

DOCUMENT

COMMONWEALTH OF PENNSYLVANIA

PUBLIC UTILITY COMMISSION

ORIGINAL

----- x
 :
Pennsylvania Public Utility Commission :
(R-00049255), U.S. Department of Defense : Docket No.
and Federal Executive Agencies (C0001), : R-00049255
PPL Industrial Customer Alliance (C0002), : R-00049255
Office of Small Business Advocate (C0003), : C0001-C0016
Office of Consumer Advocate (C0004), :
Eric Joseph Epstein (C0007), Victoria K. :
Mackin (C0008), Cheryl & Jeremy Ebert :
(C0009), Martha Wells (C0010), Margaret :
M. Stuski, Esquire (C0011), Wal-Mart :
Stores East, LP (C0012), Pennsylvania :
Energy Consortium (C0013), Donald E. :
McGarrigle (C0014), Curvin L. Snyder :
(C0015), William J. Junkin, III (C0016) :
v. PPL Electric Utilities Corporation. :
 Proposed general rate increase.

SECRETED
AUG 16 2004

Further Hearing.

----- x
 Pages 539 through 704 Hearing Room-1
 Commonwealth Keystone Building
 Harrisburg, Pennsylvania

Tuesday, August 10, 2004

Met, pursuant to adjournment, at 10:00 a.m.

BEFORE:

ALLISON K. TURNER, Administrative Law Judge
 SUSAN COLWELL, Administrative Law Judge

Y.S.M.

Commonwealth Reporting Company, Inc.
 700 Lisburn Road
 Camp Hill, Pennsylvania 17011

(717) 761-7150

RECEIVED
 2004 AUG 13 AM 9:45
 SECRETARY'S BUREAU
 PUC

1-800-334-1063

37

APPEARANCES:

DAVID MacGREGOR, Esquire
Morgan, Lewis & Bockius LLP
1701 Market Street
Philadelphia, Pennsylvania 19103
(For PPL Electric Utilities)

MICHAEL W. GANG, Esquire
JOHN H. ISOM, Esquire
Morgan, Lewis & Bockius LLP
417 Walnut Street
Harrisburg, Pennsylvania 17101

PAUL E. RUSSELL, Esquire
2 North Ninth Street
Allentown, Pennsylvania 18101
(For PPL Electric Utilities Corporation)

RICHARD A. KANASKIE, Esquire
P.O. Box 3265
Harrisburg, Pennsylvania 17105
(For Office of Trial Staff)

SHAUN A. SPARKS, Esquire
JAMES A. MULLINS, Esquire
TANYA J. McCLOSKEY, Esquire
Forum Place, Fifth Floor
555 Walnut Street
Harrisburg, Pennsylvania 17101
(For Office of Consumer Advocate)

STEVEN C. GRAY, Esquire
300 North Second Street, Suite 1102
Harrisburg, Pennsylvania 17101
(For Office of Small Business Advocate)

DAVID A. McCORMICK, Esquire
Department of the Army
Office of the Judge Advocate General
901 North Stuart Street, Suite 700
Arlington, Virginia 22203
(For the U.S. Department of Defense
and Federal Executive Agencies)

Commonwealth Reporting Company, Inc.

700 Lisburn Road
Camp Hill, Pennsylvania 17011

APPEARANCES (Continued):

PAMELA POLACEK, Esquire
DAVID KLEPPINGER, Esquire
McNees, Wallace and Nurick
100 Pine Street
P. O. Box 1166
Harrisburg, Pennsylvania 17101
(For PPL Industrial Customer Alliance)

JIM MELIA, Esquire
240 North Third Street
Harrisburg, Pennsylvania 17101
(For Wal-Mart and Pennsylvania
Energy Consortium)

JOSEPH L. VULLO, Esquire
1480 Wyoming Avenue
Forty Fort, Pennsylvania 18704-4237
(For Commission on Economic Opportunity)

ERIC JOSEPH EPSTEIN
4100 Hillisdale Road
Harrisburg, Pennsylvania 17112
(Pro se)

-0-

Commonwealth Reporting Company, Inc.

700 Lisburn Road
Camp Hill, Pennsylvania 17011

(717) 761-7150

1-800-334-1063

WITNESS INDEX

<u>WITNESS</u>	<u>DIRECT</u>	<u>CROSS</u>	<u>REDIRECT</u>	<u>RECROSS</u>
Joseph Kubas				
By Mr. Kanaskie	549	---	---	---
By Mr. MacGregor	---	551	---	---
Paul R. Moul				
By Mr. Gang	558	---	579	---
By Mr. Kanaskie	---	564	---	---
By Mr. Sparks	---	568	---	---
Julia M. Cannell				
By Mr. Gang	581	---	598	---
By Mr. Kanaskie	---	584	---	---
By Mr. Sparks	---	586	---	---
Matthew I. Kahal				
By Mr. Sparks	601	---	631	---
By Mr. Gang	603	---	---	---
Kevan L. Deardorff				
By Mr. Kanaskie	641	---	---	---
By Mr. Gang	---	646	---	---
Eric Joseph Epstein				
Direct Testimony	669	---	---	---
By Mr. MacGregor	---	679	---	---

-0-

EXHIBIT INDEX

<u>NUMBER</u>	<u>FOR IDENTIFICATION</u>	<u>IN EVIDENCE</u>
<u>OTS Statement</u>		
3	(Kubas - Direct)	549 551
3-SR	(Kubas - Surrebuttal)	549 551
1	(Deardorff - Direct)	642 645
1-SR	(Deardorff - Surrebuttal)	642 645
<u>OTS Exhibit</u>		
3	(Kubas)	549 551
3-SR	(Kubas)	549 551
1	(Deardorff)	642 645
1-SR	(Deardorff)	642 645
<u>OCA Statement</u>		
3	(Kahal - Direct)	601 603
3-S	(Kahal - Surrebuttal)	601 603
2	(Catlin - Direct)	703 703
2-S	(Catlin - Surrebuttal)	703 703
<u>OCA Cross-Examination Exhibit</u>		
1	(Securities Certificate and Affiliate Agreements filing, S-00010853 et al.)	590 597
2	(generation supply agreement stipulation)	592 597
3	(8/9/04 Federal Reserve data)	594 597
<u>Epstein Statement</u>		
1	(Epstein - Direct)	671 699
1-S	(Epstein - Surrebuttal)	671 699

EXHIBIT INDEX (Continued)

<u>NUMBER</u>	<u>FOR IDENTIFICATION</u>	<u>IN EVIDENCE</u>
<u>PPL Cross-Examination Exhibit</u>		
1 (OCA responses to Set II, Nos. 13, 14 and 15)	615	630
2 (earnings per share growth rates)	619	630
3 (consensus forecasts of US interest rates and key assumptions)	623	630
4 (S&P utilities publication, 6/2/04)	647	668

Any reproduction of this transcript
is prohibited without authorization
by the certifying reporter.

-0-

1 and I asked him to make a statement about that on the
2 record.

3 MR. MELIA: Thank you, Your Honor. I was approached
4 last week by a group by the name of Pennsylvania Retailers
5 Association, a statewide organization representing a lot of
6 large retailers within Pennsylvania. Wal-Mart, who is
7 presently in the case, is part of that group.

8 I have determined that the members fall within the
9 GS-3, LP-4 rate class. The Retailers Association is
10 desirous of filing a complaint in the proceeding, be simply
11 part of the proceeding. They will join with the, basically
12 support the testimony that's in place on behalf of Mr.
13 Selecky. They will join in the brief that we will be filing
14 on behalf of Wal-Mart and PA Energy Consortium.

15 Their desire is of course to be involved in the case
16 but not to do anything to disrupt the ongoing nature of the
17 proceedings.

18 It was frankly an organizational problem on their
19 part. They were not able to get a consensus together
20 earlier, but they would appreciate being permitted to be
21 involved and to file a complaint. It will be filed
22 tomorrow.

23 JUDGE TURNER: Okay. There's no bar to them filing a
24 complaint, the way I read the regulations. Are there any
25 other preliminary matters before we begin?

1 MR. MacGREGOR: I have one, Your Honor.

2 JUDGE TURNER: Yes, Mr. MacGregor?

3 MR. MacGREGOR: I had volunteered yesterday to report
4 the Internal Revenue Code citation which deals with the tax
5 deductibility or determination of the tax deductibility of
6 the contributions to corporate pension plans.

7 That is Section 404 of the Internal Revenue Code
8 reported at 26 USC Section 404. Regulations are promulgated
9 thereunder at 26 CFR Section 1.404.

10 JUDGE TURNER: Thank you. Anything else?

11 MR. MacGREGOR: No, Your Honor.

12 JUDGE TURNER: Ms. Polacek?

13 MS. POLACEK: Your Honor, I believe at the end of the
14 hearing yesterday you had asked me to see whether Mr. Baron
15 could come to the hearing on Thursday.

16 JUDGE TURNER: Actually, you offered that. I didn't
17 ask that.

18 MS. POLACEK: Maybe it was PP&L that offered that,
19 but I have checked with him and the other hearing that he
20 was involved with this week is very behind schedule. He has
21 not had to appear in that hearing so he is going to come to
22 Harrisburg Thursday around noon, so we will have him
23 available Thursday afternoon if we would get that far.

24 JUDGE TURNER: Okay. We've taken three witnesses off
25 the Thursday schedule so there certainly should be room for

1 him if he comes on Thursday. At least that's the way I see
2 it. Does anybody -- I'm getting nods from Mr. MacGregor.
3 All right. So if Mr. Baron can come Thursday afternoon, I
4 think we can accommodate him.

5 MS. POLACEK: Thank you. He will be here.

6 JUDGE TURNER: Any other preliminary matters?

7 (No response.)

8 JUDGE TURNER: Okay. I have a few. First, please
9 turn off your cell phones or set them on vibrate, and if you
10 have to have a conversation on cell phone, please leave the
11 room.

12 Second of all, I will try to take a break every hour
13 and a half to two hours depending on where cross-examination
14 is, and of course I'll take a lunch break. If you can plan
15 your cross that way or if that incommodes anybody, please
16 let me know. I really don't want to interrupt a line of
17 cross.

18 I think that's it for preliminary matters, and the
19 first witness on the list for today is J. Kubas. Good
20 morning, Mr. Kubas.

21 MR. KUBAS: Joseph Kubas. Good morning.

22 Whereupon,

23 JOSEPH KUBAS

24 having been duly sworn, testified as follows:

25 JUDGE TURNER: And that applies also for your pre-

1 filed statement and exhibits?

2 THE WITNESS: Yes, it does.

3 JUDGE TURNER: Please be seated. Mr. Kanaskie?

4 MR. KANASKIE: Thank you, Your Honor.

5 **DIRECT EXAMINATION**

6 BY MR. KANASKIE:

7 Q. Mr. Kubas, could you please state your name and
8 position for the record, please?

9 A. Yes. My name is Joseph Kubas and I'm a fixed
10 utility valuation engineer with the Office of Trial Staff.

11 Q. Mr. Kubas, have you prepared written testimony
12 and exhibits for the purposes of this proceeding?

13 A. Yes, I have.

14 MR. KANASKIE: Your Honor, I have previously
15 distributed to the parties, to the court reporter and to
16 Your Honors documents that have been preliminarily
17 identified as OTS Statement No. 3, the direct testimony of
18 Mr. Kubas, OTS Exhibit No. 3, an exhibit to accompany his
19 direct, as well as OTS Statement No. 3-SR and OTS Exhibit
20 No. 3-SR consisting of Mr. Kubas' surrebuttal testimony and
21 accompanying exhibit. Your Honor, at this time I ask that
22 they be marked for identification.

23 JUDGE TURNER: They may be so marked.

24 **(Whereupon, the documents were**

25 **marked as OTS Statements Nos. 3**

1 and 3-SR and OTS Exhibits Nos.

2 3 and 3-SR for identification.)

3 MR. KANASKIE: Thank you, Your Honor.

4 BY MR. KANASKIE:

5 Q. Mr. Kubas, do you have these documents that I
6 requested be marked for identification in front of you?

7 A. Yes, I do.

8 Q. Do these documents contain your direct testimony
9 and surrebuttal testimony with accompanying exhibits?

10 A. Yes.

11 Q. Were these documents prepared by you or under
12 your direct supervision?

13 A. Yes.

14 Q. Do you have any corrections or changes to make
15 to any of these documents?

16 A. Yes. I have one correction. In OTS Exhibit No.
17 3-SR, Schedule 7, the reference to the column heading is
18 incorrect. For Column E, the correct reference is "E"
19 equals "C" minus "D". That's all I have.

20 MR. KANASKIE: I would note for the record, Your
21 Honor, the copies supplied to the court reporter have the
22 corrections made already.

23 JUDGE TURNER: Thank you. That's good.

24 BY MR. KANASKIE:

25 Q. Mr. Kubas, with this change, if I were to ask

1 you the questions contained in your testimony, would your
2 answers be the same?

3 A. Yes.

4 Q. Would these answers be true and correct to the
5 best of your knowledge and belief?

6 A. Yes.

7 MR. KANASKIE: Your Honor, at this time, the Office
8 of Trial Staff requests that the documents marked for
9 identification be admitted into the record subject to timely
10 motions to strike and cross-examination by the other
11 parties.

12 JUDGE TURNER: Hearing no objections, they may be so
13 admitted.

14 (Whereupon, the documents marked as
15 OTS Statements Nos. 3 and 3-SR and
16 OTS Exhibits Nos. 3 and 3-SR were
17 received in evidence.)

18 MR. KANASKIE: Thank you, Your Honor. Mr. Kubas is
19 available for cross-examination.

20 JUDGE TURNER: Who will be handling -- Mr. MacGregor.

21 MR. MacGREGOR: Thank you, Your Honor.

22 **CROSS-EXAMINATION**

23 BY MR. MacGREGOR:

24 Q. Good morning, Mr. Kubas.

25 A. Good morning, Mr. MacGregor.

1 Q. Reviewing your prior work with the Commission,
2 am I correct that this is the first time you have testified
3 in an electric rate proceeding?

4 A. Yes, it is.

5 Q. And you have proposed an adjustment to the
6 company's present rate revenues; is that correct?

7 A. Yes, that's correct.

8 Q. And your original adjustment as set forth at
9 page two, line 15 of your direct testimony was in the
10 approximate amount of \$15.1 million; is that correct?

11 A. Yes, that's correct.

12 Q. And you have since corrected that adjustment for
13 certain errors and your new adjustment as presented in your
14 surrebuttal testimony is \$3.1 million?

15 A. Yes, it is.

16 Q. And the difference between those numbers
17 reflects a problem in the averaging of the degree-days and
18 an assumption regarding heating usage or non-heating usage
19 for Rate Schedules RTS and RTD?

20 A. Yes, that's correct.

21 Q. Would you agree with me as a general proposition
22 that sales levels for ratemaking purposes should be based on
23 normal weather conditions?

24 A. Generally that's true.

25 Q. And one part as you indicate in your testimony

1 of determining weather normal sales is to determine the base
2 load for each customer class?

3 A. Yes, that's correct. You determine the base
4 load for the classes that are affected by weather.

5 Q. And you define base load at page five, lines 15
6 through 17 of your direct testimony where you state that the
7 base load of the customers is the monthly usage of each
8 customer that is considered to be unaffected by a change in
9 temperature for purposes of the weather normalization
10 calculation; is that correct?

11 A. Yes, that's correct.

12 Q. And for purposes of your testimony in this
13 proceeding, you have selected October as the base load
14 month?

15 A. I'm just trying to find the page I state that in
16 my direct testimony.

17 Q. I believe it's page 13, beginning on line eight.

18 A. Yes, I did.

19 Q. And if we could look at your Exhibit No. 3,
20 Schedule 1 -- Schedule 3, page 1; do you have it?

21 A. Could you say that again?

22 Q. OTS Exhibit No. 3, Schedule 3, page 1 of 5.

23 A. I see it.

24 Q. Yes. Would you agree with me that the average
25 heating degree-days for October shown on that schedule for

1 the four measurement sites is 395 heating degree-days?

2 A. Yes, that's correct.

3 Q. And would you further agree with me that there
4 may be additional non-heating related or non-temperature
5 related usage that could occur in November, December and
6 January of each year as compared to October base load levels
7 you calculated that are not attributable to changes in
8 temperature or weather?

9 A. Yes, that could happen.

10 Q. For example, lighting, there may be additional
11 lighting in November and December because there are less
12 hours of daylight in those months than in October?

13 A. Yes, that's one factor.

14 Q. Now, you've also at several points in your
15 testimony asserted that the company has refused to provide
16 you with a copy of the model they used to forecast sales; is
17 that correct?

18 A. Yes, that's correct.

19 Q. And you reference in support of that an
20 interrogatory response of the company to OTS-RE-7 which is
21 appended to your exhibit at OTS Exhibit No. 3, Schedule 9;
22 is that correct?

23 A. Yes, that's correct.

24 Q. And if we could look at that question for a
25 minute, it asks that the company provide an electronic copy

1 in Excel with the formulas intact to show how the company
2 utilized the regression analysis to determine normalized
3 sales described on page four of PPL Statement No. 3?

4 A. That's what the question says.

5 Q. And the company answered by indicating that the
6 model was not available in Excel format; is that correct?

7 A. That's what the company said.

8 Q. Now, I've reviewed the additional interrogatory
9 responses that the Trial Staff had propounded in this case.
10 I see no further interrogatory question dealing with this
11 model. Is this correct?

12 A. I don't recall the context of all the
13 interrogatories we sent, so I can't answer that.

14 Q. Is there an interrogatory where the Trial Staff
15 asked for a copy of the model in some format other than
16 Excel?

17 A. No. There is no such data request.

18 Q. And lastly, Mr. Kubas, if we look at your
19 surrebuttal testimony, pages nine and ten, you respond to
20 certain testimony and exhibits presented by Mr. Woodruff
21 regarding a comparison of forecasted versus actual sales for
22 the first six months of the future test year; is that
23 correct?

24 A. Yes, beginning on page nine.

25 Q. And you compare and criticize the company's

1 forecast as unreliable for the three coldest months,
2 January, February and March, and you cite certain variances
3 on page 10, line 10 and 11 of your testimony; is that
4 correct?

5 A. Yes, it is.

6 Q. And I'd like to refer you back to Mr. Woodruff's
7 schedule, DRW-2, page 2, table 3, just so I know what we're
8 comparing here.

9 JUDGE TURNER: Could you repeat the pages again?

10 MR. MacGREGOR: It is Exhibit DRW-2, page 2 of 2.

11 BY MR. MacGREGOR:

12 Q. Have you had an opportunity to review this
13 schedule, Mr. Kubas?

14 A. Yes. The schedule is right here.

15 Q. And am I correct that the subject you were
16 addressing in your testimony is comparing the table 3, the
17 forecasted numbers, for months one, two and three, which are
18 January, February and March, versus actual in column B; is
19 that correct?

20 A. That's what Mr. Woodruff shows here.

21 Q. Am I correct that the figures in column B are
22 actual sales and are not weather corrected?

23 A. That's true, yes.

24 MR. MacGREGOR: Thank you. That's all I have, Your
25 Honor.

1 JUDGE TURNER: Does any other party have cross-
2 examination for this witness?

3 (No response.)

4 JUDGE TURNER: Do you have any redirect, Mr.
5 Kanaskie?

6 MR. KANASKIE: No, Your Honor.

7 JUDGE TURNER: Okay. Thank you very much, Mr. Kubas.

8 THE WITNESS: Thank you, Your Honor.

9 (Witness excused.)

10 JUDGE TURNER: My schedule shows that our next
11 witness is Paul Moul.

12 MR. MacGREGOR: Yes, Your Honor. The next several
13 witnesses are in the rate of return area, I think all the
14 remaining witnesses except for Mr. Epstein, and Mr. Gang is
15 going to be taking the lead on that part of the case. I'll
16 be here but out of the way.

17 JUDGE TURNER: Okay.

18 MR. GANG: At this time, Your Honor, I'd like to call
19 Paul R. Moul to the stand.

20 JUDGE TURNER: Good morning, Mr. Moul.

21 MR. MOUL: Good morning, Judge.

22 Whereupon,

23 PAUL R. MOUL
24 having been duly sworn, testified as follows:

25 JUDGE TURNER: And that pertains also to your filed

1 testimony and exhibits?

2 THE WITNESS: Yes.

3 JUDGE TURNER: Okay, thank you. First, let me say
4 good morning, Mr. Gang, and welcome.

5 MR. GANG: Good morning, Your Honor. Pleasure to be
6 here. I'll give Mr. Moul a few minutes to unpack if I may,
7 Your Honor.

8 JUDGE TURNER: Okay. We can go off the record if
9 you're not going to begin immediately.

10 (Discussion off the record.)

11 JUDGE TURNER: Back on the record.

12 **DIRECT EXAMINATION**

13 BY MR. GANG:

14 Q. Mr. Moul, would you please state your name and
15 business address for the record?

16 A. Yes. My name is Paul R. Moul. That's spelled
17 M-O-U-L and the pronunciation rhymes with the word "owl."

18 Q. By whom and in what capacity are you employed?

19 A. I am managing consultant of P. Moul and
20 Associates, an independent financial and regulatory
21 consulting firm.

22 MR. GANG: Your Honor, it's my understanding that Mr.
23 Moul's prepared direct and rebuttal testimony, Statements
24 Nos. 9 and 9-R, as well as his Exhibits PRM-1 through 5 have
25 been previously identified and admitted into evidence

1 subject to cross-examination and timely motions.

2 JUDGE TURNER: Yes, that is correct.

3 BY MR. GANG:

4 Q. Mr. Moul, referring to Statement No. 9 and
5 Statement No. 9-R, were these pieces of testimony prepared
6 by you?

7 A. Yes, they were.

8 Q. And is the information contained therein true
9 and correct to your knowledge, information and belief?

10 A. Yes.

11 Q. Do you have any corrections or additions to
12 either of those statements?

13 A. None that I'm aware of at this time.

14 Q. And also referring to Exhibits PRM-1 through 5,
15 were these exhibits prepared by you or under your
16 supervision and direction?

17 A. Yes, they were.

18 Q. And is the information contained therein true
19 and correct to the best of your knowledge, information and
20 belief?

21 A. Yes.

22 MR. GANG: Your Honor, before proceeding with Mr.
23 Moul's cross-examination I have just a few questions in the
24 nature of rejoinder.

25 BY MR. GANG:

1 Q. Mr. Moul, on page 20 of Mr. Kahal's testimony --

2 MR. GANG: Am I pronouncing that correctly? Kahal?

3 JUDGE TURNER: I'm sorry, I'm not hearing you
4 correctly.

5 MR. GANG: I was just trying to make sure I was
6 pronouncing Mr. Kahal's name correctly, Your Honor.

7 JUDGE TURNER: And is he, Mr. Kahal?

8 MR. GANG: He's indicating in the affirmative. I
9 thought I remembered it from the last time, but it's been a
10 few years. Starting again.

11 BY MR. GANG:

12 Q. On page 20 of Mr. Kahal's surrebuttal, he
13 disagrees with your position that the investor expected
14 market return for use in the CAPM is 12 percent or higher,
15 citing Zacks' forecast of earnings plus the forecasted
16 yield. Can you explain how you derived an expected market
17 return and provide us with a current forecast?

18 A. Yes, I can. In my rebuttal testimony, I relied
19 upon information provided by Mr. Kahal in response to one of
20 our interrogatory or discovery requests, and used a forecast
21 from First Call and that forecast was dated May 28, 2004.

22 In his rejoinder he made reference to a subsequent
23 forecast by another service and yesterday we went on the
24 Internet and looked up the most recent First Call forecast
25 of earnings growth.

1 In the document we accessed yesterday, the First Call
2 earnings growth rate as of August 9th is now 10.79 percent.
3 Combining that with the dividend yield, I now calculate a
4 total market return for the S&P 500 of 12.58 percent.

5 This substantiates the point that I made in my
6 rebuttal testimony that investors could reasonably expect a
7 total market return above 12 percent.

8 Q. And Mr. Moul, using that 12.58 percent expected
9 total market return as reported by First Call, what CAPM
10 result would that produce?

11 A. As I did in my rebuttal, I had two calculations
12 of a CAPM using a total market return, in this case it would
13 be 12.58 percent. The first one, using the raw Value Line
14 betas and the 6 percent risk free rate of return, I
15 calculated a CAPM result of 10.54 percent prior to an
16 adjustment for size, and with that adjustment would move the
17 CAPM result to 11.36 percent.

18 My alternative CAPM calculation utilized betas that
19 would be applicable to the book value rather than the market
20 value capital structure, and in that case the CAPM result
21 would be 10.80 percent and with the size adjustment it would
22 be 11.62 percent.

23 Q. At the bottom of page 19 and the top of page 20
24 of Mr. Kahal's surrebuttal testimony, he suggests that size
25 differences are captured in the CAPM by beta. Is this

1 assertion correct in your opinion?

2 A. No, it is not. In one of the landmark academic
3 studies of capital market returns within the last decade or
4 so, there's a famous study by Jean Fama and Ken French of
5 the University of Chicago which indicated that a multi-
6 factor model does better than the CAPM alone in explaining
7 stock market returns.

8 And in that multi-factor model, Fama-French
9 discovered that there's two additional factors aside from
10 beta that explain returns in stocks, and one of those
11 factors was size and the other one was the price to book or
12 book to price ratio.

13 So what the academic literature indicates is that
14 size is an additional factor that needs to be considered on
15 top of what the simple CAPM result provides.

16 Q. Mr. Kahal also contends that PPL Electric is
17 less risky today than it was at the time of its last rate
18 case. Is that supported by a comparison of the ratings of
19 the company by the credit agencies at the two different
20 points in time?

21 A. I don't think it is. I went back and revisited
22 my testimony in the company's last rate case which is almost
23 ten years ago, and at the time, keep in mind the company was
24 an integrated electric company at the time and of course now
25 they're a delivery only utility.

1 At the time, the bond ratings of what was then called
2 Pennsylvania Power and Light Company, the integrated
3 utility, were A-2 for Moody's and A-minus from S&P.

4 Today, as a delivery only electric utility, the
5 ratings are Baa-2 for Moody's which is a full downgrade of
6 full credit quality, and the S&P rating continues as an
7 A-minus. So the bond ratings really don't reveal any
8 significant change in the company's risk since the last
9 case.

10 Q. Finally, Mr. Moul, on page seven of his
11 surrebuttal testimony, Mr. Kahal indicates that if investors
12 expected an interest rate increase, they would not buy
13 bonds. Is that correct, in your opinion?

14 A. Well, my understanding of the point he's trying
15 to make in surrebuttal is that if investors truly believe
16 interest rates are going up from their current level, they'd
17 be faced with the prospect of the loss of principal if they
18 needed to sell their bonds when in fact interest rates go
19 up.

20 What this fails to realize is that the returns
21 actually realized on a Treasury bond are exactly equal to
22 the expectation at the time the Treasury bond is purchased
23 because when held to maturity, the investor realizes the
24 interest income he expected which is revealed in the yield
25 and he gets his full principal back.

1 So from the date of purchase to the maturity of the
2 bond, in fact the investor realizes his expected return
3 based upon today's market conditions and suffers no loss of
4 principal even if interest rates rise.

5 And then the question goes, well, if that's the case,
6 why would investors expect that interest rates go up? Well,
7 the fact is that interest rates change every day, and if Mr.
8 Kahal's premise were in fact the way the bond markets
9 operated, interest rates would never change and we know in
10 fact that they change all the time.

11 So all we're really trying to do in this case is to
12 match the interest rates forecast during the rate effective
13 period with the models we use to measure the cost of equity
14 in this proceeding.

15 MR. GANG: Thank you, Mr. Moul.

16 I have nothing further, Your Honor. The witness is
17 available for cross-examination.

18 JUDGE TURNER: Okay. Mr. Kanaskie?

19 MR. KANASKIE: Thank you, Your Honor.

20 **CROSS-EXAMINATION**

21 BY MR. KANASKIE:

22 Q. Good morning, Mr. Moul. My name is Rick
23 Kanaskie with the Office of Trial Staff.

24 A. Good morning.

25 Q. To clarify a couple things and start with a

1 general question, am I correct or would you agree that in
2 your original testimony when you were calculating DCF and
3 using some of your components, you used Value Line data as
4 of December 5, 2003?

5 A. I believe that's correct.

6 Q. Have you done any updates to your calculations
7 since filing your testimony?

8 A. Not specifically for the purpose of this case.
9 I obviously am aware of subsequent issues of Value Line, but
10 I didn't make a new calculation for this case.

11 Q. You would agree with me, though, that you did
12 update one of Mr. Deardorff's calculations?

13 A. I believe that is correct. You're referring to
14 page 28 of my rebuttal?

15 Q. Of your rebuttal.

16 A. Yes.

17 Q. If we could go to page 37 of your rebuttal --
18 I'm sorry, of your direct?

19 A. I have that.

20 Q. You talked about growth rates. You would agree
21 you're proposing a growth rate of 5.5 percent in your DCF
22 using the electric barometer group; is that correct?

23 A. Yes.

24 Q. If you could go to your Exhibit PRM-1, please,
25 pages -- I'm going to refer to pages 20 and 22 specifically.

1 A. I have that.

2 Q. Would you agree between your historical growth
3 rates found on page 20 and your five year projected growth
4 rates that only one of the entries exceeds 5.5 percent?

5 A. Yes.

6 Q. And you've stated earlier that you haven't run
7 an update specifically. Would you agree subject to check
8 that if we used updated numbers, that none of these would be
9 above 5.5 percent?

10 A. I haven't looked at that specifically so I could
11 only agree to that to the extent I have the data.

12 Q. Okay. So subject to check you would say no, or
13 -- I guess subject to check you would say no, none of them
14 would be above 5.5?

15 A. I think I can agree to that the way you framed
16 it.

17 JUDGE TURNER: Are you going to check it now, check
18 it and get back to us today?

19 THE WITNESS: I'm not sure I can do it today, Your
20 Honor.

21 JUDGE TURNER: When?

22 THE WITNESS: I know I can't do it tomorrow. I have
23 to be in Connecticut tomorrow. Thursday?

24 JUDGE TURNER: Is that okay with you, Mr. Gang?

25 MR. GANG: That's fine if that's acceptable with you,

1 Your Honor.

2 JUDGE TURNER: Okay with you, Mr. Kanaskie?

3 MR. KANASKIE: Yes, Your Honor. As long as we have
4 it by the close of record, I'm fine.

5 JUDGE TURNER: Okay. So Thursday.

6 THE WITNESS: Yes. It will probably be late in the
7 day, though, on Thursday.

8 JUDGE TURNER: But you'll submit it through your
9 attorney, right? You won't still be here, will you?

10 THE WITNESS: Oh, no, no, no.

11 JUDGE TURNER: So you'll submit it through Mr. Gang
12 or somebody else. Okay.

13 BY MR. GANG:

14 Q. Moving to page 23 of your rebuttal --

15 A. I'm sorry, what was the page reference?

16 Q. Page 23.

17 A. I have that.

18 Q. On lines four and five, you state that in your
19 experience an 8.75 percent rate of return common equity
20 proposal is unprecedented in a rate case before this
21 Commission for an electric utility; is that correct?

22 A. Yes.

23 Q. Can you tell me what other distribution
24 companies have had cases that you can compare it to?

25 A. None so far.

1 Q. So you would agree then that in terms of an
2 electric distribution company such as one before us now, we
3 have no precedent?

4 A. That's right, because this is the first case of
5 its kind.

6 Q. Okay. Just two other general questions. On
7 line eight, you refer to PAWC. Could you tell us who PAWC
8 is?

9 A. That would be Pennsylvania American Water
10 Company.

11 Q. And line ten, API?

12 A. Aqua Pennsylvania, Incorporated.

13 Q. Okay. So they're both water companies?

14 A. Yes.

15 MR. KANASKIE: I believe I have no further questions,
16 Your Honor.

17 JUDGE TURNER: Okay. Mr. Sparks?

18 MR. SPARKS: Thank you, Your Honor.

19 **CROSS-EXAMINATION**

20 BY MR. SPARKS:

21 Q. Good morning, Mr. Moul.

22 A. Good morning.

23 JUDGE TURNER: Mr. Sparks, can you keep your voice
24 up?

25 MR. SPARKS: Yes.

1 JUDGE TURNER: I'm having a little trouble hearing
2 you even with the microphone.

3 MR. SPARKS: This is as close to me as possible.

4 JUDGE TURNER: Thank you very much.

5 MR. SPARKS: Shall we begin.

6 BY MR. SPARKS:

7 Q. Mr. Moul, when did you prepare your direct
8 testimony?

9 A. Last winter. The case was filed I believe in
10 March, so I would suppose most of the work was probably done
11 in February because my dividend yields ran through January,
12 so the data gathering was done in February.

13 Q. February of 2004?

14 A. Correct.

15 Q. And does your discounted cash flow or DCF model
16 require the use of observed dividend yields as an input to
17 that formula?

18 A. Yes.

19 Q. And from what time period did you obtain you
20 obtain your dividend yield market data?

21 A. Well, I looked at 12 months through January of
22 2004, the oldest one being -- the first month was February
23 of 2003.

24 Q. So it's largely 2003 data?

25 A. Sure, except for one month.

1 Q. Mr. Moul, do you include a leverage adjustment
2 of 44 basis points in your cost of equity recommendation?

3 A. Yes, for the electric group. I have a separate
4 one for the gas group.

5 Q. If you would, at Appendix E of your direct
6 testimony, pages 13 through 15, do you show the calculations
7 used to derive that data?

8 A. Yes.

9 Q. And at page 14 of that same appendix, do the
10 market to book capital structures include any data
11 pertaining to the company's proposed capital structure?

12 A. I don't understand your question. Which
13 company, PP&L?

14 Q. PP&LEU, yes.

15 A. Yes, there's no information in there on PP&L,
16 no.

17 Q. On that same page, what is the source and time
18 frame of the figures that you use there?

19 JUDGE TURNER: We're on page 14?

20 MR. SPARKS: Yes, ma'am.

21 THE WITNESS: The source is annual reports for each
22 company as to the carrying amount and the market amount of
23 long term debt and preferred stock, also the annual reports
24 for the number of shares outstanding, the prices I got from
25 S&P, and those are the sources. Now, as to your question on

1 time frame, I have to look that up.

2 JUDGE TURNER: Can we go off the record for a minute,
3 please, while you're looking?

4 (Discussion off the record.)

5 JUDGE TURNER: Back on the record.

6 Let's correct the reference. We're in Appendix E to
7 Mr. Moul's testimony.

8 THE WITNESS: As to the date, as of 12/31/02, those
9 were the latest annual reports that were available when I
10 put this together in February of '04. The '03 annual
11 reports haven't come out yet.

12 BY MR. SPARKS:

13 Q. So it's 2002?

14 A. Correct.

15 Q. Okay. Remaining in Appendix E, page 14, does
16 the capitalization data here exclude short-term debt?

17 A. Yes.

18 Q. And did the proxy companies have short-term debt
19 on their balance sheets?

20 A. Yes.

21 Q. Turning to page E-15, is one of the inputs to
22 the formula on page E-15 the bond yield rate?

23 A. Yes.

24 Q. And what figure did you use to calculate the
25 utility bond yield rate for purposes of the leverage

1 adjustment?

2 A. The figure I used was 6.43 percent, and that
3 came from page 25 of Exhibit PRM-1 and it represents a six
4 month average for an A-rated public utility bond.

5 Q. Could you please clarify the time period?

6 A. That would be for the six months running from,
7 the six months August, 2003 to January, 2004.

8 Q. Thank you. Is the 6.43 percent an actual or
9 forecasted value?

10 A. Actual.

11 Q. Now, if you would turn to your direct testimony
12 at 43?

13 A. I have that.

14 Q. In your equity risk premium study, you used a
15 bond yield rate of 7.25 percent, correct?

16 A. Yes.

17 Q. Mr. Moul, does your leverage calculation also
18 require the income tax rate?

19 A. Yes, as shown on E-15.

20 Q. And what rate did you use?

21 A. Thirty-five percent.

22 Q. And did you omit state income taxes from that
23 calculation?

24 A. Yes, because income taxes vary so widely from
25 state to state.

1 Q. And does the Miller-Modigliani formula require
2 the omission of state income taxes?

3 A. I really can't say. I don't know.

4 Q. Mr. Moul, page two of Appendix E?

5 A. I have that.

6 Q. Do you describe your DCF analysis as being based
7 on the Gordon model?

8 A. Yes. Professor Gordon's name is often
9 associated with this particular model, but Footnote 1, I
10 indicate that the model was actually formulated many decades
11 -- well, two decades earlier by a professor at Harvard by
12 the name of J.B. Williams. But Gordon's name is frequently
13 associated with --

14 JUDGE TURNER: I can't hear you.

15 THE WITNESS: Gordon's name is frequently associated
16 with the model.

17 JUDGE TURNER: Okay.

18 BY MR. SPARKS:

19 Q. And do you consider Dr. Gordon to be an
20 authority on the application of a DCF model to public
21 utilities?

22 A. Yes, he's one of them, sure.

23 Q. And does Dr. Gordon's methodology include the
24 type of leverage adjustment that you testify as being
25 necessary here?

1 A. I've never seen Dr. Gordon employ that, no.

2 Q. If you would turn to your direct testimony, 37,
3 when you present your DCF results and refer to this as the
4 Gordon form of the DCF, you do not mean to imply that Dr.
5 Gordon is the source of the leverage adjustment or that he
6 endorses that adjustment; is that correct?

7 A. That's correct. To my knowledge, Dr. Gordon has
8 never even considered the leverage adjustment that I'm aware
9 of.

10 Q. Remaining on page 37 of your direct testimony,
11 you show a 5.5 percent DCF growth rate in your electric
12 proxy group, correct?

13 A. Yes.

14 Q. Would you please turn to your direct testimony,
15 Schedule 11, page one of two?

16 A. I have that.

17 Q. Is it correct that the first three measures in
18 that schedule, First Call, Zacks and Reuters, are the
19 projected five year earnings per share forecast obtained
20 from investment analysts?

21 A. Yes.

22 Q. Is the 5.5 percent growth rate averaged over all
23 eight companies in your electric group?

24 A. I don't understand the question.

25 Q. The 5.5 percent figure, did you obtain that

1 figure by simply averaging these eight companies?

2 A. No, I didn't. I didn't approach it that way,
3 no.

4 Q. Isn't the mathematical average of the growth
5 rate for this group about 3.8 to 4 percent for these eight
6 sources?

7 A. I can confirm that if you would like.

8 JUDGE TURNER: Let's go off the record while he makes
9 a calculation.

10 (Discussion off the record.)

11 JUDGE TURNER: Back on the record.

12 THE WITNESS: The figure I get is 3.83 percent.

13 BY MR. SPARKS:

14 Q. Now, to obtain that 5.5 percent growth rate,
15 would you please tell me the exact weighting that you
16 assigned to each of these eight data points, seeing as the
17 5.5 percent is not a simple mathematical average of these
18 data points?

19 A. Yes. You're quite correct, it is not a simple
20 arithmetic average. As I stated in my testimony at page 34,
21 it's derived from entire array of data presented there after
22 doing two things first: one, observing the macroeconomic
23 factors as to overall corporate earnings growth; and also
24 considering the fact that for the electric utilities there
25 are several negative factors, not the least of which is

1 emergence from the restructuring phase of the business. So
2 I can't give you specific weights because that's not the way
3 I approached the formulation of the growth rate.

4 Q. Let's move to page 17 of your rebuttal testimony
5 if you would, please.

6 A. I have that.

7 Q. You refer to updated projected dividend growth
8 rates. Does your rebuttal show an average value on line 15
9 of 5.5 percent?

10 A. Yes. That's the average shown there. I don't
11 mean to quarrel with your question, but this wasn't done
12 with the objective of doing any updating. I was working
13 with the data that we had obtained in discovery.

14 Q. Okay. I don't think that's the nature of my
15 follow-up question.

16 A. I'm sorry.

17 Q. That's okay.

18 A. But you're quite correct about what average is
19 shown there.

20 Q. In the table on that page, there are blanks
21 where dividend growth information for CH Energy and UIL
22 should be found; is that correct?

23 A. Yes.

24 Q. Is this because Value Line has a dividend growth
25 rate of zero for these two companies?

1 A. I don't think Value Line had values for those
2 companies.

3 Q. So it's zero?

4 A. Absent a value, I just ignored that variable.

5 Q. Is Value Line projecting no growth in dividend
6 for those two companies?

7 A. I'd have to check on CH Energy. For sure, UIL,
8 they're showing no growth, but I'd have to go back and look
9 at the Value Line sheet for the Central Hudson.

10 JUDGE TURNER: Do you want him to do that, Mr.
11 Sparks?

12 MR. SPARKS: No, Your Honor. Thank you.

13 BY MR. SPARKS:

14 Q. Mr. Moul, if you had included the no-growth,
15 zero percent growth rate for these two companies, you would
16 agree subject to check that the mathematical average from
17 your ten company group would be a dividend growth rate of
18 4.4 percent?

19 A. I haven't done the calculation, but I certainly
20 agree that if you inject two zeroes in that data series, the
21 average has to decline.

22 JUDGE TURNER: Now, do you want, subject to check,
23 because I want him to check it and get back to us if you
24 want a subject to check answer, or is that sufficient for
25 you?

1 MR. SPARKS: I think it's okay if we go without the
2 subject to check. Mr. Moul answered the question.

3 JUDGE TURNER: Thank you.

4 BY MR. SPARKS:

5 Q. Now, let's turn to pages nine and ten of your
6 rebuttal testimony.

7 A. I have that.

8 Q. On those pages, you discuss the Standard &
9 Poor's industry-wide announcement on business positions on
10 June 2, 2004. Has Standard & Poor's changed its credit
11 rating for PPL either at that time or since then?

12 A. The credit rating, no, but the business
13 position, yes.

14 Q. So PP&L remains at A-minus for Standard &
15 Poor's?

16 A. Yes, right. It remains as an A-minus with a
17 negative outlook, but its business position slipped from a
18 three to a four.

19 Q. Have any other reporting agencies changed their
20 credit rating for the company since the beginning of June,
21 2004?

22 A. Not that I'm aware of.

23 MR. SPARKS: Thank you, Mr. Moul.

24 The OCA has no further questions of this witness.

25 JUDGE TURNER: Thank you, Mr. Sparks.

1 Mr. Gray?

2 MR. GRAY: No questions, Your Honor.

3 JUDGE TURNER: Mr. McCormick?

4 MR. McCORMICK: No questions for Mr. Moul, Your
5 Honor.

6 JUDGE TURNER: Mr. Epstein is not present. The union
7 is not present. PPLICA?

8 MS. POLACEK: No questions, Your Honor.

9 JUDGE TURNER: And I don't believe the Sustainable
10 Energy Fund is represented this morning, so that would
11 complete cross-examination. Mr. Gang, do you have any
12 redirect?

13 MR. GANG: Yes, I do have a question. I don't know
14 what policy you're using. May we confer for just one
15 minute?

16 JUDGE TURNER: Yes.

17 (Pause.)

18 MR. GANG: Thank you, Your Honor. I am ready to
19 proceed whenever you are.

20 JUDGE TURNER: Okay.

21 MR. GANG: I have one question for Mr. Moul, at least
22 I think I can do it in one.

23 JUDGE TURNER: Okay. Go ahead.

24 **REDIRECT EXAMINATION**

25 BY MR. GANG:

1 Q. Mr. Moul, counsel for the Consumer Advocate
2 referenced your page E-14 of the appendices to your direct
3 testimony and asked you about short-term debt in the proxy
4 group companies as it relates to the leverage adjustment.
5 Can you explain why you did not use short-term debt in your
6 leverage adjustment?

7 A. Yes. Including or excluding short-term debt in
8 the calculation really isn't important. What's important to
9 the calculation is the change in leverage from the market
10 capitalization to book capitalization.

11 So if you either include short-term debt in both or
12 exclude it in both, the important point is the change in the
13 leverage and it's really not all that important as to
14 whether the short-term debt is put into the calculation or
15 not, just as long as it's handled consistently, it's either
16 in both sides of the equation or it's out of both sides of
17 the equation.

18 MR. GANG: Thank you, Mr. Moul.

19 Your Honor, I have nothing further for the witness.

20 JUDGE TURNER: So for you it was out of both sides of
21 the equation?

22 THE WITNESS: Yes, Your Honor.

23 JUDGE TURNER: Okay. Thank you. Can we then excuse
24 Mr. Moul?

25 MR. GANG: That's acceptable to the company, Your

1 Honor, unless you have questions.

2 JUDGE TURNER: No, thank you.

3 Thank you. You may step down, Mr. Moul.

4 THE WITNESS: Thank you, Your Honor.

5 (Witness excused.)

6 MR. GANG: Do you wish to proceed with the next
7 witness, Your Honor?

8 JUDGE TURNER: Yes.

9 MR. GANG: At this time, I'd like to call Ms. Julie
10 Cannell.

11 JUDGE TURNER: Good morning, Ms. Cannell.

12 Whereupon,

13 JULIE M. CANNELL

14 having been duly sworn, testified as follows:

15 JUDGE TURNER: And do you also apply that to your
16 pre-filed testimony and exhibits?

17 THE WITNESS: I do.

18 **DIRECT EXAMINATION**

19 BY MR. GANG:

20 Q. Ms. Cannell, would you please state your name
21 and business address for the record?

22 A. Julia M. Cannell, Post Office Box 199, Purchase,
23 NY, 10577.

24 MR. GANG: And for the reporter, that's spelled
25 C-A-N-N-E-L-L.

1 BY MR. GANG:

2 Q. Ms. Cannell, I refer you to what has been
3 previously identified for the record and admitted subject to
4 cross-examination as your Statement 10 and rebuttal
5 Statement 10-R. If I were to ask you the questions
6 contained therein, would you answer as listed therein?

7 A. Yes.

8 Q. Do you have any additions or corrections to that
9 statement?

10 A. I do. In Statement No. 10, my direct testimony,
11 on page 18, line 3, there is a typographical error. The
12 word should not be "friendless" but rather "friendliness."

13 Q. Would you repeat that?

14 A. Yes. In my direct testimony, page 18, line 3 --

15 JUDGE TURNER: In the quote, right?

16 THE WITNESS: That's correct. The word should be
17 "friendliness."

18 BY MR. GANG:

19 Q. Now, with that correction, are the answers
20 listed in your Statements 10 and 10-R true and correct to
21 best of your knowledge, information and belief?

22 A. Yes, they are.

23 MR. GANG: Your Honor, before proceeding with cross-
24 examination, I have one rejoinder question for Ms. Cannell.

25 JUDGE TURNER: Okay.

1 BY MR. GANG:

2 Q. Mr. Kahal in his surrebuttal testimony commented
3 or reported on a Lehman Brothers June 4, 2003 report stating
4 that Lehman Brothers predicted returns on equity allowed by
5 Commissions of 9 to 10 percent. Are you familiar with that
6 report?

7 A. Yes, I am.

8 Q. And for what period was Lehman Brothers
9 predicting returns on equity in that June, '03 report?

10 A. The predictions were for the year 2003.

11 Q. Is there and have you provided, cited for the
12 record previously a more recent report by Lehman Brothers?

13 A. Yes, I have. In my direct testimony, I
14 referenced a March, 2004 report.

15 Q. And Ms. Cannell, what did Lehman Brothers
16 predict the range of returns on equity by Commissions to be
17 for 2004 in the March, '04 report?

18 A. The predicted range was from 9.5 percent to 11
19 percent.

20 Q. And as a buy side analyst, can you tell us how
21 you would have relied if at all on such reports by Lehman
22 Brothers and similar reports?

23 A. In my 20 years' experience as a practicing
24 analyst on the buy side, and that is distinguished from the
25 sell side or the investment banking firms, I relied

1 extensively as did my colleagues on sell side reports.

2 The reason for that was not that we did not want to
3 do our own work but rather we typically on the buy side have
4 a wide range of coverage responsibilities.

5 In my own occasion, I followed not only the electric
6 utilities but for a period of time telecommunications
7 services companies, housing stocks and waste management
8 companies. As well, I had administrative duties as
9 co-director of the research department.

10 The point is that there was not enough time in most
11 buy side analysts' days to do the extensive in-depth
12 analytical work that sell side analysts, which typically
13 have staffs of three to four to five people helping them,
14 that they were able to do.

15 So we certainly used, I certainly used sell side
16 reports as, if nothing else, a reference point, a validation
17 of my own opinion.

18 MR. GANG: I have nothing further, Your Honor. The
19 witness is available for cross-examination.

20 JUDGE TURNER: Thank you. Mr. Kanaskie?

21 MR. KANASKIE: Yes, Your Honor. I just have one
22 quick question.

23 **CROSS-EXAMINATION**

24 BY MR. KANASKIE:

25 Q. Page 21 of your testimony --

1 A. Of the direct testimony?

2 Q. Yes. You make the comment on line 14 that
3 investment risk in the electric utility industry is higher
4 than it has been. When you refer to the electric utility
5 industry, are you talking the entire industry, generation,
6 or are you talking specifically the type of company we're
7 dealing with here which is distribution only?

8 A. I'm talking in my testimony about the industry
9 at whole.

10 JUDGE TURNER: So that includes generation?

11 THE WITNESS: That does include generation. As
12 restructuring began, I would say that at that point the risk
13 level started to rise, and then of course with the problems
14 that happened with Enron and the ensuing debacle, the risk
15 probably rose further.

16 And while it could be said that certain types of
17 companies might have higher risk, the fact is that the
18 entire industry was painted with the same risk brush in many
19 respects.

20 BY MR. KANASKIE:

21 Q. Am I correct if I would state that you don't
22 have information directed or specifically dealing with
23 distribution only? All your information and your data is
24 based on the industry as a whole?

25 A. I don't believe that is correct. In my

1 testimony, I put forth a number of risks that I think
2 distribution only companies face today.

3 Q. When you had spoken briefly about the Lehman
4 Brothers report, do you know the basis for their analysis?
5 Did they do distribution only or did they do electric
6 entirely?

7 A. I don't know the basis for their analysis.

8 MR. KANASKIE: I have no further questions, Your
9 Honor.

10 JUDGE TURNER: Thank you. Mr. Gray?

11 MR. GRAY: No questions, Your Honor.

12 JUDGE TURNER: Did I skip you, Mr. Sparks?

13 MR. SPARKS: Yes, Your Honor. Thank you.

14 JUDGE TURNER: My apologies.

15 **CROSS-EXAMINATION**

16 BY MR. SPARKS:

17 Q. Good morning, Ms. Cannell.

18 A. Good morning.

19 Q. Shall we begin?

20 A. Please.

21 Q. Turning to page five of your direct testimony,
22 you compare PP&L's business risk as an integrated company
23 several years ago with the company's risk today as a
24 distribution company; is that correct?

25 A. What I said in my testimony was that as an

1 integrated company, certain risk factors were able to be
2 spread across a broader base than is the case now as the
3 company is a distribution only company.

4 Q. So regarding the risk level of the integrated
5 company, in the company's 1995 base rate proceeding, what
6 was PP&L's largest single asset?

7 A. I was not involved in that proceeding so I
8 really cannot speak to that.

9 Q. Would you agree that the company's largest
10 single asset in that proceeding was the Susquehanna nuclear
11 plant?

12 A. Again, I wasn't involved in the proceeding. I
13 do know that the company at that time, being integrated, of
14 course, did have that asset in its mix.

15 Q. So the answer is you just don't know?

16 JUDGE TURNER: Excuse me?

17 THE WITNESS: I was asked, it was stated that I just
18 don't know. The answer is, I don't know with any
19 definitiveness.

20 BY MR. SPARKS:

21 Q. Okay. So to your knowledge, was excess capacity
22 for that Susquehanna plant at issue in the past PP&L rate
23 proceeding when the company was an integrated utility?

24 A. Again, I was not involved in that proceeding.

25 Q. So do you know or don't know?

1 A. I was not asked to testify on that, so no, I do
2 not. I cannot give you a definite answer.

3 Q. So given that, do you know if excess capacity is
4 an issue in this proceeding?

5 A. Because the company does not have generation,
6 PPL Electric Utilities, no, it was not an issue.

7 Q. Would you turn to your rebuttal testimony, page
8 10? The \$90 million POLR supply payment that you discuss
9 here, was that payment part of a settlement?

10 A. To my understanding, yes, it was.

11 Q. And when did that payment occur?

12 A. I don't know the specific date, but I believe it
13 was when PPL Electric was negotiating with the supply arm
14 for its POLR supply.

15 JUDGE TURNER: Did you want a date, Mr. Sparks?

16 MR. SPARKS: If Ms. Cannell knows an exact date, she
17 can give one, but if you don't, you don't.

18 THE WITNESS: I do not have an exact date, Your
19 Honor.

20 BY MR. SPARKS:

21 Q. Regarding that, the filing that you just
22 mentioned, are you familiar with the filing that the company
23 made with the Commission for approval of its affiliated
24 interest agreement associated with the contract with PPL
25 Energy Plus for a POLR supply?

1 A. It has been described to me and I have looked at
2 it. I have not read it in detail.

3 MR. SPARKS: At this time, Your Honor, the OCA would
4 request to mark for identification for the record OCA Cross-
5 Examination Exhibit No. 1. This cross-examination exhibit
6 is the filing that we just described to Ms. Cannell.

7 And while the OCA copy has no docket numbers in front
8 because it is the original filing that the company submitted
9 to the Commission, the docket numbers for the proceeding are
10 as follows.

11 JUDGE TURNER: Why don't you wait a minute until we
12 all have it so we can write them down.

13 MR. SPARKS: I'm sorry?

14 JUDGE TURNER: Why don't you wait a minute so that we
15 all have it and then we can write them down as you speak.

16 (Pause.)

17 JUDGE TURNER: The docket numbers are?

18 MR. SPARKS: They are as follows: S-00010853,
19 G-00010872, G-00010886, and finally G-00010887.

20 JUDGE TURNER: This one filing had four docket
21 numbers?

22 MR. SPARKS: Yes, ma'am. That is my understanding.

23 JUDGE TURNER: And you want this marked as OCA Cross-
24 Examination Exhibit No. 1?

25 MR. SPARKS: No. 1, yes.

1 JUDGE TURNER: Okay. It may be so marked.

2 (Whereupon, the document was marked
3 as OCA Cross-Examination Exhibit
4 No. 1 for identification.)

5 JUDGE TURNER: Do you plan to move it in at the end
6 of this testimony or are you going to wait and move them in
7 all at once?

8 MR. SPARKS: I plan to move them in all at the end of
9 the testimony. We certainly would be able to move them in
10 one at a time if that's your preference.

11 JUDGE TURNER: All at the end of what testimony, the
12 whole case?

13 MR. SPARKS: I'm sorry, at the end of my cross of Ms.
14 Cannell.

15 JUDGE TURNER: That's good. Thank you.

16 BY MR. SPARKS:

17 Q. Ms. Cannell, let me direct you to page five of
18 that particular exhibit that's in front of you. I'll give
19 you just a moment to read the section where there's a little
20 arrow indicating.

21 A. Just on that page?

22 Q. On page five.

23 A. Oh, and going into page six, okay.

24 JUDGE TURNER: Okay. Let's go off the record while
25 she reads it.

1 (Discussion off the record.)

2 JUDGE TURNER: Let's go back on the record.

3 BY MR. SPARKS:

4 Q. Would you agree with me that the company
5 indicates that the purpose of this generation supply
6 agreement is to reduce its operating risk?

7 A. Yes, I would.

8 Q. And would you agree that the company indicates
9 that it's entering a generation supply agreement and that
10 will substantially reduce its business risk?

11 A. It so states.

12 Q. Ms. Cannell, is it your testimony that the
13 Commission should adjust the company's authorized rate of
14 return in this proceeding to take that payment into account
15 in any way?

16 A. My testimony put forth some of the risks that I
17 believe are associated with a distribution only company. I
18 did not specify that payment. I understand that it was
19 made. It's part of the record. But the fact that it was
20 made does not mean that the risk disappeared. It simply is
21 that the risk was monetized.

22 In my view, investors still associate some degree of
23 risk with provider of last resort obligations, even though
24 this certain pact, specific pact encapsulated that risk for
25 a certain time frame.

1 JUDGE TURNER: Excuse me. I didn't understand one of
2 the words. You said the risk was not eliminated but it was
3 -- something?

4 THE WITNESS: Oh, it was monetized, in other words a
5 value was placed on it.

6 JUDGE TURNER: Monetized?

7 THE WITNESS: Yes, it was monetized.

8 JUDGE TURNER: Okay. Thank you.

9 MR. SPARKS: Your Honor, the OCA would request to
10 mark for identification for the record OCA Cross-Examination
11 Exhibit No. 2.

12 JUDGE TURNER: It may be so marked.

13 (Whereupon, the document was marked
14 as OCA Cross-Examination Exhibit
15 No. 2 for identification.)

16 MR. SPARKS: This cross-examination exhibit is the
17 stipulation entered into by the company and the OCA
18 regarding the generation supply agreement.

19 JUDGE TURNER: Let's go off the record while it is
20 distributed.

21 (Discussion off the record.)

22 JUDGE TURNER: Back on the record. Please go
23 forward.

24 BY MR. SPARKS:

25 Q. Ms. Cannell, have you had a chance to review the

1 underlined section on page three?

2 A. Yes, I have.

3 Q. You would agree with me that the company has
4 agreed not to seek the recovery of the \$90 million payment
5 in any way through its rates?

6 A. Yes.

7 Q. And now turn to page 10 of your rebuttal
8 testimony. At line seven, you testify that the current POLR
9 supply contract will remain in effect until 2008; is that
10 correct?

11 A. Yes.

12 Q. Isn't December 31, 2009 the last effective date
13 of the last current POLR supply contract?

14 A. Yes. I believe that this is an error. My
15 apologies.

16 Q. And is it your understanding that the
17 distribution rate cap will end this year?

18 A. Yes.

19 Q. And is it also your understanding the POLR
20 generation rate cap ends when the current POLR supply
21 contract ends?

22 A. Yes.

23 Q. I'd like to direct your attention to page three
24 of your rebuttal testimony. There, did you discuss the
25 potential for near-term increases in interest rates?

1 A. Yes, I did.

2 MR. SPARKS: Your Honor, the OCA would request to
3 mark for identification for the record OCA Cross-Examination
4 Exhibit No. 3. This exhibit consists of selective interest
5 rate data from the Federal Reserve dated August 9, 2004.

6 JUDGE TURNER: It may be so marked.

7 (Whereupon, the document was marked
8 as OCA Cross-Examination Exhibit
9 No. 3 for identification.)

10 JUDGE TURNER: Let's go off the record while it is
11 distributed.

12 (Discussion off the record.)

13 JUDGE TURNER: Let's go back on the record.

14 Are you ready to proceed?

15 MR. SPARKS: Yes, ma'am.

16 JUDGE TURNER: Okay.

17 BY MR. SPARKS:

18 Q. Ms. Cannell, I would ask you to examine OCA
19 Cross-Examination Exhibit No. 3 and ask if you recognize
20 this as interest rate data published on Monday, August 9,
21 2004 by the Federal Reserve.

22 A. Yes, it appears to be.

23 Q. Does this data show the most recent yield on 20
24 year Treasury bonds to be 5.04 percent?

25 MR. GANG: Can you tell us what page you're on,

1 counsel?

2 JUDGE TURNER: Yes, I think that would be helpful to
3 us. What page are we looking at for this number?

4 MR. SPARKS: We are looking at the week ending --
5 it's the August 6th data, so it is the fifth column in.

6 JUDGE TURNER: On page what?

7 MR. SPARKS: On page two of five.

8 JUDGE TURNER: Fifth column in?

9 MR. SPARKS: Yes. We are looking at the Treasury
10 constant maturities, 20 year.

11 JUDGE TURNER: And the figure is?

12 MR. SPARKS: I'm asking Ms. Cannell if that figure is
13 5.04 percent.

14 THE WITNESS: Yes.

15 BY MR. SPARKS:

16 Q. So, Ms. Cannell, does this data show that long-
17 term interest rates have declined since spring of this year?

18 A. I frankly find this a little confusing. The
19 first column is the week ending August 2nd?

20 Q. Well, I asked specifically about the 5.04
21 percent. I showed you that number to illustrate that that
22 is the most recent data --

23 A. Yes.

24 Q. -- published by the Federal Reserve and asked
25 you to compare it to data that was published in the spring

1 of this year.

2 A. Is that shown on this document?

3 A. That is not shown on this document. I asked you
4 on the basis of your experience. Has that rate either
5 increased or decreased based on this 5.04 percent?

6 A. I frankly cannot cite what exactly the level of
7 rates were, the 20 year bond. Generally there has been a
8 steady trend down in rates until very recently when the
9 Federal Reserve raised rates.

10 And in my discussion, in my rebuttal testimony, I was
11 talking about expectations. The expectations of investors
12 in my understanding is that rates are beginning to rise. A
13 low inflection point was finally reached and they are now on
14 the uptick.

15 JUDGE TURNER: When was it reached?

16 THE WITNESS: Your Honor, I don't remember the exact
17 date when rates were raised for the first time in years,
18 approximately one month ago. And I would also that in the
19 Sunday New York Times business section this week, there were
20 two separate articles that referenced an expectation that
21 the Fed is going to raise rates again.

22 I'm going on memory here, but I believe that when Mr.
23 Greenspan -- as you know, he is prone to communicate
24 publicly what his intentions are -- and when he did raise
25 rates for the first time, it was with the expectation that

1 he would try to stave off any increase of inflation and that
2 the incremental increases in rates would be modest.

3 JUDGE TURNER: All right. So you cannot agree with
4 Mr. Sparks that the trend in long-term debt is downwards?

5 THE WITNESS: I can't because I confess I don't
6 remember exactly what a statistic was in the spring. I can
7 agree that rates have in fact fallen, but if they have
8 fallen since -- there are different categories of rates as
9 his exhibit shows. Whether the long rates have followed the
10 direction of short rates, I cannot say specifically. They
11 don't always move in lockstep.

12 MR. SPARKS: Thank you, Ms. Cannell.

13 The OCA has nothing further for this witness.

14 THE WITNESS: You're welcome.

15 MR. SPARKS: Your Honor, at this time the OCA would
16 request to move OCA Cross-Examination Exhibits 1, 2 and 3
17 into the record.

18 JUDGE TURNER: Hearing no objection --

19 MR. GANG: May I have a moment?

20 JUDGE TURNER: Just a moment for Mr. Gang.

21 (Pause.)

22 MR. GANG: No objection.

23 JUDGE TURNER: Hearing no objection, they are
24 admitted.

25 (Whereupon, the documents marked as

1 OCA Cross-Examination Exhibits Nos.
2 1, 2 and 3 were received in
3 evidence.)

4 JUDGE TURNER: Thank you, Mr. Sparks.

5 Does any other counsel have cross-examination for
6 this witness?

7 (No response.)

8 JUDGE TURNER: In that case, Ms. Cannell, you may be
9 excused and thank you for coming today --

10 MR. GANG: Your Honor, might I have an opportunity --

11 JUDGE TURNER: Yes. I'm sorry. Redirect?

12 MR. GANG: I should have spoken up before you did.

13 Can I have just a minute to speak to the witness?

14 JUDGE TURNER: Yes.

15 (Discussion off the record.)

16 JUDGE TURNER: Let's go back on the record.

17 Mr. Gang, do you have redirect?

18 **REDIRECT EXAMINATION**

19 BY MR. GANG:

20 Q. Ms. Cannell, counsel for the OCA asked you some
21 questions about what has been identified and admitted for
22 the record as OCA Cross-Examination Exhibit No. 3, and
23 specifically counsel referenced you to a change in interest
24 rates between August 5th and August 6th which appear on page
25 two.

1 A. Yes.

2 Q. Was there a particular event on August 6th that
3 in your judgment may have affected the interest rates?

4 A. Yes. There was a very weak jobs report which
5 suggests that the economy could be weakening, and in the
6 case of weakening, the tendency is for rates to fall.

7 JUDGE TURNER: The tendency is what?

8 THE WITNESS: I'm sorry, Your Honor. The tendency is
9 for rates to decline.

10 BY MR. GANG:

11 Q. And would it be typical, if there were a
12 positive jobs report the next month or some other positive
13 news, that these rates might rise by an equal or greater
14 amount?

15 A. Yes, it is possible.

16 MR. GANG: I have no further questions, Your Honor.

17 JUDGE TURNER: Thank you, Mr. Gang.

18 MR. GANG: Your Honor, we are at the -- I'm sorry,
19 have you excused Ms. Cannell?

20 JUDGE TURNER: I was just about to. You may be
21 excused, Ms. Cannell. Thank you.

22 THE WITNESS: Thank you, Your Honor.

23 (Witness excused.)

24 JUDGE TURNER: Now, you were about to say, Mr. Gang?

25 MR. GANG: We are at your hour and a half point. I

1 can proceed or we can take a break at your convenience.

2 JUDGE TURNER: Why don't we take a short break, a
3 stretch break, say ten minutes.

4 (Recess.)

5 JUDGE TURNER: On the record.

6 I do have one item of business that can be taken care
7 of quickly, I hope, before we start with Mr. Kahal. I
8 noticed that on the first day, there are a list of exhibits
9 that were sworn in and that includes Exhibit Future 1. We
10 had Exhibit Future 1 Revised associated with the rebuttal
11 testimony. Is that the Exhibit 1 that was sworn in, that
12 was admitted, or --

13 MR. GANG: Could we defer that question until my
14 colleagues return?

15 JUDGE TURNER: There's one of them now.

16 MR. GANG: Exhibit Future 1 that we -- maybe we can
17 go off the record, Your Honor.

18 JUDGE TURNER: Yes, we can go off the record.

19 (Discussion off the record.)

20 JUDGE TURNER: Back on the record. We will deal with
21 this Exhibit Future 1 Revised at a later time in the
22 hearing. Right now, we have Mr. Kahal patiently waiting on
23 the stand. Will you raise your right hand?

24 Whereupon,

25 MATTHEW I. KAHAL

1 having been duly sworn, testified as follows:

2 JUDGE TURNER: And that applies to your pre-filed
3 testimony and exhibits as well?

4 THE WITNESS: Yes, Your Honor.

5 JUDGE TURNER: Thank you. Please be seated.

6 Mr. Sparks?

7 MR. SPARKS: Thank you, Your Honor.

8 Your Honor, I'd like to have marked for
9 identification OCA Statement No. 3, Mr. Kahal's direct
10 testimony, and OCA Statement No. 3-S, Mr. Kahal's
11 surrebuttal testimony.

12 JUDGE TURNER: They may be so marked.

13 (Whereupon, the documents were
14 marked as OCA Statements Nos. 3
15 and 3-S for identification.)

16 JUDGE TURNER: Are there any separate exhibits?
17 They're all bound up with the --

18 MR. SPARKS: Yes, there are exhibits and they are
19 bound together with the direct testimony and surrebuttal
20 testimony.

21 JUDGE TURNER: Thank you.

22 **DIRECT EXAMINATION**

23 BY MR. SPARKS:

24 Q. Would you please state your name and business
25 address for the record?

1 A. Yes. My name is Matthew I. Kahal. My business
2 address is 5565 Sterrett Place, Columbia, Maryland, 21044.

3 Q. Mr. Kahal, do you have before you a copy of your
4 prepared pre-filed direct testimony in this case consisting
5 of 49 pages of questions and answers and 36 pages of
6 schedules and exhibits and a copy of your surrebuttal
7 testimony consisting of 20 pages of questions and answers
8 and one page of exhibits?

9 A. Yes.

10 Q. And was this testimony and were these schedules
11 and exhibits prepared by you or under your direct
12 supervision?

13 A. They were.

14 Q. Do you have any additions, corrections or
15 modifications to make to your testimony, your schedules and
16 exhibits at this time?

17 A. No, I don't.

18 Q. Are the testimony, schedules and exhibits true
19 and correct to the best of your knowledge, information and
20 belief?

21 A. Yes, they are.

22 Q. If I were to ask you these same questions today
23 under oath, would your answers be the same?

24 A. Yes.

25 MR. SPARKS: Your Honor, the OCA asks that Mr.

1 Kahal's testimony marked for identification as OCA Statement
2 No. 3 and OCA Statement No. 3-S be admitted into evidence
3 subject to any timely motions by opposing counsel.

4 MR. GANG: No objection.

5 JUDGE TURNER: They may be so admitted.

6 (Whereupon, the documents marked as
7 OCA Statements Nos. 3 and 3-S were
8 received in evidence.)

9 MR. SPARKS: All parties and Your Honor were
10 previously served with copies of Mr. Kahal's testimony and I
11 have provided two copies to the court reporter. Mr. Kahal
12 is now available for cross-examination.

13 JUDGE TURNER: Thank you. Mr. Kanaskie, do you have
14 any questions?

15 MR. KANASKIE: No cross, Your Honor.

16 JUDGE TURNER: Mr. Gang?

17 MR. GANG: Yes, I do, Your Honor, thank you.

18 JUDGE TURNER: Okay.

19 **CROSS-EXAMINATION**

20 BY MR. GANG:

21 Q. Good morning, Mr. Kahal.

22 A. Good morning.

23 Q. Am I correct, Mr. Kahal, that you have accepted
24 or recommending accepting PPL Electric's projection of its
25 capital structure at December 31, 2004 except for the

1 company's projection that its retained earnings and its
2 equity balance will grow by \$15 million?

3 A. That's correct.

4 Q. Do you have any basis to dispute the company's
5 statements in rebuttal testimony that it earned \$36 million
6 in the first half of 2004 and retained \$34 million of those
7 earnings?

8 A. No. I don't dispute those factual statements.
9 I would note that, as Mr. Moul acknowledged, the dividend
10 payments, which are what is going to determine whether there
11 are any retained earnings or not, normally takes place in
12 the second half of the year.

13 Q. But we can agree, can we not, that the company
14 has earned more than enough money already in 2004 that it
15 could retain earnings sufficient to meet or exceed the
16 \$15 million projected growth in retained earnings?

17 A. Yes. The analysis that I did when I addressed
18 this issue in direct testimony was simply, that's
19 inconsistent with its historical experience.

20 Q. Well, referring to that, do you know whether the
21 company has incurred any unusual expenses in 2002 and 2003?

22 A. Unusual expenses? Are you using them in the
23 sense of extraordinary expenses?

24 Q. I was trying to avoid that word to avoid an
25 objection from counsel. Let's just characterize it in terms

1 of -- that may be another issue in the proceeding and I'm
2 not trying to get an opinion from you as to whether that
3 meets some legal standard of recovery.

4 All I'm saying is, did the company incur any expenses
5 in 2002 and 2003 that it might not expect to incur in a
6 typical year?

7 A. I didn't analyze the company's cost of service
8 in those two years. What I did was I looked at the
9 company's earnings in those two years and the company's
10 earnings in those two years appear to be roughly similar to
11 what the company was projecting for its earnings this year,
12 that is subpar earnings.

13 The company was expecting to have subpar earnings in
14 2004 and by that I mean earnings below its authorized rate
15 of return and cost of capital, and that was the case the
16 last two years --

17 JUDGE TURNER: Excuse me, Mr. Kahal. Excuse me. He
18 asked you if you knew if there were any events in those two
19 years. Is the answer to his question no, you don't know?

20 THE WITNESS: No. I did not evaluate the company's
21 cost of service in those two years. That's not what I
22 focused on.

23 JUDGE TURNER: Okay. Thank you.

24 BY MR. GANG:

25 Q. So you cannot tell us, then, whether there would

1 have been circumstances in those two years which could have
2 reduced the company's earnings which may not be expected in
3 2004?

4 A. I'm not sure I understand the question, but I
5 think the answer to that is no. As I said, I checked those
6 two years in total rather than by individual component for
7 comparability with the expectation that the company itself
8 had for 2004 and found them to be kind of similar.

9 Q. If you would refer to page 12 of your
10 surrebuttal testimony, on lines four and five?

11 A. Yes.

12 Q. And indeed in that paragraph, which is lines
13 three through seven, in the parenthetical, you say,
14 referring to the equity projection, "which seems like an odd
15 reason for increasing the rate increase award."

16 A. Yes.

17 Q. So is what you're saying there that it seems odd
18 that a company would be permitted to reflect growth in its
19 retained earnings in a future test year, that that seems odd
20 to you?

21 A. No. I was commenting on the irony of Mr. Moul's
22 argument. His argument was that in 2004, the company was
23 doing financially, in terms of earnings, a whole lot better
24 than they expected or at least somewhat better than they
25 expected to be doing.

1 Mr. Moul's position goes in the direction of
2 supporting a higher rate increase, and I just found it
3 ironic that the observation that Mr. Moul, that the fact the
4 company is doing better, that is its earnings are stronger
5 this year somehow supports a bigger rate increase. And so I
6 was simply making that observation as an aside.

7 Q. But you would agree with me, would you not, that
8 what the company has earned in the past does not determine
9 what it should be permitted to be earn in the future, does
10 it?

11 A. No. I wasn't making that argument. But it may
12 be, how the company is doing this year may be indicative --
13 I mean, I'm not the cost of service witness -- but it might
14 be indicative as to how large of a rate increase is
15 requires. But that's outside of my part of the case.

16 Q. Well, let me ask the question this way. Would
17 you agree that it is typical to reflect growth in retained
18 earnings in a future test year in this jurisdiction in
19 setting the equity balance for ratemaking purposes?

20 A. Yes, if -- it can be done in this jurisdiction
21 if the projection is credible and reasonable. And in this
22 case, I examined the data and found that it simply wasn't in
23 that the projections of the growth and retained earnings
24 that were stated in the company's filing just were not
25 consistent with its recent historical experience.

1 Q. Assuming that the electric utility does in fact
2 grow its earnings by \$15 million or more in 2004 and your
3 proposed capital structure and return on equity are adopted
4 by the Commission, would not the allowed return on the
5 actual balance of equity be less than what you recommend?

6 A. I'm sorry, I think that you said earnings and
7 you may have meant retained earnings in your question.

8 Q. Let me restate the question.

9 MR. GANG: May I, Your Honor?

10 JUDGE TURNER: That would be good.

11 BY MR. GANG:

12 Q. Assuming that the electric utility grows its
13 retained earnings by \$15 million or more in 2004 and your
14 proposed capital structure and return on equity are adopted,
15 would not the allowed return on the actual balance of equity
16 be less than you recommend?

17 A. No. That's not how ratemaking is done. We
18 don't have an allowed return on book equity. We have a
19 return on rate base. That's how rates are set.

20 Moreover, the capital structure that we utilize for
21 ratemaking purposes is a snapshot, anyway. It may or may
22 not be the capital structure that's actually in effect
23 during the rate effective period or the first year that the
24 rates are in effect.

25 Q. You say that the return is on rate base. That

1 is the overall rate of return; is it not?

2 A. That's correct. The overall rate of return is
3 on rate base.

4 Q. And is it not weighted by the capital structure
5 ratios?

6 A. To come up with an overall rate of return, we
7 utilize the capital structure percentages, that's correct.

8 Q. And if in fact the company has more equity than
9 you have projected in your capital structure recommendation,
10 will it not earn less than 9 percent on that equity?

11 A. No. First of all, my recommendation is 9.5
12 percent, not 9 percent.

13 Q. I apologize. It is.

14 A. Secondly, there are any number of factors that
15 are going to determine what it actually earns. Thirdly,
16 what I observed in fact was in the last two years, the
17 retained earnings balance had actually gone down, that is
18 there had been negative retained earnings. And so --

19 MR. GANG: Your Honor, this is not responsive to my
20 question. He has said that three times. I gave him a
21 hypothetical and he is now asking --

22 JUDGE TURNER: Do you feel that you've received your
23 answer?

24 MR. GANG: I don't think he's answered the question,
25 Your Honor, but I don't need an answer to a question I

1 didn't ask.

2 JUDGE TURNER: Well, I have to agree with that. Did
3 you get an answer to your question?

4 MR. GANG: I'm going to try one more time, Your
5 Honor.

6 BY MR. GANG:

7 Q. Mr. Kahal, you've recommended, and you properly
8 corrected me, a 9.5 percent return on equity.

9 A. That's correct.

10 Q. Assuming in the first year rates are in effect
11 in this proceeding the company has the equity balance that
12 it projected or greater, is it likely to earn a 9.5 percent
13 return on equity?

14 A. In terms of what the actual outcome is, I can't
15 predict what is going to happen. There are too many
16 variables that are going to determine how the company does.
17 It will depend on --

18 JUDGE TURNER: So your answer is you don't know?

19 THE WITNESS: The answer is I can't predict what the
20 actual earnings are going to be in 2005.

21 JUDGE TURNER: Okay.

22 MR. GANG: Let me make it very simple, if I may, Your
23 Honor.

24 BY MR. GANG:

25 Q. Can we agree that if the company's equity

1 balance is not correctly stated in the Commission's final
2 order, is understated, it is less likely to earn the
3 expected return or the allowed return than it otherwise
4 would be?

5 A. Can I answer it as an all else held equal?
6 Would that help?

7 Q. Yes.

8 JUDGE TURNER: I'm sorry, can you answer it as what?

9 THE WITNESS: An all else held equal.

10 JUDGE TURNER: Okay.

11 THE WITNESS: In other words, everything is perfect
12 except for this one variable that we're going to focus on.
13 If that's the case and if it turns out in 2005 that the
14 company actually has a higher equity ratio than has been
15 used for ratemaking, if everything else was held equal, if
16 everything else was perfect, then the earnings would be less
17 than 9.5 percent, and the converse is obviously also true.

18 JUDGE TURNER: Thank you, Mr. Kahal, I think. Are we
19 ready to move on, Mr. Gang?

20 MR. GANG: I will move on, Your Honor.

21 JUDGE TURNER: Okay.

22 MR. GANG: I think that gets me where I wanted to go,
23 Your Honor.

24 BY MR. GANG:

25 Q. Mr. Kahal, I'd like you to refer to your

1 Schedule MIK-4 of your direct testimony, page three in
2 particular.

3 A. I'm sorry, which page?

4 Q. Page three, we'll start on.

5 A. Sure.

6 Q. Now, if I understand your testimony and your
7 responses to interrogatories, on page three, for Value Line,
8 you are showing Value Line's projected growth rates; is that
9 not correct?

10 A. Yes.

11 Q. And that is a growth rate calculated by Value
12 Line; is that not correct?

13 A. Yes, it is.

14 Q. Now, if --

15 A. Excuse me. When Value Line calculates the
16 growth rates, they round off to the nearest half percent.

17 Q. And they use a three year base period; is that
18 not correct?

19 A. That's right.

20 Q. And these, we're now talking on page three,
21 although the schedule clearly shows this, earnings growth
22 rates; is that correct?

23 A. Yes. All the figures on that page three of
24 Schedule MIK-4 are earnings growth rates.

25 Q. Now, if we turn to page four where you list

1 additional Value Line growth measures and you show dividends
2 and book value and retained earnings?

3 A. Yes.

4 Q. Is it not correct that these are not the values
5 projected by Value Line but ones that you calculate?

6 A. No.

7 MR. GANG: One moment, Your Honor.

8 (Pause.)

9 JUDGE TURNER: That was a simple, straightforward
10 answer, Mr. Gang.

11 MR. GANG: I'm sorry, Your Honor?

12 JUDGE TURNER: That was a simple, straightforward
13 answer.

14 MR. GANG: I understand his answer, Your Honor. I'm
15 just checking something, if I may.

16 THE WITNESS: Would you like me to clarify? It might
17 hurry things up.

18 BY MR. GANG:

19 Q. If you wish to clarify, I have no objection.

20 A. To avoid a lot of paper shuffling and to make
21 this simple, when we turn to page four, the retained
22 earnings are the figures for 2007 to 2009. I like to refer
23 to that as 2008 since that's the midpoint.

24 And those are the figures, the growth figures, the
25 retained earnings growth figures actually reported by Value

1 Line. And again, I believe they round off to the nearest
2 half-percent.

3 For dividends and book values, I took the values for
4 2004 and 2008 and I did the growth rate calculations myself
5 for those two variables, so it's different for the retained
6 earnings versus the other two variables.

7 Q. So the answer to your prior question of no is
8 not correct as to dividends and book value?

9 JUDGE TURNER: But you didn't ask your question that
10 way. You asked your questions for retained earnings.

11 MR. GANG: I believe I asked about the value -- well,
12 we didn't --

13 THE WITNESS: I was trying to clarify. I understood
14 the intent of your question and it could have gotten a
15 little confused. That's why I was trying to clarify my
16 answer for you.

17 MR. GANG: And that's fine. I wasn't criticizing the
18 witness, Your Honor. I just wanted to make the record
19 clear.

20 At this time, Your Honor, I'd like to have marked as
21 PPL Electric Cross-Examination Exhibit 1 some interrogatory
22 responses on the subject that Mr. Kahal has provided to us.

23 JUDGE TURNER: Let's go off the record while they're
24 distributed.

25 (Discussion off the record.)

1 JUDGE TURNER: Back on the record. This has been
2 distributed and it may be marked as you requested.

3 (Whereupon, the document was marked
4 as PPL Cross-Examination Exhibit
5 No. 1 for identification.)

6 BY MR. GANG:

7 Q. Mr. Kahal, do you recognize these responses?

8 A. I do.

9 Q. And they are, for the record, your responses to
10 the company's Interrogatories 13, 14 and 15?

11 A. Yes. I think that they were your Set II.

12 Q. That is correct, as indicated in your response.
13 Now, just to understand what you just explained to me, if we
14 can go to the response to Interrogatory 15 which is in this
15 package and go a few pages in to the Value Line page for
16 let's say Con Edison which is I think noted as page 158?

17 A. Yes.

18 Q. If I am correct, and I go back to your Schedule
19 MIK-4, page three, the Consolidated Edison -- well, would
20 you tell me where you got the Consolidated Edison growth
21 rate number on MIK-4, page three from this schedule?

22 A. Yes. This shows that for Consolidated Edison,
23 the 2004, that is our current year, the dividends per share
24 are \$2.26 and they're projected to grow by the interval
25 2007-2009, which I characterize as being 2008, to \$2.34.

1 And to that, I just applied the standard growth rate
2 formula.

3 Q. And that's in the first set of blocks below the
4 chart, correct, or below the graph?

5 A. I'm sorry, where are you referring to, now?

6 MR. GANG: May I approach the witness, Your Honor?

7 JUDGE TURNER: Yes.

8 BY MR. GANG:

9 Q. I was just trying to show descriptively where
10 you were looking, and it's in this set of blocks --

11 A. Oh, okay --

12 Q. -- just below the graph.

13 MR. GANG: And I'll show that to you, Your Honor.

14 JUDGE TURNER: Yes, "this set of blocks" being --

15 MR. GANG: He's comparing these numbers for '04 to
16 '08 for dividends, and then --

17 JUDGE TURNER: But is this all Con-Ed?

18 MR. GANG: Yes.

19 JUDGE TURNER: Okay.

20 BY MR. GANG:

21 Q. Do you want to clarify that, Mr. Kahal?

22 A. I'm sorry, what is it you want me to clarify,
23 now? I'm using the Value Line report, and I'm just taking
24 these figures from the line that says dividends declared per
25 share, which is about a third of the way down.

1 Q. That's fine. And that is the number that you --
2 you then use those numbers to calculate the number you
3 report on page four of your MIK-4.

4 A. Yes.

5 Q. Now, turning back to MIK-4, page three, under
6 Value Line, you don't do a similar calculation; is that
7 correct? Instead, you get the number for the growth rate
8 from the block under earnings per share in the bottom left.

9 A. That's correct.

10 MR. GANG: Your Honor, you can see that if you care
11 to. The number you will see there under annual rates next
12 to earnings for '01-'03 is minus 1.5 percent.

13 BY MR. GANG:

14 Q. Is that correct, Mr. Kahal?

15 A. Yes.

16 JUDGE TURNER: I'm sorry, I'm having trouble finding
17 earnings per share here.

18 MR. GANG: May I approach, Your Honor?

19 JUDGE TURNER: You're saying on 158?

20 MR. GANG: One fifty eight. It's down on the left
21 hand corner --

22 JUDGE TURNER: Left hand corner.

23 MR. GANG: -- under annual rates.

24 JUDGE TURNER: Okay. I can find it now. Thank you.

25 BY MR. GANG:

1 Q. So basically, in what you've reported in your
2 schedules, you have accepted, or reported anyway, Value
3 Line's projection of earnings growth rate using three year
4 base periods, but you have calculated dividend growth rates
5 from Value Line numbers at the top of the page; is that
6 correct?

7 A. That's correct.

8 Q. Mr. Kahal, did you perform a similar analysis in
9 preparing your testimony similar to what you did for
10 dividends?

11 (No response.)

12 MR. GANG: Let me restate the question if I may, Your
13 Honor.

14 BY MR. GANG:

15 Q. What I'd like to ask you, Mr. Kahal, is did you
16 do the calculation that you did for dividends for earnings?

17 A. You mean, did I use the same methodology for
18 earnings as I did for dividends? Is that what you mean?

19 Q. I know that you reported a different methodology
20 in the exhibit, but I want to know, in preparing your
21 testimony, did you do the same calculation that you did for
22 dividends but for earnings?

23 A. No, not for Value Line, I didn't. I noted in my
24 testimony that the Value Line earnings projections appeared
25 to be very, very unstable and I didn't really rely on the

1 Value Line earnings. I heavily discounted the Value Line
2 earnings growth rates in my DCF analysis. They just bounce
3 around too much.

4 Q. Now, Mr. Kahal, in the PPL Cross-Examination
5 Exhibit No. 1, you give us on the response to Interrogatory
6 No. 14 the formula you used to calculate the dividend growth
7 rate from the values you took from the Value Line document;
8 is that correct?

9 A. Yes.

10 MR. GANG: Your Honor, at this time, I would like to
11 have PPL Cross-Examination Exhibit No. 2 identified for the
12 record.

13 JUDGE TURNER: It may be so identified.

14 (Whereupon, the document was marked
15 as PPL Cross-Examination Exhibit
16 No. 2 for identification.)

17 JUDGE TURNER: And let's go off the record while it's
18 distributed.

19 (Discussion off the record.)

20 JUDGE TURNER: Let's go back on the record.

21 BY MR. GANG:

22 Q. Mr. Kahal, I would ask you to accept subject to
23 check that performing the calculations that you performed on
24 PPL-OCA-14 for dividends but applying it to the data for
25 earnings would indicate a 5.67 percent earnings growth rate

1 from the Value Line data.

2 A. Yes. That's for the eight companies. For the
3 ten companies, it's 5.36.

4 Q. Thank you, Mr. Kahal. And just to clarify, I'm
5 accepting it subject to check, of course.

6 A. Of course.

7 Q. Not that I doubt your math, but --

8 A. No, please, let us know if it is not correct,
9 and I think that is the --

10 JUDGE TURNER: If you're going to check, when are you
11 going to give us the answer once you check?

12 THE WITNESS: I should be able to -- I think I can do
13 this by this afternoon or certainly by no later than
14 tomorrow morning.

15 JUDGE TURNER: That sounds good. This afternoon is
16 fine.

17 THE WITNESS: And let counsel know.

18 JUDGE TURNER: That would be good.

19 MR. GANG: Thank you, Mr. Kahal.

20 THE WITNESS: If my batteries don't run out.

21 MR. GANG: I'm sure we have a calculator here. Well,
22 Mr. Moul has a calculator that can do it. I don't.

23 MR. GANG: May I have a moment, Your Honor?

24 JUDGE TURNER: Yes.

25 (Discussion off the record.)

1 JUDGE TURNER: Back on the record.

2 BY MR. GANG:

3 Q. Am I correct, Mr. Kahal, that you have
4 established a cost of equity range based upon your DCF
5 analysis and then used your CAPM analysis as a check?

6 A. That's right.

7 Q. As I recall, you derive some CAPM cost rates, a
8 range of CAPM cost rates from 9 to 10; is that correct?

9 A. About that, yes.

10 Q. I think the top was 9.99 and you rounded it to
11 10.

12 A. The bottom may have been 9.1, but it's in the
13 ballpark of 9 to 10 percent.

14 Q. So is it correct to say that -- and I think you
15 may have already answered this, but I just want to confirm
16 it -- that you did not use the CAPM results to establish
17 your cost of equity range?

18 A. My recommendation is based upon the DCF, that's
19 correct.

20 Q. Now, in your CAPM analysis, you have used a risk
21 free rate of 5 to 5.5 percent; is that correct?

22 A. Yes.

23 Q. And that is based on recent long-term Treasury
24 bills; is that correct?

25 A. I would say that that more or less is where

1 Treasury -- I'm sorry, did you say bills? It's not bills,
2 it's bonds. But long-term Treasury bonds, gosh, going back
3 to maybe late 2003, although I like to focus on the most
4 recent six months, it's been approximately in that range.

5 There have been times when it's been a bit lower than
6 5 percent, but for the vast majority of time since the
7 beginning of this year, it's been in the 5 to 5.5 percent
8 range.

9 Q. And that's what you based your recommendation
10 on, is that not correct, that last six months?

11 A. No. My recommendation is based on the DCF.

12 Q. I'm sorry, yes. I was not clear in my question.
13 That was what you based your determination of the risk free
14 rate for use in the CAPM upon, the data for Treasury bonds
15 over the last approximately six months?

16 A. Yes, although as I indicated, it's also true
17 that they were in that range during the latter part of 2003
18 as well.

19 Q. Can we agree that the Blue Chip consensus
20 forecast for long-term Treasury bonds indicates that they
21 will rise to approximately 6 percent in 2005?

22 A. I don't think that I have that document.

23 Q. I can provide it to you.

24 MR. GANG: One moment, Your Honor?

25 JUDGE TURNER: Yes.

1 (Pause.)

2 JUDGE TURNER: Are you going to show him the
3 document?

4 MR. GANG: I am, Your Honor. I am going to mark this
5 as Cross-Examination Exhibit No. 3.

6 JUDGE TURNER: I think you should show that to Mr.
7 Sparks before you take it to the witness.

8 MR. GANG: I'm sorry, Your Honor?

9 JUDGE TURNER: I think you should show that to Mr.
10 Sparks before you give it to the witness. That's not an
11 interrogatory answer, is it?

12 MR. GANG: That is correct, Your Honor.

13 JUDGE TURNER: It's a completely new document.

14 MR. GANG: And I appreciate you're reminding me of
15 that.

16 (Pause.)

17 MR. GANG: I have to mark these, Your Honor.

18 JUDGE TURNER: Yes. I think we're on the record. It
19 may be marked as PPL Electric Cross-Examination Exhibit No.
20 3.

21 (Whereupon, the document was marked
22 as PPL Cross-Examination Exhibit
23 No. 3 for identification.)

24 JUDGE TURNER: And can we proceed, Mr. Sparks?

25 MR. SPARKS: Yes, and we may object to this exhibit

1 when counsel attempts to move it into the record.

2 JUDGE TURNER: Well, do you want to object to it now?

3 MR. SPARKS: In point of fact, we need our expert
4 witness to examine it prior to our objecting to it.

5 JUDGE TURNER: And your expert witness is Mr. Kahal?

6 MR. SPARKS: That is correct.

7 JUDGE TURNER: So you want him to examine it before
8 he's cross-examined on it?

9 MR. SPARKS: He may look at the document, but we're
10 in a bit of a bind as that goes, so --

11 JUDGE TURNER: Okay. Let's go off the record again
12 here.

13 (Discussion off the record.)

14 JUDGE TURNER: Back on the record.

15 Do you have an objection to this exhibit, Mr. Sparks?

16 MR. SPARKS: If Your Honor will allow Mr. Kahal to
17 examine the document, we would request that the entire
18 report -- it seems to be one page of several reports,
19 there's a 2 up at the top, we are not certain of the origin
20 of this document -- that the entire document come in. And
21 we may object as we see more of what company counsel tries
22 to do with this document.

23 JUDGE TURNER: All right. But at this point, we can
24 go ahead with cross-examination?

25 MR. SPARKS: Yes.

1 MR. GANG: I'm sorry, I couldn't hear the last
2 comment you made, counsel. Would you mind repeating it?

3 JUDGE TURNER: Yes. Even though we have microphones
4 today, it is hard to hear. I apologize for it. I don't
5 know how I can improve the acoustics, but --

6 MR. SPARKS: We should proceed with the cross, if you
7 would, and at the end we could look at the entire document.

8 JUDGE TURNER: He wants to see the entire volume and
9 based on that he may have an objection as I understand it.

10 MR. SPARKS: This document is not a document
11 sponsored by Mr. Kahal. It is not part of a response, so
12 the company is certainly free to use it for purposes of
13 impeachment. However, Mr. Kahal cannot testify to the
14 veracity of anything that this document says and we would
15 object to it being admitted to the record for purposes of
16 proving any statements that are contained within this
17 document.

18 JUDGE TURNER: Okay. Not admitted for the truth, but
19 admitted for cross-examination purposes, and you pointed out
20 that it's number two, so you're assuming that this is part
21 of a series of pages and you want all of those pages.

22 MR. SPARKS: Yes, ma'am.

23 JUDGE TURNER: All right. Did you hear that, Mr.
24 Gang?

25 MR. GANG: I did, Your Honor. I would just like to

1 comment that counsel just provided one of our witnesses with
2 a similar document that she didn't sponsor and cross-
3 examined her on, but they're entitled to object if they
4 wish.

5 BY MR. GANG:

6 Q. Mr. Kahal, are you familiar with Blue Chip
7 forecasts?

8 A. In general I am. I subscribe or the firm
9 subscribes rather to Blue Chip economic forecasts, which is
10 a sister publication. It's of the same family of
11 publications. I don't happen to subscribe to this specific
12 publication. So I'm in general familiar with the Blue Chip
13 organization and what they do.

14 Q. And they attempt to produce consensus forecasts
15 of interest rates, among other things; is that not correct?

16 A. It's more of a survey. To my knowledge, Blue
17 Chip doesn't produce its own forecasts. What it does is it
18 goes out and surveys people who are in the forecasting
19 business and compiles information on their forecasts and
20 then publishes it. That's basically what they do. So
21 they're providing sort of a service that's a convenience.

22 Q. Do you think that they influence investors'
23 expectations of what interest rates may be in the future?

24 A. It's hard to say whether they do or the
25 underlying forecasts do. As I said, they're in the business

1 of just providing a convenience to whoever's interested in
2 this information which may be investors. And I'm sure that
3 some investors look at this information, they look at other
4 information, they may look at the underlying forecasts that
5 go into the survey. So it's all part of the type of
6 information that investors look at and consider.

7 JUDGE TURNER: So your answer would be yes?

8 THE WITNESS: It would be yes in part, yes. Yes,
9 along with a great many other things, yes.

10 JUDGE TURNER: Okay.

11 BY MR. GANG:

12 Q. Now, if we look at the line on this cross-
13 examination exhibit, Treasury note, 20 year, and look at the
14 forecasts in the right hand box for 2005, it would indicate
15 that the forecast is approximately 6 percent for 2005; is
16 that not correct?

17 A. It's a range of 5.8 to 6.1 for the four quarters
18 of 2005.

19 Q. That's accurate.

20 A. And averages to close to 6 percent.

21 Q. Is it conceivable to you that an investor
22 performing a CAPM analysis might use that as their risk free
23 return to determine the cost of equity in 2005?

24 A. Anything is conceivable, Mr. Gang, but -- and I
25 think you stated your question in the singular, an investor.

1 Q. Yes.

2 A. It's conceivable that there is an investor out
3 there who might do it because different investors have
4 different opinions. It would not be correct to say that the
5 average investor would use the 6 percent because that would
6 be completely inconsistent with market evidence.

7 Q. In your opinion, do analysts that make forecasts
8 of earnings like Zacks make any judgments about future
9 interest rates when they forecast earnings?

10 A. Interest rates may play some role. Generally
11 speaking, analysts do not reveal the methodology that they
12 use in formulating their projections of earnings.

13 My belief is that there is a strong element of
14 judgment involved in projecting earnings as well as
15 equations and formulas. But could interest rates be one
16 element that plays into it? It's possible.

17 Q. And specifically, analysts' projections of
18 future interest rates, could that also be a factor in
19 earnings forecasts?

20 A. It could be. It's possible that there might be
21 for some analysts, that among many things that they take
22 into account might be interest rates.

23 I tend to doubt that that would be the most important
24 factor or among the most important factors because I believe
25 that earnings projections tend to be very firm specific,

1 that is it's really driven by the business circumstances of
2 the individual company as being the primary driver.

3 MR. GANG: Thank you, Mr. Kahal.

4 I have nothing further, Your Honor.

5 JUDGE TURNER: Thank you. Is there cross-examination
6 of the witness from any other party?

7 (No response.)

8 JUDGE TURNER: Is there redirect, Mr. Sparks?

9 MR. SPARKS: If we may have a minute, Your Honor?

10 JUDGE TURNER: Yes.

11 MR. GANG: Your Honor, would you like me to move
12 these exhibits now or after redirect?

13 JUDGE TURNER: Just as long as we get them in.

14 MR. GANG: I'll move them right now. I'd like to
15 move for admittance into evidence PPL Cross-Examination
16 Exhibits 1 through 3, and I'd be more than happy to provide
17 the full copy of the document. I will have to make copies
18 of it. I can't do it now, although I can make it available
19 to counsel.

20 JUDGE TURNER: Are you listening? He's moved 1
21 through 3, and he says he can't give you the full copy of
22 the document now but he will provide it later.

23 MR. GANG: I didn't quite say that, Your Honor.

24 JUDGE TURNER: I'm sorry.

25 MR. GANG: I have a copy and if counsel wishes to

1 look at it, I'd be more than happy to provide it to him.

2 JUDGE TURNER: Okay.

3 MR. SPARKS: May we confer for a moment, please, Your
4 Honor?

5 JUDGE TURNER: Yes. Let's go off the record.

6 (Discussion off the record.)

7 JUDGE TURNER: Back on the record.

8 PPL Cross-Examination Exhibits Nos. 1, 2 and 3 are
9 admitted.

10 (Whereupon, the documents marked as
11 PPL Cross-Examination Exhibits Nos.
12 1, 2 and 3 were received in
13 evidence.)

14 JUDGE TURNER: And I believe there is thought being
15 given to whether there's going to be redirect examination.
16 You're still thinking about that?

17 MR. SPARKS: Yes, ma'am.

18 JUDGE TURNER: Okay.

19 MS. POLACEK: Do you want to do redirect before
20 lunch, Your Honor?

21 JUDGE TURNER: I would like to finish this witness
22 before we go to lunch. That is my thought. And we are off
23 the record at this point.

24 (Discussion off the record.)

25 JUDGE TURNER: On the record.

1 Mr. Sparks, do you have redirect examination?

2 MR. SPARKS: Yes, Your Honor, thank you.

3 JUDGE TURNER: All right. Proceed.

4 **REDIRECT EXAMINATION**

5 BY MR. SPARKS:

6 Q. Mr. Kahal, we've been shown PPL Cross-
7 Examination Exhibit No. 2. These calculations were not
8 performed by you; that is correct?

9 A. That is correct. They were performed by or for
10 counsel and then provided to me and I will check the math.

11 JUDGE TURNER: Excuse me. They were performed by
12 who?

13 THE WITNESS: By counsel, by or for counsel.

14 JUDGE TURNER: Okay. And then provided to you?

15 THE WITNESS: And they were provided to me, and I
16 will check the math during the lunch break.

17 JUDGE TURNER: Okay.

18 BY MR. SPARKS:

19 Q. I would just ask that Mr. Kahal clarify which
20 counsel provided the documentation.

21 A. I'm sorry, it was counsel for the company, for
22 PP&LEU.

23 Q. I would also ask, do you think if this method is
24 appropriate for calculating a growth rate?

25 A. It's one way that you could calculate a growth

1 rate. For earnings as opposed to dividends, I don't think
2 it's the best way to calculate the growth rate for a couple
3 of reasons. One is that we really don't know what the
4 earnings are going to be for the company in 2004, so these
5 growth rates are not being calculated off of a known base
6 year. That's the first problem.

7 The second problem, is really the rationale for the
8 Value Line methodology to begin with, and that is that
9 earnings for any given company in any given year can be
10 atypical.

11 And I believe that what Value Line was attempting to
12 do or attempts to do in using a base year averaged over the
13 three most recent historical years is to obtain a somewhat
14 normalized or smoothed base year value for earnings per
15 share. That's why they do it. But this is another way of
16 doing it. I think that utilizing a smooth base year is
17 probably a better way of calculating earnings per share.

18 Q. And in regard to PPL Electric Cross-Examination
19 Exhibit No. 3, why is it you believe that the average
20 investor would not use this information?

21 A. Well, the average investor might look at this
22 information and might factor it in along with anything else
23 that's out there. My point, and what I was trying to
24 explain in the context of the CAPM, is that these forecasts
25 simply don't represent investor expectations.

1 They may play a role in forming investor expectations
2 but they are not investor expectations, and that's simply
3 based upon the notion that markets are efficient.

4 If the long-term or 20 year interest rate today on
5 Treasury bonds is 5 percent, then there may be some
6 investors out there who believe it's going to go up to 6
7 percent in 2005 but that's not a consensus.

8 The consensus would be something close to 5 percent.
9 It doesn't have to be exactly 5 percent, but it would be
10 something close to 5 percent.

11 The reason being is that if there was a consensus
12 among investors, that is let's say they all believe that
13 interest rates over the next year were going to rise by a
14 full percentage point, from 5 percent to 6 percent, that
15 would be equivalent to bond prices, an expectation that bond
16 prices would fall from let's say a value of 100 this year to
17 85 or 90 in 2005.

18 And if you believe that the price of bonds was going
19 to fall, that is within the next year, why in the world
20 would you hold these long-term bonds today?

21 It would make more sense, if you truly believe that
22 bond prices were going to fall, which is the same thing as
23 interest rates going up, for you to be in cash today and
24 therefore hang on to your cash, wait until next year and
25 then purchase those bonds at a lower price.

1 To say that investors have an expectation that
2 interest rates are going to be 6 percent next year would be
3 another way of saying that investors are irrational or that
4 markets are inefficient, neither of which I believe to be
5 true.

6 So I think that investors look at a great many
7 things. I think they're influenced by a great many things,
8 including the forecasting gurus out there, but the best
9 estimate that we have of interest rates -- let me put it a
10 different way -- the best estimate we have of the market's
11 estimate, what the market believes is going to be true about
12 interest rates next year is what interest rates are at the
13 present time.

14 JUDGE TURNER: Didn't Mr. Greenspan say that
15 investors were irrational?

16 THE WITNESS: I think Mr. Greenspan believes that
17 investors are rational. I think that what he was concerned
18 about was unusual events taking place, and this is back in
19 1999 or maybe earlier than that, 1998, during the tech boom,
20 which he thought that the tech boom got out of hand and
21 that's the infamous phrase of irrational exuberance takes
22 place.

23 But I think that when you're talking about very, very
24 liquid markets, well behaved, well understood markets such
25 as Treasury, securities, those markets are clearly efficient

1 markets and therefore investors simply won't hold Treasury
2 bonds today if they think it's going to, if those bonds are
3 going to fall in price within the next year by 10 or 15
4 percent.

5 I look at forecasts too. I make use of them and I
6 consider them in fact in my recommendation. Ultimately, I
7 would caution against substituting speculative forecasts for
8 observable market data, and I think that's the key point.
9 We shouldn't be throwing out market data.

10 JUDGE TURNER: Okay. Mr. Sparks, do you have another
11 question?

12 MR. SPARKS: Thank you, Mr. Kahal. We have nothing
13 further.

14 JUDGE TURNER: All right. Now, what is the
15 resolution on the report from which PPL Cross-Examination
16 Exhibit No. 3 was extracted? Do you want to look at that
17 over lunch and see if you would like the full copy in or --

18 MR. SPARKS: Yes, Your Honor. We would like to
19 examine it over lunch.

20 JUDGE TURNER: Okay. But we can excuse Mr. Kahal
21 now?

22 MR. SPARKS: Yes, Your Honor.

23 JUDGE TURNER: Okay. Thank you, Mr. Kahal.

24 (Witness excused.)

25 MR. GANG: Your Honor, where are we on the exhibits?

1 Have they been admitted subject only to the question of
2 whether the entire document comes in?

3 JUDGE TURNER: Actually, they were admitted, I
4 believe. They didn't make an objection, was my
5 understanding.

6 MR. GANG: I was just clarifying that, Your Honor.

7 JUDGE TURNER: And they're going to continue to see
8 whether they're going to ask for the whole thing to come in.

9 MR. GANG: And that's fine. Counsel, if you don't
10 mind, if you want the whole document to come in, since you
11 have it, would you be kind enough to make copies of it for
12 me?

13 MR. SPARKS: Yes.

14 JUDGE TURNER: Okay. I'd like to take a lunch break
15 now. Let's go off the record while we talk about that.

16 (Discussion off the record.)

17 JUDGE TURNER: Back on the record.

18 It's now, I have almost 12:45, and we'll be back in
19 an hour and a half after lunch which would be -- 2:00? It
20 seems a little late, but we'll be back at 2:00, and we will
21 finish both of those witnesses before we leave today, okay?
22 Thank you all very much. See you later.

23 (Whereupon, at 12:45 p.m., the hearing was adjourned,
24 to be reconvened at 2:00 p.m., this same day.)

25

AFTERNOON SESSION

(2:00 p.m.)

1 JUDGE TURNER: Let's go on the record.

2 This afternoon, we have two witnesses, Mr. Deardorff
3 and Mr. Epstein. And before we begin, I have a question
4 which was deferred from this morning, which is when you
5 moved exhibits in, and I have a list here, not right here
6 but I have a list here which said Exhibit Future 1.
7

8 MR. MacGREGOR: Yes, Your Honor.

9 JUDGE TURNER: And we have Exhibit Future 1 and
10 Exhibit Future 1 Revised.
11

12 MR. MacGREGOR: Yes, Your Honor.

13 JUDGE TURNER: So, which one was moved in?

14 MR. MacGREGOR: Both.

15 JUDGE TURNER: Both?

16 MR. MacGREGOR: They are both on there in a very
17 illogical way. If you look above, the first set of
18 exhibits, at the very bottom, it's actually listed there.

19 JUDGE TURNER: Oh, I see it.

20 MR. MacGREGOR: It's in an illogical place and it's
21 easy to miss.

22 JUDGE TURNER: It is. That must have been why I
23 didn't notice it. Let's make it clear. Exhibit Future 1
24 Revised is to be substituted for Exhibit Future 1 in all of
25 the proceeding?

1 MR. MacGREGOR: Yes. The Exhibit Future 1 Revised is
2 a complete exhibit and it contains all the pages, those that
3 changed and those that did not change. So all references
4 should be to Exhibit Future 1 Revised for briefing purposes.

5 JUDGE TURNER: Okay, and for anything that we want to
6 check on from somebody's testimony or --

7 MR. MacGREGOR: Yes.

8 JUDGE TURNER: I mean, there may be references to it
9 in your witnesses' testimony, Exhibit Future 1, but we
10 should use Exhibit Future 1 Revised?

11 MR. MacGREGOR: That's correct.

12 JUDGE TURNER: Okay. Thank you. Now, let us call
13 Mr. Deardorff.

14 MR. VULLO: Your Honor, before we begin, could I just
15 raise a housekeeping matter?

16 JUDGE TURNER: Yes. Who are you?

17 MR. VULLO: Joe Vullo for CEO.

18 JUDGE TURNER: Joe who?

19 MR. VULLO: Joe Vullo.

20 JUDGE TURNER: How are you, Mr. Vullo?

21 MR. VULLO: Fine. How are you? I represent CEO. I
22 came this afternoon expecting Mr. Dahl to testify but it's
23 my understanding he's been moved to tomorrow.

24 JUDGE TURNER: Yes.

25 MR. VULLO: So while I'm here, I'd like to raise just

1 a couple of matters, to see if any party has cross-
2 examination for CEO Witnesses Brady and Howat. I know the
3 company does. I don't know if any other party does.

4 The other issue, Your Honor, is I intend to introduce
5 into evidence the company's responses to CEO's
6 interrogatories, only Set I and II. I wanted to know if any
7 party has any objection to the admission of those documents
8 through Mr. Dahl. He was the responding witness.

9 MR. MacGREGOR: I do object, Your Honor, on the
10 grounds that I don't think it's appropriate to have
11 wholesale introduction of interrogatory responses into the
12 record. I think the interrogatory responses are supposed to
13 be used to develop the testimony and you attach the ones you
14 want to use, and it's not appropriate -- new issues could be
15 raised that are not raised in testimony.

16 In fact, years ago, I frankly used to do this all the
17 time on behalf of my utility clients and it was roundly
18 objected to, and I think the practice is not to permit
19 wholesale introduction of interrogatory responses into the
20 record.

21 JUDGE TURNER: Well, I don't know about wholesale,
22 but it's certainly true that the answering party cannot
23 introduce interrogatory answers. But Mr. Vullo, I think you
24 should probably just bring them with you and introduce them
25 as you see fit, and if we have an objection, we'll rule on

1 it.

2 MR. VULLO: Okay.

3 JUDGE TURNER: Okay?

4 MR. VULLO: Thank you, Your Honor.

5 JUDGE TURNER: Is that it for preliminary matters?

6 MR. KANASKIE: Your Honor, we still have an issue
7 with Consumer Advocate on possible additional pages before
8 we get to Mr. Deardorff.

9 JUDGE TURNER: Do you want to add additional pages,
10 Mr. Mullins and Mr. Sparks?

11 MR. SPARKS: No, we do not.

12 JUDGE TURNER: No?

13 MR. SPARKS: No, we do not at this point.

14 JUDGE TURNER: Okay. Thank you, Mr. Kanaskie.

15 MR. KANASKIE: You're welcome, Your Honor.

16 JUDGE TURNER: Any other issues that anyone would
17 like to bring up?

18 MR. MULLINS: Your Honor, just one more. We could
19 either handle this now or at the conclusion of the
20 witnesses' appearances.

21 I do have faxed copies of Mr. Catlin's affidavits for
22 both of his statements, so I can either move those into the
23 record now or --

24 JUDGE TURNER: Why don't we do that at the end.

25 MR. MULLINS: Okay, that's fine. Thank you.

1 JUDGE TURNER: Thank you.

2 MR. VULLO: Your Honor, I'm sorry, I forgot one
3 additional issue. As far as Mr. Brady and Mr. Howat are
4 concerned, is it possible to do Mr. Brady after Mr. Dahl
5 tomorrow morning?

6 JUDGE TURNER: Listen, why don't you work out your
7 scheduling issues off the record with the parties? I'd
8 really like to go ahead with testimony.

9 MR. VULLO: Okay, Your Honor.

10 JUDGE TURNER: Please be seated. Okay. Mr.
11 Deardorff? How are you, Mr. Deardorff?

12 MR. DEARDORFF: Very good.

13 JUDGE TURNER: Good.

14 Whereupon,

15 KEVAN L. DEARDORFF

16 having been duly sworn, testified as follows:

17 JUDGE TURNER: And is that also true for your pre-
18 filed testimony and exhibits?

19 THE WITNESS: Yes.

20 JUDGE TURNER: Thank you. Please be seated.

21 Mr. Kanaskie?

22 MR. KANASKIE: Thank you, Your Honor.

23 **DIRECT EXAMINATION**

24 BY MR. KANASKIE:

25 Q. Mr. Deardorff, could you please state your name

1 and position for the record?

2 A. My name is Kevan L. Deardorff, and I'm a fixed
3 utility financial analyst with the Office of Trial Staff.

4 Q. Mr. Deardorff, have you prepared written
5 testimony and exhibits for the purpose of this proceeding?

6 A. Yes.

7 MR. KANASKIE: Your Honors, I have previously
8 distributed to the parties, the court reporter and yourself
9 four documents that have been preliminarily identified as
10 OTS Statement No. 1, the direct testimony of Mr. Deardorff,
11 OTS Exhibit No. 1, OTS Statement No. 1-SR, his surrebuttal
12 testimony, and OTS Exhibit No. 1-SR, the exhibit to
13 accompany his surrebuttal testimony, and I ask that they be
14 marked for identification at this time.

15 JUDGE TURNER: They may be so marked.

16 (Whereupon, the documents were
17 marked as OTS Statements Nos. 1
18 and 1-SR and OTS Exhibits Nos.
19 1 and 1-SR for identification.)

20 MR. KANASKIE: Thank you, Your Honor.

21 BY MR. KANASKIE:

22 Q. Mr. Deardorff, do you have these documents that
23 I just referenced in front of you?

24 A. Yes, I do.

25 Q. Do these documents represent your direct and

1 surrebuttal testimony and accompanying exhibits as
2 represented?

3 A. Yes.

4 Q. Were these documents prepared by you or under
5 your supervision?

6 A. Yes, they were.

7 Q. Do you have any additions or corrections to any
8 of these documents?

9 A. Yes, I have two corrections. On page 27 of my
10 direct testimony, errors are in the Footnote 6. On the
11 first line of the footnote, the three company barometer
12 group should be a nine company barometer group, and the 2.27
13 should read 1.54. In the second line, it's --

14 JUDGE TURNER: Hold on a minute. What was your first
15 correction? I have the 1.54, but --

16 THE WITNESS: Okay. The three company barometer
17 group should read nine company barometer group.

18 JUDGE TURNER: Oh, okay. Thank you.

19 THE WITNESS: The second line, the seven company
20 barometer group should read six company, and the 2.48 should
21 read 1.62. And the source should be Value Line Investment
22 Survey, March 5, 2004.

23 JUDGE TURNER: Is this the way you originally
24 calculated it or are you changing your testimony after
25 recalculating it?

1 THE WITNESS: No. It was an error that was reflected
2 in the water group from the last --

3 JUDGE TURNER: Ah, cutting and pasting, okay. What
4 date, March 5th?

5 THE WITNESS: Yes.

6 JUDGE TURNER: Mr. Kanaskie, are there more
7 corrections?

8 MR. KANASKIE: I believe there's one more.

9 THE WITNESS: Yes. On the exhibit, OTS Exhibit No.
10 1, Schedule 4, page 4, under column 1, line 9, Pepco
11 Holdings --

12 JUDGE TURNER: Excuse me. OTS Exhibit No. 1, I have
13 two pages.

14 THE WITNESS: OTS Exhibit No. 1, Schedule No. 4, page
15 4 of 4, line 9, Pepco, the growth rate for Pepco should be
16 35 percent rather than 3.5 percent.

17 JUDGE COLWELL: Could you give us that number again,
18 please?

19 THE WITNESS: The growth rate for Pepco Holdings for
20 Value Line dividend growth, column 1, should be 35 rather
21 than 3.5.

22 JUDGE COLWELL: Thank you.

23 JUDGE TURNER: I found it, thank you.

24 THE WITNESS: Which changes the averages for line 10
25 and line 11. The nine company average is 6.83 and the --

1 JUDGE TURNER: Instead of 3.38?

2 THE WITNESS: 6.83.

3 JUDGE TURNER: Right.

4 THE WITNESS: And the six company average is 7.83.

5 MR. GANG: 7.83, Mr. Deardorff?

6 THE WITNESS: Yes.

7 MR. GANG: Thank you.

8 BY MR. KANASKIE:

9 Q. Mr. Deardorff, with these changes, if I were to
10 ask you the questions contained in your direct and
11 surrebuttal testimony and accompanying exhibits, if I were
12 to ask you those questions again today, would your answers
13 be the same?

14 A. Yes, they would.

15 Q. Would your answers be true and correct to the
16 best of your knowledge and belief?

17 A. Yes.

18 MR. KANASKIE: Your Honor, at this time, the Office
19 of Trial Staff requests that these documents that have been
20 marked for identification be admitted into the record
21 subject to timely motions to strike by the parties and
22 cross-examination by all parties.

23 JUDGE TURNER: They may be so admitted.

24 (Whereupon, the documents marked as
25 OTS Statements Nos. 1 and 1-SR and

1 OTS Exhibits Nos. 1 and 1-SR were
2 received in evidence.)

3 MR. KANASKIE: Thank you, Your Honor. Mr. Deardorff
4 is available for cross-examination.

5 JUDGE TURNER: Did we establish his name and his
6 employment or are you relying on the testimony for that?

7 MR. KANASKIE: I'm sorry, Your Honor?

8 JUDGE TURNER: I said, did you establish the correct
9 spelling of his name and his employment or are you relying
10 on the testimony for that? It is in here.

11 MR. KANASKIE: Yes, I believe it is.

12 JUDGE TURNER: Okay. And that would be Mr. Gang?

13 MR. GANG: Yes, Your Honor, if you're ready for me.

14 **CROSS-EXAMINATION**

15 BY MR. GANG:

16 Q. Good afternoon, Mr. Deardorff.

17 A. Good afternoon, Mr. Gang.

18 Q. Mr. Deardorff, on page three of your surrebuttal
19 testimony, starting in the area of lines 8 through 15, you
20 talk about the company's bond rating. Would you agree that
21 it would be appropriate for PPL Electric to strive to
22 improve its bond rating from A-minus to "A"?

23 A. Yes. That typically is the standard which the
24 Commission looks to for a well run utility.

25 Q. Would you also agree that currently, PPL

1 Electric is under credit watch or has been warned by S&P
2 that if it does not improve its credit ratios, it may be
3 further downgraded?

4 A. Yes.

5 Q. Now, on page three, line 11, you suggest that
6 the reason PPL cannot achieve an "A" bond rating is that for
7 a company with a business position of four, it doesn't have
8 enough equity. Is that a fair statement of your testimony
9 there?

10 A. Yes. According to these criteria set forth by
11 Standard & Poor's, the range as I said there requires a
12 higher equity ratio.

13 MR. GANG: At this time, Your Honor, I'd like to have
14 PPL Cross-Examination Exhibit No. 4 identified for the
15 record.

16 JUDGE TURNER: It may be so identified.

17 (Whereupon, the document was marked
18 as PPL Cross-Examination Exhibit
19 No. 4 for identification.)

20 (Pause.)

21 JUDGE TURNER: Are all parties ready for us to
22 proceed?

23 MR. GANG: We'll get the reporter a couple more
24 copies here, Your Honor.

25 JUDGE TURNER: Thank you.

1 MR. GANG: You didn't get one, either?

2 (No response.)

3 MR. GANG: You're not very good at this.

4 MR. MacGREGOR: Well, you only gave me five copies.

5 (Laughter.)

6 JUDGE TURNER: He has other job duties that he
7 performs well.

8 (Laughter.)

9 MR. GANG: I had eight of them. Where did they all
10 go?

11 JUDGE TURNER: Okay. Does every party have a copy of
12 this, every party who is going to cross-examine have a copy
13 of this? Those who do not can get a copy later. Apply to
14 Mr. MacGregor directly.

15 MR. MacGREGOR: I'll do better next time, Your Honor.

16 JUDGE TURNER: Okay. So, Mr. Kanaskie, you have a
17 copy?

18 MR. KANASKIE: Yes.

19 JUDGE TURNER: Do you want some time to review it
20 before we go ahead?

21 MR. KANASKIE: If you could give me a moment.

22 JUDGE TURNER: Surely. Let me just check, the
23 witness has a copy?

24 THE WITNESS: Yes.

25 JUDGE TURNER: Okay. Let's go off the record.

1 (Discussion off the record.)

2 JUDGE TURNER: Back on the record.

3 Mr. Gang?

4 MR. GANG: Thank you, Your Honor.

5 BY MR. GANG:

6 Q. Mr. Deardorff, if you would refer to page three
7 of this document, first let me ask you, I believe that you
8 confirmed to me informally that you have seen this document
9 before?

10 A. Yes.

11 JUDGE TURNER: Page three is the one with the table
12 of revised financial guidelines?

13 MR. GANG: That is correct, Your Honor. That is the
14 one to which I'm referring.

15 BY MR. GANG:

16 Q. Now, at the bottom of the page, the criteria of
17 total debt to total capital is shown and down in the left
18 hand column of the page you see business profile. Now, for
19 a company with a business profile of four, does this not
20 indicate that the debt ratio must be between 45 and 52
21 percent?

22 A. Well, unfortunately, that's different than the
23 one that Mr. Moul sent to me, this one right here. That's
24 where I took the numbers from.

25 JUDGE TURNER: Okay. So you haven't seen this --

1 THE WITNESS: It's not in this document. It was
2 attached to the document that he referred me to when I
3 telephoned him.

4 JUDGE TURNER: Okay. So you haven't seen this
5 before?

6 THE WITNESS: It's a different document that I took
7 my numbers from, and it's dated June 21st. That was the
8 one, what you referred me to. So apparently they changed
9 the numbers.

10 JUDGE TURNER: But your answer to the question, have
11 you seen this document before --

12 THE WITNESS: Yes, I have seen this document --

13 JUDGE TURNER: -- the answer is no? No, you're
14 seeing it for the first time today?

15 THE WITNESS: No.

16 JUDGE TURNER: Okay. Will you explain?

17 THE WITNESS: Mr. Moul discussed this with me and he
18 said it was an attachment to the interrogatories in York, so
19 I referred to the York testimony in order to look at this.
20 So I did see it before.

21 JUDGE TURNER: York Water Company?

22 THE WITNESS: Yes.

23 JUDGE TURNER: But you used different numbers?

24 THE WITNESS: Well, the attachment on there was
25 different. He had more information on that interrogatory

1 response.

2 MR. GANG: Are you done, Your Honor? I don't want to
3 interfere.

4 JUDGE TURNER: I guess so. I'm struggling a little
5 bit with --

6 BY MR. GANG:

7 Q. Let's go back to the document. The document
8 that I provided to you as PPL Cross-Examination Exhibit No.
9 4 is a Standard & Poor's document published June 2, 2004; is
10 that correct?

11 A. Yes.

12 Q. And admitting that there could be some confusion
13 here, can we agree that at least this document appears to
14 indicate that if you have a business profile of four, you
15 can achieve an "A" rating with a 45 to 52 percent equity
16 ratio?

17 A. Yes, that is correct.

18 Q. Now, so, Mr. Deardorff, the company with its
19 current or at least projected debt ratio of 51.3 percent
20 could achieve an "A" bond rating if it otherwise met the
21 credit criteria?

22 A. It would be at the very top end of the range of
23 52 percent. That is correct.

24 Q. Now, Mr. Deardorff, is it not true that if the
25 Commission were to adopt your 9 percent return

1 recommendation, return on equity recommendation, that the
2 company, even if it was able to earn 9 percent, would not
3 have sufficient earnings to meet the credit profile of "A"?

4 A. Not using their capital structure that they are
5 recommending. No, that is correct.

6 Q. Well, didn't we just establish that they're
7 recommending a capital structure of 45 to 52 percent?

8 A. It would be at the top end of the range, but in
9 order to fairly achieve an "A" rating, they should be at the
10 midpoint of that range.

11 Q. Is that the only credit criteria? I mean --

12 A. No, but those are the two important, main
13 criteria.

14 Q. What is the other one besides --

15 A. Coverage. And changing the capital structure
16 does change the coverage ratio. They are intertwined.

17 MR. GANG: One moment, Your Honor.

18 (Pause.)

19 BY MR. GANG:

20 Q. Is it correct that there is no coverage criteria
21 in these S&P criteria any longer?

22 JUDGE TURNER: I'm sorry. Your question was, is
23 there --

24 MR. GANG: That S&P no longer includes a coverage
25 criteria.

1 THE WITNESS: Well, not in this document, but I find
2 it very hard to believe that they would drop that as a
3 criteria. I've seen no document that says that they do not
4 look at that any more.

5 BY MR. GANG:

6 Q. Looking at the criteria on this page and
7 assuming that they are accurate, PPL would meet the total
8 debt to total capital criteria; is that correct?

9 A. Just barely.

10 Q. Would it meet the other criteria on this page if
11 it earned your recommended return on equity of 9 percent?

12 A. No. I already answered that, not given their
13 current capital structure.

14 Q. I understand your answer.

15 JUDGE TURNER: We're still referring to page three?

16 MR. GANG: That is correct, Your Honor. Actually,
17 I'm done with it, I think.

18 BY MR. GANG:

19 Q. Now, referring to your comments on the company's
20 current equity ratio, if the company's equity ratio were
21 higher in this case, would that increase the revenue
22 requirement?

23 A. Yes.

24 Q. Couldn't the same result in terms of meeting the
25 S&P criteria be achieved by allowing the company a higher

1 return on equity at the projected equity ratio?

2 A. That's one possibility, that's true.

3 Q. Thank you, Mr. Deardorff. And did you not on
4 page 21 of your direct testimony -- if you want to go there,
5 I'll give you a second -- recommend that the company be
6 afforded the low end of your equity recommendation, 8.75,
7 because it had a higher equity ratio than the barometer
8 group?

9 A. Yes. That is true.

10 Q. I guess what I'm confused about, Mr. Deardorff,
11 is on one hand you're saying the company can't get an "A"
12 bond rating because it doesn't have a high enough equity
13 ratio, but then in your direct testimony you're reducing the
14 return further because it has a higher equity ratio. I
15 mean, it seems to me like a Catch-22.

16 MR. GANG: Maybe that's not a question, Your Honor.

17 BY MR. GANG:

18 Q. But I'm confused by your statements. They seem
19 contradictory to me. Should the company be increasing its
20 equity ratio or not?

21 A. Yes. In response to a Standard & Poor's recent
22 increase in the risk profile, the company should strive to
23 satisfy the requirements in order to maintain an "A" rating.

24 Q. Do you still believe that -- well, let me take
25 this another step further. Now, in your surrebuttal you

1 have changed your recommendation from 8.75 to 9 as a return
2 on equity; is that correct?

3 A. That is correct.

4 Q. Can you explain to me what caused you to change
5 that recommendation?

6 A. Updates in the growth rates and dividend yields.
7 As a result, the DCF was higher than in my original
8 testimony.

9 Q. What I'd like to do is compare your DCF results
10 as shown in your exhibits to your surrebuttal and your
11 direct testimony. And I'll give you those references here
12 in a second. In your direct testimony, looking at the six
13 electric companies, the two references I would draw your
14 attention to are your Schedule 4, page 1 of 4, and I think
15 the correct reference in your surrebuttal is Schedule 2,
16 page 1 of 4.

17 JUDGE TURNER: Schedule 2, what?

18 MR. GANG: Schedule 2, page 1 of 4.

19 THE WITNESS: Yes, that is correct.

20 BY MR. GANG:

21 Q. Those are comparable numbers; is that correct?

22 A. Yes.

23 MR. GANG: Let me know when you're ready, Your Honor.

24 JUDGE TURNER: We're ready.

25 BY MR. GANG:

1 Q. Okay. Comparing those sets of numbers, for the
2 52 week average, the dividend yield is approximately the
3 same; is that correct?

4 A. Approximately, yeah. It's off by one basis
5 point.

6 Q. And for the 52 week average calculation, the
7 associated growth rate is about 23 basis points higher?

8 A. Yes.

9 Q. And similarly for the spot price, the dividend
10 yield in your surrebuttal has declined?

11 A. That is correct.

12 Q. And you have also increased the growth rate to
13 4.13 percent?

14 A. That is correct.

15 Q. Now, I don't see a lot of variation here in
16 these numbers, quite frankly, Mr. Deardorff. I'm trying to
17 understand what it is that caused you to increase your
18 recommendation.

19 A. The DCF is higher in my updated numbers than in
20 my original testimony.

21 Q. Did you change your range, cost of equity range?

22 A. No. Well, yes, I did. It's obvious that since
23 the six company barometer group has a higher return, the
24 range is now higher. I didn't specifically state what it
25 was. I based my primary recommendation upon the six company

1 barometer group, and the average there is 9.05.

2 Q. Hence my question. What is your new range?

3 A. Well, based upon that, it would most likely be
4 between 9 and 9.25.

5 Q. Okay. Then if your range is 9 to 9.25, are you
6 still recommending the bottom end of the range because PPL
7 Electric has more equity than the barometer group?

8 A. Yes.

9 Q. Am I correct that you have employed only a DCF
10 analysis in arriving at your recommendation of the cost of
11 common equity?

12 A. That is correct.

13 Q. Can you, Mr. Deardorff, conceive of any
14 circumstances where a DCF analysis would understate the cost
15 of equity?

16 A. No, mainly because it's based upon investors'
17 expectations, unless of course you could show that the
18 analysts are biased in some way.

19 Q. Assuming it is correctly done. I'm not
20 suggesting you're biased, Mr. Deardorff. Assuming it is
21 correctly performed, you can conceive of no way that the DCF
22 analysis just mis-specified the cost of equity?

23 A. No.

24 Q. Now, can we agree that the DCF analysis depends
25 largely on the analysts' judgment or the investors' judgment

1 of the forecast in earnings?

2 A. Yes.

3 Q. Really, more accurately, the forecast in growth,
4 and you have chosen in your analysis to rely on forecasted
5 earnings; is that true?

6 A. That is correct.

7 Q. Is it possible that analysts are being very
8 conservative about projected growth rates, given the
9 uncertainties based by electric companies these days?

10 A. I can't answer that because I don't know what's
11 in analysts' minds. The numbers reported are what the
12 numbers are.

13 Q. But you would concede that analysts could be
14 wrong about projected growth rates?

15 A. Well, yes. I pointed that out in my surrebuttal
16 testimony, that Value Line did make a few errors in their
17 forecasted dividend growth rate.

18 Q. Actually, that brings me to my next subject. On
19 page five of your testimony, surrebuttal testimony, top of
20 the page, you are talking about Value Line's calculation of
21 the Duquesne Light dividend growth rate; is that correct?

22 A. That is correct.

23 Q. And on line eight, you refer to Value Line's
24 perverse methodology of factoring in a decrease that
25 occurred in 2002; is that correct?

1 A. Yes. Their methodology utilizes not only
2 forecasts but also they go back a few years. It's a
3 smoothing technique.

4 JUDGE TURNER: What technique, smoothing?

5 THE WITNESS: A smoothing technique.

6 JUDGE TURNER: Thank you.

7 BY MR. GANG:

8 Q. Does Value Line use the same methodology to
9 calculate its projected earnings growth rates?

10 A. Yes.

11 Q. And did you use this methodology in your
12 Schedule 4, page 4 --

13 A. Yes.

14 Q. -- in arriving at your estimated growth rate?

15 A. Yes. I gave Value Line one-quarter weight, but
16 I also examined whether or not there were any peculiar
17 factors like this in that data.

18 Q. And did you not testify in direct testimony that
19 the purpose of using a barometer group was to smooth out
20 aberrations for a specific company?

21 A. Yes. That technique can smooth out small
22 variations, but whenever you get very large variations such
23 as that 35 percent growth in dividends, it's too large. It
24 just doesn't smooth something that large out.

25 Q. To what extent if any does your recommendation

1 reflect projections of increasing interest rates?

2 A. To the extent that investors are well aware of
3 those projections and price it into the price of the six
4 companies in my barometer group.

5 MR. GANG: Could I have one moment, Your Honor?

6 JUDGE TURNER: Yes.

7 (Pause.)

8 BY MR. GANG:

9 Q. Mr. Deardorff, would you be kind enough to refer
10 to your Schedule 3 of your original exhibit, OTS Exhibit No.
11 1?

12 A. Yes, I have that.

13 Q. Now, if you would see under the column, Moody's
14 Aaa corporate bond yields, you have forecast on line --

15 JUDGE TURNER: Excuse me, Mr. Gang. Could you wait
16 for me to catch up with you?

17 MR. GANG: I'm sorry.

18 JUDGE TURNER: I'm sorry. So where are we?

19 MR. GANG: We are on Mr. Deardorff's original
20 exhibit, which is Exhibit 1, Schedule 3, Your Honor.

21 JUDGE TURNER: Thank you. I was only one page away.
22 Thank you very much.

23 BY MR. GANG:

24 Q. Looking at the column entitled Moody's Aaa
25 corporate bond yields and lines 24 through 29, those in fact

1 are the Blue Chip financial forecasts as of June, 2004; is
2 that correct, Mr. Deardorff?

3 A. That is correct.

4 Q. And in fact, they are forecasting or, as I think
5 Mr. Kahal explained this morning, that's a kind of survey of
6 economists' forecasts of interest rates; is that correct?

7 A. That is correct.

8 Q. So we're seeing at least forecast indicate a
9 rise in the Aaa bond yield of about .9 or 90 basis points,
10 from 6 to 6.9 from the second quarter of 2004 to the third
11 quarter of 2005?

12 A. Yes. And as he also pointed out, that they are
13 analysts, forecasters, and that it's just one factor that
14 investors take into consideration when they're pricing
15 equities.

16 Q. So is it your opinion that those forecasts are
17 built into your 9.0 percent ROE recommendation?

18 A. Yes, if in fact they come true. It's been my
19 experience that the Blue Chip financial forecasts have a
20 slight bias upwards. Even over the past 20 years when
21 interest rates were falling, the majority of times they were
22 forecasting interest rates to go up.

23 And in fact, over the last three years, interest
24 rates have gone sideways and they've been forecasting
25 interest rates to go up.

1 Q. Now, you also said in -- assuming that an
2 investor believes that interest rates are going to rise and
3 you're telling me it's in your DCF calculation, does that
4 suggest to you that the cost of equity today is something
5 less than 9 percent?

6 A. No.

7 Q. So it will still be 9 percent when interest
8 rates are 6.9 percent and it's 9 percent today when interest
9 rates are 6 percent?

10 A. In the future, if interest rates do go up, most
11 likely the cost of equity will climb, too.

12 Q. Oh, so then your recommendation of 9 percent
13 does not reflect --

14 A. It reflects --

15 Q. -- higher interest rates?

16 A. -- the probability that investors place upon
17 those forecasts. It's partially in the statistics. As the
18 financial press reports, the futures puts probabilities on
19 factors that are going to happen in the future and they
20 price that into their prices, much the same way that
21 investors view these numbers and they put probabilities on
22 it and price it into the prices of utility stocks.

23 Q. I gathered from your comments that you don't
24 believe interest rates are going to rise.

25 A. No.

1 Q. So it's a fair --

2 A. Well, I have to qualify that. Short-term
3 interest rates may come back into equilibrium. As I pointed
4 out in my original testimony, the Fed funds rate has been
5 extraordinarily kept down low in order to get the economy
6 moving, to the point where short-term investors are earning
7 a negative rate of return.

8 And the Federal Reserve chairman will most likely
9 bring that number back up to where it's in the normal range.
10 But that increase is already priced in, according to the
11 financial press, into current prices of equities and debt,
12 long-term prices.

13 Q. For the benefit of the record, by saying
14 investors and short-term interest rates are achieving a
15 negative return, what you're talking about is the yield on
16 short-term rates minus inflation is negative; is that
17 correct?

18 A. Yes.

19 Q. So that on a post-inflation basis, if you're
20 investing in a short-term security, you're currently earning
21 negative amounts --

22 A. Yes.

23 Q. -- after inflation?

24 A. That is correct.

25 Q. And as I think you characterize that in your

1 direct testimony, that is not sustainable and --

2 A. Exactly. I've been expecting the Fed to raise
3 short-term rates all along, but I also believe that that's
4 already priced into long-term rates.

5 MR. GANG: One moment, Your Honor?

6 JUDGE TURNER: Yes.

7 (Pause.)

8 BY MR. GANG:

9 Q. When investors anticipated in April of this year
10 that the Fed was going to begin to increase short-term
11 rates, did not long-term rates rise as well?

12 A. Yes, they went up, but they're already back
13 down. You'd be surprised, if you looked at the 10 year and
14 the 30 year bond, the interest rate on it is exactly where
15 it was one year ago. It's been basically flat.

16 Q. But you just told me that it is reasonable to
17 anticipate that short-term rates will rise and in fact the
18 last time investors anticipated short-term interest rates
19 were going to rise and in fact they did, long-term rates
20 rose as well, did they not?

21 A. Yeah, it was like a knee jerk reaction. They
22 overemphasized the impact of a slight increase in the Fed
23 funds rate.

24 Q. In your testimony, your surrebuttal testimony,
25 you suggest that inflation is not likely to increase. Is it

1 possible that interest rates can rise, both short- and long-
2 term interest rates, even if inflation doesn't increase?

3 A. It's possible.

4 Q. On page six of your surrebuttal testimony, lines
5 four through nine, you indicate that Ms. Cannell is
6 proposing a higher than normal equity return. Can you tell
7 me where she said that?

8 A. She didn't say that in so many words but that
9 was the flavor of her testimony.

10 Q. Are you concluding that from her testimony that
11 she said investors expect equity allowance in the 10 to 12
12 percent range, and you were recommending 9? I mean, is your
13 statement based upon the fact that her statements about
14 investor expectations are higher than your recommendation?

15 A. No. I wasn't referring to investor
16 expectations. I was referring to her recommendation there.

17 Q. And you cannot identify -- in your opinion, has
18 Ms. Cannell made an equity recommendation in this
19 proceeding?

20 A. No. She was just providing support for Mr.
21 Moul's recommendation.

22 MR. GANG: Thank you, Mr. Deardorff.

23 I have no further questions, Your Honor.

24 JUDGE TURNER: Okay. Do any other counsel have
25 questions for this witness?

1 (No response.)

2 JUDGE TURNER: Okay. I just have one question, Mr.
3 Deardorff. What is the relationship between interest rates
4 and equity rates?

5 THE WITNESS: Well, over the long term, there is
6 close to a one to one relationship. From time to time, it
7 does not track, but they are very competitive.

8 JUDGE TURNER: Competitive?

9 THE WITNESS: Yes. Both equity and debt is very
10 competitive. It's all in the capital markets, and
11 investors, corporations are competing for investors' money.

12 JUDGE TURNER: So when interest rates go up, equity
13 rates go down?

14 THE WITNESS: No, they go up.

15 JUDGE TURNER: Equity rates go up?

16 THE WITNESS: Right.

17 JUDGE TURNER: Okay. And did you factor that
18 relationship into your calculation --

19 THE WITNESS: Yes.

20 JUDGE TURNER: -- of the equity rate?

21 THE WITNESS: I believe I have because investors are
22 well aware, they have expectations of where interest rates
23 are going. And when they know where they're going, they'll
24 price the equities at the appropriate level in order to set
25 the required rate of return in the DCF at the appropriate

1 level.

2 JUDGE TURNER: Okay. So what you're saying is that
3 the numbers that you have used from the market already
4 reflect the interest rates? You haven't used a separate
5 calculation for interest rates?

6 THE WITNESS: That is correct.

7 JUDGE TURNER: Okay. Thank you.

8 Mr. Kanaskie, do you have redirect?

9 MR. KANASKIE: If I may have a moment?

10 JUDGE TURNER: Sure. We're off the record.

11 (Discussion off the record.)

12 JUDGE TURNER: Back on the record.

13 Do you have any redirect?

14 MR. KANASKIE: We have no redirect, Your Honor.

15 JUDGE TURNER: Okay, thank you. Then this witness
16 may be excused?

17 MR. KANASKIE: Yes, Your Honor.

18 (Witness excused.)

19 JUDGE TURNER: Thank you very much, and we have moved
20 in your exhibits, or they have already been moved in?

21 MR. KANASKIE: Yes, Your Honor.

22 JUDGE TURNER: No question they're in the record,
23 right?

24 MR. KANASKIE: It is my understanding, yes.

25 MR. GANG: Your Honor, I would like to move for

1 admission of PPL Electric Cross-Examination Exhibit No. 4.

2 JUDGE TURNER: Not hearing any objection, it is
3 admitted.

4 (Whereupon, the document marked as
5 PPL Cross-Examination Exhibit No. 4
6 was received in evidence.)

7 JUDGE TURNER: Do you have anything else, Mr. Gang?

8 MR. GANG: I do not, Your Honor. Thank you for your
9 patience.

10 JUDGE TURNER: Okay. And Mr. Kanaskie, do you have
11 anything else on this subject?

12 MR. KANASKIE: No, Your Honor, I do not.

13 JUDGE TURNER: Okay. Thank you. I think that
14 completes our rate of return witnesses; is that correct?

15 MR. GANG: That is correct, Your Honor.

16 JUDGE TURNER: Okay. And we're turning to Mr.
17 Epstein. Why don't we take a brief ten minute break. Off
18 the record.

19 (Recess.)

20 JUDGE TURNER: Let's go back on the record.

21 The next witness that we are scheduled to hear from
22 is Eric Epstein. Correct me, do you pronounce your name
23 Epstein (ep-STEEN) or Epstein (ep-STINE)?

24 MR. EPSTEIN: Epstein (ep-STINE).

25 JUDGE TURNER: Epstein (ep-STINE), okay. I'll try to

1 do that from now on.

2 I understand there is a motion to strike portions or
3 all of the testimony?

4 MR. MacGREGOR: Portion, Your Honor.

5 JUDGE TURNER: Portion. Should we do that before I
6 swear him in?

7 MR. MacGREGOR: Whatever you prefer.

8 JUDGE TURNER: Okay. Will you raise your right hand?
9 Whereupon,

10 ERIC JOSEPH EPSTEIN
11 having been duly sworn, testified as follows:

12 **DIRECT TESTIMONY**

13 JUDGE TURNER: And do you apply that also to your
14 former testimony, pre-filed testimony?

15 THE WITNESS: Yes, I do.

16 JUDGE TURNER: All right. Please be seated.

17 THE WITNESS: Do you want me to move, to proceed
18 before we --

19 JUDGE TURNER: Beg your pardon?

20 THE WITNESS: I have documents pre-marked as Epstein
21 1 and as Epstein 1 Surrebuttal. I was just going to proceed
22 to try and introduce them before we discuss whether or not
23 they're going to be stricken. I didn't know what you wanted
24 to --

25 JUDGE TURNER: Why don't you wait and see?

1 THE WITNESS: That's what I was going to wait and
2 see.

3 JUDGE TURNER: Okay.

4 THE WITNESS: I'm anxious.

5 JUDGE TURNER: I can tell. Will you state your name
6 and spell it for the record?

7 THE WITNESS: Eric Joseph Epstein, Eric, E-R-I-C,
8 Joseph, J-O-S-E-P-H, Epstein, E-P-S-T-E-I-N.

9 JUDGE TURNER: And what is your address?

10 THE WITNESS: 4100 Hillsdale Road, Harrisburg, PA,
11 17112.

12 JUDGE TURNER: And you are a customer of PPL?

13 THE WITNESS: Yes.

14 JUDGE TURNER: Okay. And you have previously
15 submitted direct testimony and surrebuttal testimony?

16 THE WITNESS: Yes.

17 JUDGE TURNER: And there are no separate exhibits?

18 THE WITNESS: There are exhibits embedded in the
19 testimony.

20 JUDGE TURNER: Okay. And how do you wish to mark
21 them?

22 THE WITNESS: I'd like to mark the direct testimony
23 as Epstein Statement 1 and the surrebuttal testimony as
24 Epstein 1-S. I did have two documents of those pre-marked,
25 Epstein Statement 1 and Epstein Statement 1-S which I did

1 submit to the court reporter.

2 JUDGE TURNER: Okay.

3 (Whereupon, the documents were
4 marked as Epstein Statement No. 1
5 and Epstein Statement No. 1-S for
6 identification.)

7 THE WITNESS: They were previously provided to you
8 and to the rest of the parties.

9 JUDGE TURNER: Now, I understand that there has been
10 and we have discussed, at least established that there's
11 been a motion to dismiss portions of the testimony. Mr.
12 MacGregor, do you want to tell us what portions you're
13 trying to strike?

14 MR. MacGREGOR: Yes, Your Honor. It is the testimony
15 contained in Section "K" of the direct testimony at pages 20
16 and 21, and then testimony on the same issue in Statement
17 Epstein 1-S, Section II(1) at pages two through seven.

18 JUDGE TURNER: What is it you want to strike on page
19 two?

20 MR. MacGREGOR: Of the surrebuttal?

21 JUDGE TURNER: Yes.

22 MR. MacGREGOR: Yes. My surrebuttal testimony as it
23 printed out starts at the top of page two with the heading,
24 II, surrebuttal testimony, sub 1, property tax appeals.

25 JUDGE TURNER: Okay. That's on page three for me.

1 THE WITNESS: It's II, page three?

2 JUDGE TURNER: Yes.

3 MR. MacGREGOR: It has page two on the top of mine.

4 JUDGE TURNER: All right. So why don't we identify
5 it that way. You want to strike II of surrebuttal
6 testimony, 1, property tax appeals.

7 MR. MacGREGOR: Yes.

8 JUDGE TURNER: And the following text to --

9 (Pause.)

10 MR. MacGREGOR: That entire section, and then the
11 next part of the testimony that begins Section 2, AMR
12 displacement costs, I am not moving to strike.

13 JUDGE TURNER: So that would be up to and through the
14 bullet, real estate tax dispute is settled, and that is on
15 page eight in the testimony document that I have, so we're
16 talking about three through eight in this text.

17 Is this the page numeration in the copy you submitted
18 to the court reporter?

19 THE WITNESS: The copy that you have is the same copy
20 I have. I'm not sure what happened --

21 JUDGE TURNER: Well, I want to know what the court
22 reporter has, because that's what will be in the record for
23 the Commission to review.

24 THE WITNESS: I made you an extra copy --

25 JUDGE TURNER: Okay.

1 THE WITNESS: -- of what I just handed to the court
2 reporter.

3 JUDGE TURNER: I just want to know --

4 THE WITNESS: Dave, I have an extra copy for you,
5 too.

6 JUDGE TURNER: Okay. Let's go off the record to get
7 this straight.

8 (Discussion off the record.)

9 JUDGE TURNER: Back on the record.

10 We will be referring to a version of this document
11 which has the material that PPL finds offensive on pages
12 three through eight of the surrebuttal testimony and that is
13 the pagination on the document submitted to the court
14 reporter for surrebuttal testimony.

15 Now, do you want to proceed to discuss your motion?

16 MR. MacGREGOR: Yes, Your Honor. This testimony in
17 the direct and surrebuttal testimony focuses on the level of
18 real estate taxation on PPL Corporation's generating plants.

19 The generating plants are not owned by PPL Electric
20 Utilities. They were spun out of the electric utility after
21 the Commission's restructuring proceeding. They are now
22 owned by a separate corporation, PPL Generation Company, who
23 is responsible for paying the real estate taxes on those
24 plants.

25 No part of those taxes on those generating plants is

1 being requested or recovered in any portion of PPL
2 Electric's transmission and distribution rates that are at
3 issue in this proceeding.

4 This proceeding is about a proposal to increase the
5 transmission and distribution rates of PPL Electric. This
6 testimony presented by Mr. Epstein relates to the level of
7 local real estate taxation on generating plants that are not
8 owned by PPL Electric nor are any portion of the costs of
9 those claimed as part of the transmission and distribution
10 rates in this case.

11 We therefore believe the testimony is irrelevant in
12 any determination of just and reasonable transmission and
13 distribution rates and therefore should be stricken.

14 JUDGE TURNER: Okay. And these tax rates and taxes
15 are not, as you've said before, included at all in the
16 calculations in this case?

17 THE WITNESS: That is correct.

18 JUDGE TURNER: Okay. Mr. Epstein, do you have a
19 response?

20 THE WITNESS: Yeah, I do have a response. Actually,
21 I have a written response. It may be easier. I anticipated
22 PP&L's motion to strike.

23 I think the problem is that based on the testimony
24 and based on information that I've ascertained, is that PPL
25 Electric Utilities was in fact a generating company through

1 2001. I'll briefly address that right now, if I may.

2 JUDGE TURNER: Okay.

3 THE WITNESS: First of all, I want to agree with Mr.
4 MacGregor's statement yesterday during his cross-examination
5 of Mr. Weakley regarding Isabel recovery, and think it's
6 germane to what I'm trying to say today, and that is I think
7 Mr. MacGregor opposed a ten year recovery period because
8 bills should be paid on time. Money has value.

9 I would also understand that some of my evaluations
10 or recommendations may be innovative or potentially
11 precedent setting, but so too was my 4 percent
12 decommissioning proposal in 1998 that was adopted and so to
13 is PPL's present DSIC proposal.

14 Looking at the facts, it's clear to me that PPL
15 Electric Utility Corporation served as a generating company
16 on paper through 2001, all right. Now, the issue for me is,
17 the communities I live in, these generating companies began
18 devaluating their taxes in 2000.

19 What I found by going to the Public Utilities
20 Fortnightly guidebook on electric companies is that February
21 14, 2000, PPL changed its name to PPL Electric Utilities
22 which together with Pennfuels Gas was to become the PPL
23 utility.

24 According to testimony yesterday, PPL Electric
25 Utilities was not transferred until July 1, 2000, so at

1 least for the first six months of 2000, by their own
2 admission, they were a generating company and a composite
3 entity.

4 In fact, I think it was Mr. Morgan's testimony
5 yesterday that indicated that PPL Electric Utilities
6 retained generating assets through 2001. I didn't have
7 access to the same day transcription, but paraphrasing Mr.
8 Morgan yesterday, he said still some generating assets that
9 were on the books had to be taken off.

10 So clearly PPL Electric Utilities was still acting as
11 a generating company through 2001. So I don't have a clear
12 understanding as when the separation took place. In my
13 mind, there is a fluid, composite entity, PPL Electric
14 Utilities, PPL. And that's why I'm looking to address some
15 of these issues through this proceeding.

16 JUDGE TURNER: Mr. MacGregor?

17 MR. MacGREGOR: Your Honor, this case is about
18 revenues, expenses, rate base and taxes for the future test
19 year 12 months ended December 31, 2004. During 2004, the
20 company owned no generating plants.

21 The testimony presented by Mr. Epstein deals with
22 appeals of tax assessment for the Susquehanna nuclear
23 station and the Brunner Island coal plant, both of which
24 were transferred out of the utility corporation effective
25 July 1, 2000. Whether the date is 2000 or 2001, 2000 taxes,

1 2001 taxes have nothing to do with this proceeding.

2 The purpose of this proceeding is to establish rates
3 based upon 2004 future test year, a year in which PPL
4 Electric Utilities owns no generating assets and is making
5 no claim to recover any costs associated with any generating
6 assets.

7 JUDGE TURNER: All right. Are those costs at all
8 included in Exhibit Historic 1?

9 MR. MacGREGOR: No, Your Honor.

10 THE WITNESS: Can I respond, Your Honor?

11 JUDGE TURNER: Yes.

12 THE WITNESS: I think this case is about more than
13 that. This case has an impact on people like me that pay
14 our rates, and what I would say to you is that the districts
15 that I articulated in this particular case, for example
16 Brunner Island, an 8.1 percent in costs on top of the costs
17 that have gone up to pay the real estate taxes on top of the
18 fact that that district lives at a 20 percent poverty level
19 would have an adverse impact on quality of life.

20 So I don't think this proceeding is just about a
21 sterile request dealing with rate structure and rate equity.
22 I'm trying to provide a context as to what impact this
23 request will have on my community based on other impacts
24 that previous requests have had on my community. And I
25 think there's a continuity and a context that can't be

1 excluded.

2 JUDGE TURNER: Well, I'm afraid I disagree with you.

3 THE WITNESS: I had a feeling you might say that.

4 JUDGE TURNER: I agree that the case is about more
5 than just cold, hard figures. It is also about quality of
6 life. However, legally, there is no involvement in this
7 case of the real estate tax issues, and there isn't any
8 involvement even in the historic test year.

9 And those rates or those transfers were made while
10 the cap was in effect. These rates are to take effect after
11 the cap is gone, and I can't see any relevancy.

12 THE WITNESS: Can I make one additional comment,
13 because there's the confusion too because at some point I
14 thought rates were set based on rate generations. It was my
15 understanding that a rate generation is, what, seven years,
16 every seven years.

17 JUDGE TURNER: Beg your pardon?

18 THE WITNESS: That for purposes of ratemaking, a
19 ratepayer generation is seven years. Every seven years is a
20 new generation. Is that correct or not?

21 MR. MacGREGOR: No, I plan to ask you about that
22 statement in your testimony. I've done utility work for 25
23 years and that's new to me.

24 THE WITNESS: Then okay. That was my understanding,
25 so I think you'll deal with me later on that, huh, David?

1 MR. MacGREGOR: I'm looking forward to an answer
2 because that was new to me.

3 JUDGE TURNER: But the point you were trying to make
4 is?

5 THE WITNESS: Would have been made, is that if the
6 ratepayer generation was seven years, then regardless of
7 when the company was decoupled, regardless of when the
8 settlement was, there's cross-generations that are being
9 impacted, or there's one generation being impacted more than
10 others. But I'm not going to pursue that argument.

11 JUDGE TURNER: Thank you. All right. So you've had
12 my ruling. Do you accept it?

13 THE WITNESS: Yes.

14 JUDGE TURNER: Okay. In that case -- and there's
15 nothing else that you want to strike based on irrelevancy?

16 MR. MacGREGOR: No, Your Honor.

17 JUDGE TURNER: All right. Would you like to begin
18 your cross-examination of Mr. Epstein?

19 MR. MacGREGOR: Yes. I just have a few clarifying
20 questions.

21 **CROSS-EXAMINATION**

22 BY MR. MacGREGOR:

23 Q. First, Mr. Epstein, the subject of AMR, the
24 automatic meter reading project, you present a fair amount
25 of testimony on that subject. Are you opposed to the AMR

1 project in and of itself?

2 A. No.

3 Q. So you don't challenge the prudence of the
4 company's decision to undertake that program?

5 A. I don't agree with the way you phrased the
6 question.

7 Q. Okay. You have not presented any challenge here
8 to the company's decision to implement and install automatic
9 meter reading devices?

10 A. No. I disagree with the rate recovery mechanism
11 that penalizes my neighbors.

12 Q. And is it your position that after the company
13 installed the automatic meter reading devices, that it
14 should not have terminated the employment of the meter
15 readers who previously performed that function?

16 A. Say that again. I want to make sure I hear that
17 correctly, David.

18 Q. Is it your position that once the company
19 undertook and installed the meter reading devices and no
20 longer required the services of meter readers, that the
21 company should or should not have terminated the employment
22 of those employees?

23 A. No. I would have reassigned them to another job
24 function within the corporate structure.

25 Q. And their cost of those employees would have

1 remained part of the utility's cost and rate structure?

2 A. Yes.

3 Q. And on page seven I think of your -- or maybe
4 it's eight of your direct testimony.

5 A. Well, you need to be clear, because one of them
6 is now non-existent.

7 JUDGE TURNER: Page seven, labor reductions and
8 outsourcing?

9 MR. MacGREGOR: Yes.

10 JUDGE TURNER: Okay.

11 THE WITNESS: Would put you, direct testimony, is
12 that right?

13 JUDGE TURNER: That's correct.

14 BY MR. MacGREGOR:

15 Q. Direct testimony. Toward the bottom, the
16 paragraph after the block quote -- there are not line
17 numbers here so I'm just going to have to give you a general
18 reference -- you note an amount of outsourcing that's
19 projected to increase or work by others will increase to
20 \$53.36 million; is that correct?

21 A. Uh-huh.

22 Q. And subject to check or if you know, is that
23 number less than 3 percent of the total operating and
24 maintenance expenses of PPL Electric Utilities?

25 A. I don't know, but frankly to me it's not

1 relevant.

2 Q. Are you opposed to outsourcing as a --

3 A. Yes.

4 Q. -- general matter if it reduces costs?

5 A. Yes.

6 JUDGE TURNER: Okay, Mr. Epstein. You need to let
7 him finish his question.

8 THE WITNESS: Yes.

9 JUDGE TURNER: Then you can answer. Okay.

10 BY MR. MacGREGOR:

11 Q. So my question is, you're opposed to outsourcing
12 at any level, even if it reduces costs?

13 A. Well, you have to define outsourcing. I mean,
14 there's three different definitions that I work with in my
15 field. I don't know if it's the same definition for you,
16 but we have outsourcing and insourcing. I oppose both
17 conceptually.

18 Q. Regardless of the cost impact?

19 A. Regardless of the cost of impact to -- I think
20 there needs a balance, clearly, and I'm not asking to have
21 employees stay on and perform a job function that's no
22 longer necessary. What I'm opposed to is having that job
23 function outsourced to another country or to a non-union
24 entity that may not provide the same degree of health care
25 benefits and protections that currently exist within the

1 corporate structure.

2 Q. And on page 11 of your direct testimony, and you
3 do this a couple of times in your testimony -- this is
4 subpart "C" -- you say, PPL's proposed rate structure and
5 rate design are appropriate, and then you state that your
6 position on this matter would be affected by testimony
7 submitted by other parties and you --

8 A. Yeah, I'm not following you. Where are you at,
9 Dave? I'm sorry.

10 Q. Top of 11.

11 JUDGE TURNER: At the top of the page, your "C"
12 says --

13 THE WITNESS: Okay, got you, yeah, right.

14 BY MR. MacGREGOR:

15 Q. So you do this on several points in your
16 testimony, and I take it what you plan to do is to tell us
17 what your position is for the first time in your main brief?

18 A. No. And perhaps this was just a communication
19 issue since I didn't arrange it in a standard methodology
20 where there's a question and then an answer follows.

21 I raised the issue and that issue has no value to it,
22 where PPL's proposed rate structure and rate design are
23 appropriate. I'm not saying that I support that. That's
24 the issue I'm raising.

25 Then in response to that, what I say is, Mr.

1 Epstein's position on this matter will be affected by
2 testimony submitted by other parties. As such, he offers no
3 formal testimony on this issue, da da da da da.

4 I didn't have a position per se there, and I think it
5 would be correct to say that my final position would be
6 articulated in a main brief based on testimony that I
7 reviewed, rebuttal testimony, surrebuttal testimony in
8 evidentiary hearings.

9 Q. Well, it won't be your -- I mean, it may be your
10 final position. It will also be your first position on the
11 issue; is that correct?

12 A. Yes, that's true. You're right. Well, first
13 position to you. I think you probably know where I stand.

14 Q. Further down on page 11 --

15 JUDGE TURNER: Wait a minute. Your brief must be
16 based on evidence of record.

17 THE WITNESS: Okay.

18 JUDGE TURNER: Okay. You can't provide a detailed
19 position and remedies that you have plucked from the air in
20 your brief.

21 THE WITNESS: No. What I had anticipated on doing
22 and what I have done in the past is just offer support for
23 other positions that have been offered by parties that have
24 more experience and expertise in those matters.

25 JUDGE TURNER: Okay. So you're not going to provide

1 a detailed position as well as remedies in your main brief.

2 You're going to provide --

3 THE WITNESS: Oh, no, no, no. No.

4 JUDGE TURNER: Well, you shake your head, but that's
5 what you say here.

6 THE WITNESS: Okay. Well, I'm sorry if I --

7 JUDGE TURNER: You're going to support other parties
8 in your main brief.

9 THE WITNESS: Okay.

10 BY MR. MacGREGOR:

11 Q. Further down on page 11, the next to last
12 paragraph, you say that the DSIC tariff is inherently
13 discriminatory since PPL has proposed that the DSIC only be
14 levied on customers with less than 12,470 volt service.

15 Have you examined the types of property that the
16 company proposes to include in its DSIC?

17 A. No. Well, when you say -- could you be more
18 specific when you say types of property?

19 Q. What types of property would be eligible for
20 inclusion in the DSIC?

21 A. No, I didn't think it would be appropriate to
22 trespass on people's property.

23 Q. My question is, are you aware that of the
24 property that the company has said it would claim as
25 eligible for recovery in the DSIC, none of that property is

1 used to serve or provide distribution service to customers
2 taking service at 12,470 volts or above?

3 A. Would you say that again?

4 Q. Are you aware that the type of property that the
5 company has listed in detail in its testimony that will be
6 eligible for inclusion in the DSIC, that none of that
7 property is used to provide service to customers who take
8 service at 12,470 volts or higher?

9 A. Yes, I do know that.

10 Q. And that is why the company has not proposed to
11 charge a DSIC to those customers?

12 A. Yes, I do know that.

13 Q. And how is that discriminatory, not to charge a
14 customer class a rate related to property which does not
15 provide it any service?

16 A. Because I think we've found in other proceedings
17 and in this proceeding in particular where there's cross-
18 subsidies, so I don't think it would be the first time that
19 somebody would propose a cross-subsidy. This would be
20 extreme, no doubt, but I wanted to make my position crystal-
21 clear.

22 Q. Well, on the question of clarification, on page
23 12, we have a heading, intergenerational rate tariffs and
24 intergenerational equity, and I quite honestly couldn't
25 figure out what you were talking about there. Is there some

1 specific issue you're trying to raise here or some specific
2 adjustment you're trying to make in this case?

3 A. Well, it's an issue that I have been advocating
4 since I first began testifying in 1984 and that is, frankly,
5 I don't believe that people who do not receive a service
6 should pay for it.

7 And I don't know how far you want me to go into this,
8 but this began with the construction of the nuclear power
9 plant at Susquehanna where I felt generations who would not
10 receive service would wind up paying for it.

11 I apply that concept throughout my testimony in I
12 think every proceeding that I've been involved with since
13 1984. I just believe if you receive a benefit for
14 something, you should pay for it. If you get a bill, you
15 should be able to pay for it, real, real basic principle.

16 Q. And part of what you --

17 JUDGE TURNER: Okay. Let's apply it to this case.

18 THE WITNESS: Yeah.

19 JUDGE TURNER: Okay. First of all, previously, Mr.
20 MacGregor challenged the generation as equal to seven years.

21 MR. MacGREGOR: That was my next question.

22 JUDGE TURNER: Okay. And second of all, what are you
23 saying? You're saying that the DSIC is going to place costs
24 on people for property and services that they won't benefit
25 from?

1 THE WITNESS: No, I'm not saying that. I don't think
2 that's what the company proposed. I was just making a
3 statement. I think it was pretty clear that I didn't really
4 have a problem with -- I have a problem with the DSIC just
5 in the way it's implemented.

6 JUDGE TURNER: But this is not the problem that you
7 have with it?

8 THE WITNESS: No. That's not, that unfortunately was
9 not the prime part of my testimony and I'm sorry if it did
10 cause confusion.

11 However, it was more to address the issue of cross-
12 subsidies that exist in rates, and I think you were asking
13 me why I would oppose something that wouldn't provide a
14 service to some other class, and my response being it
15 wouldn't be the first time.

16 Now, if I can add, I don't know why we're talking
17 about -- wasn't 12 struck from the testimony?

18 MR. MacGREGOR: No.

19 THE WITNESS: Okay.

20 JUDGE TURNER: Would you like to have it stricken?

21 MR. MacGREGOR: No, I don't. That's okay.

22 THE WITNESS: Were you asking me?

23 JUDGE TURNER: Yes.

24 (Laughter.)

25 THE WITNESS: I don't know. Will it curry favor with

1 you?

2 JUDGE TURNER: I'm not the one you have to curry
3 favor with. It's the Commission.

4 BY MR. MacGREGOR:

5 Q. I'm just confused, though, Mr. Epstein, about
6 the statement and I guess I indicated this earlier, the
7 traditional ratemaking premise that a generation is equal to
8 seven years.

9 A. Yeah, I was --

10 Q. That's new to me, frankly, and just wonder what
11 support you have that that's a traditional ratemaking
12 premise.

13 A. Well, I'm always glad to furnish you with new
14 information, however it's an assumption I've been operating
15 on for 20 years and I will go back and produce the
16 supporting material for you tomorrow. I may not be here --
17 is Thursday okay?

18 JUDGE TURNER: Yes.

19 MR. MacGREGOR: It's okay with me.

20 JUDGE TURNER: But Mr. MacGregor, I do believe there
21 is a concept of generation of ratepayers. I'm not sure that
22 it's any different than any other generation, but in terms
23 of who you're collecting costs from. So --

24 MR. MacGREGOR: I understand that, Your Honor, and I
25 agree. I was unclear as to how it was being applied in this

1 case if at all and to what adjustment or part of the
2 company's claim in this case was viewed as being consistent
3 or inconsistent with that standard.

4 THE WITNESS: Frankly, I think it's a moot point
5 because the part of my testimony that was featuring this
6 thread has been stricken. I was trying to basically develop
7 an undue burden on certain generations.

8 MR. MacGREGOR: Okay.

9 THE WITNESS: But I'm still going to try and get you
10 that material because that's the kind of guy I am.

11 JUDGE TURNER: I think I do need to note here that
12 the Commission's suspension order specified an investigation
13 of existing rates as well as the proposed rates.

14 MR. MacGREGOR: That is correct, Your Honor.

15 JUDGE TURNER: So it's not that existing rates are
16 off bounds here, but --

17 MR. MacGREGOR: Absolutely, but as those rates are
18 charged based on a 2004 test year to be applied in 2005.

19 JUDGE TURNER: I'm talking about the rates we're
20 paying right now.

21 MR. MacGREGOR: Yes, that's correct.

22 JUDGE TURNER: Okay. Not "we." I'm not a PP&L
23 customer.

24 MR. MacGREGOR: Nor am I.

25 JUDGE TURNER: Okay.

1 THE WITNESS: Well, you should be. The service is
2 good right the way it is now without a cost adjustment.

3 JUDGE TURNER: Okay. I'll move back. What can I
4 say?

5 MR. MacGREGOR: Please note that for the record.

6 (Laughter.)

7 BY MR. MacGREGOR:

8 Q. Page 13, again, by way of clarification, you're
9 referencing the company's rate of return here and you state
10 that PPL has chosen to usurp the water model and apply it to
11 electric transmission and distribution. Where in Mr. Moul's
12 testimony or Ms. Cannell's testimony or anywhere here has
13 the company proposed to usurp any model, much less a water
14 model?

15 A. The DSIC model. It was your own testimony
16 yesterday, wasn't it?

17 Q. So we're under rate of return here and we're
18 talking about DSIC again?

19 A. Well, I thought you were using the water model
20 in the DSIC. Is that not clear?

21 Q. It is, but we're under heading "F" here that
22 says, the rate of return on equity proposed by PPL and other
23 aspects of the company's proposal result in a fair rate of
24 return.

25 A. Yeah, I think that's a fair --

1 JUDGE TURNER: Mr. Moul does use water companies in
2 his barometer groups.

3 MR. MacGREGOR: Well, I want to know if that's what
4 he -- oh, no, we don't use -- he used electric and gas, not
5 water, in his barometer group.

6 JUDGE TURNER: I believe he did use some water
7 companies.

8 MR. GANG: He refers to the Commission's recent
9 decisions on water companies. Perhaps that's what you're
10 thinking.

11 MR. MacGREGOR: But they weren't in his barometer
12 group per se.

13 THE WITNESS: No, but I was --

14 JUDGE TURNER: They are not in his barometer group.
15 Okay.

16 THE WITNESS: I was referring to his referral to the
17 American Water decision.

18 MR. MacGREGOR: Okay, and we look at Footnote 7 --

19 JUDGE TURNER: Thank you for the correction, Mr.
20 Gang.

21 BY MR. MacGREGOR:

22 Q. Pennsylvania-American Water Company's increase
23 in equity from 10 to 10.6, as a result of the Commission's
24 retroactive recovery award -- now, I've reviewed that order
25 and I find no reference to a retroactive recovery award and

1 I don't know what you're --

2 A. It was my understanding that it was retroactive.

3 I may --

4 JUDGE TURNER: I'm sorry, where are you?

5 MR. MacGREGOR: I'm sorry, Footnote 7, Your Honor.

6 JUDGE TURNER: Thirteen?

7 MR. MacGREGOR: Yes, page 13, Footnote 7.

8 JUDGE TURNER: But where?

9 MR. MacGREGOR: The reference to a retroactive --

10 JUDGE TURNER: Oh, the footnote.

11 MR. MacGREGOR: -- recovery award.

12 JUDGE TURNER: Okay.

13 BY MR. MacGREGOR:

14 Q. My understanding, that was a base rate
15 proceeding which established prospective rates and there was
16 nothing retroactive about it, but I --

17 A. That was not my understanding.

18 Q. I guess the order will speak for itself.

19 JUDGE TURNER: Well, it is possible that the
20 Commonwealth Court decision resulted in the Commission
21 placing the rates into effect on the originally proposed
22 date.

23 MR. MacGREGOR: That's not what happened here, Your
24 Honor.

25 JUDGE TURNER: Okay. Which he might have interpreted

1 as retroactive, but --

2 THE WITNESS: I looked at the appeal that OCA entered
3 with Commonwealth Court and that was my interpretation of
4 their appeal, but I can -- well, I don't know if you need me
5 to go and follow up on that, Dave.

6 MR. MacGREGOR: No, that's okay.

7 THE WITNESS: Okay.

8 JUDGE TURNER: Well, we can look at the decision if
9 we need to, but --

10 THE WITNESS: Okay.

11 JUDGE TURNER: -- Mr. MacGregor says as statement of
12 counsel that that's not what happened, and Mr. Epstein says
13 that's his understanding of what happened.

14 MR. MacGREGOR: The order can speak for itself, Your
15 Honor.

16 JUDGE TURNER: Okay.

17 THE WITNESS: We can settle it outside.

18 BY MR. MacGREGOR:

19 Q. Page 14, at the top of your testimony, just by
20 clarification, the information that you provide in the block
21 quote is all for PPL Corporation, the parent holding
22 company, and not specifically for PPL Electric; is that
23 correct?

24 A. I wouldn't agree with that. It was in the
25 annual report.

1 Q. Of?

2 A. PPL.

3 Q. Corporation, the holding company?

4 A. Of which PPL Electric is -- I mean, I have a
5 problem with that. I mean, you're a sibling from the
6 parent. I'm not able to make that disassociation.

7 JUDGE TURNER: Are we on page 14, now?

8 MR. MacGREGOR: Page 14.

9 BY MR. MacGREGOR:

10 Q. We reported record earnings of \$4.24 per share.
11 Did PPL Electric Utilities have that level of earnings per
12 share in 2003?

13 A. No, its parent did.

14 Q. Okay. Thank you. Page 15, again by way of
15 clarification, we're discussing the company's storm damage
16 claim and its petition for deferral.

17 A. Uh-huh.

18 Q. If you refer to Footnote 11, you say, PPL's
19 initial gambit was firmly rejected. Am I correct that that
20 case that you cite in Footnote 11 had nothing to do with
21 storm damage expense?

22 A. No. It was trying to broach the rate cap.
23 That's why I thought it was -- the gambit being the same
24 type of policy.

25 Q. But it had nothing to do with storm damage?

1 A. Not that I'm aware of.

2 Q. And finally, on page 17 of your testimony --

3 A. Well, this is the one I've been waiting for,

4 Dave. I hope this isn't the last question.

5 Q. Actually, page 18.

6 A. Okay.

7 JUDGE TURNER: Skipping to 18?

8 MR. MacGREGOR: Yes, 18, I'm sorry.

9 JUDGE TURNER: Okay. Can I ask, before we go on, was
10 Judge Cocheres' decision affirmed or adopted by the
11 Commission?

12 MR. MacGREGOR: I believe it was, Your Honor.

13 JUDGE TURNER: Okay.

14 THE WITNESS: Yes, it was.

15 BY MR. MacGREGOR:

16 Q. Your testimony above the final block quote, PPL
17 needs to revise their depreciation estimates by using a more
18 accurate and contemporary geometric matrix that incorporates
19 site specific assets with the goal of appraising these
20 assets at fair market value --

21 A. Uh-huh.

22 Q. -- are you aware or not that the Pennsylvania
23 Supreme Court decisions -- and actually a provision in the
24 Public Utility Code that prohibits fair value ratemaking and
25 requires original cost ratemaking in this jurisdiction?

1 A. Yeah, but I'm interested in making new law.

2 MR. MacGREGOR: Okay. That's all --

3 JUDGE TURNER: I didn't hear your answer.

4 THE WITNESS: Yes.

5 JUDGE TURNER: You're aware of it?

6 THE WITNESS: Yes.

7 MR. MacGREGOR: That's all I have, Your Honor.

8 THE WITNESS: I have a problem with it, but I'm --
9 it's probably not going to go anywhere.

10 JUDGE TURNER: Well, why don't you save it for your
11 redirect.

12 THE WITNESS: What, I redirect myself?

13 JUDGE TURNER: Yes. You're going to have to.

14 MR. MacGREGOR: Wait a minute, is that right?

15 JUDGE TURNER: Right here in public.

16 (Laughter.)

17 JUDGE TURNER: Let me see if anyone else has cross-
18 examination of this witness. Is there any other party that
19 has cross-examination of Mr. Epstein?

20 (No response.)

21 JUDGE TURNER: Okay.

22 THE WITNESS: I have to confer with myself before --

23 JUDGE TURNER: Please do.

24 THE WITNESS: I've never redirected cross-examination
25 of myself.

1 JUDGE TURNER: If it makes you uncomfortable, you
2 don't have to do it.

3 THE WITNESS: No, I mean, would you -- is there
4 something that you suggest I go over? I mean, I may have a
5 conversation with myself and undermine my credibility as an
6 expert witness.

7 JUDGE TURNER: I mean, you put on your direct
8 testimony yourself without any question.

9 THE WITNESS: How'd I do?

10 JUDGE TURNER: Not well.

11 THE WITNESS: Well, then, I don't want to redirect if
12 that's the initial --

13 JUDGE TURNER: You don't have to redirect. The
14 question is, do you have any issues that you want to
15 correct, something that came out on cross-examination --

16 THE WITNESS: Oh.

17 JUDGE TURNER: -- that you want to have understood in
18 a different way or better by the Commission?

19 THE WITNESS: No, I think I've been pretty clear when
20 I answered the questions.

21 JUDGE TURNER: Okay.

22 THE WITNESS: I feel pretty comfortable that my
23 position has been strongly stated.

24 JUDGE TURNER: Okay. In that case, thank you very
25 much.

1 THE WITNESS: Do I have to move to enter --

2 JUDGE TURNER: Yes, you should.

3 THE WITNESS: Okay.

4 JUDGE TURNER: Because it's only been marked, right?

5 THE WITNESS: Yes, but I'll need David's help,
6 because some things have been stricken, I believe. I guess
7 Mr. Epstein, which is myself, moves to enter Epstein
8 Statements No. 1 and 1-S into the record.

9 JUDGE TURNER: As amended by the motion to strike
10 which was granted.

11 THE WITNESS: Yes.

12 JUDGE TURNER: All right.

13 (Whereupon, the documents marked as
14 Epstein Statement Nos. 1 and 1-S
15 were received in evidence.)

16 JUDGE TURNER: Let's identify now those pages that
17 were stricken, those items that were stricken. I believe we
18 identified that as far as the surrebuttal testimony. I'm
19 not sure we identified it in the direct.

20 MR. MacGREGOR: In the direct, I think I did identify
21 it as Subsection "K".

22 JUDGE TURNER: Subsection "A"?

23 MR. MacGREGOR: "K" as in Kate or something, which
24 begins on, I think the corrected version I have, begins in
25 the middle of line 20 -- middle of page 20.

1 JUDGE TURNER: Okay, so you're talking about Section
2 "K", starting in the middle of 20, and going through to the
3 middle of 21?

4 MR. MacGREGOR: That's right.

5 JUDGE TURNER: Value of building permits, okay.

6 MR. MacGREGOR: And then the previous portions you
7 identified of the surrebuttal.

8 JUDGE TURNER: Okay.

9 THE WITNESS: Wait. You said "A"?

10 MR. MacGREGOR: "K".

11 THE WITNESS: No, but did you say "A" initially?

12 JUDGE TURNER: No.

13 THE WITNESS: Okay, I'm sorry, just "K".

14 JUDGE TURNER: Section "K" in the direct and pages 5
15 through 13 in the redirect -- excuse me, in the surrebuttal,
16 is that --

17 MR. MacGREGOR: Three through eight.

18 JUDGE TURNER: Three through eight?

19 MR. MacGREGOR: Yes, of the surrebuttal.

20 JUDGE TURNER: All right. So they are stricken.

21 THE WITNESS: Thirteen through 15, is that correct,
22 in the direct?

23 JUDGE TURNER: No, 13 through 15 in the surrebuttal.

24 THE WITNESS: Okay.

25 MR. MacGREGOR: No, three to eight in the

1 surrebuttal, 20 and 21 in the direct and three through
2 eight.

3 JUDGE TURNER: In the surrebuttal. Okay. Do we have
4 that right, Mr. Reporter?

5 THE REPORTER: Yes, Your Honor.

6 JUDGE TURNER: Okay.

7 THE WITNESS: So 20 through 21, that's just "K" only,
8 doesn't affect "L"?

9 JUDGE TURNER: Right.

10 THE WITNESS: Okay.

11 JUDGE TURNER: In that case, I think we can discharge
12 Mr. Epstein.

13 THE WITNESS: Thank you.

14 (Witness excused.)

15 JUDGE TURNER: And I should take back my comment when
16 you said, "How did I do?" and I said, "Not well." That was
17 a joke. You did okay.

18 MR. EPSTEIN: Oh, then can I conduct redirect, then?

19 JUDGE TURNER: No.

20 MR. EPSTEIN: Okay. I'm leaving.

21 JUDGE TURNER: Okay. What I would like to bring up
22 to PPL from Mr. Epstein's testimony is page 10 of the
23 direct. We had a public input hearing in Williamsport and
24 there was a witness who asked what portion of the salaries
25 of certain people came from PPLEU, and the response was the

1 figures aren't kept like that. But here, we can see what
2 percentage is charged to PPLEU. Do you remember this
3 exchange, Mr. Russell?

4 MR. RUSSELL: Yes, I do, Your Honor.

5 JUDGE TURNER: So I'd like you to send this
6 information to that witness.

7 MR. RUSSELL: Let me review the interrogatory
8 response that's the source of this information and get back
9 to you on that.

10 JUDGE TURNER: Get back to me or get back to the
11 witness?

12 MR. RUSSELL: Both.

13 JUDGE TURNER: Okay. But if you can give her a
14 broken out figure, I think you should, and it appears that
15 you can. All right. Is there anything else to do this
16 afternoon? Yes, Mr. Mullins?

17 MR. MULLINS: Mr. Catlin's testimony.

18 JUDGE TURNER: Fine. Let's do that.

19 MR. MULLINS: Thank you, Your Honor. At this time,
20 the Office of Consumer Advocate would like to identify for
21 the record OCA Statements Nos. 2 and 2-S. OCA Statement No.
22 2 is the direct testimony of Thomas S. Catlin. OCA
23 Statement No. 2-S is the surrebuttal testimony of Mr.
24 Catlin. Two copies of OCA Statements No. 2 and 2-S have
25 been provided to the court reporter, Your Honor, and the

C E R T I F I C A T E

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

I hereby certify, as the stenographic reporter, that the foregoing proceedings were taken stenographically by me and thereafter reduced to typewriting by me or under my direction, and that this transcript is a true and accurate record to the best of my ability.

COMMONWEALTH REPORTING COMPANY, INC.

By: John A. Kelly

John A. Kelly,
Certified Verbatim Reporter

-0-

RECEIVED

2004 AUG 13 AM 9:45

SECRETARY'S BUREAU
PUC

FORM 1