

PHILADELPHIA ELECTRIC COMPANY

Schedule 6

PECO Sources & Uses of Funds
1970-1980

| | 1970 | 1971 | 1972 | 1973 | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 |
|----------------------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| Net Income | \$ 68,376 | \$ 93,624 | \$107,974 | \$122,867 | \$129,097 | \$143,925 | \$164,618 | \$173,439 | \$184,861 | \$194,471 | \$227,131 |
| Less: Total AFC | 18,513 | 31,691 | 42,450 | 58,763 | 70,841 | 66,874 | 77,641 | 86,078 | 90,997 | 113,383 | 147,550 |
| Fuel Cost Def. (Recovery) | -- | -- | -- | -- | 21,655 | (3,722) | 1,921 | 3,154 | (18,781) | 79,285 | (72,464) |
| Less: | | | | | | | | | | | |
| Pfd. Div. | 8,612 | 15,320 | 22,046 | 28,056 | 34,272 | 36,026 | 39,414 | 40,712 | 43,877 | 44,760 | 52,973 |
| Common Div. | 53,683 | 60,689 | 67,735 | 78,350 | 86,458 | 95,439 | 107,683 | 124,893 | 135,687 | 144,984 | 157,423 |
| Balance | (12,432) | (14,076) | (24,257) | (42,282) | (84,129) | (50,692) | (62,041) | (81,398) | (66,919) | (187,941) | (58,351) |
| Plus: | | | | | | | | | | | |
| Non-Cash Exp. | 52,293 | 60,453 | 69,691 | 77,468 | 126,806 | 124,046 | 179,550 | 175,808 | 193,173 | 164,901 | 146,368 |
| Funds From Operations | 39,861 | 46,377 | 45,434 | 35,186 | 42,677 | 73,354 | 117,509 | 94,410 | 126,254 | (23,040) | 88,017 |
| (Incl) Depr Other Work Cap | (3,292) | (633) | 508 | 17,122 | (68,945) | (1,690) | (38,301) | (20,279) | (5,436) | 28,114 | 36,286 |
| Nonrecurring Item | -- | -- | -- | -- | -- | 18,750 | 64,000 | -- | -- | -- | -- |
| Net Funds | 36,569 | 45,744 | 45,942 | 52,308 | (26,268) | 90,414 | 143,208 | 74,131 | 120,818 | 5,074 | 124,303 |
| Construction | 351,554 | 351,514 | 399,676 | 494,187 | 476,696 | 361,368 | 380,007 | 393,134 | 405,606 | 421,615 | 579,802 |
| Less: Total AFC | 18,513 | 31,691 | 42,450 | 58,743 | 70,841 | 66,874 | 77,641 | 86,078 | 90,997 | 113,383 | 147,550 |
| Net Construction | 333,041 | 319,823 | 357,226 | 435,444 | 405,855 | 294,494 | 302,366 | 307,056 | 314,609 | 308,232 | 432,252 |
| Debt Retirement | 10,140 | 34,838 | 18,130 | 14,290 | 69,313 | 95,193 | 63,271 | 38,945 | 31,422 | 56,169 | 140,671 |
| Other | 1,704 | (1,867) | 34,413 | (29,240) | (10,093) | 9,480 | 12,971 | 13,196 | 9,106 | 9,629 | 3,599 |
| Total Requirement | 344,885 | 352,794 | 409,769 | 420,494 | 465,075 | 399,167 | 378,608 | 359,197 | 355,137 | 374,030 | 576,522 |
| Int % of Total | 10.6 | 13.0 | 11.2 | 12.4 | (5.6) | 17.9 | 20.9 | 20.6 | 34.0 | 1.3 | 21.6 |
| Int of % of Constr | 11.0 | 14.3 | 12.9 | 12.0 | (6.5) | 24.3 | 26.2 | 24.1 | 38.4 | 1.6 | 28.8 |
| External Financing: | | | | | | | | | | | |
| Short-term Debt | (23,262) | (26,247) | 54,543 | 43,922 | 30,192 | (69,970) | (100,726) | 7,649 | 1,344 | 68,968 | (32,597) |
| Long-term Debt | 206,700 | 160,000 | 140,000 | 100,000 | 375,000 | 249,000 | 200,000 | 173,500 | 150,000 | 200,000 | 275,000 |
| Pfd. Stock | 65,000 | 70,000 | 75,000 | 75,000 | 75,000 | -- | 50,000 | -- | 50,000 | -- | 72,000 |
| Common Stock | 59,878 | 103,297 | 94,284 | 149,264 | 11,151 | 133,723 | 86,128 | 103,917 | 32,975 | 99,988 | 137,816 |
| Total | 308,316 | 307,050 | 363,827 | 368,186 | 491,343 | 308,753 | 235,400 | 285,066 | 234,319 | 368,956 | 452,219 |

Source: Published Company Reports

PHILADELPHIA ELECTRIC COMPANYPECO Construction Forecasts
(\$MM)

| <u>Date</u> | <u>1975</u> | <u>1976</u> | <u>1977</u> | <u>1978</u> | <u>1979</u> | <u>1980</u> |
|-------------------------|-------------|-------------|-------------|-------------|-------------|-------------|
| 5/28/75 | 410 | 469 | 481 | 550 | 674 | |
| 5/24/76 | 361A | 437 | 414 | 390 | 478 | 470 |
| 4/19/77 | | 380A | 448 | 434 | 455 | 511 |
| 5/10/78 | | | 393A | 483 | 418 | 465 |
| 4/30/79 | | | | 406A | 406 | 466 |
| Post 1975 Reductions | 49 | 89 | 88 | 144 | 268 | 4 |

1975 External Financing Forecast
(\$MM)

| <u>Date</u> | <u>1975</u> | <u>1976</u> | <u>1977</u> | <u>1978</u> | <u>1979</u> |
|-------------|-------------|-------------|-------------|-------------|-------------|
| 5/28/75 | 355 | 328 | 320 | 349 | 523 |

A - Actual

Source: Published Company Data

Schedule 8

SEE ATTACHMENTS

PHILADELPHIA ELECTRIC COMPANYRating Agency Changes

| | <u>Duff & Phelps</u> | | <u>Moody's</u> | | <u>Standard & Poors</u> | |
|-------|--------------------------|-----------|----------------|-----------|-----------------------------|-----------|
| | <u>From</u> | <u>To</u> | <u>From</u> | <u>To</u> | <u>From</u> | <u>To</u> |
| 11/70 | | | Aaa | Aa | | |
| 09/74 | | | Aa | A | AA | A |
| 02/76 | | | | | A | A- |
| 04/76 | 6* | 7 | | | | |
| 09/78 | 7 | 8 | | | | |
| 04/80 | 8 | 9 | | | A- | BBB+ |
| 06/81 | | | A | Baa | BBB+ | BBB |
| 09/82 | | | | | BBB | BBB- |
| 01/83 | | | Baa2 | Baa3 | | |

*Prior D&P rating scale stated as 2-Med.

Source: Agency Announcements

Schedule 10

Duff and Phelps Credit Rating Scale

| <u>D&P Rating</u> | <u>Generic Category</u> | <u>Description</u> |
|-----------------------|-------------------------|--|
| 1 | <u>Triple A</u> | Highest credit quality. The risk factors are negligible, being only slightly more than for risk-free U.S. Treasury debt. |
| | <u>Double A</u> | |
| 2 | High | High credit quality. Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions. |
| 3 | Medium | |
| 4 | Low | |
| | <u>Single A</u> | |
| 5 | High | Protection factors are average but adequate. However, risk factors are more variable and greater in periods of economic stress. |
| 6 | Medium | |
| 7 | Low | |
| | <u>Triple B</u> | |
| 8 | High | Below average protection factors but still considered sufficient for institutional investment. Considerable variability risk during economic cycles. |
| 9 | Medium | |
| 10 | Low | |
| | <u>Double B</u> | |
| 11 | High | Below investment grade but deemed likely to meet obligations when due. Present or prospective financial protection factors fluctuate according to industry conditions or company fortunes. Overall quality may move up or down frequently within this category. |
| 12 | Medium | |
| 13 | Low | |
| | <u>Single B</u> | |
| 14 | High | Below investment grade and possessing risk that obligations will not be met when due. Financial protection factors will fluctuate widely according to economic cycles, industry conditions and/or company fortunes. Potential exists for frequent changes in quality rating within this category or into a higher or lower quality rating grade. |
| 15 | Medium | |
| 16 | Low | |
| 17 | Substantial Risk | Well below investment grade with considerable uncertainty as to timely payment of interest, preferred dividends and/or principal and sinking funds. Protection factors are narrow and risk can be substantial with unfavorable economic/industry conditions, and/or with unfavorable company developments. |
| 18-20 | | Reserved for later use. |



Duff and Phelps, Inc.

Utility investment
research service

BASIC
REPORT

PHILADELPHIA ELECTRIC COMPANY

September 21, 1978

FILE COPY
DO NOT REMOVE

Summary

Philadelphia Electric Company provides electric service in Philadelphia and environs which contributed 84% of 1977 revenues and 89% of pre-tax income. Gas service is supplied to suburban areas around Philadelphia (13% of revenues) and steam service accounts for the small balance. In terms of invested capital, Philadelphia Electric is the ninth largest utility in the U.S. Annual revenues approach the \$1.5 billion mark. The territory is highly industrialized and diversified. Customer growth is sluggish and kwh growth is projected at a below average 3%-4% annually. Pennsylvania regulation is currently ranked in our Group IV category.

Construction expenditures including nuclear fuel are forecast at \$483 million for 1978, \$418 million of 1979 and aggregate \$2.5 billion for the five years ended 1982. Internal sources are expected to provide 40% for 1978 and around 45% of the required funds for 1979-1982; invested capital will compound at 6% annually through 1982 as compared with a 9% rate recorded in the five years ended 1977. At June 30, 1978, capitalization totaled \$4.2 billion and consisted of 52% total debt, 14% Preferred and 34% Common equity. No additional public financings are anticipated until early 1979.

Earnings for the 12 months ended July 31, 1978, were \$1.65 per share versus \$2.08 for the prior similar period and \$1.87 for calendar 1977. The earnings erosion principally reflects commercial operation of the nuclear Salem No. 1 (453-mw) at mid-1977 with little offsetting rate relief. A rate order on the pending \$119 million (11.5%) application filed August 1977 is anticipated by year-end 1978. Excluding further rate relief in 1978, we estimate 1978 earnings at \$1.55 per share. If the final order is retroactive to the July 1978 suspension date, the Company has indicated 1978 earnings may be restated upward. Assuming \$90 million of annual rate relief is reflected in 1979 and commercial operation of Salem No. 2 at mid-1979, we project a recovery in 1979 earnings to around \$1.80 per share, equating to a still below average return on Common of about 9.5%. Further generating additions have been rescheduled to 1985 and 1987, thus easing financing pressures in the early 1980s. Combined with adequate rate relief, this could allow for some restoration in per share earnings and returns in the intervening years.

Investment Opinion

Trading at 17-3/4 (latest 52-week market range: 20-1/4 - 16-7/8) and at an approximate 8% discount to book value, the shares sell at 11.5 times our 1978 estimate of \$1.55 per share. The yield is 10.1% on the \$1.80 dividend established in March 1977. In 1977, 27% of the dividend was considered a tax-free return of capital. Some portion could also be so classified in 1978. We expect this dividend to be maintained at least until receipt of the Pennsylvania rate decision, at which time the situation will be reviewed by the Board of Directors. The cash coverage of the 1978 dividend is estimated at about 1.75 times. This is below average but adequate.

We are lowering our qualitative rating of the Company from D&P-II to D&P-III because of the deteriorating Pennsylvania regulation and the diminished financial flexibility of the Company. We also regard the Common stock as having below average attraction except for those investors able to benefit from the combination of high current yield, partial non-taxability of the Common stock dividend and exemption from personal property taxes for Pennsylvania residents.

PHILADELPHIA ELECTRIC COMPANY

Territory

Philadelphia Electric Company is a combination electric, gas and steam utility serving southeastern Pennsylvania including Philadelphia and the surrounding suburban area. Electric operations in 1977 accounted for 84% of total Company revenues of \$1.39 billion and 89% of pre-tax operating income. Gas contributed 13% of revenues and 10% of pre-tax operating income. The small steam operations provide 3% of revenues and are marginally profitable in most years.

The total service area encompasses 2,475 square miles and a population of 3.9 million or approximately one-third of the state's inhabitants. The City of Philadelphia represents only 5% of the total geographical area but contributes 40% of electric revenues. The gas service area is somewhat smaller in size and generally excludes the City of Philadelphia. The Philadelphia suburban area has shown population gains slightly in excess of those of Pennsylvania and the U.S. but population trends in the City proper have been static. In the five years ended 1977 total customer growth of 5% has been well below the 12% experienced by the electric utility industry. Income levels and growth in per capita incomes have slightly exceeded the U.S. averages.

Philadelphia is the fourth largest U.S. metropolitan area and is a principal financial and commercial center. The economy is well diversified with many basic industries such as metal and machinery, petroleum refining and chemical production, food, rubber and transportation equipment. Commercial and industrial growth has been sluggish in recent years. Additionally, the heavy industrial mix exposes the service area to cyclical swings in the economy.

Overall, considering the mature urban territory coupled with the industrial base, we regard the service area as below average for the operation of an investor-owned electric utility. We project kwh growth at 3%-4% annually including the use of electricity for heating and as an alternate fuel source.

Business - Electric

Electric operating revenues of \$1,178 million (84% of total) in 1977 were derived 36% from residential sales, 14% from commercial, 44% industrial and 6% other. Retail sales accounted for essentially all of total kwh sales. The Company's revenue structure is heavily weighted to the industrial category (nearly one-half of which is non-manufacturing). Conversely, the commercial segment is below average. Electric customers approximate 1.27 million.

Electric sales growth in the 1972-1977 period averaged only 2.1% annually, less than half of that for the industry for the same period. Retail sales expanded at an average 5% annual rate for the five years ended 1973. However, this pattern was sharply interrupted by such factors as the Arab oil embargo, conservation, recession, and mild weather. The industrial sector has been particularly slow to recover and the 1977 level of industrial sales was still 3% below the peak recorded in 1973. Recessions have impacted the area more severely and for a longer period of time than in many other sections of the country because of the industry mix and little industrial expansion.

At the same time both the residential and commercial sales gains also trailed the D&P Averages. This is traceable largely to the sluggish growth in the number of new customers, competition from natural gas, a greater mix of multiple-family low-usage dwelling units and a low (3%) saturation of electric space heating. Average residential usage in 1977 was 7,097 kwh, 6% over 1976, and about 14% under the investor-owned electric utility average. Overall kwh sales registered a 3.5% gain in 1977, largely attributed to relatively hot weather with increased use of air conditioning; the residential category registered a 7% increase.

Reflecting sluggish sales growth, some rate relief and operation of the fuel adjustment clause, Philadelphia Electric's retail revenue growth of 105% compared with a 124% gain for the electric utility industry during the 1972-1977 years. The Company's 1977 residential realization averaged 5.27¢ per kwh versus 4.92¢ for 1976. This realization was higher than the 4.06¢ of the investor-owned utility average but closer to other nearby East Coast utilities such as 5.08¢ for Delmarva Power & Light, 4.29¢ for Baltimore Gas and Electric (incorporating a large nuclear component) and 4.67¢ for Potomac Electric.

Electric Power and Fuel Supply

Net installed electric generating capacity totaled 8,198 mw at year-end 1977 consisting of 1,346 mw of nuclear base load generating units (16%), 3,834 mw of conventional steam (47%), 1,626 mw of combustion turbine peaking units (20%), 512 mw of hydro and 880 mw of pumped storage (17%). Over 800 mw of the conventional steam capability is composed of four relatively old and inefficient stations with heat rates exceeding 13,000 Btu.

The two Peach Bottom nuclear units (the Company's share totals 886 mw) were installed in 1974 and are jointly-owned with other utilities but are operated by Philadelphia Electric. The nuclear Salem unit is also jointly-owned but operated by Public Service Electric and Gas Company. This unit began commercial operation in June 1977 with 480 mw accruing to Philadelphia. The 400 mw oil-fired Eddystone unit was added in June 1976. These generating units placed in service during the past four years represented a 27% increase in installed generating capability and a 116% increase in the cost of production plant. At the end of 1977 the installed cost was \$230 per kw. Reflecting work on four additional nuclear projects underway, construction work in progress was 23% of total electric plant at year-end 1977.

Based on the highest summer peak attained to date--5,888 mw in 1977--and generating capability of 7,954 mw (adjusted for removal of 238 mw from service temporarily), the 1978 reserve margin was 35%. Assuming 3% average annual peak load growth, availability of existing units and addition of a new unit prior to 1980, the reserve margin will be 25% or above through 1982. Additionally, the Company is a member of the Pennsylvania-New Jersey-Maryland interconnection (PJM) which fully integrates the bulk power generating and transmission operations of eleven electric utilities. The 1978 reserve margin of the PJM Pool is estimated at an ample 36%. In recent years Philadelphia Electric has been a net purchaser of power with 20%-30% of its needs purchased on a net interchange basis.

There has typically been a relatively wide 20%-30% variation between summer and winter peaks which we attribute to the weather sensitivity, particularly to summer air conditioning loads, as well as the low saturation of electric space heating. Also, a large part of the industrial sales category represents non-manufacturing with little round-the-clock consumption. These factors in concert with the purchase of relatively large amounts of economy power from the PJM Pool result in a below average load factor generally ranging in the 56%-58% area.

Principally due to slower load growth projections, the Company has stretched out its schedule for new generating additions. The next unit is the nuclear Salem No. 2 being constructed in conjunction with Public Service Electric and Gas Company. The Company's share, 474 mw, is expected to be available at mid-1979. Two wholly-owned Limerick nuclear units, each 1,055 mw, have been rescheduled to 1985 and 1987. The current estimated cost of Salem No. 2 is over \$600 per kw and for the Limerick units about \$1,500 per kw. Construction permits for the two Limerick units have been received and over one-quarter of the estimated costs has already been expended.

Nuclear will represent a growing portion of the Company's generation. Sources

of electric output for 1978 are estimated at nuclear 28%, coal 29%, oil 18% and other including purchased power and net interchange 25%. With Salem No. 2 in service; nuclear generation will account for about 35% of the power generated.

Most of the coal and oil requirements are contracted for annually on a short-term one to five years basis. Commitments for the nuclear fuel supply cycle have been made for four (Peach Bottom and Limerick) units through 1981-1985 and the two Salem units through at least 1979. Additional arrangements are being sought. Unit fuel costs have escalated sharply in recent years, particularly in 1974; and for 1977 fuel and interchange expense averaged 1.66¢ per kwh sold, somewhat above our D&P Average. The high fuel component represents use of sizeable quantities of imported oil and purchase of interchange power. Cost increases in recent years have been modified by the growing use of nuclear generation.

The Company is subject to Federal, state and local regulation with respect to environmental matters. Use of high sulfur coal does not meet prescribed pollution control standards and certain stations are currently operating under consent orders. The Peach Bottom station has operated under thermal limitations and may be required to install a closed cycle cooling system. The Company estimates approximately \$100 million of expenditures could be required for compliance, part of which is included in current construction estimates.

Overall, we view the Company's power generation and fuel supply as satisfactory well into the 1980s. The Company is attempting to comply with regulations or is seeking variances. We think the Company's commitment to nuclear generation is a positive element.

Business - Gas

The Company provides gas service to 271,000 customers in the surrounding suburban area of Philadelphia. Gas revenues of \$175 million in 1977 were contributed by residential with heating 48%, residential other 5%, commercial-firm 22%, Industrial-firm 23%, and other 2%. For the 1972-1977 period, gas revenues rose 87% despite 15% lower sales volume, with rate relief, purchased gas cost adjustments and elimination of the lower realization interruptible industrial sales category. Industrywide, gas revenues increased 122% for the same five year period.

Heating degree days for the service area average 4,945 under normal weather conditions but the 1973-1975 years were all warmer than normal. In calendar 1976, heating degree days registered 5,199 or 5% colder than normal temperatures and in 1977, 5,166 heating degree days were recorded in the territory. Mcf sales of gas decreased 14% in 1975 due to gas curtailments by the major pipeline suppliers. In 1976 gas sales increased 13% resulting from the availability of gas under emergency contracts and increased sendout in the abnormally cold October-December 1976 months. Gas sales were marginally lower in 1977. Residential space heating saturation is about 65%. The Company has not been able to increase the number of customers served in recent years.

Philadelphia Electric purchases nearly two-thirds of its natural gas requirements from Transcontinental Gas Corporation under contracts expiring in 1990 and the other one-third from Texas Eastern Transmission Corporation under contracts expiring in 1987. The Company's contracted supply was curtailed 25% in 1975, 29% in 1976 and 30% in 1977. The 1978 curtailment is anticipated to be similar to that experienced in 1977. Gas service was partially curtailed to large industrial customers January through April 1977. To alleviate curtailments, the Company has 1) obtained additional gas on 60 day emergency contracts, and 2) used SNG and substitute gas from oil. It also received production from several gas wells it has participated in on a joint basis. Gas storage contracts will enable the Company to store about 42% of the anticipated 1978-1979 heating season sendout.

The 1977 residential realization was \$3.26 per Mcf, up from \$2.91 in 1976, \$2.72 in 1975 and \$2.39 in 1974. Purchased gas adjustment clauses pass on increased costs of gas but do not fully reflect overhead and basic costs which apply to the reduced unit volume. However, profitability of the gas operation increased from a depressed \$16.0 million in 1975 to \$22.4 million in 1976 reflecting the higher sales volume coupled with some rate relief which was applicable. In 1977 gas operating income equalled \$20.9 million; the attrition was primarily due to minimal rate relief.

Overall, with static to declining gas supplies and substantially higher prices of natural gas together with inflation, these operations appear to offer limited growth and are dependent on periodic rate relief.

Regulation

Previous rate decisions by the Pennsylvania Public Utilities Commission have been based on fair value, end-of-period historical rate bases and the adjusted book Common equity returns have been 14-14.5%. Interim rate relief has been granted and normalization of accelerated depreciation tax deferrals on post-1969 property was allowed.

Two Pennsylvania statutes adopted in late 1976 and effective for filings dated after October 7, 1977, provide for several modifications. These include: 1) the establishment of a maximum seven month suspension period plus 60 days for the filed effective date of a general rate increase (nine months effectively vs. eleven previously), 2) authorization (not mandated) of the use of a future test year (vs. historical previously), and 3) prohibition of potential rate retroactivity of multiple rate filings (pancaking) and interim rate relief other than for emergency purposes. An Office of Administrative Law Judge was created to conduct hearings and submit recommendations.

The Pennsylvania Commission adopted a new Energy Rate Clause (ERC) effective July 1, 1978. This fuel clause includes nuclear and the fuel component of purchased power (excluding the demand charge). The base is that established and approved in the last general rate case or the latest 12 months scrutinized by the staff. Philadelphia Electric has received Commission approval for its base to be the 12 months ended October 1977. The new ERC will be a rolling six-month average, updated monthly, with an approximate two-month lag. The Commission has approved a plan for amortization over nine months for recovery of the deferred fuel costs.

In the Company's last rate case concluded in February 1977, the Pennsylvania Commission authorized an electric rate increase of \$72 million in response to a \$95 million request filed November 1975 in a two-part application. The Company requested the first part--\$47 million--not be suspended. In January 1976 the Commission suspended both parts for up to six months but permitted an interim increase of \$24.3 million to be effective subject to possible refund. In July 1976 the PUC authorized an additional interim increase of \$22.7 million effective August 1976. The \$25 million additionally granted in February 1977 was retroactive to October 1976. The February 1977 decision was based on a period-end fair value rate base; the test year was the 12 months ended August 1975; and the overall return allowed incorporated about a 14.15% return on book Common equity. The decision allowed a slightly lower return on book Common equity than the prior March 1975 Order and took 15 months to process but the interims granted partially mitigated the delay.

An Order was received in late 1976 allowing \$9.2 million of increased gas rates in two steps. The first part consisting of \$6.4 million went into effect June 1975, subject to refund. The additional \$2.8 million allowed was retroactive to March 1976. The decision was issued in almost 20 months and, according to the Company, was based on an inadequate rate of return on Common equity and an insufficient allowance for depreciation.

Philadelphia Electric made a two-part electric rate filing August 1977. The first part sought to transfer the existing electric fuel adjustment charges into base rates, eliminate the electric fuel adjustment clause for residential and small commercial customer (30% of kwh sales) and to substitute a new energy adjustment clause for other customers (including nuclear). Part two involved a \$119 million increase (11.5%) in electric rates, half of which is designed to recover the additional operating and capital charges associated with the commercial operation of the Salem No. 1 nuclear unit on June 30, 1977. Both parts were suspended until April 4, 1978. In December 1977 an Administrative Law Judge recommended an interim increase of \$32.5 million; the Company urged the PUC to grant a \$53.6 million increase; and on April 4, 1978 the Commission awarded the Company only \$11.8 million, subject to refund, and further suspended the case to July 4, 1978. The opinion of the Administrative Law Judge is expected to be available around October 1978 and we are anticipating receipt of an Order by year-end 1978. If the final Order is retroactive to the July 4, 1978 maximum suspension date as expected, the Company has indicated 1978 earnings may be restated.

The Company filed for a \$2.1 million annual increase in wholesale rates with FERC in May 1977; the increase went into effect July 1977 subject to refund. Additional rate increases totaling \$4.1 million were placed in effect on September 1, 1978, subject to refund.

We currently rate Pennsylvania regulation in our Group IV category. Recent Commission actions point to a deteriorating atmosphere and this ranking will be carefully reviewed upon receipt of several expected forthcoming orders.

Construction

Construction expenditures including nuclear fuel are currently budgeted at \$483 million for 1978, \$418 million for 1979, \$465 million for 1980, \$509 million for 1981, and \$604 million for 1982. About 85% of this five-year program which aggregates \$2.479 billion is earmarked for the electric department with the majority of the money to be spent on new nuclear generating capacity. This budget compares with \$2.1 billion expended in the five years ended 1977. Cost of certain pollution control equipment that may ultimately be required is not included in the preceding forecast.

Financing and Capitalization

Capital requirements for 1978 are estimated at \$513 million including \$483 million for construction and \$30 million for debt maturities and sinking funds. Internal sources are expected to provide about 40% of 1978 construction funds. Financing in 1978 is anticipated to total about \$300 million and to consist of approximately \$250 million debt including the \$100 million of First Mortgage bonds sold on March 7, \$50 million of 8-3/4% Preferred privately placed, and the balance bank loans. A contemplated offering of First Mortgage bonds as well as sale of four million shares of Common (around \$70 million @ 18) tentatively scheduled for October 1978 have been deferred to the first quarter of 1979. Shareholder Dividend Reinvestment and Employee Plans contribute about \$20 million of capital annually.

For 1979-1982 we estimate about 45% of the construction program can be funded from internal sources. In addition, debt maturities will require \$51 million in 1979, \$126 million in 1980, \$130 million in 1981 and \$60 million in 1982. We expect sales of debt and Common in each of the years 1979 through 1982; Preferred will be sold every other year.

Capitalization at December 31, 1977 totaled \$4.1 billion and consisted of 44.1% Mortgage debt, 51.8% total debt, 13.1% Preferred and 35.1% Common equity. We estimate 1978 year-end ratios to be 52% total debt, 14% Preferred and 34% Common equity. Our calculations indicate total capitalization will

increase about 6% annually in the five years ending 1982 as compared with a 9% compound annual rate experienced for the prior five years ended 1977. At a market price of 17-3/4, the Common currently sells at 92% of its June 30, 1978, book value of about \$19.25.

Accounting Practices

Tax deferrals related to accelerated depreciation on property additions since 1970 are normalized; for additions prior to 1971, the resultant tax deferrals are flowed-through to income. Tax deferrals from the use of ADR are normalized. Investment tax credits are amortized over the estimated useful life of the utility plant. Income tax credits applicable to non-operating activities (primarily interest relating to construction work in progress) are reported in other income with an offsetting increase in operating income taxes. For 1977 the income tax rate was 29%, as compared with a 24%-32% rate in last five years.

Depreciation as a percent of average depreciable utility plant in service was 2.99% for 1977. AFC was computed at a net after-tax rate of 8%-8.4% during 1975-1976. On January 1, 1977 a rate of 8.60% was adopted in accordance with the FERC method of accounting; the rate was increased to 8.70% on July 1, 1977. Effective January 1, 1978 the basis for calculating AFC was changed and a 7.1% net after-tax rate is applied to the CWIP base including prior AFC and is will be compounded semi-annually. This rate and application are equivalent to an 8.7% rate previously used when applied to a CWIP base excluding prior AFC. We note AFC has been a relatively high proportion of reported earnings in recent years.

Beginning January 1974 deferred fuel cost accounting was adopted. At December 31, 1977 deferred fuel expense totaled \$23 million, as compared with \$20 million at year-end 1976. Under the new ECR fuel clause, use of deferred fuel accounting has been discontinued and permission has been received to amortize the balance in this account over nine months beginning July 1978.

We consider the overall quality of reported earnings to be about average. Both the quality of earnings and the level of cash flow have improved in recent years.

Earnings Record

Various statistical tables are presented at the end of this report. Earnings per share have shown no progress in the latest five-year period 1972-1977 nor even in the last ten years. Per share earnings declined 10% during the five years ended 1977 as compared with a 12% gain for the D&P Average. We attribute this record principally to: 1) sluggish sales growth which contributed to below average Company revenue gains, 2) somewhat higher increases in operating and maintenance expenses than the industry partially related to operation of new generating capacity and pollution control equipment, extra costs associated with operating in a major metropolitan area, and high wage rates and increases, and 3) somewhat higher financing costs than the industry.

For the 1972-1977 period, Philadelphia Electric's capitalization growth was 9.2%. The Common equity portion of the capitalization structure compounded at 10% annually and the number of average Common shares outstanding rose 7%. By comparison, invested capital growth of the D&P Average was 11% annually and Common shares outstanding increased 5%. The Common equity component was generally maintained in the 34-35% area except for 1974 when a Common stock sale was delayed. With a high payout ratio (averaging 89%) earnings retention was low and four of the five Common stock sales were consummated below book value. Thus, book value declined slightly during the five years 1972-1977 from \$20.00 per share to \$19.26. Returns on average Common equity generally fluctuated in the 9%-10% range during the 1973-1977 years. These returns averaged

about 18% below the D&P Average. Overall, we conclude the Company has been unable to secure rate relief in sufficient amounts on a timely basis.

In 1977 kwh sales rose 3.5% and gas volumes declined 1%. The first Salem nuclear unit, owned in conjunction with Public Service Electric and Gas Company, began commercial operation at mid-year 1977 and added 453 mw to the system. This penalized 1978 earnings by about 20¢ per share. A non-recurring offsetting factor was the conversion of residential and commercial customers from bi-monthly to monthly meter reading and billing which benefited earnings by 11¢ per share. Only a nominal amount of rate relief was effective. On 8% more average shares outstanding, earnings were reported at \$1.87 per share, down slightly from the \$1.91 recorded for the prior year. APC was about flat on a per share basis for both years.

Current and Prospective Earnings

Earnings for the 12 months ended July 31, 1978 were \$1.65 which compared with \$2.08 for the prior similar period on 8% additional average shares. The decline principally reflected a full year's operation of the Salem nuclear unit No. 1 with little offsetting rate relief. As mentioned earlier, the Commission permitted an \$11.9 million interim increase amounting to less than 1% of revenues, to become effective April 4, 1978, subject to refund. We anticipate the final order by year-end 1978. In the first half of 1978 kwh sales experienced a 2.5% gain, gas sales were up 9.3%, APC was down about 10%, and maintenance and depreciation charges were up 15% and 13%, respectively. Favorable interchange sales during the coal strike aided the Company's results.

Our expectations for the balance of 1978 are for continued earnings attrition until significant rate relief becomes effective. The 11¢ per share non-recurring benefit from transition to monthly billing in the latter half of 1977 will be phased out during the balance of 1978. Additionally, the new energy clause will eliminate any advantage to the Company from interchange sales or nuclear fuel savings as both of these components are automatically passed through to customers. Thus, we estimate 1978 earnings at \$1.55 per share. The Company has announced deferment of the Common stock offering previously planned for fall of 1978. Based on 7% additional average outstanding shares, a return of around 8.2% on average Common equity is indicated.

The most important factor affecting the level of earnings in 1979 will be the amount of rate relief obtained. The Company will be burdened by costs associated with the installation of the second Salem nuclear unit which is anticipated to be placed in commercial operation at mid-year. A large amount of rate relief is required to offset the higher fixed and operating costs of the Salem nuclear units estimated at around \$60 million annually for each. We look for a 3%-4% kwh growth and around \$30 million in costs related to a half year's operation of the new generating unit. Assuming \$90 million of rate relief initially reflected during the year, 5% more average shares, and higher financing costs not offset by APC, we estimate 1979 earnings at \$1.80 per share. This estimate would produce a return of about 9.5% on average Common equity.

In response to a projected 3% annual gain in kwh sales, Philadelphia Electric has stretched out its construction plans with new units now scheduled for 1985 and 1987. Invested capital growth is anticipated to compound at a below average 6% annual rate with around 45% internal cash generation. Beginning in 1980 APC will rise on a per share basis. Financial pressures could begin to ease somewhat in the early 1980s. However, in view of the very low level of current earnings and returns being achieved coupled with the relatively large size of the Company and the number of outstanding Common shares, large dollar amounts of rate relief will still be required for the Company to restore earnings and returns to acceptable levels.

Dividends

The \$1.80 annual dividend was established March 1977, up from \$1.64 which had been paid since 1967. Based on a 17-3/4 price for the Common stock, the yield is 10.1%. In 1977, 27% of the dividend was considered a tax-free return of capital. Some portion may also be so classified in 1978. We think the dividend will be paid at the current rate at least until a rate decision is forthcoming, at which time the Board of Directors will review the earnings outlook for the next year or two. The dividend cash coverage for 1978 is estimated at around 1.75 times. This is below average but adequate. The Company has a Shareholders' Reinvestment Plan and a voluntary Employee Stock Purchase Plan.

Management

Mr. Robert E. Gilkinson (61), Chairman of the Board, joined Philadelphia Electric in 1939, held various positions including that of President for six years and was elevated to his present position in 1971. Mr. James L. Everett (52), a mechanical engineer, has been employed by the Company for 28 years and became President in 1971. He was designated the Chief Executive Officer April 1978. A new position was created April 1978 with the advancement of John H. Austin, Jr. (50) to Executive Vice President. He previously held several technical and accounting positions, most recently as Vice President - Finance and Accounting. Eleven Vice Presidents (including Joseph K. Pacquette, Jr. (44), recently named Vice President - Finance and Accounting,) and eight other officers comprise the senior management roster.

The eleven-member Board of Directors is composed of the three top corporate officers plus eight outside leaders from business, financial, government and educational institutions.

In our opinion, management is capable and experienced in utility operations. Management has had to contend with a sluggish territory and an increasingly political and unresponsive regulatory climate which has not enabled the Company to obtain sufficient rate relief to offset the increasing operating, construction and capital costs. Clearly, the principal challenge of management is to improve returns and earnings per share.

Dorothy M. Jelinek, C.F.A.

PHILADELPHIA ELECTRIC COMPANY

Capitalization

| | 1967 | | December 31, 1972 | | 1977 | |
|----------------------|------------------|--------------|-------------------|--------------|------------------|--------------|
| | \$1,000 | % | \$1,000 | % | \$1,000 | % |
| Debt - Long-Term | 701,548 | 52.0 | 1,300,759 | 49.3 | 2,106,926 | 51.4 |
| Debt - Other | 47,700 | 3.5 | 103,810 | 4.0 | 14,875 | 0.4 |
| Preferred Stock | 87,472 | 6.5 | 337,472 | 12.8 | 534,268 | 13.1 |
| Common Equity | 512,599 | 38.0 | 894,686 | 33.9 | 1,437,202 | 35.1 |
| Total | 1,349,319 | 100.0 | 2,636,727 | 100.0 | 4,093,271 | 100.0 |
| Index (1967 = 100) | | 100 | | 195 | | 303 |
| Company | | 100 | | 177 | | 298 |
| D&P Avg. | | | | | | |
| Shares Outstanding | | | | | | |
| Book Value per Share | | 29,031,919 | | 44,728,691 | | 74,624,517 |
| | | \$17.66 | | \$20.00 | | \$19.26 |

Earnings Record

| | Oper. Revenues (\$1,000) | Income Before Interest (\$1,000) | Earned on Avg. Capitalization % | Balance for Common (\$1,000) | Earned on Avg. Com. Equity % | Inc. Tax Rate % |
|-----------------------|--------------------------|----------------------------------|---------------------------------|------------------------------|------------------------------|-----------------|
| 1977 | 1,394,762 | 337,067 | 8.50 | 132,734 | 9.6 | 29 |
| 1976 | 1,224,141 | 315,781 | 8.43 | 125,596 | 9.9 | 32 |
| 1975 | 1,134,810 | 288,317 | 8.14 | 107,899 | 9.4 | 31 |
| 1974 | 1,011,726 | 249,560 | 7.75 | 95,415 | 8.9 | 24 |
| 1973 | 766,658 | 213,183 | 7.56 | 95,267 | 9.8 | 25 |
| Gain 1972-1977 | | | | | | |
| Company | 104 | 81 | | 54 | | |
| D&P Avg. | 128 | 90 | | 71 | | |
| 1972 | 685,038 | 185,759 | 7.56 | 86,416 | 10.3 | 29 |
| 1971 | 608,134 | 160,769 | 7.54 | 78,304 | 10.8 | 27 |
| 1970 | 504,371 | 126,382 | 6.88 | 59,764 | 9.4 | 24 |
| 1969 | 440,494 | 109,277 | 6.93 | 58,366 | 10.3 | 36 |
| 1968 | 405,231 | 96,323 | 6.83 | 56,424 | 10.9 | 36 |
| Gain 1967-1972 | | | | | | |
| Company | 82 | 101 | | 45 | | |
| D&P Avg. | 65 | 83 | | 45 | | |

Common Stock Data

| | <u>Earnings</u> \$ | <u>Shares</u> <u>Outstanding</u> (1,000) | <u>Dividend</u> <u>Rate</u> \$ | <u>Payout</u> % |
|-------------------------|-----------------------|--|--------------------------------------|--------------------|
| 7/31/78 | 1.65 | 73,979 | 1.80 | 109.1 |
| 1977 | 1.87 | 70,844 | 1.80 | 96.3 |
| 1976 | 1.91 | 65,606 | 1.64 | 85.9 |
| 1975 | 1.86 | 58,135 | 1.64 | 88.2 |
| 1974 | 1.81 | 52,717 | 1.64 | 90.6 |
| 1973 | 1.99 | 47,847 | 1.64 | 82.4 |
| <u>% Gain 1972-1977</u> | | | | |
| Company | (10) | 71 | 10 | |
| D&P Avg. | 12 | 55 | 22 | |
| 1972 | 2.08 | 41,505 | 1.64 | 78.8 |
| 1971 | 2.10 | 37,323 | 1.64 | 78.1 |
| 1970 | 1.84 | 32,556 | 1.64 | 89.1 |
| 1969 | 1.97 | 29,644 | 1.64 | 83.2 |
| 1968 | 1.94 | 29,032 | 1.64 | 84.5 |
| <u>% Gain 1967-1972</u> | | | | |
| Company | (2) | 49 | 0 | |
| D&P Avg. | 21 | 20 | 16 | |

| | <u>Market</u> | | | | <u>P/E Ratios</u> | | <u>Yield</u> | |
|---------|-------------------|------------------|--------------------|---------------------|-------------------|------------|-----------------|------------------|
| | <u>High</u> \$ | <u>Low</u> \$ | <u>Close</u> \$ | <u>To Book</u> % | <u>High</u> | <u>Low</u> | <u>Low</u> % | <u>High</u> % |
| 7/31/78 | 20.2 | 16.7 | 17.6 | 92 | 12.3 | 10.2 | 8.89 | 10.67 |
| 1977 | 21.2 | 17.1 | 19.5 | 102 | 11.4 | 9.2 | 8.47 | 10.51 |
| 1976 | 18.0 | 14.7 | 17.7 | 93 | 9.4 | 7.8 | 9.11 | 11.03 |
| 1975 | 15.4 | 11.1 | 15.0 | 79 | 8.3 | 6.0 | 10.58 | 14.74 |
| 1974 | 19.4 | 9.3 | 10.7 | 54 | 10.8 | 5.2 | 8.41 | 17.49 |
| 1973 | 23.4 | 17.0 | 18.0 | 89 | 11.8 | 8.5 | 6.98 | 9.65 |
| 1972 | 25.0 | 21.2 | 22.6 | 114 | 12.0 | 10.2 | 6.56 | 7.72 |
| 1971 | 25.1 | 20.5 | 23.7 | 122 | 12.0 | 9.8 | 6.53 | 7.95 |
| 1970 | 24.7 | 19.0 | 22.4 | 119 | 13.5 | 10.3 | 6.59 | 8.63 |
| 1969 | 32.1 | 22.0 | 24.0 | 127 | 16.3 | 11.2 | 5.11 | 7.45 |
| 1968 | 32.4 | 27.2 | 31.1 | 171 | 16.8 | 14.0 | 5.05 | 6.02 |

a - Market data for the latest 52 weeks through 9/18/78.

PHILADELPHIA ELECTRIC COMPANY

Operating Data

1977

| | <u>Electric</u> <u>(\$1,000)</u> | <u>%</u> | <u>Gas</u> <u>(\$1,000)</u> | <u>%</u> |
|-----------------------------|-------------------------------------|--------------|--------------------------------|--------------|
| <u>Revenues</u> | | | | |
| Residential | 427,622 | 36.3 | 93,753 | 53.6 |
| Commercial | 168,435 | 14.3 | 38,299 | 21.9 |
| Industrial | 513,383 | 43.6 | 42,099 | 24.1 |
| Other | 68,249 | 5.8 | 667 | 0.4 |
| Total | 1,177,689 | 100.0 | 174,818 | 100.0 |
| % of Total | 84 | | 13 | |
| Net Operating Income | 198,606 | | 20,861 | |
| % of Total | 89 | | 9 | |

Growth Trends

| | <u>% Increase 1972-1977</u> | | | |
|--------------------------------|-----------------------------|-----------------|----------------|-----------------|
| | <u>Electric</u> | | <u>Gas</u> | |
| | <u>Company</u> | <u>Industry</u> | <u>Company</u> | <u>Industry</u> |
| Customers | 5 | 12 | (1) | 5 |
| Sales - Retail | | | | |
| Residential | 18 | 28 | 1 | (7) |
| Commercial | 13 | 30 | 68 | 1 |
| Industrial | 6 | 18 | (47) | (22) |
| Total | 11 | 24 | (15) | (17) |
| Revenues - Retail | 105 | 124 | 88 | 122 |
| Residential Usage per Customer | 12 | 13 | - | - |

Power Supply

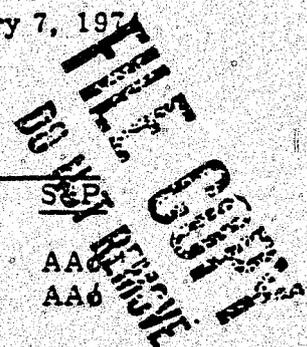
| <u>Year</u> | <u>Generating Capability*</u> mw | <u>Net Firm Purchases*</u> mw | <u>Total*</u> mw | <u>Peak Load*</u> mw | <u>Annual Growth</u> % | <u>Reserve Margin</u> % |
|-------------|-------------------------------------|----------------------------------|---------------------|-------------------------|---------------------------|----------------------------|
| 1982E | 8,405 | - | 8,405 | 6,700 | 3 | 25 |
| 1981E | 8,411 | - | 8,411 | 6,500 | 3 | 29 |
| 1980E | 8,428 | - | 8,428 | 6,300 | 3 | 34 |
| 1979E | 7,954 | - | 7,954 | 6,090 | 3 | 30 |
| 1978E | 7,954 | - | 7,954 | 5,888 | - | 35 |
| 1977 | 8,202 | - | 8,202 | 5,888 | 10 | 39 |
| 1976 | 7,166 | - | 7,166 | 5,346 | (3) | 34 |
| 1975 | 7,214 | - | 7,214 | 5,530 | 2 | 30 |
| 1974 | 6,768 | 200 | 6,968 | 5,431 | (6) | 28 |

* - At time of peak.

FIXED INCOME SECURITIES DATA

January 7, 1974

PHILADELPHIA ELECTRIC COMPANY



| | Ratings | | |
|-----------------|---------|---------|-----|
| | D&P | Moody's | S&P |
| Mortgage Bonds | 2 | Aa* | AA |
| Preferred Stock | 1 | | AA |

* - Downgraded one level in 1970

♠ - Downgraded one level in 1968

| | Pro Forma 1973# | 1973# | 1972 | 1971 | 1970 |
|---|-----------------------|-------|------|------|------|
| Times Earned Pre-Tax: | | | | | |
| Total Debt Interest | | | | | |
| Excl. IDC | 2.08 | 2.24 | 2.36 | 2.42 | 2.23 |
| Incl. IDC | 2.66 | 2.87 | 2.91 | 2.90 | 2.55 |
| Times Earned After-Tax: | | | | | |
| Total Int. & Pfd. Divs. (a) | 1.72 | 1.83 | 1.87 | 1.95 | 1.90 |
| Margin of Safety | | | | | |
| Total Interest - % (a) | 20.9 | 21.8 | 21.7 | 20.9 | 17.8 |
| Capital Ratios - Debt - % | | | | | |
| - Preferred | 50.9 | 50.1 | 53.3 | 54.0 | 56.8 |
| - Common | 13.9 | 14.1 | 12.8 | 11.5 | 9.7 |
| | 35.2 | 35.8 | 33.9 | 34.5 | 33.5 |
| % Increase Avg. Capital. | 15.2E | 14.2E | 15.2 | 16.1 | 16.4 |
| Int. Cost on Avg. Debt - % | 6.62E | 6.24E | 5.91 | 5.70 | 5.56 |
| % Earned on Reported Avg. Capitalization | 5.69E | 5.62E | 5.84 | 6.13 | 6.06 |
| Common Equity | 9.3E | 10.0E | 10.3 | 11.6 | 10.8 |

(a) - IDC included in Income.

- October 31, 1973; Pro forma for \$125 million bond offering scheduled January 16, 1974, assumed interest 8%.

Including the unreflected portion of a 9% electric rate increase received in August, 1973, pro forma pre-tax coverages would be closer to 2.65 times excluding IDC and 3.30 times including IDC. Coverages since 1970 have benefited from periodic rate relief and sales of equity. A substantial electric rate increase filing is planned for later in January, 1974. We consider Pennsylvania regulation as reasonable and constructive.

Construction continues relatively heavy geared largely to adding nuclear capacity. About 75% of capital requirements in the five years ending 1977 need to be obtained externally. We project capitalization in these five years increasing about 14% annually, on average. We look for capitalization ratios to remain relatively well balanced and with continued management aggressiveness in seeking rate relief, current debt quality ratings should be maintained.

RJS/mb

DUFF AND PHELPS

FIXED INCOME SECURITIES DATA

March 2, 1976

PHILADELPHIA ELECTRIC COMPANY

| | Pro Forma \emptyset | % of Cap. | D&P | Ratings | |
|-----------------|-----------------------|-----------|-------|---------|--------|
| | | | | Moody's | S&P |
| Capitalization: | | | | | |
| \$3,655 million | Mtg. Bonds | 44.5 | 2-Med | A(1) | A-(2) |
| Revenues: | Debentures | 3.5 | 3-Med | Baa | BBB |
| \$1,135 million | Pfd. Stock | 13.3 | 2 | "a" | BBB(3) |

- (1) - Downgraded one level in 1970 and again in October 1974.
 (2) - Downgraded one level in 1968, October 1974 and again in Feb. 1976.
 (3) - Downgraded one level in 1968, April 1974 and again in October 1974.

| | Pro Forma | | | | |
|------------------------------|-----------|------|------|------|------|
| | 1975 | 1975 | 1974 | 1973 | 1972 |
| Times Earned Pre-Tax: | | | | | |
| Total Debt Interest | | | | | |
| Excl. IDC | 1.91 | 1.98 | 1.83 | 2.16 | 2.36 |
| Incl. IDC | 2.36 | 2.44 | 2.42 | 2.81 | 2.91 |
| Times Earned After-Tax: | | | | | |
| Total Int. & Pfd. Divs. (a) | 1.57 | 1.60 | 1.62 | 1.81 | 1.87 |
| Margin of Safety | | | | | |
| Total Interest - % (a) | 17.9 | 18.3 | 16.9 | 21.3 | 21.7 |
| % Capital Ratios - Tot. Debt | 53.2 | 53.2 | 54.4 | 51.0 | 53.3 |
| - Preferred | 13.3 | 13.3 | 14.2 | 13.7 | 12.8 |
| - Common | 33.5 | 33.5 | 31.4 | 35.3 | 33.9 |
| % Increase Avg. Capital. | 10.1 | 10.1 | 14.1 | 14.9 | 15.2 |
| Int. Cost on Avg. Debt - % | 7.67 | 7.57 | 7.38 | 6.15 | 5.91 |
| % Earned on Reported Avg. | | | | | |
| Capitalization | 8.20 | 8.14 | 7.75 | 7.56 | 7.56 |
| Common Equity | 9.1 | 9.4 | 8.9 | 9.8 | 10.3 |

(a) - IDC included in income.

Construction forecasts are \$437 million for 1976 and an aggregate of \$2,242 million for 1976-1979. We estimate internal funds will provide 30% of 1976 needs and 42% for 1977-1979. Capitalization is expected to increase 10% annually and debt, Preferred and Common sales are scheduled in each of the years through 1979. We anticipate 1976 pretax total debt interest coverages to decline slightly to 1.85 times ex IDC and 2.3 times including IDC. The Company received \$24 million (2.5%) of rate relief effective February 1976 and \$70 million additional is currently pending. Pennsylvania regulation is subject to uncertainty with recent installation of two new Commission members. With annual sales of additional Common stock and adequate rate relief, we think coverages will be satisfactory to maintain current ratings.

DMJ:gs

FILE COPY

DUFF AND PHELPS

SECURITIES DATA

April 12, 1976

PHILADELPHIA ELECTRIC COMPANY

| | <u>Pro Forma</u> | % of <u>Cap.</u> | <u>D&P</u> | <u>Ratings</u> | |
|-----------------|------------------|---------------------|----------------|----------------|----------------|
| | | | | <u>Moody's</u> | <u>S&P</u> |
| Capitalization: | | | | | |
| \$3,655 million | Mtg. Bonds | 43.3 | 2-Med | A(1) | A-(2) |
| Revenues: | Debentures | 4.2 | 3-Med | Baa | BBB |
| \$1,144 million | Pfd. Stock | 14.6 | 2 | "a" | BBB(3) |

(1) - Downgraded one level in October 1974.

(2) - Downgraded one level October 1974 and again in Feb. 1976.

(3) - Downgraded one level April 1974 and again in October 1974.

| | <u>Pro Forma</u> | | | | |
|-----------------------------|------------------|-------------|-------------|-------------|-------------|
| | <u>1975</u> | <u>1975</u> | <u>1974</u> | <u>1973</u> | <u>1972</u> |
| Times Earned Pre-Tax: | | | | | |
| Total Debt Interest | | | | | |
| Excl. IDC | 1.97 | 1.98 | 1.83 | 2.16 | 2.36 |
| Incl. IDC | 2.43 | 2.44 | 2.42 | 2.81 | 2.91 |
| Times Earned After-Tax: | | | | | |
| Total Int. & Pfd. Divs. (a) | 1.55 | 1.60 | 1.62 | 1.81 | 1.87 |
| Margin of Safety | | | | | |
| Total Interest - % (a) | 18.2 | 18.3 | 16.9 | 21.3 | 21.7 |
| Capital Ratios - All Debt | 51.9 | 53.2 | 54.4 | 51.0 | 53.3 |
| - Preferred | 14.6 | 13.3 | 14.2 | 13.7 | 12.8 |
| - Common | 33.5 | 33.5 | 31.4 | 35.3 | 33.9 |
| Increase Avg. Capital. | 10.1 | 10.1 | 14.1 | 14.9 | 15.2 |
| Int. Cost on Avg. Debt - % | 7.66 | 7.57 | 7.08 | 6.15 | 5.91 |
| Earned on Reported Avg. | | | | | |
| Capitalization | 8.15 | 8.14 | 7.75 | 7.56 | 7.55 |
| Common Equity | 8.9 | 9.4 | 8.9 | 9.3 | 10.3 |

(a) - IDC included in income.

* - Pro formed for February sale of \$100 million Mortgage Bonds and April sale of Preferred with proceeds used to repay debt.

Construction forecasts are \$437 million for 1976 and an aggregate of \$1,986 million for 1976-1979. We estimate internal funds will provide 31% of 1976 needs and 42% for 1977-1979. Capitalization is expected to increase 9% annually and debt, Preferred and Common sales are scheduled in each of the years through 1979. We anticipate 1976 coverages to decline slightly from 1975 levels. The Company received \$24 million (2.3) of rate relief effective February 1976 and \$70 million additional is currently pending. Pennsylvania regulation is subject to uncertainty with recent installation of two new Commission members. We rank Pennsylvania regulation as Group IV, slightly below average in our Group I (highest to Group VI (lowest) rating system. With annual sales of additional common stock and adequate rate relief, we think earnings protection for the senior securities will be satisfactory to maintain current ratings.

DMJ:us



FILE COPY

September 30, 1976

DO NOT REMOVE

PHILADELPHIA ELECTRIC COMPANY

| | <u>Pro Forma</u> | <u>% of</u> <u>Cap.</u> | <u>D&P#</u> | <u>Ratings</u> | |
|-----------------|------------------|----------------------------|-----------------|----------------|----------------|
| | | | | <u>Moody's</u> | <u>S&P</u> |
| Capitalization: | Mtg. Bonds | 43.9 | 7 | A(1) | A(2) |
| \$3724 million | Debentures | 4.0 | 8 | Baa | BBB |
| Revenues: | Pfd. Stock | 14.0 | 8 | "a" | BBB(3) |
| \$1164 million | | | | | |

(1) - Downgraded one level October 1974; (2) - Downgraded one level October 1974 and again February 1976; (3) - Downgraded one level April 1974 and again October 1974.

| | <u>Pro Forma</u> | | | | |
|-----------------------------|------------------|-------------|-------------|-------------|-------------|
| | <u>1976</u> | <u>1976</u> | <u>1975</u> | <u>1974</u> | <u>1973</u> |
| Times Earned Pre-Tax: | | | | | |
| Total Debt Interest | | | | | |
| Excl. AFC | 1.91 | 1.99 | 1.98 | 1.83 | 2.16 |
| Incl. AFC | 2.38 | 2.48 | 2.44 | 2.42 | 2.81 |
| Times Earned After-Tax: | | | | | |
| Total Int. & Pfd. Divs. (a) | 1.55 | 1.62 | 1.60 | 1.62 | 1.81 |
| Margin of Safety | | | | | |
| Total Interest - % (a) | 18.1 | 18.6 | 18.3 | 16.9 | 21.3 |
| % Capital Ratios - All Debt | 52.0 | 52.5 | 53.2 | 54.4 | 51.0 |
| - Preferred | 14.0 | 14.4 | 13.3 | 14.2 | 13.7 |
| - Common | 34.0 | 33.1 | 33.5 | 31.4 | 35.3 |
| % Increase Avg. Capital. | 8.0 | 6.5 E | 10.1 | 14.1 | 14.9 |
| Int. Cost on Avg. Debt - % | 7.71 | 7.63 | 7.57 | 7.08 | 6.15 |
| % Earned on Reported Avg. | | | | | |
| Capitalization | 8.17 | 8.20 | 8.14 | 7.75 | 7.56 |
| Common Equity | 8.7 | 9.6 | 9.4 | 8.9 | 9.8 |

(a)-AFC in Income E-Estimate 0-12 months ended May 31, 1976

Construction forecasts have been revised downward to \$388 million for 1976, \$414 million for 1977, and an aggregate of \$2,140 million for 1976-1980. Internal funds are expected to provide 55% of 1976 construction requirements and 40% for 1977-1980. Our projected capitalization growth averages 8% annually 1976-1980 as compared to 13% compounded for the five years ended 1975. Rate relief of \$24 million (2.5%) became effective February 1976, \$23 million (2.3%) in August 1976 and PUC orders pertaining to an additional \$59 million are expected by late fall 1976. We rank Pennsylvania regulation as Group IV, slightly below average in our six-step rating system. We estimate year-end 1976 pre-tax total debt coverages at 1.85 times ex AFC and 2.30 times including AFC. With a moderating trend in capitalization growth and in external financing coupled with annual sales of common and adequate rate relief, we think earnings protection for the senior securities will be satisfactory.

Dorothy M. Jelinek, C.F.A.



March 14, 1977

PHILADELPHIA ELECTRIC COMPANY

| | <u>Pro Forma</u> | <u>% of Cap.</u> | <u>D&P</u> | <u>Ratings</u> | |
|-----------------|------------------|----------------------|----------------|----------------|----------------|
| | | | | <u>Moody's</u> | <u>S&P</u> |
| Capitalization: | | | | | |
| \$3,841 million | Mtg. Bonds | 44.9 | 7 | A | A- |
| Revenues: | Debentures | 3.8 | 8 | Baa | BBB |
| \$1,224 million | Pfd. Stock | 13.6 | 8 | "a" | BBB |

| | <u>Pro Forma</u> | | | | |
|-----------------------------|------------------|-------------|-------------|-------------|-------------|
| | <u>1976</u> | <u>1976</u> | <u>1975</u> | <u>1974</u> | <u>1973</u> |
| Times Earned Pre-Tax: | | | | | |
| Total Debt Interest | | | | | |
| Excl. AFC | 1.96 | 2.08 | 1.98 | 1.83 | 2.16 |
| Incl. AFC | 2.45 | 2.59 | 2.44 | 2.42 | 2.81 |
| Times Earned After-Tax: | | | | | |
| Total Int. & Pfd. Divs. (a) | 1.59 | 1.66 | 1.60 | 1.62 | 1.81 |
| Margin of Safety | | | | | |
| Total Interest - % (a) | 18.9 | 19.6 | 18.3 | 16.9 | 21.3 |
| % Capital Ratios - All Debt | 52.7 | 51.6 | 53.2 | 54.4 | 51.0 |
| - Preferred | 13.6 | 13.9 | 13.3 | 14.2 | 13.7 |
| - Common | 33.7 | 34.5 | 33.5 | 31.4 | 35.3 |
| % Increase Avg. Capital. | 7.1 | 5.8 | 10.1 | 14.1 | 14.9 |
| Int. Cost on Avg. Debt - % | 7.72 | 7.70 | 7.57 | 7.08 | 6.15 |
| % Earned on Reported Avg. | | | | | |
| Capitalization | 8.44 | 8.43 | 8.14 | 7.75 | 7.56 |
| Common Equity | 9.4 | 9.9 | 9.4 | 8.9 | 9.8 |

(a) - AFC included in income.

Electric operations provided 84% of 1976 revenues and 88% of pre-tax operating income; the balance was derived from gas and steam. Construction is budgeted at \$414 million for 1977, \$390 million for 1978, and \$1,752 million for the four years 1977 through 1980. The Company estimates internal sources can provide about 42% of 1977-1980 requirements. Invested capital will compound 8.2% annually as compared with a 10% rate applicable to the prior four-year period ended 1976. We rank Pennsylvania regulation in Group III in our I (highest) to VI (lowest) rating system. Fuel generation in 1977 is expected to be 29% coal, 27% nuclear, 21% oil, 4% hydro, and 19% other. We estimate 1977 pre-tax total debt interest coverages at 1.9 times ex AFC and 2.4 times including AFC. A moderating rate of growth in capitalization coupled with rate relief and sale of Common should allow earnings protection for the senior securities to be satisfactory.

Dorothy M. Jelinek, C.F.A.



February 22, 1978

PHILADELPHIA ELECTRIC COMPANY

| <u>Fixed Income Securities</u> | <u>Amount</u> | <u>% of</u> | <u>Ratings</u> | | |
|--------------------------------|---------------|-------------|----------------|----------------|----------------|
| | <u>\$MM</u> | <u>Cap.</u> | <u>D&P</u> | <u>Moody's</u> | <u>S&P</u> |
| Mortgage Bonds | 1,878 | 45.2 | 7 | A | A- |
| Debentures | 149 | 3.6 | 8 | Baa | BBB |
| Preferred Stock | 534 | 12.9 | 8 | "a" | BBB |

| | | <u>Pro</u> | <u>December 31</u> | | | |
|-------------------------------|-------------|--------------|--------------------|--------------|--------------|--------------|
| | | <u>Forma</u> | <u>1977</u> | <u>1976</u> | <u>1975</u> | <u>1974</u> |
| <u>Total Capitalization</u> | <u>\$MM</u> | <u>4,153</u> | <u>4,093</u> | <u>3,841</u> | <u>3,655</u> | <u>3,431</u> |
| All Debt | % | 52.5 | 51.8 | 51.6 | 53.2 | 54.4 |
| Pfd. | % | 12.9 | 13.1 | 13.9 | 13.3 | 14.2 |
| Common | % | 34.6 | 35.1 | 34.5 | 33.5 | 31.4 |
| <u>Increase Avg. Capital.</u> | % | 6.7 | 5.9 | 5.8 | 10.1 | 14.1 |
| <u>Avg. Debt Int. Cost</u> | % | 8.0 | 8.0 | 7.7 | 7.6 | 7.1 |
| <u>Coverages and Ratios</u> | | | | | | |
| Pre-Tax - Tot. Int. | | | | | | |
| Excl. AFC | X | 1.84 | 1.97 | 2.08 | 1.98 | 1.83 |
| Incl. AFC | X | 2.33 | 2.49 | 2.59 | 2.44 | 2.42 |
| Aftax-Int. | X | 1.59 | 1.65 | 1.66 | 1.60 | 1.62 |
| Margin of Safety | % | 16.6 | 17.5 | 19.6 | 18.3 | 16.9 |
| Earned on Average | | | | | | |
| Capitalization | % | - | 8.5 | 8.4 | 8.1 | 7.6 |
| Common Equity | % | - | 9.6 | 9.9 | 9.4 | 8.9 |
| Effective FIT Rate | % | - | 40 | 42 | 41 | 37 |

Comment: Our ratings reflect a reasonable capital structure and a manageable construction program. However, sluggish sales growth in the important electric division mandate dependency on periodic rate relief coupled with annual sales of Common.

Coverages slipped in 1977 as a result of the operation of the nuclear Salem No. 1 generating unit at mid-year. Only modest rate relief was reflected in 1977. The Company filed for a \$119 million two-part electric increase in August 1977, a portion of which reflects the impact of the Salem unit. The Company requested \$53.6 million of interim relief while an Administrative Law Judge recommended \$32.5 million in December 1977. A Commission decision is expected February 24, 1978 and a final Order is anticipated around April 1978. In the meantime, almost all of the nuclear fuel cost savings has accrued to customers. The Pennsylvania Commission has proposed a new generic fuel clause (ECR) for the state effective July 1978 which could be detrimental in its present form. Even with substantial rate relief, we expect modest erosion in coverages in 1978.

Dorothy M. Jelinek, C.F.A.

SUITE 4000 • 55 EAST MONROE STREET • CHICAGO, ILLINOIS 60603 • (312) 263-2610 • TELEX 25-5465

This material is confidential for the use of our clients only and may not be reprinted or reproduced.

Copyright © 1978 by Duff and Phelps, Inc.



September 21, 1978

PHILADELPHIA ELECTRIC COMPANY

| <u>Fixed Income Securities</u> | | <u>Amount</u> | <u>% of</u> | <u>D&P</u> | <u>Ratings</u> | |
|--------------------------------|--|---------------|-------------|----------------|----------------|----------------|
| | | <u>SMM</u> | <u>Cap.</u> | | <u>Moody's</u> | <u>S&P</u> |
| Mortgage Bonds | | 1,874 | 44.4 | 8 | A | A- |
| Debentures | | 149 | 3.5 | 9 | Baa | BBB |
| Preferred Stock | | 583 | 13.8 | 9 | "a" | BBB |

| | | <u>December 31,</u> | | | | |
|-------------------------------|------|---------------------|-------------|-------------|-------------|-------------|
| | | <u>6/30/78</u> | <u>1977</u> | <u>1976</u> | <u>1975</u> | <u>1974</u> |
| <u>Total Capitalization</u> | \$MM | 4,222 | 4,093 | 3,841 | 3,654 | 3,432 |
| <u>All Debt</u> | % | 52.0 | 51.8 | 51.6 | 53.2 | 54.4 |
| <u>Pfd.</u> | % | 13.8 | 13.1 | 13.9 | 13.3 | 14.2 |
| <u>Common</u> | % | 34.2 | 35.1 | 34.5 | 33.5 | 31.4 |
| <u>Increase Avg. Capital.</u> | % | 6.3 | 5.9 | 5.8 | 10.1 | 14.1 |
| <u>Avg. Debt Int. Cost</u> | % | 7.9 | 8.0 | 7.7 | 7.6 | 7.1 |
| <u>Coverages and Ratios</u> | | | | | | |
| <u>Pre-Tax - Tot. Int.</u> | | | | | | |
| Excl. AFC | X | 2.0 | 2.0 | 2.1 | 2.0 | 1.8 |
| Incl. AFC | X | 2.5 | 2.5 | 2.6 | 2.4 | 2.4 |
| Aftax-Int. & Pfd Div. | X | 1.6 | 1.6 | 1.7 | 1.6 | 1.6 |
| Margin of Safety | % | 17.2 | 17.6 | 19.7 | 18.3 | 16.9 |
| <u>Earned on Average</u> | | | | | | |
| Total Capitalization | % | 8.3 | 8.5 | 8.4 | 8.1 | 7.8 |
| Common Equity | % | 9.2 | 9.6 | 9.9 | 9.4 | 8.9 |
| Income Tax Rate | % | 32 | 29 | 32 | 31 | 24 |

Comment: The Company has a reasonable capital structure and a manageable construction program. However, sluggish electric sales growth together with low current returns and coverages indicate the need for both substantial periodic rate relief and annual sales of Common. Sale of Common and bonds has been delayed until the first quarter of 1979; short-term bank loans are being utilized in the interim.

Operations in the latter half of 1977 were impacted significantly by the commercial operation of the nuclear Salem No. 1 generating unit offset in part by a non-recurring gain from the changeover to monthly billing. In early 1978 some benefit was derived from interchange sales during the coal strike and a \$10.8 million interim allowed by the Commission in March. A final order relating to the \$119 million (11.5%) August 1977 filing is anticipated by yearend 1978.

We expect coverages to remain under pressure until rate relief beyond that currently filed is obtained to offset the increase in fixed and operating costs associated with the mid-1979 commercial operation of the Salem No. 2 nuclear unit. Two wholly-owned Limerick nuclear generating plants have been deferred until 1985 and 1987.

Dorothy M. Jelinek, C.F.A.

SUITE 4000 • 55 EAST MONROE STREET • CHICAGO, ILLINOIS 60603 • (312) 263-2610 • TELEX 25-5165

This material is confidential for the use of our clients only and may not be reprinted or reproduced.

Copyright © 1978 by Duff and Phelps, Inc.



FILE COPY
October 8, 1979

PHILADELPHIA ELECTRIC COMPANY

| Fixed Income Securities | Pro Forma 7/31/79 | | D&P | Ratings | | | |
|-------------------------------|-------------------|--------------|----------------|-------------|-------------|-------------|-------|
| | \$MM | % of Cap. | | Mood's | S&P | S&P | |
| Mortgage Bonds | 1,970 | 43.9 | 8 | A | A- | | |
| Debentures | 147 | 3.3 | 9 | Baa | BBB | | |
| Preferred Stock | 580 | 12.9 | 9 | "a" | BBB | | |
| | <u>1980E</u> | <u>1979E</u> | <u>7/31/79</u> | <u>1978</u> | <u>1977</u> | <u>1976</u> | |
| <u>Total Capitalization</u> | \$MM | 4,850 | 4,600 | 4,438 | 4,301 | 4,093 | 3,841 |
| All Debt | % | 53 | 53 | 52.3 | 52.1 | 51.8 | 51.6 |
| Preferred | % | 13 | 12 | 13.1 | 13.6 | 13.1 | 13.9 |
| Common | % | 34 | 35 | 34.6 | 34.3 | 35.1 | 34.5 |
| <u>Increase Avg. Capital.</u> | % | 6.2 | 6.0 | 5.4E | 5.8 | 5.9 | 5.8 |
| <u>Avg. Debt Int. Cost</u> | % | 8.7 | 8.4 | 8.4E | 8.2 | 8.0 | 7.7 |
| <u>Coverages and Ratios</u> | | | | | | | |
| Pre-Tax - Tot. Int. | | | | | | | |
| Excl. AFC | X | 1.9 | 1.8 | 1.8 | 1.9 | 2.0 | 2.1 |
| Incl. AFC | X | 2.4 | 2.4 | 2.4 | 2.4 | 2.5 | 2.6 |
| Aftax-Int. & Pfd. Div. | X | 1.6 | 1.7 | 1.7 | 1.6 | 1.6 | 1.7 |
| Margin of Safety | % | | | 17.7 | 17.6 | 17.6 | 19.7 |
| Earned on Average | | | | | | | |
| Total Capitalization | % | | | 9.0E | 8.7 | 8.5 | 8.4 |
| Common Equity | % | | | 10.3E | 9.7 | 9.6 | 9.9 |
| Income Tax Rate | % | | | 24 | 28 | 29 | 32 |

Comment: Philadelphia Electric provides electric, gas and steam service to areas of southeastern Pennsylvania. The service territory is subject to cyclical economic fluctuations because of the recession-prone heavy industry mix, including metal, machinery and rubber production. Customer and sales growth has been below average, as commercial and industrial growth was sluggish in recent years. Kwh sales growth is forecast to remain below average at 2%-3% annually over the next several years.

Construction is forecast at \$406 million for 1979, about equal to 1978. However, after 1979, expenditures should steadily increase, reaching \$677 million in 1983. The 1979-83 budget totals \$2.8 billion versus \$2.0 billion for the previous five years. The Company has a 43% interest in Public Service EsG's 1,115 mw Salem 2 nuclear unit, now expected to be in service by mid-1980. With reserve margins projected to average about 32% through 1983, the Company has agreed to sell Jersey Central Power & Light energy from its 474 mw share of Salem 2 until at least 1984. Philadelphia Electric has two wholly-owned Limerick nuclear units, each 1,055 mw, planned for 1985 and 1987.

Coverages have remained within a narrow range in recent years, declining slightly in 1977 and 1978 with the addition of new capacity and increases in related fixed and operating costs. We look for 1979 and 1980 coverages to remain at about the 1978 levels or slightly lower. A \$3 million steam rate increase was recently granted, and a small gas increase is expected by the end of 1979. An order in the pending \$123 million (9.8%) electric rate increase is expected in the first half of 1980. AFC should continue to rise until Salem 2 is in operation. Over the longer term, coverages should remain fairly stable assuming periodic rate relief in a below average regulatory climate. Despite annual Common stock sales, we see no significant increase in the Common equity ratio over the next few years. With low returns earned, the Common stock payout ratio has been 90% or above, permitting little plowback.

Byron C. Karzas, C.F.A.
Mary Beth M. Bopp

SUITE 4000 • 55 EAST MONROE STREET • CHICAGO, ILLINOIS 60603 • (312) 263-2610 • TELEX 25-5165

This material is confidential for the use of our clients only and may not be reprinted or reproduced.

Copyright © 1979 by Duff and Phelps, Inc.

FILE COPY
DO NOT REMOVE



Duff and Phelps, Inc.

Utility investment
 research service

March 11, 1980

PHILADELPHIA ELECTRIC COMPANY

| Fixed Income Securities | Pro Forma 12/31/79 | | | Ratings | |
|-------------------------|--------------------|-----------|-----|---------|-----|
| | SMM | % of Cap. | D&P | Moody's | S&P |
| Mortgage Bonds | 1,970 | 42.7 | 8 | A | A- |
| Debentures | 146 | 3.2 | 9 | Baa | BBB |
| Preferred Stock | 654 | 14.2 | 9 | "baa" | BBB |

* Lowered one level in February 1980.

| | | 1981E | 1980E | 1979 | 1978 | 1977 | 1976 |
|-------------------------------|-----|-------|-------|-------|-------|-------|-------|
| Total Capitalization | SMM | 5,290 | 5,015 | 4,615 | 4,301 | 4,093 | 3,841 |
| All Debt | % | 52 | 53 | 53.2 | 52.1 | 51.8 | 51.6 |
| Preferred | % | 13 | 13 | 12.6 | 13.6 | 13.1 | 13.9 |
| Common | % | 35 | 34 | 34.2 | 34.3 | 35.1 | 34.5 |
| Increase Avg. Capital. | % | 7.0 | 8.0 | 6.2 | 5.8 | 5.9 | 5.8 |
| Avg. Debt Int. Cost | % | 9.1 | 8.9 | 8.5 | 8.2 | 8.0 | 7.7 |
| Coverages and Ratios | | | | | | | |
| Pre-Tax - Tot. Int. | | | | | | | |
| Excl. AFC | X | 1.7 | 1.7 | 1.6 | 1.9 | 2.0 | 2.1 |
| Incl. AFC | X | 2.3 | 2.3 | 2.2 | 2.4 | 2.5 | 2.6 |
| Aftax-Int. & Pfd. Div. | X | 1.6 | 1.6 | 1.6 | 1.6 | 1.6 | 1.7 |
| Margin of Safety | % | | | 15.2 | 17.6 | 17.6 | 19.7 |
| Earned on Average | | | | | | | |
| Total Capitalization | % | | | 8.9 | 8.7 | 8.5 | 8.4 |
| Common Equity | % | | | 9.8 | 9.7 | 9.6 | 9.9 |
| Income Tax Rate | % | | | 19 | 28 | 29 | 32 |

Comment: Coverages declined after 1976 reflecting (1) the addition of new capacity and increases in related fixed and operating costs, (2) lack of adequate rate relief, and (3) continued below average gains in customers and sales. The service territory is subject to cyclical economic fluctuations because of the large industrial mix.

Construction is forecast at \$610 million for 1980, 45% higher than in 1979 due to inflation, increased NRC requirements for nuclear plants, and pollution-control additions. After 1980, expenditures should remain large, reaching \$677 million in 1983. The Company has a 43% interest in the 1,115 mw Salem 2 nuclear unit, currently expected to be in service around fall 1980. With reserve margins projected at 27%-36% through 1983, the Company has agreed (subject to FERC approval) to sell Jersey Central Power & Light energy from its share of Salem 2 until at least 1984. Philadelphia Electric's two wholly-owned Limerick nuclear units, each 1,055 mw, are planned for 1985 and 1987.

The Company received small gas and steam rate increases in late 1979, and an electric rate order is anticipated in April 1980 on a \$123 million (10%) request. The Administrative Law Judge has just recommended a \$79.9 million increase. Even with these increases and assuming some additional rate relief late in 1981, we estimate 1980 and 1981 coverages remaining no better than level. In each year, financing costs should be sizeable with sales of debt and Preferred. Over the longer term, we look for coverages to stay under pressure unless rate relief becomes more responsive in meeting increasing operating expenses and capital costs. We see no significant improvement in the Common equity ratio, despite annual Common stock sales over the next few years.

Mary Beth M. Bopp

SUITE 4000 • 55 EAST MONROE STREET • CHICAGO, ILLINOIS 60603 • (312) 263-2610 • TELEX 25-5165

This material is confidential for the use of our clients only and may not be reprinted or reproduced.

Copyright © 1980 by Duff and Phelps, Inc.



FILE COPY

April 21, 1980

PHILADELPHIA ELECTRIC COMPANY

| Fixed Income Securities | Actual 12/31/79 | | D&P ^a Rating | | | Reg. Rank D&P |
|-------------------------|-----------------|-----------|-------------------------|-------|------------------|------------------|
| | SMM | % of Cap. | D&P | Mdy's | S&P ^b | |
| Mortgage Bonds | 1,970 | 42.7 | 9 | A | BBB+ | IV |
| Debentures | 146 | 3.2 | 10 | Baa | BBB- | |
| Preferred Stock | 579 | 12.6 | 10 | "baa" | BBB- | |

a New D&P ratings in expanded #1-#11 system: #9-Middle "BBB"; #10-Low "BBB".
b Lowered one level in April 1980.

| | SMM | 1981E | 1980E | 1979 | 1978 | 1977 | 1976 |
|-----------------------------|-----|-------|-------|-------|-------|-------|-------|
| <u>Total Capitalization</u> | | 5,310 | 5,030 | 4,614 | 4,301 | 4,093 | 3,841 |
| All Debt | % | 52 | 53 | 53.2 | 52.1 | 51.8 | 51.6 |
| Preferred | % | 13 | 13 | 12.6 | 13.6 | 13.1 | 13.9 |
| Common | % | 35 | 34 | 34.2 | 34.3 | 35.1 | 34.5 |
| <u>Incr. in Cap.</u> | % | 5.6 | 9.0 | 7.3 | 5.1 | 6.6 | 5.1 |
| <u>Avg. Int. Cost</u> | % | 9.1 | 9.0 | 8.5 | 8.2 | 8.0 | 7.7 |
| <u>Coverages</u> | | | | | | | |
| Pre-Tax Int. | | | | | | | |
| Excl. AFC | X | 1.7 | 1.6 | 1.6 | 1.9 | 2.0 | 2.1 |
| Incl. AFC | X | 2.2 | 2.2 | 2.2 | 2.4 | 2.5 | 2.6 |
| Aftax-Int. & Pfd. Div. | X | 1.6 | 1.6 | 1.6 | 1.6 | 1.6 | 1.7 |
| <u>Margin of Safety</u> | % | - | - | 15.2 | 17.6 | 17.6 | 19.7 |

Distinguishing Characteristics

Coverages declined after 1976 reflecting (1) the addition of new capacity and increases in related fixed and operating costs (2) lack of adequate rate relief, and (3) continued below average gains in customers and sales. The service territory is subject to cyclical economic fluctuations because of the large industrial mix.

Construction is forecast at \$610 million for 1980, 45% higher than in 1979 due to inflation, increased NRC requirements for nuclear plants, and pollution-control additions. After 1980, expenditures should remain large, reaching \$677 million in 1983. The Company has a 43% interest in the 1,115 mw Salem 2 nuclear unit, currently expected to be in service around fall 1980. With reserve margins projected at 27%-36% through 1983, the Company has agreed (subject to FERC approval) to sell Jersey Central Power & Light energy from its share of Salem 2 until at least 1984. Philadelphia Electric's two wholly-owned Limerick nuclear units, each 1,055 mw, are planned for 1985 and 1987.

The Company received small gas and steam rate increases in late 1979, and an electric rate order is anticipated in April 1980 on a \$123 million (10%) request. The Administrative Law Judge has recommended a \$79.9 million increase. Even with these increases and assuming some additional rate relief late in 1981, we estimate 1980 and 1981 coverages remaining no better than level. In each year, financing costs should be sizeable with sales of debt and Preferred. Over the longer term, we look for coverages to stay under pressure unless rate relief becomes more responsive in meeting increasing operating expenses and capital costs. We see no significant improvement in the Common equity ratio, despite annual Common stock sales over the next few years.

Mary Beth M. Bopp

DUFF AND PHELPS, INC.

BULLETIN PHILADELPHIA ELECTRIC COMPANY

DATE October 7, 1974

REFER TO Our Summary dated July 17, 1974.

CROSS REFERENCE

NEW SIX AND TWENTY YEAR BONDS

On or about October 17, 1974, Philadelphia Electric proposes to sell two separate bond issues in a negotiated offering through underwriters headed by Drexel, Burnham & Company, Inc., and The First Boston Corporation. The two issues are (1) \$50 million First and Refunding Mortgage Bonds, ___% Series, due October 15, 1980 and (2) \$75 million First and Refunding Mortgage Bonds, ___% Series, due October 15, 1994. Net proceeds aggregating about \$125 million will be used to refund at maturity \$65 million 2-3/4% bonds due November 1, 1974 with the balance applied to partial repayment of short-term debt incurred for construction.

The six year \$50 million Bond issue will carry a conventional five year non-call provision, i. e., prior to October 15, 1979, none of the new six year Bonds may be redeemed with proceeds of any refunding operation involving borrowed funds having an interest cost to the Company less than ___%. We expect this percentage to be the effective interest cost of the new six year issue. No sinking fund is provided for the six year issue.

For the 20 year \$75 million new Bond issue, the non-call provision will be ten years or prior to October 15, 1984 rather than five years. In addition, the new 20 year Bonds will have a 5% annual sinking fund commencing in 1979. The sinking fund, equivalent to \$3,750,000 annually, is designed to retire 75% of the new 20 year Bonds prior to maturity. At the Company's option the sinking fund could be doubled annually; this option is non-cumulative.

INVESTMENT OPINION

We carry the Company's outstanding mortgage bonds on our No. 2 Bond List (medium relative quality on that list) where we shall also place the new issues. Early in October 1974, Standard & Poor's downgraded the Company's bonds to single-A from double-A and its Preferred stock to triple-B from single-A. More recently, Moody's announced that it was reducing the rating on the Company's bonds from double-A to single-A.

As computed by us, latest coverages for the 12 months ended July, 1974 were at their lowest levels for quite some time after declining slightly, in general, in recent years. The Company adopted deferred fuel cost accounting earlier

THE INFORMATION CONTAINED IN THIS MEMORANDUM IS OF A CONFIDENTIAL NATURE AND IS INTENDED FOR THE EXCLUSIVE USE OF THE PERSON OR FIRM TO WHOM IT IS FURNISHED

FILE COPY
DO NOT REMOVE

this year with the result that latest coverages are more liberally stated. Including the annualization of the April 4% rate increase, being collected subject to refund, we compute pro forma pretax coverages for long term debt interest at around 1.8 times excluding IDC and nearly 2.4 times including IDC. The April interim rate relief is the first part of a three part filing seeking \$136 million or 21%. We expect a decision early in 1975.

Recently announced construction cutbacks for the five years ending 1978 amount to around 20%. The Company estimates that about 67% of total capital requirements in the five years ending 1978 will be financed externally with the other 33% obtained internally. We estimate total capitalization in these five years increasing slightly less than 10% annually. By comparison, the rate of increase was nearly 15-1/2% compounded annually in the prior five years. Pro forma capitalization ratios would include 14.7% bonds and 8.3% other debt for a total debt ratio 53.0%, 14.8% Preferred stock, and 32.2% Common stock equity.

We think the new six year issue in today's market would probably be offered at a yield around 10.75%. For the twenty year issue, the offering yield would probably be around 11.75%.

SYSTEM OPERATIONS

This utility provides electric service in and around Philadelphia and natural gas service in suburban Philadelphia. The electric department accounts for nearly 90% of after-tax net operating income. About 40% of total revenue is obtained within the city itself. The Company's current projections contemplate that following about a 2% decrease in electric sales for 1974 because of conservation measures and adverse weather, sales growth of about 5-1/2% in 1975 and 6-7% for several years thereafter could be expected. The Company's projections seem reasonable to us.

Philadelphia Electric received general electric rate increases in 1969, 1971, and 1973. In January, 1974, the Company filed for additional electric rate increases of \$136 million annually or about 21%. The filing was divided into three separate parts and was rather innovative inasmuch as, among other things, a forward looking test period is being sought. Part one was designed to increase revenue by \$24 million or 4%, was in effect a "make-whole", and was allowed to go into effect subject to refund April 1, 1974. The Commission has suspended to January 1, 1975, the second and third steps amounting to \$54 million (8%) and \$58 million (9%), respectively, while it conducts an investigation as to the reasonableness of the entire \$136 million. If everything goes as presently scheduled, a final decision on this three part filing would be handed down in early 1975.

In the past we have considered Pennsylvania regulation as reasonable and constructive. However, there is a risk that the regulatory climate could change inasmuch as the chairman of the Commission is a Republican whose term expires in 1975. If the present Democratic Governor is re-elected in November, 1974, we think it unlikely that the present chairman will be reappointed for another term with the result that the character of the Commission could change. Currently there is one vacancy on the five-man Commission and already one Governor-nominee has been turned down by the Senate which has the power of confirmation.

Power supply additions over the next decade are strongly oriented to nuclear power. In July, 1974, Peach Bottom No. 2, a nuclear generating unit with a capacity of 1,051 mw began commercial operation. Philadelphia Electric's share of this unit is 447 mw, equivalent to 43%. The Company is also entitled to 447 mw of Peach Bottom No. 3, the nuclear unit planned to go on line later this year.

Recently announced construction cut backs would delay the in service date of the six nuclear units at the Salem, Limerick and Fulton stations. The Salem No. 1 generating unit, of which the Company's portion is 464 mw, has been rescheduled from 1975 to late 1976 and the second Salem unit rescheduled to 1979 from 1976. Four units at the wholly-owned Limerick and Fulton units aggregating 4,430 mw are now scheduled for the 1981 through 1986 period. Also placed in service this 1974 summer were eight combustion turbine generating units with a total capacity of 432 mw. Two oil-fired units of 344 mw each are scheduled for operation in the fall of 1974 and the summer of 1975.

Company-owned generating capability is backed by the PJM Pool interconnection. Through the constant interchange of electricity, this integrated operation affords greater reliability and economy than would be possible if the power systems of the same companies were developed independently. The PJM installed capacity was approximately 37,400 mw on August 31, 1974 which provides a reserve margin of around 22% over the forecasted 1974 summer peak load.

Philadelphia Electric's electric output for 1974 is expected to be obtained 30% from oil-fired generation, 19% from service area coal-fired generation, 12% from jointly owned mine-mouth-fired coal generation, 10% from nuclear capacity, 5% from hydro capacity, 5% from internal combustion capacity, and 19% from net purchases from the PJM Pool, of which around one-half is generated on coal-fired equipment.

Effective January 1, 1974, the Company was allowed by the Pennsylvania Commission to institute a new fuel adjustment clause which recognized increases or

decreases in the average cost per kwh generated by all fossil fuels. The time lag for recoupment is about two months. The Company changed to deferred fuel cost accounting in May, 1974 retroactive to the first of the year.

With respect to obtaining the necessary oil for electric generation, Philadelphia Electric expects that its deliveries through at least June, 1975 will meet its projected requirements. At present, the Company's oil storage facilities have on hand about 15 days requirements. With respect to coal, the Company continues its attempts to increase its coal inventories. Currently on hand is around 600,000 tons which represents approximately a 95 day supply for the Philadelphia service area units currently burning coal.

In the gas department, the situation continues very tight and no new customers are being connected. The Company does not expect its supplies to improve appreciably in the immediate future nor is there any assurance that deliveries to it may not be further curtailed. The Company purchases natural gas from Texas Eastern Transmission Corporation and from Transcontinental Gas Pipeline Corporation. Because of the continued tight gas supply situation, it appears to us that the gas department will continue to be essentially a no-growth situation over the next several years.

CONSTRUCTION

The Company recently announced cutbacks in construction estimates of around 8% to \$520 million for 1974 and 26% to \$417 million for 1975. In addition, the Company now estimates that construction for the years 1975 through 1978 will amount to \$1.7 billion representing a reduction of \$430 million or around 20% from previous estimates.

As compared with the current construction estimates of \$2,635 million in the five years ending 1978, gross property additions in the prior five years ended 1973 amounted to about \$1,861 million. Whereas gross plant increased 88% or around 13.5% compounded annually in the five years ended 1973, we estimate gross plant increasing around 68% or around 11% compounded annually in the five years ending 1978, based on current estimates.

FINANCING AND CAPITALIZATION

The Company estimates that internally generated cash will provide about \$133 million in 1974 or 25% of anticipated 1974 construction. For the entire five years ending 1978, total capital requirements are estimated at around \$2,936 million consisting of construction expenditures and \$300 million for sinking fund payment and bond maturities. The Company estimates that approximately 67%

of these capital requirements will be obtained externally and 33%. It currently appears that total capitalization in the five years ending 1978 will increase slightly less than 10% compounded annually. By comparison, the rate of increase was nearly 15-1/2% compounded annually in the prior five years ended 1973.

The depressed market price of the Company's Common stock has resulted in Philadelphia Electric deferring to a later date its \$100 million Common stock sale previously scheduled for the fall, 1974. The market price of about 10 at present is only around 50% of book value. At the current depressed market price, such a \$100 million offering would have necessitated about a 20% increase in shares outstanding. Current Company thinking is to perhaps sell additional Common after a decision in the pending rate case.

Actual and pro forma capitalizations as of July 31, 1974 are shown on the following page. Our pro forma adjustments include the proposed sale of Bonds, the retirement at maturity of a \$65 million 2-3/4% bond issue, and a \$60 million reduction in bank loans.

As computed by us, pro forma capitalization ratios would include 44.7% bonds and 8.3% other debt for a total debt ratio of 53.0%, 14.8% Preferred stock, and 32.2% Common stock equity. This would be below the Company's longer term objective of maintaining around a 37% Common stock equity ratio. Our calculations indicate that to have even a 35% Common equity at the end of 1978, some \$500 million of outside Common stock equity would have to be raised. We expect sales of additional Common stock every year through 1978.

If coverages remain at or below present levels, the result may be greater use of unsecured debt or Common stock, or the further curtailment or rescheduling of a portion of the program if such unsecured debt or Common stock is not marketable on acceptable terms. To sell additional mortgage bonds, pre-tax earnings before IDC have to cover pro forma mortgage bond interest at least 2 times. On a pro forma basis, the coverage under the mortgage for the 12 months ended July 31, 1974 would be 2.01 times assuming the new Bonds at an average interest rate of 10-1/2%. To sell additional Preferred stock, the earnings test is 1.5 times as compared with an actual 1.47 times and based on this earnings coverage test, no Preferred stock may be issued at the present time.

VALUATION

Principal asset support for pro forma capitalization as of July 31, 1974 is shown on page 7. Carried at original cost, Philadelphia Electric had utility plant in service of \$2,944 million at the balance sheet date. This was made

PHILADELPHIA ELECTRIC COMPANY

Capitalization - July 31, 1974

| | Actual | | Pro Forma | |
|--|------------------|-------|------------------|-------|
| | \$ 1,000 | % | \$ 1,000 | % |
| Debt: | | | | |
| First & Refunding Mtg. Bonds | | | | |
| 23 Series - 2/3/4% - 9% | | | | |
| due 1975 - 2004 | 1,350,200 | | 1,350,200 | |
| 2-3/4% Series, due 1974 | 65,000 | | - | |
| % Series, due 1980 | - | | 50,000 | |
| % Series, due 1994 | - | | 75,000 | |
| Total Mortgage Bonds | <u>1,415,200</u> | 42.9 | <u>1,475,200</u> | 44.7 |
| Long-Term Notes due 1979 | 125,000 | 3.8 | 125,000 | 3.8 |
| Pollution Control Note, 5.5% | 40,000 | 1.2 | 40,000 | 1.2 |
| 4.85% S/F Debs., due 1986 | 29,387 | 0.9 | 29,387 | 0.9 |
| Unamortized D. D. & Prem. | 1,301 | - | 1,301 | - |
| Subsidiary Debt | 24,985 | 0.8 | 24,985 | 0.8 |
| Total Long-Term Debt | <u>1,633,271</u> | 49.6 | <u>1,693,271</u> | 51.4 |
| Bank Loans | 67,600 | 2.0 | 7,600 | 0.2 |
| Commercial Paper | 46,520 | 1.4 | 46,250 | 1.4 |
| Total Debt | <u>1,747,391</u> | 53.0 | <u>1,747,391</u> | 53.0 |
| Preferred Stock - Cum., \$100 Par | | | | |
| 11 Series, 3.8%-9.50% | | | | |
| 4,863,835 Shares | 486,383 | 14.8 | 486,383 | 14.8 |
| Total Debt & Preferred | <u>2,233,774</u> | 67.8 | <u>2,233,774</u> | 67.8 |
| Common Stock Equity: | | | | |
| Common Stock - No Par | | | | |
| 52,804,226 Shares | 777,641 | | 777,641 | |
| Other Paid-in Capital | 1,305 | | 1,305 | |
| Retained Earnings | 284,714 | | 283,714 | |
| Total Common Equity | <u>1,062,660</u> | 32.2 | <u>1,062,660</u> | 32.2 |
| Total Capitalization | <u>3,296,434</u> | 100.0 | <u>3,296,434</u> | 100.0 |
| Book Value Per Share - Preferred | \$318.48 | | | |
| - Common | 20.12 | | | |

| | |
|--------------------------------|------------------|
| | <u>\$ 1,000</u> |
| Utility Plant at Original Cost | 2,944,233 |
| Less: Depreciation Reserve | 700,361 |
| Net Plant in Service | <u>2,243,872</u> |
| Construction Work in Progress | 1,013,750 |
| Net Plant | <u>3,257,622</u> |
| Other Property and Investments | 11,839 |
| Pro Forma Net Working Capital | 63,430 |
| Total | <u>3,332,891</u> |

up about 86% electric, 9% gas, and the small balance steam and common plant. The reserve for depreciation was equivalent to nearly 24% of plant in service. Despite the fact that the Peach Bottom No. 2 nuclear unit went in service early in July, 1974, construction work in progress at July 31, 1974 was substantial at \$1,013.8 million. Overall, we arrive at total asset support of \$3,332.9 million or some \$36.5 million in excess of our pro forma capitalization. This primarily reflects nearly \$61 million of deferred income taxes and unamortized investment credits which have been invested in plant, but are not included by us in capitalization, net of \$26.6 million of deferred fuel expense carried as a deferred debit.

The pro forma mortgage bonds are equivalent to 45% of the aforementioned total net plant and 44.2% of the aforementioned asset support. In other words, there would be \$2,259 of asset support for each \$1,000 of pro forma mortgage bonds.

ACCOUNTING PRACTICES

Effective in 1971, PE started treating on a normalized basis the tax deferrals related to accelerated depreciation taken on property additions after December 31, 1969. Prior years acceleration is still being flowed through but as time goes on, the amount of flow-through will be reduced and the amount normalized will be increased, thereby contributing to cash flow. Tax deferrals from the use of ADR are normalized. Income tax reductions resulting from investment tax credits arising from new plant placed in service are being amortized over a five year period at the former 3% rate, and over the estimated useful life of utility plant and credit for the new 4% rate under the Revenue Act of 1971. For book purposes, the composite depreciation rate is 2.9%. Credit for interest charged to construction was taken at an 8% rate July 1, 1970 through September 30, 1973; effective October 1, 1973 the rate was reduced to 7-1/2% in conformance with an Order of the Pennsylvania Public Utility Commission which accepted the Company's request to allocate non-utility income, the income tax reductions arising from interest charges

associated with debt used to finance construction work in progress. We calculate the effective book income tax rate at 34% for 1973 and 32% in 1972.

Effective in April 1974 and retroactive to the first of the year, PE changed to deferred fuel cost accounting under which electric generation fuel expense (which is recoverable under the fuel adjustment clause) is not booked until it is recovered in fuel adjustment revenue. This accounting change indicates a less conservative approach than before. If the Company had not gone to deferred fuel cost accounting, the impact of sharply rising fuel costs on fuel cost lag would have cost the Company 24¢ per share. We regard the quality of reported earnings to be about average noting that the buildup in normalized accelerated depreciation tax deferrals will raise the quality over time. Only about 6¢ per share of earnings in 1974 will be from flow-through of accelerated depreciation tax deferrals.

EARNINGS AND COVERAGES

Detailed income statements covering the calendar years 1970 through 1973 and the 12 months ended July, 1974, are presented on the following page. At the bottom of the page we show the Company's returns earned on average capitalization and on average Common equity as well as our computation of the book effective income tax rate.

We show below coverages and margins of safety beginning with the year 1971. Our pro forma coverages are after annualizing all interest and Preferred stock dividends and assume a 10% interest rate on the new \$50 million of six-year Bonds and an 11% interest rate on the new \$75 million 20 year Bonds.

| | Pro Forma | | -Actual- | | | |
|-----------------------------|-------------------|-------------------|----------|-------|-------|-------|
| | 1974 ^b | 1974 ^b | 1973 | 1972 | 1971 | 1970 |
| Times Earned Pre-Tax: | | | | | | |
| Long-Term Debt Interest | | | | | | |
| Excl. IDC | 1.68 | 2.22 | 2.30 | 2.51 | 2.67 | 2.57 |
| Incl. IDC | 2.24 | 2.97 | 2.99 | 3.09 | 3.20 | 2.94 |
| Total Debt Interest | | | | | | |
| Excl. IDC | 1.62 | 2.01 | 2.16 | 2.36 | 2.43 | 2.23 |
| Incl. IDC | 2.16 | 2.69 | 2.81 | 2.91 | 2.90 | 2.55 |
| Times Earned After-Tax: | | | | | | |
| Total Debt Interest | | | | | | |
| Excl. IDC | 1.38 | 1.60 | 1.71 | 1.84 | 1.92 | 1.86 |
| Incl. IDC | 1.92 | 2.28 | 2.36 | 2.30 | 2.30 | 2.18 |
| Total Int. & Pfd. Divs. (a) | 1.50 | 1.75 | 1.81 | 1.87 | 1.95 | 1.90 |
| Margin of Safety: | | | | | | |
| Total Debt Interest (a) | 16.8% | 19.6% | 21.3% | 21.7% | 20.9% | 17.8% |

(a) - Includes IDC.

b - 12 Months ended July 31, 1974.

PHILADELPHIA ELECTRIC COMPANY
Income Statements

- In Thousands of Dollars -

| | 1974 ^o | 1973 | 1972 | 1971 | 1970 |
|-------------------------------------|-------------------|----------------|----------------|----------------|----------------|
| Operating Revenues: | | | | | |
| Electric | 756,696 | 646,758 | 574,431 | 506,670 | 412,496 |
| Gas | 103,371 | 100,508 | 93,286 | 87,290 | 80,960 |
| Steam | 23,810 | 19,392 | 17,321 | 14,174 | 10,915 |
| Total | <u>883,877</u> | <u>766,658</u> | <u>685,038</u> | <u>608,134</u> | <u>504,371</u> |
| Operating Expenses | | | | | |
| Operation | 486,089 | 392,729 | 331,927 | 294,616 | 234,781 |
| Maintenance | 59,377 | 58,742 | 55,461 | 49,242 | 48,078 |
| Depreciation | 68,860 | 64,271 | 60,515 | 55,937 | 53,947 |
| General Taxes | 63,177 | 57,353 | 52,980 | 47,109 | 38,410 |
| Total | <u>677,503</u> | <u>573,095</u> | <u>500,883</u> | <u>446,904</u> | <u>375,216</u> |
| Operating Income | | | | | |
| (Before Income Taxes) | 206,374 | 193,563 | 184,155 | 161,230 | 129,155 |
| Federal Income Taxes | 33,327 | 24,335 | 23,541 | 21,695 | 17,834 |
| State Income Taxes | 9,593 | 7,608 | 7,890 | 7,457 | 5,330 |
| Deferred Income Taxes | 10,989 | 9,601 | 7,306 | 3,947 | 818 |
| Investment Tax Credit - Net | 6,869 | 3,596 | 1,870 | 569 | 836 |
| Net Operating Income | <u>145,596</u> | <u>148,423</u> | <u>143,548</u> | <u>127,562</u> | <u>107,645</u> |
| Other Income | | | | | |
| IDC | 69,826 | 58,743 | 42,450 | 31,591 | 18,513 |
| Income Tax Credit on IDC | 13,556 | 4,748 | - | - | - |
| Taxes on Other Income | 761 | 1,374 | 435 | 1,680 | 190 |
| Other - Net | 1,440 | 2,643 | 196 | 3,196 | 34 |
| Income Before Interest | <u>234,557</u> | <u>219,188</u> | <u>185,759</u> | <u>150,769</u> | <u>126,882</u> |
| Interest Deductions | | | | | |
| Long-Term Debt | 93,249 | 84,837 | 73,383 | 60,854 | 50,336 |
| Short-Term Debt | 9,848 | 5,479 | 4,402 | 5,291 | 7,570 |
| Total | <u>103,097</u> | <u>90,316</u> | <u>77,785</u> | <u>67,145</u> | <u>58,006</u> |
| Net Income | 131,560 | 128,867 | 107,974 | 93,624 | 68,876 |
| Preferred Dividends | 30,731 | 27,600 | 21,558 | 15,320 | 9,512 |
| Balance for Common | <u>100,829</u> | <u>101,267</u> | <u>86,416</u> | <u>78,304</u> | <u>59,364</u> |
| Effective Tax Rate | 35% | 34% | 32% | 29% | 25% |
| % Earned on Reported Average | | | | | |
| Capitalization | 7.69 | 7.56 | 7.56 | 7.54 | 6.88 |
| Common Equity | 10.0 | 9.8 | 10.3 | 10.8 | 9.4 |

- Red figure.

^o - 12 months ended July 31, 1974.

Despite the 1971 and 1973 permanent rate increases, coverages in general have slowly declined, a reflection of the relatively slow electric and gas sales growth, higher operating expenses, and heavy outside financing. Actual and pro forma coverages for the 12 months ended July 31, 1974 reflect only about one-quarter of the \$24 million rate increase effective April 1, 1974, subject to refund. This was the first part of a three-part filing seeking \$136 million or 21%. We calculate that if the pro forma figures shown above were to be further adjusted for the annualization of this \$24 million rate increase, the coverage for long-term debt interest pre-tax would be around 1.8 times excluding IDC and 2.4 times including IDC. We think coverages for the full year will be only slightly above those just cited. With satisfactory rate relief early in the year and satisfactory operation of the two Peach Bottom nuclear units, we would visualize coverages in 1975 improving slightly.

Philadelphia Electric several years ago undertook a massive construction program geared largely to adding nuclear capacity. Substantial fuel savings are in prospect as nuclear generation increases as a percent of total and oil generation declines. In the current environment of unprecedented high capital costs, construction cutbacks have been made thus reducing somewhat the need for outside financing. Nevertheless, substantial outside financing is necessary. Following sale of these mortgage bonds and the near-term payment at maturity of the 2-3/4% Bonds, the Company will have the ability to issue \$65 million of Bonds without regard to the earnings test. Sale of a substantial amount of additional Common stock is indicated for early 1975. The timing and amount granted of the pending rate relief will be a very important determinant of near-term coverages. Further rate increase applications appear to be required and we think management will continue to seek rate relief. We have considered Pennsylvania regulation as reasonable and constructive. However, as discussed earlier, the regulatory climate could change within the next nine months or so.

BOND INDENTURE PROVISIONS

Trustee: The Fidelity Bank is trustee under the mortgage.

Maturity: The \$50 million six-year Bonds will be due on October 15, 1980, and the \$75 million twenty-year Bonds will be due on October 15, 1994.

Security: No securities may be issued by the Company which will rank ahead of the Bonds as to security. Both of the new Bond series will be secured equally and proportionately with all outstanding series by a first mortgage lien on substantially all of the Company's fixed property, now owned or hereafter acquired with the usual minor exceptions. All the Common stock of Philadelphia Electric Power Company (a wholly-owned subsidiary) is pledged as additional security.

Additional Bonds: Additional bonds may be issued against 60% of net property additions, deposited cash, or for refunding. For this purpose, property additions are confined to those located in Pennsylvania or within 150 miles of Philadelphia. Property additions used exclusively in the steam business are not bondable until all bonds issued prior to September 1, 1957 are no longer outstanding. Except in the case of refunding, additional bonds may be issued only if net earnings computed before income taxes and IDC but after depreciation are equal to at least 2 times pro forma bond interest.

The new \$125 million of Bonds are to be issued against available bondable property additions. Coverage under the earnings test of the mortgage for the 12 months ended July 31, 1974 would be 2.01 times giving effect to the payment of the 2-3/4% bonds at maturity on November 1, 1974 and the sale of \$125 million aggregate principal amount of new Bonds at an assumed average interest rate of 10-1/2% per year. In order to meet the earnings test of the mortgage, the aggregate principal amount of new Bonds would have to be decreased by approximately \$1 million for each increase of 1/8th of 1% in the actual interest rate of the new Bonds over such assumed average interest rate of 10-1/2%.

Upon the retirement of the \$65 million 2-3/4% bonds due November 1, the Company will be entitled under the mortgage to issue an additional \$65 million of mortgage bonds without regards to the earnings test.

Redemption Provisions: Prior to October 15, 1979, for the new \$50 million six-year Bonds and prior to October 15, 1984 for the new \$75 million twenty-year Bonds, the new Bonds may not be redeemable as a part of or in anticipation of any refunding operation involving the use of borrowed funds having an effective interest cost to the Company of less than _____% in the case of the new Bonds due 1980, or of less than _____% in the case of the new Bonds due 1994. In both cases, we think this percentage will be the effective interest cost to the Company of the respective series. Other than this, the exact redemption provisions are to be announced.

Sinking Fund: No sinking fund is provided for the new six-year Bonds due 1980. For the twenty-year Bonds, the sinking fund is \$3,750,000 or 5% annually, commencing October 15, 1979. This may be met with cash or new Bonds, but not property additions. The sinking fund is designed to retire 75% of the new twenty-year Bonds prior to maturity. In addition, the Company has the non-cumulative option to increase any sinking fund payments by an amount not exceeding the required 5% payment.

Maintenance, Depreciation and Improvement Provisions: The Company has covenanted in the mortgage that it will maintain the mortgaged property in good repair, working order and condition, and that it will maintain in its accounts a reasonably adequate reserve for renewals and replacements or depreciation. Certain other, more specific maintenance, depreciation and improvement covenants contained in the mortgage will expire upon the retirement at maturity of the Company's 2-3/4% bonds due November 1, 1974.

Conclusion: Largely because of the absence of any control of depreciation cash after 1974, we consider the Indenture to be rather loose.

CERTAIN PENNSYLVANIA TAX MATTERS

Philadelphia Electric's new Bond issue is, in the opinion of Company Counsel, exempt from all existing personal property taxes in Pennsylvania. However, the Company is required by law to deduct the Pennsylvania Corporate Loans Tax from interest payments to individuals and partnerships resident in Pennsylvania and to certain fiduciaries.

RJS/mb



September 27, 1977

PHILADELPHIA ELECTRIC COMPANY

COMMON STOCK OFFERING

On October 5, 1977, Philadelphia Electric Company proposes to sell 4.0 million shares of Common stock (no par value) at a negotiated price with underwriters headed by Drexel Burnham & Co. and The First Boston Corporation. The offering will represent a 5.7% increase in shares outstanding to 74.1 million. Proceeds of approximately \$78 million will be used to retire short-term debt and for construction; such short-term debt is expected to be \$42.3 million at August 31, 1977.

INVESTMENT OPINION

The Company provides electric, gas and steam service to Philadelphia and its environs. In the 12 months ended July 31, 1977 electric operations accounted for 84% of revenues and 88% of pre-tax income. Kwh sales are projected at 4%-5% annually. We rank Pennsylvania regulation as Group III in our I (highest) to VI (lowest) rating system.

Construction expenditures aggregate \$2,392 million for 1977-1981. The Company estimates internal sources can provide 44% of the \$448 million budgeted for 1977 and about 46% of 1978-1981 expenditures amounting to \$1,944 million. Capitalization at July 31, 1977 on a pro forma basis consisted of 52.1% total debt, 13.2% Preferred stock and 34.7% Common equity. We project capitalization growth at 7% annually for the five years ended 1981 versus an 11% annual rate recorded in the prior five year period ended 1976.

Per share earnings for the 12 months ended July 31, 1977 were reported at \$2.08 versus \$1.84 for the similar prior period and \$1.91 for calendar 1976. Earnings for the 12 months ended July 1977 benefited principally from an increase in AFC of \$10 million since year-end 1976 and rate relief. A slowdown in financing cost increases was also a positive factor. However, as a result of commercial operation of the Salem nuclear unit at June 30, 1977, AFC will begin to decline \$2 million monthly and depreciation will rise \$900,000 monthly; other fixed charges relating to this generating addition will increase. Less rate relief will also be effective for the balance of 1977. A small offset will be the nuclear fuel savings. Overall, we expect some attrition in per share earnings for the balance of 1977 and until rate relief is received. Thus, we are maintaining our 1977 earnings estimate of \$2.00 per share on 8% additional average outstanding shares which equates to a 10.3% return on average equity.

Common Stock Data

| | <u>Earnings</u> \$ | <u>Avg. Shares Outstanding</u> (1,000) | <u>Dividend Rate</u> \$ | <u>Payout</u> % |
|-------------------------|-----------------------|---|----------------------------|--------------------|
| 7/31/77 | 2.08 | 68,612 | 1.80 | 86.5 |
| 1976 | 1.91 | 65,606 | 1.64 | 85.9 |
| 1975 | 1.86 | 58,135 | 1.64 | 88.2 |
| 1974 | 1.81 | 52,717 | 1.64 | 90.6 |
| 1973 | 1.99 | 47,847 | 1.64 | 82.4 |
| 1972 | 2.08 | 41,505 | 1.64 | 78.8 |
| <u>% Gain 1971-1976</u> | | | | |
| Company | (9) | 76 | 0 | |
| D&P Average | 15 | 52 | 19 | |
| 1971 | 2.10 | 37,323 | 1.64 | 78.1 |
| 1970 | 1.84 | 32,556 | 1.64 | 89.1 |
| 1969 | 1.97 | 29,644 | 1.64 | 83.2 |
| 1968 | 1.94 | 29,032 | 1.64 | 84.5 |
| 1967 | 2.13 | 27,880 | 1.64 | 77.0 |
| <u>% Gain 1966-1971</u> | | | | |
| Company | 1 | 36 | 11 | |
| D&P Average | 19 | 13 | 19 | |

| <u>Year</u> | <u>Market</u> | | | | <u>P/E Ratios</u> | | <u>Yield</u> | |
|----------------|-------------------|------------------|--------------------|---------------------|-------------------|------------|-----------------|------------------|
| | <u>High</u> \$ | <u>Low</u> \$ | <u>Close</u> \$ | <u>To Book</u> % | <u>High</u> | <u>Low</u> | <u>Low</u> % | <u>High</u> % |
| 7/31/77 ϕ | 21.2 | 17.1 | 19.6 | 104 | 10.2 | 8.2 | 8.47 | 10.51 |
| 1976 | 18.0 | 14.7 | 17.7 | 93 | 9.4 | 7.8 | 9.11 | 11.03 |
| 1975 | 15.4 | 11.1 | 15.0 | 79 | 8.3 | 6.0 | 10.58 | 14.74 |
| 1974 | 19.4 | 9.3 | 10.7 | 54 | 10.8 | 5.2 | 8.41 | 17.49 |
| 1973 | 23.4 | 17.0 | 18.0 | 89 | 11.8 | 8.5 | 6.98 | 9.65 |
| 1972 | 25.0 | 21.2 | 22.6 | 114 | 12.0 | 10.2 | 6.56 | 7.72 |
| 1971 | 25.1 | 20.5 | 23.7 | 122 | 12.0 | 9.8 | 6.53 | 7.95 |
| 1970 | 24.7 | 19.0 | 22.4 | 119 | 13.5 | 10.3 | 6.59 | 8.63 |
| 1969 | 32.1 | 22.0 | 24.0 | 127 | 16.3 | 11.2 | 5.11 | 7.45 |
| 1968 | 32.4 | 27.2 | 31.1 | 171 | 16.8 | 14.0 | 5.05 | 6.02 |
| 1967 | 34.7 | 28.4 | 29.5 | 168 | 16.4 | 13.4 | 4.70 | 5.75 |

ϕ - Market range and close through September 19, 1977.

For 1978 our estimate is \$2.05 per share. The decision of the Pennsylvania Commission on the Company's recent petition regarding proposed changes in the fuel clause and request for \$119 million of annual rate relief--which has been suspended to April 1978--will be a primary determinant of the level of earnings for the year. Assuming reasonable treatment by the Commission, on 7% additional shares, our \$2.05 estimate indicates a 10.6% return on average equity. Longer term, with capitalization growth slowing and financing pressures easing, we envision modest earnings progress, assuming rate relief is received on a timely basis.

We rate the Common D&P II. Trading at 19-3/4 (1977 market range: 21-1/4 - 17-1/8) and at a 4% premium to its book value, the shares sell at 9.8 times our 1977 estimate of \$2.00 per share. Yield on the \$1.80 dividend established March 1977 is 9.1% which compares with an 8.0% average yield for other utility issues on our II electric list. The current dividend is a 90% payout of our 1977 earnings estimate of \$2.00. However, cash flow covers the dividend around 1.8-1.9 times. The Company estimates between 15% and 30% of the 1977 dividend will be considered a non-taxable return of capital. We regard the Common stock as a Better Value for its above average current income.

SYSTEM OPERATIONS

Philadelphia Electric Company is a combination electric, gas and steam utility serving southeast Pennsylvania including Philadelphia and the surrounding suburban areas. Electric revenues contributed 84% of total revenues for the 12 months ended July 31, 1977 and provided 88% of pre-tax operating income. The City of Philadelphia itself accounts for only 5% of total geographical service area but about 40% of electric revenues are derived therein. Overall, population and customer growth have been below average--characteristics of a mature service territory.

Philadelphia is the fourth largest U.S. metropolitan area and is a principal financial and commercial center. The economy is well diversified with many basic industries. A weakening economy together with voluntary conservation adversely affected kwh sales growth in 1974 and 1975. In 1976 kwh sales registered some improvement with a 4% gain being experienced; gas sales rebounded 13% due to the abnormally cold weather. Kwh sales showed a 3.4% increase in the initial seven months of 1977 while gas sales declined 4%. Company forecasts anticipate a 5% kwh growth rate over the next few years. This rate appears attainable with growth of electric space heating and use of electricity as an alternative energy source.

REGULATION

Previous rate decisions by the Pennsylvania Public Utilities Commission have been based on fair value, end-of-period historical rate bases and the adjusted book Common equity returns have been 14%-14-1/2%. Interim rate relief has been granted and normalization of accelerated depreciation tax deferrals on post-1969 property was allowed.

Two Pennsylvania statutes adopted in late 1976 and expected to be effective to filings dated October 1977 provide for several modifications to regulation. These include: 1) the establishment of a maximum seven month suspension period plus 60 days for the filed effective date of a general rate increase (nine months effectively vs. eleven previously), 2) authorization of a possible future test year (vs. historical previously), and 3) prohibition of potential rate retroactivity of multiple rate filings (pancaking) and interim rate relief other than for emergency purposes. Additionally, regulatory lag, filling vacancies and defining what constitutes a majority of the Commission was also addressed. There has been one vacancy on the five person Pennsylvania Commission since April 1977; the man nominated by the Governor has not yet been confirmed by the Senate.

An electric fuel adjustment clause which recognizes increases or decreases in the average cost per kwh generated by all fossil fuels and also covers external power purchases is applicable to virtually all sales. Nuclear is excluded from the fuel clause per se, but does enter into the picture inasmuch as the fuel adjustment is calculated by dividing total dollars of fossil fuel by total kwh sold. The lag for recoupment is two months. A May 1976 Commission Order requires advance notice of the fuel adjustment computation and provides for continuous review. Philadelphia Electric adopted deferred fuel cost accounting January 1974. A gas fuel adjustment clause recovers higher costs of all purchased gas and of alternate gas supplies.

In February 1977 the Pennsylvania Commission authorized an electric rate increase of \$72 million in response to a \$95 million request filed November 1975 in a two-part application. The Company requested the first part--\$47 million--not be suspended. In January 1976 the Commission suspended both parts for up to six months but permitted an interim increase of \$24.3 million to be effective subject to possible refund. In July 1976 the PUC authorized an additional interim increase of \$22.7 million effective August 1976. The \$25 million additionally granted in February 1977 was retroactive to October 1976. The February 1977 decision was based on a period-end, fair value rate base; the test year was the 12 months ended August 1975; and the overall return allowed incorporated about a 14.15% return on book Common equity. The decision allowed a slightly lower return on book Common equity than the prior March 1975 Order and took 15 months but the interims partially mitigated the delay.

An Order was received in late 1976 allowing \$9.2 million of increased gas rates in two steps. The first part consisting of \$6.4 million went into effect June 1975, subject to refund. The additional \$2.8 million allowed was retroactive to March 1976. The decision took almost 20 months and was based on a calendar 1974 test period. We calculate the return allowed on Common equity at around 13.5%. The Company has appealed the Order based on an inadequate rate of return.

Philadelphia Electric made a two-part electric rate filing August 1977. The first part seeks to transfer the existing electric fuel adjustment charges into base rates, eliminate the electric fuel adjustment clause for residential and small commercial customers (30% of kwh sales) and to substitute a new energy adjustment clause for other customers (including nuclear). Part two calls for a \$119 million increase (11.5%) in electric rates. Both parts have been suspended to April 1978.

We rank Pennsylvania regulation in Group III in our I (highest) to VI (lowest) rating system.

POWER, GAS AND FUEL SUPPLY

Net installed electric generating capacity totaled 8,202 mw at July 31, 1977 which included the June 1976 addition of the 400 mw oil-fired Eddystone unit and the commercial operation of the Salem nuclear unit June 30, 1977 to which the Company is entitled to 464 mw. Based on an estimated peak load of 6,000 mw, the generating reserve margin was 36%. However, outages relating to refueling and repair modifications on the nuclear units have effectively reduced capability and have held the actual reserve margin to around 23%. Assuming 5% peak load growth, full operation of existing units and present construction plans, the reserve margin will be above 20% through 1980. Additionally, the Company is a member of the Pennsylvania-New Jersey-Maryland interconnection (PJM) and the PJM reserve margin was approximately 37% for 1977.

Fuel system input for the 12 months ended July 1977 was coal 25%, oil 21%, nuclear 18%, hydro 4%, gas 3%, and purchased and net interchange 29%. Nuclear is expected to supply a growing proportion of the power generation with the addition of Salem No. 1 June 1977 and 474 mw from Salem No. 2 scheduled for commercial operation in 1979. Public Service Electric and Gas Company has the construction and operating authority for these two Salem units. An additional two nuclear units have been delayed until 1983 and 1985.

Most of the coal and oil requirements are contracted for annually or on a short-term one to five year basis. Commitments for the nuclear fuel supply cycle have been made for four units through 1981-1985 and the two Salem units through 1979. Unit fuel costs escalated sharply, particularly in 1974 to 1.46¢ per kwh, but cost increases have been modified with the growing use of nuclear generation and from economy interchange purchases. However, for the 12 months ended July 1977 fuel and interchange expense rose 10% to 1.57¢ per kwh sold.

Overall, we view the Company's power generation and fuel supply as satisfactory through the 1970's. The Company does not currently meet all the Federal, state and local pollution control regulations but is attempting to comply or is seeking variances. Equipment failures have resulted in cooling tower outages at the Peach Bottom Nuclear Station of which the Company has an 886 mw ownership interest.

Natural gas service is supplied to the surrounding suburban area of Philadelphia and contributed 12% of total revenues and 10% of pre-tax operating income in the 12 months ended July 31, 1977. The Company purchases about two-thirds of its gas from Transcontinental Gas Corporation under contracts expiring in 1990 and about one-quarter from Texas Eastern Transmission Corporation under contracts expiring in 1987. The Company's contracted supply of 79 billion cubic feet was curtailed 25% in 1975, 29% in 1976 and the 1977 curtailment is anticipated at 32%. Gas service was partially curtailed to large industrial customers January through April 1977. Gas storage contracts enable the Company to store 40% of heating season gas deliveries. Purchases of LPG and SNG together with small amounts of gas from its own drilling and exploration program are expected to supplement regular gas supplies. Based on normal winter weather conditions, the Company considers curtailments to non-interruptible customers during the 1977-1978 heating season as unlikely. However, the Company cannot increase the number of customers served and longer term growth prospects appear limited.

CONSTRUCTION

Construction expenditures including nuclear fuel are currently budgeted at \$448 million for 1977, \$434 million for 1978, \$455 million for 1979, \$511 million for 1980, and \$544 million for 1981. This five year program is a reduction from prior estimates and aggregates \$2,392 million. Gross plant will increase 7.8% annually which compares with the prior five year program of \$2,112 million which resulted in a 10.7% annual increase in gross plant. Most of this budget will be spent on the electric department with two-thirds of the expenditures geared to the addition of new generating facilities. Also included is \$88 million for environmental requirements.

FINANCING AND CAPITALIZATION

Financing

Capital requirements for 1977 are estimated at \$486 million including \$448 million for construction and \$38 million for debt maturities and sinking funds. Internal sources are expected to provide 44% of 1977 construction funds. Financing in 1977 has consisted of \$24 million of Pollution Control bonds in February, \$75 million of First Mortgage bonds in March and again in July, and the current sale of 4.0 million shares of Common together with that issued through the Shareholder Dividend Reinvestment and Employee Plans.

For 1978-1981 the Company estimates about 46% of the construction program can be funded from internal sources, which appears reasonable to us. In addition, debt maturities total \$333 million with \$26 million of debt maturing in 1978, \$51 million in 1979, \$126 million in 1980 and \$130 million in 1981. We expect debt and Common to be sold in each of the years 1978-1981 and Preferred to be sold in 1978, 1980 and 1981.

Capitalization

Pro forma capitalization at July 31, 1977 as shown on the following page, totaled \$4.05 billion. It consisted of 44.5% mortgage debt, 52.1% total debt, 13.2% Preferred and 34.7% Common equity. Our calculations indicate total capitalization will increase about 7% annually in the five years ending 1981 as compared with an 11% compound annual rate experienced for the prior five years. At a market price of 19-3/4, the Common currently sells at a 4% premium to its book value of \$18.99.

ASSET SUPPORT

Principal asset support for pro forma capitalization as of July 31, 1977 is presented in the table below capitalization. Carried at original cost, Philadelphia Electric had utility plant in service of \$3,895 million at the balance sheet date, 88% of which applies to the electric plant. The \$915 million total reserve for depreciation was equivalent to 24% of gross plant in service. Primarily reflecting work on new generating capacity, construction work in progress at the balance sheet date of \$994 million represented one-quarter of total net plant. Total assets were about double total pro forma debt, similar to the ratio for the Duff and Phelps Electric Utility Average.

ACCOUNTING PRACTICES

Tax deferrals related to accelerated depreciation on property additions are normalized; prior to 1971 the resultant tax deferrals were flowed through to income. Tax deferrals from the use of ADR are normalized. Investment tax credits are amortized over the estimated useful life of the utility plant. Income tax credits applicable to non-operating activities (primarily interest relating to construction work in progress) are reported in other income with a corresponding increase in income taxes. For the 12 months ended July 31, 1977 the effective book Federal income tax rate (computed by us) was an above average 41%, similar to that of recent years.

Depreciation as a percent of average depreciable utility plant in service was 2.98% for the 12 months ended July 31, 1977. AFC was computed at a net after-tax rate of 8% on January 1, 1975, 8.25% on July 1, 1975, 8.20% on January 1, 1976, and 8.40% on July 1, 1976. A rate of 8.60% on January 1, 1977 and 8.70% beginning July 1, 1977 was adopted in accordance with the FPC method of accounting. We note net after-tax AFC has been a relatively high proportion of reported earnings in recent years and in 1977 will contribute over one-half of the Balance for Common. Beginning January 1974 deferred fuel cost accounting was adopted. At July 31, 1977 deferred fuel expense totaled \$39 million, up from \$20 million at year-end 1976. We consider the overall quality of reported earnings to be about average; both the quality of earnings and cash flow have improved in recent years.

PHILADELPHIA ELECTRIC COMPANY
Capitalization - July 31, 1977

| | Actual | | Pro Forma | |
|--|------------------|--------------|------------------|--------------|
| | \$1,000 | % | \$1,000 | % |
| Debt: | | | | |
| First & Ref. Mortgage Bonds | 1,804,345 | 45.1 | 1,804,345 | 44.5 |
| Note Payable to Bank | 125,000 | 3.1 | 125,000 | 3.1 |
| Pollution Control Note | 37,000 | 0.9 | 37,000 | 0.9 |
| Debentures | 150,148 | 3.7 | 150,148 | 3.7 |
| Unamortized Debt Disc. & Prem.-Net | (6,142) | (0.1) | (6,142) | (0.1) |
| Total Long-Term Debt | <u>2,110,351</u> | <u>52.7</u> | <u>2,110,351</u> | <u>52.1</u> |
| Short-Term Debt | 31,680 | 0.8 | - | - |
| Total Debt | <u>2,142,031</u> | <u>53.5</u> | <u>2,110,351</u> | <u>52.1</u> |
| Cumulative Preferred Stock, \$100 Par | | | | |
| 5,350,690 Shares | 535,069 | 13.3 | 535,069 | 13.2 |
| Total Debt & Preferred | <u>2,677,100</u> | <u>66.8</u> | <u>2,645,420</u> | <u>65.3</u> |
| Common Stock Equity: | | | | |
| Common Stock - No Par | | | | |
| 70,102,536 Shares | 1,018,096 | - | 1,097,096 | - |
| 74,102,536 Shares | - | - | 1,713 | - |
| Other Paid-In Capital | 1,713 | - | 308,172 | - |
| Retained Earnings | 308,172 | - | 1,406,981 | 34.7 |
| Total Common Equity | <u>1,327,981</u> | <u>33.2</u> | <u>4,052,401</u> | <u>100.0</u> |
| Total Capitalization | <u>4,005,081</u> | <u>100.0</u> | <u>4,052,401</u> | <u>100.0</u> |
| Book Value per Common Share | \$ 13.94 | | \$ 18.99 | |
| Recent Market to Book Value | 104% | | 104% | |

Asset Support - July 31, 1977

| | \$1,000 |
|---|------------------|
| Utility Plant at Original Cost | 3,895,104 |
| Less: Accumulated Depreciation | 915,361 |
| Net Plant in Service | <u>2,979,743</u> |
| Construction Work in Progress | 994,284 |
| Nuclear Fuel | 30,976 |
| Net Plant | <u>4,055,003</u> |
| Other Property and Investments | 18,006 |
| Pro Forma Net Working Capital | 199,164 |
| Total Assets | <u>4,272,173</u> |
| \$ Per \$1,000 First & Ref. Mortgage Bonds | |
| Net Plant | 2,247 |
| Total Assets | <u>2,368</u> |
| \$ Per \$1,000 Total Debt | |
| Net Plant | 1,921 |
| Total Assets | <u>2,024</u> |

EARNINGS

Detailed income statements for the calendar years 1973 through 1976 and for the 12 months ended July 31, 1977 are presented on the following page. Also shown are the Company's effective book Federal income tax rates and returns earned on average capitalization and average Common equity which we compute at 8.80% and 11.1%, respectively, applying to the 12 months ended July 31, 1977.

| | Pro | December 31, | | | | |
|------------------------------------|-------|--------------|------|------|------|------|
| | Forma | 7/31/77 | 1976 | 1975 | 1974 | 1973 |
| Times Earned Pre-Tax: | | | | | | |
| Long-Term Debt Interest | | | | | | |
| Excl. AFC | 2.03 | 2.14 | 2.13 | 2.09 | 2.08 | 2.30 |
| Incl. AFC | 2.56 | 2.71 | 2.65 | 2.58 | 2.74 | 2.99 |
| Total Debt Interest | | | | | | |
| Excl. AFC | 2.03 | 2.11 | 2.08 | 1.98 | 1.83 | 2.16 |
| Incl. AFC | 2.56 | 2.67 | 2.59 | 2.44 | 2.42 | 2.81 |
| Times Earned After-Tax: | | | | | | |
| Total Debt Interest | | | | | | |
| Excl. AFC | 1.56 | 1.61 | 1.58 | 1.53 | 1.48 | 1.71 |
| Incl. AFC | 2.09 | 2.16 | 2.09 | 2.00 | 2.07 | 2.36 |
| Total Int. & Pfd. Divs. | 1.68 | 1.72 | 1.66 | 1.60 | 1.62 | 1.81 |
| Margin of Safety: | | | | | | |
| Total Debt Interest-% ^a | 19.3 | 19.8 | 19.6 | 18.3 | 16.9 | 21.3 |

a. - Includes AFC.

Earnings Record

1) Earnings for the five years ended 1976 ranged from \$2.08 per share in 1972 to a low of \$1.81 in 1974. Earnings recovered to \$1.91 per share with receipt of rate relief in 1976. Kwh growth of 12% compared with the D&P Average of 26% for the period, with all categories significantly underperforming the industry. Electric revenues rose 78% for the period; sales contributed only a small portion of this increase and realizations, including rate relief and pass-through of higher fuel costs, accounted for the larger portion. AFC rose substantially but only partially offset the rapid advance in interest charges and Preferred dividends. In comparison, revenues of the D&P Average rose 67%.

2) Capitalization growth at 11% annually was similar to that of the D&P Average. Internal cash generation was only slightly lower than the industry. However, Common shares outstanding rose 73% or 11-1/2% annually, reflecting sales in 1973, 1974, 1975 and 1976 being made below book value. The high payout ratio also resulted in a below average retention of earnings. Book value remained stationary during this five year period versus a 4% annual gain by the D&P Average.

PHILADELPHIA ELECTRIC COMPANY

Income Statements

In Thousands of Dollars

| | 7/31/77 | December 31, | | | |
|--|------------------|------------------|------------------|------------------|----------------|
| | | 1976 | 1975 | 1974 | 1973 |
| Operating Revenues: | | | | | |
| Electric | 1,118,904 | 1,024,814 | 978,368 | 873,474 | 646,758 |
| Gas | 163,949 | 158,865 | 117,989 | 108,929 | 100,508 |
| Steam | 42,171 | 40,462 | 38,453 | 29,323 | 19,392 |
| Total | <u>1,325,024</u> | <u>1,224,141</u> | <u>1,134,810</u> | <u>1,011,726</u> | <u>766,658</u> |
| Operating Expenses: | | | | | |
| Operation | 718,666 | 656,464 | 620,287 | 584,646 | 392,729 |
| Maintenance | 86,871 | 75,030 | 62,313 | 61,971 | 58,742 |
| Depreciation | 102,344 | 97,980 | 91,221 | 77,802 | 64,271 |
| General Taxes | 87,037 | 82,644 | 77,567 | 67,143 | 57,353 |
| Total | <u>994,918</u> | <u>912,118</u> | <u>851,388</u> | <u>791,562</u> | <u>573,095</u> |
| Operating Income: | | | | | |
| (Bef. Income Taxes) | 330,106 | 312,023 | 283,422 | 220,164 | 193,563 |
| Federal Income Taxes | (3,134) | 6,147 | 42,161 | 10,986 | 24,335 |
| State Income Taxes | 19,207 | 18,336 | 15,868 | 12,340 | 9,643 |
| Def. Income Taxes | 37,912 | 23,447 | 19,955 | 23,140 | 7,566 |
| Invest. Tax Cr. (Net) | 51,480 | 52,568 | 8,353 | 20,691 | 3,536 |
| Net Operating Income | <u>224,641</u> | <u>211,425</u> | <u>197,085</u> | <u>153,007</u> | <u>148,423</u> |
| Other Income: | | | | | |
| AFC | 87,387 | 77,641 | 66,874 | 70,841 | 58,743 |
| Inc. Tax Credit on AFC | 26,322 | 24,701 | 22,520 | 25,135 | 1,743 |
| Taxes on Other Income | (845) | (534) | (249) | 306 | (1,374) |
| Other - Net | 3,097 | 2,548 | 2,087 | 271 | 2,643 |
| Income Before Interest | <u>340,702</u> | <u>315,781</u> | <u>288,317</u> | <u>249,560</u> | <u>213,193</u> |
| Interest Deductions: | | | | | |
| Long-Term Debt | 155,394 | 147,596 | 135,507 | 106,298 | 84,837 |
| Short-Term Debt | 2,149 | 3,567 | 7,885 | 14,163 | 5,472 |
| Total | <u>157,543</u> | <u>151,163</u> | <u>143,392</u> | <u>120,461</u> | <u>90,309</u> |
| Net Income | <u>183,159</u> | <u>164,618</u> | <u>144,925</u> | <u>129,097</u> | <u>122,867</u> |
| Preferred Dividends | 40,719 | 39,022 | 36,025 | 33,682 | 37,500 |
| Balance for Common | <u>142,440</u> | <u>125,596</u> | <u>108,899</u> | <u>95,415</u> | <u>85,367</u> |
| Avg. Com. Shs. Outstg. (000's) | 68,612 | 65,606 | 58,135 | 52,717 | 47,847 |
| Earnings per Avg. Share | \$ 2.08 | \$ 1.91 | \$ 1.65 | \$ 1.61 | \$ 1.99 |
| Dividends per Avg. Share | 1.68 | 1.64 | 1.64 | 1.64 | 1.64 |
| Effective Tax Rate | 41% | 42% | 41% | 37% | 34% |
| 1 Earned on Reported Average Capitalization | 8.90 E | 8.43 | 3.14 | 7.75 | 7.24 |
| Common Equity | 11.1 E | 9.9 | 9.4 | 8.9 | 9.8 |

3) Returns earned on average Common equity ranged between 10.3% in 1972 to 8.9% in 1974 and partially recovered to 9.9% in 1976. These returns averaged about 15% below the D&P Average.

We attribute Philadelphia Electric's below average five year record to: 1) sluggish sales growth, 2) high financing costs, and 3) lags in obtaining sufficient rate relief.

Current and Prospective Earnings

Earnings for the 12 months ended July 31, 1977 were reported at \$2.08 per share versus \$1.84 a year earlier on 8.2% additional average outstanding shares. Seven-month earnings of \$1.23 per share compared with \$1.06 for the similar 1976 period. Seven-month 1977 revenues of \$810 million were up 14% from the similar 1976 period reflecting a modest 2% gain in kwh sales, a small decline in Mcf gas sales, pass-through of higher fuel charges, about \$17 million higher AFC and electric rate relief.

As a result of commercial operation of the Salem nuclear unit June 30, 1977, pre-tax earnings will be reduced \$900,000 monthly due to depreciation charges and AFC will decline \$2 million monthly. A small offset will be the nuclear fuel savings, although most of the savings will accrue to customers under operation of the present fuel clause. For the balance of 1977, only about \$10 million of rate relief is expected to be effective. We expect some attrition in per share earnings until rate relief is received. Thus, we are maintaining our 1977 earnings estimate of \$2.00 per share on about an 8% gain in average outstanding shares. This estimate represents a 10.3% return on average Common equity.

For 1978 our estimate is \$2.05 per share. A most important facet will be the Commission decision regarding proposed fuel clause changes and the related rate relief for inclusion of Salem No. 1 into rate base. As noted earlier, the Company's filing has been suspended until April 1978. Assuming reasonable treatment and rate relief is effective by mid-1978, our \$2.05 estimate on 7% additional average outstanding shares equates to about a 10.6% return on equity. Longer term, with capitalization growth slowing and financing pressures easing, Philadelphia Electric has an opportunity to show modest earnings progress, assuming a moderate amount of rate relief is received on a timely basis.

DIVIDENDS

The \$1.80 annual dividend was established March 1977, up from \$1.64 which has been paid since 1967. The payout ratio of 90% on our \$2.00 earnings estimate compares with a ten-year historical rate of 84%. The Company estimates 15% to 30% of the 1977 dividend will be considered a non-taxable return of capital. In view of the high payout and anticipation of annual sales of Common stock, we do not foresee another dividend increase near term. The dividend

coverage for 1977-1978 is estimated at around 1.8-1.9 times. This is below average but adequate. Yield based on the current market price of 19-3/4 is 9.1%. This above average yield compares with an 8.0% average for our D&P II list. The Company has a Shareholders' Reinvestment Plan and a voluntary Employee Stock Purchase Plan.

COMMON STOCK PROVISIONS

Shares Authorized

There are 100 million shares of Philadelphia Electric no par value Common stock authorized, of which 74,102,536 shares are expected to be outstanding following the proposed offering. The Common stock is fully paid and nonassessable. There are no outstanding convertible securities.

Voting Rights

Shareholders are entitled to one vote per share of Common stock held with cumulative voting permitted in the election of Directors. Preferred stockholders normally have no voting rights, but with respect to certain matters the consent of a majority of the Preferred stockholders is required. In the case of default in payment of four full quarterly dividends the holders of the Preferred stock would be entitled to elect a majority of the Board of Directors until all dividends in default have been paid or declared and set apart for payment.

Dividend Rights

Common stock dividends may be declared out of legally available earnings. The Company's Charter prohibits payment of any dividend on Common stock if after giving effect thereto the Common stock equity would be less than the involuntary liquidating value of the Preferred stock. In this respect, the Common stock equity is currently more than two times the liquidating value.

Preemptive Rights

No class of securities of the Company presently outstanding has any preemptive or conversion rights.

Other Provisions

The Company may not purchase or otherwise acquire for value, shares of its Common stock whenever it is in arrears on any dividends on its Preferred stock.

Conclusion

In our opinion, the provisions relating to Philadelphia Electric's Common stock are generally comparable to those of many other electric utility Common stocks.

Dorothy M. Jelinek, C.F.A.

DEC 23 1985

SECRETARY'S OFFICE
Public Utility Commission

PECO STATEMENT NO. 3

R-850152 12/24/85 Hbg JK

PENNSYLVANIA PUBLIC UTILITY COMMISSION V.
PHILADELPHIA ELECTRIC COMPANY,
Docket No. R-850152

DOCKETED
DEC 31 1985

DIRECT TESTIMONY OF
JOSEPH F. PAQUETTE, JR.

**DOCUMENT
FOLDER**

LIMERICK 1 AND COMMON PLANT
FINANCIAL MANAGEMENT
NEED FOR RATE INCREASE

September 27, 1985

1 TESTIMONY OF JOSEPH F. PAQUETTE, JR.

2 Q. Please state your name and business address for the
3 record.

4 A. Joseph F. Paquette, Jr., 2301 Market Street,
5 Philadelphia, Pennsylvania.

6 Q. By whom are you employed Mr. Paquette and in what
7 capacity?

8 A. I am the Vice President of the Finance and Accounting
9 Department of the Philadelphia Electric Company.

10 Q. What is your educational background?

11 A. I was graduated in 1956 from Yale University with a
12 Bachelor of Engineering Degree, and I have also attended
13 the Graduate Evening Business School at Temple University
14 in Philadelphia where I took advanced courses in
15 accounting, economics, finance, statistics and management.

16 Q. Can you tell us something of your experience with
17 Philadelphia Electric Company?

18 A. I joined Philadelphia Electric Company as a Junior
19 Engineer in the Engineering Department following
20 graduation from college in 1956. From 1956 until 1963, I
21 held various non-supervisory positions, working in the
22 area of economic analysis, rate design, and contract
23 administration. From 1963 to 1966, I held supervisory
24 positions in those same areas and also in financial
25 planning. In 1966, I was appointed to the position of
26 Staff Engineer, Corporate Planning; in 1969, I was named
27 Manager of the Financial Division; in August of 1971, I

1 was appointed Controller of the Company; in January 1972,
2 I was appointed Manager of the Finance and Accounting
3 Department; and in April 1978, I was elected to my
4 present position as Vice President.

5 Q. Have you been active in any professional organizations?

6 A. From 1971 to July 1975, I was a member of the Application
7 of Accounting Principles Committee of the Edison Electric
8 Institute (EEI) and of the American Gas Association.

9 This committee has the responsibility for keeping
10 informed of the developments of accounting principles,
11 conventions, and practices in the accounting profession
12 and in regulatory accounting, and for preparing proposed
13 releases relating to the industry position on accounting
14 principles. I was also a member of the EEI Accounting
15 Executive Committee which has the responsibility for
16 coordinating the activities of all EEI accounting-related
17 committees, such as the Application of Accounting
18 Principles Committee.

19 Since 1978, I have also been a member of the EEI
20 Finance Committee, which is composed of the chief
21 financial officers of the member companies, and I was
22 recently chairman of that national committee. I have
23 also been a member of the Financial Executives' Institute
24 since 1979. I am currently a member of the Board of
25 Directors of the First Pennsylvania Corporation, the
26 First Pennsylvania Bank, the Keystone - AAA Automobile
27 Club and its Insurance Company and the Nuclear Electric

1 Insurance Limited (NEIL).

2 Q. What are your responsibilities as Vice President of the
3 Finance and Accounting Department?

4 A. As Vice President of Finance and Accounting, I am
5 responsible for all matters relating to finance and
6 accounting, including rate administration and rate
7 structure, the planning and execution of the Company's
8 financing and shareholder/investor relations programs,
9 proceedings before regulatory commissions relating to
10 these matters, the establishment and review of financial
11 controls of the Company, and all other matters relating
12 to finance and accounting policy and management.

13 Q. Have you testified in any previous proceedings on
14 financial or accounting matters?

15 A. Yes. I have presented testimony in prior electric
16 filings including: the 1974 Electric Rate Case (RID
17 129), the 1975 Electric Rate Case (RID 295), the 1977
18 Electric Rate Case (RID 438), the 1979 Electric Rate Case
19 (R-79060865), the 1980 Electric Rate Case (R-80061225),
20 and the 1981 Electric Rate Case (R-811626). I have also
21 testified in the Limerick Nuclear Generating Station
22 Investigation (Docket I-80100341) and the Limerick Unit
23 No. 2 Nuclear Generating Station Investigation (Docket
24 I-840381).

25 In addition, I have presented testimony in prior gas
26 filings including: the 1972 Gas Rate Case (RID 60), the
27 1975 Gas Rate Case (RID 227), and the 1979 Gas Rate Case

1 (R-79030781). Finally, I have testified before the
2 Maryland Public Service Commission concerning an electric
3 rate increase of Conowingo Power Company, a subsidiary of
4 Philadelphia Electric Company, and before the Federal
5 Power Commission concerning a wholesale rate proceeding
6 involving service to the Borough of Lansdale.

7 Q. Would you please describe your personal involvement in
8 the Company's financings.

9 A. Since I have become Vice President, I have assumed all of
10 the responsibilities of dealing with our financings and
11 investor relations. This involves negotiating sales of
12 securities with our underwriters; discussions with the
13 various rating agencies regarding the Company's credit
14 standing, presentations before and discussions with the
15 many segments of the investment community and many other
16 facets involving the financial community. As Vice
17 President, and also during my tenure as Manager of the
18 Finance and Accounting Department, I have participated in
19 the analysis or deliberations of the Company respecting
20 the scheduling of completion of the Limerick Project.

21 Q. What is the purpose of your testimony?

22 A. The Company expects to put Limerick Unit No. 1 into
23 commercial operation in the first quarter of 1986. I
24 will present testimony describing the Company's need to
25 bring Limerick Unit No. 1 and Common Plant into rate base
26 and to earn an adequate rate of return on the Company's
27 investment in those facilities. I will describe the

1 Company's claim from the financial perspective.

2 My testimony will also address the circumstances
3 which caused cash constraints on the Company during the
4 1970's. All of these had a significant negative impact
5 on the Company's ability to finance its construction
6 program and were paramount in the decisions made in the
7 1970's to delay Limerick's construction schedule.

8 Q. Would you please provide an overview of this rate
9 increase request describing any special features or
10 provisions?

11 A. In developing this rate increase application we have
12 taken a number of steps to minimize the financial impact
13 on our customers and the economy of our service
14 territory. For example, the rate increase is based on a
15 15.75% rate of return on common equity which is not only
16 less than the 16.75% return granted in our last electric
17 rate case but also lower than the true cost of equity
18 today. We have also reduced current revenue requirements
19 by extending the depreciable lives of our Eddystone and
20 Cromby generating stations as a result of the planned
21 implementation of life extension programs.

22 In addition, we have requested a three-year phase-in
23 of the total rate increase in order to enable our
24 customers to better adjust to the increase through
25 orderly, predictable increments. We have also proposed
26 that the revenue which is not billed in the first two
27 years of the phase-in period should be collected through

1 a separate surcharge in years four through six, but
2 without adding interest on the delayed billings.
3 Finally, the Company intends not to request another
4 electric base rate increase before September 27, 1987
5 unless, in the Company's judgment, a failure to file such
6 a request would jeopardize its financial viability.

7 We believe this comprehensive proposal represents a
8 significant effort on the Company's part to minimize the
9 impact on its ratepayers. We have made every effort to
10 keep this increase as low as possible, while maintaining
11 a minimum acceptable level of financial integrity to
12 enable the Company to proceed with our responsibility to
13 provide adequate service to the public. PE needs to
14 maintain and improve its financial performance to
15 continue to attract needed capital.

16 Q. As a frame of reference, would you please describe the
17 financial planning process at PECO.

18 A. Yes. The Company has a detailed forecasting process that
19 begins with sales (kWh) and peak load (kW) forecasts that
20 are based upon many input items including econometric
21 models, studies, and projections. From the basis of
22 these load expectations, a construction program is
23 developed to meet the peak load requirements, including
24 such considerations as: generation mix, fuel cost
25 projections, reserve margins, fuel supply and plant
26 retirements. Bond maturities, sinking fund requirements
27 and credit agreement/term loan repayment schedules are

1 added to construction cost estimates to develop total
2 capital requirements. Next, internal sources of funds
3 are derived and external financing requirements are
4 determined by deducting internal funds from total capital
5 requirements. Various considerations, including coverage
6 ratios, rating considerations, market environment and
7 capitalization ratios, are involved in planning the
8 actual size and type of each security offering to fund
9 the external requirements.

10 This basic forecast is prepared annually, projecting
11 the next five years. In addition, the Company utilizes a
12 40-year financial model (FINAN) in its financial planning
13 process which aids long-term planning.

14 Q. Employing data produced by this forecasting process, have
15 you made any estimates of the Company's earnings and
16 interest coverage ratios with and without the requested
17 rate increase?

18 A. Yes, I have. The results appear on Tables 1 through 5.
19 Tables 1 and 2 reflect our latest thinking with Limerick
20 Unit No. 1 and 100% of Common Plant in commercial
21 operation on February 15, 1986, adding \$3.8 billion to
22 rate base. Table 1 shows the Company's forecasted income
23 and earnings through 1986 based on present rates. The
24 capital charges, interest expense and preferred dividend
25 payments assume that long-term interest rates and
26 preferred stock rates will be 12.5% in 1985 and 1986,
27 with short-term rates of 9.5%.

1 On September 28, 1984, the PUC adopted a Declaratory
2 Order for Limerick Unit No. 1 that permits the Company to
3 synchronize the accounting for Limerick Unit No. 1 and
4 Common Plant with the associated ratemaking. Therefore,
5 AFUDC (actually, equivalent carrying charges) for Unit
6 No. 1 and Common Plant is continued and operating and
7 maintenance expenses are capitalized net of fuel savings
8 from the start of commercial operation to the effective
9 date of rate relief which is assumed to be July 1, 1986.

10 As can be readily seen on Table 1, with Limerick in
11 service on February 15, 1986, and without rate relief but
12 giving full effect to the terms of the Commission's
13 Declaratory Order, to July 1, 1986, the results are
14 devastating as earnings drop from \$2.79 (estimated) per
15 share in 1985 to \$1.76 per share in 1986, substantially
16 below our dividend of \$2.20 per share. Table 1 shows
17 that, with present rates, total operating income is
18 expected to decrease from \$465 million in 1985 to \$447
19 million in 1986 without the proposed Limerick rate
20 increase. With the decreased amount of CWIP, AFUDC,
21 which will be \$432 million (91% of earnings) in 1985,
22 will amount to \$346 million (106% of earnings) in 1986.
23 Net income decreases from \$566 million in 1985 to \$429
24 million in 1986, and the return on common equity declines
25 to 10.0% in 1986.

26 Table 2 shows the interest coverage ratio and ratio
27 of cash flow to construction expenditures for 1986

1 consistent with Table 1 income. Interest coverage under
2 the mortgage, which was 2.5 times in 1984, will remain at
3 about 2.5 times in 1985 but decline to 2.0 times in
4 1986. The SEC interest coverage ratio including AFUDC
5 will decline from 2.4 times in 1985 to 2.0 times covered
6 in 1986. Without AFUDC, the SEC coverage ratio will be
7 only 1.5 times in 1985 and 1.3 times in 1986.

8 It should be emphasized that the 1986 results
9 reflect the equivalent of only half a year of Limerick
10 1's full cost and thus do not present proforma results
11 without rate relief, which results would be significantly
12 worse. Furthermore, neither our 1985 nor 1986 results
13 include the potential effect of any disallowance by the
14 Commission in Docket Nos. P-830453, M-840375, M-FACE8408
15 et al. of replacement fuel cost recovery associated
16 primarily with Salem Unit No. 1 outages that occurred in
17 1983 and 1984 and deferred 1983 MgO operating costs. A
18 \$75 million disallowance in 1985 as tentatively voted on
19 by the PUC would reduce common stock earnings by
20 approximately 20 cents a share and depress 1985 mortgage
21 interest coverage from 2.5 times covered to 2.3 times,
22 SEC coverage with AFUDC from 2.4 times covered to 2.2
23 times, and SEC coverage without AFUDC from 1.5 times
24 covered to 1.3 times. Also, these results do not reflect
25 any possible cost recovery disallowances at issue in
26 Docket No. M-850010 et al. involving additional Peach
27 Bottom and Salem outages in 1984 and 1985.

1 Q. Have you computed what impact the proposed rate increase
2 would have on the Company's financial ratios if granted
3 in full?

4 A. Yes, that information is presented on Tables 3 and 4.
5 The first column of Table 3 shows the estimated income
6 statement for 1986 without any rate relief for Limerick.
7 The second column shows adjustments to the forecast
8 necessary to reflect ratemaking accruals and the third
9 column shows the additional revenue, expenses and income
10 associated with the requested rate increase. The fourth
11 column shows 1986 with the proposed rate increase.

12 Table 3 shows the 1986 proforma income with the full
13 increase in effect for the entire year, with Limerick
14 Unit No. 1 and Common Plant in service for the entire
15 year, and with no effect of the PUC's Declaratory Order.
16 This table shows that proforma 1986 earnings per share
17 would be only \$0.32 per share without rate relief, and
18 would increase to only \$2.79 on a fully proforma basis (a
19 15.5% return on equity). As shown in Table 4, column 2,
20 on a fully proforma basis, the pre-tax mortgage interest
21 coverage ratio would rise to 4.6 times, the SEC interest
22 coverage ratio including AFUDC would be 3.2 times and
23 excluding AFUDC would be 2.9 times.

24 Q. How do the Company's financial ratios compare with the
25 various categories of bond ratings?

26 A. Table 5 shows how the resultant PECO financial ratios fit
27 into Standard and Poor's (S&P) new financial benchmarks

1 on a full proforma basis. In February, 1985, S&P
2 disclosed these new financial benchmarks which it has
3 been using for rating investor-owned, electric utility
4 debt securities. S&P calculates three benchmarks or
5 ratios - (1) pre-tax interest coverage excluding AFUDC
6 divided by gross interest charges; (2) net cash flow
7 divided by total capitalization (including net leased
8 property, short-term borrowings used for bridge
9 financing, pollution control notes, bank loans, and
10 long-term debt due within one year); and (3) total debt
11 (including short-term borrowings used for bridge
12 financing, pollution control notes, bank loans, and
13 long-term debt due within one year) divided by total
14 capitalization (as described above).

15 Although qualitative elements are also considered,
16 using only these three new quantitative measures and
17 including the proforma effects of the proposed rate
18 increase, PE would still remain in the BBB category.
19 Pre-tax interest coverage excluding AFUDC would be only
20 2.9 times which is in the A/BBB category. However, with
21 the other two indices, we would clearly stay in the BBB
22 category. PE's net cash flow divided by total
23 capitalization is 3.5% in 1986 after the rate increase,
24 within S&P's BBB category. Debt capitalization as
25 measured by S&P is anticipated to be above 50% of total
26 capitalization at year-end 1986, also in the BBB range of
27 S&P's benchmark.

1 Table 5 shows that even with the full proforma
2 increase the Company will still clearly not qualify for a
3 single A rating. Moreover, these financial ratios are
4 conservative and fail to reflect three important factors
5 which may negatively impact the Company's securities
6 ratings. First, the phase-in proposal will result in the
7 deferred collection of a substantial portion of the rate
8 increase. In fact, under the phase-in mechanism accrued
9 revenues will, in substantial part, simply be substituted
10 for AFUDC in the first year of the increased rates'
11 effectiveness. Second, as explained by Mr. Farling,
12 phase-in revenues may require discounting when placed in
13 the Company's financial statements. Third, the financial
14 ratios do not fully take into account the impact of
15 attrition. The financial ratios with the full, proforma
16 rate increase as shown on Table 5 are based on calendar
17 year 1986 costs. However, the Company will not collect a
18 full year of the higher rates until July 1987. Thus, the
19 stated financial ratios do not reflect the attrition
20 which will occur from January 1, 1987 to June 30, 1987.

21 In my opinion, a single A rating is desirable for
22 Philadelphia Electric or any electric utility both to
23 reduce capital attraction costs and to assure that
24 capital can be attracted when needed. However, because
25 of its conservatism resulting from our efforts to reduce
26 the impact upon customers, our requested rate increase
27 will not permit obtaining that rating, but will rather

1 merely strengthen our existing BBB rating. I believe
2 that this data clearly demonstrates the Company's need to
3 have Limerick Unit No. 1 and Common Plant promptly
4 included in rate base to provide a fair return to the
5 Company, to enable the continuation of reliable service
6 to our customers and to provide the necessary access to
7 reasonable cost capital for continuing our construction
8 program.

9 Q. Would you now please describe the external conditions
10 that impacted the Company's financial planning from 1970
11 to 1980?

12 A. There were several key conditions which had significant
13 financial impact on Philadelphia Electric in the 1970's
14 and early 1980's:

15 1) Escalating inflationary pressures affected all
16 costs and expenses since 1970 with annual inflation rates
17 consistently in excess of 5.0 percent and in the 8.0 to
18 9.5 percent range during several periods (1974, 1975,
19 1979, 1980 and 1981) (See Table 6);

20 2) Interest rates escalated, increasing our costs
21 and decreasing our interest coverage ratios;

22 3) Coupled with this general inflation was the
23 effect of the Middle East boycott on fuel oil prices
24 beginning in the fall of 1973. The Arab oil embargo
25 drove up fuel oil prices which pushed up electricity
26 prices;

27 4) The development of nuclear power as an

1 essential, economical source of generation for growth and
2 oil displacement inherently required more capital.
3 Moreover, as the decade progressed, the capital cost of
4 nuclear power plants grew, requiring the attraction of
5 greater and greater amounts of capital. Additional
6 capital attraction requirements also were associated
7 with our coal generating equipment, principally due to
8 the need to add costly equipment for environmental
9 protection;

10 5) Environmental restrictions forced the Company
11 to use low sulfur oil which increased costs further;

12 6) The higher electricity prices resulted in
13 reduced consumer demand for electricity.

14 A most significant event occurred in April 1974 when
15 Consolidated Edison passed its common stock dividend.
16 The repercussions of that omission impacted not only Con
17 Ed but virtually all other utilities for many subsequent
18 months. In the short run, the electric utility industry
19 experienced declines in stock prices and reduced
20 price-earnings multiples. PE's already weak financial
21 condition deteriorated further as the price of the common
22 stock dropped to \$9.375 per share in 1974.

23 Combatting these external pressures required
24 continual infusions of rate relief. Unfortunately, rate
25 relief was delayed and amounts ultimately approved were
26 below requested levels. Consequently, the actual rate of
27 return on total electric investment consistently fell

1 substantially short of the PUC-allowed return during the
2 1970's. PE's actual return on electric common stock
3 equity averaged about 3.7 percentage points below the
4 PUC-allowed return, (see Table 7). Further, attrition
5 increased to the 4 to 6 point range during the 1974 to
6 1979 period. Beginning in 1979, the use of a future test
7 year and a shorter suspension period partially
8 ameliorated this problem.

9 As a result of price increases and our customers'
10 desire to conserve energy, PE's rate of peak load growth
11 dropped from 7-8% per year in the early 70's to
12 essentially zero in the 1979 to 1982 period.

13 Electric kWh sales growth was similarly reduced from 5-7%
14 per year in the early 70's to about 1% in 1979 and
15 actually turned negative during the 1981 and 1982
16 recession. As a result, revenues were also below earlier
17 expectations. Reduced peak load and sales forecasts
18 required changes to our long-term construction plans such
19 as the cancellation of the Fulton and Summit plants in
20 1975.

21 Q. Mr. Paquette, would you please discuss the changes which
22 occurred in investors' attitudes toward utilities and
23 Philadelphia Electric Company in particular during the
24 1970's and early 1980's?

25 A. Since the mid-1970's, in particular, the financial
26 community has viewed the electric utility industry with
27 increasing concern due to the perception of significantly

1 increased risk. As a result of the many problems
2 discussed above, we entered an era which was typified by
3 the loss of investor confidence in the traditional safety
4 of public utility investment, declining market values,
5 and sharply higher costs of new capital.

6 Specific examples of investor attitudes relative to
7 Philadelphia Electric are contained in various investment
8 rating agency reports as cited in Appendix A.

9 Q. Would you please summarize Philadelphia Electric's
10 financial condition throughout the 1970 to 1980 period?

11 A. During the 1970's, the Company experienced a period of
12 financial weakness and poor financial performance.

13 Several key indicators of this weakness were lower sales
14 growth, reduced levels of cash flow, poor quality of
15 earnings as a result of an increasing percentage of
16 non-cash earnings from AFUDC, reduced levels of
17 internally generated funds, returns on equity that fell
18 well below allowed returns, debt coverage ratios that
19 declined precipitously to very low levels, and increasing
20 cash requirements for the construction program.

21 Table 8 lists several specific indicators which show
22 the severity of our financial condition.

23 Return on Equity - The actual return earned on common
24 stock equity ranged between 8.9% and 9.9% from 1973 to
25 1979, a very poor performance by any standard and
26 substantially below the 12.9% to 15.2% range authorized
27 for electric operations by the PUC.

1 AFUDC as a percentage of earnings - This is a measure
2 which analysts use as an indicator of the quality of
3 earnings. Since 1970, AFUDC has accounted for an
4 ever-increasing share of earnings, rising from 31% to 84%
5 at year-end 1980. PE's percentage has consistently
6 exceeded the industry's average.

7 SEC interest coverage including AFUDC - declined from 2.9
8 times in 1971 to 2.1 times in 1979 and 1980.

9 SEC interest coverage excluding AFUDC - also declined
10 from 2.4 times in 1971 to 1.6 and 1.5 times in 1979 and
11 1980.

12 Mortgage indenture coverage - must exceed 2.0 times to
13 permit additional mortgage debt issuance under the
14 earnings test of the indenture. From 2.5 times in 1972,
15 mortgage coverage dropped to 2.1 times at year-end in
16 1974 and 1979 and was actually below the 2.0 times
17 minimum for a few months in 1974 and 1975.

18 Dividend coverage - measures the number of times that the
19 common stock dividend is "covered" by the internal cash
20 flow. Dividend coverage improved from 2.1 times in 1970
21 to 2.8 times in 1976 and then declined to the 2.0 level
22 in 1980.

23 Internal sources as a percentage of construction
24 expenditures, - including AFUDC, ranged from 17% to 52%
25 in the 1970 to 1976 period and then declined to the 34%
26 level in 1980. Excluding AFUDC, internal sources ranged
27 from 8% to 40% from 1970 to 1976 and then declined from

1 1976 to 1980, falling to 11% in 1980.

2 Dividend yield on common stock - was high through the
3 1970-1980 period as the rate was 15% in 1974 and ranged
4 from 12% to 14% from 1978 to 1980. The later high levels
5 reflect the discounting of the common stock due to the
6 perceived risk of investment in the Company.

7 Market price to book value ratio - reveals the depressed
8 price of the common stock as the year-end market price
9 was consistently below the year-end book value for every
10 year after 1972, except 1977.

11 Q. What do these statistics indicate about the Company's
12 financial condition?

13 A. These statistics demonstrate the poor financial condition
14 of the Company throughout the 1970 to 1980 period. All
15 measures were generally weak and well below the levels of
16 comparably-rated utilities. In fact, the rating
17 agencies, reflecting this fact, downgraded the Company's
18 securities during this period. On Table 9, there is
19 shown a comparison of our financial condition and that of
20 other similarly rated electric utilities for the period
21 1975-1980. As shown on the Table, despite our A rating
22 throughout this period, our financial condition was even
23 below the average of Moody's Baa rated utilities.

24 Q. How did PE's financial condition compare to other
25 utilities which deferred completion of nuclear power
26 plants because of a depressed financial condition?

27 A. A comparison of PE to other utilities was performed by

1 Theodore Barry & Associates (TB&A). Many utilities
2 deferred construction in 1974, but TB&A included in their
3 study only those utilities which also experienced
4 financially related deferrals subsequent to 1974. The
5 following six utilities were examined:

| 6 | <u>Utility</u> | <u>Plant</u> |
|----|------------------------|-------------------|
| 7 | Carolina Power & Light | Harris 1 |
| 8 | Consumers Power | Midland 1, 2 |
| 9 | Detroit Edison | Fermi 2 |
| 10 | Duquesne Power | Beaver Valley 2 |
| 11 | Illinois Power | Clinton 2 |
| 12 | Niagara Mohawk | Nine Mile Point 2 |

13 The utilities were compared according to yield,
14 price/earnings ratio, return on equity, and AFUDC as a
15 percentage of earnings for the period 1973 to 1980.

16 Table 10 shows that PE's financial condition was at least
17 as bad and was generally worse overall than the sample
18 companies who also deferred construction schedules.

19 1) Among the sample companies, PE had the highest
20 yield almost every year implying a higher perceived risk
21 by the investment community.

22 2) PE's price/earnings ratio was generally in the
23 lower half of the sample utilities.

24 3) PE's return on equity was well below the
25 average of these other financially constrained utilities.

26 4) PE also tended to have consistently poorer
27 quality of earnings, as indicated by its generally higher

1 than average amount of AFUDC as a percent of earnings.

2 TB&A's comparison also included our neighboring
3 utility, PP&L, which was in a superior financial position
4 compared to PE throughout the entire period due primarily
5 to the effect of the Electric Fuel Adjustment Clause that
6 was operative until mid-1978. Under that Clause,
7 although energy was purchased or sold at the
8 "split-savings" level (i.e. the mid-point between the
9 Seller's cost of production and the Buyer's avoided cost
10 of reliance upon his own system), the energy was included
11 in the Clause at a cost (for purchasers) or a credit (for
12 sellers) equal to the Company's average actual cost of
13 its own fossil generation. Net-purchasers generally lost
14 money (i.e. did not recover their cost of purchases)
15 under the Clause because the purchase price was higher
16 than the system fossil cost, while net-sellers made money
17 because their actual receipts for sales were higher than
18 the credit used in the Clause. As shown on Table 11, we
19 were a net purchaser throughout the mid and late 1970's
20 with average purchases of 7.7 billion kWh per year, or
21 about 27% of our annual output. PP&L, a coal-based
22 utility not subject to the same environmental
23 restrictions that required PE to burn oil, was a net
24 seller, realizing about \$220 million per year from sales
25 to the interconnection. This was one of the primary
26 reasons that PP&L's return on equity and financial
27 condition indicators were consistently better than ours

1 during this period.

2 Q. Mr. Paquette, you have commented about the external
3 environment as it affected the Company from 1970 to 1980
4 and provided detailed financial statistics and
5 comparisons. Are there any other qualitative, rather
6 than quantitative, factors that affected your financing
7 program decision-making?

8 A. The major qualitative factor affecting financial
9 decision-making in the 1970's was uncertainty. Four
10 types of uncertainty existed. First, there was
11 uncertainty respecting the condition of the financial
12 markets. As a result of the Consolidated Edison dividend
13 omission, the Arab oil embargo, fluctuating inflation and
14 other factors, the capital markets were often unsettled.
15 This affected both the cost of attracting capital and
16 also the ability to raise funds. At times the cost of
17 raising capital was prohibitive and financings had to be
18 deferred.

19 Second, there was uncertainty as to the Company's
20 future financial condition, i.e. whether its coverage
21 levels and other financial indicators would permit it to
22 raise capital. This occurred because coverage levels
23 depended upon income levels, which in turn depended upon
24 sales levels, expense levels and rate relief. As I
25 describe below, the timing and amount of rate relief was
26 a major uncertainty for us through the late 1970's.
27 Sales also fluctuated and were consistently below

1 expected levels, producing lower than anticipated
2 revenues and a worse than anticipated financial
3 condition. Expense levels also fluctuated with the
4 changing rate of inflation, which often exceeded our
5 expectations and produced worse than expected financial
6 results.

7 Third, there was uncertainty respecting our capital
8 attraction needs. The level of our capital attraction
9 needs depends upon our construction program's capital
10 requirements and the level of our internal cash
11 generation. As I have described above, each of these was
12 uncertain in some degree.

13 Finally, there was the major uncertainty respecting
14 maintenance of our securities ratings throughout the mid
15 to late 1970's. A major goal of our financial planning
16 was to maintain our ratings in order to maintain a lower
17 capital cost and to assure access to capital. We took
18 action throughout this period in an effort to maintain
19 our ratings, and were successful for a period.

20 The extent of this uncertainty and its effect on our
21 decision-making cannot be adequately appreciated simply
22 by reviewing a table of annual financial statistics or
23 bond downgradings such as Tables 8 and 12. These
24 statistics give the false impression of a known and
25 certain financial position as planning takes place. This
26 was not the case.

27 In developing judgments as to the cash available to

1 spend at Limerick, the Company considered the above
2 uncertainties and the possibility that financial results
3 would be less than planned or than actually occurred.
4 For example, in a year where mortgage indenture coverage
5 in fact equalled 2.1 times (i.e. 1974 and 1979),
6 projections suggested the possibility of even lower
7 levels often dependent upon the outcome of a pending rate
8 case. In its planning and allocation of cash to
9 Limerick, the Company had to consider this possibility.

10 With the facts and uncertainties that existed, in
11 our judgment, it was not prudent to press to the
12 financial limit, i.e. to unreasonably deplete our
13 financial reserves. Also, of paramount importance during
14 these difficult times was the serious concern that our
15 access to the capital markets would "dry up" and we would
16 be left with a partially completed plant, unable to be
17 completed, if we overextended our financial resources by
18 attempting too ambitious a construction schedule.

19 Q. Mr. Paquette, can you present any specifics to
20 demonstrate the significance of this concern?

21 A. Yes, there were occasions during this period (i.e.
22 1974-1980) when we were unable to raise all of the
23 capital we desired or had to rely upon more costly,
24 non-traditional capital sources. For example, in 1974,
25 we were advised by our underwriters that the market for
26 our common stock was extremely poor and a sale of
27 additional shares was postponed. In 1975, we had to

1 issue debentures rather than mortgage bonds despite their
2 higher cost because we could not meet our indenture
3 coverage test. Throughout this period, there were times
4 when low rated companies, such as PECO, could not issue
5 all of the securities desired or with the extended
6 maturities which are the historic norm. The experience
7 with higher interest rates on debt or lower prices
8 obtained from common stock sales not only increased the
9 cost of raising capital, but the threat of further cost
10 increases caused great uncertainty about the prospects of
11 attracting additional capital. Review of this data,
12 along with our continuous discussions with the financial
13 community and the rating agencies, made it clear to us
14 that maintaining our bond ratings would be critically
15 important to our ability to attract needed capital at a
16 reasonable cost.

17 Q. Mr. Paquette, what were the capital requirements of your
18 existing service operations during this period?

19 A. During the period 1976 to 1980, we spent a total of about
20 \$200 million annually on our Peach Bottom units and our
21 other generating plants; to keep them in proper operating
22 condition and to comply with new NRC requirements; on
23 electric transmission and distribution equipment; and on
24 other current service needs. In our judgment, it was not
25 reasonable for us to endanger our ability to meet those
26 service requirements by pressure to construct Limerick
27 more rapidly.

1 Q. Mr. Paquette, on several occasions you have spoken about
2 the uncertainty of the amount and timing of rate relief.
3 Can you provide us with specifics demonstrating this
4 uncertainty.

5 A. Yes. This can best be demonstrated by reviewing the
6 procedural history and results of our 1975 and 1977 rate
7 applications. In November 1975, we filed a rate request
8 for \$94.6 million of additional revenues on the basis of
9 an August 1975 historic test year. As part of the
10 filing, we requested that \$47 million be permitted into
11 effect on January 19, 1976, the end of the notice period,
12 as interim rate relief. This interim rate relief was
13 needed in order to offset inflation which had occurred
14 since the end of the test year employed in our prior rate
15 case (12 months ended June, 1974). In our prior rate
16 requests since the late 1960s, our requests for interim
17 relief had generally been granted. However, in this
18 case, the Commission granted only half (\$24 million) of
19 the interim amount requested. Shortly after this
20 Commission action, in February 1976, our bonds were
21 downgraded from A to A- by Standard & Poor's
22 Corporation. Additional interim rate relief was allowed
23 in August 1976 (equal only to the other half of interim
24 relief which we had requested to become effective in
25 January 1976). However, the case completion did not
26 occur until April 1977 at which time the PUC approved
27 approximately only \$72 million of the \$94.6 million we

1 had requested. Thus, a final decision did not occur in
2 the case until 17 months after the proposed rates were
3 requested, and 20 months after the end of the historic
4 test year used to establish the need for rate relief.

5 Our 1977 rate application provides a more extreme
6 example. In August 1977, we requested additional
7 revenues of \$118.6 million, including an interim relief
8 request of approximately \$54 million. This request was
9 needed, as we explained, in order to prevent impairment
10 of our financial condition following the June 1977
11 commercial operation of Salem 1. At that time, AFUDC
12 ceased and operating and maintenance expenses began,
13 seriously eroding earnings as the Unit was not reflected
14 in rates. Interim relief in an amount equal to
15 approximately \$12 million was finally granted in March
16 1978. The case was not finally decided until March 1979,
17 fully 19 months after its filing and 15 months after the
18 end of the historic test year employed as the basis of
19 the relief granted. The relief granted equalled but
20 \$78.9 million of the \$118.6 million requested (See Table
21 13).

22 In each of these cases, parties opposing the Company
23 asserted that little or no rate relief should be granted,
24 further adding to the uncertainty with which rate case
25 results were viewed.

26 Q. Mr. Paquette, did these rate case events have any other
27 serious effects upon the Company other than the creation

1 of uncertainty?

2 A. Yes, they did. As I have noted, the resolution of these
3 rate cases, for various reasons, was significantly
4 delayed. By examining Table 7, one can see that during
5 the period of these cases, and in part because of the
6 delay and/or reduction in interim rate relief, attrition
7 experienced was very high, i.e. 4.05% to 6.30% of
8 approved common equity return. In percentage terms, this
9 amounts to between approximately 30% and 40% of approved
10 common equity earnings. This attrition was caused by the
11 historically high rates of inflation existing during this
12 period and was greater than has been experienced since or
13 than was experienced during the early 1970's. This high
14 attrition was the major contributor to our weak financial
15 condition during this period and to the security
16 downgradings which we experienced.

17 In presenting this data, I do not seek to criticize
18 the Commission or the Commissioners sitting during that
19 period. As many have noted, it was simply the case that
20 the tools available to regulators at that time (i.e.
21 principally the historic test year and no effective limit
22 upon the suspension period) were not adequate to meet the
23 cost pressures being imposed upon utilities (i.e.
24 inflation and needed but costly new capital additions).
25 Indeed, in recognition of this fact, the General
26 Assembly, in 1978, passed a statute implementing new
27 procedures to mitigate these problems.

1 Q. Mr. Paquette, you have stated that the Company's
2 financial condition as measured by various coverage
3 ratios and other indicators was projected or in fact fell
4 for brief periods to levels significantly below the
5 annual results shown on Table 8. Have you any specifics
6 to demonstrate this concern?

7 A. Yes. As an example, we had earnings approximately
8 equal to or below our dividend during May through
9 November 1978, mortgage coverage ratios at or below our
10 indenture requirement during October through December
11 1979, and preferred coverage ratios at or below the 1.5
12 minimum coverage level during July through October 1978.
13 Our hopes to improve these financial performance
14 standards were entirely dependent upon rate relief,
15 which was delayed and disallowed on an interim basis.
16 Given the uncertainty attached to the timing and level of
17 rate relief, and our marginal financial position as shown
18 by the above numbers, we believed it prudent to be
19 cautious in our funding decisions respecting the Limerick
20 Plant.

21 Q. Mr. Paquette, did the Company communicate these financial
22 difficulties to the Commission during this period?

23 A. Yes, we did, many times in our various rate cases. In
24 addition, we attempted other steps to alleviate our
25 financial condition. For example, in our rate case which
26 was decided in April 1975, we requested unsuccessfully
27 that the Commission approve the allowance of CWIP in rate

1 base. Similar requests were being made by other major
2 electric utilities engaged in nuclear construction
3 programs. We explained that approval of this request
4 would improve our financial condition, permit more rapid
5 completion of these projects and produce long-run
6 benefits for our customers.

7 Again, in November 1975, in support of our request
8 for interim rate relief, we explained our precarious
9 financial condition and that absent approval of our
10 request, our bond ratings would be downgraded and that we
11 might be forced to reduce the level of our expenditures
12 at Limerick. As I describe below, we presented similar
13 explanations in our rate case filed in 1979.

14 Q. What actions did the Company take to overcome these
15 financial difficulties and attract the capital needed to
16 continue its construction program?

17 A. In order to try to provide the funds necessary to
18 complete our construction program during these difficult
19 times, the Company took many steps to diversify and
20 expand its sources of capital. Beginning in the early
21 1970's, the Company began to tailor each issue to
22 specific needs and segments of the market to appeal to
23 the increasing sophistication of investors. The approval
24 by the Company's shareholders of the elimination of
25 mandatory common stock rights offerings in 1975 increased
26 flexibility and reduced costs by permitting direct
27 underwritten offerings by large underwriting syndicates.

1 New preferred stock issues were tailored for specific
2 buyers (retail, institutions) with specific provisions to
3 appeal to their needs. During this period as interest
4 rates were escalating, the Company began notifying common
5 shareholders by letter whenever it issued new bonds.
6 This broadened the market for our debt securities.

7 Certain bonds and notes with intermediate maturities were
8 also placed privately to meet special needs of investors.

9 In order to reduce the amount of funds required from
10 the capital markets, the Company increased its use of
11 bank credit. In early 1974, the Company negotiated \$225
12 million of term loans with four large New York banks that
13 provided the Company with a fixed-term commitment that
14 could be repayed early without penalty. This financing
15 was arranged to avoid selling mortgage bonds when our
16 coverage ratio was exceedingly low. To extend the
17 Company's short-term borrowing capabilities, PE also
18 negotiated a \$400 million revolving loan/credit agreement
19 through domestic banks in 1980 and a \$100 million
20 Eurodollar Revolver in 1981. Among other innovative
21 financing vehicles that the Company developed to tap new
22 and different sources of capital were the following:

23 1) Tax-exempt pollution-control notes with low
24 interest rates beginning in 1972, and also in 1977 and
25 1981;

26 2) A new-issue, common stock dividend reinvestment
27 plan was started in 1973 (PE was the third electric

1 utility to implement such a plan which offered no
2 discount, thus minimizing dilution);

3 3) Floating rate, monthly-demand, pollution
4 control notes;

5 4) \$10 depositary preferred stock to open up sales
6 to smaller, retail purchasers;

7 5) Leasing arrangements for the Company's
8 combustion turbines, computer and related equipment,
9 fleet vehicles, magnesium oxide facilities and nuclear
10 fuel for Peach Bottom and Salem stations;

11 6) The sale of tax benefits for the Company's
12 share of Salem Unit No. 2 in 1981, as permitted under the
13 Economic Recovery Tax Act of 1981, which generated \$54
14 million of capital for the Company;

15 7) The Limerick Credit Agreement provided an \$800
16 million revolving line of credit for 8 years to help
17 complete Limerick Unit No. 1 and Common Plant, part of
18 which included \$240 million of tax-exempt securities.

19 Q. I would like now to direct your attention to the
20 announced delays in Limerick completion which occurred in
21 1974, 1976 and 1978. First, in the fall of 1974, why did
22 the Company announce a change in the Limerick completion
23 schedule so as to schedule the first unit for commercial
24 operation in April 1981 instead of July 1979?

25 A. I responded to that question in the first Limerick
26 Investigation Docket at I- 80100341. Instead of
27 repeating my answer here, I have attached the pertinent

1 portion of my testimony in that proceeding as Appendix
2 B. Also included in Appendix B is that portion of my
3 I-80100341 testimony which pertains to the 1976 and 1978
4 announcements that I will discuss later.

5 Q. Did the Public Utility Commission address the 1974 delay
6 announcement in the 1980 Limerick Investigation?

7 A. Yes, it did. The Commission agreed that the 1974
8 decision to reduce our capital spending was a reasonable
9 one. Specifically, the Opinion and Order at Docket I-
10 80100341 entered August 27, 1982 states at page 15:

11 "However, placing ourselves in the position of
12 PECO's Management with the facts and trends
13 available to it at that time, we cannot conclude
14 that Management was imprudent and unreasonable in
15 its Decision in 1974 to delay construction."

16 Q. Is it correct that the Company in April 1976 announced
17 that Limerick Unit No. 1's completion would be
18 rescheduled from April 1981 to April 1983 and that in May
19 of 1978 an announcement was made rescheduling completion
20 from 1983 to 1985?

21 A. Yes, such announcements were issued by the Company.

22 Q. Please explain why the Company made the April 1976
23 announcement.

24 A. As I indicated in the first Limerick Investigation Docket
25 at I-80100341, the 1976 delay was caused by the
26 combination of the continued weak financial condition of
27 the Company and the realization that the Limerick

1 capacity would not be needed as soon as planned because
2 of slower growth rates in demand.

3 The primary factor affecting our decision was the
4 amount of financial uncertainty facing us which cast
5 significant doubt on our ability to raise the capital
6 needed in a timely fashion to maintain the April 1981
7 schedule. As I have described above, the Commission
8 granted only one-half of our requested interim rate
9 relief in our 1975 rate case. Immediately following
10 that, i.e. in February 1976, Standard & Poor's reduced
11 our bond rating. Our financial indicators as shown on
12 Table 8 (i.e. 1973 to 1975) were exceedingly poor,
13 despite our previous steps to restrict our market
14 activity in 1974 and 1975 to avoid jeopardizing further
15 our financial condition.

16 Reflecting upon these facts, it was our conclusion
17 that it would not be prudent or reasonable for us to
18 needlessly strain further, and quite possibly overwhelm,
19 our financial resources to maintain the earlier
20 completion schedule. During this period, a concern of the
21 investment community having a significant impact on
22 security ratings was the level of a utility's
23 construction and external financing programs. As
24 mentioned before, I have attached Appendix A, which
25 contains statements from Moody's and Standard & Poor's
26 evaluations of our securities during this period, to
27 demonstrate this point. These statements generally refer

1 to inadequate earnings and coverage levels and
2 "inadequate" and "unresponsive" rate relief as concerns
3 of the rating agencies and investment community. As an
4 alternative to improvement of these factors, and if
5 security ratings are to be maintained, the rating
6 agencies speak of the need to reduce construction
7 spending. For example, Moody's Bond Survey on December
8 23, 1974, noted that "a further cut in construction
9 spending will be needed to maintain present debt
10 quality." On July 21, 1975, Moody's further approvingly
11 noted that: "In the past year, capital spending plans
12 have been reduced by over \$800 million. Reflecting this
13 move, along with recent rate action, a more manageable
14 financing program should work to improve the Company's
15 overall financial posture." On February 10, 1976, the
16 Dow Jones News Ticker noted that the Company's bond
17 rating had recently been cut by S&P due to "less than
18 adequate" regulatory response to the Company's rate
19 request and the Company's "heavy financing program."

20 The immediate purpose of our April 1976 announcement
21 was to inform the financial community that, absent a
22 significant improvement in our financial condition, we
23 would be reducing our construction and external financing
24 program. Table 14 demonstrates the substantial reduction
25 which we achieved. Our ultimate objective was to
26 maintain our securities ratings and thus a lower cost of
27 capital and greater financial flexibility, each of which

1 is of benefit to ratepayers. Our action was directly
2 responsive to the messages we were receiving from the
3 financial community. I think it should be emphasized
4 that our actions, i.e. both in 1976 and in 1978, were
5 successful at the time. As shown on Table 12, our
6 security ratings were maintained at their 1976 levels
7 until the early 1980's, resulting in continuing cost
8 savings to ratepayers.

9 Q. Mr. Paquette, would you please explain why the Company
10 made the May 1978 delay announcement.

11 A. In the spring of 1978, as in 1976, the PUC had recently
12 and even more severely reduced an interim rate relief
13 request. Although as indicated on Table 8, our financial
14 indicators (i.e. 1976-1978) were relatively stable, we
15 were very concerned with our projected 1978 results and
16 their effect upon our security ratings and broader
17 financial position. Our contacts with security rating
18 agencies and investment analysts indicated continued
19 concern over the level of our construction and external
20 financing program relative to our financial condition.
21 Again, our peak load and sales growth projections had
22 been reduced so that Limerick's completion was not
23 required from a supply standpoint on its then current
24 schedule.

25 Thus, for reasons essentially identical to those
26 described above as to 1976, in 1978 we announced a
27 two-year completion deferral pursuant to a general

1 reduction in our construction program. The amount of
2 this reduction is shown on Table 15. Most of the
3 reduction was, however, in non-Limerick construction
4 programs. As explained by Mr. Boyer, we funded Limerick,
5 both in 1978 and 1979, with what we thought were
6 sufficient funds to permit Project completion on the
7 prior 1983/1985 schedule.

8 Q. Did the ALJ and PUC criticize these actions at Docket
9 I-80100341?

10 A. As stated in the Commission's decision at page 14:

11 "....the ALJ concluded that.....the 1976 and 1978
12 delays may have been unreasonable. As previously
13 noted, the ALJ did not find it appropriate to
14 recommend any specific action regarding the 1976 and
15 1978 delays be taken at this time."

16 Thereafter the Commission stated:

17 "Considering the foregoing, we are of the opinion
18 that PECO Management did not exercise judgment
19 sufficient to meet our reasonable man standard in
20 delaying construction at Limerick in 1976 and 1978.
21 Having so found we are requested by Staff and the
22 OCA to quantify the cost of the delays to the
23 ratepayer. We are of the opinion that to do so at
24 this time is inappropriate. We have not been
25 presented in this proceeding, with a claim for
26 recovery of any of the costs associated with the
27 construction of those plants. Consequently we can

1 make no adjustment to any claim."

2 Q. Do you agree with the comments of the ALJ and the PUC in
3 the first Limerick Investigation?

4 A. No. I believe the comments reflect an erroneous view
5 that PECO delayed Limerick Unit No. 1 to protect itself
6 from an excess capacity adjustment and without regard to
7 the impact of delay on its customers. Thus, the
8 Commission's August 27, 1982 decision at page 16 quotes
9 the ALJ as indicating that the 1976 postponement was
10 "made without careful analysis of the impact of such
11 delay on ratepayers" and that "consumers should not be
12 expected to pay for delay which results from a conscious
13 Management decision to protect its own interests without
14 adequate weight being given to the ratepayer's interest."

15 These comments do not in any way reflect the PECO
16 approach to the delays in 1976 and 1978. Ratepayer
17 interests were given extensive consideration on both
18 occasions as I will explain. In addition, the 1978 delay
19 announcement was not actually implemented in that funding
20 for the Project was provided at a level we believed would
21 be sufficient to permit its completion upon the 1983/1985
22 schedule.

23 I might also note that it seems inconsistent to me
24 that in the first Limerick Investigation the Commission
25 concluded that the Company had failed to act reasonably
26 by electing to delay the Limerick Project in both 1976
27 and 1978, while also concluding that the Company could

1 delay construction of Limerick Unit No. 2 further in 1982
2 for similar financial reasons. The fact is that the
3 financial conditions surrounding the PUC's decision to
4 offer an option to delay Limerick Unit No. 2 in 1982 were
5 similar to the conditions that prevailed in the mid and
6 late 1970's.

7 Q. Please expand on this latter observation.

8 A. I have prepared Table 16 to present the relevant
9 comparison. The major indicators of our financial
10 condition shown on Table 16 are the relationship of
11 dividends to earnings, mortgage coverage ratio, SEC
12 coverage and AFUDC as a percentage of earnings. Yield is
13 also an indicator but, in this instance, is affected by
14 general capital cost levels and is thus not comparable
15 across the period analyzed. The comparison is made for
16 the periods April 1976, May 1978 and August 1982, i.e.
17 the approximate dates upon which deferral actions were
18 taken or directed.

19 As shown, our financial position was substantially
20 the same in each period. Payout ratio, the measure of
21 dividends relative to the earnings, was lower (i.e.
22 better financial posture) in 1982 than in either 1976 or
23 1978. Indeed, in 1978 earnings were below the dividend.
24 Mortgage coverage in 1978 was significantly below that of
25 1982 (i.e. 2.2 versus 2.4 times), while coverage in 1976
26 approximately equalled that of 1982. A similar condition
27 existed with respect to preferred stock coverage. SEC

1 coverage in 1982 was below that of 1976 and 1978 (i.e.
2 approximately 2.2 versus 2.4 times), but this was true of
3 utilities in general. Thus, our relative position in the
4 industry was not worse. Our quality of earnings and the
5 market price of our stock was somewhat worse in 1982 than
6 in 1976 and 1978.

7 Q. Mr. Paquette, in the 1980 Limerick Investigation the PUC
8 stated that the Company was protecting its own interests
9 without affording adequate consideration to the interests
10 of its ratepayers in announcing completion deferrals in
11 1976 and 1978. You have stated that these comments are in
12 error. Please explain why this is so.

13 A. In making each announcement, we gave much consideration
14 to the interests of our ratepayers. As I have explained,
15 a major contributor to our decision to reduce our
16 construction budgets in 1976 and 1978 was the need to
17 reduce financial pressures in order to maintain our
18 security ratings. The net effect of this was to benefit
19 our ratepayers by reducing capital attraction costs and
20 thus rate levels, by avoiding impairment of our ability
21 to raise capital and by maintaining our securities'
22 value. A second consideration to our analysis was the
23 recognition that Limerick's capacity was not needed as
24 early as originally projected and that completion on the
25 early schedule could cause premature increases in rates
26 for customers.

27 Q. How would customers be subject to premature increases in

1 rates?

2 A. If Limerick were placed in commercial operation and added
3 to the rate base before it was needed to meet service
4 requirements, customers would have to bear the resulting
5 increase in rates before service needs made that
6 necessary. Also, as I describe below, our review of
7 Commission Orders convinced us that the preferred public
8 policy choice was to avoid short-term rate effects, even
9 though long-term costs could be increased. In evaluating
10 these considerations, as well as those described above,
11 we were considering the interests of ratepayers.

12 Q. Please describe further how the Company evaluated the
13 cost effects of delayed Limerick completion.

14 A. A study the Company performed in 1978 indicated that a
15 one year advancement in the completion date of Limerick
16 Unit 1 would on a levelized basis save customers \$16
17 million a year over the Unit's service life, but the
18 additional revenue requirement in year 1 would be \$189
19 million and that higher revenue requirements would
20 continue for over four years. A two year acceleration
21 magnifies this burden on customers in the early years.

22 In addition to the primary financial pressures which
23 I have previously described, our decision to announce a
24 completion deferral was secondarily based upon our belief
25 that avoidance of these major short-term costs was
26 preferable even if this would result in the incurrence of
27 modestly greater costs during the plant's remaining life.

1 There are numerous decisions which the Commission
2 makes in every rate case which result in differing cost
3 effects upon present versus future ratepayers -- for
4 example, tax normalization versus flow through, with the
5 adoption of the former reducing costs for future
6 ratepayers and the latter reducing costs for current
7 ratepayers. Disallowance of CWIP in rate base decreases
8 costs to current customers, but increases costs for
9 future customers. Our decision was also consistent with
10 public policy as we perceived it during this period.

11 Finally, it would be incorrect to simply conclude
12 from our studies that, even over the long-term,
13 ratepayers would clearly be disadvantaged by Project
14 deferral. Our studies assumed simplistically that the
15 plant could be completed without special rate relief to
16 improve our financial posture. However, on several
17 occasions we requested special rate relief to permit
18 Limerick's early completion. As I describe below, it
19 would not have been possible for us to have completed the
20 plant on a substantially advanced schedule absent such
21 relief.

22 Q. Please explain the basis for the statement which you made
23 regarding public policy.

24 A. Our perception of public policy as established by the
25 Commission was derived from the denial of our request for
26 CWIP in our 1975 rate case. This perception was
27 confirmed when, in our 1979, 1980 and 1981 rate cases,

1 the Commission denied us requested rate relief to permit
2 advancing or at least greater assurance of adherence to
3 the planned completion schedule of Limerick.

4 For example, in our 1979 rate case, I testified to
5 our "urgent need for rate relief" and explained that:

6 "Unless we are able to improve our cash flow and the
7 achieved rate of return on invested capital, there
8 are serious doubts as to whether we will be able to
9 continue to finance our planned construction program
10 and maintain adequate coverage of our dividend."

11 In our 1979 rate case, we specifically requested
12 additional rate relief in order to permit advancement of
13 completion of Limerick Unit No. 1 to 1983. As explained
14 by Mr. Boyer, we had expended additional money in excess
15 of that required for 1985 completion of the plant in both
16 1978 and 1979 in order to maintain the option of advanced
17 completion in 1983. In making our request for the
18 additional rate relief, we explained that economic
19 conditions, principally increased oil and coal prices,
20 had changed to such an extent that Limerick's early
21 completion would not result in the higher short-term
22 costs for ratepayers which our earlier deferral decisions
23 had sought to avoid. The Commission's action in denying
24 these requests for additional rate relief, I should note,
25 were subsequently confirmed as mandatory state policy by
26 the General Assembly when it passed the anti-CWIP statute
27 (Act 335 of 1982, 66 Pa.C.S. 1315).

1 Q. Mr. Paquette, was concern over an excess capacity
2 adjustment a significant basis for the Company's Limerick
3 decision making?

4 A. No, it was not. Our decisions were made in light of the
5 necessity to maintain our financial position, thereby
6 avoiding the risk of being excluded from the capital
7 markets with dire consequences to our ability to provide
8 service and in recognition of the fact that early
9 completion of the plant was not required to provide
10 service and was not economically advantageous to current
11 ratepayers.

12 Q. Mr. Paquette, your explanation of the 1976 and 1978
13 construction delays is consistent with the position taken
14 by the Company in the first Limerick Investigation at
15 I-80100341. Yet in that case the Commission in its Order
16 at page 17 stated that "we are of the opinion that PECO
17 management did not exercise judgment sufficient to meet
18 our reasonable man standard in delaying construction in
19 1976 and 1978." Since your explanations in this
20 testimony are the same as those discussed by the
21 Commission, why should the Commission change its
22 conclusion?

23 A. Although my explanations are substantially the same, I
24 have tried to elaborate on them in order to permit a
25 better understanding of the facts. The Commission's
26 comments as they appear in the August 27, 1982 Decision
27 do not in my view reflect a full understanding of these

1 facts.

2 The Order acknowledges that our delays were caused
3 by financial difficulties but suggests that these in turn
4 were caused by our "ambitious construction program and
5 our ever decreasing load growth." It then states that
6 our financial difficulties would have been less acute if
7 construction at Limerick had been terminated. This can
8 hardly be debated since the major pressure on our
9 financial condition was indeed the construction of
10 Limerick. If my testimony is correct that a delay in
11 that construction eased our financial problems, then
12 clearly cancellation altogether would have very
13 substantially removed these problems. However, as others
14 will explain in greater detail, the facts available to us
15 in 1976 and 1978 clearly established that cancellation
16 was not an appropriate or even a possible choice.

17 Indeed, as I read its Order, the Commission
18 concluded in 1982 that the public interest required
19 timely completion of Limerick Unit 1 and that completion
20 of both Units was economically desirable. While
21 cancellation or suspension of Limerick Unit 2 was
22 recommended, the basis for that conclusion was the
23 preservation of PECO's financial integrity, not the need
24 for or economic viability of Unit 2. Moreover, as
25 discussed in the testimony of Vincent S. Boyer, the
26 Company performed numerous studies throughout this period
27 which demonstrated that, both from a load growth and

1 economic generation perspective, Limerick should be
2 completed. This conclusion is also supported by the
3 independent analysis presented in the testimony of Dr.
4 Lewis J. Perl of National Economic Research Associates.

5 Further discussion in the Commission's 1982 Limerick
6 Order indicates that if Limerick can be economically
7 justified when compared to alternative sources of power
8 and the retirement of oil-fired plants which have been
9 extensively depreciated, the relative benefits to current
10 ratepayers would have been greater had this oil capacity
11 and its cost been retired earlier by way of compressing
12 rather than expanding the construction schedule.

13 Although I may not understand the import of the
14 Commission's comments, the Commission appears to suggest
15 that the Company should have rushed Limerick to
16 completion at the risk of further financial deterioration
17 and perhaps financial catastrophe. My testimony explains
18 the reasons why we believe that this would have been a
19 highly imprudent and, indeed, an impossible effort. We
20 needed the additional generation provided by Limerick,
21 which was at all times our lowest cost generation
22 alternative. Thus cancellation was not an appropriate
23 course. However, we did not need it upon a compressed
24 construction schedule, and early completion would have
25 imposed substantial near-term cost disadvantages upon our
26 customers and was, as I explain below, not feasible due
27 to financial constraints in any event. Our response of

1 carefully controlling our expenditure levels at the plant
2 so as not to unduly jeopardize our financial condition
3 while completing the plant as rapidly as possible was the
4 only feasible and reasonable response to the conditions
5 which we faced and the information we had available.

6 Q. If the Company had sought to raise additional funds
7 during this period, could it have completed Limerick on a
8 substantially advanced schedule?

9 A. No, it could not have done so. Based on our Forecast 2
10 prepared in 1976, the direct cost of the Limerick Station
11 (i.e. Unit No's. 1 & 2 and Common) based on an estimated
12 commercial operation date for Limerick Unit 1 and Common
13 of April 1982 was \$1.7 billion, of which \$1 billion
14 reflects the then cost estimate for Limerick Unit 1 and
15 Common. As shown in the joint TBA/Company study
16 presented in Exhibit 2, the regulatory and other
17 externally imposed direct cost increase for Unit 1 and
18 Common since Forecast 2 approximates \$1 billion and the
19 general design changes to enhance plant safety,
20 reliability and operability cost approximately \$75
21 million. Had we sought to complete Limerick
22 substantially sooner than we in fact did, we would have
23 had to have raised additional capital above our actual
24 capital program to fund these substantial expenditures,
25 as well as their associated capital carrying charges not
26 reflected in the analysis.

27 Employing a conservative \$1 billion figure, this

1 additional cost would have required us to raise \$500
2 million of additional debt and \$500 million of additional
3 equity financing in the period 1976 to 1981. Our
4 mortgage and SEC coverages and our dividend coverage in
5 the 1976 to 1980 period as already discussed (Table 8)
6 would clearly not have permitted us to attract this
7 capital without very substantial additional rate relief.
8 In light of the difficulty which we had during this
9 period in obtaining the rate relief we did receive and
10 the denials of requests for additional rate relief which
11 we made to permit greater construction funding, I believe
12 it is clear that we could not have obtained the
13 additional revenues. Thus, I believe we would have been
14 forced to curtail our construction program by the
15 financial markets if we had not done so ourselves.

16 Q. Mr. Paquette, you have spoken of reductions in capital
17 expenditures adopted in the Company's 1976 and 1978
18 construction budgets. Did you in fact reduce
19 expenditures at Limerick over the initially budgeted
20 level (i.e. Forecast 1) during the 1975 to 1980 period?

21 A. No, we did not. The actual capital expenditure
22 reductions were made in projects other than Limerick. As
23 shown on Table 17, our actual Limerick expenditures
24 during the 1975 to 1981 period totaled \$1.2 billion,
25 exceeding the Forecast 1 budgeted total of \$1.0 billion
26 and, on an annual basis, in four of the seven years.
27 However, as Limerick Project cost increases were

1 recognized during this period for reasons that Mr. Kemper
2 and others describe, we did not increase our funding of
3 the Project commensurately principally because of the
4 financial pressures which I have described.

5 Q. Would you please summarize your testimony?

6 A. Philadelphia Electric Company has a prudent financial
7 planning process which has been utilized through the
8 1970's and 1980's. Construction and financing plans are
9 developed in consideration of a myriad of forces, both
10 internal and external, and must be prepared in the best
11 long-run interests of ratepayers and shareholders.

12 We believe that the Company successfully met its
13 construction and financial challenges to the best of its
14 ability during the 1970 to 1984 period. The Company did
15 everything possible to finish construction of Limerick at
16 the right time in the right way.

17 We were able to raise \$3.3 billion of new capital
18 from 1970 to 1979 under extremely difficult conditions.
19 It would have been extremely imprudent and perhaps
20 impossible to have tried to raise more capital than we
21 raised in this period or to raise it faster.

22 Q. Does that conclude your testimony, Mr. Paquette?

23 A. Yes, it does.

24

25

26

27

PHILADELPHIA ELECTRIC COMPANY SYSTEM
STATEMENT OF OPERATIONS
(Million Dollars)
1984-1986

TABLE 1

| | Actual 1984 | Estimate 1985 | Forecast 1986 (a) |
|--------------------------------------|----------------|------------------|----------------------|
| Electric Operating Revenue | \$2,436 | \$2,572 | \$2,438 |
| Electric Operating Expense | | | |
| Fuel & Interchange | 773 | 810 | 680 |
| O&M Expenses | 443 | 477 | 522 |
| Nuclear Fuel Storage | 20 | 17 | 13 |
| Nuclear Decommissioning | 4 | 4 | 4 |
| Total Electric Operations | 1,240 | 1,308 | 1,219 |
| Customer Accts, A&G | 220 | 243 | 244 |
| Depreciation & Amortization | 163 | 161 | 224 |
| Total Taxes | 398 | 436 | 345 |
| Electric Operating Expenses | 2,021 | 2,148 | 2,032 |
| Electric Operating Income | 415 | 424 | 406 |
| Gas Operating Income | 35 | 39 | 40 |
| Steam Operating Income | 4 | 2 | 1 |
| Total Operating Income | \$ 454 | \$ 465 | \$ 447 |
| Other Income | | | |
| AFUDC | 134 | 162 | 130 |
| Income Taxes | 116 | 138 | 113 |
| Other | 1 | 1 | (4) |
| Total Other Income | \$ 251 | \$ 301 | \$ 239 |
| Income Before Interest Charges | \$ 705 | \$ 766 | \$ 686 |
| Interest Charges | | | |
| Interest | 433 | 470 | 473 |
| AFUDC-Credit | (220) | (270) | (216) |
| Total Interest Charges | \$ 213 | \$ 200 | 257 |
| Net Income | \$ 492 | \$ 566 | \$ 429 |
| Preferred Dividends | \$ 82 | \$ 92 | \$ 103 |
| Earnings for Common Stock | \$ 410 | \$ 474 | \$ 326 |
| Average Common Shares (million) | 151.8 | 169.9 | 185.5 |
| Earnings per average share (dollars) | \$ 2.70 | \$ 2.79 | \$ 1.76 |
| Ratios | | | |
| AFUDC per share | \$ 2.33 | \$ 2.55 | \$ 1.87 |
| AFUDC - % Total Earnings | 86% | 91% | 106% |
| Return on Common Equity | 15.2% | 15.6% | 10.0% |

(a) Based upon current base rates as of September 1985

PHILADELPHIA ELECTRIC COMPANY SYSTEM
VARIOUS FINANCIAL RATIOS
1984 -1986

| <u>Item</u> | <u>Actual 1984</u> | <u>Estimate 1985</u> | <u>Forecast 1986 (1)</u> |
|---|------------------------|--------------------------|------------------------------|
| Interest Coverage Ratios: | | | |
| Mortgage | 2.5X | 2.5X | 2.0X |
| SEC with AFUDC | 2.4X | 2.4X | 2.0X |
| SEC without AFUDC | 1.6X | 1.5X | 1.3X |
| Internal Sources as % of Construction Expenditures | | | |
| With AFUDC | 30.7% | 47.1% | 29.0% |
| Without AFUDC | (3.9%) | 3.8% | (15.0%) |

(a) Details of Internal Sources (with present rates) (Million \$)

| | | | |
|--|---------------|--------------|--------------|
| Retained Earnings | \$ 75 | \$100 | \$(82) |
| Depreciation (Excl. Spent Fuel and Decomm.) | 175 | 177 | 241 |
| Def. Inc. Taxes* | 27 | 107 | 117 |
| ITC Adj. | 50 | 69 | (14) |
| Total Int. Sources | <u>\$ 327</u> | <u>\$453</u> | <u>\$262</u> |
| Less AFUDC | 355 | 433 | 346 |
| Int. Sources w/o AFUDC | (28) | 20 | (84) |
| Total Construction Exp. | | | |
| Incl. AFUDC | 1,064 | 962 | 905 (2) |
| Excl. AFUDC | 709 | 529 | 559 |
| % Int. Sources/Construction | | | |
| Incl. AFUDC | 30.7% | 47.1% | 29.0% |
| Excl. AFUDC | (3.9%) | 3.8% | (15.0%) |

*A/C Liberalized Depreciation Only

(1) Based upon current base rates and with Limerick Unit No. 1 costs reflected from July 1, 1986.

(2) Construction expenditures in 1986 include \$129 million associated with 1986 AFUDC and capitalized expenses, accrued between commercial operation and July 1, 1986.

PHILADELPHIA ELECTRIC COMPANY SYSTEM
 PROFORMA EFFECT ON 1986 EARNINGS AND COVERAGE
 OF \$682 MILLION ELECTRIC RATE INCREASE
 (MILLIONS OF DOLLARS)

| | Forecast 1986* | Adj. to Forecast (d) | Effect of Rate Increase | Proforma 1986 With Increase |
|-------------------------------|-------------------|-------------------------|----------------------------|--------------------------------|
| Total Operating Revenue | \$ 2,967 | | | \$3,649 |
| Operating Expense: | | | \$ 682 (a) | |
| Other Than Income Taxes | 2,448 | \$ (23) | | 2,232 |
| Income Taxes | 56 | 6 | (193) (b) | 497 |
| Total | <u>2,504</u> | <u>(17)</u> | <u>435 (c)</u> | <u>497</u> |
| Operating Income | \$ 463 | \$ 17 | 242 | <u>2,729</u> |
| Other Income | | | \$440 | \$ 920 |
| AFUDC - Other Funds | 50 | | | 50 |
| Income Tax Credits | 45 | | | 45 |
| Other - Net | (4) | | | (4) |
| Total | <u>\$ 91</u> | | | <u>\$ 91</u> |
| Income Before Int. Charges | \$ 554 | \$ 17 | | \$ 571 |
| Interest Charges | | | \$440 | \$1,011 |
| Interest | 473 | | | 473 |
| AFUDC Credit | (82) | | | (82) |
| Total | <u>\$ 391</u> | | | <u>\$ 391</u> |
| Net Income | \$ 163 | \$ 17 | | \$ 180 |
| Preferred Dividends | \$ 103 | | \$440 | \$ 620 |
| Earnings for Common Stock | \$ 60 | \$ 17 | | \$ 103 |
| Avg. Common Shares (millions) | 185.5 | | \$440 | \$ 517 |
| Earnings per Average Share | \$ 0.32 | | | 185.5 |
| Return on Common Equity | 1.9% | | | \$ 2.79 |

| | |
|-------------------------------|-----------------|
| (a) Higher Revenue | \$893 million |
| Limerick Fuel Savings | = - 211 million |
| Net Increase | \$682 million |
| (b) Higher Gross Receipts Tax | \$ 18 million |
| Limerick Fuel Savings | (211) million |
| Net | \$193 million |
| (c) Higher Base Revenue | \$893 million |
| Gross Receipts Tax @ 2% | - 18 million |
| Net | 875 million |
| Tax Effect @ 49.768% | \$435 million |

(d) Proforma rate case adjustments, including: life extensions, decommissioning, and Limerick depreciation.

* At present rates not incorporating the effects of the P. U. C. Declaratory Order.

TABLE 4

PHILADELPHIA ELECTRIC COMPANY SYSTEM
EFFECT ON INTERNAL CASH FLOW OF
ELECTRIC RATE INCREASE

| | <u>Forecast 1986</u> Without Rate Increase | <u>Proforma 1986</u> With Full Rate Increase |
|--|--|--|
| Interest Coverage Ratios | | |
| Mortgage | 2.0X | 4.6X |
| SEC w/AFUDC | 2.0X | 3.2X |
| SEC w/o AFUDC | 1.3X | 2.9X |
| Internal sources as % of Construction Expenditures (a) | | |
| Including AFUDC | 29.0% | 66.6% |
| Excluding AFUDC | (15.0%) | 58.7% |
| AFUDC % of Common Earnings | 106% | 26% |

(a) Details of Internal sources

| | (Million \$) | |
|-------------------------------------|--------------|----------|
| Retained Earnings | (\$ 82) | \$109 |
| Depreciation | 241 | 266 |
| Deferred Income Taxes* | 117 | 77 |
| Investment Tax Credit Adjustment | <u>(14)</u> | <u>8</u> |
| Total Int. Sources | \$262 | \$460 |
| Less AFUDC | 346 | 132 |
| Int. Sources w/o AFUDC | (84) | 328 |
| Total Construction Exp. | | |
| Incl. AFUDC | 905 | 691 |
| Excl. AFUDC | 559 | 559 |
| % Int. Sources/Construction | | |
| Incl. AFUDC | 29.0% | 66.6% |
| Excl. AFUDC | (15.0%) | 58.7% |

* A/C Liberalized Deprecation Only

PHILADELPHIA ELECTRIC COMPANY
STANDARD & POOR'S BENCHMARK CALCULATIONS for 1986

| | | <u>Proforma 1986</u> | |
|--|--------------------------------|----------------------------------|------------------------------------|
| <u>S & P Benchmarks</u> | <u>S & P Standards</u> | <u>Without Rate Increase</u> | <u>With Full Rate Increase</u> |
| I. Pre-tax Interest Coverage (excl. AFUDC) | | | |
| | A 2.5 - 4.0x | Estimate: 1.1x | 2.9x |
| | BBB 1.5 - 3.0x | Implied Rating: BB | A/BBB |
| | BB less than 2.0x | | |
| II. Net Cash Flow Divided by Total Capitalization | | | |
| | A 5.0 - 8.0% | Estimate: (1.4%) | 3.5% |
| | BBB 2.5 - 6.0% | Implied Rating: BB or lower | BBB |
| | BB less than 3.0% | | |
| III. Debt Capital Divided by Total Capitalization | | | |
| | A 44 - 52% | Estimate: 53.5% | 53.0% |
| | BBB 50 - 58% | Implied Rating: BBB | BBB |
| | BB more than 56% | | |

Inflation Rates
(GNP Deflator Rates)

| | |
|------|------|
| 1970 | 5.4% |
| 1971 | 5.0 |
| 1972 | 4.2 |
| 1973 | 5.8 |
| 1974 | 8.8 |
| 1975 | 9.3 |
| 1976 | 5.2 |
| 1977 | 5.8 |
| 1978 | 7.4 |
| 1979 | 8.6 |
| 1980 | 9.2 |
| 1981 | 9.4 |
| 1982 | 6.0 |
| 1983 | 3.8 |
| 1984 | 3.8 |

Source: Department of Commerce, Bureau of Economic Analysis,
Economic Report of the President - February, 1985.

PHILIPPINE ELECTRIC COMPANY - ELECTRIC

RATE OF RETURN
(\$1,000)

Average
Deficiency
for 10 yrs

| | 1970 | 1971 | 1972 | 1973 | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 |
|---|------------|------------|------------|------------|------------|------------|--------------|--------------|--------------|--------------|
| Operating Revenue | \$ 408,960 | \$ 503,008 | \$ 570,631 | \$ 642,983 | \$ 668,768 | \$ 972,084 | \$ 1,017,039 | \$ 1,170,916 | \$ 1,216,642 | \$ 1,305,542 |
| Operating Expenses | 109,389 | 157,553 | 173,510 | 218,487 | 380,995 | 383,180 | 381,736 | 462,229 | 446,962 | 501,864 |
| Total Fuel & Interchange | 35,710 | 40,030 | 48,731 | 56,558 | 66,296 | 65,730 | 74,846 | 100,934 | 106,052 | 124,613 |
| Other Production Expenses | 36,566 | 37,906 | 42,095 | 47,035 | 49,309 | 53,022 | 61,083 | 66,555 | 73,080 | 76,441 |
| Total T & D | 42,360 | 43,176 | 49,025 | 52,071 | 56,584 | 68,841 | 75,824 | 88,131 | 101,289 | 111,433 |
| Customer Expensed, A&D | 47,069 | 48,895 | 52,593 | 55,676 | 66,564 | 79,487 | 85,906 | 95,675 | 103,949 | 107,508 |
| Depreciation | 40,008 | 67,260 | 80,772 | 86,527 | 117,319 | 147,119 | 195,253 | 162,195 | 167,068 | 158,972 |
| Total Taxes | | | | | | | | | | |
| Gain or Loss from Disposition of Utility Plant | | | | | | | | | | |
| TOTAL OPERATING EXPENSE | 319,102 | 594,870 | 616,756 | 576,336 | 731,054 | 797,379 | 831,660 | 975,647 | 990,198 | 1,080,600 |
| Operating Income | 89,858 | 108,138 | 123,878 | 126,629 | 131,604 | 174,705 | 182,391 | 195,269 | 218,444 | 224,742 |
| Net Investment (13 Month Average) | 1,651,802 | 1,798,271 | 1,930,298 | 2,016,214 | 2,308,066 | 2,792,494 | 2,851,859 | 3,157,174 | 3,407,479 | 3,494,598 |
| Plant in Service | 50,921 | 53,755 | 98,290 | 94,662 | 96,304 | 99,161 | 100,811 | 100,926 | 102,252 | 100,634 |
| Allocated Common Plant | (195,406) | (501,556) | (554,462) | (572,598) | (618,283) | (668,604) | (726,027) | (807,036) | (857,739) | (904,851) |
| Provision for Depreciation | 29,911 | 29,366 | 30,518 | 32,001 | 51,329 | 71,253 | 74,817 | 82,856 | 75,656 | 84,209 |
| Materials & Supplies | 10,090 | 12,699 | 11,309 | 10,100 | 9,404 | 12,400 | 12,610 | 13,297 | 14,425 | 7,303 |
| Cash | (114,883) | (174,532) | (24,268) | (30,778) | (40,085) | (52,219) | (63,831) | (114,942) | (147,136) | (172,961) |
| Deferred Income Taxes | 1,262,037 | 1,378,003 | 1,511,591 | 1,593,541 | 1,810,735 | 2,194,215 | 2,233,239 | 2,432,275 | 2,556,937 | 2,528,926 |
| TOTAL NET INVESTMENT | 1,262,037 | 1,378,003 | 1,511,591 | 1,593,541 | 1,810,735 | 2,194,215 | 2,233,239 | 2,432,275 | 2,556,937 | 2,528,926 |
| Return on Net Investment | 7.12% | 7.85% | 8.20% | 8.17% | 7.27% | 7.96% | 8.17% | 8.03% | 8.51% | 8.09% |
| Actual Allowed by PUC (Table 1a) | 7.30 | 7.50 | 8.00 | 8.60 | 8.70 | 9.50 | 9.90 | 9.90 | 9.90 | 9.80 |
| Deficiency | .18 | (.35) | .80 | .63 | 1.43 | 1.54 | 1.73 | 1.87 | 1.39 | 0.91 |
| Capitalization Percentage (System - From Financial Statement) | 55.1% | 52.9% | 51.4% | 48.5% | 52.0% | 51.9% | 51.5% | 51.7% | 52.0% | 52.3% |
| Long Term Debt | 10.1 | 11.8 | 13.3 | 14.4 | 14.9 | 13.7 | 13.9 | 13.1 | 13.6 | 12.8% |
| Common Equity | 38.8 | 35.3 | 35.3 | 37.1 | 33.1 | 34.4 | 34.6 | 35.2 | 34.4 | 34.9 |
| Embedded Cost | 5.5% | 6.0% | 6.0% | 6.1% | 6.0% | 7.5% | 7.7% | 7.6% | 7.9% | 8.8% |
| Long Term Debt Preferred Stock | 6.3 | 6.7 | 7.0 | 7.0 | 7.4 | 7.4 | 7.6 | 7.6 | 7.7 | 7.7 |
| Weighted Cost (Capitalization Percentage x Embedded Cost) | 3.03 | 3.17 | 3.08 | 2.96 | 3.24 | 3.69 | 3.97 | 4.03 | 4.11 | 4.60% |
| Long Term Debt | 0.64 | 0.72 | 0.93 | 1.01 | 1.10 | 1.01 | 1.06 | 1.00 | 1.05 | 0.99 |
| Preferred Stock | 3.67 | 3.96 | 4.01 | 3.97 | 4.64 | 4.30 | 5.03 | 5.93 | 5.16 | 5.59 |
| WOB TOTAL | 3.45 | 3.89 | 4.19 | 4.20 | 2.63 | 3.06 | 3.14 | 3.00 | 3.38 | 3.30% |
| Amount to Common Equity | 3.45 | 3.89 | 4.19 | 4.20 | 2.63 | 3.06 | 3.14 | 3.00 | 3.38 | 3.30% |
| (Amount to Common Equity + The Capitalization Percentage for Common Equity) | 9.91% | 11.02 | 11.87 | 11.32 | 7.95 | 8.90% | 9.08% | 8.52% | 9.63% | 9.45% |
| Actual Allowed by PUC (Table 1a) | 11.70 | 11.90 | 13.30 | 13.10 | 12.90 | 15.20 | 14.90 | 14.10 | 13.90 | 13.50 |
| Deficiency | 1.79 | .88 | 1.43 | 1.78 | 4.95 | 6.30 | 5.82 | 5.58 | 4.07 | 4.05 |

TABLE 7

PHILADELPHIA ELECTRIC COMPANY SYSTEM

Various Financial Statistics

| | <u>1970</u> | <u>1971</u> | <u>1972</u> | <u>1973</u> | <u>1974</u> | <u>1975</u> | <u>1976</u> | <u>1977</u> | <u>1978</u> | <u>1979</u> | <u>1980</u> |
|---|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Return on Avg. Common Equity | 9.4% | 10.8% | 10.3% | 9.8% | 8.9% | 9.4% | 9.9% | 9.6% | 9.7% | 9.8% | 10.7% |
| AFUDC - as % of Common Stock Earning | 31.0% | 40.5% | 49.1% | 61.7% | 74.3% | 62.0% | 61.8% | 64.9% | 64.4% | 75.7% | 84.3% |
| SEC Coverage Including AFUDC | 2.6 | 2.9 | 2.8 | 2.7 | 2.3 | 2.4 | 2.5 | 2.4 | 2.4 | 2.1 | 2.1 |
| SEC Coverage excluding AFUDC | 2.2 | 2.4 | 2.3 | 2.1 | 1.8 | 1.9 | 2.0 | 1.9 | 1.9 | 1.6 | 1.5 |
| Mortgage Indenture Coverage | 2.3 | 2.4 | 2.5 | 2.4 | 2.1 | 2.5 | 2.5 | 2.3 | 2.4 | 2.1 | 2.3 |
| Dividend Coverage | 2.09 | 2.29 | 2.30 | 2.20 | 2.57 | 2.45 | 2.85 | 2.44 | 2.42 | 2.15 | 1.99 |
| Internal Sources as % of Construction Expenditures incl. AFUDC | 16.6 | 22.2 | 22.1 | 19.1 | 26.4 | 38.2 | 52.2 | 45.7 | 46.0 | 35.4 | 33.5 |
| Internal Sources as % of Construction Expenditures excl. AFUDC | 12.0 | 14.5 | 12.9 | 8.2 | 13.5 | 24.2 | 39.9 | 30.5 | 30.4 | 11.7 | 10.8 |
| Year-end Yield on Common Stock | 7.3 | 6.9 | 7.2 | 9.1 | 15.1 | 10.9 | 9.2 | 9.0 | 11.6 | 13.1 | 14.4 |
| Market Price as % of Book Value | 118.7 | 122.2 | 113.8 | 89.0 | 53.8 | 78.7 | 93.4 | 101.9 | 80.4 | 72.1 | 66.8 |

3153S-7

PHILADELPHIA ELECTRIC COMPANY
1980 AND 5-YEAR AVERAGE ENDING 1980 FINANCIAL STATISTICS
COMPARISON WITH AVERAGE A AND Baa NORMALIZED UTILITIES

| <u>1980</u> | <u>Average of Normalized Utilities</u> | | <u>PE</u> |
|---------------------------------------|--|-------------------|-----------|
| | <u>A Rated*</u> | <u>Baa Rated*</u> | |
| Pre-tax Interest Coverage incl. AFUDC | 2.66X | 2.19X | 2.14X |
| Pre-tax Interest Coverage excl. AFUDC | 2.28X | 1.76X | 1.52X |
| Effective Tax Rate | 33.54 | 29.03 | 16.40 |
| Return on Equity | 11.66 | 10.31 | 10.60 |
| AFUDC in % Common Earnings | 43.60 | 61.18 | 84.30 |

| <u>5-Year Average Ending 1980</u> | <u>Average of Normalized Utilities</u> | | <u>PE</u> |
|---------------------------------------|--|-------------------|-----------|
| | <u>A Rated*</u> | <u>Baa Rated*</u> | |
| Pre-tax Interest Coverage incl. AFUDC | 2.85X | 2.40X | 2.37X |
| Pre-tax Interest Coverage excl. AFUDC | 2.50X | 1.98X | 1.83X |
| Effective Tax Rate | 33.95 | 26.00 | 24.88 |
| Return on Equity | 11.47 | 10.70 | 9.92 |
| AFUDC in % Common Earnings | 37.47 | 53.51 | 70.20 |

Source: First Boston Report "Electric Utility Industry - Credit and Equity Analysis" dated June 1981.

*Moody's Rating

3153S-8

PHILADELPHIA ELECTRIC COMPANY SYSTEM
Comparison Statistics with Other Utilities
Building Nuclear Units During the 70s/80s

| | <u>1973</u> | <u>1974</u> | <u>1975</u> | <u>1976</u> | <u>1977</u> | <u>1978</u> | <u>1979</u> | <u>1980</u> |
|---------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| <u>Yield</u> | | | | | | | | |
| Philadelphia Electric Company | 7.1% | 8.6% | 12.5% | 10.2% | 9.2% | 9.6% | 12.3% | 12.3% |
| Pennsylvania Power & Light | 6.5 | 8.0 | 10.0 | 9.0 | 8.2 | 8.9 | 11.0 | 10.8 |
| Carolina Power & Light | 7.6 | 8.0 | 8.0 | 7.1 | 7.5 | 8.0 | 10.7 | 10.9 |
| Consumers Power | 6.7 | 8.0 | 12.0 | 10.0 | 8.7 | 9.1 | 11.7 | 12.4 |
| Detroit Edison | 6.1 | 8.1 | 11.3 | 10.0 | 9.4 | 9.4 | 11.5 | 12.4 |
| Duquesne Power | 6.9 | 8.2 | 10.7 | 9.4 | 8.4 | 9.7 | 13.0 | 12.2 |
| Illinois Power | 6.9 | 8.1 | 9.9 | 8.1 | 8.3 | 9.0 | 12.1 | 11.9 |
| Niagara Mohawk | 6.3 | 8.4 | 11.1 | 9.3 | 8.3 | 9.1 | 10.9 | 11.7 |
| <u>Price/Earnings Ratio</u> | | | | | | | | |
| Philadelphia Electric Company | 11.2 | 9.0 | 6.9 | 8.5 | 9.3 | 10.0 | 7.3 | 7.9 |
| Pennsylvania Power & Light | 11.3 | 12.7 | 12.7 | 11.8 | 11.4 | 11.7 | 12.7 | 10.4 |
| Carolina Power & Light | 8.0 | 8.0 | 8.5 | 9.6 | 8.4 | 8.8 | 6.4 | 6.2 |
| Consumers Power | 11.1 | 8.9 | 6.7 | 8.0 | 7.2 | 7.3 | 6.3 | 5.9 |
| Detroit Edison | 10.2 | 10.0 | 7.2 | 9.1 | 9.3 | 8.1 | 6.8 | 6.8 |
| Duquesne Power | 10.7 | 8.9 | 6.8 | 8.0 | 10.2 | 10.1 | 8.2 | 8.7 |
| Illinois Power | 13.6 | 10.6 | 8.4 | 9.4 | 10.6 | 9.5 | 7.0 | 7.1 |
| Niagara Mohawk | 9.5 | 10.8 | 6.5 | 7.4 | 10.6 | 8.5 | 6.8 | 6.5 |
| <u>Return on Equity</u> | | | | | | | | |
| Philadelphia Electric Company | 9.8 | 8.9 | 9.4 | 9.9 | 9.6 | 9.7 | 9.8 | 10.7 |
| Pennsylvania Power & Light | 11.3 | 12.7 | 12.7 | 11.8 | 14.3 | 11.7 | 12.7 | 10.4 |
| Carolina Power & Light | 10.9 | 9.6 | 11.9 | 11.9 | 11.3 | 12.6 | 12.3 | 11.1 |
| Consumers Power | 8.7 | 4.7 | 8.8 | 12.1 | 10.5 | 11.3 | 11.2 | 11.0 |
| Detroit Edison | 8.7 | 7.5 | 7.5 | 8.0 | 9.3 | 9.1 | 10.0 | 9.4 |
| Duquesne Light | 11.0 | 10.3 | 10.8 | 8.4 | 7.6 | 8.4 | 9.1 | 10.5 |
| Illinois Power | 12.7 | 11.3 | 13.2 | 11.3 | 12.7 | 12.8 | 12.4 | 13.4 |
| Niagara Mohawk | 8.2 | 10.3 | 12.2 | 9.7 | 10.4 | 11.1 | 11.4 | 10.5 |
| <u>AFUDC as a % of Earnings</u> | | | | | | | | |
| Philadelphia Electric Company | 62 | 74 | 62 | 62 | 65 | 65 | 76 | 84 |
| Pennsylvania Power & Light | 30 | 33 | 50 | 57 | 44 | 68 | 79 | 117 |
| Carolina Power & Light | 72 | 106 | 79 | 53 | 57 | 57 | 80 | 115 |
| Consumers Power | 37 | 62 | 35 | 30 | 45 | 55 | 74 | 85 |
| Detroit Edison | 52 | 57 | 60 | 59 | 45 | 60 | 61 | 76 |
| Duquesne Light | 39 | 44 | 43 | 46 | 35 | 45 | 49 | 45 |
| Illinois Power | 18 | 21 | 15 | 21 | 33 | 43 | 51 | 54 |
| Niagara Mohawk | 37 | 31 | 31 | 24 | 35 | 40 | 45 | 44 |

PHILADELPHIA ELECTRIC COMPANY
INTERCONNECTION BILLING INFORMATION
1974 - 1980

| | <u>Philadelphia Electric Company</u> | | <u>Pennsylvania Power & Light Company</u> | |
|---------------------|---------------------------------------|---|---|--|
| | <u>Net Purchases</u> (Million kWh) | <u>Net Payment</u> (Million Dollars) | <u>Net Sales</u> (Million kWh) | <u>Net Receipts</u> (Million Dollars) |
| 1974 | 4,835 | \$ 89.1 | 4,888 | \$ 82.4 |
| 1975 | 7,254 | 122.2 | 7,126 | 148.2 |
| 1976 | 7,412 | 115.2 | 6,768 | 135.6 |
| 1977 | 9,366 | 180.8 | 10,781 | 273.2 |
| 1978 | 5,701 | 96.3 | 8,352 | 217.3 |
| 1979 | 8,986 | 236.2 | 9,351 | 334.9 |
| 1980 | <u>10,135</u> | <u>380.3</u> | <u>8,211</u> | <u>362.0</u> |
| Average per year | 7,670 | \$174.3 | 7,925 | \$221.9 |

3153S-10

PHILADELPHIA ELECTRIC COMPANY SYSTEM

SUMMARY OF SECURITIES RATINGS

| | <u>Moody's</u> | <u>S & P</u> | <u>Fitch</u> | <u>D & P</u> |
|--------------------------------------|----------------|------------------|--------------|-------------------|
| Mortgage Bonds | Baa3 (1/83) | BBB- (9/82) | BBB (9/82) | 9 (3/80)* |
| Debentures & Pollution Control Bonds | Ba1 (1/83) | BB+ (9/82) | BBB- (9/82) | 10 (3/80)* |
| Preferred Stock | Ba1 (1/83) | BB (9/82) | BB+ (9/82) | 11 (2/83) |
| Commercial Paper | P-3 (6/81) | A-3 (3/82) | - | Duff 3 (8/23/84)* |

() = Date of last change
 * Initial public rating

PHILADELPHIA ELECTRIC COMPANY SYSTEM

HISTORY OF PE'S MORTGAGE BOND RATINGS

| <u>Moody's Investors Service</u> | <u>Standard & Poor's Corporation</u> | <u>Fitch Investors Service</u> | <u>Duff and Phelps Incorporated</u> |
|----------------------------------|--|--------------------------------|-------------------------------------|
| Aaa until 12/70 | AAA until 11/68 | A until 7/81 | 9* until -- |
| Aa " 9/74 | AA " 10/74 | BBB+ until 9/82 | |
| A " 6/81 | A " 2/76 | BBB " - | |
| Baa2 " 1/83 | A- " 4/80 | | |
| Baa3 " - | BBB+ " 6/81 | | |
| | BBB " 9/82 | | |
| | BBB- " - | | |

* Initial Public Rating

NOTE: the numerical modifier to Moody's bond and debenture rating symbols shown above was initiated on April 26, 1982. The new numerical modifier for the preferred stock rating went into effect on May 3, 1982.

PHILADELPHIA ELECTRIC COMPANY
SUMMARY OF ELECTRIC RATE CASES
1970-1984

| CASE NUMBER | DATE OF FILING | DATE TO BECOME EFFECTIVE | TARIFF | SUPP # | AMOUNT REQUESTED | DATE EFFECTIVE | TARIFF | SUPP # | AMOUNT RECEIVED | % REQUEST GRANTED | P R O P O S E D | | G R A N T E D | |
|-------------|----------------|--------------------------|--------|-------------|------------------|----------------|--------|-------------|-----------------|-------------------|-----------------|---------|---------------|---------|
| | | | | | | | | | | | REQUESTED | GRANTED | RECEIVED | GRANTED |
| C-19114 | 11-19-70 | 1-18-71 | E23 | 7 | 41,992,820 | 2-18-71 | E23 | 7 | 41,992,820 | 73% | | | | |
| | | 1-18-71 | E23 | 8 | 54,431,405 | 11-17-71 | E24 | - | 30,581,180 (a) | 64% | | | | |
| | | 1-18-71 | E23 | 8 | 96,424,225 | | | | | 72,574,000 | 75% | | | |
| RID 29 | 7-14-71 | 9-12-72 | E24 | 5 | 15,732,878 | 10-05-72 | E24 | 5 | 15,448,481 | 78% | | | | |
| | | 9-12-72 | E24 | 6 | 15,160,412 | | | | | | | | | |
| | | 9-12-72 | E24 | 7 | 16,367,321 | 8-21-73 | E24 | 25 | 32,620,515 (b) | 100% | | | | |
| | | | | | | | | | 47,260,611 | | | | | |
| RID 129 | 1-31-74 | 4-01-74 | E24 | 30 | 23,598,704 | 4-01-74 | E24 | 30 | 23,598,704 | 78% | | | | |
| | | 4-01-74 | E24 | 31 | 52,983,915 | 4-10-75 retro | E24 | 45 | 79,263,289 | | | | | |
| | | 4-01-74 | E24 | 32 | 55,696,488 | to 01-01-75 | | | | | | | | |
| | | | | | | | | | 132,279,107 | | | | | |
| | | | | | | | | | 102,861,993 | | | | | |
| RID 295 | 11-19-75 | 1-18-76 | E24 | 51 | 47,009,944 | 2-06-76 | E24 | 57 | 24,290,002 | 76% | | | | |
| | | E24 | 52 | 47,595,511 | 8-05-76 | E24 | 62 | 22,706,055 | | | | | | |
| | | | | | | 3-01-77 retro | E24 | 67 | 24,999,427 | | | | | |
| | | | | | | | | | 94,605,455 | | | | | |
| | | | | | | | | | 71,995,484 | | | | | |
| RID 438 | 8-05-77 | 10-04-77 | E24 | #73 | 118,643,541 | 3-03-78 | E24 | 78 | 11,865,504 | 66% | | | | |
| | | | | | | 3-02-79 retro | E25 | - | 67,027,979 | | | | | |
| | | | | | | to 07-04-78 | | | | 78,893,483 | | | | |
| | | | | | | | | | 118,643,541 | | | | | |
| RID 865 | 7-27-79 | 9-25-79 | E25 | 6 | 122,731,000 | 5-10-80 | E25 | 15 | 88,813,000 | 73% | | | | |
| | | E25 | 19 | 303,729,000 | 4-25-81 | E25 | 25 | 187,565,000 | 62% | | | | | |
| | | E25 | 28 | 344,039,000 | 5-21-82 | E25 | 34 | 221,708,000 | 64% | | | | | |
| RID 1626 | 7-29-81 | 9-27-81 | E25 | 40 | 228,233,000 | 11-23-83 | E26 | - | 143,518,000 | 63% | | | | |
| RID 2291 | 2-23-83 | 4-25-83 | E25 | 3 | 152,229,000 (c) | 1-25-85 | E26 | 11 | 48,581,000 (c) | 32% | | | | |
| RID 2590 | 4-27-84 | 6-27-84 | E26 | | | | | | | | | | | |

(a) Includes \$1,312 million adjustment for annualization
 (b) Includes adjustment for different test year.
 (c) Includes \$101 million fuel savings from Salem #2 operation.

PHILADELPHIA ELECTRIC COMPANY
 CONSTRUCTION and FINANCING FORECAST
 1976 - 1979
 (Million Dollars)

| | <u>1976</u> | <u>1977</u> | <u>1978</u> | <u>1979</u> |
|-----------------------------|-------------|-------------|-------------|-------------|
| <u>Spring 1975 Forecast</u> | | | | |
| Construction Expenditures | \$ 469 | \$ 481 | \$ 550 | \$ 674 |
| Internal Funds | <u>205</u> | <u>202</u> | <u>233</u> | <u>286</u> |
| New Financing Required | \$ 264 | \$ 279 | \$ 317 | \$ 388 |
| <u>Spring 1976 Forecast</u> | | | | |
| Construction Expenditures | \$ 437 | \$ 414 | \$ 390 | \$ 478 |
| Internal Funds | <u>229</u> | <u>179</u> | <u>179</u> | <u>195</u> |
| New Financings Required | \$ 208 | \$ 235 | \$ 211 | \$ 283 |
| <u>Change in Financing</u> | (\$56) | (\$44) | (\$106) | (\$105) |
| Percentage | (21%) | (16%) | (33%) | (27%) |

PHILADELPHIA ELECTRIC COMPANY
 CONSTRUCTION and FINANCING FORECAST
 1978 - 1981
 (Million Dollar)

| | <u>1978</u> | <u>1979</u> | <u>1980</u> | <u>1981</u> |
|--------------------------------|-------------|-------------|-------------|-------------|
| <u>Spring 1977 Forecast</u> | | | | |
| Construction Expenditures | \$ 434 | \$ 455 | \$ 511 | \$ 544 |
| Internal Funds | <u>198</u> | <u>232</u> | <u>233</u> | <u>229</u> |
| New Financing Required | \$ 236 | \$ 223 | \$ 278 | \$ 315 |
| <u>Spring 1978 Forecast</u> | | | | |
| Construction Expenditures | \$ 483 | \$ 418 | \$ 465 | \$ 509 |
| Internal Funds | <u>207</u> | <u>248</u> | <u>236</u> | <u>248</u> |
| New Financings Required | \$ 276 | \$ 170 | \$ 229 | \$ 261 |
| <u>Change in New Financing</u> | \$ 40 | (\$53) | (\$49) | (\$54) |
| Percentage | 17% | (24%) | (18%) | (17%) |

PHILADELPHIA ELECTRIC COMPANY
 VARIOUS STATISTICS - TWELVE MONTH ENDED

| | <u>April 1976</u> | <u>May 1978</u> | <u>August 1982</u> |
|----------------------------|-----------------------|---------------------|------------------------|
| Earnings Per Share | \$ 1.86 | \$ 1.79 | \$ 2.53 |
| Dividend Per Share* | \$ 1.64 | \$ 1.80 | \$ 2.02 |
| Payout Ratio | 88.2% | 100.6% | 86.7% |
| Mortgage Coverage | 2.48X | 2.21X | 2.41X |
| SEC Coverage w/AFUDC | 2.41X | 2.43X | 2.24X |
| Common Stock Price-Mo. end | \$16.50 | \$ 17.50 | \$15.875 |
| AFUDC as % of Earnings | 61.6% | 63.0% | 78.0% |
| Yield | 9.9% | 10.3% | 13.4% |
| PFD Stock Coverage | 1.59X | 1.55X | 1.63X |
| Moody Bond Rating | A | A | Baa2 |
| S&P Bond Rating | A- | A- | BBB |
| PE Mort. Bond Financing | 9.125% 2/76 | 9.125% 3/78 | 15.375% 9/82 |

31253-15

PHILADELPHIA ELECTRIC COMPANY
LIMERICK EXPENDITURES
(MILLIONS OF \$)

| | <u>1975</u> | <u>1976</u> | <u>1977</u> | <u>1978</u> | <u>1979</u> | <u>1980</u> | <u>1981</u> | <u>Total</u> |
|----------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|--------------|
| Forecast 1 (Aug. '75) | \$ 92 | \$155 | \$160 | \$180 | \$180 | \$168 | \$ 85 | \$1,020 |
| Forecast 2 (Aug '76) | 107* | 119 | 112 | 170 | 200 | 180 | 140 | 1,028 |
| Forecast 3 (Nov '77) | 107* | 147* | 160* | 156 | 164 | 174 | 143 | 1,051 |
| Forecast 4 (Dec '79) | 107* | 147* | 160* | 142* | 142* | 172 | 201 | 1,071 |
| Actual Direct Expenditures | 107 | 147 | 160 | 142 | 142 | 196 | 269 | 1,163 |

*Actual

APPENDIX A

EXCERPTS FROM VARIOUS RATING AGENCY REPORTS

1) December 31, 1973 - (Moody's Bond Survey)

The proposed new issue of \$125 million mortgage bonds were rated Aa "ranking in the lower range of their rating category. In light of the prospective large amounts of debt to be sold annually, periodic rate relief will be necessary to maintain debt protection measurements at satisfactory levels."

2) September 30, 1974 - (Moody's Bond Survey)

Ratings on all outstanding mortgage bonds, pollution control revenue bonds and PECO's sinking fund debentures were downgraded. "While capitalization ratios have been maintained at fairly reasonable levels, the earnings on invested capital are not now sufficient to provide interest protection at levels appropriate for a high-grade bond rating."

3) October 1, 1974 - (Dow Jones News Ticker)

Philadelphia Electric Securities downgraded by S&P. An S&P spokesman cited "a decline in fixed-charge coverage although additional rate relief is pending, plus planned reductions in the Company's construction program - the outlook for a recovery of earnings protection appears uncertain for quite some time."

4) December 23, 1974 - (Moody's Bond Survey)

"Present tariff structures are not generating enough earnings to permit meaningful sales of mortgage bonds, and preferred stock and marketing considerations precluded a planned sale of common stock in the fall of 1974. In order to overcome this, the company applied for an electric increase of \$136 million in January 1974. An interim increase of \$24 million was allowed last April, with the remaining portion now suspended until January 1, 1975. A reasonable response is needed to

arrest declining debt-protection measurements over the immediate future. Meanwhile additional rate relief, sales of equity securities, along with perhaps a further cut in construction spending will be needed to maintain present debt quality."

5) July 21, 1975 - (Moody's Bond Survey)

"While the total debt ratio has been substantially reduced in recent years (from 57.8% in 1968 to around 50% - 52% in 1973 and 1974), coverage ratios have been in a steadily declining trend. In the past year, capital spending plans have been reduced by over \$800 million. Reflecting this move, along with recent rate action, a more manageable financing program should work to improve the Company's overall financial posture."

6) February 10, 1976 - (Dow Jones News Ticker)

Philadelphia Electric Bond rating cut. This change reflects "the Company's continued substandard level of fixed charge coverage and the uncertainty regarding possible improvements in the future. Regulatory response to the Company's moderately-sized increase request continues to be less than adequate in view of the heavy financing program dictated for 1976 to 1979."

7) March 3, 1980 - (Moody's Bond Survey)

Ratings lowered on new preferred and all outstanding preferred stocks of PECO. "Fixed charges and preferred dividend protection continued to erode in 1979, reflecting the Company's inadequate rates and slow sales growth. Internal cash generation also continued to slide with the build-up of deferred fuel charges and AFUDC. Without more responsive rate treatment, however, it will be difficult to manage the size of the financing program contemplated for the projected construction expenditures without resorting to less conventional forms of financing

or construction cutbacks, considering the indenture and charter restrictions facing the Company."

8) September 27, 1980 - (Standard & Poor's Fixed Income Investor)

Relative to a proposed offer of \$125 million Mortgage Bonds - "Internally generated cash flow has declined to relatively weak levels (funding less than 15% of outlays), leading to substantial external financing stress.... Based on the financial record, past rate increases have been less than adequate. Future consideration of favorable accounting principles, including, but not limited to, construction work in progress along with timely and constructive disposition of this and future cases could help to improve financial measures."

APPENDIX B

EXCERPT FROM TESTIMONY OF JOSEPH F. PAQUETTE JR.
IN DOCKET NO. I-80100341

Q. Would you please start by explaining why the Company decided in the fall of 1974 to delay Limerick's construction schedule by two years so that the first unit would come into commercial operation in April 1981 instead of July 1979, and the second unit in April 1982 instead of December 1980?

A. Yes. That decision was primarily related to adverse financial factors that were affecting the Company at that time.

As background, it is important to remember the situation that had been building up prior to 1974. For many years through the 1950's and 1960's, our financial results improved steadily and our dividend was increased on a regular basis. However, the financial picture began to change in the late 1960's as inflation accelerated and interest rates increased above 6%. As shown on Table A, our return on equity was above 12% in the years 1965 to 1967 but then it dropped steadily to a low of 9.4% in 1970 before settling in the area of 9.8% to 10.8% for the next three years. Correspondingly, our SEC pre-tax interest coverage ratio which had been 5.1 times in 1968 dropped precipitously to 2.6 times by 1970 and then was 2.7 to 2.9 times through 1973. Our mortgage coverage ratio declined even more dramatically, from 5.8 times in 1965 to 2.4 times in 1973, and we were very close to losing our ability to issue additional bonds. The price of our stock which had hit a high of \$40.50 per share during 1965 also dropped dramatically in this period, hitting a low of \$17 per share during 1973.

As a result of our deteriorated financial condition, our credit rating was lowered by Standard & Poor's from AAA to AA in 1968 and to A in 1974. Because

our earnings growth had stopped it was also necessary to terminate our practice of regular increases in our common stock dividend after 1967.

As we entered 1974, we, and the rest of the industry, were faced with the prospects of large construction programs to meet the forecasted increases in demand by our customers. Despite our weakened financial condition, we had confidence that we would attract the required capital. Most economists believed that the economy would eventually return to the favorable days of low inflation which would benefit the utility industry considerably. Furthermore, we had confidence that the PUC would allow rate increases to enable us to earn a fair return on our existing rate base which would enable us to attract the capital for our construction program.

In retrospect, the year 1974 was a turning point in our history. Since the end of World War II, our electric business had shown almost uninterrupted strong growth every year and in 1973 the Company's kilowatthour sales increased 7% and our demand reached an all time peak of 5,760 megawatts. However, late in 1973, the Arab oil embargo occurred which doubled the price of oil almost overnight. As we progressed into 1974 our fuel adjustment charge increased substantially which, together with the recession that was then in progress, led to reductions in energy usage by our customers. Our peak load for 1974 was 5,431 megawatts, a reduction of about 6% below 1973. That was the first time since the 1930's that we had seen a significant reduction in the peak load. Furthermore, kilowatthour sales decreased in 1974 by about 3% from the prior year's level.

We knew that even without these adverse external forces, 1974 was going to be a difficult year financially since we were placing into service about \$500 million of new plant consisting of the two new Peach Bottom nuclear units, the Croydon

combustion turbines and the Eddystone No. 3 oil-fired unit which would increase our electric rate base from \$1.5 to \$2.0 billion or 33%. When the units were placed into commercial operation, AFUDC would terminate, thus decreasing our earnings until rate relief was obtained. As a result, our earnings, which were \$1.99 a share in 1973, were expected to decline substantially in 1974 but we anticipated that the Commission might grant us reasonably prompt rate adjustments to recognize the new plants in service as we went through the year.

We had filed for a three-part \$136 million electric rate increase in January 1974. The first part (\$24 million) was allowed to go in effect on April 1st and we had requested that a second step, amounting to \$54 million, be allowed to go into effect on June 1, 1974 when Peach Bottom No. 2 was expected to go in service. The final part, amounting to \$58 million, was not expected to become effective until the end of the nine-months suspension period which would have been January 1975.

Thus, we had put in place positive steps to enable us to get through the year with a minimum of adversity and, to possibly show an improvement in our return on plant in service which was necessary for the substantial amount of financing that we had in front of us.

In the spring of 1974 we were predicting that our five-year construction expenditures would amount to \$3.3 billion for the period 1974 through 1978 and that we would have to finance about \$2-1/2 billion of that with new securities. As the year started, we had confidence that we could complete that program. However, as the year progressed, a number of events occurred which raised increasingly compelling doubts about our ability to raise this magnitude of new capital in the financial market place.

The first event was Con Ed's omission of its dividend in April 1974 which significantly shook investors' confidence in the entire electric utility industry. As a result, the price of PE's stock dropped from over \$19.00 per share to below \$10.00 right after the Con Ed action and then it fluctuated between \$10.00 and \$12.00 a share for the rest of the year. In addition, AA utility bond interest rates, instead of decreasing as we had hoped, rose significantly from 8% to 11% by October.

To make matters worse the second step of our rate increase was not allowed to go into effect on June 1st as we had requested. In fact, the PUC took no action prior to the end of the maximum suspension period (1/1/75) so that all of the remaining increase (\$112 million) became effective by law subject to refund. This was later reduced by \$31 million when the final order was issued on March 25, 1975, requiring retroactive refunds.

These events seriously limited our financial flexibility. We had planned to sell \$100 million of common stock in the fall of 1974. However, in late summer the price of our stock was still below \$11.00, or just above 50% of book value and an issue at that price would have caused prohibitive dilution to our shareholders equity. Furthermore, the market for new utility equities had softened considerably. Thus, the October common stock issue had to be cancelled.

In addition, because of the declining earnings of the Company and the significant rise in interest rates, our interest coverage ratio dropped below 2.0 times and we had no further ability to issue mortgage bonds under the earnings coverage test after selling an issue of Bonds in October 1974. In November 1974, a \$65 million bond issue matured which enabled us to sell that many bonds in April 1975.

With our financial condition already deteriorated, with our sales decreasing, with costs significantly increasing and with very little prospect for immediate rate relief until the end of the rate case, and with no ability to raise equity or mortgage debt capital, the Company had no choice but to cut back on its near-term construction expenditures to meet the financial conditions that existed. The obvious way to do this of course was to reduce spending at Limerick which represented the major portion of our construction budget.

Q. What specific effect did the 1974 delay have on your construction and financing program?

A. As mentioned above, our five-year forecast made in the spring of 1974 showed a construction budget of \$3.3 billion and an outside financing requirement of \$2.5 billion for the period 1974 to 1978. Almost \$1 billion was included for Limerick.

The Limerick delay announced in the Fall of 1974 and other changes enabled us to reduce our five-year spending by about \$600 million and lowered our financing needs accordingly.

Our primary objective was to adjust our financing need in the immediate years ahead. It was too late in the year to make a material change in financing requirements for 1974 but we were able to make significant reductions for the year 1975, 1976 and 1977 as indicated on Table B. Table B illustrates that we reduced our outside financing needs for construction by \$154 million or 38% in 1975, by \$174 million (38%) in 1976 and by \$129 million (26%) in 1977.

Our efforts to reduce our financing needs proved to be correct since conditions did not improve in 1975. For example, in 1975 we raised about \$184 million for our construction program, and I doubt if we could have raised any more. We were forced to sell over 10.8 million shares of common stock in 1975 at

an average price of \$12.31 per share. This increased the number of shares outstanding by 20% in just one year.

Q. Would you now please explain the reasons why, in 1976 the Company rescheduled the Limerick No. 1 unit to April 1983 and the Limerick No. 2 unit to April 1985?

A. Yes. That rescheduling was made primarily to match our growth in capacity additions with a new lower load forecast which was completed in the spring of 1976. In addition, the rescheduling was desirable from a financial standpoint. The Company had not been able to improve its financial performance to a satisfactory level and, therefore any lightening of our construction program enabled us to reduce the severe financing burden that was still facing the Company at that time which was marked by a continued high cost of capital.

During 1974 and 1975, our return on common equity was in the range of 8.9% to 9.4%, our SEC interest coverage decreased further to 2.3-2.4 times and the price of our stock remained in the area of \$10 to \$15 per share which was only 50% to 70% of book value. Also, in 1976, Standard & Poor's reduced our bond rating again to A-.

In the summer of 1975 our electric peak load was 5,530 megawatts, again below the 1973 record which gave us further convincing indications that energy conservation was having a significant effect and that we could expect a permanent adjustment in our customers' usage of energy. Therefore, at that time the Company took another step in changing our forecasted growth rate from its pre-1974 level of 7% per year down to 5%. The effect of this reduced growth rate was to lower our estimated 1980 peak load by almost 1,000 megawatts which meant that we could reduce our capacity accordingly. Therefore, we delayed the Limerick

units by two years which lowered our projected capacity by 1,055 megawatts in the years 1981 to 1984 inclusive.

The ability to delay Limerick without endangering service reliability was, of course, only the first consideration in our ultimate decision. Necessarily, we also considered the financial problems related to a continuation of the earlier schedule and the impact on our rates and thus on our customers of a two-year postponement.

To improve our weakened financial condition, we had filed for another rate increase in November 1975 for a total of \$95 million, or 10%. We had requested \$47 million to go into effect on January 19th on an interim basis, but the Commission allowed only \$24 million of the increase, a 2.5% increase, to go into effect in February 1976 and another \$23 million became effective in August of that year on an interim basis. However, it was obvious that with our substantial five-year construction program that was still in the neighborhood of \$2-1/2 billion, we would need to make further adjustments to match the Company's ability to finance.

Therefore, in the spring of 1976, we lowered our five-year construction program by about \$750 million. The impact of this action in the immediate years 1976 to 1978 is depicted on Table C. On average, we were able to reduce our outside financings in those years by about \$60 million per year, or about 20%.

In evaluating the 1976 postponement based on capacity and financial factors, it is also important to appreciate the context within which these decisions were being made. A public utility such as Philadelphia Electric has a duty to provide service and to build the facilities which are necessary to do so. Conversely, it has been historically recognized that no utility should build additional facilities which will not be useful within at least a reasonable time following their completion. Based on such an historic regulatory concept, it was clearly the view of the

Company that Limerick should not be completed well in advance of the need for it. Accordingly, when our growth forecasts began to level off and it became apparent that we would not need Limerick's capacity in 1981 and 1983, it was entirely consistent with corporate and regulatory policy to slow down the construction of that plant in order to avoid bringing it on line in advance of its need. This policy appeared to be confirmed when in the rate proceedings of 1975 and 1976 questions were raised by the Commonwealth of Pennsylvania concerning reserve margins and the possibility that the Company then had "excess capacity" which should be eliminated from its rate base. Although the PUC rejected the Commonwealth's arguments in that case, it did indicate that the Company would be required to justify its installed capacity in the next rate case. In such an environment the Company concluded that the public interest did not warrant speedy completion of Limerick. Indeed the questions concerning the Company's "excess capacity" indicated that there was certainly some risk that if the Company brought on the Limerick plant in 1981 and 1983, the Public Utility Commission might exclude it from rate base with very dire financial consequences to the Company.

Offsetting all of these factors dictating a delay in the Limerick construction schedule there was, of course, recognition by the Company of the possibility that such a delay could result in a higher ultimate cost for the Limerick station. The amount of this increased cost could, of course, not be accurately determined on any of the postponement dates. However, there was little question that additional AFUDC would be accrued as a result of the postponement, and it was also clear that the maintenance of the construction staff for a longer period at the site would increase overhead costs.

Balancing these factors, it was clear that the cost to the customers would be greatly reduced in the short term from a postponement of Limerick since they would not have to pick up the carrying costs for the plant in 1981 and 1983 but would have these costs postponed for at least two years. In other words, the delay decision involved clear short-term benefits to customers offset by possible long-term burdens, although the exact amount of those long-term burdens could not be precisely determined at the time.

In evaluating this question, the Company was of the view that the Pennsylvania Commission's preference would be to have lower rates in the short term even though that might result in some increases long term. Our judgment in this respect was based on a review of Commission actions and orders at that time. For example, the Commission had refused the Company's request to include some CWIP in rate base and to normalize additional deferred taxes. Each of these PUC actions produced lower rates in the short term, but higher rates in the long term and delay of Limerick seemed to fit in with this concept.

- Q. Would you now explain the decision made in May 1978 to reschedule the Limerick units from 1983-85 to 1985-87?
- A. Although the Company announced a decision to reschedule those units in May of 1978, the Company did not in fact change the critical path of the construction schedule from 1978 through 1980. In those three years, the Company did, in fact, authorize and spend the additional dollars which were necessary to maintain the 1983-1985 service dates, in the event that it became desirable to complete the units earlier than 1985-1987. Accordingly, although a delay decision was announced, there was really no delay imposed on the construction schedule in fact by the Company's decisional process. It is true of course that our current projected

completion dates are 1985-87, but they have been created principally by the construction and licensing problems which the Company faces, rather than by any 1978 management delay decision.

As for the reasons for announcing a delay in 1978, those reasons can be found in many of the same factors which were involved in the 1976 decision. By 1978 we had two additional years of experience with no growth in sales, confirming that it was not a temporary "dip" but the beginning of a new trend line. Our electric peak load continued to hover in the range of 5,300 to 5,800 megawatts on a weather corrected basis, and it was obvious that there had been further reductions in the long-term growth rate of kilowatthour usage. As a result, in the spring of 1978, our load forecasting group once again lowered its peak load forecasts, this time from the compound growth rate of 5% to 3% per year.

The type of financial constraints which I discussed in connection with the 1976 decision also continued to prevail in 1978.

In April 1977, after 17 months, the PUC issued a final order in our rate request of November 1975, which permitted another increase of \$25 million effective retroactively to October 21, 1976. The total increase amounted to \$75 million out of \$95 million originally requested.

Because of continuing high inflation and low earnings, we requested another increase of \$119 million in August 1977. We requested that approximately \$50 million be allowed as interim rate relief to permit recovery of the carrying charges on Salem #1 which went into service on July 1977. However, the PUC granted an interim increase of only \$11.8 million in March 1978. The final order for this case was not issued until March 1979, 19 months after we filed, and it granted an additional \$67 million increase retroactive to July 4, 1978.

In the decision of the ALJ in connection with this rate increase, there was a recommendation that the Commission adjust rate base for "excess capacity". We viewed this as another "message" from the public sector directing us not to optimize the installed capacity of our generating facilities, but to minimize current costs and rates. The regulatory philosophy for constructing additional capacity and the preference of short-term cost savings over long-term cost increases discussed in connection with the 1976 delay were all present in causing the delay announcement which was made in 1978. However, as noted, we did not in fact cut back on our construction schedule critical path in 1978 because there was substantial discussion at that time concerning the relative merits of completing Limerick on an accelerated schedule, and it appeared to us that we should preserve that option so long as there was some possibility of meeting the earlier timetable. One of the reasons for maintaining the possibility for an earlier construction schedule was the fact that oil costs continued to escalate in this period and it was beginning to appear that completion of Limerick at an early date, if that were possible, might be advantageous to customers even if the capacity was not required simply because the fuel cost savings from the plant would more than offset the carrying costs of the unit.

- Q. Did you in 1978, perform any analysis to determine the level of short-term savings vs. long-term costs attributable to deferring completion of the plant?
- A. Yes we did. A delay would have the effect of lowering our short-term revenue requirements by significant amounts, but of increasing the longer-term revenue requirements only slightly.

In 1978 we estimated that a one-year delay would reduce revenue requirements in the first year by about \$190 million which represented the net

savings to customers, consisting of a saving of \$350 million in base rates offset by the higher operating expenses by about \$160 million due to continued purchases of energy as opposed to operating the nuclear unit. However, beginning in the second year and every year thereafter customers' bills would be approximately \$47 million higher so that it would take approximately five years before the customers would see a cumulative penalty offsetting the first year's savings.

Q. IR-OCA-10-3.

Refer to PECO Statement 19, page 8. Please provide a table showing, for each of the past 10 years, the actual rate of inflation and the actual percentage increase in PECO's wage costs.

RECEIVED

DEC 26 1985

Q. IR-OCA-10-3.

| <u>Year</u> | <u>Rate of Inflation</u> | | <u>Wage % Increase (a)</u> |
|-------------|--------------------------|------------|----------------------------|
| | <u>GNP</u> | <u>CPI</u> | |
| 1985 | 3.7 (Est.) | 3.6 (Est.) | 5.4 |
| 1984 | 3.8 | 4.3 | 6.0 |
| 1983 | 3.8 | 3.2 | 6.75 |
| 1982 | 6.0 | 6.1 | 8.8 |
| 1981 | 9.6 | 10.4 | 9.75 |
| 1980 | 9.2 | 13.5 | 9.5 |
| 1979 | 8.6 | 11.3 | 7.2 |
| 1978 | 7.4 | 7.7 | 7.0 |
| 1977 | 5.8 | 6.5 | 7.5 |
| 1976 | 5.2 | 5.8 | 8.0 |

SECRETARY'S OFFICE
Utility Commission

(a) Effective August 1 of each year

Responsible Witnesses: T.P. Hill, Jr., Asst. Manager - Rate Division
A.J. Solecki, Manager - Budget & Control

DOCKETED
DEC 31 1985

FOLDER

STAFF EXHIBIT
R-850152
12/29/85
1400
JK

STATEMENT NO. 9
Pa. PUC I-80100341

RECEIVED

DEC 28 1985

SECRETARY'S OFFICE
Public Utility Commission

LIMERICK NUCLEAR GENERATING STATION INVESTIGATION

DOCKETED
DEC 31 1985

DIRECT TESTIMONY OF
JOSEPH F. PAQUETTE, JR.
PHILADELPHIA ELECTRIC COMPANY

EXHIBIT
FOLDER

February 1981

TESTIMONY OF

JOSEPH F. PAQUETTE, JR.

Q. Please state your name and business address for the record.

A. Joseph F. Paquette, Jr., 2301 Market Street, Philadelphia, Pennsylvania.

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

A. I am the Vice President of the Finance and Accounting Department of the Philadelphia Electric Company.

Q. What is your educational background?

A. I was graduated in 1956 from Yale University with a Bachelor of Engineering Degree, and I have also attended the Graduate Evening Business School at Temple University in Philadelphia where I took advanced courses in accounting, economics, finance, statistics and management.

Q. Can you tell us something of your experience with Philadelphia Electric Company?

A. I joined Philadelphia Electric Company as a Junior Engineer in the Engineering Department following graduation from college in 1956. From 1956 until 1963 I held various non-supervisory positions, working in the area of economic analysis, rate design, and contract administration. From 1963 to 1966 I held supervisory positions in those same areas and also in financial planning. In 1966 I was appointed to the position of Staff Engineer, Corporate Planning; in 1969 I was named Manager of the Financial Division; in August of 1971 I was appointed Controller of the Company; in January 1972 I was appointed Manager of Finance and Accounting and in April 1978 I was elected to my present position as Vice President.

Q. Have you been active in any professional organizations?

A. From 1971 to July 1975, I was a member of the Application of Accounting Principles Committee of the Edison Electric Institute and of the American Gas Association. This committee has the responsibility of keeping informed of the developments of accounting principles, conventions, and practices in the accounting profession and in regulatory accounting, and to prepare, for approval, proposed releases relating to the industry position on accounting principles. I am now a member of the EEI Accounting Executive Committee which has the responsibility for coordinating the activities of all EEI accounting-related committees such as the Application of Accounting Principles Committee.

I am also a member of the EEI Finance Committee which is composed of the chief financial officers of the member companies and am now a member of its Executive Committee. I have also been member of the Financial Executives' Institute since 1979.

Q. What are your responsibilities as Vice President of the Finance and Accounting Department?

A. As Vice President of Finance and Accounting, I am responsible for all matters relating to finance and accounting, including rate administration and rate structure; the planning and execution of the Company's financings and shareholder and investor relations programs; proceedings before regulatory commissions relating to these matters; the establishment and review of financial controls of the Company; and all other matters relating to finance and accounting policy and management.

Q. Have you testified in any previous proceedings on financial or accounting matters?

A. Yes. I have presented testimony in all of our recent gas and electric rate cases before the Pennsylvania Commission including at Docket No.

R-80061225, involving our last electric rate increase. I have also testified on the same subjects before the Maryland Public Service Commission concerning an electric rate increase of Conowingo Power Company, a subsidiary of Philadelphia Electric Company and before the Federal Power Commission concerning a wholesale rate proceeding involving service to the Borough of Lansdale.

Q. Would you please describe your personal involvement in the Company's financings.

A. Since I have become Vice President, I have assumed all of the responsibilities dealing with our financings and investor relations. This involves negotiating sales of securities with our underwriters, discussions with the various rating agencies regarding the Company's credit standings, presentations before and discussions with the many segments of the investment community and many other facets involving the financial community. The Treasurer of the Company, Mr. Rimerman, shares these duties with me and I have also delegated to him the day-to-day responsibility for maintenance of the Company's short-term cash needs which consists primarily of bank relationships and sales of commercial paper.

Q. What is the purpose of your testimony?

A. I will explain the reasons why the Company decided to delay the completion dates of the Limerick Station on three occasions in 1974, 1976 and 1978 and I will also discuss the potential impact on the Company and its customers if the Limerick project is altered or terminated.

Q. Would you please start by explaining why the Company decided in the fall of 1974 to delay Limerick's construction schedule by two years so that the first unit would come into commercial operation in April 1981 instead of July 1979, and the second unit in April 1982 instead of December 1980?

A. Yes. That decision was primarily related to adverse financial factors that were affecting the Company at that time.

As background, it is important to remember the situation that had been building up prior to 1974. For many years through the 1950's and 1960's, our financial results improved steadily and our dividend was increased on a regular basis. However, the financial picture began to change in the late 1960's as inflation accelerated and interest rates increased above 6%. As shown on Table A, our return on equity was above 12% in the years 1965 to 1967 but then it dropped steadily to a low of 9.4% in 1970 before settling in the area of 10% to 11% for the next three years. Correspondingly, our SEC pre-tax interest coverage ratio which had been 5.1 times in 1968 dropped precipitiously to 2.6 times by 1970 and then was 2.7 to 2.9 times through 1973. Our mortgage coverage ratio declined even more dramatically, from 5.8 times in 1965 to 2.4 times in 1973, and we were very close to losing our ability to issue additional bonds. The price of our stock which had hit a high of \$40.50 per share during 1965 also dropped dramatically in this period, hitting a low of \$17 per share during 1973.

As a result of our deteriorated financial condition, our credit rating was lowered by Standard & Poor's from AAA to AA in 1968 and to A in 1974. Because our earnings growth had stopped, it was also necessary to terminate our practice of regular increases in our common stock dividend after 1967.

As we entered 1974, we, and the rest of the industry, were faced with the prospects of large construction programs to meet the forecasted increases in demand by our customers. Despite our weakened financial condition, we had confidence that we could attract the required capital. Most economists believed that the economy would eventually return to the

favorable days of low inflation which would benefit the utility industry considerably. Furthermore, we had confidence that the PUC would allow rate increases to enable us to earn a fair return on our existing rate base which would enable us to attract the capital for our construction program.

In retrospect, the year 1974 was a turning point in our history. Since the end of World War II, our electric business had shown almost uninterrupted strong growth every year and in 1973 the Company's kilowatthour sales increased 7% and our demand reached an all time peak of 5,760 megawatts. However, late in 1973, the Arab oil embargo occurred which doubled the price of oil almost overnight. As we progressed into 1974 our fuel adjustment charge increased substantially which, together with the recession that was then in progress, led to reductions in energy usage by our customers. Our peak load for 1974 was 5,431 megawatts, a reduction of about 6% below 1973. That was the first time since the 1930's that we had seen a significant reduction in the peak load. Furthermore, kilowatthour sales decreased in 1974 by about 3% from the prior year's level.

We knew that even without these adverse external forces, 1974 was going to be a difficult year financially since we were placing into service about \$500 million of new plant consisting of the two new Peach Bottom units, the Croydon combustion turbines and the Eddystone No. 3 oil-fired unit which would increase our electric rate base from \$1.5 to \$2.0 billion or 33%. When the units were placed into commercial operation, AFUDC would terminate, thus decreasing our earnings until rate relief was obtained. As a result, our earnings, which were \$1.99 a share in 1973, were expected to decline substantially in 1974 but we anticipated that the Commission might grant us reasonably prompt rate

adjustments to recognize the new plants in service as we went through the year.

We had filed for a three-part \$136 million electric rate increase in January 1974. The first part (\$24 million) was allowed to go in effect on April 1st and we had requested that a second step, amounting to \$54 million, be allowed to go into effect on June 1, 1974 when Peach Bottom No. 2 was expected to go in service. The final part, amounting to \$58 million, was not expected to become effective until the end of the nine-months suspension period which would have been January 1975.

Thus, we had put in place positive steps to enable us to get through the year with a minimum of adversity and, to possibly show an improvement in our return on plant in service which was necessary for the substantial amount of financing that we had in front of us.

In the spring of 1974 we were predicting that our five-year construction expenditures would amount to \$3.3 billion for the period 1974 through 1978 and that we would have to finance about \$2-1/2 billion of that with new securities. As the year started, we had confidence that we could complete that program. However, as the year progressed, a number of events occurred which raised increasingly compelling doubts about our ability to raise this magnitude of new capital in the financial market place.

The first event was Con Ed's omission of its dividend in April 1974 which significantly shook investors' confidence in the entire electric utility industry. As a result, the price of PE's stock dropped from over \$19.00 per share to below \$10.00 right after the Con Ed action and then it fluctuated between \$10.00 and \$12.00 a share for the rest of the year. In addition, AA utility bond interest rates, instead of decreasing as we had hoped, rose significantly from about 8% to 11% by October.

To make matters worse, the second step of our rate increase was not allowed to go into effect on June 1st as we had requested. In fact, the PUC took no action prior to the end of the maximum suspension period (1/1/75) so that all of the remaining increase (\$112 million) became effective by law subject to refund. This was later reduced by \$31 million when the final order was issued on March 25, 1975, requiring retroactive refunds.

These events seriously limited our financial flexibility. We had planned to sell \$100 million of common stock in the fall of 1974. However, in late summer the price of our stock was still below \$11.00, or just above 50% of book value and an issue at that price would have caused prohibitive dilution to our shareholders equity. Furthermore, the market for new utility equities had softened considerably. Thus, the October common stock issue had to be cancelled.

In addition, because of the declining earnings of the Company and the significant rise in interest rates, our interest coverage ratio dropped below 2.0 times and we had no further ability to issue mortgage bonds under the earnings coverage test after selling an issue of Bonds in October 1974. In November 1974, a \$65 million bond issue matured which enabled us to sell that many bonds in April 1975.

With our financial condition already deteriorated, with our sales decreasing, with costs significantly increasing and with very little prospect for immediate rate relief until the end of the rate case, and with no ability to raise equity or mortgage debt capital, the Company had no choice but to cut back on its near-term construction expenditures to meet the financial conditions that existed. The obvious way to do this of course was to reduce spending at Limerick which represented the major portion of our construction budget.

Q. What specific effect did the 1974 delay have on your construction and financing program?

A. As mentioned above, our five-year forecast made in the spring of 1974 showed a construction budget of \$3.3 billion and an outside financing requirement of \$2.5 billion for the period 1974 to 1978. Almost \$1 billion was included for Limerick.

The Limerick delay announced in the fall of 1974 and other changes enabled us to reduce our five-year spending by about \$600 million and lowered our financing needs accordingly.

Our primary objective was to adjust our financing need in the immediate years ahead. It was too late in the year to make a material change in financing requirements for 1974 but we were able to make significant reductions for the years 1975, 1976 and 1977 as indicated on Table B. Table B illustrates that we reduced our outside financing needs for construction by \$154 million or 38% in 1975, by \$174 million (38%) in 1976 and by \$129 million (26%) in 1977.

Our efforts to reduce our financing needs proved to be correct since conditions did not improve in 1975. For example, in 1975 we raised about \$284 million for our construction program, and I doubt if we could have raised any more. We were forced to sell over 10.8 million shares of common stock in 1975 at an average price of \$12.31 per share. This increased the number of shares outstanding by 20% in just one year.

Q. Would you now please explain the reasons why, in 1976, the Company rescheduled the Limerick No. 1 unit to April 1983 and the Limerick No. 2 unit to April 1985?

A. Yes. That rescheduling was made primarily to match our growth in capacity additions with a new lower load forecast which was completed in

the spring of 1976. In addition, the rescheduling was desirable from a financial standpoint. The Company had not been able to improve its financial performance to a satisfactory level and, therefore any lightening of our construction program enabled us to reduce the severe financing burden that was still facing the Company at that time which was marked by a continued high cost of capital.

During 1974 and 1975, our return on common equity was in the range of 8.9% to 9.4%, our SEC interest coverage decreased further to 2.3-2.4 times and the price of our stock remained in the area of \$10 to \$15 per share which was only 50% to 70% of book value. Also, in 1976, Standard & Poor's reduced our bond rating again to A-.

In the summer of 1975 our electric peak load was 5,530 megawatts, again below the 1973 record which gave us further convincing indications that energy conservation was having a significant effect and that we could expect a permanent adjustment in our customers' usage of energy. Therefore, at that time the Company took another step in changing our forecasted growth rate from its pre-1974 level of 7% per year down to 5%. The effect of this reduced growth rate was to lower our estimated 1980 peak load by almost 1,000 megawatts which meant that we could reduce our capacity accordingly. Therefore, we delayed the Limerick units by two years which lowered our projected capacity by 1,055 megawatts in the years 1981 to 1984 inclusive.

The ability to delay Limerick without endangering service reliability was, of course, only the first consideration in our ultimate decision. Necessarily, we also considered the financial problems related to a continuation of the earlier schedule and the impact on our rates and thus on our customers of a two-year postponement.

To improve our weakened financial condition, we had filed for another rate increase in November 1975 for a total of \$95 million, or 10%. We had requested \$47 million to go into effect on January 19th on an interim basis, but the Commission allowed only \$24 million of the increase, a 2.5% increase, to go into effect in February 1976 and another \$23 million became effective in August of that year on an interim basis. However, it was obvious that with our substantial five-year construction program that was still in the neighborhood of \$2-1/2 billion, we would need to make further adjustments to match the Company's ability to finance.

Therefore, in the spring of 1976, we lowered our five-year construction program by about \$750 million. The impact of this action in the immediate years 1976 to 1978 is depicted on Table C. On average, we were able to reduce our outside financings in those years by about \$60 million per year, or about 20%.

In evaluating the 1976 postponement based on capacity and financial factors, it is also important to appreciate the context within which these decisions were being made. A public utility such as Philadelphia Electric has a duty to provide service and to build the facilities which are necessary to do so. Conversely, it has been historically recognized that no utility should build additional facilities which will not be useful within at least a reasonable time following their completion. Based on such an historic regulatory concept, it was clearly the view of the Company that Limerick should not be completed well in advance of the need for it. Accordingly, when our growth forecasts began to level off and it became apparent that we would not need Limerick's capacity in 1981 and 1983, it was entirely consistent with corporate and regulatory policy to slow down the construction of that plant in order to avoid bringing it on line in advance of its need. This policy appeared to be confirmed

when in the rate proceedings of 1975 and 1976 questions were raised by the Commonwealth of Pennsylvania concerning reserve margins and the possibility that the Company then had "excess capacity" which should be eliminated from its rate base. Although the PUC rejected the Commonwealth's arguments in that case, it did indicate that the Company would be required to justify its installed capacity in the next rate case. In such an environment the Company concluded that the public interest did not warrant a speedy completion of Limerick. Indeed the questions concerning the Company's "excess capacity" indicated that there was certainly some risk that if the Company brought on the Limerick plant in 1981 and 1983, the Public Utility Commission might exclude it from rate base with very dire financial consequences to the Company.

Offsetting all of these factors dictating a delay in the Limerick construction schedule, there was, of course, recognition by the Company of the possibility that such a delay could result in a higher ultimate cost for the Limerick station. The amount of this increased cost could, of course, not be accurately determined on any of the postponement dates. However, there was little question that additional AFUDC would be accrued as a result of the postponement, and it was also clear that the maintenance of the construction staff for a longer period at the site would increase overhead costs.

Balancing these factors, it was clear that the cost to the customers would be greatly reduced in the short term from a postponement of Limerick since they would not have to pick up the carrying costs for the plant in 1981 and 1983 but would have these costs postponed for at least two years. In other words, the delay decision involved clear short-term benefits to customers offset by possible long-term burdens, although the exact amount of those long-term burdens could not be precisely determined at the time.

In evaluating this question, the Company was of the view that the Pennsylvania Commission's preference would be to have lower rates in the short term even though that might result in some increases long term. Our judgment in this respect was based on a review of Commission actions and orders at that time. For example, the Commission had refused the Company's request to include some CWIP in rate base and to normalize additional deferred taxes. Each of these PUC actions produced lower rates in the short term, but higher rates in the long term and delay of Limerick seemed to fit in with this concept.

Q. Would you now explain the decision made in May 1978 to reschedule the Limerick units from 1983-85 to 1985-87.

A. Although the Company announced a decision to reschedule those units in May of 1978, the Company did not in fact change the critical path of the construction schedule from 1978 through 1980. In those three years, the Company did, in fact, authorize and spend the additional dollars which were necessary to maintain the 1983-1985 service dates, in the event that it became desirable to complete the units earlier than 1985-1987. Accordingly, although a delay decision was announced, there was really no delay imposed on the construction schedule in fact by the Company's decisional process. It is true of course that our current projected completion dates are 1985-87, but they have been created principally by the construction and licensing problems which the Company faces, rather than by any 1978 management delay decision.

As for the reasons for announcing a delay in 1978, those reasons can be found in many of the same factors which were involved in the 1976 decision. By 1978 we had two additional years of experience with no growth in sales, confirming that it was not a temporary "dip" but the beginning of a new trend line. Our electric peakload continued to hover

in the range of 5,300 to 5,800 megawatts on a weather corrected basis, and it was obvious that there had been further reductions in the long-term growth rate of kilowatthour usage. As a result, in the spring of 1978, our load forecasting group once again lowered its peak load forecasts, this time from the compound growth rate of 5% to 3% per year.

The type of financial constraints which I discussed in connection with the 1976 decision also continued to prevail in 1978.

In April 1977, after 17 months, the PUC issued a final order on our rate request of November 1975, which permitted another increase of \$25 million effective retroactively to October 21, 1976. The total increase amounted to \$75 million out of \$95 million originally requested.

Because of continuing high inflation and low earnings, we requested another increase of \$119 million in August 1977. We requested that approximately \$50 million be allowed as interim rate relief to permit recovery of the carrying charges on Salem #1 which went into service on July 1977. However, the PUC granted an interim increase of only \$11.8 million in March 1978. The final order for this case was not issued until March 1979, 19 months after we filed, and it granted an additional \$67 million increase retroactive to July 4, 1978.

In the decision of the ALJ in connection with this rate increase, there was a recommendation that the Commission adjust rate base for "excess capacity". We viewed this as another "message" from the public sector directing us not to optimize the installed capacity of our generating facilities, but to minimize current costs and rates. The regulatory philosophy for constructing additional capacity and the preference of short-term cost savings over long-term cost increases discussed in connection with the 1976 delay were all present in causing the delay announcement which was made in 1978. However, as noted, we did

not in fact cut back on our construction schedule critical path in 1978 because there was substantial discussion at that time concerning the relative merits of completing Limerick on an accelerated schedule, and it appeared to us that we should preserve that option so long as there was some possibility of meeting the earlier timetable. One of the reasons for maintaining the possibility for an earlier construction schedule was the fact that oil costs continued to escalate in this period and it was beginning to appear that completion of Limerick at an early date, if that were possible, might be advantageous to customers even if the capacity was not required, simply because the fuel cost savings from the plant would more than offset the carrying costs of the unit.

Q. Did you in 1978, perform any analysis to determine the level of short-term savings vs. long-term costs attributable to deferring completion of the plant?

A. Yes we did. A delay would have the effect of lowering our short-term revenue requirements by significant amounts, but of increasing the longer-term revenue requirements only slightly.

In 1978 we estimated that a one-year delay would reduce revenue requirements in the first year by about \$190 million which represented the net savings to customers, consisting of a saving of \$350 million in base rates offset by the higher operating expenses by about \$160 million due to continued purchases of energy as opposed to operating the nuclear unit. However, beginning in the second year and every year thereafter customers' bills would be approximately \$47 million higher so that it would take approximately five years before the customers would see a cumulative penalty offsetting the first year's savings.

Q. Mr. Paquette, the Commission has directed that this investigation consider various alternatives to completing Limerick such as conversion

to coal or complete abandonment of the Project. Would you please comment on the impact such alternatives could have on Philadelphia Electric and its customers?

- A. I believe that these alternatives are not in the public interest since all of them would increase our revenue requirements vs. completion of Limerick and could increase our use of oil.

Mr. Lawrence's testimony contains a comparison of our revenue requirements under the various Limerick alternatives which illustrate that our customers bills would be significantly less if Limerick is completed as scheduled vs. any of the alternatives. That analysis assumes that if Limerick is not completed its sunk cost would be completely recovered in revenues which is critical to the continued financial viability of Philadelphia Electric.

If we are not allowed to recover Limerick's construction cost and must, instead, write-off the cost against shareholders' equity, I believe that such a write-off, coupled with the necessity to terminate AFUDC on the Limerick project, would have a catastrophic impact on the Company's shareholders and its customers.

By the end of 1981, we will have approximately \$2.1 billion invested in the Limerick construction project, including commitments, of which about \$530 million will be AFUDC and the remaining \$1.6 billion, would be a potential tax writeoff. Based on our present and projected income, it appears very unlikely that a significant part of this investment could, in fact, be utilized as a tax writeoff. Thus, we could be faced with a possible charge against shareholders' equity of up to \$2.0 billion if Limerick is abandoned and we are not permitted to recover its cost in rates.

A write-down of \$2.0 billion would completely eliminate our common stock equity which would undoubtedly have a catastrophic reaction in the price of the Company's common stock. Thus, the Company's equity holders would see their earnings per share reduced by about 70% through termination of AFUDC on Limerick and their net worth eliminated. The Company's management would undoubtedly be forced to immediately eliminate payment of all dividends on common stock, and perhaps on preferred stock, in order to conserve cash. With such a deteriorating financial condition, I doubt very seriously that the Company could raise any capital.

We would also be forced to terminate the projects to install SO₂ removal equipment at Eddystone and Cromby since we would not be able to raise new capital.

Under the consent decree with the EPA, termination of the SO₂ project at Eddystone and Cromby would force us to stop burning coal at those stations, the immediate impact on customers bills would be an increase of about \$80 million per year due to switching to oil or purchased energy from the interconnection. Since it would be uncertain whether these projects would ever be resumed, we would also be faced with the possibility of writing off our investment in these projects also and terminating AFUDC.

Longer term without Limerick, our customers would be faced with the serious possibility of load curtailment in the mid-1980s when our capacity margin is expected to be approaching zero.

- Q. Mr. Paquette, if the Company had not made the various decisions to delay the Limerick service dates as you have described, do you believe Limerick could have been completed on its original schedule and at its then-estimated cost?

A. No, I do not. In fact, I doubt if conditions would be significantly different than they are now. I believe the financial market place would have forced us into delaying the Limerick units if we had not done so ourselves.

As a result of the various adjustments we made to our construction program since 1974, we were able to reduce our construction spending by about \$1.5 billion as compared with original estimates for the years 1975 to 1979. Even with these cuts, our actual 1979 mortgage coverage ratio was only 2.1 times, barely above the minimum of two times required under our indenture to issue additional bonds. If we had not made those construction cuts, we would have had to issue about \$700 million of additional debt but we could not have done that unless our earnings for interest coverage were higher which would have required significant rate increases.

I estimate that additional rate increases of at least \$150 million would have had to have been in effect prior to 1979 for this purpose. In light of the great difficulty we had in obtaining the rate increases we did receive during this period, I doubt very much that we could have obtained an additional \$150 million of increases. Thus, I believe we would have been forced to curtail our construction program if we had not done so ourselves.

On the other hand, if we had somehow been able to finance Limerick on its original 1979-81 schedule, our customers today would be seriously questioning the wisdom of that plan because we would now be in the process of adding Limerick's cost to our rate base.

Based on the estimate prepared in early 1974 which indicated that Limerick would cost about \$1.5 billion and ignoring the fact that inflation has been considerably higher than we were forecasting then, we

would now have to increase our base rates by at least \$300 million to add Limerick to rate base. That much of an increase would be in addition to the other increases now required to offset inflation.

If Limerick were in service this summer, our installed capacity would amount to about 9,800 mW which would represent a reserve margin of about 66% above the 1981 expected peak demand.

Q. What conclusions do you draw as to the financial implications of the Limerick Project?

A. I conclude that Limerick should be completed as scheduled. Even under the most conservative load forecasts, the Limerick capacity is needed by our customers in this decade. Limerick was, and is still, the economic choice. Every conversion alternative or substitute project postulated for Limerick at this time is more costly.

The project has been well managed on a schedule that has been prudently responsive to regulatory direction and financial constraints. Failure to complete the project at this late date could be a severe financial blow to the Company, would raise costs for our customers and would be an unjustified breach of good faith with investors. Clearly, at this point, finishing Limerick on time is the only choice in the public interest.

Philadelphia Electric Company Financial Results

1965 - 1980

| | <u>1965</u> | <u>1966</u> | <u>1967</u> | <u>1968</u> | <u>1969</u> | <u>1970</u> | <u>1971</u> | <u>1972</u> |
|-------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Earnings per Share | \$ 1.92 | 2.08 | \$ 2.13 | \$ 2.13 | \$ 1.97 | \$ 1.84 | \$ 2.10 | \$ 2.08 |
| Return on Common Equity | 12.3% | 12.7% | 12.2% | 11.9% | 10.3% | 9.4% | 10.8% | 10.3% |
| SEC Coverage Ratio | | | | | | | | |
| Incl. AFUDC | 5.1 | 5.1 | 4.4 | 3.6 | 3.2 | 2.6 | 2.9 | 2.8 |
| Mortgage Coverage Ratio | 5.8 | 5.3 | 4.5 | 3.8 | 3.5 | 2.3 | 2.4 | 2.5 |
| Stock Price at Year End | \$36.88 | 31.63 | \$29.63 | \$31.13 | \$24.00 | \$22.50 | \$23.88 | \$22.75 |
| | <u>1973</u> | <u>1974</u> | <u>1975</u> | <u>1976</u> | <u>1977</u> | <u>1978</u> | <u>1979</u> | <u>1980</u> |
| Earnings per Share | \$ 1.99 | \$ 1.81 | \$ 1.86 | \$ 1.91 | \$ 1.87 | \$ 1.87 | \$ 1.86 | \$ 2.00 |
| Return on Common Equity | 9.8% | 8.9% | 9.4% | 9.9% | 9.6% | 9.7% | 9.8% | 10.6% |
| SEC Coverage Ratio | | | | | | | | |
| Incl. AFUDC | 2.7 | 2.3 | 2.4 | 2.5 | 2.4 | 2.4 | 2.1 | 2.1 |
| Mortgage Coverage Ratio | 2.4 | 2.1 | 2.5 | 2.5 | 2.3 | 2.4 | 2.1 | 2.3 |
| Stock Price at Year End | \$18.00 | \$10.88 | \$15.00 | \$17.88 | \$19.63 | \$15.50 | \$13.75 | \$12.50 |

TABLE A

Philadelphia Electric Company
Construction and Financing Forecast
1974 - 1977

| | Million \$ | | | |
|----------------------------------|--------------|--------------|--------------|--------------|
| | <u>1974</u> | <u>1975</u> | <u>1976</u> | <u>1977</u> |
| <u>Spring 1974 Forecast</u> | | | | |
| Construction Expenditures | \$556 | \$571 | \$665 | \$740 |
| Internal Funds | 140 | 169 | 217 | 250 |
| New Financings Required | <u>\$416</u> | <u>\$402</u> | <u>\$448</u> | <u>\$490</u> |
| <u>Fall 1974 Revision</u> | | | | |
| Construction Expenditures | \$519 | \$417 | \$480 | \$590 |
| Internal Funds | 106 | 169 | 206 | 229 |
| New Financings Required | <u>\$413</u> | <u>\$248</u> | <u>\$274</u> | <u>\$361</u> |
| Change in New Financing Required | (3) | (\$154) | (\$174) | (\$129) |
| % | (1%) | (38%) | (38%) | (26%) |

Philadelphia Electric Company
Construction and Financing Forecast
1976 - 1978

| | Million \$ | | |
|-----------------------------|-----------------|-----------------|-----------------|
| | <u>1976</u> | <u>1977</u> | <u>1978</u> |
| <u>Spring 1975 Forecast</u> | | | |
| Construction Expenditures | \$469 | \$481 | \$550 |
| Internal Funds | <u>205</u> | <u>202</u> | <u>233</u> |
| New Financings Required | \$264 | \$279 | \$317 |
| <u>Spring 1976 Forecast</u> | | | |
| Construction Expenditures | \$437 | \$414 | \$390 |
| Internal Funds | <u>229</u> | <u>179</u> | <u>170</u> |
| New Financings Required | \$208 | \$235 | \$241 |
| Change in New Financing | (\$56) (21%) | (\$44) (16%) | (\$76) (24%) |

R-850152
12/20/85
Hbg JF

COMMONWEALTH OF PENNSYLVANIA
PUBLIC UTILITY COMMISSION

RECEIVED

----- x
:
Limerick Nuclear Generating Station :
Investigation :
Further Hearing :
----- x

Docket Number
I-80100341
SECRETARY'S OFFICE
Public Utility Commission

Pages 485 through 591 Hearing Room 1
State Office Building
Broad and Spring Garden Streets
Philadelphia, Pennsylvania

FOLDER

Tuesday, March 31, 1981

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

BEFORE:

JOSEPH J. KLOVEKORN, Administrative Law Judge

APPEARANCES:

ROBERT H. YOUNG, Esquire
Morgan, Lewis & Bockius
2100 The Fidelity Building
123 South Broad Street
Philadelphia, Pennsylvania 19109
(For Philadelphia Electric Company)

IRENE A. MCKENNA, Esquire
Assistant Counsel
2301 Market Street
Philadelphia, Pennsylvania 19101
(For Philadelphia Electric Company)

GREGG C. SAYRE, Esquire
PUC Trial Staff
P.O. Box 3265
North Office Building
Harrisburg, Pennsylvania 17120
(For the Public Utility Commission Trial Staff)

RECEIVED
SECRETARY'S OFFICE
PUBLIC UTILITY
COMMISSION
APR 6 3 16 PM '81

DOCKETED
DEC 31 1985

1 delays as opposed to those other two factors.

2 Q Am I correct that your prior answer is an explanation
3 of a basic answer to my previous question, which is yes?

4 A My answers were explanations of the question, yes.

5 Q At the bottom of page 11 of your Statement number 9,
6 you are referring to the 1976 postponement, I believe.

7 A Yes.

8 Q And you talk about short-terms costs to customers
9 and possible long-term burdens.

10 A Right.

11 Q Short-term costs that you are referring to are
12 increased capital costs for the period of time after the plant
13 would have come on line on the faster schedule, up until the
14 date that the plant was due to come on line on the postponed
15 schedule, is that correct?

16 A That's correct.

17 Q In making the 1976 postponement, did the company
18 evaluate what the long-term loss to the customers would be
19 after that period of time due to the two year delay?

20 A I don't recall that we made a specific study.

21 Q In the 1978 postponement, I gather from your statement
22 at page 14, that you did make a special study and estimated
23 that 1983 bills would be \$190 million less but for each of,
24 I guess, the next 35 or 40 years the bills would be \$47 million
25 higher per year?

303

A. That's correct.

Q. Did you do any kind of present value analysis, comparing the long-term benefits and burdens?

A. I'm not sure. It's possible that we did. We don't usually, but it's possible.

Q. You don't recall?

A. I don't recall.

Q. I'd like to go back to Table A now --

A. Table A?

Q. In your testimony, yes. It was in 1969 that the company made the decision to build Limerick, is that correct?

A. Yes.

Q. I gather from Table A that at that time your return on common equity and interest coverage ratios were declining?

A. That's correct.

Q. Isn't it correct that at that time PECO expected them to keep declining because PECO was in the process of building Peach Bottom?

A. No. We did not expect that our return on equity or our interest coverage ratio would continue to decline.

Q. Even though Peach Bottom was under construction at the time?

A. That's correct.

Q. Was PECO financially healthy in 1969, as you would define that term, when the decision was made to go forward?

1 the figures I have, it was slightly lowered in the '76 to '78
2 period than it was in the prior two years, yes.

3 Q. PECO is not still spending money on the pre-1978
4 '83/'85 schedule is it?

5 A. Well, I believe we are now on a '85/'87 schedule.

6 Q. So is it correct that the 1981 budgeted expenditures
7 are below the level that was scheduled for the '83/'85 completio

8 A. I don't believe that's true, but Mr. Boyer would --
9 you're talking about absolute dollars we are spending this
10 year versus what was earlier projected for this year based on
11 an '83/'85 schedule?

12 Q. Right.

13 A. I don't have that number. Perhaps Mr. Boyer could
14 answer that question.

15 Q. Okay.

16 A. The whole world of inflation has changed considerably
17 as compared to a couple years ago.

18 Q. Now, I'm going to walk into the jaws of what I
19 trust will be a good trap for me, and ask you to explain the
20 statement that you make on page 13 of your testimony.

21 On that page you refer to a message, which word that
22 you put in quotation marks, from the Administrative Law Judge's
23 decision in R.I.D. 438, which involved an excess capacity
24 adjustment recommended by the ALJ and rejected by the PUC,
25 is that right?

1 A. Yes.

2 Q Does PECO normally make or revise its plan involving
3 construction projects of this size based on unapproved ALJ
4 recommendations?

5 A Well, no, and we didn't in this case either. But as
6 I indicated here and elsewhere in my testimony this was one
7 of the many factors that they took into consideration, as
8 we always do. It's not a very simple thing when we make any
9 decision -- big decision -- such as we did on the Limerick
10 project as enumerated in my testimony.

11 It's not just one factor that we look at but many,
12 many factors; the current ratings of the company, the prospect
13 for improving our ratings, the prospect for inflation, the
14 prospect for interest rates and the prospect, of course, for
15 when the plant goes into service, for getting it promptly
16 in the rate base so that we can overcome the attrition that's
17 caused when AFUDC stops and we must get the plant in the rate
18 base. We have had many delays in getting both the Peach Bottom
19 and the Salem units into rate base with the Commission.

20 This seemed to be another factor that did weigh
21 heavily on our thinking, because not only with the Administrative
22 Law Judge but later on in one of the subsequent decisions,
23 the last decision, the Commission did, in fact, reduce our
24 rate base for excess capacity. So this was just another factor
25 adding weight onto a whole mountain of evidence that brought us

1 to come to the conclusion that we should delay Limerick until
2 such time as it was necessary from a capacity standpoint, which
3 was, in those years, the primary determinant that the company
4 had followed in designing our system, that we should put
5 equipment in at approximately the time that it's necessary
6 to serve our customers from a capacity standpoint and not
7 unreasonably before that and not unreasonably after that.

8 Q. During that period, is it your testimony that that
9 was PECO's main analysis, not what would cost more or less
10 in the long or the short-term for the rate payers?

11 A. We always try to build and design a system in the
12 most economical fashion in conjunction with putting in capacity
13 when it's needed for our customers. To take the point that
14 you're leading to to its ultimate extreme, it would be most
15 efficient and least costly for us to put all the capacity in
16 now that we are going to need for the next 50 years, because
17 we can certainly build it cheaper now than we can build it
18 in the year 2000. But it would be crazy to put it in today
19 because it isn't necessary to serve our customers. So you have
20 to balance the need for the equipment, be it a turbine or
21 be it a pole, to serve the customer with the economics of when
22 it's most efficient to serve the customer,

23 Q. The bottom line economic question is, isn't it, what
24 is going to minimize rates while maintaining an adequate level
25 of capacity for contingencies over the long run?

1 A. Our number one objective is to provide the most
2 reasonably priced service to our customers as they need the
3 service in the most reliable fashion.

4 Q. Now, did PECO treat the PUC's failure in R.I.D.
5 438 to make an excess capacity adjustment as an opposite
6 message to the message that you refer to on page 13? Was it --

7 A. It was half an opposite message.

8 Q. Let me finish the question.

9 A measure that the Commission wants the company to
10 seek long-term savings even at the price of short-term increases
11 in costs? Can you answer that question?

12 A. No, I did not interpret it as a clear signal to
13 reduce costs in the long run because, as I recall, in that
14 order, while they rejected the Administrative Law Judge's
15 recommendation for a deduction from the rate base, they did
16 put the company on notice that in the next filing we had to
17 justify our load and capacity position, which as I recall we
18 did do.

19 So they did raise the point that in the next case
20 the company had better be on the defensive in terms of its,
21 quote, excess capacity.

22 Q. In your opinion, is it automatically prudent for a
23 utility such as PECO to do what the PUC suggests?

24 A. No, it's not automatically true for a utility to always
25 do what the PUC suggests.

1 Q Now, on page 17 there is another statement that I
2 would like to give you an opportunity to explain. You state
3 that if you had somehow been able to finish Limerick on its
4 1979 to 1981 schedule the customers today would be seriously
5 questioning the wisdom of that plant.

6 Isn't it your position today that Limerick will
7 result in a savings, and a substantial savings, to the customer,
8 regardless of whether or not it's needed in terms of capacity
9 planning, but because it provides substantial fuel cost
10 savings?

11 A Well, our position is that when Limerick is scheduled
12 to come in in 1985/'87, it will produce significant savings.
13 I'm not sure that I've seen an analysis that said that if it
14 were to go into service today it would be producing the same
15 savings, but I believe it would.

16 Q If, for example, you had a two and a half billion
17 dollar Limerick I cranking out power right now, that would be
18 still more valuable from a cost standpoint, wouldn't it?

19 A I don't know whether we have looked at the specifics
20 of that two and a half billion cost versus today's cost of
21 energy, but I will go along with you and assume that it would.

22 Q Now, I --

23 A But I still believe, though, even though we are
24 producing net savings for our customers, I don't think the
25 public, because of the way the whole issue gets presented by

RECEIVED

COMMONWEALTH COURT OF PENNSYLVANIA

DEC 26 1985

PHILADELPHIA ELECTRIC COMPANY, :
 :
 Petitioner :
 :
 v. :
 :
 PENNSYLVANIA PUBLIC UTILITY :
 COMMISSION, :
 :
 Respondent :

No. 2365

SECRETARY'S OFFICE
PUBLIC UTILITY COMMISSION

Commonwealth Court

Docket 1982



BRIEF FOR PETITIONER

PHILADELPHIA ELECTRIC COMPANY

In support of its Petition for Review of the Order of the Pennsylvania Public Utility Commission, entered August 27, 1982 at Investigation Docket No. I-80100341.

Robert H. Young
Walter R. Hall, II
Michael G. Nearing
John B. Wright



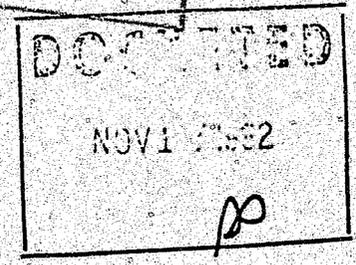
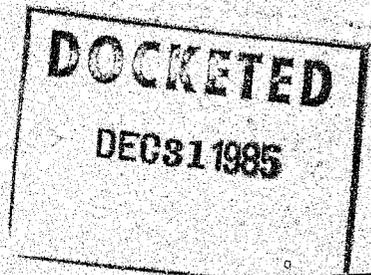
2300 The Fidelity Building
123 South Broad Street
Philadelphia, PA 19109
(215) 875-5530

Counsel for Petitioner
Philadelphia Electric Company

Of Counsel:

Edward G. Bauer, Jr., Esq.
Vice President & General Counsel
Irene A. McKenna, Esq.
Philadelphia Electric Company
2301 Market Street
Philadelphia, PA 19101

MORGAN, LEWIS & BOCKIUS
2100 The Fidelity Building
123 South Broad Street
Philadelphia, PA 19109



Clearly, the General Assembly is capable of granting the PUC broad "public interest" authority where it desires to do so, but it has not done so in the area of utility plant construction decisions.

3. The PUC has No Evidentiary Basis for Asserting that Concurrent Completion of Limerick Units 1 and 2 is "Not Financially Feasible".

Even if the Commission had statutory authority to impose cancellation or deferral of construction of Limerick 2, its only basis for that action is its "not financially feasible" finding (August 27 Order, pp. 21-25). Upon this one determination, the Commission rests both the evidentiary and legal justification for its Order. However, the finding is unsupported by evidence of record and is based upon a denial of the constitutional right to a fair hearing and a reasoned decision upon record evidence.

In reaching its "not financially feasible" determination, the PUC advances without prior notice and out of the context in which presented, various statements made and facts presented by PECO witnesses in support of its request for the approval of CWIP (i.e., construction work in progress) in rate base at Docket No. R-811626. This was the Commission's Investigation Docket at which PECO's 1981 Rate Application was examined.

The Commission's exclusive reliance on evidence from another docket, without affording notice and opportunity to address the proper interpretation to be accorded that evidence, is clearly reversible error. It violates both PECO's due process and statutory rights to a fair hearing, to know the issues and to

present evidence bearing upon the issues. See, e.g., 66 Pa. C.S. §331; National Automobile Service Corp. of Pa. v. Barfod, 289 Pa. 307, 127 A.601 (1927); Town Development Inc. v. Pa. P.U.C., 50 Pa. Cmwlth. 104, 107, 411 A.2d 1317 (1980); Montefiore Hospital Association of Western Pennsylvania v. Pa. P.U.C., 54 Pa. Cmwlth. 279, 421 A.2d 481 (1980); Westinghouse Electric Corp. v. Pa. P.U.C., 44 Pa. Cmwlth. 407, 404 A.2d 712 (1979).

The PUC has been repeatedly reversed where it has sought to rest its decision on such non-record material, though properly within its knowledge as the result of presentation in other proceedings. United Natural Gas Co. v. Pa. P.U.C., 153 Pa. Super. 252, 33 A.2d 752 (1943); Philadelphia Rapid Transit Co. v. Pa. P.S.C., 78 Pa. Super. 593 (1922). Given the potential billion dollar consequences of this decision to PECO and its ratepayers, clearly the PUC should not be permitted any short cuts in compliance with due process hearing requirements.

However, even if such non-record evidence were admissible, it does not support the PUC's finding. Thus, in support of its "not financially feasible" determination, the Commission cites the following asserted facts from the rate case Docket R-811626 record:

- 1) PECO's "most recent mortgage debt issue" (i.e. April 1982) sold with a coupon rate of 18.2% and is currently rated BBB (August 27 Order, p. 21).
- 2) projections of PECO financial strength indicators in the event that no rate relief would be awarded PECO at Docket R-811626.
- 3) the assertion that "PECO's interest coverage is less than 2.7 times with AFUDC and is dangerously close to levels which will prevent the issuance of the bonds necessary for the continued construction of both units".

- 4) the risk that BBB rated securities may not be capable of sale at some future point in time (August 27 Order, pp. 21-22).
- 5) PECO's achieved equity return in 1981 and various actual financial results for 1980.
- 6) PECO's 1981 common stock market to book value ratio of 65%.
- 7) various quotes from the testimony of PECO witness Paquette, the Company's Vice President of Finance and Accounting, as to the necessity for improvement in PECO's financial condition (August 27 Order, pp. 22-23).

Based upon its review of the above, the PUC concludes that it must either approve CWIP in rate base to improve PECO's financial condition, a step which it rejects as producing unjust and unreasonable rates, or direct that Limerick 2 construction be deferred or terminated (August 27 Order, p. 24).

PECO did argue at Docket No. R-811626 that its financial condition was not satisfactory and that a rate increase in excess of that granted by the Commission was required to permit the Company to obtain a "satisfactory" condition. Further, PECO argued that a rate increase at the level approved by the Commission imposed "serious risks" upon PECO's ability to continue the Limerick project for completion in 1985/1987. However, these arguments do not support the PUC's conclusion that Limerick 2 construction must now be deferred or cancelled.

First, the Court should note that much of the financial "data" cited by the PUC is simply not probative on the only matter here at issue - whether PECO's financial strength is sufficient to permit concurrent completion of Limerick Units 1 and 2. For example, PECO's achieved financial results in 1980

are not at all probative as to its financial strength to continue Limerick construction in the period 1982-1984, for the PUC has granted PECO approximately \$400 million in rate relief effective in 1981 and 1982.^{8/} As a result, financial strength indicators have been substantially improved. In addition, estimated indicators of PECO's financial condition which assume no rate relief granted at Docket R-811626 are of little probative value since the PUC subsequently granted a rate increase of approximately \$221.7 million. Further, an 18.2% interest rate for PECO's "most recent mortgage debt issue" (i.e. April 1982) has no probative value since the average BBB rated electric utility mortgage bond coupon rate was 17.7% in the first six months of 1982.^{9/}

Of the "data" set forth by the PUC, the only items which provide even the most remote support for its conclusions are its quotations from the testimony of Mr. Paquette, the fact that PECO is BBB rated and that certain BBB rated utilities have experienced difficulty in three of the past nine years in attracting all of the investment capital which they desired. In

^{8/} Pa. P.U.C. v. PECO, Docket No. R-811626, Opinion and Order entered May 21, 1982 (\$221.7 million); Pa. P.U.C. v. PECO, Docket No. R-80061225, Opinion and Order entered April 24, 1981 (\$188 million).

^{9/} PECO's most recent mortgage bond issue (September 1982) sold with a coupon rate of 15 3/4%. That PECO's common stock sold at 65% of book value during 1981 is a sign of financial weakness and, if not corrected, an impediment to capital attraction. However, PECO's common stock has sold at a high of \$17.125 during the past three months, which produces a market to book ratio of 90.5%. On average, PECO's market to book ratio during this period has been 86.4%. (Mortgage Rate - EBASCO Analysis of Public Utility Financing, EBASCO Business Consulting Co. weekly reports - January-June 1982; Book Value - PECO Stockholder Quarterly Report, September 30, 1982, Common Stock Sales - Wall Street Journal).

his testimony, Mr. Paquette speaks of the "urgent need for substantial rate relief", of the need to "substantially improve our financial performance" and of the "serious possibility that we would have to delay the Limerick project because of our inability to sell additional securities in a limited market" (August 27 Order, pp. 22-23). Similarly, the Moody's Bond Survey of February 8, 1982, quoted by the Commission at page 23, note 19 of its Order, states that maintenance of the current "baa" rating is "highly doubtful" without CWIP in rate base or Limerick completion deferral. The PUC did, of course, approve the "substantial rate increase" referred to by Mr. Paquette, which, as will be described below, has improved PECO's financial condition.

As for the remainder of Mr. Paquette's quoted statements, the Court should note that they speak of the "risk" of Limerick deferral if a certain level of additional revenues is not provided. Mr. Paquette does not state categorically that such a deferral will result. The same may be said of the Moody's bond survey. However, what Mr. Paquette and Moody's warned against, i.e., further deferral of Limerick completion, is mandated by the August 27 Order.¹⁰

The PUC further notes that PECO is a BBB rated utility

¹⁰ The Court should be aware that both Mr. Paquette's opinions and the projected financial indicators to which he testified were based on several important assumptions - i.e. the continuation of inflation at 8.5% for the 1982-1984 period, a prime rate of 17% and long-term fixed security attraction costs of 17%. These assumptions have not proved accurate, with actual inflation rates and capital attraction costs falling below the estimated level. (R-811626, PECO St. 1A, p. 1).

and that there is a risk that PECO will be unable to attract sufficient capital to concurrently complete Limerick Units 1 and 2. This is true. However, this assertion must be placed in its proper context to understand the magnitude of the risk that is involved. Fully 35% of the major privately owned electric utilities are rated BBB or lower.¹¹ BBB rated companies, including PECO, are able to raise capital at the present time. Moreover, as shown upon the following page, which is a copy of Table D from PECO's Exceptions to the ALJ's decision at Docket R-811626, PECO's financial indicators under the PUC's approximately \$221.7 million rate relief are equal to the BBB average in 1982 and equal to or only slightly below that average in 1983.

The Commission has also ignored the fact that PECO is free (and indeed plans) to request additional rate relief to become effective prior to the end of 1983. If granted in amounts consistent with the law, PECO will be able to maintain its financial indicators above the BBB average. Moreover, as the result of the improvements in the capital markets, a reduced rate of inflation, and the reduction in the prime rate and long term debt cost rates, PECO's financial condition has an opportunity to improve over the level shown on Table D.¹²

¹¹ Standard and Poors Ratings, Utility Timing Market Analysis, Lehman Brothers Kuhn Loeb Research, October 27, 1982.

¹² The PUC asserts that certain BBB rated utilities were unable in three of the last nine years to raise all of the capital which they required. This only indicates that there is a risk that Limerick deferral might be required should PECO be unable to improve its security ratings above BBB. That risk is remote at present as the conditions which gave rise to (continued)

TABLE D

KEY FINANCIAL STATISTICS
COMPARISON
INDUSTRY VS. PECO

Baa & A Rated Utilities
Recent Key Financial Statistics 1/
(1979-1981)

| | <u>A Rated</u> | <u>Split A/Baa (1981 only)</u> | <u>Baa Rated</u> |
|--|----------------|------------------------------------|------------------|
| SEC Pre-tax w/AFUDC | 2.7x | 2.4x | 2.2x to 2.3x |
| SEC Pre-tax w/o AFUDC | 2.3x to 2.4x | 1.9x | 1.7x to 1.8x |
| AFUDC as a % of net income | 45% | 61% | 60 to 70% |
| Internal Cash in % Construction (1978-1980 only) | 42% | | 30 to 40% |

PECO Assuming \$209.5 Million
Increase 2/

| | <u>1982</u> | <u>1983</u> |
|---------------------------------|-------------|-------------|
| SEC Pre-Tax w/AFUDC | 2.30x | 2.21x |
| SEC Pre-Tax w/o AFUDC | 1.71x | 1.55x |
| AFUDC % of net income | 74% | 85% |
| Internal Cash % Construction | 14.0% | 11.5% |

PECO Assuming \$344.5 Million
Increase 2/

| | <u>1982</u> | <u>1983</u> |
|---------------------------------|-------------|-------------|
| SEC Pre-Tax w/AFUDC | 2.42x | 2.39x |
| SEC Pre-Tax w/o AFUDC | 1.90x | 1.97x |
| AFUDC % of net income | 62% | 66% |
| Internal Cash % Construction | 21.8% | 21.4% |

1/ PECO St. 13, Sched. 7, p. 1

2/ PECO Exceptions, Table A

In sum, the evidence illegally imported into this record from Docket R-811626 does not, even if accepted, support the PUC's "not financially feasible" finding.

The Court should note that the PUC's order rests upon one final irrational and unsupported premise. The PUC's evidentiary citations simply state that there is a "risk" that Limerick deferral may be required by financial conditions. There is no reason to believe that, should such financial conditions materialize, PECO management will not act, as even the PUC recognizes it has done in the past (August 27 Order, pp. 11-13), to defer Limerick 2 construction. The PUC makes no finding that PECO management lacks this capability. In its Application for Supersedeas, the Court will recall that PECO committed to do just this (See Appendix A, p. 10). Moreover, the PUC's powers are ample to protect the customers if such delays should ultimately have any improper impact upon customer charges.

4. There is No Evidence To Support and the PUC has Not Found that PECO's Financial Condition will be Significantly Improved by Deferral or Cancellation of Limerick 2.

The PUC finds that the public interest requires 1) "preservation of PECO's financial integrity, 2) protection of the public from unjust and unreasonable rate increases, 3) protection of adequate service and 4) timely completion of Limerick Unit 1." Without further explanation or subsidiary factual findings, the Commission then asserts that "either the cancellation or

that inability are not presently in existence (i.e., the 1974 Consolidated Edison dividend omission, 20% prime rate and long-term capital attraction cost rate levels) (See PECO St. 9, pp. 4-7).

suspension of construction at Limerick 2 is in the public interest." It would appear that it is the Commission's view that, by cancelling or suspending construction at Limerick 2, PECO's financial condition will be improved and thus the public interest objectives of the Commission's Order will be obtained.

These conclusions, if valid, should be demonstrated by the PUC through specific factual findings of how and to what extent cancellation or suspension of construction at Limerick Unit 2 will improve PECO's financial condition. The August 27 Order entirely omits such essential findings. In fact, the record demonstrates that the benefits of suspension or cancellation of Limerick 2 construction to PECO's financial condition in 1982 and 1983 are insignificant at best.

The benefit to PECO's financial condition which could theoretically be obtained under the PUC's August 27 Order arises from the suspension of the expenditure of funds in the construction of Limerick 2. Ceasing to expend such funds, in theory, will reduce the financial pressures upon the Company and thus improve its financial condition. However, there are two reasons why this "benefit" is theoretical only. First, as demonstrated by the record, PECO is not spending any significant funds at Limerick 2 at the present time. As shown in Consolidated Ex. No. 1, IR-2, Q.1-27, PECO planned to expend prior to the August 27 Order but \$49 million in 1982, \$95 million in 1983 and \$167 million in 1984 on Limerick 2. The Court should note that in comparison to PECO's earnings base of approximately \$3 billion (see Docket R-811626, Opinion & Order entered May 21,

1982, Table I), this is not a very substantial amount of money. The real financial burden for PECO is completion of Limerick 1 (including common plant), on which expenditures will be \$176 million in 1982, \$146 million in 1983 and \$64 million in 1984.^{13/}

Clearly, the expenditures on Limerick as a whole dovetail, with expenditures on Limerick 1 decreasing as significant expenditures begin on Limerick 2. The Commission's findings ignore this fact.

Clearly, the August 27 Order will achieve no benefits to PECO's financial integrity, its ability to complete Limerick 1, its ability to render service or its ability to provide service at just and reasonable rates. Accordingly, the PUC's Order is arbitrary and capricious, and entirely lacking in evidentiary or logical support.^{14/}

5. The Finding that Limerick 2 Should be Cancelled or Deferred is Capricious and Against the Weight of the Evidence.

The PUC's findings and order respecting the cancellation or deferral of Limerick 2 are capricious in two additional respects.

^{13/} The above constitute direct construction costs. Taxes, overhead and AFUDC have been excluded as their continuation (even for Limerick 2) is not affected by the August 27 Order (at p. 25). Actual annual expenditure levels will be somewhat increased since the Project's total cost has increased since this projection was made.

^{14/} This Court has repeatedly held that the PUC's failure to make "necessary findings" or to set forth persuasive reasoning alone requires reversal of PUC Orders. See, e.g., The Peoples Natural Gas Company v. Pa. P.U.C., 47 Pa. Cmwlt. 512, 526-527, 409 A.2d 446 (1978); Park Towne v. Pa. P.U.C., 61 Pa. Cmwlt. 285, 433 A.2d 610 (1981); Columbia Gas of Pennsylvania v. Pa. P.U.C., 42 Pa. Cmwlt. 118, 400 A.2d 1321 (1979); United States Steel Corp. v. Pa. P.U.C., 37 Pa. Cmwlt. 173, 390 A.2d 865 (1978).

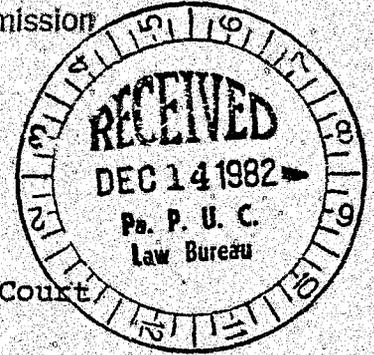
DEC 26 1985

STAFF EXHIBIT No. 17

R-850152 Hg 72
12/20/85

SECRETARY'S OFFICE
Public Utility Commission

COMMONWEALTH COURT OF PENNSYLVANIA



PHILADELPHIA ELECTRIC COMPANY, :

Petitioner :

No. 2365

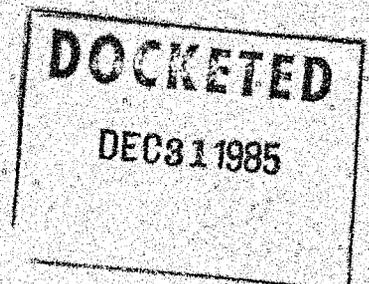
v. :

Commonwealth Court

PENNSYLVANIA PUBLIC UTILITY
COMMISSION, :

Docket 1982

Respondent :



REPLY BRIEF FOR PETITIONER

PHILADELPHIA ELECTRIC COMPANY

In support of its Petition for Review of the Order of the
Pennsylvania Public Utility Commission, entered August 27,
1982 at Investigation Docket No. I-80100341.

Robert H. Young
Walter R. Hall, II
Michael G. Nearing
Margaret B. Dardess



2300 The Fidelity Building
123 South Broad Street
Philadelphia, PA 19109

Counsel for Petitioner
Philadelphia Electric Company

Of Counsel:

Edward G. Bauer, Jr., Esq.
Vice President & General
Counsel
Irene A. McKenna, Esq.
Philadelphia Electric Company
2301 Market Street
Philadelphia, PA 19101

MORGAN, LEWIS & BOCKIUS
2100 The Fidelity Building
123 South Broad Street
Philadelphia, PA 19109

as "conservation" are those which "educate" and "encourage" "effective and efficient use. . . of . . . energy", not massive mandatory investment or financing programs imposed by PUC edict upon PECO and ratepayer alike as proposed by the OCA and others in this record.^{5/}

IV. THERE WAS NO AGREEMENT ALLOWING IMPORTATION OF RATE CASE EVIDENCE INTO THE LIMERICK RECORD, NOR WAS THE "EVIDENCE" ADVANCED BY THE OCA AND THE PUC AS RECORD SUPPORT FOR THE PUC'S "NOT FINANCIALLY FEASIBLE" DETERMINATION ACCEPTED BY THE ALJ OR PUC.

PECO did not invite interchangeable use of the evidentiary records in Docket No. R-811626 and the Limerick proceeding as argued by both the OCA and the PUC. (PUC Brief, pp. 38-39, Appendix A; OCA Brief, pp. 58-60). Rather, PECO merely responded to the Commission Prosecutory Staff's motion that selected portions of the Limerick record be accepted into the evidentiary record at the rate case No. R-811626. In doing so, PECO cited the Commission Order

5/

The OCA cites a recent New York case, Consolidated Edison Co. v. Public Service Commission, 47 N.Y.2d 94, 390 N.E.2d 749 (1979), reversed on other grounds sub nom Central Hudson Gas v. Public Service Commission, 447 U.S. 557 (1980). The cited Consolidated Edison Co. decision sustained the authority of the New York Public Service Commission to prohibit "promotional advertising" of electricity; a cost-of-service (i.e. rate) issue also within the jurisdiction of the Pennsylvania PUC and by which the PUC could promote conservation while dealing with "matters within the Commission's jurisdiction" per §308(c). The OCA's quotation from Central Hudson Gas, supra, intended to suggest PUC statutory authority to mandate "conservation efforts" misstates the import of that decision. The Supreme Court specifically notes that it did not address that issue. 447 U.S. at 560, n.3.

initiating the Limerick Investigation (R.2a) and noted that it was clearly the intent of the Commission that evidence gathered in the course of the Limerick Investigation be available for consideration in Company rate proceedings. PECO therefore did not oppose use of the Limerick record by the ALJ or the Commission in deciding issues in the rate case.

After hearing argument on the need for notice and an opportunity to respond from counsel for the Commission (PUC Brief, Appendix A, Tr. 1800) and the OCA (Id., Tr. 1801), the ALJ approved a procedure proposed by PECO which allowed each rate case party to designate Limerick evidence to be used and an opportunity to respond to Limerick evidence used by other parties. (Id., Tr. 1805). Accordingly, the due process rights of all parties were protected and no party objected before the Commission or this Court to the ALJ's ruling.

These same procedural safeguards were denied PECO when evidence from the R-811626 record was imported into the Limerick proceeding without notice or an opportunity to be heard. It is this action, the complete antithesis of the procedure followed in the rate case, to which PECO here objects (see PECO Initial Brief, pp. 20-21).

The assertion of the PUC that "no real harm" has been done PECO by this importation, because the data employed in the Limerick Order are "cold, hard facts" (PUC Brief, p. 40), is spurious. As PECO demonstrated in its Initial Brief, the "cold, hard facts" employed in that Order are, at a minimum, subject

to interpretation and have been misinterpreted by the PUC. (PECO Initial Brief, pp. 20-26). By denying PECO notice and an opportunity to be heard, the Commission has denied the Company an opportunity to supplement and interpret those facts in the context of the specific issue in dispute in the Limerick proceeding, i.e., the benefits, costs or risks of Limerick 2 deferral based upon an accurate assessment of PECO's financial condition.

In apparent recognition of the legal infirmities of the PUC's evidentiary "importation", both the PUC and the OCA present argument that the Limerick record contains evidence from which the Commission might have concluded that construction of Limerick 2 is "not financially feasible". This argument suffers from two deficiencies. First, this "evidence" does not establish that continued construction of Limerick 2 is financially infeasible. Second, none of this evidence was relied upon by the Commission in support of its "not financially feasible" conclusion.

Three witnesses are quoted to demonstrate that continued construction of Limerick 2 cannot be economically justified when compared with aggressive conservation programs proposed by the OCA or the City of Philadelphia (OCA Brief, pp. 51-53). The OCA fails to note that the "aggressive conservation programs" of both the OCA and the City were rejected by the ALJ in his Initial Decision as invalid (R. 164a), or irresponsible (R. 182a), as vague and unsupported, as optimistic hopes, conjecture and surmise (R. 181a). The OCA also fails to note that the August 27

Order adopted these findings (R. 305a), and specifically refused to adopt the conservation approach offered by these witnesses (R. 304a).

Both the OCA and the PUC offer quotations intended to demonstrate that PECO's current rate allowance is insufficient to permit continued construction of Limerick 2. (PUC Brief, pp. 34-35; OCA Brief, pp. 55-58). A statement of PECO Vice President Paquette to the effect that "based on current economic factors" PECO "probably" would not be able to attract all of the capital needed to complete Limerick absent Commission use of new ratemaking techniques or the grant of extraordinary rate allowances is offered (PUC Brief, p.35; OCA Brief, p. 55). Neither party notes that Mr. Paquette's statement was made before two recent PUC rate orders, which allowed PECO some \$400,000,000 in additional rate relief (PECO Initial Brief, p. 23). Further, in those two rate cases, the PUC permitted for the first time recognition of a prospective wage expense increase and non-revenue pollution control capital expenditures each of which were to occur during the year that the proposed rates would be in effect, rate base inclusion of nuclear fuel in process, and an allowance for equity return of 17.75% which is high compared to historic levels. Pa. P.U.C. v. PECO, Docket No. R-811626, Opinion and Order entered May 21, 1982; Pa. P.U.C. v. PECO, Docket No. R-80061225, Opinion and Order entered April 24, 1981.

Accordingly, Mr. Paquette's statement is so out of line as to be of no probative value and, further, the conditions which he postulates for continued Limerick construction have been met by recent PUC actions.

Likewise, the OCA quotes an interrogatory response of PECO Vice President Vincent Boyer asserting that it states that the entire rate request at Docket R-811626 was necessary if delay in Limerick construction was to be avoided (OCA Brief, p. 55). Mr. Boyer, an engineering witness, is not the Company officer who is responsible for its financial condition or rate strategy. Mr. Paquette, the Financial Vice President, is responsible for these matters. Mr. Paquette simply noted that there was "a serious risk" that delay "might" occur if rates were held to the level approved by the PUC (see PECO Initial Brief, pp. 23-24).^{6/}

The OCA further quotes the initial testimony of its witness, Ray Czahar, concerning the continued financial risk of Limerick construction (OCA Brief, pp. 56-67), ignoring the fact that the testimony quoted does not conclude that PECO cannot continue financing Limerick construction. Mr. Czahar opines only that such construction continues at considerable financial risk. More important, the OCA fails to note that Mr. Czahar's

^{6/} Moreover, all Mr. Boyer's interrogatory response states, in any event, is the obvious -- i.e., that PECO views as "adequate" and proper the rates which it filed and which were then under litigation before the PUC.

opinion is premised upon a computer analysis of PECO's financial requirements which contained a serious misinterpretation of PECO's mortgage bond indenture coverage requirements; an error admitted by Mr. Czahar on the Limerick record and which necessitated the effective withdrawal and complete resubmission of his testimony. (Tr. 2062-2075). In subsequent corrected testimony, Mr. Czahar established the achieved return on equity necessary to continue construction of Limerick at 16% (OCA St. 2B, p. 8). Mr. Czahar's corrected 16% equity return requirement, in fact, supports PECO's continued ability to construct Limerick Units 1 and 2, especially when viewed in light of the Commission's recent allowance of an equity return of 17.75% at Docket No. R-811626.

The OCA also cites the opinion of Amory Lovins (OCA Brief, pp. 57-58). Mr. Lovins' quoted opinion, based upon that of Mr. Czahar's initial and uncorrected opinion must be disregarded. In addition, it must be noted that Mr. Lovins' qualifications as a financial witness were challenged on this record. (Tr. 333-338, 358-365). The PUC, of course, does not in its Order accept the opinions of either Mr. Czahar or Mr. Lovins, and its ALJ in fact rejected each (R. 164a, 211a, 247a-248a). Accordingly, there is no probative evidence in the Limerick record as to whether PECO can or cannot finance completion of Limerick 2 concurrent with Limerick 1.

Finally, the Commission's unsupported finding that continued construction of Limerick 2 is "not financially

feasible" has spawned the dependent argument that continued construction will interfere with PECO's ability to provide safe and reliable service. (PUC Brief, pp. 27-28; OCA Brief, pp. 12-14). The effect of continued construction upon PECO's ability to provide safe and reliable service was neither noticed, addressed in evidence nor argued below. The PUC's assertion that the Limerick Investigation focused upon PECO's ability to provide safe and reliable service (PUC Brief, p. 5) is sheer fantasy. The October 10, 1980 Order initiating the Investigation, and the August 27 Order which summarized the issues noticed by the PUC (R. 2a, 278a, 279a), both cited by the PUC in support of this assertion, contain no reference to this issue. There is no reference to, or resolution of, such an issue in the Initial Decision of the Administrative Law Judge in the proceeding below.

V. CONCLUSION

For the reasons stated above and in the Initial Brief of Petitioner, the Order of the Pennsylvania Public Utility Commission entered August 27, 1982 at In Re Limerick Nuclear Generating Station Investigation, Docket No. I-80100341 should be reversed as unsupported by the evidence, based on errors of law, and in violation of PECO's constitutional and statutory rights to a fair hearing and a reasoned decision upon record evidence.

RECEIVED

STAFF COUNSEL NO. 10
R-880152 Hkg
12/20/85 TR 0

DEC 26 1985

IN THE SECRETARY'S OFFICE
SUPREME COURT OF PENNSYLVANIA
The Utility Commission

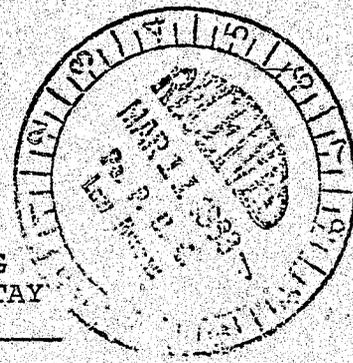
PENNSYLVANIA PUBLIC UTILITY
COMMISSION, Petitioner

v.

PHILADELPHIA ELECTRIC COMPANY,
Respondent

OFFICE OF CONSUMER ADVOCATE,
Intervenor

No. 23 E.D. Appeal
Docket 1983



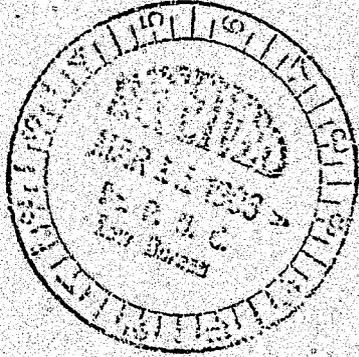
ANSWER AND APPLICATION OPPOSING
PETITIONER'S APPLICATION FOR STAY
PENDING APPEAL

NOW COMES Philadelphia Electric Company ("PECO" or the "Company"), by its counsel, and answers the Application for Stay Pending Appeal filed by the Pennsylvania Public Utility Commission ("PUC") and, in the alternative, applies to this Honorable Court pursuant to Rules of Appellate Procedure 123, 1732 and 1736(b) requesting elimination of any automatic supersedeas to which the PUC may be entitled. In support of its Answer and Application, the Company states as follows:

1. By Order entered December 15, 1982, the Pennsylvania Commonwealth Court reversed a PUC Order entered August 27, 1982 ("August 27 Order") terminating the latter's Limerick Nuclear Generating Station Investigation at Docket No. I-80100341. On January 27, 1983, the Commonwealth Court issued its opinion setting

FOLDER

DOCKETED
DEC 31 1985



APPENDIX B

Affidavit of Joseph F. Paquette, Jr., Vice
President, Finance and Accounting, sworn
March 8, 1983

AFFIDAVIT OF JOSEPH F. PAQUETTE, JR.
VICE PRESIDENT, FINANCE AND ACCOUNTING

Joseph F. Paquette, Jr., whose business address is 2301 Market Street, Philadelphia, Pa., on oath deposes and says:

1. I am employed by Philadelphia Electric Company as Vice President of Finance and Accounting. I have held my present position since 1978. Prior to my election as Vice President, I served beginning in 1972 as Manager of Finance and Accounting performing functions similar to those which I now perform, but under the direction and supervision of the then Vice President. In my present position, I am responsible for all matters relating to finance and accounting, including rate administration and rate structures; the planning and execution of the Company's financings and shareholder and investor relations programs; proceedings before regulatory commissions related to these matters; the establishment and review of financial controls of the Company; and all other matters relating to finance and accounting policy and management. Specifically, I negotiate sales of securities with our underwriters, discuss our credit standing and financial strength with various rating agencies pursuant to their preparation of published evaluations of our securities, and make presentations and discuss the Company with many segments of the financial and investment community.

As Vice President and as Manager of Finance and Accounting, I have participated in the major financial and

scheduling decisions made by the Company as respects the Limerick Nuclear Generating Station construction project since the early 1970s. I have, on several occasions, presented testimony explaining such decisions, describing the Company's financial condition and its difficulties in attracting needed investment capital in rate and other proceedings before the Pennsylvania Public Utility Commission ("PUC"). I was a major Company witness in the Commission's Limerick Investigation at Docket No. I-80100341 on financial condition, planned financings and the reasons for the Company's decisions to defer completion of the Limerick Station made during the mid and late 1970s.

2. I have reviewed the PUC's Order entered August 27, 1982 concluding its Limerick Investigation ("August 27 Order"). I am familiar with the current status of the construction of Limerick Units 1 and 2, the level of expenditures which the Company has made to date upon said Units and which it proposes to make through to their completion, with the Company's estimates of the costs associated with a further major deferral in Limerick Unit 2 completion, with its estimates of the effects of such a deferral upon employment at the plant and of the perceptions of the Company's financial condition and the August 27 Order by the investment community. As of December 31, 1982, approximately \$1.35 billion had been spent on Limerick 1 (approximately 83% complete), \$563 million on Limerick 2 (approximately 30% complete), and \$627 million on plant used jointly by the two units. Accordingly, the sunk investment in Limerick Unit 2 and its 50% share of common facilities

expended as of December 31, 1982 equals \$877 million. If Limerick Unit 2 were to be canceled, one option posed by the August 27 Order, this investment at a minimum would constitute a loss which would have to be borne or shared by PECO ratepayers and shareholders.

Construction at a two unit nuclear station progresses through the following basic stages: engineering and design activity, construction of building structures and equipment housing, installation of equipment and piping, installation of wiring and control centers and testing operations. To permit efficient utilization of personnel and to take advantage of experience gained during construction and design activity, each stage of construction is scheduled so as to complete activities related to Unit 1 and then immediately thereafter initiate and complete related activities as to Unit 2. Experience has shown that this schedule produces construction cost savings.

By restricting expenditures permitted on Limerick Unit 2, the August 27 Order prevents the Company from obtaining these cost savings. In addition, as construction and design work ends on Limerick 1, the restrictions imposed by the Commission on the financing and expenditure of funds on Limerick 2 prevent the Company from transferring experienced engineers and construction personnel to available work on that Unit. Should this occur, these experienced personnel would be lost and the Company would be unable to complete the Limerick 2 project upon the 1988 completion schedule which it has determined is least cost and most beneficial to its ratepayers and shareholders.

The Company's total projected Limerick 2 expenditures for engineering, design and initial construction activities over the next six months equal but \$12 million. Unless these dollars are expended, the Company will be required to further defer completion of Limerick 2 which action will result in an additional cost to complete the Unit of \$470 million, the details of which are explained in an Affidavit of Vincent S. Boyer, Senior Vice President - Nuclear Power filed with the Commonwealth Court in support of the Company's Application to it for an Order of Supersedeas (See Appendix A: Brief for Petitioner, Appendix B). In the event of a deferral, approximately 2500 construction jobs at the plant site will be eliminated temporarily or permanently beginning in the summer and fall of this year.

3. The principal reason that the Company opposes granting of the PUC's requested supersedeas is the effect which such action would have upon the investment community.

It is my understanding that granting of the PUC's supersedeas request connotes that there exists a substantial likelihood that the PUC will succeed in reversing the Order of the Commonwealth Court and reimposing the terms of the August 27 Order. The Company must attract approximately \$1.8 billion of external capital over the next two years from the investment community simply to permit it to complete construction of Limerick Unit 1 and normal plant expansion and refurbishment projects. The August 27 Order imposes significant and abnormal risks upon investors in the Company. For example, the Order

creates uncertainty as to the Company's ability to complete Limerick Unit 2 in which \$876 million has already been invested and the PUC provides no positive guidance in the Order as to whether the Company will be permitted to recover this investment in rates in the event that construction is cancelled.

The investment community is well aware of the terms of the August 27 Order and of that Order's reversal by the Commonwealth Court. Were that Court's Order now stayed, the risks, uncertainties and fears as to the Company's financial condition created by the August 27 Order among the investment community would be magnified. In my opinion, the Company's ability to attract needed capital from that community for Limerick 1, Limerick 2 and even non-Limerick capital projects could be significantly reduced and the cost of that capital would be increased.

Uncertainties and risks created by the August 27 Order must be disclosed by the Company in its security registration statements which are employed by investors as a partial basis of their analysis of whether to purchase company securities. For example, to satisfy Securities and Exchange Commission disclosure requirements, the Company has been required to include in its Form 10-K Annual Report and Form S-3 Security Registration Statements the following statements:

In the fall of 1980 the PUC instituted an investigation into various matters related to the Limerick Station, including its economics and necessity and the reasons for increases in its projected completion cost and delays in its

anticipated completion date. Despite a draft opinion by the Administrative Law Judge to the contrary, on August 27, 1982, the PUC issued an Order (Order) to the effect that continued construction of Limerick Unit 2 was not in the public interest. The Order directed the Company to inform the PUC within 120 days of the Company's decision to cancel or suspend construction of Unit 2. The Order stated that, if the Company continued construction of Unit 2, the PUC, pending completion of Unit 1, would not approve new securities issuances the proceeds of which would be used, in whole or in part, for the construction of Unit 2 and would deny recovery of Allowance For Funds Used During Construction (AFUDC) on any such additional investment in Unit 2. As the basis for its decision, the PUC stated that, in light of its own refusal to provide rate base recognition of construction work in progress relating to Limerick, completion of both units by 1985 and 1987, as then scheduled by the Company, was not financially feasible if the Company were to ensure the continued maintenance of safe and reliable service to the public.

The Order did not address a number of major issues, such as whether, if Unit 2 is cancelled, all common plant and other added costs will be allowed in rate base for Unit 1 and what recovery will be allowed of Unit 2 sunk costs. The Order did permit accrual of AFUDC on the Company's investment in Unit 2 at the date of the Order (assuming the Company elects to suspend Unit 2) and the financing of, and the accrual of AFUDC on, the costs of shutting down construction of Unit 2 and maintaining the site should the Company elect to defer construction. In considering the delays of the Limerick construction schedule announced in 1974, 1976 and 1978, the PUC found that the 1974 delay was not unreasonable but that, with respect to the 1976 and 1978 delays, the Company's management "did not exercise judgment sufficient to meet the PUC's reasonable man standard". However, the PUC concluded that quantifying the costs of the 1976 and 1978 delays and determining the rate-making treatment of those costs would not be appropriate until completion of Limerick construction and presentation by the Company of a claim for the inclusion of Limerick costs in rate base.

On September 23, 1982, the Company appealed the Order on a number of issues to the Commonwealth Court. The Company also requested the Commonwealth Court to stay the Order pending resolution of the appeal. A stay

was granted by the Commonwealth Court but was subsequently vacated by the Pennsylvania Supreme Court. On December 15, 1982, the Commonwealth Court unanimously reversed the Order. On January 14, 1983, the PUC and the Pennsylvania Consumer Advocate filed Petitions for Allowance of Appeal asking the Pennsylvania Supreme Court to review the Commonwealth Court's decision, which Petitions have been granted. In its written opinion issued January 27, 1983, the Commonwealth Court held that the PUC lacked authority either directly or indirectly to order the Company to suspend or cancel construction of Unit 2. The Commonwealth Court concluded that the PUC's authority to approve the issuance of securities did not include the authority to inquire into the necessity of the project to be financed with the proceeds of such securities or to use its jurisdiction over the issuance of securities to control construction indirectly. The PUC has requested a stay of the Commonwealth Court's reversal of the Order pending resolution of the appeal to the Supreme Court.

The Company cannot predict whether the Order will be reinstated by the Pennsylvania Supreme Court or the future regulatory treatment of the additional costs, if any, associated with the 1976 and 1978 delays of the Limerick construction schedule, of its investment in Unit 2 (including any portion of its present or future investment in common plant facilities deemed by the PUC to be attributable to Unit 2) or of any cancellation or other charges (which charges may be substantial) it may incur, should Unit 2 be deferred or cancelled. If Unit 2 were ultimately cancelled, the Company would request that it be permitted to recover its investment in Unit 2 through rates. Any portion of the Company's investment in Limerick not allowed to be recovered would have to be written off, and such writeoff could have a material adverse effect on the Company's financial condition and could impair the Company's ability to issue securities and to pay dividends. (Emphasis added).

The reports of security rating agencies, a second substantial basis of investor decisions to buy or not buy Company securities, also fully reflect the risks and uncertainties associated with the Commission's August 27 Order (see Standard and Poor's Credit Week, September 13, 1982):

Philadelphia Electric's outstanding publicly rated first mortgage bonds and collateralized industrial revenue bonds are lowered to 'BBB-' from 'BBB'. In addition, unsecured senior debt and industrial revenue bonds are lowered to 'BB+' from 'BBB-', and preferred stock to 'BB' from 'BBB-'. . . . The rating reduction reflects prospects for continuing substandard cash flow and earnings protection measures through at least the completion of Limerick 1 in 1985. The Pennsylvania commission's unwillingness and inability to provide cash returns on major project construction work in progress (CWIP) will be a significant contributor to the company's chronic financial difficulties. The greatest threat to the company's financial integrity at this time is the uncertainty that was created by the commission regarding the ultimate regulatory treatment, i.e., potential rate base disallowances of the Limerick 1 investment, as well as the status of Limerick 2. The commission has indicated that delays in 1976 and 1978 did not meet their standards of reasonableness, although it declined to quantify the costs of these delays until the plant is completed. Additionally, the commission found that cancellation or suspension of Limerick 2 would be in the public interest, but did not indicate what treatment the approximate \$460 million dollar investment would be accorded if this option were chosen. Through these actions, the Pennsylvania commission has required investors to assume significantly greater risks, which S&P believes must be reflected in the credit ratings of the company's securities. Finally, based on current cost estimates of \$3.1 billion for the first Limerick unit, the plant will represent 45%-50% of utility plant in service.

More recently, the Moody's Bond Survey (dated February 7, 1983) reported the downgrading of the Company's preferred stock by Moody's Investment Services Inc. from its rating category B3 to B1, thus bringing its rating of the Company's preferred stock

securities into conformance with the ratings assigned those securities by most other major financial rating agencies. Moody's stated that the downgrading reflected "the increased cost of the Limerick plant, questionable support by the Pennsylvania PUC for the ongoing construction of the second Limerick Unit, and additional pressures that external financing will place on protection measurements." Moody's further noted as a basis for its rating decision the uncertainties created by the Commission's appeal of the Commonwealth Court's Order as follows:

Last December the Commonwealth Court reversed the PUC Order of August 27, 1982, which required the Company to either cancel or suspend construction of Unit 2, but the decision has been appealed to the Pennsylvania Supreme Court by the PUC and the Consumer Advocate.

In my opinion, and based upon my conversations with rating agency officials, the PUC's August 27 Order has been a principal causative factor in recent downgradings of Company securities. The reimposition of that Order pursuant to the grant of the PUC's requested supersedeas would simply create additional negative pressure on rating agencies to reduce Company security ratings and upon investors to refrain from purchasing Company securities. The cost consequences if the Company is unable to attract sufficient capital to continue its Limerick 1 and non-Limerick construction programs would exceed the cost consequences of additional deferral of Limerick 2.

4. I have reviewed pages 5 through 7 of the PUC's Application for Stay Pending Appeal. The implication of the discussion on page 5 of that Application that the Company's security ratings were reduced as the result of its late January announcement that it would resume construction of Limerick Unit 2 is incorrect. Of the four major rating agencies, only Moody's reduced the Company's security rating (i.e. mortgage bonds and preferred stock) in late January.^{1/} Further, Moody's reduction of those rating was simply to the equivalent level at which other major rating agencies had already placed the financial quality of the Company's securities. Those other rating agencies reduced the Company's ratings in late fall of 1982 following publication of the PUC's August 27 Order.

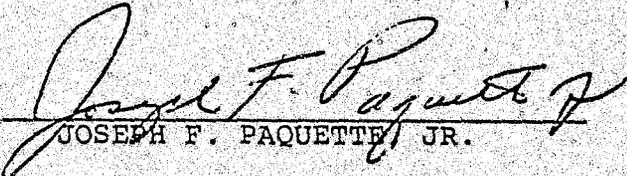
I further reject the assertion at page 6 of the Application that "PECO's latest actions are exacerbating the Company's deteriorating financial condition". In fact, the Company's financial condition is improved over that which existed at the close of the Limerick record and publication of the Limerick Order. This improvement reflects the effects of the Commission's approval of a \$221.7 million rate increase for the Company effective May 27, 1982.

^{1/}

A second rating agency, Duff & Phelps, reduced its rating of the Company's preferred stock.

5. I should like to emphasize that, as demonstrated by the Limerick record and indeed the Commission's own Order (at pp. 9-12), the Company will defer Limerick 2 expenditures if required to maintain its financial integrity and the scheduled completion of Limerick 1. Accordingly, I see little purpose to the Commission's effort to prohibit Limerick 2 expenditures, if the only reason which can be advanced in support of that prohibition is the belief that it is necessary to prevent the Company from overextending itself to the detriment of Limerick 1 and present service operations.

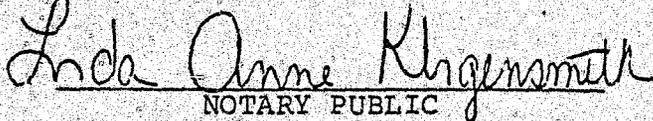
AND I FURTHER depose and say that the foregoing is true and correct to the best of my knowledge, information and belief, and that I am competent and authorized by Philadelphia Electric Company to testify thereto.


JOSEPH F. PAQUETTE JR.

COMMONWEALTH OF PENNSYLVANIA

COUNTY OF PHILADELPHIA

Sworn to and subscribed before
me this 8th day of March,
1983.


NOTARY PUBLIC

My commission Expires:

LINDA ANNE KLINGENSMITH
Notary Public, Phila., Phila. Co.
My Commission Expires Feb. 9, 1985

DOCKET NO. R-850152

R-850152 Hbg JK
12/20/85

RECEIVED

DEC 23 1985

SECRETARY'S OFFICE
Public Utility Commission

DOCKETED
DEC 31 1985

FOLDER

October 25, 1978

Dear _____:

As I mentioned to you yesterday, Philadelphia Electric Company is interested in selling its share of the output of Salem #2 unit (474 MW) from its date of commercial operation in 1979, and for a period of up to ten years. Furthermore, our Limerick #1 unit could be placed in commercial operation in 1983, and we would be interested in selling 50% of its output for some period of time to better match our increments of capacity with our load growth.

I appreciate your offer to mention this to Mr. _____ After the _____ meeting on November 2, I will call again to see if you have any further interest.

Sincerely,

May 17, 1979

R.F. HOLMAN
FILE

FROM: T. P. Welch
TO: D. P. Scott, Controller
Finance & Accounting Department
SUBJECT: Sale of 10% of Limerick to

Following up on our recent discussion of the need to develop arrangements for monthly accounting and billing for [redacted]'s 10% share of the expenses of Limerick Station, there is enclosed, as you requested, a copy of the latest PE draft of the Agreement with

The first draft of this Agreement was presented for discussion in a meeting of PE and [redacted] representatives in late February 1979. At that meeting, [redacted] agreed to review the draft and send us comments. We agreed to include provisions for sharing costs of the DRBEUG water storage reservoir and this was done in the enclosed revised draft which we sent to [redacted] on April 9, 1979.

At the meeting with [redacted] we also agreed to expand and clarify the procedure for calculating carrying charges (Schedule 1 of draft Agreement). I had revised Schedule 1 (copy attached) after discussion with Jon Katherine and Warren Smith but we concluded that more work was needed to clarify the internal accounting procedures before offering it to [redacted]. Your help in this area would be appreciated.

[redacted] has not, as yet, sent us any comments on the draft Agreement but they have informed us that they now want a 10 year rather than life-of-plant Agreement.

J. P. Welch
Administrative Analyst
Corporate Planning

Attachments 3

cc: W. C. Astley
R. F. Holman ✓
J. A. Katherine
W. H. Smith

AGREEMENT
between
PHILADELPHIA ELECTRIC COMPANY
and
...

This AGREEMENT, made as of _____, 1979, by and between
PHILADELPHIA ELECTRIC COMPANY, a Pennsylvania Corporation (PE), and
_____, a _____ Corporation

WITNESSETH THAT:

WHEREAS, PE is constructing the Limerick Project consisting principally
of two 1055 MW Nuclear Units #1 and #2 (herein called UNITS) and associated
water supply, switching station and transmission facilities required to
connect the UNITS to its system, and _____ will purchase ten percent of the
capacity and associated output of the UNITS for their life, and

WHEREAS (other clauses as required)

NOW, THEREFORE, the parties hereto, each in consideration of the
agreements of the other herein set forth, hereby mutually agree as follows:

July 7, 1982

FROM: J. S. Kemper
TO: R. F. Holman, Vice President, Corporate Planning
SUBJECT: Available Capacity at Limerick

We have reviewed the load and capacity forecast and determined that we could have 250 mw of each Limerick unit - 1 & 2 - available for sale to for 10 years' duration. The 10 years' duration of this sale assume Limerick 1 in service in 1985 and Limerick 2 in service in 1988. Any delay in these service dates would reduce the duration of the sale by the amount of the delay.

In order to provide for a 25% reserve objective to the year 2000, some retirements of PECO capacity must be delayed. However, even with no sale, some retirements must be delayed to maintain a 25% reserve objective if no new PECO capacity is planned in this period. The attached tables show the various plans and possible means of implementing them.

John S. Kemper
Vice President
Engineering & Research

Attachment

CC: W. J. Cloues

LIMERICK GENERATING STATION CAPACITY SALE

Retirements to Maintain 25% Reserve With

Sale or No Sale Except as Noted*

Limerick 1985/1988 500 Mw
Limerick 1985 Only 250 Mw

Mw Reserve Over 25% Objective
Limerick 1985/1988 No Sale 500 Mw Sale
Limerick 1985 Only No Sale 250 Mw Sale

| Year | Base Retirement | Sale or No Sale | Same except CT's (473 mw) "mothballed" | Sale or No Sale | 923 | 673 | 923 | 673 |
|------|---|-----------------|---|-----------------|-----|-----|------|------|
| 1985 | Richmond 9 & CT's (642 mw) | Same | | | 923 | 673 | 923 | 673 |
| 1986 | - | - | | | 860 | 610 | 860 | 610 |
| 1987 | - | - | | | 798 | 548 | 798 | 548 |
| 1988 | Southwark 1&2, Schuylkill 1, Delaware 7&8, CT's (917 mw) | Same | Southwark 1&2 (358 mw) | | 874 | 374 | 377 | 127 |
| 1989 | - | - | | | 812 | 312 | 314 | 64 |
| 1990 | - | - | | | 737 | 237 | 239 | -11 |
| 1991 | - | - | Reactivate CT's (473 mw)* | | 662 | 162 | 164 | 387 |
| 1992 | - | - | | | 587 | 87 | 89 | 312 |
| 1993 | - | - | | | 512 | 12 | 14 | 237 |
| 1994 | Cromby 1&2 (345 mw) | - | | | 437 | -63 | -61 | 162 |
| 1995 | - | - | Delaware 7&8 (250 mw)* | | 325 | 75 | 87 | 87 |
| 1996 | Eddystone 1&2, CT's (672 mw) | - | | | 274 | 24 | 0 | 0 |
| 1997 | - | - | | | 187 | -63 | -88 | -88 |
| 1998 | - | - | | | 99 | 99 | -175 | -175 |

* 473 mw of CT's reactivated in 1991 for sale of Limerick 1, reactivation deferred to 1995 for no sale.

July 9, 1982

Dear _____:

After receipt of your June 25, 1982 letter, we reviewed our latest load and capacity forecast data and have determined that 250 MW of capacity from Limerick #1 could be made available to _____ for a ten-year period. I might add that an additional 250 MW of capacity from Limerick #2 could be made available for a ten-year period in the event that we continue the present construction schedule for that unit.

Very truly yours,

DOCKET NO. R-850152

R-850152 12/20/85
Hbg TX

RECEIVED

DEC 20 1985

SECRETARY'S OFFICE
PUBLIC UTILITY COMMISSION

DOCKETED
DEC 31 1985

DOCUMENT
FOLDER

At this meeting I stated that PE could not move Limerick up to 1981 due to the affect on earnings per share of putting such a large unit in before actually needed. I stated that PE could justify advancing Limerick #1 to 1982 only if advance payments were made by

I stated that we would be willing to sell unit power to in 1982 and 1983, but this too would require advance payments. continued to propose sharing ownership in and I stated that PE would not pay any more for per kilowatt, than we would have invested in Limerick if the dates of operation had remained 1983 and 1985.

In essence, I was proposing that if we shared joint ownership in and Limerick, we would share with a portion of the savings in investment from advancing Limerick #1. I also indicated that both parties should require some form of protection if the construction of either plant was delayed for an unreasonable length of time.

I believe is interested only in sharing ownership and not in a unit purchase for a limited number of years. I will see again on 9/1/76.

WCA
8/13/76

cc: J. F. Paquette
E. Kasum

DOCKET NO. R-850152

R-850152 Nbg 7K
12/20/85

DOCKETED
DEC 31 1985

DOCUMENT
FOLDER

Philadelphia Electric Company

Annual Report
1977





R. F. Gilkeson, Chairman of the Board

1977 was a year of continued progress for Philadelphia Electric Company. Electric kilowatt-hour sales set new records; the first of two units at the Salem Nuclear Power station began commercial operation; our gas supply improved substantially; and we successfully completed a major step forward in customer service. Reflecting this progress and our confidence in the future, the quarterly dividend was increased from 41¢ per share to 45¢ per share beginning in June.

However, 1977 was not without problems. The economy of our service territory continued to be sluggish and our sales growth for the year was disappointing. Inflation continued to significantly impact our expenses. Regulatory delay in approving needed rate increases for incurred costs continued to penalize earnings.

For the year, common stock earnings were \$133 million, an increase of 6 percent over last year. Earnings per share were \$1.87, on 8 percent more average shares outstanding, compared to \$1.91 in 1976. Our 1977 earnings benefited by 11¢ per share as a result of a non-recurring revenue increase due to the conversion of residential and small commercial customers from bi-monthly to monthly meter reading and billing, but were penalized by approximately 20¢ per share as a result of the Salem unit being in service, but not in the rate base.

Electric revenue increased \$153 million, or 15 percent above last year. The increase was due to the recovery of higher fuel costs, rate increases, and a 3.5 percent increase in electric sales. Recovery of higher fuel costs resulted in an increase in gas revenue of \$16 million or 10 percent above last year. Steam revenue increased almost \$2 million or 4 percent.

NUCLEAR POWER

The first Salem nuclear unit, constructed and operated by Public Service Electric and Gas Company, of New Jersey, was placed in commercial operation on June 30, 1977. The Company owns a 42 percent share in this 1079 megawatt unit and will own a like share of the second unit scheduled for completion in 1979. This addition brings our system nuclear generating capacity to 1346 megawatts, or about 16% of our total capacity. Nuclear energy is expected to account for over 25% of our annual output in 1978.

Our Peach Bottom nuclear units continue to perform well although we were disappointed by the length of outages due to some "shakedown" problems. The nuclear units presently in service reduce our system fuel costs by about \$150 million annually.

Construction continues at the Limerick nuclear plant. The two 1055 megawatt units are scheduled for service in 1983 and 1985. When Limerick is completed, nuclear generation should account for more than half of our total output.

We carried a new record electric peak load last summer of nearly 5900 megawatts without difficulty. We have a reserve capacity of about 40% and our ability to serve our loads is comfortable after a decade of "blackout" worries.

CUSTOMER SERVICE

Efficient, reliable, reasonably priced service is our public responsibility and an essential ingredient to insuring the present and future profitability of our shareholders' investment. In 1977, we took another

major step forward in fulfilling this responsibility. Recognizing that energy costs are now a larger part of the family budget, we converted our residential and small commercial customers from bi-monthly to monthly meter reading and billing. Now our customers receive a bill each month for their actual use based on meter readings, enabling them to pay their actual bills monthly just as they do most other household bills.

Our enviable record of reliability for electric service continued through 1977. For the past four years we did not quite achieve 100% reliability, but we did achieve over 99.99%.

After years of unheeded warnings, severe shortages of natural gas finally occurred. The severe winter of 1977, one of the coldest in the recorded history of eastern Pennsylvania, provided a major test of our Company's ability to provide reliable service. The eastern half of the United States suffered from shortfalls of gas and increased curtailments. The result was the closing of schools and the curtailing of natural gas use by business and industry.

Despite the severe winter, it was not necessary to curtail our residential customers. On January 17, 1977, the Company set a new daily sendout record of 441 million cubic feet of natural gas. Our steam system also set a peak load record in January 1977.

Although we experienced a new all time winter peak and there were heavy demands on our electric system, our Company, through the PJM Interconnection, was still able to assist in supplying electric energy to other utilities.

In anticipation of the recent coal miners strike, our Company accumulated coal reserves which would permit operations through the 1977-78 winter. Nuclear units, free from the limitations of conventional fuel supply and delivery, perform well in the winter cold.

GAS OPERATIONS PLANS AHEAD

We entered the winter of 1977-78 well prepared. Supplies of natural gas from pipelines have been subject to less curtailments. In addition, we have taken some other important steps to firm up our own supply. These steps are increased underground storage capacity, purchases of synthetic natural gas and local refinery gas, and participation in ventures for exploration. We established a wholly-owned subsidiary called Eastern Pennsylvania Exploration Company. The subsidiary is a partner in ventures for exploring and drilling for gas in the Gulf Coast area. Some of the ventures have already proven successful.

In the near future, gas supplies look more plentiful. Hopefully, regulatory restrictions concerning the addition of new customers could be lifted.

FINANCING/RATE INCREASES

During 1977, we sold \$173.5 million of mortgage bonds and over 5 million shares of common stock. The sale of these securities provided a financing mix which preserved our strong equity capital position.

Construction expenditures totaled \$393 million, of which 45 percent was financed by internally generated funds. Conservative financing and good cash flow continue to be fundamental strengths of the Company.

In August 1977, we filed with the Pennsylvania Public Utility Commission for a two-step change in electric rates in order to recover the higher costs of new plants now in service and inflation. The first step proposed to eliminate the fuel adjustment clause for our residential and small commercial customers in return for an improved fuel clause for large commercial and industrial customers which would not pass through the fuel savings of a new nuclear plant until it is fully reflected in our base rates. The second step proposed to increase electric revenue by \$119 million.

The Commission has suspended both parts of the request until April, 1978. Hearings on the full increase are underway and are expected to continue over the next several months. Pending completion of the hearings, we have asked for interim rate relief because our earnings have been decreasing as a result of the Salem unit being in service but not in rate base.

IN CLOSING

1977 was indeed a year of progress for our company—progress which was the direct result of the combined efforts of a capable and dedicated employee team. This progress was accomplished with about 1,000 fewer employees than we had five years ago.

Our report this year includes some views of our employees at work serving our customers, our community and you, our shareholders. We are justifiably proud of these individuals and acknowledge their contributions to the progress which has been achieved in the past year.

March 1, 1978



Chairman of the Board

OCA EXHIBIT NO. 60

DOCKET NO. R-850152

R-850152 12/20/85

146g 52

RECEIVED

DEC 28 1985

SECRETARY'S OFFICE
Public Utility Commission

DOCKETED
DEC 31 1985

DOCUMENT
FOLDER

PHILADELPHIA ELECTRIC COMPANY



ANNUAL REPORT 1978

The year 1978 was a year of progress for the Company. Rate increases necessary to recover higher costs to improve earnings and to continue attracting new capital were obtained. Cost control programs were successfully continued and financing needs were met. Planning and construction to meet future needs continued.

In 1978 PE's basic strengths withstood the impact of a sluggish local economy, continuing inflation, high interest rates and regulatory delay in granting a vitally needed rate increase. Despite these mounting difficulties, the Company was able to earn \$1.87 per share in 1978, the same as the previous year although average shares outstanding increased by 6.5 percent.

Earnings

During the second half of the year, 12 months earnings per share were reported at levels below the dividend rate. This was due to delay in the rate relief to reflect the investment cost of the Salem No. 1 nuclear generating unit even though the unit was in operation. The Pennsylvania Public Utility Commission (PUC) rendered its final decision on December 28, 1978 on the \$116 million electric rate request, originally filed in August 1977. The Company was granted an increase of \$78.9 million per year to cover the capital and operating costs of Salem and other cost increases. The increase is retroactive to July 4, 1978, and will be billed during 1979. Financial results for calendar year 1978 include the estimated retroactive effects of the PUC's final order and are subject to possible change since the PUC order, entered February 5, 1979, is subject to appeal.

The \$78.9 million rate increase is offset by the fuel savings from Salem No. 1, estimated to approach \$55 million per year, which are automatically passed on to customers through lower fuel adjustment charges.

PE achieved total earnings of \$141 million in 1978, highest in the Company's 97-year history and 6.5 percent over 1977. Several important factors contributed to the results:

- The electric rate order added \$21 million to 1978 earnings.
- During the first quarter of 1978, sales to other utilities during the coal strike aided earnings by \$8 million.
- The new electric Energy Clause, which became effective July 1, has had a beneficial effect on earnings by recovering the actual cost of all fuels, including nuclear fuel and interchange energy.
- Earnings were penalized in the first half of the year by approximately 26¢ per share as a result

of the Salem unit being in service but not in the rate base. However, the recent rate increase corrected this situation for the second half of the year.

- Operating expenses were up only 3.6 percent over 1977 due mainly to higher electric output, higher gas fuel costs and increased depreciation, which were offset by the savings from increased nuclear generation. The Peach Bottom nuclear plant achieved a more than 75 percent capacity factor — a good performance in the industry.

The dividend was increased in mid-1977 and a full \$1.80 dividend was paid in 1978. PE has paid its regular common stock dividend since 1902. Forty-one percent of dividends paid on common stock during 1978 represents a return of capital for federal income tax purposes, and, therefore, is not taxable as ordinary dividend income.

In 1978, operating revenue was \$1.5 billion or 4.4 percent over the previous year due to higher electric, gas and steam sales and rate increases. Electric sales were one percent higher than last year and gas sales were up one percent. This sluggish growth is indicative of the economic problems of the region. The Company is adjusting to a slower growth rate by reducing its construction program and gearing operations to these reduced levels, while at the same time, an area development program is working to hold existing customers and to attract new business to the area.

Electric Rate Case

Management continues to have as an objective the establishment of prices for Company utility services that are equitable both to the rate payers and the shareholders. The Company will continue to employ all cost cutting efficiencies as long as they do not result in a reduction in the service reliability our customers desire and expect. Such policies should enable the Company to keep the price of its product at levels that are reasonable when compared to alternative energy sources and to general inflation, and will also earn a fair return for shareholders on their investment.

To secure such a return, on August 5, 1977 the Company filed for a \$116 million electric rate increase to provide for the cost associated with the \$600 million of additional plant installed since the completion of prior rate proceedings, and also to reimburse the Company for the inflationary increases in other expense categories.

The PUC granted an interim \$12 million increase which became effective on March 3, 1978, but the

remainder of the \$116 million request was suspended to July 4, 1978, the maximum suspension period allowed under the Law.

Hearings were concluded during June 1978, and the Administrative Law Judge in mid-November issued a recommendation for a \$73 million increase. The Company, in its exceptions to that proposed order, argued that the total increase was required to guarantee the future quality of service and that allowable 1977 expenses should not be denied by "after the fact" judgments.

On December 28, 1978 the PUC came to a final decision which granted a \$78.9 million increase retroactive to July 4, 1978.

Customer Growth and Reserve Capacity

In the late 60's, because of rapid load growth, the fear of "blackouts" was prevalent. Long lead times were needed to plan and build nuclear units which were the most economic source of energy available. Capacity planning to meet this anticipated load growth was prudently initiated, and in fact was encouraged by the Public Utility Commission in 1968. The Commission told the industry at that time to plan for a 10 percent per year load growth. However, the Company could not justify this high rate of growth and planned on the basis of approximately a 7 percent increase in yearly peak.

To meet this expected growth in customers' usage of electricity, the Company embarked on the largest expansion program in its history. From 1970 to 1978, \$2 billion was invested in new facilities which more than doubled plant investment.

The oil embargo of 1973-74 caused a significant and unpredicted change in world-wide economic growth and demand for energy which immediately affected customers' usage. As fuel prices soared, electric bills increased rapidly and customer conservation also became significant. As early as 1974 the Company realized that the lower load growth being experienced was not temporary in nature and the capacity planned would not be needed when originally scheduled. However, the high cost of oil made it economic to complete construction of the Peach Bottom and Salem nuclear units. The two Peach Bottom units went into service in 1974 and the first Salem unit in 1977. The second unit is scheduled for completion in 1979. Long range plans to build two nuclear units at Fulton were cancelled.

The availability of nuclear capacity has many advantages for customers. It produces substantial fuel cost savings and reduces dependence on imported oil. Today, the Company has the ability to serve existing customers with greater reliability and has the ability to accommodate new customer

growth without concern for blackouts or brownouts.

The continued sluggish growth in the economy of the eastern seaboard and conservation by customers has caused the Company to reduce the estimated rate of growth of electric kilowatt-hour sales and of kilowatt peak load to about 3 percent annually. Due to the reduced growth rate, the two Limerick nuclear generating units have been rescheduled to go in service in 1985 and 1987. The rescheduling of Limerick enabled the Company to reduce total construction expenditures for the next three years (1979-1981) from \$1.65 billion to \$1.40 billion, a reduction of \$250 million. At the end of 1978, the Limerick Station was approximately 42 percent complete.

In 1978, \$412 million was spent on the Company's construction program. Although expenditures for nuclear generating capacity accounted for about two-thirds of the construction dollar, the Company continues to provide additions and improvements to the transmission and distribution systems. The Company is dedicated, as in the past, to provide its customers with quality service at a high level of reliability.

The construction program also includes expenditures for uranium and gas exploration. Future sources of energy have been strengthened this year as the Company obtained uranium commitments to supply its nuclear units into the early 1990's. In addition, gas supplies have become more plentiful.

Coal Strike

The impact of the national strike by coal miners during the opening three months of 1978 was borne largely by the Company's Electric Production Department and the Purchasing and General Services Department. Coal supplies for the Eddystone Units 1 and 2 and Cromby Unit 1 had been stockpiled through the autumn in anticipation of the miners' strike. When the threat became reality the Company had a stockpile good for 100 days of coal-fired generation for the three units.

The availability of nuclear units at Peach Bottom and Salem, and the operation of oil-fired units, enabled the Company to operate during the coal strike without curtailments.

As the strike went on, Philadelphia Electric, normally a purchaser of economic coal-fired power from the Pennsylvania-New Jersey-Maryland Interconnection (PJM), supplied energy to the Interconnection. On January 10, with coal piles frozen solid on neighboring power systems, PE and PJM both set new winter peaks on a day of 50 MPH winds and near zero temperatures. PE's participation in

DOCKET NO. R-850152

R-850152 12/20/85
Hag-rx

RECEIVED

DEC 23 1985

SECRETARY'S OFFICE
Public Utility Commission

DEC 31 1985

DOCUMENT
FOLDER

Present:

PE - W. C. Astley
R. F. Holman
D. M. Hunt

Summary of Statements and Positions:

cannot afford and thus is no longer interested in ownership of a share of Limerick. Such ownership would require too much front end cash and annual progress payments. However, they expressed interest and a need for a temporary unit purchase of 200 mw of Limerick No. 1 for the years 1983 through 1986, and of 200 mw of Limerick No. 2 for the year 1985 through 1988.

PE is not interested in sale of ownership of a share of Limerick, since its cash flows are quite satisfactory with the present 1983-85 Limerick service dates. However, the PE reserves are such that it is agreeable to a temporary sale of 200 mw of Limerick No. 1 for 1983 through 1986, and 200 mw of Limerick No. 2 for 1985 through 1987. Reserves are inadequate for a 200 mw sale in 1988. The cost of such temporary sales would be at the total 2 unit plant cost, since so much common plant is capitalized with the first unit cost. Sale of PE capacity based on an FFC type rate was considered unacceptable to PE due to the apparent burden such a rate would place on PE customers, and has been dropped from further consideration by both companies.

is planning a large nuclear or coal fueled unit for 1987 service. For the unit to be nuclear, must share ownership of at least 300 mw with presumably PE. For a coal fired unit PE can share ownership if it wishes. A nuclear plant would be at and PE would own 300 mw of a 900 mw unit, or 600 mw of a 1200 mw unit. has solicited bids on a nuclear plant, and would aim for 1987 service. The alternative coal plant would be on the Some reference was also made to a 1989 or 90 unit at the same sites.

PE stated that ownership of a 300 mw share of a 1987 unit appears feasible when associated with temporary Limerick sales, but might require either some delayed payment of progress payments on , or possible advanced payment for the purchased Limerick capacity. Ownership of a 600 mw share of might result in excessive PE cash flows, and thus may not be a realistic alternative.

Summary

1. would purchase 200 mw of Limerick No. 1 from 1983 to 1986, and 200 mw of Limerick No. 2 from 1985 to 1987. In return PE would purchase ownership of 300 mw of for 1987 service.
2. will look into their capability to advance pay for capacity or to defer PE payments for , but are awaiting data on what and when these payments might be.

DMH:tms
8/17/76

David M. Hunt

OCA EXHIBIT NO. 70

DOCKET NO. R-850152

R-850152 12/20/88

Hly JZ

RECEIVED

DO NOT
SECRETED
SECRETARY'S OFFICE
DECEMBER 21 1988
Commission

DO NOT
FOLDER

PHILADELPHIA ELECTRIC COMPANY

2301 MARKET STREET

PHILADELPHIA, PA. 19101

(215) 841-5800

JOHN H. AUSTIN, JR.
VICE PRESIDENT

March 18, 1977

Mr. Lorin H. Drennan, Jr., Chief Accountant
Federal Power Commission
825 N. Capitol Street, NE
Washington, DC 20426

Dear Mr. Drennan:

Re: Common Facilities at Large Plants

Philadelphia Electric Company is a joint owner with Public Service Electric and Gas Company, Atlantic City Electric and Delmarva Power and Light in the Salem Nuclear Generating Station which is now under construction in New Jersey. The station consists of two nuclear-powered units with a capacity of 1,100,000 kilowatts each. Unit #1 is expected to be placed in commercial operation in the first half of 1977 and Unit #2 is expected to go in commercial operation sometime in 1979. PE's 42.5% share of the estimated final cost (including AFDC) of the plant is as follows. (Figures are only approximate.)

| | |
|---|---------------|
| Costs Directly Assignable to Unit #1 | \$200 million |
| Costs Directly Assignable to Unit #2 | 250 " |
| Costs of Facilities Common to #1 and #2 Units | <u>150</u> " |
| Total Cost (PE Share) | \$600 " |

The purpose of this letter is to inform you of our plans for accounting for the common facilities associated with the Salem units. The common facilities, which will cost approximately \$150 million as indicated above, consist of yard improvements, buildings (auxiliary, turbine generator, service and administration), various tunnels, storage tanks, auxiliary systems and plant equipment which is being installed to service both the #1 and #2 Units.

When the Salem #1 Unit is placed in commercial operation in 1977, we will transfer the investment directly assignable to the #1 Unit and the entire \$150 million investment in common facilities from Account 107 to Account 101. However, in order to conform to the Pennsylvania Public Utility Commission's (PUC) ratemaking policy regarding common facilities we will continue to accrue AFDC on 50% of the common facilities investment until such time as the #2 Unit is placed in commercial operation, now estimated to be in 1979, and we will assign such accrual to the Unit #2 facilities. Because of practical problems of maintaining vintage plant records, depreciation expense will be accrued on the entire common facilities. However, in any rate proceeding in which the test year does not include the #2 Unit, the Company will deduct one-half of the common facilities from rate base so that we will not obtain a return from revenue while we are continuing to accrue AFDC on that investment.

This accounting will conform to the Pennsylvania PUC's present policy of allowing only half of common facilities in rate base when the first unit of a large two-unit station is placed in service, and of allowing AFDC to continue on the remaining common facilities until such time as the second unit is placed in commercial operation.

BACKGROUND

The PUC first adopted this policy in its order dated March 25, 1975 at R.I.D. 129 involving PE's requested \$136 million electric rate increase. In that rate case the test year was the 12 months ending June 30, 1974 and rate base was based on plant in service at the end of the test year. As an adjustment to rate base, the Company had requested the Commission to include \$218 million for its 42.49% share of the Peach Bottom Nuclear Unit #2 which entered commercial operation on July 5, 1974, five days after the end of the test year. The requested plant addition included approximately \$100 million for the entire common facilities at the Peach Bottom station. Peach Bottom Nuclear Unit #3, which is a twin of the #2 Unit, was placed in service in December 1974 but was not included in rate base and was not an issue in that case.

In its order the PUC included Peach Bottom #2 in rate base but excluded one-half, or \$50 million, of the common plant. Attached Item A is a copy of pages 21, 22 and 23 from the Commission's order dated March 25, 1975 which discusses the Commission's disallowance of one-half of the common facilities on the ground that the #3 Unit was not in service at the end of that test year.

Subsequent to that order, the PUC has taken a similar position on the identical issue of common facilities at the Three Mile Island Station (TMI) in its June 2, 1976 order for an electric rate increase by the Pennsylvania Electric Company at R.I.D. 172 and 173 and also in its order of June 22, 1976 involving a rate increase of the Metropolitan Edison Company at R.I.D. 172 and 173. Item B is a copy of page 10 from the June 2, 1976 order and Item C is a copy of pages 10, 11 and 12 from the June 22, 1976 order. In both of these orders where the first unit was in service but the second unit was still under construction, the PUC also disallowed one-half of the common facilities of the two-unit nuclear plant. Furthermore, the PUC has stated, "We agree with both complainant and respondent that the AFDC on disallowed common plant should be allowed to continue for rate case purposes until the second unit becomes operational. In future rate proceedings, we will give consideration to AFDC on the disallowed portion of the common plant for the period of time between the commercial service dates of Unit #1 and Unit #2 at TMI."

In light of this clear ratemaking policy which has been established by the PUC in three consecutive rate orders, it is obvious that the PUC will also allow only one-half of Salem's common facilities in rate base when the Salem Unit #1 is placed in service and for future rate purposes it also will allow AFDC to be accrued on the remaining common facilities until Unit #2 goes into commercial production.

DISCUSSION

We believe that the above-described accounting is proper for Philadelphia Electric Company because it provides a better matching of costs and revenues and because it also meets the economic objective of allocating large common costs in proportion to savings and benefits of sequentially installed units.

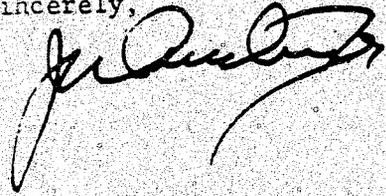
The Pennsylvania Public Utility Commission has jurisdiction over approximately 98% of the Company's revenues, and, therefore, its ratemaking policy should be given considerable weight in the interpretation of the System of Accounts. Unless the Company continues to accrue AFDC on its investment in one-half of the Salem common plant, there will be a period of several years during which there will be no earnings to offset the capital charges on this substantial investment. Such a condition would represent a permanent loss to the shareholders and would further adversely affect the market for the Company's securities.

Although cash flow would benefit if all of the common facilities were included in rate base when the Unit #1 is placed in service, it must be recognized that the common facilities are designed and sized to service both units. Thus, it is clearly evident that some portion of the common plant in fact does not go into service until the second unit is in service; and from a physical point of view a reasonable rule is that this portion amounts to one-half.

The accounting convention which has been followed heretofore of treating the entire common plant as though it were in service when only the first unit goes into service originated during the pre-nuclear period. At that time the cost of common facilities was usually a lesser proportion of the total cost of a multi-unit plant, and the time interval between the service dates of the several units was much less than it is now due to construction, permit and financing delays. For example, it is estimated that there will be an approximate 2-1/2 year interval between the service dates of the two Salem units whereas there used to be only a few months' difference. Appropriate plant accounting must recognize and adapt to changing economic conditions and regulatory rulings.

Please acknowledge receipt of this letter and let me know if you or members of your staff have comments or questions regarding this matter.

Sincerely,



cc: Mr. B. T. Helhowski, Director, Bureau of Rates
and Research, Pennsylvania Public Utility Commission

OCA EXHIBIT NO. 71

DOCKET NO. R-850152
R-850152 12/20/85
Hbg rx

RECEIVED

DEC 26 1985

SECRETARY'S OFFICE
Public Utility Commission

RECORDED
DEC 31 1985

DOCUMENT
FOLDER

Q. IR-OCA-3-5. Please describe all actions which were taken by PECO stockholders (e.g., votes on shareholder resolutions at annual meetings, etc.), from 1974 to the present, concerning PECO's continued involvement in the Limerick project. Please provide copies of all proxy statements and other documents describing the position of PECO management with respect to such actions, proposals, etc.

A. IR-OCA-3-5. Listed below are the attachments included herewith of copies of the pertinent portions of the proxy statements and the report of the annual meetings from 1980 until 1985 which describe actions which were taken by PECO stockholders concerning PECO's continued involvement in the Limerick project and the position of PECO management with respect to such actions, proposals, etc.

Attachment IR-OCA-3-5(a) - Voting at Annual Meetings on the Limerick Proposal
Attachment IR-OCA-3-5(b) - Notice of Annual Meeting - April 10, 1985
Attachment IR-OCA-3-5(c) - Report of Annual Meeting - April 10, 1985
Attachment IR-OCA-3-5(d) - Notice of Annual Meeting - April 11, 1984
Attachment IR-OCA-3-5(e) - Report of Annual Meeting - April 11, 1984
Attachment IR-OCA-3-5(f) - Notice of Annual Meeting - April 13, 1983
Attachment IR-OCA-3-5(g) - Report of Annual Meeting - April 13, 1983
Attachment IR-OCA-3-5(h) - Notice of Annual Meeting - April 14, 1982
Attachment IR-OCA-3-5(i) - Report of Annual Meeting - April 14, 1982
Attachment IR-OCA-3-5(j) - Notice of Annual Meeting - April 1, 1981
Attachment IR-OCA-3-5(k) - Report of Annual Meeting - April 1, 1981
Attachment IR-OCA-3-5(l) - Notice of Annual Meeting - April 9, 1980
Attachment IR-OCA-3-5(m) - Report of Annual Meeting - April 9, 1980

During the period 1974 through 1979, no shareholder resolutions were presented for shareholder action concerning PECO's continued involvement in the Limerick project.

Responsible Witness: J.F. Paquette, Jr., Vice President

Voting on Limerick Proposal

| | | Votes Cast | | | |
|------|----|------------|----------|----------|-----------|
| | | For | Against | Abstain | |
| 1980 | 1 | | | | |
| | 2 | 3702319 | 46616817 | 4802624 | 55121760 |
| | 3 | | | | |
| 1981 | 4 | 4684775 | 57618170 | 2630686 | 64933631 |
| | 5 | | | | |
| 1982 | 6 | 7477188 | 64022961 | 4693710 | 76193859 |
| | 7 | | | | |
| 1983 | 8 | 8835758 | 77235006 | 6255104 | 92325868 |
| | 9 | | | | |
| 1984 | 10 | 12833545 | 82607502 | 7217807 | 102658854 |
| | 11 | | | | |
| 1985 | 12 | 13720305 | 95914399 | 10528999 | 120163703 |
| | 13 | | | | |
| | 14 | | | | |
| | 15 | | | | |
| | 16 | | | | |
| | 17 | | | | |
| | 18 | | | | |
| | 19 | | | | |
| | 20 | | | | |
| | 21 | | | | |
| | 22 | | | | |
| | 23 | | | | |
| | 24 | | | | |
| | 25 | | | | |
| | 26 | | | | |
| | 27 | | | | |
| | 28 | | | | |
| | 29 | | | | |
| | 30 | | | | |
| | 31 | | | | |
| | 32 | | | | |
| | 33 | | | | |
| | 34 | | | | |
| | 35 | | | | |
| | 36 | | | | |
| | 37 | | | | |
| | 38 | | | | |
| | 39 | | | | |
| | 40 | | | | |
| | 41 | | | | |
| | 42 | | | | |
| | 43 | | | | |
| | 44 | | | | |
| | 45 | | | | |
| | 46 | | | | |
| | 47 | | | | |
| | 48 | | | | |
| | 49 | | | | |
| | 50 | | | | |
| | 51 | | | | |
| | 52 | | | | |

documents which support and are reported in OCA Exhibit No. 27 (IR-OCA-1-26). As part of the response to this question include the inputs and the input assumptions relied on by the Company to develop this information.

4
R-850152
Heg
12/20/85
JK

This data request response should also include the following requests raised on cross-examination of PECO Witness Hill on 12-13-85. All relate to OCA Exh. 27 (IR-OCA-1-26):

RECEIVED

1. Define "other" under "construction expenditures".
2. Define "other" under "internal sources".
3. Define "other" under "outside financing" specifically identify what the \$200 million figure under the 1986 forecast represents.
4. Footnote 1 - The footnote states that the forecast anticipates revenues in the forecast years will be "sufficient to support construction expenditures internal sources of cash flow and financing". What growth rate in annual revenues is assumed to support this statement? What rate of return? What interest coverage?
5. Footnote 5 - The footnote states the "objective" of the financing plan is to "maintain maximum financial flexibility" and "assure ready access to required capital at reasonable cost". How does this objective affect anticipated revenues? Interest coverage? Rate of Return?

DEC 26 1985

SECRETARY'S OFFICE
Public Utility Commission

DOCKETED
DEC 31 1985

DOCUMENT
FOLDER

6. Footnote 6 - What rate for capitalizing APUDC was assumed for each of the forecast years? What was assumed with respect to capital structure? Cost of capital?
7. Footnote 6 - What was the GWIP balance assumed for each forecast year?
8. Footnote 7 - What amounts of investment tax credit are assumed to be carried forward each year of the forecast? How is the amount carried forward reflected in the forecast? What ITC rate is actually utilized in the forecast, by year?
9. On Forecast Sheet - Under "sources of capital/outside financing" what are the costs associated with each of the issuances for:
 - a. long-term debt/"other-net"
 - b. preferred stock
 - c. short term debt
10. Under significant income items please provide workpapers and calculations for the forecast values for "income tax reductions allocated to construction"
11. Please provide workpapers and calculations for the forecast values for the line item "deferred federal income taxes from liberalized depreciation".

A. DR-TPH1-GEC(12/13/85)

The information reported in OCA Exhibit No. 27 is supported by the Company's on-line budgeting and forecast system and is based upon data submitted by the approximately 165 responsible areas. Assumptions supporting the forecast data are presented in the Notes to the Financial Analyst Forecast Information (OCA Exhibit No. 27) and the budget instruction letter (DR-Staff-REB-4a). 

requests:

1. "Other" in the construction expenditure category refers to common plant and steam plant.
2. Other under Internal Sources includes deferred income taxes, investment tax credits, retained earnings and other miscellaneous items charged to expense in excess of cash.
3. The \$200 million figure under "Other" outside financing in the 1986 forecast represents the assumed sale of nuclear fuel designated for the Limerick Generating Station.
4. No specific assumptions with regard to growth rate in annual revenues, rate of return or interest coverage were made or are necessary to support the statement.
5. The objective has no direct impact on revenues, interest coverage or rate of return.
6. The AFUDC rates used for the forecast periods are as follows:

| | |
|------|------|
| 1986 | 9.6% |
| 1987 | 9.7 |
| 1988 | 9.8 |
| 1989 | 9.9 |

The Capital Structure assumed in the AFUDC rate calculations is as follows:

| | |
|-----------------|---------------|
| Long-term Debt | 51.1% |
| Preferred Stock | 12.4 |
| Common Equity | 36.5 |
| Total | <u>100.0%</u> |

The cost rate assumptions in the AFUDC calculations are as follows:

| | 1986 | 1987 | 1988 | 1989 |
|------------------|--------|--------|--------|--------|
| Short-term Debt | 11.50% | 11.50% | 11.50% | 11.50% |
| Long-term Debt* | 11.57 | 11.84 | 12.01 | 12.15 |
| Preferred Stock* | 10.04 | 10.20 | 10.28 | 10.35 |
| Common Equity | 15.50 | 15.50 | 15.50 | 15.50 |

*Embedded Cost

7. The CWIP balances assumed for each forecast year were as follows:

| | |
|------|-----------------|
| 1986 | \$2,430,866,000 |
| 1987 | 3,013,970,000 |
| 1988 | 3,730,179,000 |
| 1989 | 4,244,865,000 |

8. The forecast reflects Investment Tax Credits to the extent utilized. (See Note 7 of OCA-Exhibit 27). The amounts of Investment Tax Credit carried forward for each of the forecast years are indicated in the following table:

| | (\$ Millions) | | | |
|-------------------------------|---------------|------|------|------|
| | 1986 | 1987 | 1988 | 1989 |
| Amount of ITC Carried Forward | 144 | 120 | 29 | -0- |

9. The costs of capital assumed for outside financings were as follows:

| | |
|-----------------|-----|
| Long-term Debt | 14% |
| Preferred Stock | 14% |
| Short-term debt | 12% |

10. Income Tax reductions allocated to construction were computed as follows:

| | (\$000) | | | |
|------------------------------|-----------|-----------|-----------|-----------|
| | 1986 | 1987 | 1988 | 1989 |
| Allowance for Borrowed Funds | \$135,000 | \$152,000 | \$187,000 | \$221,000 |
| Composite Tax Rate | .5092 | .5092 | .5092 | .5092 |
| Income Tax Reductions | \$ 68,742 | \$ 77,398 | \$ 95,220 | \$113,042 |

11. Deferred Federal Income Taxes from liberalized depreciation were computed as follows:

| | (\$000) | | | |
|-------------------------|-----------|-----------|-----------|-----------|
| | 1986 | 1987 | 1988 | 1989 |
| Base | \$275,000 | \$280,000 | \$242,000 | \$277,000 |
| Effective Fed. Tax Rate | .418659 | .418659 | .418659 | .418659 |
| Def. Fed. Income Tax | \$115,000 | \$117,000 | \$101,000 | \$116,000 |

Responsible Witness: J.F. Paquette, Jr., Vice President
Finance and Accounting