial operation earlier than the end of the test year, we will authorize PP&L to enter on its books of account, as a deferred item, the reasonable costs associated with the operation of that plant.

There are numerous advantages to allowing these procedural changes to traditional regulatory practice. It provides assurances that the first nuclear power plant to begin commercial operation in Pennsylvania since the accident at Three Mile Island will be completed and safely tested on a timely basis, unaffected by rate case considerations and pressures, and not rushed into operation to coincide with a rate case. Second, it establishes a procedure which addresses both an early and late contingency and permits PP&L to file a rate proceeding requesting recognition, in the establishing of rates, the costs associated with Susquehanna Unit I on a date which helps insure that the unit will, in fact, be in commercial operation before the Commission renders a decision on its used and useful nature. Additionally, it removes Susquehanna Unit 1 from the subjective second-guessing that can occur if some unforeseen event occurs after the rate case is filed. Third, establishing a mechanism for rate recognition of Unit 1 at this time eliminates the procedural and evidentiary conflicts which otherwise might well arise in a future rate proceeding were the issue left unresolved. Finally, it promotes the Petitioner's financial stability and the confidence of the investment community by establishing clear cut procedures for recognizing the rate effect of a major investment, to the mutual benefit of Company and ratepayers. Were we not to act, the potential financial consequences could be dire. Innovative solutions beyond those provided by traditional ratemaking procedures are clearly required.

We do not believe that this action is adverse to consumers' due process rights, as claimed by the OCA.<sup>3/</sup> The matters approved herein are of procedure and not substance. Our allowance of the deferred accounting device, where Unit 1 commences operation prior to

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<sup>3/</sup> We note PP&L's statement that its Petition was served upon the OCA and counsel for PP&L's large power customers who participated in the base rate case, as well as announced in a "news release describing the filing ... to all newspapers in the Company's service territory." Comments of Pennsylvania Power and Light Regarding Answer and Response of the Office of Consumer Advocate, at 5.

the end of the test period, authorizes a book accounting change only. A change in rates cannot be implemented until we issue a final order approving such a rate change. The same is true with respect to the contingency wherein, Unit 1 comes on line after the end of the test year period. Any changes in rates can occur only after the rate case has been filed, notice thereof provided to all customers, full evidentiary hearings held, briefs filed and all the other due process safeguards we have built into our processes observed. Contrary to the OCA's assertion, no issue, including excess capacity, is prejudged by our action today. The burden to show the justness and reasonableness of any proposed rate change including recovery of deferred costs shall remain squarely with PP&L. In the appropriate rate case, we fully retain and will vigorously exercise our statutory duty to review all costs associated with Unit 1, including the deferred debit and credit accounts, and determine the reasonableness and propriety thereof prior to authorizing any change in rates.

For the identical reasons stated above, we deny the Petition to the extent that PP&L requests approval to amortize any deferred costs over a five year period. This issue is clearly substantive in nature and an approval of this claim now would be dispositive of the issue in the rate case and prejudicial to the parties' due process rights. The parties may address the propriety of recovery, the proper amortization and reasonableness of any deferred costs in the Company's rate case which seeks recognition thereof.

We also deny PP&L's Petition insofar as it requests authority to credit any interim energy savings and interchange sales against the deferred costs where the plant comes on line early. Again, due process requires this issue, which is substantive in nature, be relegated to a rate proceeding and a decision thereon be held in abeyance pending notice and hearings.

However, we will allow PP&L to revise its energy cost rate as requested so that any decrease in energy costs, including increases in interchange revenues, which are made possible by the availability of Unit 1, not be immediately passed through to consumers in the energy cost rate. Under existing ECR procedures, the commercial operation of Unit 1 would require an immediate downward revision in PP&L's fuel clause, irrespective of the base rate status of that unit. Hence, customers would receive the energy benefits of Unit 1 while avoiding the associated capacity and operating costs. More importantly, the present ECR practice would precipitate a situation where PP&L's rates would decrease substantially (e.g., 20%) due to the pass through of energy savings, only to increase (e.g., 40%) sometime shortly thereafter when the plant is reflected in base rates. Therefore, from both an equity and financial viewpoint, as well as the perspective of ratepayer comprehension and acceptability, we find that the ECR change should be synchronized with the attendant base rate change and recognized simultaneously. These savings will be deferred as a credit in account 253 - "Other Deferred Credits." Again, this is a procedural accounting change. The substantive issue of the proper treatment or disposition of this deferred credit will be addressed in a PP&L's rate case which claims the deferred costs.

Finally, we hold that commercial operation is an appropriate catalyst or "trigger" for the commencement of deferral accounting, where the plant comes on line prior to the end of the test year, or for the rate recognition of Unit 1, if that plant commences operation after the end of the test year. After the NRC operating license is issued, but before commercial operation is declared, the plant will be subject to vigorous testing for a period of approximately ten to twelve months. We believe Company management will carefully and cautiously study the operation of the plant under test conditions prior to declaring commercial operation. This declaratory order provides the Company with the proper incentives to insure that result. Further, the use of commercial operation as the "trigger" is consistent with our Uniform System of Accounts and the cessation of AFUDC on that date. In any event, we retain our full statutory power to determine the used and useful status of that unit and should the plant not operate to our satisfaction, appropriate action will be taken; THEREFORE,

IT IS ORDERED: That the Petition of Pennsylvania Power and Light Company for a Declaratory Order be and is hereby granted in part and denied in part, as follows:

1. That if Unit 1 of the Susquehanna plant begins commercial operation before the end of the test year period employed in PP&L's rate proceeding involving Susquehanna Unit 1, the Commission hereby authorizes the following procedure:

- A. As soon as the Company knows that Unit 1 of the Susquehanna plant will be in commercial operation before the end of the test year period, the Company shall notify the Commission, the presiding Administrative Law Judge, and all parties to the proceeding.
- B. When Susquehanna Unit 1 begins commercial operation, PP&L will record the following costs related to that unit as a deferred asset in Account 186 - Miscellaneous Deferred Debits: (1) carrying charges applicable to the investment; (2) depreciation; and (3) operation and maintenance expenses including insurance, employee pensions and benefits, and payroll taxes. At the same time, PP&L will record as a deferred credit in Account 253 - Other Deferred Credits the value of generation from Susquehanna Unit 1.
- C. PP&L will record the following journal entries from the date of commercial operation of Susquehanna Unit 1 until the costs of Unit 1 are recognized in rates:

	<u>Debit</u>	<u>Credit</u>
(1)		
Account 186 - Miscellaneous Deferred Debits - Recoverable Susquehanna Unit 1 Costs	X	
Account 401 - Operation Expense		X

To record the deferral of operation and maintenance expenses, depreciation, property insurance, employee pensions and benefits and payroll taxes applicable to Susquehanna Unit 1.

	<u>Debit</u>	<u>Credit</u>
(2)		
Account 186 - Miscellaneous Deferred Debits - Recoverable Susquehanna Unit 1 Costs	X	
Account 419.1 - Allowance for Funds Used During Construction - Susquehanna Unit 1		X

To record the deferral of the carrying costs applicable to the investment in Susquehanna Unit 1 equivalent to the Allowance for Funds Used During Construction which would have been capitalized if the unit were not in service.\*

	<u>Debit</u>	<u>Credit</u>
(3)		
Account 557 - Other Expenses - Interim Generation from Susquehanna Unit 1	X	
Account 253 - Other Deferred Credits		X

To record the value of generation from Susquehanna Unit 1 employing the methodology for valuing test power that is currently a part of PP&L's tariff.

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\* The deferred balance associated with this item must be factored up for income taxes when reflected in charges to customers.

- D. The level of PP&L's Energy Cost Rate (ECR) will not be revised to reflect the effect of the commercial operation of Unit 1 on PP&L's energy costs; any such effect shall be determined by methods compatible with those employed to determine the value of test power, charged to Account 557, and credited to the balance of Account 253. The charge to Account 557 shall be included as a cost of energy in proceedings under Section 1307(e) of the Public Utility Code.
- E. PP&L's ECR tariff sheet is hereby modified by the addition of the following sentence to the last paragraph of the definition of F<sub>c</sub> therein:

Such interim revision of the ECR shall not become effective unless and until rates reflecting the unit's base rate revenue requirements become effective by order of the Commission.

- F. PP&L is hereby directed to file a tariff reflecting the change set forth in paragraph E above within 30 days from the issuance of this order. The tariff is to be effective on one day's notice.
- G. Coincident with the effective dates of new base rates recognizing the costs of Unit 1 and of a revised ECR reflecting the effect of Unit 1 on PP&L's energy costs, PP&L will cease recording costs in Account 186 and energy savings in Account 253 as described above.
- H. In the Company's rate proceeding seeking recognition of any deferred costs, the Commission will address the disposition of those amounts then recorded as a deferred asset in Account 186 and the energy savings recorded as a deferred credit in Account 253.

2. That if Susquehanna Unit 1 begins commercial operation after the end of the test year period utilized by PP&L in its rate proceeding involving that unit, the Commission hereby authorizes the following procedure:

- A. As soon as the Company knows that Unit 1 of the Susquehanna plant will not be in commercial operation before the end of the test

year period the Company shall notify the Commission, the presiding Administrative Law Judge and all parties to the proceeding.

- B. The Commission will, at the end of the statutory suspension period, issue a final order resolving all of the issues in the proceeding with respect to PP&L's rates including all issues with respect to the inclusion of the costs of Susquehanna Unit 1.
- C. The final order issued at the end of the suspension period also will authorize the Company to make effective such level of rates as the Commission has concluded to be appropriate, excluding all costs and investments relating to Unit 1 of the Susquehanna plant.
- D. When Susquehanna Unit 1 begins commercial operation, PP&L shall notify the Commission, the presiding Administrative Law Judge and all parties in the base rate proceeding.
- E. Within 15 days of receipt of this notification, the Commission shall issue a final order recognizing that Susquehanna Unit 1 is in commercial operation and available to supply service to customers. At that time the Commission (assuming it has found that Unit 1 is used and useful) will authorize the Company to replace the rates made effective at the end of the seven month suspension period with such level of rates as the Commission has concluded to be appropriate including the allowed costs and investments relating of Unit 1 of the Susquehanna plant, to be effective on one day's notice.
- F. Commencing with the end of the first quarter following entry of the final order described above, for one (1) year, PP&L shall furnish the Commission with quarterly reports of the unit's operating capacity factor and provide documentation of any outages during the report period. In the event these reports indicate that Unit 1 is not in fact used and useful in providing generation for the customers of PP&L, the

Commission may open a proceeding on its own motion for the purpose of considering the advisability of adjusting PP&L's annual operating revenues to reflect the elimination of Susquehanna Unit 1.

3. The issuance of this Order does not in any manner whatsoever determine the used or useful nature of Susquehanna Unit 1. Also, it is not a determination by the Commission that the costs involved were prudently incurred, that the energy savings properly recorded or that the Company may recover deferred costs or retain deferred energy savings. Recovery of these costs will be subject to subsequent Commission audit and final disposition in a rate case proceeding.

BY THE COMMISSION,

Jerry Rich  
Secretary

(SEAL)

ORDER ADOPTED: July 1, 1982

ORDER ENTERED: July 29, 1982

Dissent  
of  
Commissioner Michael Johnson  
Petition of PP & L  
Docket No. P-820367

I dissent from the majority response to the petition of PP & L at docket no. P-820367.

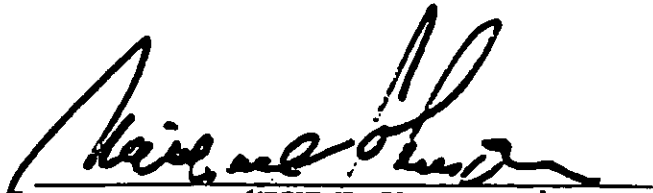
The Commission was confronted with a choice between two separate 'policy' approaches in dealing with the utility's request to establish the ground rules for a rate case that the utility has been preparing to file: give the company what it wanted vs. require the utility to advise its customers what it wanted and provide an opportunity for comments from the customers. On the motion of Commissioner James Cawley, the majority elected to respond to the petition, granting essentially what had been requested by the utility, without the benefit of extending an opportunity to the public to be heard.

The utility had approached this Commission, its staff and the Consumer Advocate some months ago on the design of a petition to deal with the problem of matching its next rate case with the start up of its Susquehanna Unit No. 1. The case that the company intended to file as early as September of this year for an increase of 45% in base rates could be delayed until mid-November if it could be assured that the revenue that it might lose would be recovered.

Matters of rate making substance are included in the petition and much money is at stake. Yet I can envision no reason why we should endorse a proposal without even letting the ratepayers know that one is being considered. The Commission's Law Bureau recommended that the petition be denied pending notification of customers and the OCA has opposed it strenuously.

At this moment a final order is not available and we have before us only the majority position on a staff report. This is a dissent from that position.

DATE: 7/1/82

  
MICHAEL JOHNSON  
COMMISSIONER

PENNSYLVANIA  
PUBLIC UTILITY COMMISSION  
Harrisburg, PA 17120

Public Meeting held November 2, 1983

Commissioners Present:

Linda C. Taliaferro, Chairman  
Michael Johnson, concurring in part and dissenting in part  
James H. Cawley

Petition of Pennsylvania Power and Light  
Company for Declaratory Order

P-830461

OPINION AND ORDER

BY THE COMMISSION:

On September 16, 1983, Pennsylvania Power and Light Company (PP&L) filed with the Commission a petition for declaratory order regarding the Company's Susquehanna Unit 2 nuclear generating facility at Berwick, Pennsylvania. In its petition, PP&L avers that its 1050 megawatt Unit 2 reactor is tentatively scheduled to go into commercial operation in November 1984. Specifically, the PP&L petition seeks: 1) Commission approval for implementation of a system of deferral accounting for the recognition of costs and expenses associated with the commercial operation of Unit 2 prior to its base rate recognition, assuming Unit 2 is brought on line commercially prior to the end of the test year period employed in the base rate proceeding for Unit 2 recognition (the so-called "early window" deferral accounting mechanism) and 2) concomitant approval of an alternative procedure whereby, assuming the facility would not be ready to commence commercial operation until after the end of the test year period utilized by PP&L in the base rate case seeking recognition of Unit 2, the Commission would adjudicate in the rate proceeding the appropriate base rate recognition of Unit 2, but postpone implementation of that portion of any approved base rate increase associated with the generating facility until such time as Unit 2 was actually put into commercial operation (the so-called "late window" base rate adjustment mechanism).

As explained in the September 16 filing, the Unit 2 petition is essentially identical to an earlier petition at P-820367 where the Company sought similar Commission declarations regarding potential base rate recognition of its Susquehanna Unit 1 reactor. The Unit 2 petition, however, has been revised somewhat from the earlier petition so as to be consistent with the Commission's Orders of July 1 and December 3, 1982

approving the Unit 1 petition. The Unit 2 petition also differs somewhat from the Unit 1 petition in that certain ECR tariff language changes required to implement PP&L's "early window" proposal have already been implemented as a result of the Unit 1 petition and thus were not sought as part of the Unit 2 petition.

The Office of Consumer Advocate (OCA) filed a response to the Company's Unit 2 petition. The OCA response sought specific modification of the "early window" deferral request and denial of the "late window" mechanism. PP&L subsequently filed comments answering OCA's response.

We have reviewed the averments contained in OCA's responsive pleading and find no substantial merit in the arguments presented in opposition to PP&L's request. Inasmuch as the Unit 2 petition seeks relief identical to that ultimately approved with regard to Susquehanna Unit 1 and inasmuch as the rationale, incorporated herein by reference, expressed in the Commission's earlier orders at P-820367 regarding the Unit 1 petition is equally applicable to the Company's Unit 2 petition, we find that PP&L's request for a declaratory order regarding Unit 2 is reasonable and in the public interest; THEREFORE,

IT IS ORDERED: That the Petition of Pennsylvania Power and Light Company for a Declaratory Order be and is hereby granted as follows:

1. If Unit 2 of the Pennsylvania Power and Light Company nuclear generating facility at Berwick, Pennsylvania (Susquehanna Unit 2) begins commercial operation before the end of the test year period employed in the PP&L rate proceeding seeking base rate recognition of Unit 2, the Commission hereby authorizes the following procedure:

- A. As soon as the Company knows that Unit 2 will be in commercial operation before the end of the test year period, the Company shall notify the Commission, the Presiding Administrative Law Judge and all parties to the proceeding.
- B. When Unit 2 begins commercial operation, PP&L will record the following costs related to that unit as deferred assets in Account 186 - Miscellaneous Deferred Debits: (1) carrying charges applicable to the investment, (2) depreciation and (3) operation and maintenance expenses including insurance, employee pensions and benefits, and payroll taxes. At the same time, PP&L will record as a deferred credit in Account 253 - Other Deferred Credits the value of generation from Unit 2.

C. PP&L will record the following journal entries from the date of commercial operation of Unit 2 until the costs of Unit 2 are recognized in base rates:

	<u>Debit</u>	<u>Credit</u>
(1)		
Account 186 - Miscellaneous Deferred Debits - Susquehanna Unit 2 Costs	X	

Account 401 - Operation Expense		X
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To record the deferral of operation and maintenance expenses, depreciation, property insurance, employee pensions and benefits, and payroll taxes applicable to Susquehanna Unit 2.

	<u>Debit</u>	<u>Credit</u>
(2)		
Account 186 - Miscellaneous Deferred Debits - Susquehanna Unit 2 Costs	X	

Account 419.1 - Allowance for Funds Used During Construction - Susquehanna Unit 2		X
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To record the deferral of carrying costs applicable to the investment in Susquehanna Unit 2 equivalent to the Allowance for Funds Used During Construction which would have been capitalized if Unit 2 were not in service.\*

	<u>Debit</u>	<u>Credit</u>
(3)		
Account 557 - Other Expenses - Interim Generation from Susquehanna Unit 2	X	

Account 200 - Other Deferred Credits		X
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To record the value of generation from Susquehanna Unit 2 employing the methodology for valuing test power that is currently a part of the PP&L tariff.

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\* The deferred balance associated with this item must be factored up for income taxes when reflected in charges to customers.

- D. In any proceeding seeking rate recognition of deferrals pursuant to this Paragraph, the Commission will address the disposition of those amounts then recorded as deferred assets in Account 186 and the energy savings recorded as deferred credits in Account 253.
2. If Susquehanna Unit 2 begins commercial operation after the end of the test year period utilized by PP&L in its rate proceeding seeking base rate recognition of Unit 2, the Commission hereby authorizes the following procedure:
- A. As soon as the Company knows that Susquehanna Unit 2 will not be in commercial operation before the end of the test year period, the Company shall notify the Commission, the Presiding Administrative Law Judge and all parties to the proceeding.
- B. The Commission will, at or near the end of the statutory suspension period, issue a Final Order resolving all of the issues in the proceeding regarding PP&L rates including all issues with respect to the inclusion of the costs and expenses of Unit 2.
- C. The Final Order issued at or near the end of the suspension period will also authorize the Company to make effective such level of rates as the Commission has concluded to be appropriate, excluding all costs and expenses relating to Unit 2.
- D. When Unit 2 begins commercial operation, PP&L shall notify the Commission, the Presiding Administrative Law Judge and all parties in the base rate proceeding.
- E. Within 15 days after receipt of the notification specified in Subparagraph 2.D., above, the Commission shall issue an order recognizing that Unit 2 is in commercial operation. At that time, and to the extent that Unit 2 has been found to be "used and useful" in the Final Order referenced in Subparagraph 2.B., above, the Commission will authorize the Company to replace the rates

made effective at the end of the seven-month statutory suspension period with such level of rates as the Commission has concluded to be appropriate including the allowed costs and expenses relating to Unit 2, to be effective on one day's notice.

- F. For one year, commencing with the end of the first quarter following entry of the supplemental order described in Subparagraph 2.E., above, PP&L shall furnish the Commission with quarterly reports of Unit 2 operating capacity factors and provide documentation of outages during the report period. To the extent these reports dictate, the Commission may take appropriate action to adjust rates and annual operating revenues of PP&L.

3. The issuance of this Order does not in any manner whatsoever determine the used or useful nature of Susquehanna Unit 2. Also, it is not a determination by the Commission that the costs involved were prudently incurred, that the energy savings were properly recorded or that the Company may recover deferred costs or retain deferred energy savings. Any claim for recovery of these costs will be subject to subsequent Commission audit and final disposition in an appropriate proceeding filed subsequent to the entry of a Final Order in the Susquehanna Unit 2 rate case proceeding. In said subsequent proceeding PP&L shall file actual cost data and the full accounting detail in support thereof and notice and opportunity to be heard will be provided. The question of whether the Company may recover the deferred costs, the reasonableness of these costs, and the merits of a cost recovery mechanism will be determined by the Commission in said subsequent proceeding.

4. Whether the achievement of "commercial operation" or any other greater or lesser criterion shall be a sufficient factual basis for concluding that all or part of PP&L's investment in Susquehanna Unit 2 is "used and useful" and thus properly includable in the rates of PP&L is a question which is intended to be left for ultimate resolution by the Commission in accordance with the law at some future date after notice, evidentiary hearings and legal argument in the appropriate proceeding.

BY THE COMMISSION,

Jerry Rich  
Secretary

(SEAL)

ORDER ADOPTED: November 2, 1983

ORDER ENTERED: NOV 9 1983

CERTIFICATE OF SERVICE

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

I hereby certify that I have this day served a true copy of the foregoing document, Office of Consumer Advocate's Main Brief, upon parties of record in this proceeding in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a participant), in the manner and upon the persons listed below:

Dated this 16th day of June, 1995.

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**DOCKETED**  
JUN 16 1995

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