BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY COMMISSION	:	
v.	:	Docket No. R-00943271
PENNSYLVANIA POWER & LIGHT COMPANY	:	

REPLY BRIEF OF THE OFFICE OF CONSUMER ADVOCATE

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

For:
Irwin A. Popowsky
Consumer Advocate

Office of Attorney General
Office of Consumer Advocate
1425 Strawberry Square
Harrisburg, PA 17120
(717) 783-5048

Dated: June 27, 1995

TABLE OF CONTENTS

TABLE OF CITATIONS

CASES

ADMINISTRATIVE DECISIONS

STATUTES AND REGULATIONS

MISCELLANEOUS

I. INTRODUCTION

On June 16, 1995, Main Briefs were filed by Pennsylvania Power & Light Company ("PP&L" or "Company"), the Office of Consumer Advocate ("OCA"), the Office of Trial Staff ("OTS"), the Office of Small Business Advocate ("OSBA"), the PP&L Industrial Customer Alliance ("PPLICA"), the Department of Defense and the Federal Executive Agencies ("DOD"), Bethlehem Steel Corporation ("Beth Steel"), the Central Eastern Pennsylvania Fuel Oil Dealers ("CEPFOD"), the Crown American Realty Trust ("Crown"), the University/College Coalition ("UCC"), the Commission on Economic Opportunity ("CEO"), the Sierra Club, and Eric Epstein ("Epstein"). The Office of Consumer Advocate now files its Reply Brief in response to PP&L's Main Brief and the arguments raised by the OTS, OSBA, PPLICA, UCC, DOD, CEPFOD, Beth Steel, and Crown (collectively referred to as "other parties") relating to cost of service and rate design issues. The OCA believes that its Main Brief ("M.B.") provides the Administrative Law Judge ("ALJ") and the Pennsylvania Public Utility Commission ("Commission" or "PUC") with a comprehensive discussion of the issues in this proceeding. The OCA's Main Brief fully addresses and responds to virtually all of the contentions made by the Company and the other parties in their Main Briefs.

It is not the purpose of this Reply Brief to respond to all of the arguments contained in the these Briefs. The OCA will limit its reply to those issues requiring additional clarification. Thus, any failure of the OCA to address specific arguments

contained in the Company's and the other parties' Main Briefs should not be considered as acquiescence to a specific argument or position. The OCA would note that based on a review of these Main Briefs, the OCA is not revising any of its adjustments or positions. The OCA respectfully refers the ALJ, the Commission and other interested parties to its Main Brief for a full discussion of these issues.

Before addressing PP&L's specific arguments, however, the OCA wishes to provide a general response to the Company's presentation. The Company, in its Main Brief characterizes the positions of the Complainant parties in this case as "disturbing" and "negative" in their overall approach and result. The Company characterizes many of the proposed adjustments by the parties as "penalties" that should not be adopted by the Commission.

The OCA submits, however, that it is the Company's proposals in this case that are disturbing and would penalize current ratepayers by shifting excessive costs onto these ratepayers as the Company positions itself for the possibility of increased competition in the electric industry. In essence, through its proposals in this case, the Company has sought the authority to increase its rates over the next five years by nearly $440 million, not just the $261 million that the Company has identified in this case, due to its unprecedented request for automatic recovery of the capacity costs associated with expiring off-system sales. As the many ratepayers testified at the eleven public input hearings, it is they who feel "penalized" by the

enormity of the Company's rate increase request and its proposals in this case to recover more of its costs in fixed customer charges from low usage customers.[1]

Even a cursory review of the Company's claims in this case reveals the attempts by the Company to extract excessive revenues from its current customers. PPLICA, in its Main Brief succinctly summarized these claims as follows:

> (1) a 13.0% return on common equity when the Commission most recently awarded an electric utility 11.5% return on common equity;
>
> (2) a $45 million revenue requirement claim for prospective fossil decommissioning costs when the Commission recently rejected an identical claim by an electric utility;
>
> (3) a $19 million claim for accelerated depreciation on fossil fueled generating units based on a depreciation schedule that does not reflect the Company's own system planning documents;
>
> (4) a $30 million increase in depreciation expense to reflect a change in the Company's originally selected depreciation methodology for the Susquehanna Steam Electric Station ; and
>
> (5) an automatic $35 million per year rate increase to reflect the possible return of expiring off-system sales.

PPLICA M.B. at 5. To this list, the OCA would add a $62 million increase to reflect the return on equity associated with Susquehanna 2 -- a return which the Commission disallowed upon

---

[1] At the request of the ALJ, the OCA has provided a comprehensive Summary of the Public Input Testimony, bound separately, as an expansion of the OCA's summary as to certain customers provided in its Main Brief at pages 297-299.

finding that the unit constituted excess capacity. As the OCA has demonstrated this unit remains uneconomic capacity that is not fully needed by the Company.

As set forth fully in the OCA's Main Brief and the Briefs of the Complainant parties, the Company has failed to justify its many requests, or establish that its proposed increase will produce rates that are just and reasonable.

Additionally, a review of the Company's Main Brief reveals that the Company failed to address several adjustments raised by the OCA during the course of this proceeding. The OCA submits that Section 5.501(a)(3) requires the Company to address all issues in its Main Brief. That section states:

> (3) . . . The party with the burden of proof shall, in its main or initial brief, completely address, to the extent possible, every issue raised by the relief sought and the evidence adduced at hearing.

52 Pa. Code § 5.501(a)(3) (emphasis added). The Company's failure to address these issues precludes PP&L from presenting any affirmative claim for this issue in its Reply Brief. Specifically, the Company failed to respond to several adjustments to PP&L's cash working capital calculation, including the OCA's proposals to: remove the interest on customer deposits and the Sunbury pump invoice from the O&M expense lag; adjust the payment lag associated with interest on long-term debt and preferred stock dividends; and to exclude a one-day prepayment of interest and preferred dividends. OCA M.B. at 75-85. The Company also failed

to address the OCA's adjustment to reflect the benefit savings associated with PP&L's reduction in employees. OCA M.B. at 96. In addition, PP&L did not address the OCA's recommendation to eliminate the Company's accrual for potential state and federal tax deficiencies or the OCA's tax synchronization adjustment. OCA M.B. at 207-210. The OCA submits that these adjustments must be adopted since the Company has clearly failed to meet its affirmative burden of proving that these claims are just and reasonable.

As set forth in detail in its Main Brief and as is discussed below, it is the position of the Office of Consumer Advocate that PP&L's rate increase should be denied and he Company's rates should be reduced by $66,464,000. See OCA M.B. at Appendix A, Table 1.

II. SUMMARY OF REPLY ARGUMENT

As indicated in the OCA's Main Brief, the OCA submits that rather than a $261 million increase PP&L should reduce its rates by approximately $66 million.[2] For the reasons discussed below, and in the OCA's Main Brief, the OCA submits that the arguments presented in PP&L's Main Brief are not supported by substantial evidence and otherwise fail to meet its burden of proof and the requirements of the Pennsylvania Public Utility Code. Consequently, the Company's position should be rejected. The OCA urges the Commission to adopt the recommendations of the OCA.

---

[2] Although the OCA is the only party recommending that the Company's rates be reduced in this proceeding. Other parties have recommended significant reductions to the Company's claim. OTS has recommended that PP&L receive no more than $20,455,000. OTS M.B. at 148 PPLICA recommended a revenue increase of no more than $24 million. PPLICA M.B. at 46.

III. EXCESS CAPACITY

A. Introduction

The Company argues at great length in its Main Brief that the OCA's recommendation for the Commission to continue its excess capacity disallowance for Susquehanna 2 would constitute bad policy and send the wrong message to utilities regarding the planning and operation of their systems. In addition, the Company argues that the OCA has sought to "change the rules of the game" and "mix ratemaking methodologies" by recommending that current market information be used in the analysis of whether Susquehanna 2 provides net economic benefits to ratepayers. The OCA submits that these arguments are nothing more than a mischaracterization of the nature and purpose of an excess capacity adjustment and the facts in this case.

There are very few factual disputes in this case regarding the issue of excess capacity. Rather, the arguments center around the policy that should guide the Commission in the review of these facts. The OCA submits that the Commission's policy in these matters is clear--utility assets that are not used and useful in providing service to the public should not be fully included in rates. This policy has been established by the Commission in a consistent series of cases from 1978 to 1990, and upheld by the Commonwealth Court in the landmark case of Philadelphia Electric Company v. Pennsylvania Public Utility Commission, 61 Pa. Commonwealth 325, 433 A.2d 620 (1980)(PECO 1980). The Commission's precedent was codified by the General

Assembly in 1986 in Section 1323. In this case, the OCA is simply applying this long-standing policy to the facts of this case.

The OCA submits that, as set forth in Section 1323 of the Public Utility Code, a base load generating unit that does not provide reliability and economic benefits to ratepayers is not used and useful, and constitutes excess capacity under the law. As such, the OCA submits that the Commission must apply Section 1323(a) of the Public Utility Code and appropriately balance the interests of shareholders and ratepayers in bearing this uneconomic burden.

The OCA would note that the facts regarding the issue of excess capacity are not in serious dispute. For example, there is no dispute on the following facts:

1. The Company is presently not authorized to earn a return on Susquehanna 2 based on the Commission's prior excess capacity disallowance, and such recovery has <u>never</u> been authorized in rates.

2. The OCA's recommendation in this case is to continue the Commission's previous disallowance using precisely the same method of calculation as used by the Commission in PP&L's 1985 rate case.

3. PJM assigns PP&L a 12% reserve margin obligation based upon the one day in ten-year loss of load standard, which is based upon a review of relevant uncertainties and reliability concerns.

4. PP&L has used, and continues to use, a 12% reserve margin for planning purposes, and such reserve margin will enable PP&L to maintain its present level of reliability.

5. PP&L's current reserve margin for the test year, including its NUG resources, is 24%. (PP&L Exh. JFS-1)

6. Despite substantial projected load growth, PP&L has no need for new capacity until 2008.

7. No witness specifically endorses a 22% reserve margin, for either planning or ratemaking.

8. No PP&L witness has provided a specific "ratemaking reserve margin" recommendation.

9. The cost of Susquehanna 2 is about 6¢/kwh.

10. PP&L's avoided costs over the next ten years are 2.8¢/kwh. Market price estimates developed by both the OCA and PP&L over the next 5-10 years are 3¢ to 4¢/kwh on average.

The OCA submits that in light of these facts, it is clear that Susquehanna 2 represents both physical and economic excess capacity. As a result, the OCA submits that its recommendation to continue the equity disallowance on Susquehanna 2 should be adopted in this proceeding. As set forth fully by the OCA in its Main Brief, this disallowance would equitably share the burden of the excess capacity between PP&L's shareholders and ratepayers.

B. Section 1323 Applies To The Company's Claim For A Return On Equity Associated With Susquehanna 2.

The Company has argued in this case that Section 1323 does not apply to its claim for a return on equity associated with its investment in Susquehanna 2. PP&L M.B. at 47-48. The Company argues that Section 1323 does not apply because this is not the utility's first claim for recovery of the costs associated with Susquehanna 2. PP&L M.B. at 47-48. In addition, the Company argues that the Commission has never applied Section 1323 to a base load generating unit that was in commercial operation prior to the enactment of Section 1323. Id. As set forth fully in the OCA's Main Brief at pages 21 to 27, the OCA submits that these arguments must be dismissed. Section 1323 applies to PP&L's claim in this

case since PP&L seeks to earn, for the first time, a return on equity associated with its investment in Susquehanna 2. 66 Pa.C.S. § 1323. Moreover, even if Section 1323 does not apply, the OCA submits that the Commission should apply both an economic and a physical excess capacity test when considering PP&L's claim.

The Company's argument is premised on its reading of the phrase "[w]henever a public utility claims the costs of an electric generating unit in its rates for the first time..." in Section 1323. PP&L M.B. at 47-48. The Company argues that since it has previously claimed the costs of Susquehanna 2 in its 1984 base rate case, its current claim for a return on common equity, which was denied in its previous rate case, is exempt from the provisions of Section 1323. Id.

The Company, however, ignores the Commission's previous precedent regarding its interpretation of this language. As the OCA set forth in its Main Brief, the Commission has previously interpreted this language to mean that the costs associated with the unit have not been included in any previous Commission-made rates. Pa. P.U.C. v. West Penn Power Company, 61 Pa. PUC 711, 736-37, 77 PUR4th 220, 245 (1986). Additionally, the Commission has applied Section 1323 on at least two other occasions despite the fact that the utility's involved had claimed the costs associated with the generating facility at issue in a previous proceeding. See, Pa. P.U.C. v. Duquesne Light Company, 66 Pa. PUC 518 (1988) and Pa. P.U.C. v. Pennsylvania Power Company, 67 Pa. PUC 91 (1988). As the OCA discussed in its Main Brief, the Commission's

interpretation of this language is reasonable, and avoids the absurd result of a utility being able to reverse an excess capacity decision under Section 1323 merely by filing a second case the day after the first case was concluded.

Based on this prior Commission precedent, it is clear that Section 1323 applies to the Company's claim for a return on common equity associated with Susquehanna 2. The costs associated with a return on equity for Susquehanna 2 have never received ratemaking recognition from this Commission.[3] As such, the OCA submits that Section 1323 must apply to the Company's claim in this case.

PP&L has also argued that since Susquehanna 2 was in commercial operation prior to the enactment of Section 1323, the provisions of this Section do not apply to Susquehanna 2. PP&L M.B. at 47-48. As the OCA pointed out in its Main Brief, however, Section 1323(c) makes clear that it applies to units that were in commercial operation for at least one year prior to the enactment of the statute. Section 1323(c), in relevant part provides:

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

---

[3] The Company, at page 48 of its Main Brief, argues that "to a large extent, the costs of SSES 2 are already reflected in current rate levels." The crucial point for consideration in this case is that a major cost--the return on equity associated with SSES 2--has never been specifically authorized in Pennsylvania jurisdictional rates.

66 Pa.C.S. § 1323(c)(emphasis added). As can be seen, the fact that Susquehanna 2 was in commercial operation prior to the enactment of Section 1323 is irrelevant.[4]

Moreover, as noted in the OCA's Main Brief, the legislative history of Section 1323 confirms that the General Assembly believed that Section 1323 would apply to PP&L. See, OCA M.B. at 25-26. PP&L was specifically referred to when the Report of the Committee of Conference on HB 1639, PN 3778 was called for consideration. See, Legislative Journal of Pennsylvania House of Representatives, Report to the General Assembly on June 25, 1986, at 1554 (Vol. II, 1986). It is apparent from the discussion of the Report that it was believed that the provisions of the Act, later enacted as Section 1323, would apply to PP&L.

The OCA submits that, in accordance with prior precedent, the Commission must apply Section 1323 to the Company's claim for a return on common equity associated with the investment in Susquehanna 2. For the Commission to find otherwise would produce the absurd result that a utility could reverse a Commission imposed excess capacity adjustment by merely filing another base rate case any time after the Commission's Order was entered in its first case. The OCA submits that such a result would be contrary to the public interest and the clear legislative intent of the statute.

---

[4] Susquehanna 2 was in commercial operation for at least one year prior to the enactment of Section 1323. The Commission's Order recognizing the commercial operation of Susquehanna 2 was entered in April 1985 and Section 1323 was enacted on July 10, 1986 (P.L. 1238, No. 114).

For the reasons set forth above, and for the reasons set forth in the OCA's M.B. at pages 21-27, the OCA submits that Section 1323 applies to the Company's claim for a return on equity associated with Susquehanna 2.[5]

C. Physical Excess Capacity.

1. Introduction.

The Company, in its Main Brief, has argued that it does not have physical excess capacity in that its reserve margin should be set higher for ratemaking purposes than for planning purposes, and its NUG (QF) capacity should not be counted in determining whether the Company has physical excess capacity. The Company also argues that even if the Company is found to have physical excess capacity, it is the 500 MW of NUG capacity that constitute the excess, not Susquehanna 2.

The OCA submits that these arguments are without merit and should be dismissed. As the OCA has set forth in its Main Brief, a reasonable reserve margin for PP&L is in the range of 12% to 15%. This reserve margin properly reflects PP&L's obligation to PJM and provides a reasonable 3% cushion to account for planning uncertainties. Moreover, when determining whether the Company has

---

[5] Even if the Commission finds that Section 1323 is not directly applicable to the Company's claim, the OCA submits that the Commission should consider both physical and economic excess capacity in reviewing the Company's claim. Indeed, in PP&L's last rate case, the Company itself encouraged the Commission to consider the economic benefits of Susquehanna 2 and not just whether the unit constituted physical excess capacity. PP&L 2, 59 Pa. PUC at 347. The Company has provided no reason why its claim should be exempt from this type of review in this case. See, OCA M.B. at 28-30.

physical excess capacity, the OCA submits that it is proper to include the 500 MW of NUG resources. PP&L's ratepayers pay all costs associated with these purchases through the ECR, and PP&L reflects these resources for its own planning purposes. As such, the OCA submits that it is appropriate to include these resources in assessing whether PP&L has physical excess capacity.

2. PP&L's NUG Resources Should Be Included In The Determination Of Available Resources For Excess Capacity Purposes.

The Company sets forth several policy arguments against the inclusion of the NUG capacity in the determination of excess capacity. First, the Company argues that by including the NUG capacity, the Commission will be sending the message to utilities to say no to QF capacity for fear that it will be counted against them in a future excess capacity determination. PP&L M.B. at 23. *Second, the Company argues that use of NUG capacity in the excess* capacity determination, particularly pursuant to Section 1323(c) is inconsistent with Section 523 which encourages the purchase of QF capacity. Third, the Company relies upon a Commission policy statement, that was issued in 1987 and never finalized, to argue that in cases where Section 1323(c) does not apply, the Commission has found that the inclusion of the NUG capacity in excess capacity determinations would discourage continued development of QFs. PP&L M.B. at 28. The OCA submits that these arguments are flawed and should be disregarded for the reasons set forth below.

The OCA submits that the majority of the Company's arguments have already been resolved by the General Assembly when

it enacted Section 1323(c) of the Public Utility Code specifically addressing the treatment of NUG capacity in excess capacity determinations. 66 Pa.C.S. §1323(c). As set forth fully in the OCA's Main Brief, Section 1323(c) specifically provides:

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

66 Pa.C.S. §1323(c). Clearly, the legislature did not intend to exempt QF capacity from consideration in an excess capacity determination forever as the Company argues. If it had, the General Assembly could have so stated in this section.[6]

Instead, the General Assembly established an eight year "window" during which the NUG capacity cannot be considered in an excess capacity determination. To exempt this capacity forever from an excess capacity determination would "send the wrong message" to utilities regarding appropriate system planning, and it

---

[6] In light of this statutory authority, the Company's reliance on a 1987 Policy Statement that was never finalized (and issued after PP&L had already entered into many of these contracts) is misplaced. The Commission chose not to finalize its Policy Statement, and the OCA would question its applicability to the facts before the Commission in 1995.

would unfairly burden ratepayers who pay all of the costs associated with QF capacity in the ECR.[7]

Additionally, the Company's argument that Section 523 and 1323(c) are inconsistent is misplaced. A simple reading of Section 523 reveals that its purpose is to consider a utility's actions in procuring NUG capacity according to the utility's need. Nothing in Section 523 encourages a utility to procure NUG capacity that is excess, and nothing in Section 523 limits the Commission's authority to make an excess capacity adjustment when the fact of excess capacity exists. Section 523 merely exists as an incentive to prudent and appropriate procurement of needed cogeneration resources. If anything, Section 1323(c) complements the incentive in Section 523 by providing favorable treatment to NUG capacity in the excess capacity determination. NUG capacity is given the protection of being excluded from the excess capacity determination for a period of eight years, whereas no such protection is provided to a utility's own resources.

Moreover, the OCA submits that the Company's arguments misunderstand the nature of an excess capacity determination. An excess capacity adjustment deals with the fact that excess capacity exists on the utility's system, regardless of its exact cause or

---

[7] As OCA witness Kahal noted, the eight year time frame should provide a sufficient "window" for a utility to adjust its planning and resources for the addition of QF capacity through such things as off-system sales and engaging in potential buyouts or buydowns. Interestingly, the Company has acknowledged that it did not submit a bid in either the ODEC solicitation for 150 MW or the BG&E solicitation for 140 MW. Tr. 263-266. In addition, the Company acknowledges that it does not yet have a comprehensive marketing strategy. Tr. 2312-2316.

source. As OCA witness Kahal noted, excess capacity could just as easily have resulted from a loss of load due to an economic downturn, or other events arguably beyond the utility's control. OCA St. 2 at 12. The cause of the excess capacity, though possibly relevant to the remedy, is not relevant to the factual determination of excess capacity.

The Commission has often recognized that an excess capacity adjustment is intended to share the resulting burden of these types of events between shareholders and ratepayers, even where neither is at fault. In a Penn Power case, the Commission stated:

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

Pa. P.U.C. v. Pennsylvania Power Company, 52 Pa. PUC 459, 471 (1978).

The Company's arguments that an excess capacity determination which includes NUG capacity will encourage utilities to resist QF purchases or would "penalize" a utility for prudently seeking capacity credits for NUG capacity similarly misunderstand the purpose of an excess capacity adjustment. Importantly, a utility that improperly resists the purchase from a QF source for fear that it would be counted in an excess capacity adjustment would also then not build its own resources, or purchase from other utilities, for fear that these resources may be included in an

excess capacity determination at some point in the future. Similarly, an excess capacity adjustment does not penalize a utility for prudent planning, or serve as a deterrent to prudent planning. Rather, it provides important ratepayer protection.

As Judge Starr so aptly noted in his concurring opinion in Jersey Central Power & Light Company v. FERC, 810 F.2d 1168 (D.C. Circuit 1987), an excess capacity, or "used and useful" review is an important protection in regulation, not a deterrent. Justice Starr stated:

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

Id. at 1190, n.1. As can be seen, an excess capacity adjustment provides an appropriate regulatory safeguard, rather than sending the "wrong message" to utilities.

Moreover, the Company's argument that such adjustment could be a never ending cycle that results in a disallowance of all utility capacity while the NUG capacity remains on the system is misguided. There is nothing in PURPA that "requires" a utility to purchase capacity that is unneeded or overpriced at the time that a contract is entered into. As with all utility resource decisions, however, economic forces can work against an investment even if prudent when made. There is, however, no reason to assume that federal law, or even PURPA, will require a utility to make

imprudent decisions as to its capacity planning at the time the decisions are made.[8]

Finally, the Company argues that if there is physical excess capacity, the NUGs are the cause of this excess capacity since they were the last resource added to PP&L's system. However, the Company ignores the facts that in this case, the Company has sought a return on equity associated with its investment in Susquehanna 2, which the Commission has previously found to be excess capacity. It is the Company which has sought to reverse the Commission's previous determination as to Susquehanna 2 in this case, and that is the issue that must be addressed in this case.

For the reasons set forth above, and for the reasons set forth in the OCA's Main Brief at pages 40 to 44, the OCA submits that PP&L's 500 MW of NUG capacity resources should be included in the determination of physical excess capacity.

---

[8] Additionally, the Company's reliance on the Commonwealth Court's discussion of the issues in Pennsylvania Electric Co. v. Pa. P.U.C., 119 Pa. Commonwealth 413, 648 A.2d 63 (1994) (Penelec) is misplaced. In that case, the Court was considering a Commission action which ordered a utility to enter into a long term contract with two QFs despite the utility's argument that the capacity was unneeded and overpriced. As the Court correctly noted in dicta, due to the direct pass through of the costs of this purchase to ratepayers, the risk of the transaction was shifted to the ratepayers. Thus, it was crucial for the Commission to appropriately resolve the issues of need and avoided cost in cases where the Commission is being asked to make such a determination for QF capacity. The Court was not ruling on whether the Commission may, at some point in the future, include QF capacity in a determination of whether a utility's own capacity represents physical excess capacity.

3. A Reasonable Reserve Margin For PP&L Is In The Range Of 12% To 15%.

In its Main Brief, PP&L argues that a reasonable reserve margin for ratemaking purposes should be set higher than the Company's PJM obligation since reliability calculations used to determine reserve margins are not perfect. PP&L M.B. at 31-41. The Company, however, again fails to support any upper bound for a reasonable reserve margin to account for these imperfections. The OCA submits that OCA witness Kahal's 3% cushion, to account for just such uncertainties, results in a reasonable reserve margin of between 12% to 15% for PP&L for ratemaking purposes.

The Company has argued that the reserve margin for ratemaking purposes, should be substantially above its PJM obligation to account for such things as the effect of cold weather on generating unit availability (p. 36);[9] "lumpiness" from the addition of large generating units (p. 37); after-the-fact PJM accounting adjustments (p. 36, 43); the Company's lack of full control over its interruptible load (p. 35); the Company's lack of full control over the NUGS; and other such factors. PP&L M.B. at 34-40. The OCA does not disagree that these are factors to be considered in determining an appropriate reserve margin. However,

[9] Although the Company mentions the issue of cold weather on at least two occasions in its Main Brief (PP&L M.B. at 19 and 36), even the Company has not argued that it is reasonable for a utility to plan its system solely based on the coldest day in a century. In fact, in response to a question posed by Judge Turner, Company witness Sipics acknowledged that you must look at these issues from a cost/benefit perspective, and not necessarily avoid every worst case scenario. Tr. 272.

the OCA submits that these factors do not justify a ratemaking reserve margin that significantly exceeds the Company's PJM capacity obligation.

Importantly, the OCA submits that many of the factors relied upon by the Company are already included in the PJM determination of reliability that is used to establish PJM's reserve margin, which is then allocated to the member companies. For example, on cross-examination, PP&L witness Sipics acknowledged that PJM takes into account the reliability of interruptible load and NUG capacity. Tr. 269. In addition, Mr. Sipics acknowledged that to an extent, the possibility of extreme weather is taken into account by PJM. Tr. 270. In addition, Mr. Sipics acknowledged that PJM takes into account such factors as load diversity, planned outages, and unplanned outages when determining appropriate reserve margins. Tr. 273.[10] As such, many of the factors relied upon by the Company for significantly increasing its reserve margin for ratemaking purposes are already considered by PJM when determining

[10] At page 43 of its Main Brief, the Company sweepingly asserts that the factors discussed by Mr. Sipics in his testimony which must be considered in the determination of an appropriate reserve margin are not included in PJM's determination of a reserve margin. This is directly contrary to Mr. Sipics testimony on cross-examination at Tr. 269-273. Mr. Sipics, in rebuttal, subsequently listed additional factors which he asserted were not considered by PJM in its reserve margin calculation, such as the after-the-fact capacity deficiency accounting and emerging competitive markets. PP&L St. 9-R at 2. As OCA witness Kahal explained, however, the Company does account for these items in its own planning, and its own planning assumptions utilize reserve margins in the range of 11.5% to 12.5%. OCA St. 2A at 13-15. Moreover, Mr. Sipics did not demonstrate that Mr. Kahal's 3% cushion was insufficient to account for these factors.

the appropriate reserve margin obligation of PP&L on the PJM system.

4. Conclusion.

For the reasons set forth above, and for the reasons set forth in the OCA's Main Brief at 30 to 45, the OCA submits that PP&L has physical excess capacity. Using a reasonable reserve margin range of between 12% to 15%, and including the NUG capacity as an installed resource for PP&L, the OCA has concluded that PP&L has physical excess capacity in the range of 400 MW to 800 MW. Although this is somewhat less than the 850 MW of Susquehanna 2 that serves native load customers, the OCA submits that the equity return disallowance should continue to apply to the entire unit since the unit also constitutes economic excess capacity.

D. Economic Excess Capacity

1. Introduction

The Company, in its Main Brief, has argued that an economic excess capacity test should not apply to Susquehanna 2 since Section 1323 does not apply to its claim in this case. PP&L M.B. at 47-48. In addition, the Company argues that the OCA, in using market data in its economic excess capacity analysis, has introduced a new test that has never been adopted by this Commission or any other Commission. PP&L M.B. at 49. The Company argues that the test, or standard to be used, is the coal proxy analysis set forth in rebuttal by its witness Hieronymus. Finally, the Company argues that the OCA has "prejudged" the stranded cost

issue by recommending the continuation of the disallowance of the equity return on Susquehanna 2.

The OCA submits that these arguments are without merit. As set forth above, the OCA submits that Section 1323 clearly applies to the Company's claim to earn, for the first time in Pennsylvania jurisdictional rates, a return on equity associated with Susquehanna 2. See, OCA M.B. at 21 to 28 and OCA Reply Brief, Section III B. Additionally, the Company's arguments that the OCA has recommended a new test or standard, and prejudged the stranded cost issue by using market information in its analysis mischaracterizes the nature of the OCA's analysis and its recommendation. The OCA has merely used the economic test set forth in the statute to evaluate whether the Company has excess capacity. In employing this test, the OCA has utilized market information as a measure of the economics of the unit. As the Commission has often noted, the use of life cycle analyses and long term assumptions has not been particularly useful in determining economic excess capacity. With a developing market for generation, the information is now available to the Commission to make a meaningful analysis of this question. The OCA has utilized this information to provide just such a meaningful analysis.

Additionally, the OCA's recommended disallowance in this case does not "prejudge" the stranded cost issue. The OCA has recommended that the Commission's existing disallowance be continued in this case, using the exact same methodology that the Commission had previously employed. The only difference is that

the OCA's recommended disallowance in this case is at a lower level than the Commission's previous disallowance in PP&L's last base rate case.

2. The Use Of Current Information To Analyze The Economic Benefits Of Susquehanna 2 Is Reasonable.

The thrust of the Company's argument on economic excess capacity is that the use of market information to assess the economics of a regulated utility asset is improper. PP&L M.B. at 49-51. The OCA submits, however, that the use of current information on the price for power, information which is now readily available due to the developing wholesale market, is not improper. The question in an economic excess capacity determination has always been what benefits does the base load unit provide as compared to other resources available to the utility. At this time, due to the Energy Policy Act of 1992, a wider range of options is available to the utility than previously, and this has been reflected in the cost of alternative resources to the utility--what has been referred to as market information. The use of this information in the basic analysis of economic excess capacity does not alter the fundamental test applied by the Commission. If anything, the developing market provides the Commission with just the type of meaningful information, without relying on long-term, controversial assumptions, that the Commission had sought in previous cases.

Moreover, the Company argues that OCA witness Kahal has used prices for a fully deregulated environment, which does not

exist, as a comparison to the regulated price of Susquehanna. PP&L M. B. at 53. This is simply not so. As OCA witness Kahal explained, he explicitly utilized a five to ten year time frame for his analysis due to the possibility that ratepayers would pay market rates for generation after the year 2005 in a fully deregulated environment. Mr. Kahal stated:

> Given the strong possibility that ratepayers will pay market rates for generation in the years after 2005, I believe that the next five to ten years are the most meaningful for evaluating economic excess capacity.

OCA St. 2 at 18. Simply put, the market information utilized by Mr. Kahal was based on current information that reflects the market at this time and reflects the price to the utility of alternative resources.[11]

The Company has also argued that if a market test is to be applied, then Susquehanna 2 should not be isolated for consideration, and all other assets should be considered for valuation at market prices. PP&L M.B. at 50. Specifically, the Company argues that its transmission and distribution facilities should be valued at market prices which should exceed their

---

[11] The Company has also argued that the market prices used by Mr. Kahal in his analysis were derived from PP&L sources, but that the PP&L estimates were understated and assumed a fully competitive market. As OCA witness Kahal explained, however, he confirmed these estimates by reviewing a wide range of evidence. These estimates were found to be consistent with (1) PP&L's own wholesale transactions; (2) other recent transactions for base load capacity between utilities in the PJM region; (3) PP&L's own estimates of avoided cost; and (4) the busbar costs of power from a new gas-fired combined cycle unit which PP&L could construct. OCA St. 2A at 30. Moreover, PP&L witness Sipics testified that the Company's estimates of market prices "steps into a fully competitive generation market between 1994 and 2000." Tr. 247-248.

embedded cost value. PP&L M.B. at 50. As OCA witness Kahal explained, however, there is no market for transmission and distribution facilities at this time. These facilities remain as monopoly functions and are expected to remain as monopoly functions even as generation facilities become more competitive. OCA St. 2A at 32. As to PP&L's other generating assets, although there are some that may be below market prices, PP&L's overall generation cost still remains above market prices. OCA St. 2A at 31.

At page 52 of its Main Brief, the Company argues that a market test is inconsistent with Section 1323 because under Section 1323, the utility must be provided a meaningful opportunity to rebut the presumption of excess capacity and it is doubtful that any large base load plant could rebut such a presumption.[12] PP&L M.B. at 52. The OCA submits, however, that just because PP&L cannot rebut the presumption of economic excess capacity from Susquehanna 2 does not mean that the economics of the plant should not be considered by the Commission. The Company's argument is tantamount to saying that every time a utility cannot meet an economic test, regulators should waive the economic test as it applies to that utility. Such an argument would force ratepayers to pay nothing but uneconomic costs and would undo the careful sharing of uneconomic burdens that Pennsylvania regulation has established over the last two decades.

---

[12] The OCA would again note that the Company put on no direct case establishing that Susquehanna 2 was an economic resource.

The Company has also argued that market information represents a moving target that cannot be used in an economic analysis of the benefits of Susquehanna 2. As an example, the Company points to the testimony of OCA witness Kahal in a case involving Pennsylvania Electric Company (Penelec) where the avoided cost for Penelec was being determined for the purpose of setting a rate for the purchase from of capacity and energy from a QF. PP&L M.B. at 54. The Company argues that in that case, Mr. Kahal determined that the levelized avoided cost for Penelec was 8.5¢/kwh, with a 1997 avoided cost of 5.75¢/kwh. Id. The Company then jumps to the conclusion that if it had filed a base rate case three years ago, at the time of the Penelec case, Susquehanna would have passed the economic test. PP&L M.B. at 55.

The Company's argument misses several key points, however. Initially, it must be noted that the Company fails to recognize that the issue of excess capacity is evaluated at a point in time, given the circumstances of the time. The Company assumes that the facts of 1995 would be the same as in 1991. Yet, in 1991, the cost of Susquehanna may have been higher, and the Company's physical excess capacity may have been more severe due to four years less load growth. Moreover, the Company fails to recognize that the decision to file a base rate case, and the timing of that case, is within the discretion of the Company. The Company obviously determined that its earnings were sufficient in 1991, even with the existing excess capacity disallowance.

Importantly, the Company fails to recognize that the analysis in Penelec was based on the resource that Penelec may have elected to construct in the 1991 time frame, prior to the enactment of the Energy Policy Act of 1992 which has increased options for procurement of alternative resources in the wholesale market. Second, the levelized avoided cost calculated by Mr. Kahal in that proceeding, which he deemed the highest he could justify (PP&L Late Filed Exh. 1), was based on 30 years of assumed data, beginning in 1997. Tr. 2375-2378. This is just the type of long-term assumptions that the Commission has found not to be meaningful in its prior excess capacity determinations. Pa. P.U.C. v. Pennsylvania Power & Light Co., 59 Pa. PUC 332, 348 (1985) and Pa. P.U.C. v. Duquesne Light Co., 66 Pa. PUC 518, 651 (1988). In fact, as the Company notes, the first year avoided cost figure was 5.75¢/kwh in 1997, two years after the test year in this case. The 5.75¢/kwh avoided cost is still lower than the cost of Susquehanna as determined by either Mr. Kahal (6.0¢/kwh) or PP&L witness Hieronymus (6.7¢/kwh). If the Company had filed this case three years ago, and the Commission looked at the time frame until 1997, it is clear that Susquehanna would still not have been economic, contrary to the Company's assertion.

3. The Company's Alternative Analysis Presented In Rebuttal Is Not Meaningful.

Finally, the Company argues that Dr. Hieronymus' coal proxy analysis should be adopted since it is consistent with the way in which the Commission has applied the economic benefits test

in Pa. P.U.C. v. Pennsylvania Power Co., 67 Pa. PUC 91, 125-126 (1988) and Pa. P.U.C. v. Philadelphia Electric Co., 74 Pa. PUC 1 (1990). But, as the OCA has discussed in its Main Brief, the coal proxy test as applied in this case by Dr. Hieronymus does not provide a meaningful basis for analysis of the economic benefits of Susquehanna 2.

In PECO, the Commission described the test as follows:

> [U]nder the Commission's recent analysis of economic excess capacity, the standard which a plant must meet is that it would be cheaper than a plant which could replace it if construction began now.

PECO, 74 PA. PUC at 141 (emphasis added).

As the Company acknowledges, if it were to replace Susquehanna 2 now, it would not construct a new coal plant. Tr. 2319-2320. The Company's 1995 Annual Resource Planning Report (ARPR) demonstrates that a coal plant is an uneconomic resource for PP&L, showing a $600 million cost disadvantage for a 300 MW unit. It is abundantly clear that PP&L would not replace Susquehanna 2 with a coal plant. In fact, PP&L has conducted an alternative analysis for its 1995 ARPR where it assumes the loss of 700 MW of coal-fired capacity in 2003. Under this scenario, the least cost method of replacing this capacity is through the combination of purchases and combined cycle facilities, not the construction of a new coal plant. Tr. 1916-1917.

Even assuming that an analysis should be conducted assuming that PP&L replaced Susquehanna 2 in 1985, when it came on line, the Company cannot demonstrate that the construction of a

coal plant would have been the least cost alternative for replacing Susquehanna 2 at that time. Despite the Company's completely unsupported assertion in its Brief that coal generation was the most economic alternative in 1985 (PP&L M.B. at 55-56), PP&L's own witness on this issue testified that he did not even consider other resources such as the QF capacity that was then being made available to PP&L. Tr. 2353. Dr. Hieronymus admitted that he used a coal plant for his 1985 assumption because he thought that was what most utilities were building then. Tr. 2353. If, however, PP&L had replaced Susquehanna 2 with a coal plant to come on line in 1995, the Commission would now be looking at the question of whether this coal plant was an economic resource for PP&L. It is clear from the record in this case that such a resource is not, and was not, the least cost economic resource for PP&L.

As such, Dr. Hieronymus's alternative plant analysis is flawed and should not be utilized in this proceeding.

4. Conclusion

As set forth above, and as set forth fully in the OCA's Main Brief at 46-63, the OCA submits that the facts of this case establish that Susquehanna 2 constitutes economic excess capacity. By comparing the 6¢/kwh cost of Susquehanna to the market cost of between 3¢/kwh and 4¢/kwh, it is clear that Susquehanna does not produce net economic benefits to ratepayers within a reasonable time frame. As such, the OCA submits that the Commission's disallowance of the equity return on Susquehanna 2 should be continued.

E. Conclusion

For the reasons set forth above, and for the reasons set forth in the OCA's Main Brief at 11 to 63, the OCA submits that PP&L has failed to rebut the presumption that Susquehanna 2 constitutes both physical and economic excess capacity. As such, the OCA submits that the Commission should continue the return on equity disallowance associated with Susquehanna 2 that was established in PP&L's last rate case. In this proceeding, based on the OCA's recommended return on equity, the disallowance is approximately $62 million on a Pennsylvania jurisdictional basis. The final disallowance must be consistent with the Commission's rulings on return on equity, rate base adjustments, and jurisdictional allocation percentage.

IV. RATE BASE

A. Introduction

In this proceeding, OCA witness Catlin proposed three adjustments to PP&L's rate base claim: (1) accrued pensions; (2) prepayments in the Company' Cash Working Capital requirement; and (3) the Company's cash working capital allowance. Adoption of these adjustments reduces PP&L's proposed future test year rate base claim of $5,017,178,000 by $80,459,000, resulting in a future test year rate base of $4,937,249,000. OCA M.B. at 64-85; OCA St. 6, Sch. TSC-2 (Updated 5/19/95).

As discussed below and in the OCA's Main Brief, the OCA's recommendations are supported by the evidence of record.

B. The OCA's Adjustments To PP&L's Cash Working Capital Should Be Adopted.

1. Introduction.

PP&L maintains that because it has made no claim for cash working capital ("CWC") in this proceeding, the adjustments to its cash working capital claim proposed by the OCA and the OTS should have "no practical consequence in this case."[13] PP&L M.B. at 63. The Company argues that these adjustments should be rejected due to the Commission's practice of setting negative cash working capital requirements at zero.

---

[13] The OCA notes that in its Main Brief, the OCA mistakenly identified the OCA's proposed cash working capital requirement for PP&L. See OCA M.B. at 81. As discussed below, the OCA's adjustment to PP&L's cash working capital requirement for PP&L is negative ($9,857,000). OCA St. 6A, Sch. TSC-6 (Updated 5/19/95).

As discussed in the OCA's Main Brief, PP&L determined its cash working capital requirement in this proceeding to be a negative ($837,000). See PP&L St. 3; PP&L Exh. Future 1 (Revised), Sch. C-4. Rather than recognize this adjustment, the Company has chosen to set its cash working capital requirement at zero. The Company arrived at this result by offsetting the positive balance of prepayments of $12,444,000 by the negative result obtained from the lead/lag study. The OCA adjusted the Company's cash working capitol requirement on a Pennsylvania jurisdictional basis by reducing the balance of prepayments by ($9,012,000) and adjusting the Company's lead/lag study upwards by $2,587,000 resulting in a negative cash working requirement of ($6,425,000). See OCA Main Brief, Appendix A, Schs. TSC-2, 5 & 6.

The OCA submits that as set forth in its Main Brief, and discussed below, the adjustments to the Company's balance of prepayments and to PP&L's lead/lag study are consistent with Commission precedent and should be adopted by the Commission. OCA M.B. at 67-85.

2. The Commission Is Not Required To Set PP&L's Cash Working Capital Allowance At Zero.

As the Company noted, and as the OCA recognized in its Main Brief, the Commission in the past has set cash working capital allowances at zero rather than adopting negative cash working capital allowances. PP&L M.B. at 64; OCA M.B. at 72-73. However, the OCA submits that the Commission is not precluded from adopting a negative cash working capital requirement, and has adopted a

negative cash working capital allowance in the past. See Pa. P.U.C. v. ALLTELL Pennsylvania , 59 Pa. PUC 447, 457-58 (1985).

As PP&L acknowledged, the Company's negative cash working capital requirement results from the "offset" for accrued interest and dividends. However, the Company argues that "the 'offset' should not be used to reduce a utility's rate base below the amount of positive cash working capital actually claimed for rate base inclusion." PP&L M.B. at 63. The OCA submits that this argument ignores the Commission's longstanding policy of deducting the accumulated debt interest and preferred stock dividends from cash working capital as funds available for unrestricted use by respondent. See Pa. P.U.C. v. Pennsylvania Power & Light Company, 54 Pa. PUC 645, 655 (1981); Pa. P.U.C. v. Pennsylvania Power Company, 55 Pa. PUC 552 (1982). OCA M.B. at 72.

As discussed in the OCA's Main Brief, the evidence of record and the established precedent recognizing the accrued interest and dividends supports a finding of a negative cash working capital adjustment in this proceeding. OCA M.B. at 73-75. Absent this adjustment, PP&L will be allowed the use of ratepayer supplied funds to offset other working capital requirements. The OCA submits that the Commission is not required to set the Company's cash working capital allowance at zero and that recognition of the Commission's longstanding precedent requiring the deduction of accumulated debt interest and preferred stock fund dividends provides a sufficient justification for allowing a negative cash working capital. Adoption of the OCA's adjustments

to the Company's lead lag study and balance of prepayments results in a cash working capital requirement on a Pennsylvania jurisdictional basis of negative ($6,425,000). OCA St. 6A, Sch. TSC-2 (5/19/95 Update).

3. PP&L's Expense Lag Improperly Included CAAA Permit Fees and Interest on Customer Deposits.

Although the OCA proposed three adjustments to PP&L's lead/lag study, the Company has chosen to respond to only one of these adjustments, removal of the CAAA permit fees from the expense lag.[14] PP&L M.B. at 66-69. OCA witness Catlin adjusted PP&L's O&M expense lag to remove Clean Air Act Amendment ("CAAA") permit fees and interest on customer deposits, and proposed to treat these items as separate expense items in determining the composite O&M expense payment lag. OCA M.B. at 75-79; OCA St. 6 at 10-11.

The Company argued that because Mr. Catlin "plucked out a single expense" his adjustment is incorrect and should be rejected. PP&L M.B. at 67. In addition, PP&L contends that Mr. Catlin has "misconstrued the payment pattern associated with CAAA permit fees." Id. at 67-68.

[14] The three adjustments included: removing the CAAA permit fees and interest on customer deposits from the O&M expense lag; excluding the Sunbury pump invoice from the O&M expense lag; and adjusting the expense lags associated with interest on long-term debt and preferred stock dividends. OCA M.B. at 75-82. Mr. Catlin also adjusted the revenue lag to correct the 20-day account lag, this adjustment was adopted by PP&L during the rebuttal phase of the proceeding. OCA M.B. at 75. Mr. Catlin also adjusted revenues, expenses and taxes to recognize the OCA's recommended adjustments to the Company's request. OCA M.B. at 82.

The OCA addressed both of these arguments in its Main Brief at length and will therefore limit its response. Initially, it should be noted that PP&L's argument fails to recognize that the OCA's adjustment was not limited to "a single expense" since Mr. Catlin also adjusted the composite expense lag to separately recognize interest on customer deposits. OCA M.B. at 76-77; OCA St. 6 at 11. More importantly, the Company's contention ignores the evidence of record. PP&L argues that its average expense lag was derived from a representative random sample, so it is inappropriate to select one item, such as the CAAA permit fees, that is longer than the average for a separate adjustment. PP&L M.B. at 67.

However, as Mr. Catlin testified:

> ... the payment lag for CAAA permit fees is almost 14 months. This is clearly not a typical lag, particularly for such a large expense. Therefore, the expense payment lag of 32 days for other O&M is simply not representative and appropriate for CAAA permit fees.

OCA M.B. at 76-77; OCA St. 6 at 11 (emphasis added). In addition, as shown on OCA St. 6A, Catlin Exhibit 1, the 1995 estimate for 1994 CAAA fees is $1,618,000. In response to cross-examination, PP&L witness Bernini agreed that an expense the size of the CAAA permit fees is not common. Tr. 523-524. The OCA submits that it is inappropriate to include an expense with a lag of 421 days, particularly as large an expense as the CAAA permit fee, in a sampling of "representative" expenses.

Finally, PP&L argues that Mr. Catlin "apparently confused the time frame of data used to calculate the CAAA permit fees." PP&L M.B. at 67-68. This argument, however, is contradicted by the evidence provided by the Company. OCA M.B. at 77-79. As shown on OCA St. 6A, Catlin Exhibit 1, the Company provided information stating that 1994 emissions fees are paid in 1995. Id. at 78. The OCA submits that consistent with the Commission' finding in Pa. P.U.C. v. West Penn Power Company, Docket No. R-00942986, (December 28, 1994), slip op. at 18, the Company's CAAA permit fees should be treated as separate expense items in determining the composite O&M expense payment lag.

Adoption of the OCA's adjustment recognizing both the CAAA permit fees and interest on customer deposits as separate line items in the Company's lead/lag analysis increases the composite expense payment lag calculated on Schedule C-4 of PP&L Exhibit Historic 1 from 30.9 days to 31.1 days.

4. The OCA Properly Adjusted PP&L's Balance Of Prepayments.

Witnesses for both the OCA and the OTS in this proceeding recommended reductions to the balance of prepayments in PP&L's cash working capital claim. OCA M.B. at 82-85; OTS M.B. at 15-23. OCA witness Catlin eliminated the balance of prepaid insurance and adjusted balance of other prepayments to exclude the effects of a one-day prepayment of interest and preferred dividends. OCA M.B. at 82-85.

The Company did not respond in its Main Brief to the adjustment related to the exclusion of the effects of a one-day prepayment of interest and preferred dividends. Instead, PP&L's only argument was that the elimination of the prepayment for insurance, postage, etc., is not a double count "because the prepayment balance was not included in the expense balance." PP&L M.B. at 66.

The OCA addressed this argument in its Main Brief. OCA M.B. at 83-84. Contrary to the Company's argument, there is a double count resulting from the inclusion of the balance of prepaid insurance in rate base and the inclusion of insurance premiums in the lead/lag study. As Mr. Catlin testified:

> ... the lag assigned to insurance premiums is not based on timing of when the premiums are charged to expense. If it was, the lag would be 15.2 days. Instead PP&L has assigned insurance premiums a 134 day lead based on the timing of when the premiums are paid relative to the policy period. This is exactly what the prepayment balance represents.

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

The adjustment to the balance of "other" prepayments to exclude the effects of the prepayment of interest and preferred dividends was unopposed by the Company. OCA M.B. at 84-85. Therefore, the OCA submits this adjustment which reduces total

Company rate base by $5,164,000 and Pennsylvania jurisdictional rate base by $4,469,000 should be adopted. OCA St. 6A, Sch. TSC-5 (5/19/95 Update).

C. The OCA Properly Deducted PP&L's Balance Of Accrued Pension Liability From Rate Base.

OCA witness Catlin recommended that PP&L's accrued pension liability which represents funds that have been recovered from ratepayers, but which have not been contributed to the pension fund by the Company should be deducted from ratebase.[15] OCA M.B. at 65-67.

PP&L contends that Mr. Catlin's adjustment is flawed and must be rejected. PP&L M.B. at 71-75. The Company's first argument is that but for the change in accounting rules, no accrued pension liability would have been booked under SFAS 87 and there would be no basis for Mr. Catlin's adjustment. Id. at 72. The OCA submits that this argument asks the Commission to ignore the fact that since 1987, PP&L has recorded its pension costs pursuant to SFAS 87 and not on a cash basis. As OCA witness Catlin explained:

> Since 1987, the pension costs recorded on the Company's books have either already been recovered from ratepayers as an expense in the year in which they were recorded or are being recovered as a component of the capitalized overheads included in the cost of plant in service.

---

[15] As Mr. Catlin explained: The accrued pension liability which is reflected on PP&L's books represents the difference between the pension costs which have been reflected on PP&L's books and the Company's contributions to its pension fund since the implementation of Statement of Financial Accounting Standard ("SFAS") No. 87 in 1987. OCA M.B. at 65; OCA St. 6 at 5.

OCA M.B. at 65; OCA St. 6 at 5. Thus, the Company has reflected this expense on their books, but have not contributed the funds to the pension trust.

Second, the Company argued pension liability was accrued because it represents an expense booked but not paid, thus it represents the amount the pension plan is underfunded not overfunded. PP&L M.B. at 72. As discussed in OCA Main Brief, this is the very reason why it is appropriate to deduct the accrued pension liability from rate base. As Mr. Catlin testified in surrebuttal:

> The underfunding to which Mr. Berish refers represents the pension costs which have been recorded on the books as an expense and, hence, recovered from ratepayers, but not contributed to the pension trust.

OCA St. 6A 4. The OCA submits that the Company created this liability by recording it as an expense, but did no make the contributions to the pension trust.

The Company's final argument is that the OCA through this adjustment is proposing "a 'true up' of the difference between the pension expense included in the Company's last claim and the actual pension expense incurred". PP&L M.B. at 73. The OCA submits that this argument misstates both Mr. Catlin's testimony and the OCA's adjustment. In surrebuttal, Mr. Catlin responded to PP&L witness Berish's argument that the ratepayers have not paid the pension costs recorded on the books under SFAS No. 87 because SFAS No. 87 was not adopted by the Company until after its last rate case. Mr. Catlin stated:

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

OCA St. 6A at 4 (emphasis added).

As noted in the OCA's Main Brief, the adoption of SFAS No. 87 resulted in the amount of expense remaining relatively unchanged from the allowance that was explicitly reflected in rates since PP&L's last rate case. Thus, as Mr. Catlin testified: "the Company cannot argue that the adoption of SFAS No. 87 resulted in a level of pension expense which was in excess of the amount provided for in rates." The OCA submits that this adjustment which recognizes that these funds have been recovered from ratepayers but not contributed to the pension fund is appropriate and should be adopted. As shown on OCA St. 6, Sch. TSC-3, this adjustment reduces total Company rate base by $85,537,00 and Pennsylvania jurisdictional rate base by $74,034,000.

V. REVENUES

A. Economic Development Credits

At page 284 to 286 of its Main Brief, the Company argues that ratepayers should pay for all revenue shortfalls, approximately $25 million, that arise from the provision of economic development credits, referred to as EDI and IDI credits, to certain industrial customers. The OCA has proposed that there be an equitable sharing of these revenue shortfalls between ratepayers and shareholders.

The Company argues that it has demonstrated that its EDI/IDI program provides system benefits, and thus the costs should be absorbed by ratepayers. PP&L M.B. at 284-285. As the OCA has pointed out, however, the Company's analysis unreasonably assumes that there were no "free riders" on these discounted rates. See, OCA M.B. at 87-88. The Company has made no attempt in this case to present an analysis that does not just simply assume that the load would have been lost without the fully discounted rate.

In addition, the Company has not accounted for the fact that in the time period from 1987 until the present, PP&L's ratepayers were absorbing the higher fuel costs through the ECR that resulted from these incremental sales, while the net revenue from these sales benefitted PP&L's shareholders in this time frame. OCA St. 5 at 17. Moreover, PP&L's shareholders will continue to benefit from increased sales made under these programs after this rate case until the Company's next rate case.

The OCA submits that given these benefits to shareholders, it is appropriate for ratepayers and shareholders to equally share these revenue shortfalls. As the New York Commission has recently recognized:

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

Re Competitive Opportunities Available to Customers of Electric and Gas Services, 154 PUR4th 19, 25 (N.Y.P.S.C. 1994).

For the reasons set forth above, and for the reasons set forth in the OCA's Main Brief at pages 86-93, the OCA submits that its revenue adjustment of $12,665,535, as shown on Sch. TSC-21, which reflects a 50%/50% sharing of the revenue shortfalls from the provision of discounted rates under the EDI/IDI programs, should be adopted.

VI. EXPENSES

A. Introduction

As set forth in the OCA's Main Brief, PP&L has requested a level of expense that is overstated and unreasonable. The OCA has proposed a number of adjustments to the Company's expense claims that are reasonable and consistent with the Public Utility Code and case law. The Company's challenges to these adjustments are unfounded and should be disregarded. The OCA's adjustments are fully explained and supported in the OCA's Main Brief at pages 94-162 and will not be discussed in detail herein. Below, the OCA replies to certain contentions by the Company regarding the OCA's adjustments.

B. The Company Did Not Contest The OCA's Adjustment To Reduce PP&L's Expense Claim By $197,000 To Reflect The Benefit Savings Associated With The Reduction in Employees.

In this proceeding, the OCA proposed an adjustment to the Company's claim reflecting the projected year end level of employees and wages, in order to include the cost savings resulting from the reduction in benefits and payroll taxes associated with the reduction in employees. OCA M.B. at 96. The Company provided no rebuttal to this adjustment and did not address this adjustment in its Main Brief. Accordingly, the OCA submits that this adjustment must be adopted. As shown on Sch. TSC-8, this adjustment reduces test year expenses by $197,000 on a total company basis and $171,000 on a jurisdictional basis. The concomitant increases in net income are $114,000 and $99,000, respectively. OCA St. 6 at 13, Sch. TSC-8.

C. The Company's Expense Claim For Prospective Costs Of Decommissioning Its Coal Plants Must Be Denied.

The Company, in its Main Brief, recognizes that it is against Commission and Court precedent to allow prospective recovery for net negative salvage, or future "decommissioning" costs related to fossil fueled generating plant. PP&L M.B. at 147. Despite this recognition, the Company argues that the Commission should reevaluate its policy. The Company states that its recommended approach is "far more reasonable and should be adopted." PP&L M.B. at 148.

The OCA notes that the Commission has indicated before that it will not revisit past precedent on this issue unless the Company presents compelling reasons to do so. Pa. P.U.C. v. West Penn Power Company, Docket No. R-942986 (December 28, 1994) at 62 ("West Penn II"). The OCA submits that PP&L has not presented any novel or compelling reasons to support its claim and therefore it should be rejected.

The Company contends that the current method of net negative salvage cost recovery as applied to this claim for fossil fueled generating facilities would result in an inequitable distribution of costs among different generations of customers. PP&L M.B. at 148. This argument by PP&L is not novel to the Commission. As is discussed in the OCA's Main Brief, the Commission rejected this argument in West Penn II. OCA M.B. at 100-101. The Commission stated:

> We agree with the presiding ALJ. . . We do so precisely because our precedent sought to separate current and future negative salvage

> in order to ensure that customers are not required to pay the net expenses associated with retiring plant and equipment before those costs are actually incurred.

West Penn II at 61-62.

Similarly, the Company contends that it should be able to pre-fund fossil decommissioning costs because it will assure that public health and safety risks are adequately addressed. PP&L M.B. at 150. The Company argues that, "the same kinds of public health and safety concerns which drove the creation of nuclear decommissioning trust funds justify the pre-funding of fossil decommissioning." Id. However, the Commission has decided twice that the "vital health and safety problems" associated with nuclear decommissioning are not present in fossil fuel decommissioning. Pa. P.U.C. v. West Penn Power Co., 54 Pa. PUC 602, 630 (1981); West Penn II. Thus, the OCA submits that PP&L has not presented any new reasons for the Commission to revisit precedent.

The Company also argues that the magnitude of its decommissioning costs will make an "after the fact amortization" burdensome for ratepayers. PP&L M.B. at 153-154. The OCA submits, however, that the Company's argument as to the possible costs of future recovery is inherently problematic. It is the speculative nature of all prospective net negative salvage claims which prevents their prospective recovery. In Penn Sheraton, the Commission stated of prospective negative salvage, "[I]t is a cost which has not yet been incurred; [and] it is uncertain when and if it will be incurred. . . . " Penn Sheraton Hotel et al. v. Pa. Public Utility Commission, 198 Pa. Super. at 627; 184 A.2d at 329.

Similarly, in Pa. P.U.C. v. West Penn Power Company, the Commission stated, "The Company's alternative approach. . . would substitute an uncertain and speculative claim in place of the current cost approach." Pa. P.U.C. v. West Penn Power Company, Docket No. R-942986 (December 28, 1994)("West Penn II"). The OCA submits that PP&L's claim is no different.

Furthermore, as OCA witness Catlin stated "[I]t is common for electric utilities to undertake plant life extensions in which the generating facility is overhauled and the life extended." OCA M.B. at 100. In fact, PP&L witness LaGuardia acknowledged in his rebuttal testimony that it is possible that PP&L's fossil units will be life-extended and/or the sites and structures reused. Id. Thus, PP&L can only speculate about its possible future costs.

The OCA submits that PP&L's claim is subject to the same speculation and uncertainty as the claim in Penn Sheraton and the West Penn cases that followed it. Penn Sheraton Hotel et al. v. Pa. Public Utility Commission, 198 Pa. Super. 618; 184 A.2d 324; Pa. P.U.C. v. West Penn Power Company, 54 Pa. PUC 602 (1981)("West Penn I"); Pa. P.U.C. v. West Penn Power Company, 54 Pa. PUC 602 (1981). Therefore, for all the reasons enumerated in the OCA's Main Brief at pages 97 to 103 and set forth above, the OCA submits that the Company's claim for fossil fuel decommissioning costs must be denied and its test year expense claim should be reduced by $45,284,000 as shown on Schedule TSC-16 (Updated).

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

PP&L is seeking to recover $39,215,000 of deferred early window costs related to Susquehanna Units 1 & 2, through a ten year amortization. PP&L Exh. Future 1 (Revised), Sch. D-14. As set forth in the OCA's Main Brief, the OCA submits that the Company's claim for early window costs must be denied as an improper attempt to retroactively recover costs incurred long in the past. OCA M.B. at 103-117. The OCA submits that the rule against retroactive ratemaking, which "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" prohibits the Company's claim. Popowsky v. Pa. P.U.C., 164 Pa. Commonwealth 338, 344, 642 A.2d 648, 651 (1994).

In its Main Brief, the Company recognizes the rule against retroactive ratemaking; however, it argues that its claim should be allowed as an exception to this rule. PP&L M.B. at 102. As the OCA discusses in its Main Brief, the Commission has found in only limited circumstances that a Company's factual situation warranted a departure from traditional regulatory practice prohibiting retroactive recovery in rates of costs incurred in the past. OCA M.B. at 107-110. The OCA submits that PP&L has not shown that such a departure is warranted in this case.

Notably, the Commission will not find that such a departure is justified if the Company has not: (1) presented a timely claim; (2) shown that the costs were non-recurring or

"qualitatively" extraordinary; and (3) shown that the costs were "quantitatively" extraordinary. Pa. P.U.C. v. Pennsylvania American Water Company, Docket No. R-932670 (July 26, 1994)("PAWC 1994"); OCA M.B. at 109-114. The OCA submits that PP&L has failed to meet these three criteria.

In order to show that its costs are "quantitatively extraordinary" as outlined in PAWC 1994, PP&L must establish that a denial of the recovery of its early window costs would have a "substantial negative financial impact on the utility." Pa. P.U.C. v. Philadelphia Electric Company, 74 Pa. PUC 1 (1990)("PECO 1990"). The Company argues that denial of its claim would have a "severe impact on the Company's earnings" and asserts that it would have to write-off approximately $0.25/share if the Company's claim was disallowed. PP&L M.B. a 102. As the OCA explained in its Main Brief, PP&L's claimed reduction in earnings would be approximately 17.7%. OCA M.B. at 113-114. This claimed write-off does not approach the level of loss that the Commission found justifies an exception to the rule against retroactive ratemaking such as in PECO 1990 or PG&W 1993. In those cases, the Commission granted early window claims when the Company's reductions to earnings were approximately 50%. PECO 1990; Pa. P.U.C. v. Pennsylvania Gas & Water Company, 79 Pa. PUC 349, 366 (1993)("PG&W 1993"). Therefore, the OCA submits PP&L has failed to establish that its claim is "quantitatively extraordinary".

In addition, as explained fully in the OCA Main Brief, the OCA submits that PP&L has failed to establish that the lack of

recovery of its early window costs had a substantial negative impact during the period the costs were experienced. OCA M.B. at 114-116. It was this test that Commissioner Rolka stated was important to determine whether a company's early window costs qualified as "extraordinary." See, Pa. P.U.C. v. Philadelphia Electric Company, 74 Pa. PUC 1, 235 (1990)(concurring opinion of Commissioner Rolka)("PECO 1990"). The Company's failure to seek rate relief to reflect these expenses sooner is evidence of the fact that the Company was satisfied with the rates it obtained in the last rate case and its earnings over the subsequent nearly ten years.

As to whether PP&L's claim is timely, in its brief the Company asserts that the Commission's Orders approving the deferral of these costs did not include a time limit on PP&L's ability to ask for recovery. PP&L M.B. at 99. The OCA submits that, while it may be true that the deferral orders did not specify a time limit, the Company still must present a timely claim in order to recover these costs. The rule against retroactive ratemaking is based on the principle that past costs should not be included in future rates. See, OCA M.B. at 104-107. Unless the Company presents a timely claim that establishes its significant financial harm, the Commission will not depart from this rule. The OCA submits that PP&L has failed to show such a level of financial harm for either now or in the past and a that a timely claim is not one that is presented 9 1/2 to 11 1/2 years after the costs were incurred. In the two recent cases where the Commission has granted recovery of

early window claims the Company sought recovery in 3 or 4 years. PECO 1990; PG&W 1993. The OCA submits that current ratepayers should not have to pay expenses from ten years ago, particularly when the Company claiming them has not demonstrated that it has suffered any harm during those ten years.

In addition, if the Company had been suffering from financial hardship, it had the ability to seek rate relief. As discussed in the OCA's Main Brief, the decision on when to file a rate case is, and has been, within the sole discretion of PP&L's management. This is in contrast to PG&W 1993, where PG&W's management was unable to obtain rate relief until its service problems improved. OCA M.B. at 111-112. PP&L could have filed for rate relief earlier had it required such relief. OCA M.B. at 111.

The Company also contends that the OCA, by its "timeliness" argument, is encouraging more frequent base rate cases. PP&L M.B. at 100. The OCA submits that this is not the case. Rather, the OCA is advocating enforcement of the rule against retroactive ratemaking. Since PP&L has failed to show that the lack of recovery of its early window costs had a substantial negative impact during the period the costs were experienced, or that its claim is "quantitatively and qualitatively extraordinary" as laid out in PAWC 1994, then it must be denied as violative of the rule against retroactive ratemaking. See, OCA M.B. at 107-110. The OCA's adjustment reflects the long-standing principle that current ratepayers should not bear past costs.

The Commission has specifically noted that actual recovery of deferred early window costs is not to become part of routine regulatory practice. Re Pennsylvania Power Co., 59 Pa. PUC 541, 545, 68 PUR4th 357, 360 (1985). This Commission has granted early window claims only in limited situations when factual circumstances warrant a departure from traditional ratemaking. PECO 1994; PG&W 1993. If the Commission allowed PP&L's request, particularly given the lack of record evidence that its circumstances warrant a Commission-determined exception to the retroactive ratemaking principle, then such a result renders Commission approval of retroactive post-in-service claims a part of standard regulatory practice. Such a result, the OCA submits, would be wholly inconsistent with Commission precedent to treat the issue on a case-by-case basis. OCA M.B. at 107.

For the reasons stated in the OCA's Main Brief at pages 103-117 and those above, PP&L's claim for the recovery of its early window expenses associated with Susquehanna Units 1 & 2 must be denied. Accordingly, the OCA submits that there should be an adjustment to the Company's net income of $3,922,000 to account for the elimination of the early window deferrals. OCA Schedule TSC-17 (Updated).

E. PP&L's Claim For Refueling Outage Expense Should Be Revised To Exclude Abnormal Costs.

OCA witness Catlin proposed adjusting the amortization of refueling outage costs claimed by PP&L to reflect the annualized level of costs based on the level of amortization associated with the most recent outage for each unit as of the end of the test

period. OCA M.B. at 117-122. As Mr. Catlin testified utilizing the most recent outages eliminates the "higher than normal" costs associated with Reload 6 at Susquehanna Unit 2. OCA St. 6 at 31; OCA M.B. at 118.

The Company argues this adjustment should be rejected because it is "arbitrary and unsupported". PP&L M.B. at 103-105. As discussed in the OCA Main Brief, the evidence provided by the Company establishes that PP&L experienced problems during Reload 6 at Susquehanna Unit 2 which resulted in higher costs. OCA M.B. at 118-121. The Company's argument that Mr. Catlin's concern about Reload 6 at Unit 2 was "unfounded" is contradicted by the evidence of record. PP&L M.B. at 104; OCA M.B. at 119-121. PP&L witness Berish testified that Reload 6 lasted "18 days" longer than planned. Tr. 2017. Mr. Berish also acknowledged that there were problems during Reload 6, including four accidents involving the breaking of refueling masts, and a problem with a jet pump beam which required an unplanned replacement. Tr. 2016-2017. The OCA submits that due to the problems that occurred during Reload 6 at Unit 2, the costs associated with that outage were atypical and should not be included in the amortization of refueling outage costs

The Company's argument that the costs of Unit 1, Reload 8 are "almost identical" to Unit 2, Reload 6 does not support the inclusion of the Unit 2, Reload 6 costs in the Company's claim. As Mr. Catlin testified in surrebuttal:

> In his rebuttal testimony, Mr. Berish argues that the costs of Reload 6 at Unit 2 were not

> atypical by comparing those costs to the costs for Reload 8 at Unit 1. However, this is not an appropriate comparison because the costs of the refueling outages at Unit 1 are normally higher than those at Unit 2, as can be seen from the following table.

OCA St. 6 at 2; OCA M.B. at 120. Moreover, as discussed in the OCA's Main Brief, total costs associated with Unit 2 outages have been lower than the costs at Unit 1. Id. 119-121.

The Company did not dispute the fact that Mr. Catlin's adjustment reflected the annual costs associated with the most recent outage at each Susquehanna unit. The OCA submits that, particularly given the abnormal level of expense associated with Reload 6 at Unit 2, the amortization of refueling outage costs should be based on the costs of reload 8 at Susquehanna Unit 1, and the cost of reload 7 at Unit 2. Adoption of this adjustment reduces total company expenses by $1,416,000 and jurisdictional expenses by $1,111,000. The resulting increases in net income are $819,000 and $643,000, respectively. OCA St. 6, Sch. TSC-18.

F. Depreciation

1. The Company's Proposal to Change Its Depreciation Methodology For Pre-1989 Susquehanna Plant Should Be Denied.

PP&L has proposed to change the way it accrues depreciation on the Susquehanna plant from the current MSF method to a levelized depreciation accrual for the period of September 30, 1995 through December 31, 1998. The Company's proposed modification increases test year expense by $30 million. OCA M.B. at 122. The OCA submits that the Company's proposal distorts the

relationship between depreciation accruals and rate base. OCA M.B. 122-129.

The Company contends that its proposal will "recover the same amount of depreciation that would have been recovered by the MSF method" during the 39 month period. PP&L M.B. at 160-161. The OCA submits that under the Company's proposal it will book the same amount over the 39 month period. However, as is fully explained in the OCA Main Brief, the Company will recover much more from ratepayers at the test year amount under the Company's levelization proposal than it would under the MSF approach. OCA M.B. at 126. The Company will only recover the same amount under either method if rates are adjusted annually. OCA M.B. at 124-127.

As explained in the OCA's Main Brief, if the Company does not file a base rate case every year, the effect will be that revenues will be set to recover: return at current levels of rate base, and a set level of depreciation expense, a test year amount. The corresponding effect that this test year amount of depreciation expense will have on rate base and return will not be reflected in rates until the next base rate proceeding.

Thus, as OCA witness Johnson explained, the Company would recover approximately $469 million each year from ratepayers until the Company files another base rate case. OCA M.B. at 125. If the Company does not file in four years, this amounts to $1,876 million, which is $133 million more than the amount of capital the levelized approach would require if the Company filed annually and the revenues were set each year to reflect the accompanying changes

in rate base. Thus, the Company will overrecover under the levelization proposal if does not file annually. OCA M.B. 124-127.

The Company also contends that the MSF approach involves marked increases in the annual accrual and that these increases are likely to drive PP&L to file more rate cases. PP&L M.B. at 162. However, because the MSF method involves a relatively constant total recovery of capital, the Company can avoid filing a rate case every year. Additionally, the Company will not substantially overrecover from ratepayers under MSF. OCA M.B. at 125. As OCA witness Dr. Johnson explained, the increase in depreciation accruals is almost exactly offset by the decrease in return on rate base under the MSF approach. Id. OCA witness Dr. Johnson noted:

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

OCA M.B. at 127; OCA St. 5 at 4. Thus, the difference in the total capital recovered by the Company under MSF and the capital required to meet the MSF accruals is minimal.

The Company further contends, as it did in rebuttal, that OCA witness Dr. Johnson's reasoning is flawed because it uses "a static analysis of rate base." PP&L M.B. at 164. PP&L asserts that Dr. Johnson's arguments in favor of the MSF approach could only be correct if "one assumes that the Company will not make any new investment in plant after rates are put into effect." PP&L M.B. at 164-165. However, as OCA witness Johnson explained, it would be inappropriate to consider the effect of future investment

in Susquehanna in the present depreciation analysis. Dr. Johnson stated:

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

OCA M.B. at 165; OCA St. 5A at 4 (emphasis in original).

Thus, as discussed above, and in the OCA Main Brief at pages 122-129, the Company's proposal to change to a levelized depreciation accrual distorts the relationship between depreciation accruals and rate base. The OCA submits that the extent of this imbalance is unreasonable. For these reasons, the OCA submits that the Company's proposal to levelize the depreciation accrual for SSES be denied. On a jurisdictional basis, the Company's claim should be reduced by $22,864,760. OCA St. 5 at 7. This adjustment has been incorporated with other depreciation adjustments on schedule TSC-20 (Updated).

2. PP&L's Proposal To Increase Depreciation Expense On Fossil Fueled Units Should Be Denied.

PP&L has proposed to accelerate depreciation for seven of its fossil-fired generating units. PP&L M.B. at 167-168. However, as is clear from the Company witness' testimony, the Company has no plans to actually retire these units on the deactivation date

proposed for depreciation purposes in this case. As discussed in the OCA's Main Brief, Company witness Krall testified that the Company made a decision to reflect in the depreciation schedule the possibility that the units at issue would be retired earlier. OCA M.B at 132. The OCA submits that the Company has not adequately justified the change in deactivation dates which increases depreciation expense by approximately $15 million.

As discussed in the OCA's Main Brief, the Company's own documents favor continued operation of these units. For example, PP&L's 1994 Five Year Coal Upgrade Plan concludes that it would be prudent to continue operation of the units through the year 2013. OCA M.B. at 131. Although the Company claims that this document was completed prior to the Company's "analyses," the Company's May 1995 Annual Resource Planning Report ("ARPR") reaches the same conclusion and it was completed well after the Company's decision to change the deactivation dates. OCA M.B. at 138.

In fact, except for the documentation provided during this rate case, the Company has no written analysis supporting its decision. Company witness Krall testified that the Company memorialized that decision only in his direct testimony, and that no memorandum or other document was prepared. OCA M.B. at 134; Tr. at 165. The only analysis the Company has offered in the case as the basis for this proposed change is the brief one and a quarter page text of an interrogatory response, and an expanded version of this text at the rebuttal stage. OCA M.B. at 136. As discussed fully in the OCA's Main Brief, the OCA submits that neither of

these are sufficient as a cost/benefit analysis, nor are they sufficient as support for a decision that will impose $15 million of additional expense on ratepayers. OCA M.B. at 134-139.

The Company contends in its Main Brief that when it set the deactivation dates for these units in 1988, it did not foresee the substantial costs that would be necessary to comply with the 1990 Clean Air Act Amendments ("CAAA"). PP&L M.B. at 168. However, the requirements for compliance with the CAAA are still not yet certain. PP&L witness Krall acknowledged this uncertainty on cross examination. He stated:

> The issue specifically with regard to Title I and Title III is one of uncertainty.
>
> At this point in time, we really can't say what our option is as far as compliance, because we really don't have regulations to comply with.

OCA M.B. at 137; Tr. 160. More importantly, there was no change in CAAA requirements between PP&L's 1994 Coal Upgrade Plan and the preparation of its testimony in this case.

In addition, the Company tries to liken its situation to a York Water case and several cases from other states. PP&L M.B. at 174. The OCA submits that these cases are inapposite. In Pa. P.U.C. v. York Water Company, 78 Pa. PUC 87, 109-110, and the other cases the Company mentioned, the OCA or the Consumers Counsel was recommending that the Commission extend the lives of the plant. In this instance, the OCA is not proposing to add any years onto the service lives of these generating units. Rather, the OCA is proposing to utilize the service lives of these plants that the

Company reflects in its own system planning documents for depreciation purposes.

It is the Company who is proposing to shorten the lives that it obtained Commission approval for in 1988. If anything is applicable from the cases the Company cited, it is that the Company has failed to provide an "analysis which would clearly indicate the necessity" of accelerating the depreciation of these plants. 78 Pa. PUC at 110. It is the Company that proposes this change, and the Company has not met its burden of showing that this change in service life dates for depreciation purposes is reasonable or that it has any sound basis.

Thus, for the reasons set forth above and in the OCA's Main Brief at pages 129-139, the Company's depreciation accrual should be reduced by $18,743,803 on a total Company basis, which is $15,274,409 on a Pennsylvania jurisdictional basis. OCA St. 5 at 11. This adjustment has been incorporated with the other depreciation adjustments shown on TSC-20.

3. PP&L's Depreciation Expense Based On Amortization of Small Value Items Is Overstated.

The Company has proposed to change from depreciation accounting to amortization accounting for its small value general plant accounts. PP&L M.B. at 180. The OCA does not oppose the Company's proposal to change to amortization accounting for these accounts. The OCA does submit, however, that the Company's plan overstates the test year level of expense by using amortization periods that are too short, and by calculating the test year level

of amortization improperly. The OCA submits that Dr. Johnson's method sets a normalized level of amortization that is appropriate for this transition period and uses amortization periods that are more reasonable.

The Company contends in its Main Brief that it has used the same procedures for adopting amortization accounting as were employed by West Penn and UGI in recent cases. PP&L M.B. at 181. The OCA submits that the Commission's Orders in these cases do not specify the specific implementation method that these Companies used. Pa. P.U.C. v. West Penn Power Co., Docket No. R-942986 (December 29, 1994); Pa. P.U.C. v. UGI Utilities, Inc. -Electric Div., Docket No. R-932862 (July 27, 1994). Again, the OCA has no objection to the change to amortization accounting.[16]

As explained fully in the OCA's Main Brief, the OCA opposes eight of the Company's ten amortization periods because they are unreasonably short and not supported by the record evidence. The OCA submits that the amortization periods proposed by Dr. Johnson are more reasonable. OCA M.B. at 140-147. The Company, in its Main Brief, questions the basis for Dr. Johnson's recommendation.[17] PP&L M.B. at 183 (Replaced). The OCA submits

---

[16] The OCA notes that the Company can record for book purposes amortization in the manner it has proposed. Correspondingly, the OCA has not made any specific adjustment related to the Company's indication that it plans to treat any plant in these accounts that is older than the amortization period selected by the Company as retired, regardless of the fact that it will not be taken out of service.

[17] The Company quotes its witness rebuttal testimony in which Mr. Hoch criticized Dr. Johnson's use of the 1994 retirement rate analysis related to Laboratory Equipment. PP&L M.B. at 183. The

that Dr. Johnson clearly outlined the basis for his proposal in his testimony. Dr. Johnson explained:

> I have reviewed all of the data provided by PP&L about these accounts and find that in each instance, the data support longer amortization periods than requested by the Company. The current lives for these accounts are shown on Exhibit___(CEJ-2), Schedule 2, by way of comparing the current lives with PP&L's requested lives and my proposed lives.
>
> In Exhibit___(CEJ-2), Schedule 3, I have provided, for each account, a summary of the information that was described for account 391.2 above. The average age of retirements, life for the curve of best fit and the number of years when over 50 percent of the account still survived are shown on that Exhibit.
>
> Finally, I compared the amount of depreciation booked in these accounts during the test year with the amount claimed by PP&L under their proposed amortization and show these in Exhibit___(CEJ-2), Schedule 3.

OCA St. 5 at 14. Thus, as explained in the OCA Main Brief, Dr. Johnson reviewed PP&L's own data and analysis regarding this plant and found that the Company's amortization periods were not supported by the evidence. OCA M.B. at 140-147. Therefore, Dr. Johnson proposed more reasonable amortization periods that conformed with the Company's data and prior analysis.

The Company, in support of its procedures, contends that the Commission has adopted the remaining life method of depreciation as the most appropriate capital recovery method for ratemaking purposes, and that the whole life depreciation method

---

OCA notes, however, that Dr. Johnson revised his proposal related to this account in his rebuttal testimony (OCA St. 5A at 7) and therefore these criticisms are no longer valid.

has inherent deficiencies. PP&L M.B. at 182 (Replaced). The OCA submits, however, that what is at issue is the Company's amortization method, not its depreciation method. Thus, the Company's discussion of Pa. P.U.C. v. Western Pennsylvania Water Co., 59 Pa. PUC 178, 214-222 (1985), is inapplicable to this case. Id.

As Dr. Johnson explained in his testimony, an appropriate amortization method would define reasonable amortization periods, and determine the level of amortization to include in the test year for ratemaking purposes based on these periods. He explained:

> The appropriate level of amortization to include in the test year for ratemaking purposes would be the gross level in each account divided by the appropriate amortization period. Had PP&L been employing amortizations in the past, the amount of amortization booked for each account would be the gross plant divided by the amortization period.
>
> For example, account 391.2, furniture, currently contains $16,044,199. If my 30-year amortization period had been used during the past 30 years each vintage during that period would be amortized 1/30th each year, including the current year. Thus, it would be appropriate to include 1/30th of the $16,044,199, or $534,807 in test year expense for ratemaking purposes. The level of amortization included in the test year by Mr. Hoch is $2,068,390, nearly four times as large.

OCA St. 5A at 10. On the other hand, the Dr. Johnson explained how the Company's approach differs from his. He stated that,

> What [PP&L] has attempted to do is to ignore the appropriate amortization level to include on a going forward basis and try to recover the current unrecovered balance in each

> account over a period only characterized as the remaining recovery period.

OCA St. 5A at 9-10. Thus, the OCA submits that the Company has used inappropriate amortizations for test year levels that overstate the cost to Pennsylvania ratepayers.

For the reasons listed above, and as more fully detailed in the OCA Main Brief (at pages 139-147), the OCA submits that the Company's depreciation expense is overstated. Accordingly, the Company's test year level of expense should be reduced by $3,028,129 on a total Company basis. This number reflects the Company's correction made during oral rejoinder on May 23, 1995, Tr. 1844-45. This adjustment has been incorporated, on a Pennsylvania jurisdictional basis, with the other depreciation adjustments shown on Schedule TSC-20 (Updated).

G. The Company Provided No Evidence To Support Its Proposed Discount Rate For Its Pension and Postretirement Benefits.

PP&L proposes to use a 7.5% discount rate to calculate its pension and postretirement benefit claims. As set forth in the OCA Main Brief, the OCA submits that the discount rate should be more reflective of market bond yields. The OCA's recommended 8.5% rate corresponds with the approximate 1.5% increase in bond yields as of December 1994. See, OCA M.B. at 148-149. In addition, the Company's actuary, Towers Perrin, and other actuaries, have recommended discount rates in the range of 8.5% for 1995 for other utilities. OCA M.B. at 149-150. In its Main Brief, the Company contends that the OCA's adjustment to increase the discount rate to 8.5% should be rejected because: (1) the Company's rate is

consistent with SFAS 87 and SFAS 106, and (2) the rate used by Pennsylvania American Water Company is not dispositive in this proceeding. PP&L M.B. at 89-91.

The OCA submits that the Company offers no explanation of how the Company's selection of a discount rate corresponds to the statements in SFAS 87 and SFAS 106. The Company makes the assertion that its discount rate is "completely consistent with the current market rates at which pension obligations could be settled."[18] PP&L M.B. at 90. In addition, the Company states that it's proposed discount rate "was determined based on a detailed analysis of a variety of factors." PP&L M.B. at 90. Yet, the Company fails to enumerate or discuss these factors. The OCA submits that the Company has failed to provide sufficient evidence to support its conclusory assertion that its discount rate is "completely consistent" with SFAS 87 and SFAS 106.

PP&L further asserts that its 7.5% discount rate may in fact be too high. PP&L M.B. at 90. However, as noted in the OCA's Main Brief, PP&L's own actuary has recommended higher discount rates to other utilities for 1995. OCA M.B. at 149-150. PP&L's actuary, Towers Perrin, recommended an 8.75% discount rate to Pennsylvania American Water Company for 1995. Likewise, Towers Perrin recommended a discount rate of 8.5% in March of 1995 to Philadelphia Suburban Water Company, and a discount rate of 8.7% in May of 1995 to UGI Utilities. Moreover, PP&L witness Beers

---

[18] The Company quotes SFAS 87 as stating, "[a]ssumed discount rates shall reflect the rates at which the pension benefits could be effectively settled." PP&L M.B. at 89-90.

testified on cross examination that the discount rate is normally based on investment grade bonds. Tr. 88. The OCA submits that the discount rate PP&L selected is not too high, but too low.

The Company argues that the discount rate used by Pennsylvania American Water Company ("PAWC") is not dispositive in this proceeding. PP&L M.B. at 89-91. However, PP&L provides no explanation as to why its circumstances are different than PAWC so as to justify a different rate. The OCA submits that it is important to consider that PP&L has failed to differentiate its case from those companies that have utilized a rate in the range of 8.5%, especially when PP&L's own actuary made the rate recommendation to several of these companies. OCA M.B. at 150. The OCA submits that, as shown in its Main Brief at pages 147-151, and above, the Company's discount rate is not consistent with the rise in bond yields, and the Company has not provided sufficient evidence to support its proposed discount rate. Therefore, the Company's discount rate of 7.5% should be rejected. The OCA submits that its recommended discount rate of 8.5% is reflective of the market rate and should be adopted. As such, the Company's postretirement benefits expense charged to O&M should be reduced by $481,000 on a total company basis and $416,000 on a Pennsylvania jurisdictional basis as shown on Schedule TSC-9. Similarly, the pension expense charged to O&M should be reduced by $12,296,000 on a total company basis and $7,056,000 on a jurisdictional basis as shown on schedule TSC-10 updated.

H. The Company's Claim For Retroactive Recovery Of Its OPEB Costs From 1993 Should Be Denied.

The Company contends that its claim for deferred SFAS 106 costs does not violate the general rule against retroactive ratemaking. PP&L M.B. at 93. As discussed in the OCA's Main Brief, the Commonwealth Court specifically addressed this issue and these particular costs in Popowsky v. Pennsylvania Public Utility Commission, ("PP&L 1994"). OCA M.B. at 152-155. There, the Court concluded that "the incremental costs would be prohibited by the rule against retroactive ratemaking." 164 Pa. Commonwealth 338, 348, 642 A.2d 648, 653 (1994).

The Company contends that the OCA has misconstrued the Commonwealth Court's decision. PP&L M.B. at 94. The OCA submits that it is the Company who has misconstrued the Commonwealth Court Order. As is discussed in the OCA's Main Brief, the Commonwealth Court specifically considered the exact costs PP&L is now claiming and determined that the rule against retroactive ratemaking prohibited their recovery. OCA M.B. at 154. The Court stated:

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

PP&L 1994, 164 Pa. Commonwealth at 346, 642 A.2d at 652. The Court also stated:

> [W]e believe that requiring future ratepayers to pay not only the transitional obligation costs of changing to the accrual method but also the incremental costs incurred in 1993 and beyond until the next rate case unfairly burdens the future ratepayers.

PP&L 1994, 164 Pa. Commonwealth at 347, 642 A.2d at 652. Thus, the OCA submits that the Court clearly held that the recovery of such costs in future rates would be improper.

The Company argues that the its claim should be allowed because it is requesting recovery in a base rate proceeding, and that in PP&L 1994 the Court rested its decision on the fact that the Commission inappropriately attempted to permit the recovery of past costs outside a base rate case. PP&L M.B. at 95-96. The Company appears to be suggesting that it is not a violation of the rule against retroactive ratemaking to grant recovery of past costs if it occurs during a base rate case. The OCA submits that this position is not supported by Commission precedent or case law. The Court in PP&L 1994 explained the rule against retroactive ratemaking. It stated:

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

PP&L 1994, 164 Pa. Commonwealth at 344, 642 A.2d at 651. See also; Cheltenham & Abington Sewerage Co. v. Pennsylvania Public Utility Commission, 344 Pa. 366, 25 A.2d 334 (1942); Barasch v. Pennsylvania Public Utility Commission, 507 Pa. 496, 491 A.2d 94

(1985); Pa. P.U.C. v. Philadelphia Electric Company, 58 Pa. PUC 7 (1983). Thus, the Court was clear that the rule against retroactive ratemaking applies in a base rate case.

In addition, the OCA submits that the Court held in PP&L 1994 that "recovery of the incremental costs would be prohibited by the rule against retroactive ratemaking" and that therefore the Commission's order permitting recovery in the future was improper; not that, the Commission inappropriately attempted to permit the recovery of past costs outside a base rate case, as the Company suggests. PP&L M.B. at 95; PP&L 1994, 164 Pa. Commonwealth at 348, 642 A.2d at 653.

The Company quotes the following statement of the Court to support its argument, "PP&L could have recovered those costs had it filed a rate case rather than a request for a declaratory order." PP&L 1994, 164 Pa. Commonwealth at 347, 642 A.2d at 652. However, this statement misperceives the Courts discussion in two respects.

First, the statement by the Commonwealth Court was made in the context of the Court's explanation of the fact that PP&L's incremental SFAS 106 costs are not "extraordinary," deserving of an exception to the rule against retroactive ratemaking. The following excerpts provide the context of the Court's statement:

> Extraordinary expenses are often described as unanticipated and non-recurring. . . . Extraordinary cannot mean merely unanticipated, because then every unexpected occurrence or failure to predict an item would be recoverable and the exception would overwhelm the rule, making test years meaningless. . . .

> These principles, though not explicitly, were applied in PECO. The costs of the pollution control devices in PECO were not extraordinary because those costs would be recurring as part of the cost of maintaining the existing facility. Also, the utility could have recovered the costs in rates had it filed its rate case earlier. Similarly, in this case, the incremental costs in 1993 are recurring; PP&L will be continually incurring those costs because it was required to change to the accrual method. Also, PP&L could have recovered those costs had it filed a rate case rather than a request for declaratory order.
>
> * * *
>
> Because the incremental costs were, in fact, anticipated before the request for declaratory order was filed and because the costs are recurring and could otherwise be recoverable in rates, the exception for "extraordinary" expenses does not apply.

PP&L 1994, 164 Pa. Commonwealth at 346-347, 642 A.2d at 652-653.

Second, the Court was explaining that had PP&L filed a base rate case in 1993, the costs in question would have been included within the test year and they could have then been recovered in rates. The Court was differentiating the present situation, where the Company is now trying to recover past costs. This, the Court determined, violated the rule against retroactive ratemaking.

Thus, the OCA submits that the Commonwealth Court concluded that the rule against retroactive ratemaking prohibits PP&L's recovery of its incremental costs and that the exception to this rule for "extraordinary" expenses does not apply. The OCA further submits that the Company's inference that Commonwealth Court's decision is no longer controlling, because the Company is

now requesting recovery in a base rate proceeding, is without merit.

The Company also contends that its position is supported by the Commonwealth's decision in Popowsky v. Pa. P.U.C., 164 Pa. Cmwlth. 600, 608, 643 A.2d 1146, 1150 (1994)("PAWC"). In PAWC, the Court determined that SFAS 106 transition costs qualify for the exception of "extraordinary costs." Id. However, in PAWC, the Court was not presented with the question of whether the recovery of deferred SFAS 106 costs is either retroactive ratemaking or an "extraordinary cost." Therefore, the Company's assertion that "the Court rejected arguments by the OCA that the recovery of such costs violates the general rule against retroactive ratemaking" is misplaced.

As fully discussed in the OCA's Main Brief at pages 151-155, the OCA submits that the Company's claim must be denied since the rule against retroactive ratemaking prohibits recovery of these costs. OCA M.B. at 151-155. Accordingly, the Company's net income must be adjusted by $1,040,000 on a total company basis and $900,000 on a Pennsylvania jurisdictional basis as shown on schedule TSC-11.

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

PP&L has included $996,000 in expense for the accrual of costs in the future test year under SFAS 112. The OCA submits that the Commission should deny the Company's SFAS 112 claim. OCA M.B. at 156-158. The Company in its Main Brief opposes the OCA's adjustment and contends that OCA witness Catlin "offered no

reasoned basis" for this recommendation to exclude PP&L's SFAS 112 claim from rates. PP&L M.B. at 98. However, as the OCA discussed fully in its Main Brief, the OCA submits that the Company's proposed ratemaking treatment is inconsistent with its own plan to continue to fund these liabilities on a cash basis. OCA M.B. at 156-158.

As OCA witness Catlin explained:

> [T]he Company has indicated that these accruals are relatively short-term liabilities. Therefore, the Company does not intend to fund these costs in the same manner as SFAS 106 expenses, but instead intends to pay for the costs as they become due. Test year expenses already include the annual cost associated with paying post-employment benefits. Ratepayers should not be required to pay for future liabilities which PP&L itself does not intend to pay until they become due.

OCA M.B at 157; OCA St. 6 at 19. In its Main Brief, the Company has stated that it has no plans to establish a separate fund for this liability. Thus, the OCA submits that, since the Company intends to treat these benefit costs just as it has in the past, its proposal to increase expense to reflect the accrual of these costs in the future test year for ratemaking purposes should be denied. It is for these reasons and the reasons set forth in the OCA's Main Brief at pages 156-158, that the Company's O&M expense claim should be reduced by $684,000 on a total company basis and by $592,000 on a Pennsylvania jurisdictional basis as shown on Schedule TSC-20.

J. PP&L's VERP Claim Should Include The Future Test Year Savings Associated With the Early Retirement Program.

PP&L requested a five year amortization of the $75,859,000 in costs associated with the Voluntary Early Retirement Program ("VERP") which it offered to its employees in late 1994. PP&L M.B. at 81-83. The OCA adopted PPLICA witness Kollen's adjustment to this claim which removed the cost savings realized prior to the end of the test year from the amortization of VERP costs. The OCA submits that PP&L should not be allowed to defer the costs of the program for future rate recovery without also recognizing that the VERP has produced cost savings which were similarly not reflected in rates. OCA M.B. at 158-159.

The Company contends that it would be inappropriate to reflect additional savings because although the Company may realize savings related to the VERP in the future test year, other costs will increase. PP&L M.B. at 83. As discussed in the OCA's Main Brief, the OCA submits that PP&L has recognized that the VERP will produce ongoing costs savings during the period the rates approved in this case will be in effect, but has failed to reflect these savings in its amortization request, causing a mismatch between the costs and benefits of the program. Therefore, the adjustment proposed by Mr. Kollen to net out the cost savings realized prior to the end of the test year from the VERP costs incurred prior to the end of the test year which are to be amortized is necessary and appropriate. OCA M.B. at 159-160.

The Company based its argument that the VERP has not produced cost savings to date on data from only the first four

months of 1995. See PP&L Exh. MJB-17. As PP&L witness Berish testified this data also included the one time lump sum vacation pay accruals paid to employees retiring under VERP. The OCA submits that the Company has claimed that the VERP will produce cost savings, therefore it is only appropriate to reflect the cost savings associated with the future test year in PP&L's claim for VERP costs. As shown on OCA St. 6A, Sch. TSC-28, adoption of this adjustment reduces test year expenses by $5,799,000 on a total company basis and $5,019,000 on a jurisdictional basis compared to PP&L's revised claim. The corresponding increases in net income are $3,355,000 and $2,904,000, respectively.

K. PP&L's Implementation Of Social Programs Should Be Monitored By The Commission.

In this proceeding, PP&L has requested Commission approval to implement eight programs that it has developed to serve customer and community needs. OCA M.B. at 160-162. The OTS has recommended that the costs for several of these programs should not be included in rates. OTS M.B. at 72-83. The Company, in support of these programs, sets forth a number of arguments describing the benefits of these programs in its Main Brief. PP&L M.B. at 113-124. One of these arguments notes that PP&L has "addressed the concerns of the OCA." Id. at 120.

As discussed in the OCA's Main Brief, the OCA acknowledged that the Company had provided a preliminary implementation plan for these programs, however, due to the preliminary nature of the information provided by the Company relating to these programs, the OCA recommended that PP&L should be

required to provide the final implementation plans and an outline of the future reporting requirements along with its compliance filing in this proceeding. OCA M.B. at 162. These plans should include detailed information relating to the implementation, expenditures and results of the programs. Id. The OCA submits that the Company's agreement to voluntarily report to the Commission on the status of these programs is important. Detailed reporting requirements and Commission monitoring will help to ensure that these programs accomplish the goals PP&L has set. Therefore, the OCA submits that the Commission should require the Company to provide the final implementation plans and an outline of the future reporting requirements along with its compliance filing.

VII. NUCLEAR DECOMMISSIONING ISSUES

A. Introduction

In this proceeding, PP&L's nuclear decommissioning expense claim is based on an $804 million (in 1993 dollars) estimate for costs related to the decommissioning of the two nuclear units at Susquehanna Steam Electric Station ("SSES") beginning in the year 2022. PP&L's claim for decommissioning expense is $30.042 million on a total Company basis, $23.570 million on a Pennsylvania jurisdictional basis. The OCA proposed four adjustments to the Company's decommissioning claim: removal of costs related to non-radiological decommissioning; elimination of all contingencies contained in the decommissioning cost estimates; an increase in the rate of return in decommissioning trust fund earnings assumptions from 5.5% to 7.5%; and the inclusion of the interest earned on the decommissioning trust fund during the ten to twelve years it will take to decommission the SSES Units. Adoption of these four adjustments reduces PP&L's decommissioning expense claim by $21,178,000 from $30,042,000 on a total Company basis to $8,864,000 on a total Company basis. OCA M.B. at 163-195. As set forth in the OCA's Main Brief and discussed below, the OCA submits that these adjustments are supported by the evidence of record and reflect the many changes in technology, policy, and regulation that effect the decommissioning process.

B. Non-Radiological Decommissioning Is Not Required By The NRC And Should Not Be Included In PP&L's Decommissioning Claim.

In this proceeding, the OCA, through its witness, Dale Bridenbaugh, proposed that the $127.4 million in non-radiological decommissioning costs be removed from the Company's $804.3 million decommissioning estimate. The OCA submits that the non-radiological decommissioning costs should not be included in rates at this time, because unlike radiological decommissioning, there are no federal or state regulations requiring decommissioning. In addition, the public safety concerns associated with non-radiological structures do not rise to the same level as those for radiologically contaminated areas. Moreover, the safety concerns identified by PP&L would only occur if the Company abandoned the SSES site. OCA M.B. at 176-188.

The Company acknowledges that the NRC regulations do not "explicitly require" the removal of non-radiological structures and equipment. However, the Company argues that the NRC has dictated site restoration in "many instances". PP&L M.B. at 126. As discussed in the OCA's Main Brief, the NRC regulations do not require non-radiological decommissioning. OCA M.B. at 182-186. As OCA witness Bridenbaugh testified, the NRC has not shown an active interest in regulating non-radiological decommissioning. OCA St. 4 at 19. Moreover, the Company's reference to the "many instances" where the NRC required site restoration is inapposite in the circumstances of this case. PP&L M.B. at 126. The Company's argument is based on the rebuttal testimony of Mr. LaGuardia where

he identified units where site restoration was required. However, in response to cross-examination, after identifying the locations where the NRC dictated site restoration activities, Mr. LaGuardia testified:

> Q. And all of these involved cancellation of a second or in North Anna, a third and fourth unit at multiple-unit sites; is that correct?
>
> A. That's correct, to return the site to a preconstruction condition.

Tr. 2086. As discussed in the OCA's Main Brief, the locations identified by Mr. LaGuardia were all plant sites where additional plant construction was canceled, and existing units were continuing to operate at that site, thus, these instances are distinguishable from the SSES site. OCA M.B. at 185-186.

PP&L also contends that the non-radiological decommissioning is required because radioactive decommissioning will leave the SSES site in an unstable and hazardous condition. PP&L M.B. at 126-127. As discussed in its Main Brief, the OCA is only requesting that the costs related solely to non-radiological decommissioning be removed from the decommissioning cost estimate. The OCA recognized that there are costs for removing non-contaminated items that should be included in the decommissioning estimate. However, these costs are already included in the estimate for radiological decommissioning costs. OCA M.B. at 180-182; OCA St. 4 at 22. Further, the Company's reliance on the Building Official and Code Administrators National Building Code ("BOCA Code") as support for non-radiological cost recovery is

misplaced since there is no evidence to support the assertion that the BOCA Code would require the removal of all structures regardless of condition or possible continued usage by PP&L. OCA M.B. at 183-185.

PP&L's final argument that Mr. Bridenbaugh "misunderstands" Mr. LaGuardia's study, because the study did not include the removal of facilities that might be reused was specifically rebutted by Mr. Bridenbaugh in his surrebuttal testimony. OCA St. 4A at 2-6; OCA M.B. at 187. As Mr. Bridenbaugh testified, this argument is not supported by the evidence of record:

> ... it seems totally inconsistent with the decommissioning study as submitted with Mr. LaGuardia's original testimony (Exhibit TSL-2). That Study, at page 4-7, indicates that "(a)lthough not required for license termination, it is assumed that the site is restored by regrading the site to conform to the adjacent landscape." Further, at page 4-11, it states that "(a)ll structures and site improvements will be removed to three feet below local grade and the terrain restored to the local grade level." Thus, it would appear that, other than the electrical switchyard and site drainage control he lists, his study includes the removal of all structures, regardless of possible future use.

OCA St. 4A at 2. Mr. LaGuardia even acknowledged that he projected the removal of such structures as warehouses. The OCA submits that the Commission should reevaluate its policy of including non-radiological decommissioning costs in decommissioning cost estimates.

As discussed in the OCA's Main Brief, the OCA recognized that, after initially rejecting non-radiological decommissioning

claims, the Commission has found that non-radiological decommissioning expenses can be included in the utility's decommissioning trust claim. OCA M.B. at 178-181. However, the OCA submits that in view of the changing regulatory environment and the increased likelihood that the SSES site will be utilized in the future, the Commission should reexamine the issue of non-radiological decommissioning costs. This is particularly appropriate in this proceeding since the Commission's own prior Orders on Susquehanna 1 and 2 decommissioning did not include non-radioactive decommissioning costs. See Pa. P.U.C. v. Pennsylvania Power & Light Company, 57 Pa PUC 559, 606-607 (1983) ("PP&L 1983"); Pa. P.U.C. v. Pennsylvania Power & Light Company, 59 Pa PUC 332, 384 (1985)

The Illinois Commerce Commission recently addressed these issues and denied Commonwealth Edison's claim for non-radiological decommissioning costs, holding that:

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

Re Commonwealth Edison, 158 PUR4th 458, 499 (Illinois Commerce Commission 1995).

As discussed in the OCA's Main Brief, in view of the Commonwealth Edison decision, and the recent proposed changes in NRC regulations, as well as an examination of the facilities and equipment included in the non-radiological decommissioning estimate, the Commission should reevaluate its recent practice of

including non-radiological decommissioning costs in the decommissioning estimate. Removal of the non-radiological costs from PP&L's decommissioning claim results in a reduction of $3,195,000 on a total Company basis and by $2,506,000 on a Pennsylvania jurisdictional basis. OCA St. 6, Sch. TSC.-15.

C. Contingencies

PP&L's decommissioning cost estimate includes a range of contingencies for the different tasks ranging from 15% to 75%, which results in a total contingency of approximately 18% based on the overall estimate. The radiological portion of the estimate includes an overall contingency of approximately 19%, or $106,569,000 for contingencies.[19] OCA St. 4 at 23; Exh. DGB-5.

Witnesses for both the OCA and OTS recommended that the contingencies included in the Company's decommissioning claim should be eliminated. As discussed above and in the OCA's Main Brief, the OCA submits that the Commission should remove all costs associated with non-radiological decommissioning. However, should the Commission fail to adopt the OCA's adjustment removing non-radiological costs from PP&L's decommissioning claim, the OCA submits that the Commission should still remove any contingencies included in the non-radiological cost estimate, as well as the contingencies included in the radiological cost estimate. OCA M.B. at 189-195. See OTS M.B. at 46-53.

---

[19] In addition, the Company included a contingency of $16.235 million in its non-radiological cost estimate. OCA St. 4 at 31.

PP&L argues that the witnesses for the OCA and OTS failed to offer any reasonable basis for removing the contingency factors from the decommissioning cost estimates. PP&L M.B. at 129. However, as set forth in the testimony of OCA witness Bridenbaugh and in the OCA Main Brief, there is no justification for including the contingency factors included in PP&L's decommissioning cost estimate. OCA M.B. at 191-195.

PP&L contends that TLG's actual experience in decommissioning nuclear power plants "confirms the reasonableness of the contingency included in the SSES study." PP&L M.B. at 131. However, as discussed in the OCA's Main Brief, Mr. LaGuardia's experience at the Shippingport facility does not support the level of contingency included in the SSES cost estimate. As Mr. Bridenbaugh testified:

> The *contingency amount included in the* Shippingport decommissioning cost estimate was $11.6 million of the total $98.3 million estimate. This equates to a 13 percent contingency factor. Since the actual cost of Shippingport decommissioning was $91 million, only $4.3 million of the contingency was used.

OCA St. 4A at 8, Exhs. DGB-13A and 13B (emphasis added); OCA M.B. at 192-193. Moreover, as discussed in the OCA's Main Brief, the decommissioning activities at Yankee Rowe and Rancho Seco are still in the early stages and thus Mr. LaGuardia's claims that the activities support the inclusion of contingencies are premature. Id.

Moreover, PP&L's criticism of Mr. Bridenbaugh's concerns regarding the low-level radioactive waste ("LLRW") disposal costs,

which account for almost 27% of the Susquehanna decommissioning cost estimate actually support Mr. Bridenbaugh's position.[20] PP&L M.B. at 131-133; OCA M.B. at 191. Mr. Bridenbaugh testified that the wide range of uncertainties regarding LLRW did not "justify the use of a fictitious disposal cost that is further inflated by contingency adders". The record in this proceeding demonstrates the speculative nature of these estimates. Id.

PP&L's arguments that the "uncertainties" discussed by Mr. Bridenbaugh support the inclusion of contingencies ignores the fact that the NRC requires that cost estimates be periodically updated and thus, new versions should be able to capture much of the technical and economic uncertainties discussed in the Company's Brief. OCA M.B. at 192. Since PP&L has indicated that it plans to internally update its cost estimate every two years, the OCA submits that all costs related to contingencies should be removed from the cost estimates.

The Company acknowledges that the Commission has in the past, including PP&L's last rate case, rejected the use of contingency factors in decommissioning cost estimates, but asserts that the Commission has in the past approved decommissioning claims that included a 25% contingency, citing Pa. P.U.C. v. Pennsylvania

---

[20] The OCA notes that in support of its argument the Company included a Wall Street Journal article dated June 15, 1995. PP&L M.B. at 133-134. The record in this proceeding closed on May 26, 1995. PP&L has not sponsored this article as a late filed exhibit or even attached it to its Brief to allow the article to be read in context. The OCA strongly objects to PP&L's inclusion of extra-record evidence in its Brief and asks that the Commission to disregard this reference in the Company's Brief.

Power Company, 64 Pa. PUC 308. 85 Pa. PUR4th 323 (1987) and Pa. P.U.C. v. Pennsylvania Power Company, 67 Pa. PUC 91 (1988). PP&L M.B. at 136. However, the OCA notes that in reviewing both the Recommended Decisions and the Commission Orders in those cases, the issue of contingencies is not addressed by the Commission.

Moreover, as discussed in the OCA's Main Brief, the concerns the Commission expressed in 1983 that contingency factors were "conjecture" and subject to fluctuation "up or down" is still relevant today. See Pa. P.U.C. v. Pennsylvania Power & Light Company, 57 Pa PUC 559, 606-607 (1983). OCA M.B. at 190-193. Although the Company contends that the use of a site specific study addresses these concerns, the OCA notes that a recent Illinois Commerce Commission Order rejected a 25% contingency factor because the use of a site specific study "reduces the need for inclusion of a contingency factor". See, Re Commonwealth Edison, 158 PUR4th 458, 505 (Illinois Commerce Commission 1995). The OCA submits that this Commission's concern over the speculative and fluctuating nature of contingencies should continue to apply to the site specific study presented in this proceeding.

For the reasons set forth above, and in the OCA's Main Brief, the OCA recommends the adoption of an adjustment to remove the contingency costs from PP&L's radiological decommissioning claim. This adjustment results in a reduction of $3,207,000 on a total Company basis and by $2,516,000 on a Pennsylvania jurisdictional basis. OCA St. 6, Sch. TSC.-15.

D. PP&L's Decommissioning Trust Fund Earnings Rate Should Be Increased To 7.5%.

The OCA submits that PP&L's estimate of trust fund earnings of 5.5 percent is unreasonably low and should be increased to 7.5% OCA M.B. at 169-176. In particular, as OCA witness Kahal testified:

> PP&L's assumed rates of returns on stocks and bonds are greatly understated and out of line both with current market conditions, the long-term outlook in financial markets and available authoritative forecasts. Mr. Hill assumes a return on long-term bonds of 5.5 to 6.0 percent and a mere 10 percent rate of return on equities. This latter figure compares to the 13 percent the Company presently insists is the market-required rate of return for PP&L common stock.

OCA St. 1 at 10. The unreasonable nature of PP&L's 5.5% earnings rate is further exacerbated by the Company's limitation of 30% equity allocation for the fund. OCA M.B. at 173.

PP&L acknowledged that its 5.5% earnings rate was conservative, but argued that more aggressive earnings assumptions cannot be required unless higher inflation rates are used in the decommissioning cost rates. PP&L M.B. at 137-139. However, as OCA witness Kahal testified:

> PP&L must take responsibility for the realism of its own projections of cost, and not use its misgivings over those projections as the basis for biasing a completely separate aspect of decommissioning, i.e., trust fund earnings. This "two wrongs make a right" logic must be rejected.

OCA St. 1A at 4. The OCA submits that PP&L's 5.5% earnings rate ignores current and projected market conditions and therefore, should be increased to 7.5%.

Moreover, the OCA submits that the Company's description of the proposed 7.5% earnings rate as "aggressive" is an overstatement. PP&L M.B. at 138. Not only are the earnings assumptions that Mr. Kahal utilized fully supported by the evidence of record, Mr. Kahal utilized the conservative 30% equity allocation in his earnings analysis. OCA M.B. at .

The OCA submits that PP&L should be required to utilize a 7.5% return as an earnings standard for the decommissioning trust fund investments. Adoption of 7.5% rate of return reduces the Company's claim by $11,671,000 on a total Company basis and by $9,157,000 on a Pennsylvania jurisdictional basis assuming that the earnings assumptions discussed above are utilized. OCA St. 6, TSC-14.

E. Inclusion Of Post-Shutdown Interest Earnings Is Not Precluded By The NRC.

During the ten to twelve years that it will take to decommission Susquehanna Units 1 and 2, the decommissioning trust fund will continue to earn interest. OCA witness Catlin adjusted PP&L's decommissioning claim to include the interest earned during the post-shutdown decommissioning period. As discussed in the OCA's Main Brief, adjusting PP&L's claim to account for the continued earnings results in a reduction of $3,105,000 on a total Company basis and by $2,436,000 on a Pennsylvania jurisdictional basis. OCA St. 6 at 22; OCA M.B. at 166-169.

PP&L argues that Mr. Catlin's adjustment is "simply wrong" because the NRC requires that a nuclear decommissioning trust fund be fully funded at the time its license terminates. PP&L

M.B. at 143-144. The OCA submits that these NRC regulations do not preclude inclusion of the post-shutdown interest component in the decommissioning trust fund. As PP&L witness LaGuardia acknowledged the NRC has made exceptions to this requirement on a case by case basis. PP&L St. 13R at 14; OCA M.B. at 167-168. In fact, the NRC has accepted the funding plans of the other utilities which recognize fund earnings subsequent to the planned termination of operations of their plants in calculating the required funding contribution. Id.; OCA St. 6A at 15. This adjustment has been accepted by the Federal Energy Regulatory Commission and other regulatory Commissions. Id. Therefore, the OCA submits that PP&L's argument that the NRC regulations mandating full funding precludes Mr. Catlin's adjustment is contradicted by the evidence of record.

Moreover, as PP&L witness LaGuardia testified, the NRC regulations only address radiological decommissioning requirements, since there is no NRC funding requirement for non-radiological decommissioning costs. Tr. 2084. Therefore, should the Commission in this proceeding allow PP&L to include non-radiological decommissioning costs in its decommissioning claim, PP&L will have recovered from ratepayers funds well in excess of the NRC requirements at the time decommissioning activities actually begin. If the Commission adopts the Company's claim for recovery of non-radiological decommissioning expense, the OCA submits that it would be wholly unreasonable for the Commission to not account for the interest earned on the total decommissioning

trust fund in its determination of the appropriate level of decommissioning expense chargeable to ratepayers in this proceeding.

F. Conclusion

For the reasons set forth above, and in the OCA's Main Brief at 163 to 195, the OCA submits that its adjustments to PP&L's nuclear decommissioning expense claim are reasonable and should be adopted. Accordingly, the Company's claim should be reduced by $21.78 million to accurately reflect the Company's decommissioning costs.

VIII. TAXES

A. The OCA's Consolidated Tax Savings Adjustment Is Consistent With Both Legal Precedent And The Evidence Presented In This Proceeding.

As discussed in the OCA's Main Brief, PP&L calculated its pro forma tax expense on a stand alone basis and reflected no consolidated tax savings adjustment, despite the fact that the Company participates in a consolidated federal income tax return. OCA M.B. at 200-203. The OCA submits that PP&L's failure to pass the savings resulting from its consolidated filing to its ratepayers violates the long-standing "actual taxes paid" doctrine and should be rejected. Id.

Despite a "philosophical disagreement" with the Commission and Appellate precedent adopting consolidated tax savings adjustments, PP&L recognizes that utilities have been ordered to share consolidated tax savings with their customers. PP&L M.B. at 186-192. However, the Company argues the OCA's consolidated tax adjustment should be rejected because it is "patently inconsistent with relevant Commission precedent." Id. at 187. As discussed below, and in the OCA's Main Brief, the OCA submits that these arguments are without merit and that the OCA's adjustment should be adopted.

First, PP&L argues that the OCA's adjustment must be rejected because Mr. Catlin utilized historic tax losses related to the Pennsylvania Mines Corporation ("PMC") and Rushton Mining Corporation ("Rushton"). PP&L M.B. at 190. As discussed in the OCA's Main Brief, OCA witness Catlin requested prospective tax

information, however, the Company did not provide any information. OCA M.B. at 202. As Mr. Catlin testified:

> In response to OCA IV-122 and IX-31, PP&L has indicated that it has not prepared any projections of taxable income for its subsidiaries for calendar year 1995 or 1996. Therefore, the future test [year] represents the most current information available, and I have relied on data for 1993 through the future test year in developing my adjustment.

OCA St. 6A at 12 (emphasis added). Thus, the Company's allegation that Mr. Catlin's adjustment is flawed because he relied on historic information ignores the fact that the adjustment is based on the most recent data provided by the Company, including the future test year data.

In addition, PP&L's argument that the Rushton and PMC tax losses are non-recurring and should not be considered is contradicted by the fact that since 1993, when the Company ceased all mining-related operations, both of these companies have continued to incur tax deductible costs. This includes projected losses for the future test year of over $5.75 million. OCA M.B. at 202, OCA St. 6A at 12. The Company presented no evidence to support its position that these losses will not continue into the future, thus, it is appropriate to include these losses in the consolidated tax calculation.

PP&L's next arguments are that because PMC and Rushton were never intended to operate at a profit or loss their taxable losses should be excluded and that the tax savings have already been passed through to customers through the ECR. However, as discussed in the OCA's Main Brief, these contentions are

unsupported by the record in this proceeding. The Company provided no evidence that ratepayers have already received the tax benefits through the ECR from these tax losses. OCA M.B. at 203. The OCA submits that PP&L retains the burden of proof to establish each element of its claim. The record in this proceeding does not support the Company's arguments to reject Mr. Catlin's consolidated tax savings adjustment. See OCA M.B. at 3-6.

The OCA submits that consistent with well-established Pennsylvania precedent, PP&L should be required to pass on the tax savings associated with its consolidated tax filing. Adoption of this adjustment reduces federal income tax expense by $2,548,000 on a total company basis and $2,161,000 on a Pennsylvania jurisdictional basis. OCA M.B. at 203; OCA St. 6, Sch. TSC-25.

B. PP&L's Gross Receipts Tax Claim Should Be Adjusted To Exclude Uncollectibles.

In this proceeding, the OCA adjusted PP&L's gross receipts taxes to recognize that revenues which are not received (i.e., uncollectibles) are not subject to the tax. OCA M.B. at 196-198; OCA St. 6 at 33. The Company argued that this adjustment is "wholly inappropriate and should be rejected". PP&L M.B. at 195-196. PP&L contends that since the Company will not actually collect all of its revenue there is no basis for this adjustment. Id. at 195. As discussed in the OCA's Main Brief, this argument totally ignores the fact that in this proceeding, the Company is already seeking to recover any deficiency in its revenues due to uncollectibles from ratepayers in its uncollectible claim. OCA M.B. at 197; OCA St. 6A at 13.

In addition, the Company's contention that although it did not claim any additional uncollectibles expense, if it had claimed these costs it would have offset Mr. Catlin's adjustment is without support. The OCA submits that the Company's failure to present a request for future test year uncollectible costs cannot be used as an excuse to deny an adjustment to the Company's claim as filed. Moreover, this argument fails to address the issue that gross receipts taxes do not apply to uncollectible revenues.

Further, as discussed in the OCA's Main Brief, the Commission recently approved this same adjustment in Pa. P.U.C. v. West Penn Power Company, Docket No. R-00942986, slip op. at 80 (December 28, 1994). See also, OCA St. 6A at 13. Adoption of the adjustment excluding uncollectibles revenues reduces the taxable revenue base by $16,932,000 on both a total company and Pennsylvania jurisdictional basis. Applying the current gross receipts tax rate to this amount reduces gross receipts tax by $745,000 and increases net income by $431,000. OCA M.B. at 198; OCA St. 6, Sch. TSC-22.

C. The OCA Properly Excluded Certain Additions To PP&L's Taxable Income.

After reviewing PP&L's future test year tax claim, OCA witness Catlin excluded a number of the adjustments that PP&L had made to its income tax claim. OCA M.B. at 203-207. In particular, Mr. Catlin eliminated three items, additions to taxable income for ECR/FAC overrecoveries, refueling outage costs and bad debt accruals which the Company included as additions to taxable income for purposes of calculating future test year income tax expense.

Id.; OCA St. 6 at 33-35, OCA St. 6A at 13-14. In its Main Brief, PP&L characterizes all three adjustments as "inappropriate efforts to 'cherry pick' individual items in an effort to arbitrarily and unfairly whittle away at the Company's rate request", but only disputes the accuracy of one adjustment, the bad debt accruals. PP&L M.B. at 192-194.

As discussed in the OCA's Main Brief, and as noted by the Company, OCA witness Catlin recognized that items included in the additions to the Company's taxable income will fluctuate up and down and eliminated all inappropriate items, including the adjustment suggested by PP&L's witness. OCA M.B. at 205-206; OCA St. 6A at 13-14. The Company is apparently still not satisfied, and urges the Commission to "go further" and reject the entire adjustment. The OCA submits that the evidence of record supports the adoption of Mr. Catlin's adjustment. The Company's claims of "cherry picking" cannot hide the fact that Mr. Catlin's adjustment appropriately eliminates items from the Company's claim for income tax expense.[21]

In fact, other than the "cherry picking" argument discussed above, PP&L did not dispute the accuracy of two of Mr. Catlin's adjustments, the additions to taxable income for ECR/FAC overrecoveries and refueling outage costs. The Company's only

---

[21] The OCA notes that despite the Company's argument that Mr. Catlin only focused on taxable items that fluctuated down, PP&L identified only one item that fluctuated up, the reduction related to the power plant inventory tax accounting change. PP&L St. 3R at 19. In surrebuttal, Mr. Catlin included this item in his adjustment. OCA St. 6A at 14.

argument against the third adjustment, the bad debt accrual, is that PP&L's uncollectibles accounts expense is not based on the actual level of bad debt write-offs. PP&L M.B. at 193-194. However, as discussed in the OCA Main Brief, the evidence presented by the Company establishes that the future test year claim for uncollectibles reflects the future test year estimate of write-offs. OCA M.B. at 206-207. Thus, the Company's argument is contradicted by the evidence of record. Accordingly, the Commission should adopt Mr. Catlin's adjustment eliminating the additions to taxable income for ECR/FAC overrecoveries, refueling outage costs, bad debt accruals and the reduction to taxable income related to the power plant inventory tax accounting change. This reduces income taxes and increases net income by $3,945,000 on a total company basis. On a Pennsylvania jurisdictional basis, the reduction in income taxes and increase in net income is $4,089,000. Id.; OCA St. 6A, Schedule TSC-23 (May 1995 Update).

D. PP&L's Claim For Accrual of Tax Deficiencies Should Be Rejected.

In this proceeding, the OCA adjusted PP&L's test year income tax expense to eliminate accruals for potential state and federal income tax deficiencies. OCA St. 6 at 35, Sch. TSC-24; OCA M.B. at 207-209. The OCA submits that this claim is speculative and is not a known or measurable expense. Id. The Company did not present rebuttal testimony on this issue or address it in its Main Brief. As discussed above, the OCA submits that pursuant to 52 Pa. Code § 5.501(a)(3), PP&L is precluded from presenting any affirmative claim for this issue in its Reply Brief. The OCA's

adjustment eliminating accruals for potential federal and state tax deficiencies is supported by Commission precedent that requires ratemaking claims be based on known and measurable costs, and should be adopted. OCA M.B. at 207-209. Accordingly, this adjustment reduces the income taxes and increases net income by $1,200,000 on a total company basis and by $1,017,000 on a Pennsylvania jurisdictional basis. Id.; OCA St. 6, Sch. TSC-24.

E. The OCA's Tax Synchronization Adjustment Should Be Adopted.

In this proceeding, the OCA also proposed a tax synchronization adjustment to reflect the weighted average cost of debt in the event that the Commission determines a rate base value or capital structure different from those claimed by PP&L. OCA M.B. at 209-210; OCA St. 6A, Sch. TSC-26 (May 1995 Update). As discussed in the OCA's Main Brief, an interest synchronization adjustment is a traditionally accepted ratemaking adjustment. See e.g., Pa. Public Utility Commission v. Carnegie Natural Gas Company, 61 Pa.Commonwealth 436, 433 A.2d 938 (1981); Pa. P.U.C. v. West Penn Power Company, 79 Pa. PUC 122, 166 (1993); and Pa. P.U.C. v. West Penn Power Company, Docket No. R-00942986 (December 28, 1994) slip op. at 80-81.

As discussed above, the Company did not present rebuttal testimony on this issue or address it in its Main Brief. Accordingly, pursuant to 52 Pa. Code § 5.501(a)(3), PP&L is precluded from presenting any affirmative claim for this issue in its Reply Brief. The OCA's tax synchronization adjustment is well supported by Commission precedent and should be adopted. Adoption

of this adjustment, utilizing the OCA's recommended weighted cost of debt, reduces the Company's interest deduction $806,000, and increases state and federal income taxes by $210,000 and $596,000, respectively. OCA M.B. at 209-210; OCA St. 6A at 20, Sch. TSC-26 (May 1995 Update).

IX. COST OF CAPITAL

A. Introduction

In support of its requested overall rate of return of 10.22%, which includes a 13.0% return on equity, PP&L contends that the "fundamental risk factors" affecting electric utilities supports its request for a 13.0% return on equity. In addition, PP&L attacks the Discounted Cash Flow ("DCF") method of calculating the cost of equity, and the various rate of return recommendations of the Complainant parties to this proceeding. Further, the Company requests that "the Commission should take into account the quality of management in its fair rate of return analysis". PP&L M.B. at 214-216.

As set forth in the OCA's Main Brief, and discussed below, the OCA submits that the Company's request for a 13.0% return on equity is overstated and should be denied. OCA witness Kahal's return on equity recommendation of 11.10% is well supported by the evidence of record and addresses all of the concerns presented by the Company in this proceeding. OCA M. B. at 250-262. See also, PPLICA M.B. at 16-26; OTS M.B. at 127-132.

Moreover, the OCA submits that PP&L's request for "recognition" for its management performance over the past ten years as support for an "equity cost allowance at the upper end of the zone of reasonableness" should be rejected. Throughout this proceeding, the Company never quantified or requested an "equity adder or bonus" for management performance, and it should not be

permitted to present such an adjustment for the first time in its Main Brief.

B. Capital Structure

1. Introduction

The OCA recommended an overall cost of capital for PP&L of 9.27%, including an 11.10% return on equity. OCA M.B. at 211-215; OCA St. 1B at 9. OCA witness Kahal's recommendation incorporates the Company's projected actual capital structure and cost rates with the exception of an adjustment modifying the long term debt balance to exclude $115.9 million of unamortized losses on debt acquisitions and an adjustment to the embedded cost of debt to reflect the deferred taxes related to reacquired debt. OCA M.B. at 219-231.

In its Main Brief, the OCA discussed two concerns about the Company's capital structure, the first being the Company's reliance on a projected capital structure that incorporates an equity issuance that has not yet occurred, and second, the modification of the Company's actual capital structure related to recovery of reacquired debt. Id. at 213-231. The OCA does not intend to repeat these arguments in detail, but believes it is necessary to respond to certain contentions raised by PP&L.

2. PP&L Capital Structure Should Reflect The Company's Actual Equity Level.

PP&L's projected capital structure relies, in part, on a $100 million equity issuance scheduled to take place during the time between the close of the record in this proceeding and the

issuance of the Final Order.[22] The OCA in its Main Brief, did not object to using the projected capital structure, as long as the Company updated the Commission on the status and amount of the planned equity infusion, and utilized only the actual amount of equity issued in the capital structure. However, if the equity infusion did not occur prior to the entry of the Commission's Final Order in this proceeding, the OCA recommended that PP&L's capital structure should be revised to exclude the projected equity infusion. OCA M.B. at 213-215.

In making this recommendation, the OCA relied on the testimony of PP&L witnesses Hill and Moul, who testified that the Company planned to continue to inform the Commission of the status of the equity issuance. Id. at 213-214. However, PP&L, in its Main Brief, now argues that its projected capital structure should be adopted despite the fact that "the exact timing of the equity issuance is not certain".[23] PP&L M.B. at 202-204. The OCA submits that contrary to the Company's assertion, it has not met its "burden of proving the reasonableness of its projection". Id. at 204. Although the Company contends that it has taken "specific steps", including authorization from the Board of Directors to issue new equity, significant uncertainty exists as to the timing and amount of the equity issuance. See OCA M.B. at 213-215; PPLICA

---

[22] The $100 million equity issuance which the Company indicated is scheduled for August 1995 increases PP&L's common equity ratio by nearly a full percentage point. PPLICA M.B. at 27.

[23] As discussed in the OCA's Main Brief, both the timing and the amount of the equity issuance are uncertain. OCA M.B. at 214; Tr. 1796.

M.B. at 27-28. Notably, PP&L witness Moul testified in response to cross-examination, that the authorization from the Board of Directors does not commit management to a stock issuance, nor does it specify the timing or the amount of the stock sale. Tr. 1796. In fact in its Main Brief, PP&L gave little assurance that the equity issuance will occur at all.

The burden remains on PP&L to establish that the equity issuance has actually taken place prior to the entry of a final Order. Absent firm evidence that the equity has been issued, PP&L should not be allowed to include it in its capital structure in this rate proceeding. Doing so is tantamount to approving a hypothetical capital structure. The OCA is particularly concerned that despite earlier assurances from PP&L witnesses that the Company would continue to update the Commission on the status of the equity issuance after the close of the record, PP&L now asks the Commission to instead accept the "best available evidence" that this issuance will occur. The OCA submits that the best available evidence fails to establish with any certainty that the equity issuance will occur before the end of the future test year in this proceeding and the entry of a Final Order. OCA M.B. at 213-215. If the Company is unable or unwilling to provide the information to establish the equity issuance and the amount of the issuance, the Commission should exclude the projected equity from the Company's capital structure. See Pa. P.U.C. v. National Fuel Gas Distribution Corp., 73 Pa. PUC 552, 605-606 (1990).

Accordingly, the OCA submits that PP&L should be required to continue to update the Commission and the active parties of record on the status and amount of the planned equity infusion. Moreover, should the equity infusion not occur prior to the entry of the Commission's Final Order in this proceeding, PP&L's capital structure should be revised to exclude the projected equity infusion.

3. PP&L's Capital Structure Adjustment Fails To Provide Proper Ratemaking Treatment For Loss On Reacquired Debt.

In this proceeding, PP&L witness Moul adjusted the Company's actual projected capital structure by deducting $116 million from the Company's actual debt balance corresponding to losses on reacquired debt. OCA witness Kahal recommended that the $115.9 million of unamortized losses should not be subtracted from the debt balance for capital structure purposes, but instead that the Company's actual projected capital structure be utilized.[24] OCA M.B. at 220-227. In addition, the OCA proposed that the Commission adjust PP&L's cost of debt to reflect the balance of accumulated deferred income tax ("ADIT") on the reacquired debt. In the alternative, should the Commission adopt Mr. Moul's adjustment to PP&L's actual projected capital structure, the OCA recommended an adjustment to rate base to recognize the balance of

[24] The OCA notes that Mr. Kahal's use of the Company's projected capital structure as of September 30, 1995 was predicated on the Company's testimony that the $100 million equity issuance would take place prior to end of the future test year.

ADIT associated with the loss on reacquired debt. OCA M.B. at 225-231.

The Company argues that Mr. Kahal's recommendation to utilize the Company's actual projected capital structure is contrary to Commission precedent and penalizes the Company for reacquiring high cost debt. PP&L M.B. at 204-208. As discussed in the OCA's Main Brief, the Commission in the past has adopted the adjustment to the Company's actual capital structure that PP&L is proposing in this proceeding. OCA M.B. at 222-223. However, this argument ignores the fact that Mr. Kahal's recommendation to utilize the Company's actual projected capital structure provides PP&L with full cost recovery for the losses on reacquired debt. As Mr. Kahal testified:

> I provide PP&L with total recovery of those costs (through an amortization) plus a debt return on the unamortized balance of those reacquisition expenses. Doing so raises the embedded cost of debt from 7.40 to 7.97 percent and adds about $16 million to PP&L's cost of service (total company). Mr. Moul's capital structure adjustment adds an additional $8 million, for a total of $24 million. I did not set cost recovery at $16 million merely because it happens to be lower than $24 million. I favor the $16 million (reflected in the 7.97 percent debt cost rate) because that amount provides PP&L with full cost recovery.

OCA St. 1A at 6.[25] Thus, the OCA submits that the Commission should revisit this issue due to the fact that in addition to

[25] The OCA notes that as discussed below and in the OCA's Main Brief, recognition of the accumulated deferred income taxes associated with the loss on reacquired debt lowers the embedded cots of debt to 7.84%. OCA M.B. at 225-227; OCA St. 1B at 9.

providing PP&L with total recovery of its loss on reacquired debt, Mr. Moul's adjustment overcharges ratepayers by about $8 million. OCA M.B. at 220-225.

PP&L also disagrees with the OCA's adjustment to recognize the deferred taxes associated with the reacquired debt. PP&L M.B. at 208-209. Although both the Company and the OCA agree that investors received tax savings at the time of debt reacquisition, the Company asserts that these tax savings should be passed back to customers over the life of the debt. Id. at 208. In other words, although the shareholders have already received the tax savings, ratepayers will only see the tax savings gradually over the next 10 to 15 years. OCA M.B. at 225-227.

As discussed in the OCA's Main Brief, to recognize the deferred taxes associated with call premiums, the OCA recommended that the Commission utilize the Company's actual capital structure with a 7.84% debt cost. However, in the event that the Commission adopted Mr. Moul's adjusted capital structure, the OCA submits that PP&L's rate base must be adjusted to reflect the accumulated deferred income taxes as a rate base offset. OCA M.B. at 231. The Company argued that the rate base adjustment should be rejected because "the Company has not sought to include the premiums in rate base" and that if an "adjustment were to be made it should be made to the capital structure ratios." PP&L M.B. at 208-209. The OCA submits that although the Company may not have sought rate base recognition of the call premiums, adoption of Mr. Moul's adjustments achieves that result. As Mr. Kahal testified because

Mr. Moul "subtracts the unamortized balance from debt balance for capital structure purposes he is in effect giving that balance a combined debt plus equity return, i.e., the dollar equivalent of putting it in rate base." OCA St. 1B at 8; OCA M.B. at 227-230. Thus, a rate base offset adjustment for deferred taxes is appropriate.

The OCA submits that, as discussed above, the Company's practice of reacquiring debt gave rise to a tax timing difference, and hence, deferred taxes. In order for ratepayers to receive these tax savings in a timely manner, the OCA submits that the Commission should adopt Mr. Kahal's recommendation utilizing the Company's actual capital structure with a 7.84% debt cost. However, in the event that the Commission accepts PP&L's modified capital structure, then Mr. Catlin's rate base adjustment is required in order to recognize the accumulated deferred income taxes associated with the reacquired debt. PP&L's recommendation to exclude deferred taxes improperly supplies the Company with a return on non-investor supplied funds. As discussed above and in the OCA's Main Brief, adoption of the rate base adjustment reduces total Company rate base by $47,863,000 and reduces Pennsylvania jurisdictional rate base by $40,838,000.

C. The Evidence Of Record Does Not Support PP&L's Request For A 13.0% Return On Equity.

1. Introduction

In support of its 13.0% cost of common equity request, PP&L contends that the Commission should consider a number of factors. First, PP&L argues that the Commission must recognize the

increased risk facing electric utilities in general and PP&L in particular. PP&L M.B. at 210-216. The Company points to changes in stock prices and to the risk categories created by bond rating agencies as evidence of this increased risk. Id. at 211. Second, the Company points to recent Commission return on equity allowances and contends that because PP&L is a riskier utility, the Company deserves an equity allowance in the 12-13% range. Id. at 213. Third, the Company states that the Commission in setting PP&L's equity cost allowance should recognize PP&L's management performance. Id. at 214-216. Finally, the Company argues that the cost of equity analyses performed by PP&L witness Moul support a 13.0% return on equity. Id. 216-224.

After identifying all of the factors it claims support PP&L's equity request, the Company then asks the Commission to disregard the decline in interest rates and the resulting lower capital costs, characterizing such evidence as a "smokescreen". Id. at 214. Moreover, PP&L argues that the cost of equity recommendations presented by the witnesses for the OCA, the OTS and PPLICA, which utilized the Commission accepted DCF methodology must also be discounted as having "produced clearly unreasonable results". Id. at 225-231. As discussed below and in the OCA's Main Brief, acceptance of these arguments would require the Commission to ignore not only the evidence of record, but also substantial Commission and appellate precedent. OCA M.B. at 232-234. The OCA submits that Mr. Kahal's 11.10% return on equity

recommendation is fully supported and consistent with Commission precedent.

2. Current Capital Market Conditions Do Not Support A 13.0% Return on Equity Result.

PP&L argues that a "new level of competition" has increased the risk of investing in electric utilities. PP&L M.B. at 210-212. However, the Company ignores the fact that all of the industry wide risk factors referenced in the Company's argument are recognized and reflected in the DCF analyses performed by OCA witness Kahal. OCA St. 1 at 21-44. Mr. Kahal's DCF studies utilized all relevant information, including historical growth rates, published growth rate projections and earnings retention growth. Id. at 23. Most importantly, his study is based on late-1994 to early -1995 stock prices of electric utilities, including PP&L. Thus, his recommendation is fully responsive to conditions in capital markets during the past year and perceptions of an increasingly competitive electric industry.

Moreover, the Company's reliance on recent Commission decisions to support a higher equity return for PP&L are misplaced. Although the Commission in Pa. P.U.C. v. West Penn Power Company, Docket No. R-00942986 (December 28, 1994) awarded West Penn an 11.5% return on equity based on data from 1994 reflecting then current market conditions, also included in that determination was a 0.25% "bonus" for management performance. Id., slip op. at 99. In that case, West Penn had specifically requested and quantified an equity adder for management performance. PP&L in this

proceeding did not identify or quantify a request for management performance. In addition, in Pa. P.U.C. v. Roaring Creek Water Company, Docket No. R-00943177, slip op. at 48 (May 31, 1995), the Commission specifically recognized "that the financial markets have experienced rising interest rates" in awarding an 11.0% return on equity. In this proceeding, as even PP&L witness Moul recognized, capital costs are declining. OCA M.B. at 218.

PP&L's argument that the Commission should ignore recent evidence of a decline in interest rates, characterizing it as a "smokescreen", must also be dismissed. As discussed in the OCA's Main Brief, a review of the current market conditions reveals a significant decline in capital costs. OCA M.B. at 217-219. As Mr. Kahal testified in surrebuttal:

> I have updated my original Schedule MIK-2 so that it extends through April 1995. As this schedule indicates, long-term interest rates have moderated significantly since year-end 1994. Despite the widely publicized problems in foreign exchange markets, conditions in capital markets so far this year have shown considerable improvement. This improvement appears to be based on the view that economic activity is slowing and inflation remains moderate.

OCA St. 1A at 10-11. Further, the Company's contention that the current market conditions are influenced by "temporary short-term variations in the market rates" ignores the fact that there has been a clear downward trend in capital costs since 1990. OCA M.B. at 217.

Moreover, Mr. Kahal' 11.10% recommendation is based solely on record evidence, including data from the most recent six

months. Despite the obvious downward trend, Mr. Kahal recommended using the mid-point of each study rather than the lower end of the range of evidence. As discussed in the OCA's Main Brief, the OCA submits that Mr. Kahal's 11.1% return on equity recommendation is consistent with recent capital market data. Id. at 217-219.

3. PP&L's Request For Recognition Of Management Performance In the Determination of Its Equity Cost Rate Allowance Should Be Denied.

In it Main Brief, PP&L argues that the Commission should recognize the Company's management performance by adopting an equity cost rate allowance at "the upper end of the zone of reasonableness." PP&L M.B. at 214-216. However, at no time during this proceeding did the Company request or quantify an equity adder based on management performance. The OCA submits that, as discussed above, not only does the record in this proceeding not support a finding of a 13% cost of common equity for PP&L the record does not support a bonus to PP&L's shareholders.

The Company relies on the testimony of PP&L witness Hill to support its claim of management excellence. PP&L M.B. at 215-216. However, the OCA submits that all of the listed activities refer to activities that a utility must undertake in order to meet its obligations under Section 1501 of the Pennsylvania Public Utility Code, 66 Pa.C.S. §1501. Section 1501 requires that:

> Every public utility shall furnish and maintain adequate, efficient, safe and reasonable service and facilities....as shall be necessary or proper for the accommodation, convenience and safety of its patrons, employees and the public.

66 Pa.C.S. §1501. The OCA submits that Section 1501 establishes a standard that all utilities are required to achieve, and PP&L's request that it receive a bonus for "excellent management" asks the Commission to reward the Company for providing the quality of service it is mandated to provide.

The Commission has in the past examined the issue of an incremental return based on a utility's quality of service. In Pa. P.U.C. v. National Fuel Gas Distribution Corp., 73 Pa. PUC 552, 121 PUR4th 434 (1990). In NFGD, the Company requested an incremental return based on its alleged high quality service. The Commission found pursuant to 66 Pa. C.S. § 523(a) that:

> (1) Distribution is providing efficient, effective and adequate service to its customers; (2) Distribution has implemented a program which is designed to upgrade and improve the quality of service provided to Distribution's customers; and (3) Distribution has successfully met the Commission's performance criteria concerning energy supply alternatives.

73 Pa. PUC at 612. However, even with this finding the Commission denied the Company's request stating:

> Finally, we deny NFGD's exception that the Company should receive an incremental return based upon a high quality of service. We agree with ALJ Cohen that NFGD is obligated to provide customers with a quality of service which is adequate, efficient, and reasonable. Accordingly, in the context of the instant proceeding any award is unwarranted.

73 Pa. PUC at 611. Although the Commission has in the past granted West Penn Power Company's request for an equity bonus for management performance, this reward was tied to the fact that West Penn had the lowest electric rates in Pennsylvania. See Pa.

P.U.C. v. West Penn Power Company, 73 Pa. PUC 454, 510, 119 PUR 4th 110, 116 (1990); Pa. P.U.C. v. West Penn Power Company, 79 Pa. PUC 122, 185 (1993); Pa. P.U.C. v. West Penn Power Company, Docket No. R-00942986, slip op. at 99. (Order entered December 28, 1994). There is no evidence in this proceeding that would support a similar adjustment for PP&L. Moreover, in each of the West Penn proceedings, the Company specifically included in their filing a quantified request for an equity bonus for management performance. As discussed above, PP&L had not, prior to its Main Brief, asked for an adjustment related to management performance. The OCA submits that for the reasons discussed above, PP&L is not entitled to receive a "reward" of a 13.00% return on equity for quality of service.

4. PP&L's Return On Equity Request Of 13.0% Is Overstated.

The OCA addressed the many flaws in PP&L witness Moul's cost of common equity recommendation of 13.0% in its Main Brief and will not repeat those arguments here. OCA M.B. at 250-262. However, certain arguments raised by the Company regarding Mr. Moul's return on common equity analyses require additional response. First, PP&L contends that in the cost of common equity analyses, the analyses utilizing PP&L common stock "provides the best and most direct evidence of the Company's results". However, the OCA submits that the PP&L stock is not the "best" source of data for a DCF analysis. As OCA witness Kahal testified:

> In conducting a single company DCF analysis, there is always the risk that the historical

> and market data for that firm may be atypical of what investors could reasonably expect in the future. Employing a group of firms has the advantage of averaging out the unusually high and low observations.

OCA St. 1 at 24. Although Mr. Kahal performed a PP&L stand alone DCF analysis, Mr. Kahal explained:

> I believe that proxy groups -- if correctly selected -- should produce more reliable, stable estimates than single company DCF studies. In addition, it should be noted that PP&L is in the process of reorganizing in order to facilitate investments in non-utility ventures. While this activity is nominal at present, it could become significant in the future.

OCA St. 1 at 35. Thus, as discussed in the OCA's Main Brief, the OCA submits that Mr. Kahal's DCF analyses of Mr. Moul's proxy group and the Primary proxy group provide more reliable DCF results. OCA M.B. at 234-244.

In addition, as set forth in the OCA's Main Brief, Mr. Moul's DCF analyses relied on an unsupported 4.0% growth rate and the result was then adjusted upwards for "non-company specific factors, an ex-dividend adjustment and quarterly compounding of the dividend". Mr. Moul also relied on the comparable earnings method even though it does not address the cost of equity estimation. The other two approaches used by Mr. Moul the CAPM and risk premium, have been repeatedly rejected by this Commission in the past, most recently in Pa. P.U.C. v. Roaring Creek Water Company, Docket No. R-00943177, slip op. (May 31, 1995). OCA M.B. at 251-257. The OCA submits that the Company has failed to establish that its 13.0% return on equity request is supported by the evidence of record.

5. The OCA's 11.10% Cost Of Equity Recommendation Is Fully Supported By The Evidence Of Record And Commission Precedent.

PP&L argues that the cost of common equity recommendations presented in this proceeding by the OTS, OCA and PPLICA "grossly understate the cost of capital and must therefore be rejected." PP&L M.B. at 225-231. The OCA responded to the Company's criticism of Mr. Kahal's cost of equity recommendation in its Main Brief, however, the OCA believes a few of the Company's arguments require additional clarification. OCA M.B. at 245-250.

The Company argues the DCF method alone cannot be utilized to determine the cost of common equity. OCA M.B. at 247; PP&L M.B. at 226-229. As discussed in the OCA's Main Brief, this argument ignores the fact that this Commission has consistently placed primary reliance on the results of validly conducted DCF studies in determining the appropriate cost of common equity in numerous proceedings in recent years. See, e.g., Pa. P.U.C. v. Roaring Creek Water Company, 150 PUR 4th 449, 483-487 (1994); Pa. P.U.C. v. York Water Co., 75 Pa. PUC 134, 153-167 (1991); Pa. P.U.C. v. Equitable Gas Co., 73 Pa. PUC 345-346 (1990); Pa. P.U.C. v. Philadelphia Suburban Water Co., 71 Pa. PUC 593, 623-632 (1989). Although, the Company refers to proceedings in other jurisdictions that did not utilize the DCF methodology, these findings are not binding on this Commission.

Moreover, the Company's assertion that the DCF produces "clearly unreasonable results" is not supported by the evidence in this proceeding. As OCA witness Kahal testified:

> ... a recent Edison Electric Institute (EEI) survey finds that electric utility ROE awards for 1994 averaged about 11.5 percent. (See Electric Utility Week, page 11, March 20, 1995.) While this is slightly higher than my present recommendation, capital costs have declined considerably from 1994, particularly compared to late 1994 levels.

OCA St. 1A at 9. Thus, within the electric industry, it is PP&L's 13.0% return request, not the OCA's 11.10% recommendation, that is unreasonable.

The Company's argument that the OCA's 11.10% recommendation permits "little if any" growth was specifically addressed by Mr. Kahal in his surrebuttal testimony:

> The dividend growth rate is under the control of PP&L management, not this Commission, but aside from that conceptual point, I do not agree with Moul's calculations. First, he assumes that total Company PP&L (soon to be PP&L Resources) and Pennsylvania jurisdiction are the same. Second, he employs a 1994 book value, whereas we are using a 1995 future test year in this case for ratemaking. Third, he assumes that internal retained earnings is the only source of growth. My DCF analysis assumes a growth through stock issuance factor of 0.5 percent. Thus, correcting these errors would produce a substantially different result than the 0.51 percent dividend growth rate which Mr. Moul asserts that my 11.1 percent ROE provides.

OCA St. 1A at 11. The OCA notes that if Mr. Moul had applied the same analysis shown on page 229 of PP&L's Main Brief to the 12.5% DCF result he obtained for PP&L, he would have obtained a 1.9% calculated growth rate compared to his 4.0% recommended growth rate. Id. at 11-12. As Mr. Kahal testified: "It is the "test" which is flawed, not my DCF analysis." Id. at 12.

Finally, the Company's only specific criticism of Mr. Kahal's DCF analysis is that his "proposed DCF growth rate specifically assumed returns on equity in a 12% to 12.5% range." PP&L M.B. at 230. In performing his DCF analysis, Mr. Kahal compiled data on book common equity and the retention rate for each year from 1989 through 1993. As he testified:

> Given past performance and recent return on equity awards to electric utilities, a reasonable expectation for the proxy companies would be an average future return on book equity of about 12.0 percent and a retention rate of about 20 percent.

OCA St. 1 at 28-29 (emphasis added). As Mr.Kahal explained in his surrebuttal testimony, the Company's argument confuses the fact that the market return, which the investor expects to earn, and the return on book value, which the investor expects PP&L to earn, are generally not the same. OCA St. 1A at 11.

As set forth in the OCA's Main Brief, the OCA submits that even under PP&L witness Moul's analysis, the OCA's 11.10% return on equity recommendation provides a retained earnings cushion above the current dividend. Moreover, even using Mr. Moul's pro forma calculation approach, Mr. Kahal's 11.1% return on equity recommendation provides a pre-tax coverage of 3.5x, which is consistent with a single A bond rating. Thus, the OCA submits that there is no showing that Mr. Kahal's recommendation is inadequate for maintaining PP&L's financial integrity.

For all the reasons discussed above and as discussed in the OCA's Main Brief, the OCA submits that PP&L has failed to meet its burden of proof in support of its request for this Commission

to allow it the opportunity to earn a return on equity of 13.0 percent. The OCA recommends that this Commission adopt the analyses and conclusions presented herein by the OCA in support of allowing PP&L the opportunity to earn 11.1% return on common equity and a 9.27% overall return on its rate base.

X. RATE STRUCTURE

A. Introduction

The Company has argued in its Main Brief that the testimony of most of the other parties on rate structure issues favors one party or another while the Company has taken a "middle-of-the road" approach. PP&L M.B. at 232. Thus, argues the Company, its distribution of the revenue increase should be adopted. PP&L M.B. at 233. The OCA submits, however, that the OCA's testimony highlights the unjustness and unreasonableness of many of the Company's proposals in this case. As such, the OCA submits that the Company has not justified the use of its cost-of-service study, its revenue distribution, or many of its rate design proposals.

After reviewing the Main Briefs of the parties, the OCA submits that the analysis performed by OCA witness Johnson is sound, and produces a result which is just and reasonable. As such, the OCA submits that its recommendations, as set forth in its Main Brief at 264 to 312, should be adopted.

B. OCA's Cost of Service Study

1. The Other Parties' Criticisms Of The Peak and Average Methodology Are Misplaced.

PP&L and several other parties have argued against the use of the peak and average method for the allocation of production investment. PP&L M.B. at 236-238; PPLICA M.B. at 56-61; OSBA M.B. at 7-10; DOD M.B. at 20; and Beth Steel M.B. at 19-22. These parties have advanced several criticisms of the Peak and Average

methodology which, as the OCA set forth in its testimony and Main Brief, are unfounded.

One primary argument, advanced by both PP&L and PPLICA, for rejecting the peak and average method is that it would be improper to shift cost allocation methodologies and create a radical change in cost responsibility for the classes. PP&L M.B. at 242 and PPLICA M.B. at 56. Both parties argue that changing to the peak and average methodology from the 12 CP would cause such a radical shift and violate the principles of gradualism. PP&L M.B. at 242; PPLICA M.B. at 56. The OCA submits, however, that this argument confuses cost allocation for determining cost responsibility with revenue allocation and rate design principles.

The OCA submits that it is essential that the Commission utilize a cost of service methodology that properly allocates costs to the customer classes on the basis of cost causation. The Peak and Average method, which recognizes both peak demand and energy usage, accomplishes this goal. The cost of service study, however, is used as a guide in determining revenue allocation among the classes. At this point, the principle of gradualism can be applied, if need be, to mitigate any "radical changes" or shifts in cost responsibility that have been found by the proper application of a cost of service methodology. A cost of service methodology should not be rejected simply because it reveals changes in cost responsibility among the classes.

The parties' other criticisms to the peak and average method fall into five broad categories. The parties have argued

that the peak and average methodology: (1) oversimplifies the generation planning process; (2) improperly allocates fixed costs on the basis of energy; (3) fails to recognize that if generating capacity is partially energy-related then fuel is partially demand-related); (4) double counts the average demand and (5) sends improper price signals to high load factor customers PP&L M.B. at 236-38; Beth Steel M.B. at 19-21; PPLICA M.B. at 56-60. The OCA has discussed the errors in these criticisms in its Main Brief at 274-277, and in its testimony at OCA St. 3B at 6 to 15. The OCA will not repeat that discussion herein, but a few additional points should be addressed.

The Company, at pages 236 to 237 of its Main Brief, asserts that the peak and average methodology energy component completely ignores the mix and cost of different types of generating units. The OCA submits, however, that this is precisely what the peak and average methodology captures and the 12 CP method ignores.[26]

As OCA witness Johnson explained:

> The amount of investment in generating plants is a function of both the amount of capacity the utility has and the mix of its generation capacity. A utility with a high load factor could meet its total production costs at the lowest cost by having more baseload plant than a utility with a low load factor would have. Because the energy requirements of the utility are a factor in determining the amount of production investment, the energy requirements

[26] As set forth fully in the OCA's Main Brief, the Coincident Peak Methodology particularly the 1 CP methodology favored by UCC witness Eisdorfer, fails to appropriately reflect system planning principles.

> of the rate classes should be a consideration in allocating the production investment to the classes. PP&L has not done so in its study, which results in overstating the costs of the lower load factor classes, such as residential and small commercial customers.

OCA St. 3 at 9. As can be seen, the peak and average methodology reflects both elements--peak demand and energy requirements--utilized in system planning by a utility in the determination of the mix of generating resources on a utility's system. The OCA submits that the Company's argument that the average component does not reflect a mix of generation improperly focuses on one component of the methodology, and misunderstands even that component.

Several parties also argue that there is a "break even" point for PP&L, and that only the hours of operation prior to this "break even" point are relevant to PP&L's economic decisions regarding generation investment. PPLICA M.B. at 59; Beth Steel St. 1 at 21; and PP&L M.B. at 237. For PP&L, PPLICA witness Baron has calculated the "break even" point as 2,531 hours. PPLICA St. 7-R at 9-15. The OCA submits, however, that this argument is merely another variation of the argument that fixed costs should not be recovered through usage. OCA St. 3B at 13. In this variation, the claim is simply transferred to the first 2,531 hours. Id.

Essentially, these parties argue that capacity costs are totally related to classes' demands at the time of system peak demand, and that any additional usage (or usage above the "break even" point) should be a free good, with no cost other than fuel. OCA St. 3B at 13. OCA witness Johnson explained, however, that

this is not the purpose of generating capacity. Dr. Johnson testified:

> The purpose of generating capacity is to produce energy. It is built for that purpose and is operated for that purpose. Its costs are largely incurred in carrying out that purpose. There are other factors, of course, peak demand being the major one accounted for in the peak and average method, but energy is not free of cost except during the one hour of the year for which demand is greatest.

OCA St. 3B at 13 (emphasis added). As set forth above, the OCA submits that the "breakeven" analysis is irrelevant for cost allocation purposes.

Bethlehem Steel also argues that energy consumption is double counted in the peak and average methodology. Beth Steel M.B. at 21. This argument mixes the concepts of peak demand and average demand. The peak demand of a utility is typically the highest average rate of consumption for any hour of the year. OCA St. 3B at 14. Although peak demands are measured over a period of time, such as 15 minutes, or a half hour, for customer billing purposes, it could just as well be measured instantaneously. Id. In that case, there would be zero energy consumed, because it is in zero time. Even if one agreed that there was a double count due to the measurement of the peak demand over a period of time, such as an hour, such double count could be insignificant. Thus, the argument that there is double counting of energy demands is without merit.

PPLICA has also argued that Dr. Johnson has improperly utilized the system load factor in determining the percentage of

generating investment to be allocated on class energy. PPLICA M.B. at 57. See also, OSBA M.B. at 9, PP&L M.B. at 237. PPLICA argues that Dr. Johnson has utilized a different approach than that in West Penn's 1994 rate case, and that approach would have allocated more costs to residential customers than the load factor approach used by Dr. Johnson in this proceeding. PPLICA M.B. at 57. The OCA submits, however, that Dr. Johnson, based on the facts of this case, has fully justified the use of the load factor methodology for determining the percentage of generating investment to be allocated on demand and energy.

As Dr. Johnson explained, the load factor is used in determining reasonable percentages in other cost allocation methodologies, such as the average and excess method. As Dr. Johnson testified:

> The load factor is the average usage of the system, i.e., the percentage of the capacity that would be required if every class has a 100 percent load factor. It is argued that the percentage of total capacity required to meet average loads should be allocated based on average demands, i.e., on energy. This is one of the justifications for using the load factor as the means of weighting the energy and demand components in the average and excess methodology.

OCA St. 3 at 10.

In addition, Dr. Johnson compared the percentages resulting from the use of the load factor methodology in this proceeding with another method, the equivalent peaker method. In the equivalent peaker method, the economic cost of meeting demand is considered as an appropriate measure of the amount of capacity

to be allocated based on demand, with the remaining amount allocated on energy. OCA St. 3 at 10. To make this determination, the long run cost of meeting peak demand--for example, the investment in a combustion turbine--is compared to the cost of a baseload unit. OCA St. 3 at 10-11. As Dr. Johnson notes, when this analysis is done for PP&L's existing production investment, the resulting percentages are in the same range as those produced by the load factor method. OCA St. 3 at 11.

Finally, the system load factor is stable from year to year. Thus, using the load factor approach to separating the demand-related investment from the energy-related investment would produce a relatively stable approach over time. OCA St. 3 at 12. For these reasons, the OCA submits that Dr. Johnson's use of the load factor approach for determining percentages in his peak and average study is well supported based on the facts of this case.

The OSBA has leveled one final criticism at Dr. Johnson's approach. OSBA notes that the OCA did not reduce the demand charge for GS-1 even though the peak and average method reduces the amount of demand costs assigned to GS, GH and LP classes. OSBA M.B. at 8. The OCA, however, did not make any recommendation, either supporting the Company or opposing the Company, on the issue of the demand charge, or rate design, for the commercial classes. The fact that the OCA did not make specific rate design recommendations for the commercial class is in no way inconsistent with the use of the peak and average methodology for assigning cost responsibility.

For the reasons set forth above, and for the reasons set

forth in the OCA's Main Brief at 274 to 277, the OCA submits that the other parties' criticisms of the peak and average methodology are unfounded. The peak and average methodology best reflects the cost responsibility of the classes for the PP&L system, and should be adopted as an appropriate and reasonable guide in determining revenue allocation in this proceeding.

2. Minimum System

Both PP&L and OSBA have taken issue with the OCA's adjustment to PP&L's minimum system study. PP&L M.B. at 242-246 and OSBA M.B. at 10-13. The OCA, through its testimony and in its Main Brief, has, to a great extent, addressed the arguments raised by these parties. See, OCA St. 3B at 2-6 and OCA M.B. at 281 to 285. The OCA would again note that the arguments advanced by these parties fail to address the fundamental flaw in PP&L's minimum system study--that the components used in the study have load carrying capability and thus, are not purely customer-related. The OCA submits that OCA witness Johnson's adjustment to PP&L's minimum system study to account for the load carrying capability of the system is appropriate and should be adopted in this proceeding.

PP&L and OSBA argue that no adjustment should be made to account for the load carrying capability of the minimum system. However, as OCA witness Johnson explained, it is precisely because the minimum system has load carrying capability that it fails to appropriately identify the solely customer-related costs. OCA St. 3B at 2-3. The purpose of the minimum system study is to identify the entirely customer-related component. Thus, the inclusion of

the portion of components that carry load, or are demand-related would overstate the customer costs. As OCA witness Johnson testified, the minimum system used by PP&L in its study can carry a substantial amount of distribution load. OCA St. 3B at 2-3. As such, the study overstates the customer-related costs and must be adjusted. The OCA submits that Dr. Johnson's recommendation to adjust the demand allocator will properly correct for this problem.

Both PP&L and OSBA also argue that Dr. Johnson's adjustment produces a negative customer component, which they characterize a an absurd result. PP&L M.B. at 245; OSBA M.B. at 12. PP&L even argues that Dr. Johnson did not rebut this testimony. The Company and OSBA, however, are incorrect. OSBA witness Knecht performed a calculation where he attempted to show that Dr. Johnson's adjustment produced a negative customer component. This calculation presumed that the results have to be produced by a linear combination of the demand and energy components. That is the procedure that Mr. Knecht then followed when he calculated his <u>implied</u> customer component. OSBA St. R1 at 13-16. As OCA witness Johnson explained in his surrebuttal testimony, there is simply no basis for this approach. Dr. Johnson rebutted Mr. Knecht when he stated:

> Mr. Knecht seems to believe that allocation of distribution system should necessarily be done by a linear combination of the Company's customer allocator and its demand allocator and that nothing else is acceptable. There is no theoretical or empirical basis for such an approach. His reasoning has nothing to do with the relationship between the load-carrying capability of the minimum system and

> the classes' demand allocators and should be rejected.

OCA St. 3B at 4. Thus, OSBA witness Knecht's calculation of an implied customer component, upon which the Company relies, was flawed and should be disregarded.

For the reasons set forth above and for the reasons set forth in the OCA's Main Brief at 281 to 285, the OCA submits that the criticisms of PP&L and OSBA regarding Dr. Johnson's minimum system adjustment are unfounded and should be dismissed. Dr. Johnson's adjustment properly corrects the errors in PP&L's minimum system study in a manner that is reasonable, properly justified, and properly quantified. As such, Dr. Johnson's adjustment should be adopted.

C. Revenue Distribution

1. The OCA's Proposed Revenue Allocation Is Reasonable And Should Be Adopted.

The OCA has reviewed the proposed revenue allocations of the parties, and submits that its revenue allocation is based on a sound cost of service study and is reasonable. As can be seen in the OCA's Main Brief on the Table at page 291, the OCA's proposed revenue allocation, under the Company's full rate increase request which the OCA uses for comparison purposes only, shows percentage increases of between 5.93% and 15.56%, with most increases around 11% to 11.7%, or near the system average. These increases are fully supported by the OCA's cost of service study, and are consistent with the principles of rate continuity, customer impacts and gradualism. The OCA submits that its revenue allocation

proposal, and its proposed scaleback, as set forth in the OCA's Main Brief at 291-292, should be adopted.

OSBA has criticized Dr. Johnson's revenue allocation for rate class GS-1 as being a "residual," not based on the relative costs of service produced from his cost of service study. OSBA M.B. at 18. As Dr. Johnson explained, however, in making his revenue allocation for all classes, he was guided by other considerations such as the principles of gradualism, rate continuity, and customer impacts. OCA St. 3 at 21. Dr. Johnson, on cross-examination by OSBA further explained:

> Q. Now, could you explain to me why when you reduce the costs allocated to the GS-1 class you then proposed a larger increase for that class?
>
> A. Well, primarily because I do not expect the increase requested by the company to be granted, and I view the percentage increases here to be much less firm than the ideas behind their implementation, which I described in my testimony.

Tr. 1389. In addition, as Dr. Johnson noted, he has identified the GS-1 class for first priority if the Commission orders a reduction in revenue for PP&L. As such, the OCA submits that its proposed allocation for the GS-1 class is reasonable.

The Company has also argued that the OCA's proposed allocation to the ISA class is "unsupported." Beth Steel, an ISA customer, also argues that the allocation to ISA is governed by contract and an increase above that amount is unsupported. Beth Steel M.B. at 30. The OCA submits, however, that this position ignores the results of both the Company's and the OCA's cost of service studies. As can be seen from the Table in the OCA's Main

Brief at page 289, under the Company's cost of service study, the ISA class has a rate of return of 0.79%, as compared to the Pennsylvania jurisdictional rate of return of 7.31%. Under the OCA's cost of service study, the ISA class has a -1.69% rate of return. The OCA submits that these cost of service study results indicate that an increase greater than the 0.15% increase proposed by the Company is in order, even applying the principles of gradualism. The OCA submits that it is the Company who has not supported its proposal to limit the increase to this class to a 0.15% increase.[27]

In light of these considerations, the OCA submits that the revenue allocation proposed by Dr. Johnson is reasonable. It is based on a cost of service methodology that properly allocates costs, and it has been guided by the principles of gradualism rate continuity and consideration of customer impacts for all rate classes.

D. The Rates, Terms, And Conditions For The RTS Rate Schedule Should Be Modified In Accordance With The OCA's Recommendations.

The Company and the OCA are in substantial agreement as to the appropriate modifications to the rates, terms and conditions of the RTS rate. The OCA's recommendations, and its areas of remaining disagreement with the Company are set forth in the OCA's

---

[27] As noted in the OCA's Main Brief, the rate set by the ISA contract was not previously found by the Commission to be a just and reasonable rate. See, OCA M.B. at 293-294. The OCA submits it is within the Commission's discretion to consider an appropriate revenue allocation to this class in this case in establishing just and reasonable rates. See, Pa. P.U.C. v. Roaring Creek Water Co., 73 Pa. PUC 373, 431 (1990).

Main Brief at 300-303, and will not be repeated here in detail. Basically, though, the OCA and the Company agree that the RTS rate should be frozen prospectively to new customers, and existing customer locations should be grandfathered under the existing RTS rate. The OCA and the Company agree that the Company should pursue all reasonable efforts to modify the rate and service, such as through installation of load control devices, so that the class avoids contributing large demands to the system peaks. Additionally, the OCA and the Company agree that an appropriate differential between the RS rate and the RTS rate should be maintained. See, OCA M.B. at 301; PP&L M.B. at 256.

The Central Eastern Pennsylvania Fuel Oil Dealers (CEPFOD), however, continue to recommend that the RTS rate be abolished, and that the existing RTS customers be provided with a $50/month credit for a three to five year period. CEPFOD M.B. at 26. In the alternative, if the RTS rate is retained, CEPFOD recommends that the RTS rates be increased by "the greater of either PP&L's proposed 17.4% increase, or 2 times the system average increase awarded by the Commission. CEPFOD M.B. at 26. If, for example, the Company is awarded an 11% increase, under the CEPFOD proposal, these customers would see a 22% increase in rates. The OCA submits that this proposal is unjustified, and would unfairly burden the RTS customers.

The OCA submits that CEPFOD's recommendations would unfairly burden the RTS customers for what CEPFOD argues is the imprudence of the Company. As CEPFOD witness Anderson acknowledged

on cross-examination, he has conducted no analysis to determine whether his proposal would adequately compensate the RTS customers for the large capital investments, or their expectations of energy savings for the life of their thermal storage systems. Tr. 1311. Moreover, CEPFOD's alternative proposal to increase the RTS customer's rate by two times the system average, or 17.4%, unfairly penalizes the RTS customers. Importantly, this proposal eliminates the differential between the RS rate and the RTS rate that these customers relied upon in purchasing the thermal storage units. OCA St. 3 at 28. As the OCA set forth in its Main Brief, regardless of the cause of the failure of this rate, the RTS customers made substantial investment in thermal storage heating units based on expectations of energy savings, and their belief that their actions benefitted the utility system. OCA M.B. at 297-299. These customers should not now be unfairly penalized because the rate has failed.

For the reasons set forth above, and for the reasons set forth in detail in the OCA's Main Brief at 296-305, the OCA submits that CEPFOD's recommended changes to the RTS rate should be rejected. The OCA 's proposal on the RTS rate presents a balanced approach that recognizes the concerns of existing customers and attempts to mitigate any future revenue shortfalls. As such, the OCA submits that its proposal should be adopted.

E. Rate Design

1. Customer Charge And Energy Block Changes.

The Company has argued that its residential customer charge, for both RS and RTS should be increased. OTS has also recommended an increase in the residential customer charge based on the Company's cost of service study. OTS M.B. at 135-139. CEPFOD recommended an increase in the RS customer charge. CEPFOD M.B. at 28. The OCA submits that these parties have failed to justify an increase in the residential classes' customer charge.

OCA witness Johnson is the only witness in this proceeding to provide a calculation of basic residential customer costs that is in accordance with the Commission's definition of "basic customer costs" which the Commission utilizes in establishing the customer charge. Dr. Johnson determined that the basic customer costs for the RS class are $4.73 monthly, which is below the current RS customer charge of $4.80. OCA St. 3 at 24. Dr. Johnson also calculated a basic customer cost of $8.29 monthly for the RTS class, which is below the current customer charge of $10.95. OCA St. 3 at 25. Thus, the OCA submits that an increase in the customer charge, as proposed by PP&L, OTS, and CEPFOD is not warranted.

PP&L has also argued that if the customer charge is not increased, then any costs not recovered in the customer charge should be shifted to the first billing block based on 200 kwh usage. PP&L M.B. at 251-252. This, in effect, is the same as

recovering these costs in the customer charge, and should not be permitted.

Indeed, as OCA witness Johnson points out, the Company's current proposal to increase the customer charge, and to increase cost recovery in the initial energy blocks, produces even greater revenue than the Company claims was customer related. OCA St. 3 at 26. The Company had calculated a customer related monthly cost of $17.51, while the Company's proposal produces monthly revenue of $20.40--greater than the Company's overstated customer costs. Id. The Company should not be permitted to increase its energy blocks in this manner.

2. Conclusion

For the reasons set forth above, and for the reasons set forth in the OCA's Main Brief at 305-310, the OCA submits that the customer charge for the RS class and the RTS class should remain at current levels. In addition, the Company should not be permitted to simply shift its overstated monthly customer charge cost recovery into the initial energy block.

F. OSBA's Proposal For An Automatic Annual Adjustment For the GS-1 Class Should be Rejected.

OSBA, in its Main Brief, argues for an automatic adjustment mechanism for reducing rates to the GS-1 class on each anniversary date of the effective date of new rates, and concomitantly raising rates to the RS, RTS, and GH classes. OSBA M.B. at 16. OSBA proposes that this mechanism remain in place until the next base rate proceeding, although OSBA witness Knecht testified that it would take ten annual adjustments to bring the

GS-1 rate in line. The OCA submits that this proposal, whether it be for ten years or until the next base rate filing, is unsound ratemaking.

As OCA witness Johnson testified, many factors affecting cost allocation change throughout the years, such as usage patterns and usage levels. OCA St. 3A at 9. There is no reason to expect that the relative rates of return reflected in a cost of service study today would be valid over an extended period of time, such as ten years.

For these reasons, and the reasons set forth in the OCA's Main Brief at 311-312, the OCA submits that the OSBA's proposal for an automatic annual adjustment in rates for the GS-1 class should be rejected.

G. Conclusion.

For the reasons set forth above, and for the reasons set forth in the OCA's Main Brief at 264-312, the OCA submits that its recommendations concerning cost of service, rate structure and rate design in this proceeding are reasonable and should be adopted by the Commission.

XI. PP&L'S PROPOSED ECR PASS THROUGH OF CAPACITY COSTS ASSOCIATED WITH EXPIRING OFF SYSTEM CAPACITY SALES

At pages 291-295 of its Main Brief, the Company argues that its proposal to automatically recover the capacity-related costs associated with expiring off-system sales through its ECR should be adopted. The Company accuses the OCA and other parties of having a "knee jerk" reaction to this "novel" proposal and overlooking the benefits of such proposal. PP&L M.B. at 292. The OCA submits, however, that the Company has overlooked the serious flaws with this proposal. As the OCA explained in its Main Brief, the Company's proposal for such automatic recovery of capacity costs, that have not been included in jurisdictional rates for over ten years, is improper ratemaking. Such a proposal creates a danger of overearning by the utility and it introduces perverse incentives for the utility to inadequately market the capacity.

At page 294, the Company identifies four benefits of its proposal. The OCA has thoroughly addressed these four points in its Main Brief at pages 317-320 and will not repeat that entire discussion here. Certain key points, however, should again be brought out regarding this proposal by the Company.

The Company identifies the primary benefit of its proposal as being the possible avoidance of future rate cases as these increments of capacity return to the system. PP&L M.B. at 294. The OCA submits, however, that the avoidance of a base rate filing is one of the primary detriments of the Company's proposal, particularly in light of the fact that these costs have not been included in Pennsylvania jurisdictional rates for over ten years.

If, for example, the utility's load is growing and the returning capacity is not excess, then it is also proper to reflect the additional revenues of this new load through a base rate proceeding. If the opposite is true, and the utility's load is not growing, then it is necessary to determine whether the returning capacity is excess capacity. In either case, a base rate case is necessary to determine the proper treatment of these costs at the time the Company seeks to include them in rates.

Moreover, the Company's proposal could create an overearnings problem. Under the Company's proposal, the Company would receive $35 million of additional revenue each year, up to a total of $177 million, regardless of whether it was meeting its earnings requirements.[28] OCA St. 2 at 29-30. The Company's solution to this problem is to have ratepayer representatives file for a rate reduction if this becomes a problem. PP&L M.B. at 294. The OCA submits that this is both impractical, and contradicts the Company's argument that there would be a savings of regulatory resources from such a proposal.

Most importantly, however, the Company has not addressed the perverse incentives that result from this proposal as it regards the future marketing of this capacity. If PP&L fails at its marketing efforts, it would receive automatic recovery of its full costs from ratepayers through the ECR without review. If PP&L

---

[28] The Company, in its Main Brief, has argued that this $35 million in cost is known and measurable at this time. But, as Company witness Kleha acknowledged, revenue requirements can change over time given changes in operation and maintenance costs and overall capital costs. Tr. 364.

is able to sell the capacity, but at a lower rate than what it would receive from its ratepayers through the ECR, PP&L would have little incentive to market this surplus capacity. The OCA submits that this is an unacceptable incentive to the Company.

As set forth above, and as set forth in the OCA's Main Brief at 313-320, the OCA submits that the Company's proposal for an automatic recovery mechanism for capacity costs associated with expiring off-system sales should be rejected. In addition, the Company's proposal to retain the energy savings associated with this capacity if its proposal is rejected is premature, and should not be adopted in this case. The Company should retain the right to make such a proposal in an appropriate proceeding when the capacity returns to the system.

XII. CONCLUSION

For the reasons set forth in its Main Brief and Reply Brief above, the Office of Consumer Advocate respectfully submits that Pennsylvania Power & Light Company's request for a base rate increase of $261,000,000 should be denied and PP&L's rates should be reduced by $66,464,000.

Respectfully submitted,

Tanya J. McCloskey
Assistant Consumer Advocate

Mary C. Kenney
Assistant Consumer Advocate

Gicine P. Brignola
Assistant Consumer Advocate

Counsel for:
Irwin A. Popowsky
Consumer Advocate

Office of Consumer Advocate
1425 Strawberry Square
Harrisburg, PA 17120
(717) 783-5048

Dated: June 27, 1995
20108