CLERK
SUPREME COURT OF VIRGINIA
RECEIVED
DEC 20 1978
RICHMOND, VIRGINIA

IN THE SUPREME COURT OF VIRGINIA

AT RICHMOND

COMMONWEALTH OF VIRGINIA, EX REL., OFFICE OF ATTORNEY GENERAL,	)	
Appellant,	)	
v.	)	RECORD NO. 781477 SCC CASE NO. 19810
THE POTOMAC EDISON COMPANY AND STATE CORPORATION COMMISSION OF VIRGINIA,	)	
Appellees.	)	

APPENDIX

Marshall Coleman
Attorney General of Virginia
Supreme Court Building
Richmond, Virginia 23219

Donald G. Owens
Assistant Attorney General
Shockoe Center Building,
Suite 308
11 South Twelfth Street
Richmond, Virginia 23219

Counsel for Appellant,
COMMONWEALTH OF VIRGINIA,
EX. REL., OFFICE OF
ATTORNEY GENERAL

IN THE SUPREME COURT OF VIRGINIA

AT RICHMOND

COMMONWEALTH OF VIRGINIA, EX REL., OFFICE OF ATTORNEY GENERAL,	)	
Appellant,	)	
v.	)	RECORD NO. 781477 SCC CASE NO. 19810
THE POTOMAC EDISON COMPANY AND STATE CORPORATION COMMISSION OF VIRGINIA,	)	
Appellees.	)	

APPENDIX

Marshall Coleman
Attorney General of Virginia
Supreme Court Building
Richmond, Virginia 23219

Donald G. Owens
Assistant Attorney General
Shockoe Center Building,
Suite 308
11 South Twelfth Street
Richmond, Virginia 23219

Counsel for Appellant,
COMMONWEALTH OF VIRGINIA,
EX. REL., OFFICE OF
ATTORNEY GENERAL

TABLE OF CONTENTS

Pleadings and Orders

Page

Application of The Potomac Edison Company for a Surcharge Increase in Rates, SCC Case No. 19810. 1

Order of February 17, 1977 in SCC Case No. 19810. 14

Order of April 1, 1977 in SCC Case No. 19810. 19

Application of The Potomac Edison Company for an Increase in Rates, as Supplemented, SCC Case No. 19810. 22

Order of July 6, 1977 in SCC Case No. 19810. 28

Application of the Potomac Edison Company for an Emergency Increase in Rates and Proposed Tariff. 35

Interim Order of February 10, 1978 in SCC Case No. 19810. 42

Interim Order of February 13, 1978 in SCC Case No. 19810. 45

Final Order of February 14, 1978 in SCC Case No. 19955. 48

Opinion and Final Order of June 13, 1978 in SCC Case No. 19810. 51

Revised Tariffs, Schedules A, R, TE, RA, W, C, C-A, of the Potomac Edison Company Filed Pursuant to Order of June 13, 1978 in SCC Case No. 19810. 70

Assignments of Error Filed Pursuant to Rule 5:18(i) of the Rules of the Supreme Court of Virginia. 80

Exhibits

Exhibits introduced into evidence on March 28, 1977:

Exhibit JWN-1, Pages 1-13 and Attachment Exhibits 1-3, 6 (pages 1-2), 7-11. 82

Exhibit EMV-5, Pages 7-8 and Attachment 1. 105

Exhibit JRW-6, Pages 6-9 and Attachment 5. 109

Exhibits introduced into evidence on October 4 and 5, 1977:

Exhibit JMM-1, Pages 2, 4-5. 114

Exhibit JWN-2, Schedules 3, 4 (pages 1-2), 5-6, 8. 117

Exhibit CSM-4, Tables 1, 2 (pages 1-3), 3-4 and Schedule 5. 123

Exhibit FJH-6, Schedules 1-16. 130

Exhibit JRW-10, Attachment 1. 159

Exhibit SFL-9, Statements I, II (pages 1-3), V. . . . 160

Portions of Transcript taken at Hearing of March 28, 1977 and October 4 and 5, 1977

Hearing of March 28, 1977:

Opening Remarks of Commissioner Preston Shannon. 165

Opening Statement of John W. Riely. 167

Testimony of James W. Nicol. 171

Testimony of Edward M. Vassar. 186

Hearing of October 4 and 5, 1977:

Testimony of John M. McCardell. 191

Testimony of James W. Nicol. 210

Testimony of Frank J. Hanley. 222

Testimony of S. Frank Leis. 256

Testimony of Charles S. Mullett. 258

Testimony of James R. Wittine. 284

Rebuttal Testimony of Frank J. Hanley. 302

JOHN M. McCARDELL
Executive Vice President
and General Manager

The Potomac Edison Company

Downsville Pike
Hagerstown, Maryland 21740

January 10, 1977

JAN 1977
2 PM
STATE CORPORATION COMMISSION

Virginia State Corporation Commission
Blanton Building
P.O. Box 1197
Richmond, Virginia 23209

Gentlemen:

The Potomac Edison Company applies by this letter for an increase in its rates and charges in the amount of $1,092,574. In support of this application, Potomac encloses Exhibits 1 through 10.

Exhibits 1 through 5 which are identical with the annual report submitted by the Company on December 27, 1976 cover the actual figures for the 12 months ended September 30, 1976, and projections for the 12 months ended September 30, 1977.

Exhibit No. 6 consisting of two pages details the going level adjustments to the 12 month test period ending September 30, 1976 which are necessary to properly reflect the Company's financial condition. The Company believes all adjustments are consistent with principles established by the Commission.

Exhibit No. 7 shows the rate of return for the Company during the test period. Column 1 of the exhibit reflects the figures in the Company's annual review filing being also Exhibits 1 through 5 hereof. Column 2 shows the Virginia allocation of the adjustments detailed on Exhibit No. 6. Column 3 shows the adjusted total of such figures and demonstrates that the Company has a rate of return of only 8.01% on this basis for the test period. Column 4 shows the increase of $1,092,574 needed to bring the rate of return up to the 8.75% established by the Commission in Potomac's previous Case No. 19410. Column 5 shows the adjusted total of Column 3 pro formed to earn this 8.75% rate of return.

The Commission in its order of October 31, 1972, Case No. 19139, stated: "There is no justification for offering special lower rates for space heating and water heating." It directed the Company to plan to eliminate special rates to customers with water heating and space heating facilities. Such special rates are designated as Schedules "R-A", "C-A" and "W." On May 31, 1974 Monterey Utilities Corporation was merged into The Potomac Edison Company with Commission approval and Monterey Schedules "A" and "T-E" were retained with the understanding that the

directive would also apply to both of these schedules. The Company has begun implementation of the directive by closing these schedules to new customers and by increasing these schedules more than others in Case No. 19410.

In order to continue implementing the Commission directive the Company proposes to institute a surcharge for said Schedules "R-A", "C-A", "W", "A" and "T-E" which is twice that requested for the Company's other schedules. The proposal is consistent with the surcharge granted by order dated July 31, 1974 pending application and hearings for the increase in Case No. 19410. In its next rate proceeding the Company will continue to implement the Commission's directive by narrowing the remaining differential between these closed rates and the Company's corresponding rates for general service to residential and commercial customers.

The Company requires additional revenues in the amount of $1,092,574 at the earliest practicable date in order to maintain its financial health and its capacity to render adequate public service to its Virginia customers. To obtain these revenues, the Company proposes a surcharge of 4.274% for all schedules except those Special Schedules designated above which would have a surcharge of 8.548%. As shown on Exhibit No. 8, the surcharge is designed to achieve the additional revenues required. To effect this surcharge the Company files herewith as Exhibit No. 9 original page 6-2 of the Company's tariff setting forth the surcharge. The Company also files as Exhibit No. 10, First Revision of Original Page 3-1 of its tariff amending the index page to show the inclusion of the surcharge.

The rate of return established in Case No. 19410 is inadequate under present circumstances. The Company, however, is in immediate need of rate relief and has designed the enclosed tariff filing on the conservative basis of merely restoring the Company's Virginia earnings to that level of return. The substantial disparity on this basis between authorized and achieved returns clearly shows the inadequacy of the Company's present rates and charges. The Potomac Edison Company requests institution of appropriate Commission proceedings to make the tariff surcharge filed herewith applicable to all service as soon as possible but no later than March 1, 1977.

Very truly yours,

John M. McCardell

John M. McCardell
Executive Vice President
and General Manager

JMM:pls
Enclosures

THE POTOMAC EDISON COMPANY

Projected and Actual Rate of Return - End of Period Rate Base
Twelve Months Ended September 30, 1976

2PM

ne o.		Projected (a) Total Company Col. 1	Projected (a) Virginia Jurisdiction Col. 2	Actual Total Company Col. 3	Actual Virginia Jurisdiction Col. 4
		(Thousands of Dollars)			
	Adjusted Net Operating Income				
1	Electric Operating Revenues	$215,606	$ 30,352	$201,409	$ 28,505
	Operating Expenses				
2	Operation and Maintenance	$135,926	$ 17,632	$121,725	$ 16,083
3	Depreciation and Amortization	15,912	2,412	15,912	2,510
4	Taxes Other Than Federal Income	12,691	1,863	11,813	1,882
5	Investment Credit Deferred, Net	3,066	429	3,067	483
6	Income Taxes Deferred	3,567	453	3,695	606
7	Amortization of Deferred Taxes	(1,060)	(142)	(1,056)	(166)
8	Total	$170,102	$ 22,647	$155,156	$ 21,398
9	Federal Income Tax	7,245	1,488	7,684	1,065
0	Total Operating Expenses	$177,347	$ 24,135	$162,840	$ 22,463
1	Net Operating Income	$ 38,259	$ 6,217	$ 38,569	$ 6,042
2	Allowance For Funds During Construction	685	-	705	-
13	Charitable Contributions After Income Taxes	(16)	(2)	(18)	(3)
14	Adjusted Operating Income	$ 38,928	$ 6,215	$ 39,256	$ 6,039
	Rate Base - End of Period				
15	Electric Plant	$583,474	$ 86,089	$582,965	$ 90,951
16	Accumulated Provision for Depreciation	(136,945)	(20,400)	(136,235)	(22,357)
17	Net Electric Plant	$446,529	$ 65,689	$446,730	$ 68,594
18	Fuel in Stock	12,094	1,418	13,016	1,749
19	Materials and Supplies	5,199	839	5,240	837
20	Working Capital	16,038	2,894	14,450	2,713
21	Total Rate Base	$479,860	$ 70,840	$479,436	$ 73,893
22	Rate of Return		8.77%		8.17%

(a) As filed in last years annual review filing.

THE POTOMAC EDISON COMPANY

Projected Rate of Return - End of Period Rate Base
Twelve Months Ended September 30, 1977

Line No.		Total Company Col. 1	Virginia Jurisdiction Col. 2
		(Thousands of Dollars)	
	Adjusted Net Operating Income		
1	Electric Operating Revenues	$ 213,430	$ 29,726
	Operating Expenses		
2	Operation and Maintenance	$ 139,257	$ 17,823
3	Depreciation and Amortization	16,899	2,631
4	Taxes Other Than Federal Income	14,338	2,284
5	Investment Credit Deferred, Net	6,767	1,052
6	Income Taxes Deferred	3,991	621
7	Amortization of Deferred Taxes	(1,322)	(206)
8	Total	$ 179,930	$ 24,205
9	Federal Income Tax	(1,533)	(89)
10	Total Operating Expenses	$ 178,397	$ 24,116
11	Net Operating Income	$ 35,033	$ 5,610
12	Allowance for Funds During Construction	2,303	-
13	Charitable Contributions After Income Taxes	(18)	(3)
14	Adjusted Operating Income	$ 37,318	$ 5,607
	Rate Base - End of Period		
15	Electric Plant	$ 669,647	$101,690
16	Accumulated Provision For Depreciation	(149,668)	(24,308)
17	Net Electric Plant	$ 519,979	$ 77,382
18	Fuel in Stock	17,749	2,315
19	Materials and Supplies	5,240	829
20	Working Capital	16,477	2,984
21	Total Rate Base	$ 559,445	$ 83,510
22	Rate of Return		6.71%

Exhibit 3

THE POTOMAC EDISON COMPANY

Capital Structure Statements
September 30, 1976 Projected and Actual -
September 30, 1977 Projected

Line No.		September 30, 1976 Projected[a] Col. 1	September 30, 1976 Actual Col. 2	Sept. 30, 1977 Projected Col. 3
		(Thousands of Dollars)		
1	Long-Term Debt	$ 204,500	$ 229,500	$ 229,500
2	Short-Term Debt	3,500	-	30,900
3	Long-Term Unsecured Lease Obligation	7,591	5,406	4,949
4	Long-Term Installment Purchase Obligation	-	2,419	2,163
5	Long-Term Note	-	-	5,000
6	Total Debt	$ 215,591	$ 237,325	$ 272,512
7	Preferred Stock	58,099	58,048	57,988
8	Common Equity	162,843	152,834	180,608
9	Job Development Credits	10,164	10,166	17,082
10	Tax Deferrals	13,434	14,649	17,169
11	Total Capital	$ 460,131	$ 473,022	$ 545,359

(a) As filed in last years annual review filing.

THE POTOMAC EDISON COMPANY

Rates of Return on Average Rate Bases
Twelve Months Ended September 30, 1976 and 1977

Line No.		Projected[a] 12 Months Ended 9-30-76 Total Company Col. 1	Projected[a] 12 Months Ended 9-30-76 Virginia Jurisdiction Col. 2	Actual 12 Months Ended 9-30-76 Total Company Col. 3	Actual 12 Months Ended 9-30-76 Virginia Jurisdiction Col. 4	Projected 12 Months Ended 9-30-77 Total Company Col. 5	Projected 12 Months Ended 9-30-77 Virginia Jurisdiction Col. 6
		(Thousands of Dollars)					
	Adjusted Net Operating Income						
1	Electric Operating Revenues	$ 215,606	$ 30,352	$ 201,409	$ 28,505	$ 213,430	$ 29,726
	Operating Expenses						
2	Operation and Maintenance	$ 135,926	$ 17,632	$ 121,725	$ 16,083	$ 139,257	$ 17,823
3	Depreciation and Amortization	15,912	2,412	15,912	2,510	16,899	2,631
4	Taxes Other Than Federal Income	12,691	1,863	11,813	1,882	14,338	2,284
5	Investment Credit Deferred, Net	3,066	429	3,067	483	6,767	1,052
6	Income Taxes Deferred	3,567	453	3,695	606	3,991	621
7	Amortization of Deferred Taxes	(1,060)	(142)	(1,056)	(166)	(1,322)	(206)
8	Total	$ 170,102	$ 22,647	$ 155,156	$ 21,398	$ 179,930	$ 24,205
9	Federal Income Tax	7,245	1,488	7,684	1,065	(1,533)	(89)
10	Total Operating Expenses	$ 177,347	$ 24,135	$ 162,840	$ 22,463	$ 178,397	$ 24,116
11	Net Operating Income	$ 38,259	$ 6,217	$ 38,569	$ 6,042	$ 35,033	$ 5,610
12	Allowance For Funds During Construction	685	-	705	-	2,303	-
13	Charitable Contributions After Income Taxes	(16)	(2)	(18)	(3)	(18)	(3)
14	Adjusted Operating Income	$ 38,928	$ 6,215	$ 39,256	$ 6,039	$ 37,318	$ 5,607
	Rate Base - Thirteen Month Average						
15	Electric Plant	$ 556,548	$ 82,285	$ 552,410	$ 86,541	$ 626,306	$ 95,515
16	Accumulated Provision For Depreciation	(130,041)	(19,355)	(128,830)	(21,185)	(142,952)	(23,217)
17	Net Electric Plant	$ 426,507	$ 62,930	$ 423,580	$ 65,356	$ 483,354	$ 72,298
18	Fuel in Stock	13,025	1,527	14,042	1,887	15,382	2,006
19	Materials and Supplies	5,152	837	5,134	839	5,240	829
20	Working Capital	15,839	2,695	14,239	2,506	16,438	2,945
21	Total Rate Base	$ 460,523	$ 67,989	$ 456,995	$ 70,588	$ 520,414	$ 78,078
22	Rate of Return		9.14%		8.56%		7.18%

(a) As filed in last years annual review filing.

THE POTOMAC EDISON COMPANY

Cost of Capital Based on Average Capital
Twelve Months Ended September 30, 1976 and 1977

	Average Amount	Percentage	Average Cost	Return Component
	Col. 1	(%) Col. 2 (b)	(%) Col. 3	(%) Col. 4
Thirteen Month Average Ending September 30, 1976 Projected				
Long-Term Debt	$202,192,308	45.9	7.20	3.30
Short-Term Debt	12,675,462	2.9	7.87	.23
Long-Term Unsecured Lease Obligation	7,216,601	1.6	5.61	.09
Total Debt	$222,084,371	50.4		3.62
Preferred Stock	47,737,395	10.9	7.21	.79
Common Equity	149,798,698	34.0	12.00 (a)	4.08
Job Development Credits	8,381,743	1.9	12.00 (a)	.23
Tax Deferrals	12,270,074	2.8		-
Total Capital	$440,272,281	100.0		8.72
Thirteen Month Average Ending September 30, 1976 Actual				
Long-Term Debt	$209,884,615	47.1	7.38	3.48
Short-Term Debt	11,152,385	2.5	7.33	.18
Long-Term Unsecured Lease Obligation	5,634,740	1.3	5.33	.07
Long-Term Installment Purchase Obligation	1,521,124	.3	5.03	.02
Total Debt	$228,192,864	51.2		3.75
Preferred Stock	47,706,003	10.7	7.08	.76
Common Equity	148,587,812	33.3	12.00 (a)	4.00
Job Development Credits	8,383,612	1.9	12.00 (a)	.23
Tax Deferrals	13,169,767	2.9		-
Total Capital	$446,040,058	100.0		8.74
Thirteen Month Average Ending September 30, 1977 Projected				
Long-Term Debt	$229,500,000	45.1	7.56	3.41
Short-Term Debt	15,450,000	3.0	6.25	.19
Long-Term Unsecured Lease Obligation	5,177,840	1.0	5.06	.03
Long-Term Installment Purchase Obligation	2,291,050	.5	5.00	.03
Long-Term Note	2,500,000	.5	7.00	.04
Total Debt	$254,918,890	50.1		3.70
Preferred Stock	58,018,084	11.4	7.54	.86
Common Equity	166,720,748	32.7	12.00 (a)	3.92
Job Development Credits	13,624,266	2.7	12.00 (a)	.32
Tax Deferrals	15,909,155	3.1		-
Total Capital	$509,191,143	100.0		8.80

(a) Allowed in Case No. 19410
(b) As filed in last years annual review filing.

THE POTOMAC EDISON COMPANY

ADJUSTMENTS TO TEST PERIOD

Adjustment No.	Description	Total Company	Allocated to Virginia
	Operating Revenues		
1	To adjust revenue for sales to other utilities to a normal level.	$(2,324,507)	$(290,762)
	Operation and Maintenance Expense		
2	To adjust expenses related to Adjustment 1.	$(1,952,304)	$(244,205)
3	To annualize expenses associated with wage increases during the test year.	681,914	106,106
4	To annualize expenses associated with reduction of personnel	(88,373)	(13,751)
5	To annualize the capacity charge of the Power Supply Agreement to the price in effect at January 1, 1976	74,838	10,055
	Total Operation and Maintenance Expense	$(1,283,935)	$(141,795)
	Taxes Other Than Federal Income		
6	State income tax on above adjustments	$ (13,527)	$ (670)
7	To adjust for the West Virginia property tax credit recorded in December 1975 of the test year but applicable to prior periods	697,960	109,921
	Total Taxes Other Than Federal Income	$ 684,433	$ 109,251
	Federal Income Taxes		
8	Federal Income Taxes on Adjustments 1 through 6	$ (492,982)	$ (71,183)

THE POTOMAC EDISON COMPANY

ADJUSTMENTS TO TEST PERIOD

Adjustment No.	Description	Total Company	Allocated to Virginia
	Income Taxes Deferred		
9	To adjust deferred taxes for the normalization effect of adjustment 7.	$ (421,300)	$ (66,350)
	Rate Base - Cash Working Capital		
10	Decrease due to adjustments to operation and maintenance expenses	$ (142,659)	$ (15,755)

THE POTOMAC EDISON COMPANY - VIRGINIA JURISDICTION

RATE OF RETURN

TWELVE MONTHS ENDED SEPTEMBER 30, 1976

Line No.		Column 1 Per Books(1)	Column 2 Adjustments(2)	Column 3 Adjusted Total	Column 4 Increase Needed To Earn 8.75% Rate of Return	Column 5 Pro-Formed To Earn 8.75% Rate of Return
	Adjusted Net Operating Income					
1	Electric operating revenues	$28,504,811	$ (290,762)	$28,214,049	$1,092,574(3)	$29,306,623
	Operating expenses:					
2	Operation and maintenance	$16,083,386	$ (141,795)	$15,941,591	$	$15,941,591
3	Depreciation and amortization	2,509,475		2,509,475		2,509,475
4	Taxes other than Federal income	1,882,345	109,251	1,991,596	42,985	2,034,581
5	Investment credit deferred, net	483,084		483,084		483,084
6	Income taxes deferred	606,135	(66,350)	539,785		539,785
7	Amortization of deferred taxes	(166,291)		(166,291)		(166,291)
8	Total	$21,398,134	$ (98,894)	$21,299,240	$ 42,985	$21,342,225
9	Federal income taxes	1,064,721	(71,183)	993,538	503,803	1,497,341
10	Total operating expenses	$22,462,855	$ (170,077)	$22,292,778	$ 546,788	$22,839,566
11	Operating income	$ 6,041,956	$ (120,685)	$ 5,921,271	$ 545,786	$ 6,467,057
12	Charitable contributions after income taxes	(2,776)		(2,776)		(2,776)
13	Adjusted net operating income	$ 6,039,180	$ (120,685)	$ 5,918,495	$ 545,786	$ 6,464,281
	Rate Base - End of Period					
14	Electric plant	$90,951,586	$	$90,951,586	$	$90,951,586
15	Accumulated provision for depreciation	(22,357,424)		(22,357,424)		(22,357,424)
16	Net electric plant	$68,594,162	$	$68,594,162	$	$68,594,162
17	Fuel in stock	1,748,845		1,748,845		1,748,845
18	Materials and supplies	837,192		837,192		837,192
19	Prepaid Virginia gross receipts tax	925,521		925,521		925,521
20	Working capital	1,787,043	(15,755)	1,771,288		1,771,288
21	Total Rate Base	$73,892,763	$ (15,755)	$73,877,008	$	$73,877,008
22	Rate of Return	8.17%		8.01%		8.75%

(1) From Exhibit 1, Column 4
(2) From Exhibit 6
(3) From Exhibit 8

Exhibit No. 8

THE POTOMAC EDISON COMPANY

COMPUTATION OF RATE SURCHARGE BASED ON
12 MONTHS ENDED SEPTEMBER 30, 1976

Schedule	12 Months Va. Jurisdictional Revenue Excl. Fuel	Rate Surcharge Percentage	Increased Revenue From Application of Surcharge
Schedule R	$ 5,960,135	4.274%	$ 254,736
Schedule A (Monterey)	94,812	8.548%	8,105
Schedule TE (Monterey)	49,204	8.548%	4,206
Schedule R-A	3,364,165	8.548%	287,569
Schedule C	2,199,086	4.274%	93,989
Schedule C-A	657,525	8.548%	56,205
Schedule C-A (Schools & Churches)	93,458	8.548%	7,989
Schedule PL	2,395,817	4.274%	102,397
Schedule PH	3,023,541	4.274%	129,226
Schedule PP	1,008,102	4.274%	43,086
Schedule W	988,315	8.548%	84,481
Schedule OL	247,176	4.274%	10,564
Schedule AL	45,334	4.274%	1,938
Schedule SL	22,978	4.274%	982
Schedule MSL	166,135	4.274%	7,101
Total	$20,315,783		$1,092,574

RATE SURCHARGE

I - A surcharge of 4.274% is applicable to all Rate Schedules except Schedules "R-A", "C-A", "W", "A" and "TE".

II - A surcharge of 8.548% is applicable to Rate Schedules "R-A", "C-A", "W", "A" and "TE".

The above Rate Surcharge applies to the basic rate excluding Fuel Cost Adjustment.

INDEX

	SCHEDULE	PAGE
Front Page		1
Towns Served		2
Index		3
Rules and Regulations		4
Extension of Company's Facilities		5
Fuel Cost Adjustment		6-1
Rate Surcharge		6-2
Residential Service	R	7
Residential Service - All Electric . . (Restricted)	R-A	8
General and Commercial Service	C	9
Light and Power Service (Low Load Factor)	PL	10
Light and Power Service (High Load Factor)	PH	11
Power Service - Large Primary	PP	12
Water Heating Service (Restricted)	W	13
Outdoor Lighting Service	OL	14
Private Outdoor Area Lighting Service	AL	15
Mercury Vapor Street and Highway Lighting Service	MSL	16
Street and Highway Lighting Service (Restricted)	SL	17
General Service - All Electric (Restricted)	C-A	18
Residential Service . . . . . (Restricted)	A	19
Residential Service - All Electric (Restricted)	T-E	20

STATE CORPORATION COMMISSION

AT RICHMOND, FEBRUARY 17, 1977

APPLICATION OF

THE POTOMAC EDISON COMPANY CASE NO. 19810

For an increase in rates

ON JANUARY 10, 1977, The Potomac Edison Company ("Potomac Edison" or "Company") filed earnings and financial data for the twelve months ended September 30, 1976, and projections for the twelve months ending September 30, 1977.

In a cover letter, Company pursuant to §56-240 of the Code of Virginia, requests authorization to place into effect for electric service rendered on and after March 1, 1977, a surcharge to produce additional gross revenues of $1,092,574. The surcharge tariff, if allowed to become effective, would result in a 4.274 percent surcharge on existing rate schedule charges except special schedules for space heating and water heating. The surcharge tariff for the space heating and water heating schedules would result in a 8.548 percent surcharge. The surcharge rates would apply to basic rates, excluding any charges resulting from the fuel adjustment clause.

Potomac Edison contends that it is earning substantially less than the 8.75 percent overall rate of return on rate base authorized by the Commission's Order of May 29, 1975, entered in Case No. 19410. Company requests that the surcharges become effective on March 1, 1977.

AND, NOW, THE COMMISSION, after consideration of Potomac Edison's application, is of the opinion that an investigation should be undertaken by the Commission's Staff to investigate the Company's need for interim rate relief, and that a hearing should be forthwith scheduled to receive from the Staff the results of its investigation and to hear from Company witnesses offered in support of the request for temporary relief, and that enforcement of the proposed surcharge should be suspended pending further investigation, accordingly

IT IS ORDERED:

(1) That the subject Application, together with attached documents, be assigned Case No. 19810 and that same be lodged in the Office of the Clerk of the Commission and that copies of said material forthwith be delivered to the Commission's Director of the Division of Public Utilities and Director of the Division of Public Utility Accounting;

(2) That enforcement of the proposed surcharge filed herein shall be, and it is hereby, suspended until May 1, 1977, subject to further order of the Commission;

(3) That a public hearing be held, commencing at 10:00 A.M., March 28, 1977, in the Commission's Courtroom, Blanton Building, Richmond, Virginia, for the purpose of receiving evidence from the Commission's Staff and Company regarding Company's need for an interim rate increase prior to a full investigation and public hearing to determine the need for permanent rate relief.

(4) That Potomac Edison shall give notice to the public of its application by publishing the following notice in newspapers of general circulation throughout the territory in Virginia in which it provides electric service; the notice shall be published once a week for three successive weeks in such newspapers, the first publication shall be forthwith upon issuance of this Order:

NOTICE TO THE PUBLIC OF A PROPOSED TEMPORARY INCREASE IN RATES BY THE POTOMAC EDISON COMPANY

Notice is hereby given to the public that The Potomac Edison Company, on January 10, 1977, filed with the State Corporation Commission of Virginia an application requesting authority to place in effect for electric service provided on and after March 1, 1977, a temporary surcharge, to remain in effect until such time as a complete investigation can be conducted, and a public hearing held, to determine the need for a permanent rate increase, if any. The temporary surcharge proposed by the Company, if allowed to become effective, would result in a 4.274 percent surcharge on existing rate schedule charges except special schedules for space heating and water heating. The temporary surcharge for space heating and water heating rates, if allowed to become effective, would result in an 8.548 percent surcharge on those existing rates. The surcharge rates would apply to basic rates, excluding any charges resulting from the fuel adjustment clause. Company states that this surcharge would produce additional gross revenues of $1,092,574 on an annual basis. Such additional revenues would be separately accounted for on Potomac Edison's books and records in order that Company could refund any amounts, together with interest, found excessive after a full investigation and public hearing to determine its needs for a permanent rate increase.

Company contends that it needs prompt temporary rate relief because, among other things, (1) its earnings are substantially less than were authorized by the Commission in the Company's last rate case in 1975, and (2) Company is in immediate need of additional revenues in order to maintain its financial health and capacity to render adequate public service to its Virginia customers.

Company requests that the proposed surcharge go into effect on March 1, 1977, pursuant to §56-240 of the Code of Virginia, without suspension. However, the Commission, has by Order of February 17, 1977, suspended the effective date until May 1, 1977, pending an investigation by its Staff. A hearing will be held, commencing at 10:00 A.M., March 28, 1977, in the Commission's Courtroom, Blanton Building, Richmond, Virginia. The purpose of the hearing will be to receive evidence from the Company and the Commission's Staff regarding the Company's need for a temporary rate increase prior to a complete investigation and public hearing.

THE POTOMAC EDISON COMPANY

(5) That a copy of this Order, Potomac Edison's application and proposed surcharge be served forthwith by Potomac Edison on the Commonwealth's Attorney and Chairman

of the Board of Supervisors of each county (or equivalent officials in the counties having alternate forms of government) in this State in which Potomac Edison offers service, and on the Mayor or Manager and the Attorney of every city and town (or on equivalent officials in towns and cities having alternate forms of government) in this State in which Potomac Edison offers service; such service to be made either (a) in person or by delivery to the customary place of business or to the residence of the person served, or (b) by certified mail, return receipt requested.

(6) That proof of the above publication and service be furnished to the Commission at or before the hearing.

AN ATTESTED COPY will be sent to John W. Riely, Esquire, Hunton & Williams, P. O. Box 1535, Richmond, Virginia 23212; and an attested copy shall be delivered to the Director of the Commission's Division of Public Utilities and to the Director of the Division of Public Utility Accounting.

COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

AT RICHMOND, APRIL 1, 1977

APPLICATION OF

THE POTOMAC EDISON COMPANY

For a temporary increase in rates

CASE NO. 19810

ON JANUARY 10, 1977, The Potomac Edison Company ("Potomac Edison" or "Company"), pursuant to Section 56-240 of the Code of Virginia, filed an application for authority to place into effect for electric service rendered on and after March 1, 1977, a surcharge designed to produce additional gross revenues of $1,092,574. In its tariff accompanying said application, Company proposes a 4.274% surcharge on existing rate schedule charges, excepting, however, special schedules for electric space heating and water heating. Company proposes a surcharge of 8.548% to be applied to the aforesaid electric space heating and water heating schedules.

By Order entered February 17, 1977, the Commission suspended the effective date of the proposed surcharges, and directed that a public hearing be held to receive evidence from Company relative to its requirements for such an interim surcharge pending a full investigation and public hearing to determine Company's requirements for permanent rate relief. Pursuant to said Order of February 17, 1977, a public hearing was held in the Commission's Courtroom on March 28, 1977. The following appearances were entered by counsel for the parties indicated: John W. Riely and Richard D. Gary for the Company; Donald G. Owens, Assistant Attorney General of Virginia, for the Division of Consumer Counsel; and Edward L. Flippen for the Staff of the Commission.

AND, NOW, THE COMMISSION, after reviewing Company's evidence and Commission Staff's most recent audit, is of the opinion and finds:

(1) That on or before April 15, 1977, Company should file a revised tariff schedule designed to produce temporary additional gross revenues not to exceed $960,000 annually;

(2) That the revised tariff for rate schedules "R-A", "C-A", "W", "A" and "TE" should provide for an 8.548% surcharge. The revised tariff for all other rate schedules should be reduced from the proposed 4.274% surcharge rate to a rate that will ensure that the aggregate amount of temporary additional gross revenues does not exceed $960,000 annually;

(3) That the surcharge should be separately accounted for, and the amounts collected thereunder should be reported in Potomac Edison's permanent rate hearing, both per books and on an annualized basis;

(4) That the surcharge hereby granted is authorized by Section 56-240 of the Code of Virginia, and is subject to refund as provided by that Section;

(5) That the surcharge should be effective for all service rendered on and after May 1, 1977, unless the Commission should otherwise order prior to said effective date; accordingly,

IT IS ORDERED that Company file with the Commission a revised tariff schedule conforming with the above findings, and this Case shall be continued pending a Commission decision on a permanent rate increase for Potomac Edison Company.

AN ATTESTED COPY hereof shall be sent John W. Riely, Esquire, Hunton & Williams, P.O. Box 1535, Richmond, Virginia 23212; Donald G. Owens, Assistant Attorney General, Shockoe Center, Richmond, Virginia; and an attested copy shall be delivered to the Director of the Commission's Division of Public Utilities and to the Director of Public Utility Accounting.

A True Copy

Teste: William C. Gregg Jr.

Clerk of State Corporation Commission.

Virginia:

BEFORE THE STATE CORPORATION COMMISSION

APPLICATION OF)
)
THE POTOMAC EDISON COMPANY)

No. 19810

PURSUANT TO §§56-235-56-237

OF THE CODE OF VIRGINIA

APPLICATION FOR INCREASE IN RATES

The Potomac Edison Company, Downsville Pike, Hagerstown, Maryland 21740 ("the Company") respectfully shows:

1. The Company is a Virginia public service corporation providing electric service at retail to approximately 49,000 customers in a substantial area of northwestern Virginia. The Company is also a Maryland corporation and provides electric service in portions of Maryland and West Virginia.

2. The Company has experienced rapid growth both in numbers of customers and in electrical use of those customers in recent years. Since 1971, for example, the Company's customers in Virginia have increased from 40,895 to 49,237. In addition, growth in both kilowatthour consumption and peak demand appears to have resumed after decreased growth in the 1974-75 period due to conservation efforts and the economic downturn. On the basis of 10- and 20- year forecasts prepared by the Company, growth is expected generally to follow historic trends, but at a rate somewhat lower than in the past.

3. Construction of generating facilities with total capacity in excess of 1,000 MW will therefore be required within the next decade in order to assure adequate and reliable service to the Company's customers. Inflation in the general economy has been forcing construction costs upward

at unprecedented rates. In addition, federal, state and local regulations require considerable investments in facilities to protect the environment. The Company estimates its construction expenditures for those facilities during the period 1977 through 1981 will be approximately $489,000,000, an average of about $98 million per year for that 5-year period--more than double the average construction expenditures during the 1972-76 period. Most of these expenditures must be financed by external funds and depend on the Company's ability to attract additional capital funds from investors.

5. On January 10, 1977, the Company applied for a rate surcharge pursuant to Section 56-240 of Code of Virginia. The surcharge requested was designed to raise the rate of return to the 8.75% authorized by the Commission in Case No. 19410. By order entered on April 1, 1977, in Case No. 19810, the Commission granted a surcharge, subject to refund as provided by Section 56-240 of the Code of Virginia, which was less than the requested amount.

6. The surcharge so authorized will not produce a fair rate of return on the Company's Virginia jurisdictional intrastate rate base. The surcharge was designed to achieve the authorized rate of return of only 8.75% including only a 12.0% return on common equity. Such a return is inadequate to insure the attraction of the needed additional capital funds at appropriate rates.

7. The Company's present rates, including the surcharge, do not produce sufficient revenues to meet rising costs and finance necessary construction. Therefore, pursuant to Sections 56-235 - 56-237 of the Code of Virginia, there is filed herewith as Exhibit A a revised schedule of rates and charges designed to produce an adequate rate of return on the Company's Virginia jurisdictional rate base. In the Company's opinion, no lower rates will permit it to earn such a fair rate of return.

8. The Company therefore requests that the Commission make permanent the rates and charges authorized by its order in Case No. 19810 on April 1, 1977, and permit the schedule of rates and charges filed herewith as Exhibit A to become effective for all service rendered on and after October 1, 1977.

Respectfully submitted,

THE POTOMAC EDISON COMPANY

By _____
J. M. McCardell
Executive Vice President and
General Manager

Date: May 31, 1977

STATE OF MARYLAND

COUNTY OF WASHINGTON, to-wit:

I, William E Wolford, Jr., a Notary Public in and for the state and county aforesaid, hereby certify that this day appeared before me J. M. McCardell, who, being duly sworn, made oath and said that he is Executive Vice President and General Manager of The Potomac Edison Company and the person who signed the foregoing application, and that the facts stated in such application are true to the best of his knowledge and belief.

Given under my hand and notarial seal this 27th day of May, 1977.

My commission expires July 1, 1978.

William E Wolford Jr.
Notary Public

BEFORE THE
STATE CORPORATION COMMISSION
OF VIRGINIA

Application of	)	
	)	
POTOMAC EDISON COMPANY	)	Case No. 19810
	)	
For an increase in rates	)	

SUPPLEMENTAL APPLICATION

(1) The Potomac Edison Company filed an application for increase in rates with the State Corporation Commission on May 31, 1977.

(2) The Staff of the Commission requested that certain additional data be filed and, to that end, Potomac Edison Company respectfully shows:

(a) Total gross annual revenue requested by Potomac Edison is $2,865,380 greater than the temporary annual increase in rates of $960,000 allowed by the Commission in its Order of April 1, 1977;

(b) The present test year gross revenues, including fuel clause revenues, are as follows:

Residential	$14,023,858
Commercial	5,592,084
Industrial	7,830,177
Street Lighting	216,856
	$27,662,975

(c) The proposed test year gross revenues, including fuel clause revenues, are as follows:

Residential	$15,966,535
Commercial	6,487,133
Industrial	8,782,609
Street Lighting	252,078
	$31,488,355

DATED: June 16, 1977

Respectfully submitted,

POTOMAC EDISON COMPANY

By Richard D. Gary
Counsel

John W. Riely
Richard D. Gary
Hunton & Williams
P. O. Box 1535
Richmond, Virginia 23212

Counsel

CERTIFICATE OF SERVICE

I hereby certify that on the 16th day of June, 1977, I mailed, first class postage pre-paid, a copy of the foregoing Supplemental Application to Donald G. Owens, Esq., Assistant Attorney General, 11 South 12th Street, Richmond, Virginia 23219.

Richard D. Gary
Counsel

COMMO[illegible]H OF VIRGINIA

STATE CORPORATION COMMISSION

AT RICHMOND, JULY 6, 1977

APPLICATION OF

THE POTOMAC EDISON COMPANY

For an increase in its rates
for electric service

CASE NO. 19810

ON JANUARY 10, 1977, The Potomac Edison Company ("Potomac Edison" or "Company") filed with the Commission an application requesting approval of a surcharge designed to produce additional gross revenues of $1,092,574. The application was assigned Case No. 19810, and a public hearing was held on the proposed surcharge on March 28, 1977. By order entered April 1, 1977, the Commission authorized a surcharge designed to produce temporary additional gross annual revenues of $960,000. The temporary increase in rates was placed into effect for all service rendered on and after May 1, 1977. The case was continued pending the filing of an application by Company for a permanent rate increase and a Commission Staff investigation thereof.

On May 31, 1977, Potomac Edison filed an application for a permanent increase in rates, together with new schedules of rates and charges which are proposed to become effective for all service rendered on and after October 1, 1977. On June 16, 1977, Potomac Edison filed a supplement to that application. Company proposes $2,865,380 in rate relief over existing tariff levels, and it proposes to make permanent the prior temporary increase in rates of $960,000, for a total permanet increase of $3,825,380. The Company's proposed tariffs also include changes in its fuel adjustment clause.

AND THE COMMISSION, after review and consideration of the application of May 1, 1977, the supplement thereto of June 16, 1977, and proposed tariffs filed therewith, is of the opinion that the schedules of proposed rates and charges should be suspended pending investigation, that public notice should be given of the proposed increase in rates, that an investigation should be undertaken by the Commission's Staff to determine the reasonableness of the proposed rates, that a public hearing should be scheduled regarding same, that public notice should also be given and a hearing scheduled regarding proposed changes in the Company's fuel adjustment clause, and that the temporary surcharge previously authorized should remain in effect pending completion of the preceeding acts and activities; accordingly,

IT IS ORDERED:

(1) That Case No. 19810 be reinstated on the Commission's docket of active cases, that the present application for a permanent increase, with Exhibit A, be lodged in the Office of the Clerk of the Commission as a part of the record therein, and that copies of said application, with Exhibit A, forthwith be delivered to the Commission's Chief Accountant and to its Director of Public Utilities;

(2) That the effective date of the proposed tariff revisions be, and the same hereby is, suspended for a period of sixty (60) days from and after October 1, 1977, subject to further order of the Commission;

(3) That a public hearing be held for the purpose of receiving evidence relevant to Company's proposed rates and charges, commencing at 10:00 a.m., October 4, 1977, in the Commission's Courtroom, Blanton Building, Richmond, Virginia;

(4) That a hearing, commencing at 2:00 p.m., October 5, 1977, is hereby scheduled for the special purpose of receiving evidence from all parties in interest on the Company's proposed changes in its fuel adjustment clause;

(5) That those members of the Commission's Staff who are responsible for such matters conduct an appropriate investigation and study of the reasonableness of Company's proposed tariff revisions and submit their findings and recommendation to the Commission in accordance with the schedule herein fixed;

(6) That on or before August 1, 1977, Company shall filed with the Clerk of the Commission ten (10) copies of the prepared testimony and exhibits of each witness Company intends to present in direct testimony;

(7) That on or before August 15, 1977, all persons who expect to submit evidence, cross-examine witnesses, and otherwise participate in the hearing as Protestants, as provided by Rule 4:6 of the Commission's Rules of Practice and Procedure, shall file a Notice of Protest as provided by Rule 5:16(a);

(8) That on or before September 15, 1977, the Commission's Staff, and all persons previously filing a Notice of Protest who wish to participate in the hearing as Protestants, shall file with the Clerk of the Commission ten

(10) copies of the prepared testimony and exhibits of each witness expecting to present direct testimony, and shall simultaneously serve a copy thereof upon Potomac Edison and upon any Protestant requesting same. Not later than the filing of the aforesaid testimony and exhibits, all Protestants shall likewise file and serve a Protest as required by the Commission's Rules;

(9) That Company give notice of this proceeding to the general public by publishing the following notice in a newspaper, or newspapers, of general circulation in the Virginia territory in which Company provides service, which notice shall be published once a week for four (4) successive weeks, beginning forthwith upon issuance of this Order;

NOTICE TO THE PUBLIC OF PROPOSED RATE INCREASE AND AMENDMENT TO FUEL ADJUSTMENT CLAUSE OF POTOMAC EDISON COMPANY

Notice is hereby given that on May 31, 1977, Potomac Edison Company filed with the State Corporation Commission of Virginia an application requesting a $3,825,380 permanent increase in its rates and charges for electric service. The Commission has suspended the effective date of the proposed rate changes and has scheduled a public hearing on the application in its Courtroom in the Blanton Building, Richmond, Virginia, commencing at 10:00 a.m. on October 4, 1977.

The application seeks a permanent rate increase above the level of existing rates and seeks to make permanent the existing temporary rate increase heretofore authorized by the Commission to become effective May 1, 1977. Copies of the application and the proposed schedule of rates and charges may be reviewed in the Clerk's Office of the Commission or at any office of the Company where bills may be paid.

On or before August 1, 1977, the Company will file with the Clerk of the Commission ten copies of the prepared testimony and exhibits of each witness it intends to present in direct testimony in support of Company's application. Copies of all such testimony and exhibits will be available for review on and after August 1, 1977, in the Clerk's Office of the Commission or at any office of the Company where bills may be paid.

On or before August 15, 1977, all persons who expect to submit evidence at the public hearing as a party Protestant, and to cross-examine Company witnesses, must file and serve a Notice of Protest in conformity with the Commission's Rules of Practice and Procedure.

On or before September 15, 1977, the Commission's Staff and all persons who have filed a Notice of Protest and who still expect to participate at the hearing as a party Protestant must file ten copies of all prepared testimony and exhibits of the witnesses to be offered at the hearing, and shall serve a copy thereof upon counsel for the Company and upon all other Protestants requesting same. Not later than said September 15, 1977, all Protestants also shall have filed a written Protest as required by Commission Rules.

Any interested person (public witness) who desires to make a statement at the hearing in his own behalf, either for or against the application for increased rates, but not otherwise participate in the hearing, need only appear in the Commission's Courtroom at 9:45 a.m. on October 4, 1977, and complete a Notice of Appearance Form which will be provided by the Commission. All such persons will be heard as expeditiously as possible, beginning at 10:00 a.m., or shortly thereafter, on that date. In order that the Commission may hear from the maximum number of persons desiring to make a statement, all public witnesses are requested to limit their oral comments to seven minutes. Interested persons who intend to appear and testify as public witnesses are requested to notify the Commission in advance by mail so that their comments may be received without undue delay.

All written communications regarding the application for increased rates should be addressed to William C. Young, Clerk, State Corporation Commission, Blanton Building, P.O. Box 1197, Richmond, Virginia 23209.

Additionally, Potomac Edison has proposed certain amendments to its fuel adjustment clause.

The amended fuel clause has been filed with the Company's application, and the Company's prefiled testimony and exhibits are expected to contain evidence intended to show that the amended clause complies with the Commission's new fuel clause rules.

In compliance with Virginia law, October 5, 1977, beginning at 2:00 p. m., is set aside for the special purpose of receiving evidence on the proposed changes in the Company's fuel adjustment clause.

POTOMAC EDISON COMPANY

(10) That a copy of the foregoing notice shall be forthwith mailed by Potomac Edison to each of its customers;

(11) That a copy of this order, Company's application and all the proposed tariff schedules, including the proposed fuel adjustment clause, be served forthwith by Potomac Edison on the Commonwealth's Attorney and Chairman of the Board of Supervisors of each county (or equivalent officials in the counties having alternate forms of government) in this State in which Potomac Edison offers service, and on the Mayor or Manager and the Attorney of every city and town (or on equivalent officials in towns and cities having alternate forms of government) in this State in which Potomac Edison offers service. Service shall be made either by personal delivery to the customary place of business of the person served, or to his residence, or shall be sent by certified mail, return receipt requested.

(12) That proof of the foregoing publications and service be furnished the Commission at the commencement of the public hearing;

(13) That the temporary surcharge which became effective May 1, 1977, as authorized by this Commission's Order of April 1, 1977, shall remain in effect subject to further order of this Commission.

AN ATTESTED COPY hereof shall be sent to John W. Riely, Esquire, Hunton & Williams, P.O. Box 1535, Richmond, Virginia 23212; Donald G. Owens, Assistant Attorney General, Shockoe Center, Richmond, Virginia; and an attested copy shall be delivered to the Director of the Commission's Division of Public Utilities and to the Director of Public Utility Accounting.

A True Copy

Teste: William C. Young

Clerk of State Corporation Commission.

BEFORE THE VIRGINIA

STATE CORPORATION COMMISSION

Application of
The Potomac Edison Company
For authority to surcharge
customers for recovery of additional
cost of emergency energy purchases. Case No._____

The Potomac Edison Company, Downsville Pike, Hagerstown, Maryland 21740, the applicant herein, respectfully shows the Commission as follows:

1. The applicant is a Virginia public service corporation providing electric service at retail to approximately 50,000 customers in northwestern Virginia. Applicant also provides electric service in portions of Maryland and West Virginia.

2. At the present time applicant has in effect a schedule of permanent rates and charges as approved by the Commission in Case No. 19410.

3. At the present time applicant has pending an application for an increase in its rates for electric service in Case No. 19810.

4. Most of the applicant's generating stations are coal-fired. During 1977 applicant increased its stockpiles of coal to about a ninety day supply in anticipation of a possible mine workers' strike. Since December 6, 1977, a nationwide labor strike by the United Mine Workers of America has prevented the applicant from obtaining any significant deliveries of coal to its generating stations, so that the only coal available to the

applicant for use in firing its generating stations is the coal stored in stockpiles at said stations.

5. During the period from January 1, 1978 to January 7, 1978 inclusive the geographical areas in which the applicant's generating stations are located were subject to heavy precipitation. Immediately thereafter, beginning on January 7, 1978, sub-freezing temperatures and snowfall occurred causing the applicant's coal stockpiles to become and remain frozen and resulting in temporary derating or shutdown of generating units.

6. Because of the severe winter weather, customers' demands for electric energy for heating purposes have been, and continue to be, very high.

7. Notwithstanding the efforts which the applicant has made to encourage customers to conserve energy use, an emergency now exists by reason of said labor strike, said fuel-handling problems, and losses of generating capability. The emergency has been more critical by the demands of the applicant's customers for greater quantities of electric energy. As a result of said emergency, it has been necessary for the applicant to cease making economy and short-term sales of energy to other utilities and to purchase for resale, from utilities having oil-fired generation, emergency energy and short-term energy required to provide the applicant's customers with reliable electric service. The cost to the applicant of such purchased electric energy is more than four times the normal cost of electric energy generated by applicant. Without such purchases of energy for resale, how-

ever, the applicant would have been compelled to interrupt or curtail service to its customers with resulting inconvenience, risks to health and loss of income.

8. Notwithstanding the tentative agreement announced yesterday by negotiators in the nationwide labor strike, said agreement must be ratified by members of the United Mine Workers of America to be effective. The ratification process is expected to take at least ten days and the possibility of a rejection exists. Even if said agreement is effective, applicant expects another two weeks to elapse after ratification before normal coal deliveries are resumed. Severe winter weather with resultant possible adverse operating conditions continues. In the meantime, said emergency continues.

9. During said emergency coal may become available on the market from time to time at prices above the prices normally paid for coal by the applicant prior to said emergency. The applicant intends to purchase any such available coal if deliveries thereof can be made.

10. During the month of January, 1978 the applicant purchased from other utilities having oil-fired generation, for resale to the applicant's customers, substantial amounts of energy. The appropriate allocation of such purchases to applicant's customers subject to the Commission's jurisdiction is 18,380,000 kilowatt hours at a total cost of $1,015,000.

11. Applicant is continuing to make purchases from other utilities having oil-fired generation, for resale to the

applicant's customers. Applicant expects the volume of such purchases to be at higher levels in the future during such emergency.

12. The applicant's tariffs including the fuel adjustment as presently in effect do not recover from its customers the excess cost of purchasing energy for resale to such customers. Such excess unrecovered cost for the month of January 1978 was about $818,000. Applicant anticipates that such excess unrecovered cost for the month of February 1978 will be about $1,560,000.

13. Based on budgeted kilowatt hour sales in Virginia for 1978, applicant estimates that such unrecovered excess costs for January and February 1978 would be recovered in about six and one-half months at a rate of 0.4 cents per kilowatt hour. Subsequent additional excess costs would lengthen that period. Applicant is a winter peaking company and believes it is in the best interests of the Company and its customers to complete such recovery prior to the beginning of the Fall 1978 heating season.

14. The applicant desires to recover such excess unrecovered cost already incurred and to be incurred during the existence of the emergency herein described by amending its tariff to provide for the application to customers' bills of a surcharge of 0.4 cents per kilowatt hour of energy used by a customer, effective immediately, to be applied until the applicant shall have recovered such excess unrecovered cost. A copy of such proposed tariff change, identified as the applicant's "Original Page No. 6-3, S.C.C. Va. No. 12" is attached as part hereof.

Such excess unrecovered cost will not be accurately known until termination of said emergency.

15. If this application is granted, for each month, beginning with such month as directed by the Commission, the applicant will report (a) the cost of energy purchased by it as a result of said emergency, (b) the amount billed to customers during each month as a result of applying the fuel portions in base rates and fuel adjustment absent such surcharge, and (c) the amount billed to customers during each month as a result of applying to customers' bills the surcharge sought herein.

16. This application is made for authority to change temporarily the rates of the applicant in the Commonwealth of Virginia for the purposes and in the manner described herein.

17. The emergency conditions described herein constitute good cause for the Commission, in its discretion, to allow said temporary change in rates, through application of said surcharge, to become effective immediately, without prior notice, posting or publication, subject to refund of the amount of any excess recovery, plus interest as specified by the Commission, if said surcharges are subsequently determined by the Commission to be higher than those finally fixed by it after hearing.

THEREFORE, The Potomac Edison Company, the applicant herein, prays that the Commission issue an immediate order pursuant to Section 56-240 of the Code of Virginia:

1) Allowing the applicant to amend its tariff and place in effect immediately the temporary changes

in rates, through application of said surcharge, as applied for herein sufficient to permit the applicant to recover its costs of fuel and energy purchased and to be purchased during said emergency in excess of the fuel cost level included in the applicant's rates;

2) Directing that such temporary changes in rates shall become effective immediately without prior notice, posting or publication; and

3) Setting this matter for hearing and final determination by the Commission.

THE POTOMAC EDISON COMPANY

Dated: February 7, 1978

By _____
John W. Riely
Attorney for the Applicant

TEMPORARY EMERGENCY ENERGY SURCHARGE

In addition to the charges specified in this tariff, a temporary surcharge of .4 cents per kilowatt-hour will apply to all kilowatt-hours billed under such of the schedules of this tariff to permit the Company to recover costs incurred and to be incurred by the Company as a result of the emergency as fully described in the Company's application filed with the Virginia State Corporation Commission on February 7, 1978.

Issued by
John M. McCardell
Executive Vice President and General Manager

Issued: February 7, 1978

Effective February ___, 1978

AT RICHMOND, FEBRUARY 10, 1978

APPLICATION OF

THE POTOMAC EDISON COMPANY

For an increase in rates

CASE NO. 19810
Interim Order

On May 31, 1977, The Potomac Edison Company ("Potomac Edison" or "Company") filed with the Commission an application for a permanent increase in rates and charges. The proposed increase in rates were designed to produce $3,825,380 in additional permanent gross annual revenue.

A public hearing on Potomac Edison's application was held on October 4 and 5, 1977, in Richmond, Virginia, and on October 13, 1977, in Winchester, Virginia. The Commission scheduled 2:00 P.M., October 5, 1977, for the special purpose of receiving evidence on Company's proposed changes in its fuel adjustment clause. Evidence was received as scheduled on Company's proposed fuel clause revisions. No evidence was received in opposition to the fuel clause revisions proposed by Potomac Edison.

On February 7, 1978, Potomac Edison filed an application for an emergency increase in rates, contending, *inter alia*, that the nationwide labor strike by the United Mine Workers of America has prevented Company from obtaining any significant deliveries of coal to its generating stations so that the coal available to Company for its generating stations is the coal stored in stockpiles at said stations. Company's application states that, in addition to being unable to purchase coal, recent heavy precipitation followed by subfreezing temperatures has caused coal stockpiles to become and remain frozen, resulting in temporary derating or shut-

down of generating units.

Company's emergency application further contends that due to said labor strike, frozen coal stockpiles and losses in generating capacity, an emergency now exists because of Potomac Edison's necessity to purchase emergency energy from utilities having oil-fired generation. The emergency energy purchases are necessary for Company to provide its customers with reliable electric service. The Company contends that the cost of said emergency purchases is not being adequately recovered under its existing fuel adjustment tariff.

The unrecovered fuel cost, it is contended, places Company in an immediate critical financial condition, which threatens its ability to provide adequate and reliable electric service. As stated herein, Potomac Edison's proposed changes to its existing fuel clause at the October 5, 1977 public hearing, were unopposed. And, according to staff testimony, the proposed changes were in accord with the Commission's fuel adjustment clause rules revised in Case No. 19526. Therefore, the fuel clause revisions should be accepted and, as a consequence, should mitigate the critical status of Company's present financial condition and eliminate the need for emergency rate relief. Accordingly,

IT IS ORDERED that Company's proposed revisions to its existing fuel clause should be accepted, effective for fuel costs incurred on and after this day. Company's request for a permanent increase in rates shall remain pending.

AN ATTESTED COPY hereof shall be sent to John W. Riely, Esquire, Hunton & Williams, P.O. Box 1535, Richmond, Virginia 23212; Donald G. Owens, Assistant Attorney General, Shockoe

Center, Richmond, Virginia; and an attested copy shall be delivered to the Director of the Commission's Division of Public Utilities and to the Director of Public Utility Accounting.

A True Copy

Teste: William C. Young

Clerk of State Corporation Commission

STATE CORPORATION COMMISSION

AT RICHMOND, FEBRUARY 13, 1978

APPLICATION OF

THE POTOMAC EDISON COMPANY

CASE NO. 19810
Interim Order

For an increase in rates

This day came The Potomac Edison Company (the Company) by counsel and represented to the Commission that the action permitted by the Commission by its Order entered herein on February 10, 1978 would result in percentage increases in rates that might result in difficulties for customers. The Company proposed that all rates be increased by 0.44 cents per kilowatt-hour until such time as the cost of emergency purchased power is amortized and presented a rider entitled "Temporary Energy Surcharge" to accomplish this result.

And it appearing to the Commission that the proposal of the Company is reasonable and will minimize adverse customer impact;

IT IS ORDERED:

(1) That the rider entitled "Temporary Energy Surcharge" be modified to read as follows:

TEMPORARY ENERGY SURCHARGE

All charges for the purchase of power from outside of the APS System after the effective date hereof shall be accounted for by charges to a deferred account and shall not be used in the computation of any fuel adjustment charge. In addition to the charges specified in this tariff, a temporary surcharge of 0.44 cents per kilowatt-hour will apply to all kilowatt-hours billed under all of the schedules of this tariff to permit the Company to recover costs incurred on and after the effective date hereof, by the Company as a result of the necessity to purchase power outside of the APS System. When the credit equals the charge, this surcharge shall terminate.

(2) That the "Temporary Energy Surcharge" as modified above be filed and is approved effective for all electric service rendered on and after February 10, 1978.

(3) That all costs associated with the energy purchased from electric systems other than operating Companies of the Allegheny Power System shall be excluded from the Fuel Cost Adjustment computations and that these costs will be carried in a deferred account.

(4) That all cost associated with energy purchased outside of the operating Companies of the Allegheny Power System which were incurred prior to February 10, 1978 shall be excluded from the deferred account.

(5) That all costs associated with energy purchased outside of the operating Companies of the Allegheny Power System which have been, and will be, incurred on and after February 10, 1978 shall be included in this deferred account. Such total costs shall be stated into the separate cost components of energy, generation service charges and transmission service charges. These costs as separately stated shall be reported on a monthly basis and will be shown for both APS, Potomac Edison and Potomac Edison's Virginia jurisdictional business. Such information shall include the method and calculations used in the allocation to develop Virginia jurisdictional costs. Only energy (fuel) related cost shall be recovered through this surcharge.

(6) The revenues collected through the Temporary Energy Surcharge shall likewise be stated as a separate amount and shall be reported to the Commission monthly.

(7) The Company shall forthwith arrange appropriate meetings with the Commission's Staff to develop specific reporting formats and procedures.

(8) The "Temporary Energy Surcharge" shall remain in effect until otherwise ordered.

AN ATTESTED COPY hereof shall be sent to John W. Riely, Esquire, Hunton and Williams, P. O. Box 1535, Richmond, Virginia 23212; Donald G. Owens, Assistant Attorney General, Shockoe Center, Richmond, Virginia; and an attested copy shall be delivered to the Commission's Division of Public Utilities and to the Director of Public Utility Accounting.

A True Copy

Teste: William P. Young

Clerk of State Corporation Commission.

SCC-62—7-9-58—15M (Thick).

COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

AT RICHMOND, FEBRUARY 14, 1978

APPLICATION OF

THE POTOMAC EDISON COMPANY

For authority to surcharge customers for recovery of additional cost of emergency energy purchases.

CASE NO. 19955
FINAL ORDER

On February 7, 1978, The Potomac Edison Company ("Potomac Edison" or "Company") filed with the Commission an application for an emergency increase in rates, said filing being pursuant to §56-245 of the Code of Virginia. Company states its request for an emergency increase results from the combined effects of the nationwide labor strike by the United Mine Workers of America and recent weather conditions. The labor strike has prevented Company from obtaining any significant deliveries of coal to its generating stations and the coal available for generating stations is coal that is stockpiled at those stations. Weather conditions, including recent heavy precipitation followed by sub-freezing temperatures, have caused coal stockpiles to become, and to remain, frozen, resulting in temporary derating or shutdown of generating units.

According to Potomac Edison notwithstanding Company efforts to encourage customers to conserve energy use, an emergency now exists by reason of the aforesaid labor strike and fuel-handling problems with attending losses of generating capability. The emergency has been made more critical because of the demand of Company's customers for

greater quantities of electric energy. As a result of the emergency, it has been necessary for Company to cease making economy and short-term sales of energy to other utilities and to purchase for resale, from utilities having oil-fired generation, emergency energy and short-term energy required to provide Company's customers with reliable electric service. The cost to Potomac Edison of such purchased electric energy is more than four times the normal cost of electric energy generated by Company. Without such purchases of energy for resale, however, Company contends it would have been compelled to interrupt or to curtail service to its customers with resulting inconvenience, risks to health and loss of income. Potomac Edison presented evidence on its emergency request before the Commission on February 8, 1978.

On May 31, 1977, Potomac Edison filed with the Commission an application for a permanent increase in rates and charges. A public hearing on that application, Case No. 19810, was held on October 4 and 5, 1977, in Richmond, and on October 13, 1977, in Winchester, Virginia. The Commission scheduled 2:00 P.M, October 5, 1977, for the special purpose of receiving evidence on Company's proposed changes in its fuel adjustment clause. Evidence was received as scheduled on the proposed tariff revisions. No evidence was received in opposition to the proposed fuel adjustment clause revisions.

On February 10, 1978, the Commission entered an Interim Order in Company's permanent rate proceeding, Case No. 19810, finding that Company's proposed fuel clause tariff

revision should be accepted, effective for fuel cost incurred on and after that day. The revised fuel clause tariff provides for recovery by Company of purchased electric energy under conditions giving rise to the present emergency rate proceeding. The Commission, in its Interim Order in Case No. 19810, determined that Commission acceptance of the revised fuel adjustment clause tariff should mitigate the critical status of Company's present financial condition and eliminate the need for emergency rate relief. Accordingly, the Commission is of the opinion and finds that the present proceeding should be dismissed.

IT IS ORDERED that this application for authority to surcharge customers for recovery of additional cost of emergency energy purchases be, and same hereby is, dismissed.

AN ATTESTED COPY hereof shall be sent to John W. Riely, Esquire, Hunton & Williams, P.O. Box 1535, Richmond, Virginia 23212; Donald G. Owens, Assistant Attorney General, Shockoe Center, 11 South 12th Street, Richmond, Virginia 23219; and an attested copy shall be delivered to the Directors of the Commission's Divisions of Public Utilities and Public Utility Accounting.

A True Copy

Teste: William C. Jaures

Clerk of State Corporation Commission.

COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION
RICHMOND

AT RICHMOND, JUNE 13, 1978

APPLICATION OF

THE POTOMAC EDISON COMPANY

For an increase in rates for electric service

CASE NO. 19810
OPINION AND FINAL ORDER

On January 13, 1977, The Potomac Edison Company ("Potomac Edison" or "Company") filed with the Commission, pursuant to §56-240 of the Code of Virginia, an application for a surcharge to be applied to electric service rendered on and after March 1, 1977. The proposed surcharge was designed to produce $1,092,574 in additional gross annual revenue. A public hearing was conducted by the Commission on March 28, 1977, and by order entered April 1, 1977, Company was authorized to impose a temporary surcharge, effective May 1, 1977, designed to produce $960,000 in additional gross annual revenue.

On May 31, 1977, Potomac Edison filed an application for a permanent increase in rates as shown in accompanying revised schedules of rates and charges proposed to become effective October 1, 1977. The schedule of rates and charges included a revised fuel adjustment clause, and the sum total of the proposed revisions was intended to produce $3,825,380 in additional annual gross revenue, including the surcharge.

A public hearing on the application for a permanent increase in rates was conducted on October 4, and October 5, 1977, in Richmond. A portion of the hearing on October 5 was set aside to receive evidence on the proposed fuel adjustment clause. An additional day of hearing was held on October 13, in Winchester, Virginia.

The following counsel appeared for the parties indicated: John W. Riely, Robert B. Murdock, and Richard D. Gary for Potomac Edison; Donald G. Owens for the Division of Consumer Counsel, Office of the Attorney General of Virginia; Robert L. Weinberg, pro se; Henry E. Howell, Jr. for intervener Julian Carper; Richard D. Rogers, Jr., and Wayne N. Smith for the Commission's Staff. Twenty-three customers of Company appeared as interveners during the hearing.

Subsequent to the public hearings, Company encountered difficulty in maintaining coal supplies for its generating stations. According to Company, this was due primarily to two causes, namely: (1) a nationwide labor strike by the United Mine Workers of America which prevented Company from obtaining any significant deliveries of coal, and (2) extraordinary weather which prevented Company from utilizing the coal stockpiled at its generating units. Heavy precipitation, followed by subfreezing temperatures, caused its coal stockpiles to freeze.

On February 7, 1978, Company filed an application for an emergency increase in rates - contending that an emergency existed due to the labor strike and frozen coal stockpiles. According to Company, it was necessary to purchase emergency energy from utilities having oil-fired generation, but the cost of these purchases could not be recovered through Company's existing rates. It was contended that the unrecovered fuel cost placed Company in an immediate critical financial condition which threatened its ability to provide adequate and reliable electric service. Company's application for an emergency increase in rates was assigned Case No. 19958, and a hearing thereon was held February 8, 1978.

However, instead of approving an emergency increase in rates in Case No. 19958, on February 10, 1978, the Commission entered an Interim Order in present Case No. 19810 authorizing the company to implement the revised Fuel Adjustment Clause herein before proposed. That Fuel Adjustment Clause, which became effective February 10, 1978, provides for recovery of a substantial portion of the costs of emergency purchases of power from other utilities.

Subsequent to our above order of February 10, it was determined that recovery of revenues to cover the costs of purchased power through the revised Fuel Adjustment Clause

would cause too great an impact on customers. Therefore, by order dated February 13, 1978, entered in this proceeding, a tariff was approved which will spread the recovery of the cost of purchased power over a longer period of time than would be the case under the Fuel Adjustment Clause. The tariff so approved provides as follows:

> All charges for the purchase of power from outside of the APS [Alleghany Power System] System after the effective date hereof shall be accounted for by charges to a deferred account and shall not be used in the computation of any fuel adjustment charge. In addition to the charges specified in this tariff, a temporary surcharge of 0.44 cents per kilowatt-hour will apply to all kilowatt-hours billed under all of the schedules of this tariff to permit the Company to recover costs incurred on and after the effective date hereof, by the Company as a result of the necessity to purchase power outside of the APS System. When the credit equals the charge, this surcharge shall terminate.

The foregoing surcharge is currently being applied.

POSITION OF PARTIES

In support of its application for permanent increases Potomac Edison offered information to show a declining rate of return, increasing expenses of providing service, and the need to attract capital for new plant to meet customer growth. Company contends that it should be given the

opportunity to earn a 9.75 percent return on rate base. Company's exhibits for the test period did not include an addition to income for "Allowance for Funds Used During Construction" (AFUDC). Testimony supporting the exclusion of AFUDC from income was offered by Company during the hearing. Company subsequently developed and presented exhibits reflecting AFUDC as an addition to income.

The Division of Consumer Counsel, Office of the Attorney General, objects to Company's proposed rate increase, and specifically takes exception to the exclusion of AFUDC from other income. The Division's counsel contended that the Commission should require Potomac Edison to continue to reflect AFUDC in its rate of return statements in compliance with prior Commission determinations. Further, the Division recommended Potomac Edison be given an opportunity to earn a rate of return on rate base in the range of 8.8 to 9.3 percent.

Protestant Weinberg and intervener Carper both urged the Commission to reject the application for permanent rate relief and to refund the revenue generated by the temporary surcharge - on the grounds that a rate increase is unfounded and would work a hardship on consumers.

After completing its investigation, Staff recommended that Company be granted an opportunity to earn a rate of return on rate base in the range of 9.18 to 9.43 percent.

Robert L. Weinberg filed in this proceeding a "Motion For Further Hearing In Winchester". In this motion, Mr. Weinberg contends that a hearing should be scheduled in Winchester for the purpose of receiving testimony on the revision in rates approved by the Commission's order of February 10, and of February 13, 1978. Mr. Weinberg urges that further testimony be received on the revisions and that "If the Commission permits the 'Emergency Surcharge' to remain in effect, the burden which the surcharge imposes on customers should at least be reduced by ordering the refund of the temporary increase and by denying the pending application for a permanent increase."

A number of petitions signed by individual customers of Potomac Edison and resolutions of local governing bodies have also been filed supporting the request for a local hearing. A hearing was held in Winchester, Virginia. Subsequent to that hearing the record in this proceeding was closed.

AFUDC - CWIP

Before the Commission can determine the test period income, expenses, and rate base, the appropriate rate making treatment of AFUDC must be decided.

It is the practice of this Commission to use an end-of-period valuation of rate base. The value of utility plant and working capital, after adjustments, in use on the final day of the test period constitute the rate base for determining revenue requirements. The value of "Construction Work in Progress" (CWIP) as of the end of the test period is also included in the rate base. CWIP represents the value of that portion of utility plant which is under construction but to be placed in commercial operation at a later date.

Assuming the risk of oversimplication, AFUDC approximately represents the annual cost of capital (debt and equity) which is invested in "Construction Work in Progress". AFUDC is added both to CWIP accounts and to income. The practical result of this practice is threefold. First, capitalizing AFUDC while plant is under construction causes an increase in rate base on which the utility will later seek to earn a reasonable rate of return. Second, by adding AFUDC to income, the rate of return required on that portion of rate base attributable to CWIP is largely offset by the AFUDC, and customers of the utility do not pay rates which provide a return on CWIP. Third, when construction is completed, and the plant is placed in commercial operation, the addition of AFUDC to income ceases and the utility seeks

increases in revenue to pay the annual cost of investment in the plant.

The Commission is not unalterably committed to the foregoing method of treating AFUDC - CWIP. In fact, the general practice is not followed in a number of instances by the electric utilities operating in Virginia. For example, the addition of AFUDC to income is not required for certain pollution control equipment and distribution facilities (compared to transmission equipment and generating equipment).[1] One electric utility[2] operating in Virginia does not include AFUDC in its income.

The footnoted proceedings, and others, document the Commission's concern with the proper rate making treatment of AFUDC - CWIP. In addition to formal proceedings, various reports filed by Virginia electric utilities, decisions of other regulatory commissions, and current regulatory literature all raise the question of whether the fixing of utility rates should be predicated upon the inclusion of AFUDC in

---

[1] *Application of Appalachian Power Company For an increase in rates, Opinion and Final Order*, Case No. 19723, (Va. S.C.C., October 14, 1977) Slip opinion at 8-10.

[2] *Application of Potomac Electric Power Company*, Order, Case No. 19497, 1975 Annual Report of the State Corporation Commission 232-33 (1976). PEPCO's service area is primarily in the State of Maryland and the District of Columbia. Approximately 2 percent of PEPCO's revenue comes from its Virginia business. Its service territory in Virginia is comprised of approximately 12 percent of the land area of Arlington County.

income. The Commission and its Staff are studying the ramifications of the AFUDC issue. This may lead to a revision of our policy, but our decision herein will be based on the present record.

Company offered exhibits showing rate of return and revenue requirements both including and excluding AFUDC as an addition to income. It presented as a witness, Donald V. Kane, a partner with Arthur Anderson & Co., who testified in support of Potomac Edison's proposal that rates should be set excluding AFUDC from income. In addition, James W. Nicol, Comptroller to Potomac Edison, addressed the AFUDC issue.

In his testimony, Mr. Kane advances several reasons for the elimination of AFUDC as an addition to income. He gives primary emphasis to an alleged lack of confidence of investors and financial analysts in AFUDC as an addition to income. He said, "[t]hese earnings [AFUDC] are misunderstood by and are confusing to investors . . .", ". . . [t]he lack of cash to back-up the AFC portion of reported earnings has caused investment analysts to discount or eliminate part of the reported earnings in the studies they prepare for their recommendations to investors, . . ."; and, "[i]nvestors generally are not familiar with the rate-making practices in effect throughout the country, or why AFC has been considered

to be a part of current earnings, or why the AFC accounting practice has been unique to the public utility industry."

Mr. Kane offered data and information to show the effect upon customers of excluding AFUDC from income and as an addition to capital investment compared with the present practice. His comparison is based on a hypothetical construction program incorporating the following factors:

- capital expenditures of $50,000 as of the beginning of each of two construction years,
- depreciation over a five-year service life for book and tax purposes,
- financing with 40 percent common stock equity funds and 60 percent debt funds,
- a cost of common equity of 14 percent and a cost of debt capital of 8 percent which yields a composite cost of capital of 10.4 percent,
- a 70 percent dividend payout ratio, and
- a 50 percent income tax rate.

Mr. Kane's hypothetical study shows that, in the future, it would be to the advantage of both the utility and its customers to eliminate AFUDC as an addition to income. According to Mr. Kane, rates to customers would be higher in the early years and the cash-flow to the utility would be significantly improved. According to Mr. Kane, the cumulative effect upon customers, over future years, would be the payment of less revenue than would be the case of capitalizing AFUDC and

adding it to other income. Mr. Kane's hypothetical is offered to show that payment of higher rates today will be more than offset, by rates lower than they would have been at a later date, if the practice of capitalizing AFUDC is terminated.

We cannot agree with Mr. Kane's conclusions, upon the basis of the record before us. The hypothetical presented will not support like conclusions in an actual operation such as Potomac Edison's - which has a continuing construction program, continuous financing needs and, in all respects, is an operation which changes from month-to-month and year-to-year. AFUDC will be included as other income for the purpose of determining revenue requirements in this proceeding.

INCOME AND RATE BASE

Company and Staff filed accounting exhibits based upon the twelve months ended December 31, 1976. Company stated that it did not agree with certain Staff adjustments, but that it considered their differences insignificant. No other party presented evidence on accounting matters. The Staff's determination of operating revenue, operating revenue deductions, and rate base (adjusted for AFUDC), will be adopted by the Commission.

For the test period we find operating revenue - adjusted equals $29,181,228, and operating revenue deductions total

$23,731,193. Thus, operating income amounts to $5,450,035 ($29,181,228 - $23,731,193). AFUDC for the test period, totaling $408,378, will be added to operating income. Income will be reduced by $111,011 due to revisions in Company's Power Supply Agreement which was approved by the Federal Power Commission. Finally, $2,820 of charitable contributions, net after income taxes, will be subtracted. After making the three foregoing adjustments the net operating income - adjusted for Virginia operations amounts to the sum of $5,744,582.

Staff and Company agreed that Virginia jurisdictional rate base, excluding the capitalization of AFUDC, totaled $75,218,671 for the twelve months ended December 31, 1976. Adjusting for 1975 and 1976 AFUDC, the value of rate base is increased by $434,370 to equal $75,653,041.

Upon dividing net operating income by the value of the test period rate base we find Company has a rate of return of 7.59 percent.

RATE OF RETURN

Company, Staff, and the Attorney General's Division of Consumer Counsel each presented evidence on an appropriate rate of return for Potomac Edison. The three witnesses were in agreement on capital structure and cost rates for debt

and preferred stock. The proforma capital structure consists of 50.6 percent debt, 10.5 percent preferred stock, 35.7 percent equity, and 3.2 percent cost-free capital. The embedded cost rates are 7.75 percent for debt and 7.58 percent for preferred stock. However, the three witnesses' recommendations of a reasonable return on common equity ranged from 12.0 percent to 14.5 percent.

The Attorney General's witness and Company's witness used generally the same methodology. The two witnesses examined the return on book equity for various groups of companies and made adjustments for risk and other factors. We note that the company witness agreed that he used statistics erroneously in developing his recommendation. In addition, he failed to provide sufficient statistical data to validate a regression study. This regression study was used to evaluate financial risk in the development of his recommended return on equity. Staff witness used a discounted cash flow method supplemented by comparable earnings and earnings-price comparisons. The Staff witness employed both market data and returns on book equity.

Company witness recommended a return of 14.5 percent on equity; Attorney General's witness recommended a return on equity ranging from 12.0 to 13.0 percent; and Staff witness recommended a return of 12.5 to 13.2 percent.

We noted above that all parties agreed upon Company's capital structure and cost of debt and preferred stock. We also note that Company is embarking on a major construction program requiring substantial new financing. After considering the range of recommended returns on common equity and the variety of techniques used in developing this range, we find that a just and reasonable overall rate of return for Potomac Edison is 9.5 percent. This rate of return is based upon our determination that a reasonable return on common equity is in the range of 13.3 to 13.6 percent, and that Company has a 7.75 percent cost of debt and a 7.58 percent cost of preferred stock. An opportunity to earn this rate of return will require an increase in gross annual revenue of $2,887,802, based on our 1976 test year findings.

RATE DESIGN

Company and Staff were in general agreement on the design of rates, but differences did exist over the proper design of five special rate schedules under which Potomac Edison provides service to certain residential and commercial customers. Company and Staff agree that these special rates should be eliminated from Potomac Edison's tariff. However, differences developed over the time period during which the special rates should be eliminated. Company proposes to

eliminate four of these schedules on the effective date of any rate increase. Staff contends that Potomac Edison's proposal to eliminate the special rates on the effective date of this order, coupled with a general increase in rates, would have a severe impact upon those customers. In view of the impact upon customers, we accept Staff's proposals for phased elimination of the rates.

IT IS ORDERED:

(1) That on or before June 26, 1978, Potomac Edison file with the Commission a schedule of revised rates and charges designed to produce $2,887,802 in additional gross annual revenue. These rates and charges shall become effective for service rendered on and after July 1, 1978, unless the Commission shall otherwise order;

(2) That the revised schedule of rates and charges required in (1) above reflect the same general design and distribution of increases in rates and charges as were contained in the proposed revised tariff filed on May 31, 1977, except that Staff's proposals to eliminate certain special schedules shall be adopted, namely: (a) Schedule A shall remain in effect until July 1, 1979, at which time it shall be eliminated and customers thereon transferred to Schedule R; (b) Schedule TE shall be phased out on a two year period in accordance with Staff's recommendation and customers

transferred to Schedule RA on July 1, 1980; (c) that residential customers be retained on Schedule W and that this Schedule be eliminated for all residential customers on July 1, 1979, and that such customers transferred to Schedule R or C; (d) that Schedule C-A be revised in accordance with Staff's recommendation and be retained for a period of one (1) year from the effective date of rates. On July 1, 1979, Schedule C-A shall be eliminated and customers transferred to Schedule C. Customers affected by (a), (b), (c), and (d) shall be informed of these future changes by a bill insert to be included in the first regular billing rendered after July 1, 1978. These same customers shall again be informed of the change of schedule - prior thereto - by a bill insert included in the billing;

(3) The motions to schedule further hearings are hereby denied;

(4) That Company shall continue to report on a monthly basis the collection of revenues approved by the Commission's order of February 10, and of February 13, 1978;

(5) That when the permanent rates approved herein become effective, the temporary increase approved by the Commission's order of April 1, 1977 shall cease. Revenues collected pursuant to the surcharge shall be considered permanent and no longer subject to refund;

(6) That the record in this proceeding be passed to the file of ended cases.

SHANNON, Commissioner, dissenting in part:

I concur generally in the majority's finding concerning the revenue requirements of Potomac Edison. However, for the reasons stated in my dissenting opinion in Application of Appalachian Power Company for an increase in rates, Case No. 19723, October 14, 1977, I do not agree with the majority's conclusion concerning the allowance for funds used during construction (AFUDC). While the amount involved, $408,378, is relatively small, the manner in which construction work in progress and AFUDC are treated is highly important to both the consumer and the Company. Based on a ruling of the Maryland Public Service Commission in a case involving Baltimore Gas and Light Company, Potomac Edison has discontinued AFUDC in Maryland. The Maryland Commission recognized that AFUDC has a negative effect on the quality of a utility's earnings and that there is a regulatory trend away from its use.

In the instant case, as stated, the amount involved is small, and if this Commission is to permit the Company to depart from the archaic and uneconomic practice of permitting AFUDC to be reflected in a company's revenues, now is the time to do so, for as the Utility's construction program

expands - as it surely will - non-cash AFUDC will become an increasingly larger percentage of its net income. When a generating unit under construction becomes commercial, as was recently the case with a Vepco nuclear unit, the ratepayer is required to provide the cash revenue necessary to convert paper AFUDC earnings to true earnings, the impact of which is substantial on the ratepayer. Reduced AFUDC charged to a facility under construction would result in lower rates when the new facility becomes commercial than would be assessed if the larger amount of AFUDC is capitalized during the construction period. Accordingly, I feel that the present accounting practice of capitalizing the financing costs related to construction work in progress as a non-cash source of income is obsolete, inadequate, and counterproductive to the consumer, the regulator, and the utility. I would, therefore, eliminate AFUDC from the Company's Virginia jurisdictional operations.

AN ATTESTED COPY hereof shall be sent to the following: John W. Riely, Esquire, Hunton and Williams, P.O. Box 1535, Richmond, Virginia 23212; Donald G. Owens, Esquire, Assistant Attorney General, Shockoe Center, 11 South 12th Street, Richmond, Virginia 23219; Robert L. Weinberg, Esquire, Williams & Connolly, 1000 Hill Building, Washington, D.C. 20006; Henry E. Howell, Jr., Esquire, 808 Maritime Tower,

Norfolk, Virginia 23510; and to the Commission's Divisions of Energy Regulation, Accounting and Finance, and Economic Research and Development.

A True Copy

Teste: William C. Young

Clerk of State Corporation Commission.

THE POTOMAC EDISON COMPANY

First Revision of
Original Page No. 19-1
S. C. C. Va. No. 12
Canceling
Original Page No. 19-1

RESIDENTIAL SERVICE

SCHEDULE "A"

(Rate Code No. 210)

AVAILABILITY - Restricted to territory formerly served by Monterey Utilities Corporation

Available for single phase residential service through one meter until July 1, 1979 at which time Customers will be transferred to Schedule "R".

MONTHLY RATE

First 50 Kwh . . . 6.930 cents per Kwh
Next 100 Kwh . . . 4.830 cents per Kwh
Over 150 Kwh . . . 2.938 cents per Kwh

FUEL ADJUSTMENT

Adjustment applies to all kilowatt-hours served under this schedule.

MINIMUM

$2.59 per month.

LATE PAYMENT CHARGE

Applies to this schedule as set forth in Company Rule No. 22 of this tariff.

GENERAL

Service supplied is subject to the Rules and Regulations Covering the Supply of Electric Service, and Rules and Regulations for Meter and Service Installations, of the Company as filed with the Commission.

This schedule includes service to a residence which has a commercial enterprise or office within it, provided the total installation used for purposes other than residential is not greater than 500 watts.

When two or more dwelling units including two or more houses on a farm are supplied through a single meter, each shall be classed as a single residence with the rate blocks increased proportionately to number of dwelling units. This provision restricted to those Customers and locations served in this manner on June 9, 1975.

Customers with average monthly use in excess of 1,500 kilowatt hours will have the option of using the Company's Uniform Payment Plan. Uniform monthly payment will be established by the Company as 1/12 of the total estimated revenue for the 12 months.

ACCEPTED
FOR FILING
JUN 30 1978
DIVISION OF ENERGY REGULATION
STATE CORPORATION COMMISSION

ISSUED BY JOHN M. McCARDELL, EXECUTIVE VICE PRESIDENT AND GENERAL MANAGER

Issued June 26, 1978

To become effective for
all service rendered on
and after July 1, 1978

Issued under Order of the S.C.C. dated June 13, 1978 in Case No. 19810

THE POTOMAC EDISON COMPANY

First Revision of
Original Page No. 7-1
S. C. C. Va. No. 12
Canceling
Original Page No. 7-1

RESIDENTIAL SERVICE

SCHEDULE "R"

(Rate Code No. 200)

AVAILABILITY

Available for single phase residential service through one meter.

MONTHLY RATE

First	50 kilowatt hours	7.810 cents per kilowatt hour
Next	100 kilowatt hours	5.211 cents per kilowatt hour
All over	150 kilowatt hours	3.326 cents per kilowatt hour

FUEL ADJUSTMENT

Adjustment applies to all kilowatt-hours served under this schedule.

MINIMUM CHARGE

$3.13 per month.

LATE PAYMENT CHARGE

Applies to this schedule as set forth in Company Rule No. 22 of this tariff.

GENERAL

Service supplied is subject to the Rules and Regulations Covering the Supply of Electric Service, and Rules and Regulations for Meter and Service Installations of the Company as filed with the Commission.

This schedule includes service to a residence which has a commercial enterprise or office within it, provided the total installation used for purposes other than residential is not greater than 500 watts.

When two or more dwelling units including two or more houses on a farm are supplied through a single meter, each shall be classed as a single residence with the rate blocks increased proportionately to number of dwelling units. This provision restricted to those Customers and locations served in this manner on December 1, 1972.

Customers with average monthly use in excess of 1,500 kilowatthours will have the option of using the Company's Uniform Payment Plan. Uniform monthly payment will be established by the Company as 1/12 of the total estimated revenue for the 12 months.

ACCEPTED
FOR FILING
JUN 30 1978
DIVISION OF ENERGY REGULATION
STATE CORPORATION COMMISSION

ISSUED BY JOHN M. McCARDELL, EXECUTIVE VICE PRESIDENT AND GENERAL MANAGER

Issued June 26, 1978

To become effective for
all service rendered on
and after July 1, 1978

Issued under Order of the S.C.C. dated June 13, 1978 in Case No. 19810

THE POTOMAC EDISON COMPANY

First Revision of
Original Page No. 20-1
S. C. C. Va. No. 12
Canceling
Original Page No. 20-1

RESIDENTIAL SERVICE - ALL ELECTRIC

SCHEDULE "TE-1"

(Rate Code No. 230)

AVAILABILITY - Restricted to territory formerly served by Monterey Utilities Corporation.

Available only to service locations connected and supplied hereunder prior to February 1, 1975. This schedule is applicable to single phase residential service where the entire residence is heated electrically and when all other electrical uses in the residence are billed under this schedule.

This schedule shall be eliminated on July 1, 1979, at which time all Customers shall be transferred to Schedule "TE-2".

MONTHLY RATE

First	150 kilowatt hours used for	$8.73
Next	770 kilowatt hours	2.279 cents per kilowatt hour
Next	730 kilowatt hours	1.959 cents per kilowatt hour
All over	1650 kilowatt hours	1.709 cents per kilowatt hour

FUEL ADJUSTMENT

Adjustment applies to all kilowatt-hours served under this schedule.

LATE PAYMENT CHARGE

Applies to this schedule as set forth in Company Rule No. 22 of this tariff.

TERM

One year or longer

GENERAL

Service supplied is subject to the Rules and Regulations Covering the Supply of Electric Service and Rules and Regulations for Meter and Service Installations of the Company as filed with the Commission.

Each residence or farm tenant house shall be metered and billed separately.

Each space heating installation shall be served at 200 volts or higher.

Customers will have the option of using the Company's Uniform Payment Plan. Uniform monthly payment will be established by the Company as 1/12 of the total estimated revenue for the 12 months.

ACCEPTED
FOR FILING
JUN 30 1978
DIVISION OF ENERGY REGULATION
STATE CORPORATION COMMISSION

ISSUED BY JOHN M. McCARDELL, EXECUTIVE VICE PRESIDENT AND GENERAL MANAGER

Issued June 26, 1978

To become effective for
all service rendered on
and after July 1, 1978

Issued under Order of the S.C.C. dated June 13, 1978 in Case No. 19810

RESIDENTIAL SERVICE - ALL ELECTRIC

SCHEDULE "TE-2"

(Rate Code No. 230)

AVAILABILITY - Restricted to territory formerly served by Monterey Utilities Corporation.

Available only to service locations connected and supplied hereunder prior to February 1, 1975. This schedule is applicable to single phase residential service where the entire residence is heated electrically and when all other electrical uses in the residence are billed under this schedule.

This schedule shall be effective from July 1, 1979 until July 1, 1980 at which time all Customers shall be transferred to Schedule "R-A".

MONTHLY RATE

First	150 kilowatt hours used for $8.97	
Next	770 kilowatt hours 2.549 cents per kilowatt hour	
Next	730 kilowatt hours 2.238 cents per kilowatt hour	
All over	1650 kilowatt hours 1.975 cents per kilowatt hour	

FUEL ADJUSTMENT

Adjustment applies to all kilowatt-hours served under this schedule.

LATE PAYMENT CHARGE

Applies to this schedule as set forth in Company Rule No. 22 of this tariff.

TERM

One year or longer.

GENERAL

Service supplied is subject to the Rules and Regulations Covering the Supply of Electric Service and Rules and Regulations for Meter and Service Installations of the Company as filed with the Commission.

Each residence or farm tenant house shall be metered and billed separately.

Each space heating installation shall be served at 200 volts or higher.

Customers will have the option of using the Company's Uniform Payment Plan. Uniform monthly payment will be established by the Company as 1/12 of the total estimated revenue for the 12 months.

ACCEPTED
FOR FILING
JUN 30 1978
DIVISION OF ENERGY REGULATION
STATE CORPORATION COMMISSION

ISSUED BY JOHN M. McCARDELL, EXECUTIVE VICE PRESIDENT AND GENERAL MANAGER

Issued June 26, 1978

To become effective for all service rendered on and after July 1, ~~1978~~ 1979

Issued under Order of the S.C.C. dated June 13, 1978 in Case No. 19810

THE POTOMAC EDISON COMPANY

First Revision of
Original Page No. 8-1
S. C. C. Va. No. 12
Canceling
Original Page No. 8-1

RESIDENTIAL SERVICE - ALL ELECTRIC

SCHEDULE "R-A"

(Rate Code No. 231)

AVAILABILITY

Available only to service locations connected and supplied hereunder prior to February 1, 1975. This schedule is applicable to single phase residential service where the entire residence is heated electrically and when all other electrical uses in the residence are billed under this schedule.

MONTHLY RATE

First	150 kilowatt hours used for $9.20	
Next	770 kilowatt hours 2.819 cents per kilowatt hour	
Next	730 kilowatt hours 2.516 cents per kilowatt hour	
All over	1650 kilowatt hours 2.241 cents per kilowatt hour	

FUEL ADJUSTMENT

Adjustment applies to all kilowatt-hours served under this schedule.

MINIMUM

$9.20 per month.

LATE PAYMENT CHARGE

Applies to this schedule as set forth in Company Rule No. 22 of this tariff.

TERM

One year or longer.

GENERAL

Service supplied is subject to the Rules and Regulations Covering the Supply of Electric Service, and Rules and Regulations for Meter and Service Installations of the Company as filed with the Commission.

Each residence or farm tenant house shall be metered and billed separately.

Each space heating installation shall be served at 200 volts or higher.

Customers will have the option of using the Company's Uniform Payment Plan. Uniform monthly payment will be established by the Company as 1/12 of the total estimated revenue for the 12 months.

ACCEPTED
FOR FILING
JUN 30 1978
DIVISION OF ENERGY REGULATION
STATE CORPORATION COMMISSION

ISSUED BY JOHN M. McCARDELL, EXECUTIVE VICE PRESIDENT AND GENERAL MANAGER

Issued June 26, 1978

To become effective for
all service rendered on
and after July 1, 1978

Issued under Order of the S.C.C. dated June 13, 1978 in Case No. 19810

THE POTOMAC EDISON COMPANY

First Revision of
Original Page No. 13-1
S. C. C. Va. No. 12
Canceling
Original Page No. 13-1

WATER HEATING SERVICE

SCHEDULE "W"

(Rate Code No. 240, 267 and 268)

AVAILABILITY

Available for single phase water heating service for Customers at locations served under this schedule on December 1, 1972.

Schedule "W" (Code 240) shall be eliminated for all residential Customers on July 1, 1979 and such Customers transferred to Schedule "R" (Code 200) or Schedule "C" (Code 263).

MONTHLY RATE

2.909 cents per kilowatt hour

FUEL ADJUSTMENT

Adjustment applies to all kilowatt-hours served under this schedule.

MINIMUM CHARGE

$3.60 per month. This minimum charge will be waived when the Customer receives service at the same location under another schedule of the Company.

LATE PAYMENT CHARGE

Applies to this schedule as set forth in Company Rule No. 22 of this tariff.

GENERAL

Service supplied is subject to the Rules and Regulations Covering the Supply of Electric Service, and Rules and Regulations for Meter and Service Installations, of the Company as filed with the Commission.

Electric water heaters shall be equipped with a temperature-pressure relief valve and each heating element shall be controlled by a thermostat. Heating elements shall not exceed 5500 watts and shall operate at 200 volts or higher. Tanks shall be equipped with interlocks, to prevent simultaneous operation, when using elements with a combined capacity in excess of 5500 watts. The minimum tank size shall be 30 gallons. Heaters, piping and wiring shall conform to Company standards.

ACCEPTED
FOR FILING
JUN 30 1978
DIVISION OF ENERGY REGULATION
STATE CORPORATION COMMISSION

ISSUED BY JOHN M. McCARDELL, EXECUTIVE VICE PRESIDENT AND GENERAL MANAGE

Issued June 26, 1978

To become effective for
all service rendered on
and after July 1, 1978

Issued under Order of the S.C.C. dated June 13, 1978 in Case No. 19810

THE POTOMAC EDISON COMPANY

First Revision of
Original Page No. 9-1
S. C. C. Va. No. 12
Canceling
Original Page No. 9-1

GENERAL AND COMMERCIAL SERVICE

SCHEDULE "C"

(Rate Code No. 260 and 263)

AVAILABILITY

Available for single phase and three phase service at standard Company voltage below 15,000 volts. The standard voltage available depends upon the location, character and size of Customer's load. This information can be furnished at any of the Company's offices.

ACCEPTED
FOR FILING
JUN 30 1978
DIVISION OF ENERGY REGULATION
STATE CORPORATION COMMISSION

MONTHLY RATE

First	50 kilowatt hours	7.295 cents per kilowatt hour
Next	300 kilowatt hours	5.515 cents per kilowatt hour
Next	350 kilowatt hours	4.615 cents per kilowatt hour
All over	700 kilowatt hours	2.884 cents per kilowatt hour

When Customer requires capacity over 7.5 kilowatts, the third energy block shall be increased 53 kilowatt hours for each one-half kilowatt of capacity required in excess of 7.5 kilowatts. The fourth energy block shall then include all kilowatt hours in excess of the first, second, and third energy blocks as adjusted for such additional capacity.

FUEL ADJUSTMENT

Adjustment applies to all kilowatt-hours served under this schedule.

MINIMUM CHARGE

$ 1.45 per kilowatt of capacity required but not less than $3.24

Capacity to be used in determining the minimum charge shall be the capacity required in the current month, but not less than one-half the highest kilowatt capacity required in the preceding eleven months.

VOLTAGE DISCOUNT

Company will furnish service at one voltage and at one point from the Company's existing distribution system voltage. Where Customer takes service at a voltage between 2,000 and 15,000 volts and provides all facilities beyond the service point, a voltage discount of 7¢ per kilowatt will apply.

LATE PAYMENT CHARGE

Applies to this schedule as set forth in Company Rule No. 22 of this tariff.

DETERMINATION OF CAPACITY

Capacity required is the highest demand established over a 30-minute interval.

Capacity required will be determined to the nearest one-half kilowatt.

TERM

Service is provided on a month-to-month basis for single phase service. A one-year minimum term is required for three phase service except as provided under "Monthly Service".

GENERAL

Service supplied is subject to the Rules and Regulations Covering the Supply of Electric Service and Rules and Regulations for Meter and Service Installations of the Company as filed with the Commission.

ISSUED BY JOHN M. McCARDELL, EXECUTIVE VICE PRESIDENT AND GENERAL MANAGER

Issued June 26, 1978

To become effective for
all service rendered on
and after July 1, 1978

Issued under Order of the S.C.C. dated June 13, 1978 in Case No. 19810

THE POTOMAC EDISON COMPANY

Original Page No. 9-2
S. C. C. Va. No. 12

GENERAL AND COMMERCIAL SERVICE

SCHEDULE "C" (Concluded)

(Rate Code No. 260 and 263)

MONTHLY SERVICE

Three phase monthly service is available if the Customer pays the net cost of connection and disconnection and pays the following additional charges:

Months of Continuous Service	Additional Charges
1st and 2nd Months	10% of Monthly Bill
3rd and 4th Months	8% of Monthly Bill
5th and 6th Months	6% of Monthly Bill
7th and 8th Months	4% of Monthly Bill
9th to 11th Months	2% of Monthly Bill
12th Month and Thereafter	0% of Monthly Bill

SUPPLY OF MORE THAN ONE VOLTAGE

Single and three phase service may be supplied through two meters, when the meters are adjacent and the Company's cost of facilities is not increased. In such cases meter readings will be combined for energy consumed and capacity required.

STATE CORPORATION COMMISSION
RECEIVED
JUN 4 1975
DIVISION OF PUBLIC UTILITIES
RICHMOND, VA.

ACCEPTED
FOR FILING
JUN 6 1975
DIVISION OF PUBLIC UTILITIES
STATE CORPORATION COMMISSION

ISSUED BY JOHN M. McCARDELL, EXECUTIVE VICE PRESIDENT AND GENERAL MANAGER

Issued June 4, 1975

To become effective for all service rendered on and after June 9, 1975

THE POTOMAC EDISON COMPANY

First Revision of
Original Page No. 18-1
S. C. C. Va. No. 12
Canceling
Original Page No. 18-1

GENERAL SERVICE - ALL ELECTRIC

SCHEDULE "C-A"

(Rate Code No. 261, 262 and 264)

AVAILABILITY

Available only at locations served or for which contracts have been signed as of December 1, 1972.

This schedule shall be eliminated on July 1, 1979 and Customers transferred to Schedule "C".

APPLICATION

This schedule applies to Customers contracting for electric service to heat their entire establishment by the use of electricity and when all other electrical uses in the establishment are billed under this schedule. Not applicable to establishments whose primary operations are conducted outside the heated area.

MONTHLY RATE

First	50 kilowatt hours used	7.295 cents per kilowatt hour
Next	300 kilowatt hours used	5.515 cents per kilowatt hour
Next	350 kilowatt hours used	4.615 cents per kilowatt hour
All over	700 kilowatt hours used	2.379 cents per kilowatt hour

When Customer requires capacity over 7.5 kilowatts, the third energy block shall be increased 48 kilowatt hours for each one-half kilowatt of capacity required in excess of 7.5 kilowatts. The fourth energy block shall then include all kilowatt hours in excess of the first, second and third energy blocks as adjusted for such additional capacity.

FUEL ADJUSTMENT

Adjustment applies to all kilowatt-hours served under this schedule.

MINIMUM CHARGE

$1.45 per kilowatt of capacity required but not less than $3.24 per month.

Capacity to be used in determining the minimum charge shall be the capacity required in the current month but not less than one-half the highest kilowatt capacity required in the preceding eleven months.

VOLTAGE DISCOUNT

Company will furnish service at one voltage and at one point from the Company's existing distribution system voltage. Where Customer takes service at a voltage between 2,000 and 15,000 volts and provides all facilities beyond the point of service, a voltage discount of 7¢ per kilowatt will apply.

LATE PAYMENT CHARGE

Applies to this schedule as set forth in Company Rule No. 22 of this tariff.

TERM

One year or longer.

DETERMINATION OF CAPACITY

Capacity required is the highest demand established over a 30-minute interval.

Capacity required will be determined to the nearest one-half kilowatt.

ACCEPTED
FOR FILING
JUN 30 1978
DIVISION OF ENERGY REGULATION
STATE CORPORATION COMMISSION

SPECIAL TRANSFORMATION FACILITIES

The Company normally supplies and meters service at one voltage.

When additional voltages are required, the Company may provide in addition to the primary voltage, a maximum of two transformer banks, where the Customer provides all interconnecting line facilities.

When more than one voltage is supplied service is metered at the primary voltage, or its equivalent, and the voltage discount shall not apply.

ISSUED BY JOHN M. McCARDELL, EXECUTIVE VICE PRESIDENT AND GENERAL MANAGER

Issued June 26, 1978

To become effective for all service rendered on and after July 1, 1978

Issued under Order of the S.C.C. dated June 13, 1978 in Case No. 19810

THE POTOMAC EDISON COMPANY

First Revision of
Original Page No. 18-2
S. C. C. Va. No. 12
Canceling
Original Page No. 18-2

GENERAL SERVICE - ALL ELECTRIC

SCHEDULE "C-A" (Concluded)

(Rate Code No. 261, 262 and 264)

SERVICE SUPPLIED TO SCHOOLS AND CHURCHES WITH SPACE HEATING

When a school or church uses electric service as the only means of space heating in a building, buildings, or in a separate area of a building then the kilowatt hours used in the building, buildings, or separate area of a building will be billed at the above prices. When all energy uses, except as provided hereafter, for space heating, lighting, cooking, water heating, cooling (if any) and power are provided by electrical energy, all kilowatt hours will be billed at 2.736 cents per kilowatt hour. Any form of energy may be used for instruction, training and demonstration purposes and will be excluded from the above requirement.

A building, buildings, or separate area of a building not meeting the conditions of this provision shall be separately metered and billed under the applicable rate. The word school as used herein refers to a school operated through the use of public funds or by a non-profit organization.

A school building refers to a building containing any of the following facilities: classrooms, laboratories, manual arts shops, domestic science kitchens, gymnasium, dining areas, dormitories and other facilities used for educational purposes. Service for athletic field flood lighting shall be excluded from service supplied under this provision and shall be billed for service separately.

A church building refers to a building used principally for religious worship and services.

GENERAL

Service supplied is subject to the Rules and Regulations Covering the Supply of Electric Service and Rules and Regulations for Meter and Service Installations of the Company as filed with the Commission.

ACCEPTED
FOR FILING
JUN 30 1978
DIVISION OF ENERGY REGULATION
STATE CORPORATION COMMISSION

ISSUED BY JOHN M. McCARDELL, EXECUTIVE VICE PRESIDENT AND GENERAL MANAGER

Issued June 26, 1978

To become effective for
all service rendered on
and after July 1, 1978

Issued under Order of the S.C.C. dated June 13, 1978 in Case No. 19810

IN THE

SUPREME COURT OF VIRGINIA

COMMONWEALTH OF VIRGINIA,
ex rel., OFFICE OF THE ATTORNEY GENERAL,

Appellant,

v.

THE POTOMAC EDISON COMPANY

and

STATE CORPORATION COMMISSION
OF VIRGINIA

Appellees.

ASSIGNMENTS OF ERROR

The Appellant, the Commonwealth of Virginia, ex rel. Office of the Attorney General, hereby files pursuant to Rule 5:18(i) of the Rules of the Supreme Court of Virginia its Assignments of Error to the findings and order of the State Corporation Commission of June 13, 1978 in the matter of the Application of The Potomac Edison Company for an increase in rates, etc., Case No. 19810:

1. The Commission erred in granting The Potomac Edison Company a temporary increase which became effective May 1, 1977.

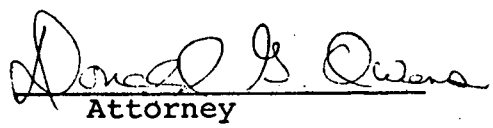
2. The Commission erred in not requiring The Potomac Edison Company to refund the temporary increase in rates which became effective May 1, 1977.

3. The Commission erred in allowing The Potomac Edison Company to implement a revision in its fuel clause in Case No. 19810 based, in part, upon evidence received in a separate proceeding.

4. The Commission erred in establishing the rates for various classes of residential subscribers in that such rates may ultimately produce revenues in excess of the increase found warranted in this proceeding.

Respectively submitted,

COMMONWEALTH OF VIRGINIA

By 
Attorney

Marshall Coleman
Attorney General

Donald G. Owens
Assistant Attorney General
Shockoe Center
11 South 12th Street
Richmond, Virginia 23219

CERTIFICATE

I, Donald G. Owens, Counsel for the Appellant herein, hereby certify that a true copy of the foregoing Assignments of Error was mailed, postage paid, this 13th day of November, 1978 to:

John W. Riely, Esquire
Hunton & Williams
707 E. Main Street
P. O. Box 1535
Richmond, Virginia 23212

1 Q. Please state your name and address.

2 A. My name is James W. Nicol and I live at 212 Mealey Parkway, in
3 Hagerstown, Maryland.

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

5 A. I have been Comptroller of The Potomac Edison Company since early in 1972.
6 It is the Comptroller's responsibility to maintain the books and accounts
7 of the Company according to the Uniform System of Accounts prescribed by
8 this Commission, to prepare necessary reports and statements for manage-
9 ment and for all of the many regulatory bodies to which we are subject,
10 and to consult with management on financial questions concerning the
11 Company.

12 Q. Mr. Nicol, have you testified before this Commission on prior occasions?

13 A. Yes. I presented accounting testimony to the Commission in Rate Case
14 No. 19410 filed in the summer of 1974, and also in our only prior
15 Virginia Rate Case No. 19139 filed in the spring of 1972. I have also
16 given testimony in accounting matters before commissions in Maryland,
17 Pennsylvania and West Virginia.

18 Q. Please describe the business of The Potomac Edison Company.

19 A. The Company is a Virginia corporation that provides electric service in
20 parts or all of 14 counties in Virginia and the City of Winchester.
21 During 1976 it provided similar service in areas of Maryland, West
22 Virginia and Pennsylvania.

23 Q. Please describe Potomac Edison and the corporate structure of which it is
24 a part.

25 A. Potomac Edison is a subsidiary of Allegheny Power System, Inc. (APS).
26 Potomac Edison and its sister operating companies, Monongahela Power
27 Company and West Penn Power Company, also subsidiaries of APS, operate

as an integrated multi-state electric system. Bulk power supply, engineering, computer, information services, and other aspects of system operations more economically or better done centrally for all three operating companies are functions of Allegheny Power Service Corporation, an integral part of the Allegheny Power system and also a subsidiary of APS.

Q. How does Potomac Edison obtain investment funds?

A. Potomac Edison issues bonds and preferred stock to the public. All of its common stock is owned by APS which purchases additional common stock as necessary to maintain a reasonable capital structure for Potomac Edison. APS issues common stock to the public.

Q. Please describe the requirements for electricity in the Company's service area.

A. For several decades the pattern of use in our area has been one of growth in both usage and kilowatthour demand at a level higher than national averages. In late 1973 the growth rate lessened due in part to conservation of energy by customers and in part to a downturn in the regional economy. Some improvement has now taken place in regional economy. The effect of many conservation efforts appear to have been one-time occurrences such as insulating houses and lowering water heater temperatures. A resumption in the increase of electric usage is now apparent.

The number of customers served also continues to grow. Our number of customers increased from 224,033 at the end of 1971 to 263,721 at the end of 1976. In Virginia, the number of customers grew from 40,895 to 49,237 in the same period which was a rate of increase slightly higher than for the total Company.

1 Total annual kilowatthours sold grew from 5,703,997,813 to
2 8,815,480,290 in the same period and peak load grew from 1,009,000 Kw to
3 1,547,000 Kw.
4 We conduct continuing studies forecasting usage and power demand
5 ten and 20 years into the future. The forecasts are based on mathemati-
6 cal analyses of historic trends adjusted for the demographic and economic
7 factors of our service area. In making the forecasts we consider infor-
8 mation ranging from plans of our industrial customers to appliance
9 saturation surveys we conduct every other year. We try to analyze
10 factors that would either decrease or increase past trends. As a result
11 of this analysis, we believe the future needs for electricity will resume
12 the historic pattern of growth but at a rate slightly less than experi-
13 enced in the past. Even a slackening pace in growth will require a
14 tremendous construction program in order to expand facilities if we are
15 to meet the future electrical needs of our area.
16 Q. What is the value of facilities which have been necessary over the last
17 few years to serve this growth?
18 A. Gross expenditures for plant additions were $43,345,000 in 1972,
19 $37,520,000 in 1973, $44,097,000 in 1974, $35,533,000 in 1975 and
20 $66,251,000 in 1976. This is an average of $45,349,200 per year during
21 the five years. Expenditures were lower than the amount that should
22 have been spent for necessary facilities because of poor financial
23 results, particularly in 1974. Financial problems forced Potomac Edison
24 to stretch out construction of the Pleasants generating station and post-
25 pone its in-service dates from 1978 and 1979 to 1979 and 1980.
26 Gross plant in service grew from $352,179 million at the end of 1971
27 to $534,320 million at the end of 1976, or 52%.

1 Q. Has the Company been required to go to the capital markets to finance
2 this construction?
3 A. Yes. In the period from January 1, 1972 through December 31, 1976 the
4 Company sold $82,000,000 of First Mortgage Bonds and $25,000,000 of
5 preferred stock. In addition, APS purchased common stock totaling
6 $30,000,000.
7 Q. What construction will be necessary in the next five years to meet the
8 growth you mentioned?
9 A. Potomac Edison will have to spend about $489,207,000 in the
10 aggregate for construction purposes during the year 1977-1981, an
11 average of $97,841,400 per year during the period.
12 Q. Why are these expenditures rising so rapidly?
13 A. Basic reasons are two-fold. First, inflation requires us to spend more
14 dollars for most items. Second, new requirements mean we spend dollars
15 on items not previously necessary. This is readily apparent in genera-
16 tion which is the largest portion of our construction budget.
17 Our generating capacity now under construction consists of two
18 626,000 kilowatt (net) coal-fired steam electric generating units at the
19 proposed Pleasants Station in West Virginia. Potomac Edison, under pre-
20 sent projections, will have an undivided 30% interest in the Pleasants
21 Station, the remaining undivided interest being owned by affiliates. The
22 Company's share of the total cost of the Pleasants units is currently
23 estimated at $188 million, of which $40 million had been expended as of
24 October 31, 1976. A substantial part of the cost of the Pleasants units
25 is due to requirements of environmental authorities. The present esti-
26 mates of the Company's portion of the cost of Pleasants units includes
27 about $54 million for environmental protection equipment. Of this total,

1 about $27 million is for a flue gas desulfurization system for reduction
2 of sulfur oxide emissions. We estimate that the environmental protection
3 costs alone for the Pleasants Station will exceed the total $140 million
4 cost of the existing Fort Martin generating station which has a capacity
5 of 1,107,000 kilowatts.
6 The result of these new expenditures and inflation is that we esti-
7 mate Pleasants will cost $529 per kilowatt compared to $205 per kilowatt
8 at our Harrison Station completed in 1974 and to $147 per kilowatt at our
9 Hatfield's Ferry Station completed in 1971.
10 Q. How will Potomac Edison finance these expenditures?
11 A. During 1977 we plan to issue $35,000,000 in First Mortgage Bonds and APS
12 plans to purchase $25,000,000 of our common stock. At least 60% of the
13 expenditures in future years will have to come from such external funds.
14 Because of its need to raise these additional funds, Potomac Edison
15 must remain attractive to investors. To do this, its earnings must be
16 maintained at a fair and reasonable level.
17 Q. When did Potomac Edison last seek rate relief from this Commission?
18 A. Potomac Edison applied to the Commission for emergency relief on July 19,
19 1974. Emergency relief was granted on July 31, 1974. Application for
20 permanent rate relief was filed on August 20, 1974. The Commission did
21 not act finally until it issued its order of May 29, 1975, in Case No.
22 19410.
23 In that case the test period used was the twelve months ended
24 September 30, 1974. The Commission authorized rates designed to produce
25 an overall rate of return of 8.75% and a return on equity capital of
26 12.0%. Those rates became effective on June 9, 1975, and have remained
27 in effect unchanged ever since, subject, of course, to the operation of

1 the fuel adjustment clause.

2 Q. What has been the Company's recent experience?

3 A. I have prepared eleven exhibits to show our experience to the Commission.

4 Most of them are based on our latest annual review filing.

5 Q. Please discuss the first exhibit.

6 A. That shows what we projected in our annual review report in 1975 and

7 what we actually experienced. The unadjusted rate of return from

8 Virginia jurisdictional business during the twelve months ended

9 September 30, 1976, was only 8.17%.

10 The Virginia jurisdictional figures in this and my other exhibits

11 are the result of an allocation study using the same methodology as the

12 study accepted by the Commission and its staff in Case No. 19410.

13 Q. What does Exhibit 2 show?

14 A. It shows that the projected rate of return for the twelve months ended

15 September 30, 1977, will drop sharply to 6.71%. This is so low it

16 jeopardizes the Company's financial health and ability to raise investor

17 funds on reasonable terms.

18 Q. What about Exhibit 3?

19 A. That shows capitalization projected and actual at September 30, 1976,

20 and projected at September 30, 1977.

21 Q. How about Exhibit 4?

22 A. That simply shows return on average rate base and has little, if any,

23 relevance to this proceeding. Similarly Exhibit 5, although required for

24 annual review, is based on averages and is likewise irrelevant.

25 Q. What does Exhibit 6 show?

26 A. Exhibit 6 consists of two pages and states the adjustment required to

27 normalize the test year.

1 Q. Please explain the first two adjustments.

2 A. Adjustments Nos. 1 and 2 are interrelated and normalize an unusual short-
3 term sales transaction with the General Public Utilities System (GPU).

4 As I previously mentioned, APS companies are operated as an inte-
5 grated electric system and there is unrestricted interchange of power
6 within the system as required. Transactions between APS companies and
7 adjacent utilities are administered by APS and each operating company
8 shares in the benefits of these transactions in accordance with the terms
9 of the Power Supply Agreement which the companies have entered into and
10 which is filed with the Federal Power Commission. These transactions
11 with adjacent utilities generally can be classified into three categories;
12 economy, emergency and short-term, and all may be described as opportunity-
13 type sales. That is, several conditions have to occur simultaneously for
14 them to happen and there is no assurance that these conditions will occur
15 or continue to occur.

16 As just mentioned, short-term sales are one of the opportunity-type
17 transactions. Such sales occur when APS has capacity to sell and an
18 adjacent utility needs some specific power for a short period of time.
19 During the test year, a sale was made to GPU which fell into the category
20 of a short-term sale; however, this transaction was extra-ordinary since
21 its purpose was to cover the consecutive outages of two large nuclear
22 generating units operated by GPU, and amounted to 600 to 800 megawatts
23 for a period of five months. This sale was unique because of:

24 1. the amount of capacity required by GPU within a short time
25 period, and

26 2. the fact that APS was able to meet this complete requirement.

27 APS does not expect another request of this magnitude for short-term

1 power and, in addition, it will not have the capacity to meet such a
2 request even if it should arise in the future.
3 Because of the unusual nature of the GPU transaction, and the fact
4 that it will not occur again, it was necessary to analyze transactions
5 with non-affiliated companies with the view to normalizing the test year
6 results.
7 The first requirement of the analysis was to remove the revenues
8 and the cost of producing the sale to GPU from the test year. This elimi-
9 nated all effect of this sale from the test year. However, if that sale
10 had not taken place, the system would have had capacity available with
11 which to make economy sales of opportunity. Past experience indicates
12 economy sales could have been made during on-peak periods. We therefore
13 imputed an economy transaction in excess of actual sales and included
14 both the additional revenues and associated expenses to reflect that
15 additional economy sales to replace the GPU transaction.
16 Using Virginia jurisdictional figures, my Adjustment No. 1 replaces
17 revenues of $1,002,377 from the GPU transaction with revenues from the im-
18 puted economy transaction of $711,615 and reduces revenues by the amount
19 shown to a normal level. Similarly, my Adjustment No. 2 replaces
20 expenses of $690,833 from the GPU transaction with expenses of $446,628
21 from the imputed economy transaction and increases expenses by the amount
22 shown to a normal level. My presentation groups revenues in one adjust-
23 ment and expenses in the other. The net difference of the adjustments
24 is to decrease revenues by $46,557.
25 An alternative presentation to normalize this abnormality would be
26 to follow F.P.C. accounting which credits economy sales to expenses in
27 Account 555. This approach would remove the GPU revenues as one

1 adjustment and would lump the economy revenues and the two expense
2 figures I mentioned into an adjustment of $955,820 with the net
3 difference of $46,557 remaining the same.
4 Q. Please briefly explain the remaining adjustments.
5 A. Adjustment No. 3 annualizes wage increases and Adjustment No. 4
6 annualizes the net reduction in personnel during the test year.
7 Adjustment No. 5 annualizes the increase in capacity charge effec-
8 tive January 1, 1976 as calculated under the provision of the Power
9 Supply Agreement previously mentioned. In the investment area the
10 agreement provides for the equalization settlements necessary to adjust
11 the participants' ownership to that portion of the APS generating
12 facilities and bulk transmission facilities related to the peaks of the
13 respective companies. The agreement also adjusts to ensure each partici-
14 pant supplies its proportionate share of spinning reserve capacity. The
15 capacity charge is recalculated as of the beginning of each year to keep
16 it current.
17 Adjustment No. 6 reflects the Pennsylvania income tax effect for
18 Adjustment Nos. 1 through 5. The liability for this tax is caused pri-
19 marily by the Company's joint ownership of the Hatfield's Ferry generat-
20 ing station located in Pennsylvania. As such the tax is like any other
21 expense associated with that generating station. Since all Potomac
22 Edison's customers benefit from the station, each should bear a fair
23 share of this tax; part of the tax is therefore allocated to Virginia.
24 Adjustment No. 7 removes a credit to taxes recorded in December 1975
25 in accordance with Federal Power Commission instructions and applicable
26 to a period outside of the test year.
27 Adjustment No. 8 reflects the Federal income tax effect on

1 Adjustment Nos. 1 through 6.

2 Adjustment No. 9 reflects the deferred income taxes recorded in
3 December 1975 associated with Adjustment No. 7.

4 Adjustment No. 10 is the change in working capital due to the various
5 adjustments to operation and maintenance expense. Working capital has
6 been calculated on the same basis used and approved in our previous
7 Virginia rate case.

8 Q. Now, let's pass to Exhibit 7. What does that show?

9 A. Exhibit 7 shows in column 3 that, after adjustments, the Company's
10 experienced rate of return on Virginia jurisdictional business was 8.01%
11 for the twelve months ended September 30, 1976. If the rate of return
12 were to be increased to 8.75%, increased revenues of $1,092,574 would
13 be required. The 8.75% figure is the last rate established by the
14 Commission for our Company.

15 Q. How would you derive these additional revenues?

16 A. As shown on Exhibit 8, we proposed a surcharge of 4.274% on rate
17 schedules R, C, PL, PH, PP, OL, AL, SH and MSL and a double surcharge of
18 8.548% on rate schedules A, TE, R-A, C-A, C-A Schools and Churches and W.

19 Q. Why are some proposed surcharges twice as high as the rest?

20 A. The Commission in its order of October 31, 1972, in Case No. 19139,
21 stated: "There is no justification for offering special lower rates for
22 space heating and water heating." It directed the Company to plan to
23 eliminate special rates to customers with water heating and space heating
24 facilities. Such special rates are designated as Schedules "R-A," "C-A"
25 and "W." On May 31, 1974 Monterey Utilities Corporation was merged into
26 The Potomac Edison Company with Commission approval and Monterey Sched-
27 ules "A" and "T-E" were retained with the understanding that the

1 directive would also apply to both of these schedules. The Company has
2 begun implementation of the directive by closing these schedules to new
3 customers and by increasing these schedules more than others in Case No.
4 19410.

5 In order to continue implementing the Commission directive the
6 Company proposes to institute a surcharge for said Schedules "R-A," "C-A,"
7 "W," "A" and "T-E" which is twice that requested for the Company's other
8 schedules. The proposal is consistent with the surcharge granted by
9 order dated July 31, 1974 pending application and hearings for the
10 increase in Case No. 19410. In its next rate proceeding the Company will
11 continue to implement the Commission's directive by narrowing the remain-
12 ing differential between these closed rates and the Company's correspond-
13 ing rates for general service to residential and commercial customers.

14 Q. Describe Exhibits 9 and 10.

15 A. Exhibit 9 is the tariff sheet reflecting the rate surcharge, while
16 Exhibit 10 is the tariff index sheet showing the new rate surcharge
17 filing.

18 Q. What about Exhibit 11?

19 A. I used a rate of return of 8.75% in Exhibit 7 because that was the over-
20 all rate granted us in Case No. 19410. At the time it was my understand-
21 ing that no changes in that rate could be made in an annual review filing.

22 Embedded costs have increased since that overall rate was determined
23 by the Commission. I have been informed that this increase could have
24 been used in developing the surcharge. Exhibit 11 shows the capital
25 structure and actual costs of debt and preferred stock at September 30,
26 1976. It continues the 12% return on common equity established in the
27 last case. Using this data the weighted return component develops a

1 rate of return of 8.83%.

2 Some recent decisions by this Commission have allowed a 13.5% return
3 on common equity. If this figure were substituted for the 12% in Exhibit
4 11, the resulting rate of return would be 9.35%.

5 Q. Why have you filed for relief under your annual review rather than filed
6 a general rate case?

7 A. We need prompt relief. As previously mentioned, we plan to sell $35
8 million of First Mortgage Bonds this year. The bond issue is planned for
9 November of 1977. Proceeds will be used to retire two issues of First
10 Mortgage Bonds - $5.5 million, 3-1/4% series due December 1, 1977 and
11 $4.0 million, 3-1/8% series due January 1, 1978. The remainder of the
12 proceeds will be used to finance part of the Company's construction
13 program.

14 In order for Potomac Edison to sell bonds it must meet the coverage
15 test provided in its mortgage indenture. The coverage test requires that
16 net earnings available for the payment of interest during twelve calendar
17 months out of the fifteen months immediately preceding issuance of new
18 bonds must cover all interest requirements, including the interest
19 charges associated with the new bonds, by at least two times. To deter-
20 mine if the Company will be able to meet the indenture coverage, a pro-
21 jection of the coverage has been made for the twelve months ending
22 September 30, 1977. Based on projected revenues and expenses and
23 assuming a 9% interest cost for the new bonds, the projections indicate
24 a bare coverage of 2.2 times. If the interest cost of the new bonds
25 would be higher than 9%, the 2.2 times coverage would be eroded downward.
26 Therefore, it is imperative that the Company start to collect additional
27 revenues as soon as possible to improve its coverage by September 30, 1977.

1 Q. Has your Company been actively seeking rate relief in other jurisdictions?

2 A. In Maryland, Potomac Edison filed on February 2, 1977, its fourth rate

3 case requesting an increase of $16.2 million.

4 In West Virginia, the Company is awaiting the Commission decision

5 on its third rate increase request of $4.5 million.

6 The Company has also filed with the Federal Power Commission its

7 third rate increase for wholesale customers requesting an increase of

8 $1.8 million.

9 Q. Do you have any final comments on why the Company needs this rate relief?

10 A. It needs the requested rate relief in order to earn a fair and reason-

11 able return on its investment. The failure to earn such a return is not

12 only unfair to the Company's stockholders but in order to maintain its

13 financial integrity such an increase is imperative. If that financial

14 integrity is jeopardized, the ability to raise the money required for

15 the construction program will be placed in danger and, unless that money

16 can be raised, service to our Virginia customers will deteriorate sharply

17 in future years.

18

19

20

21

22

23

24

25

26

27

Attachment Exhibit 1
Ex. JWN-1

THE POTOMAC EDISON COMPANY

Projected and Actual Rate of Return - End of Period Rate Base
Twelve Months Ended September 30, 1976

ne o.		Projected (a) Total Company Col. 1	Projected (a) Virginia Jurisdiction Col. 2	Actual Total Company Col. 3	Actual Virginia Jurisdiction Col. 4
		(Thousands of Dollars)			
	Adjusted Net Operating Income				
1	Electric Operating Revenues	$215,606	$ 30,352	$201,409	$ 28,505
	Operating Expenses				
2	Operation and Maintenance	$135,926	$ 17,632	$121,725	$ 16,083
3	Depreciation and Amortization	15,912	2,412	15,912	2,510
4	Taxes Other Than Federal Income	12,691	1,863	11,813	1,882
5	Investment Credit Deferred, Net	3,066	429	3,067	483
6	Income Taxes Deferred	3,567	453	3,695	606
7	Amortization of Deferred Taxes	(1,060)	(142)	(1,056)	(166)
8	Total	$170,102	$ 22,647	$155,156	$ 21,398
9	Federal Income Tax	7,245	1,488	7,684	1,065
0	Total Operating Expenses	$177,347	$ 24,135	$162,840	$ 22,463
1	Net Operating Income	$ 38,259	$ 6,217	$ 38,569	$ 6,042
2	Allowance For Funds During Construction	685	-	705	-
3	Charitable Contributions After Income Taxes	(16)	(2)	(18)	(3)
4	Adjusted Operating Income	$ 38,928	$ 6,215	$ 39,256	$ 6,039
	Rate Base - End of Period				
5	Electric Plant	$583,474	$ 86,089	$582,965	$ 90,951
6	Accumulated Provision for Depreciation	(136,945)	(20,400)	(136,235)	(22,357)
7	Net Electric Plant	$446,529	$ 65,689	$446,730	$ 68,594
8	Fuel in Stock	12,094	1,418	13,016	1,749
9	Materials and Supplies	5,199	839	5,240	837
0	Working Capital	16,038	2,894	14,450	2,713
1	Total Rate Base	$479,860	$ 70,840	$479,436	$ 73,893
2	Rate of Return		8.77%		8.17%

-a) As filed in last years annual review filing.

THE POTOMAC EDISON COMPANY

Projected Rate of Return - End of Period Rate Base
Twelve Months Ended September 30, 1977

Line No.		Total Company Col. 1	Virginia Jurisdiction Col. 2
		(Thousands of Dollars)	
	Adjusted Net Operating Income		
1	Electric Operating Revenues	$ 213,430	$ 29,726
	Operating Expenses		
2	Operation and Maintenance	$ 139,257	$ 17,823
3	Depreciation and Amortization	16,899	2,631
4	Taxes Other Than Federal Income	14,338	2,284
5	Investment Credit Deferred, Net	6,767	1,052
6	Income Taxes Deferred	3,991	621
7	Amortization of Deferred Taxes	(1,322)	(206)
8	Total	$ 179,930	$ 24,205
9	Federal Income Tax	(1,533)	(89)
10	Total Operating Expenses	$ 178,397	$ 24,116
11	Net Operating Income	$ 35,033	$ 5,610
12	Allowance for Funds During Construction	2,303	-
13	Charitable Contributions After Income Taxes	(18)	(3)
14	Adjusted Operating Income	$ 37,318	$ 5,607
	Rate Base - End of Period		
15	Electric Plant	$ 669,647	$101,690
16	Accumulated Provision For Depreciation	(149,668)	(24,308)
17	Net Electric Plant	$ 519,979	$ 77,382
18	Fuel in Stock	17,749	2,315
19	Materials and Supplies	5,240	829
20	Working Capital	16,477	2,984
21	Total Rate Base	$ 559,445	$ 83,510
22	Rate of Return		6.71%

THE POTOMAC EDISON COMPANY

Capital Structure Statements
September 30, 1976 Projected and Actual -
September 30, 1977 Projected

Line No.		September 30, 1976 Projected[a] Col. 1	September 30, 1976 Actual Col. 2	Sept. 30, 1977 Projected Col. 3
		(Thousands of Dollars)		
1	Long-Term Debt	$ 204,500	$ 229,500	$ 229,500
2	Short-Term Debt	3,500	-	30,900
3	Long-Term Unsecured Lease Obligation	7,591	5,406	4,949
4	Long-Term Installment Purchase Obligation	-	2,419	2,163
5	Long-Term Note	-	-	5,000
6	Total Debt	$ 215,591	$ 237,325	$ 272,512
7	Preferred Stock	58,099	58,048	57,988
8	Common Equity	162,843	152,834	180,608
9	Job Development Credits	10,164	10,166	17,082
10	Tax Deferrals	13,434	14,649	17,169
11	Total Capital	$ 460,131	$ 473,022	$ 545,359

(a) As filed in last years annual review filing.

THE POTOMAC EDISON COMPANY

ADJUSTMENTS TO TEST PERIOD

Adjustment No.	Description	Total Company	Allocated to Virginia
	Operating Revenues		
1	To adjust revenue for sales to other utilities to a normal level.	$(2,324,507)	$(290,762)
	Operation and Maintenance Expense		
2	To adjust expenses related to Adjustment 1.	$(1,952,304)	$(244,205)
3	To annualize expenses associated with wage increases during the test year.	681,914	106,106
4	To annualize expenses associated with reduction of personnel	(88,373)	(13,751)
5	To annualize the capacity charge of the Power Supply Agreement to the price in effect at January 1, 1976	74,838	10,055
	Total Operation and Maintenance Expense	$(1,283,935)	$(141,795)
	Taxes Other Than Federal Income		
6	State income tax on above adjustments	$ (13,527)	$ (670)
7	To adjust for the West Virginia property tax credit recorded in December 1975 of the test year but applicable to prior periods	697,960	109,921
	Total Taxes Other Than Federal Income	$ 684,433	$ 109,251
	Federal Income Taxes		
8	Federal Income Taxes on Adjustments 1 through 6	$ (492,982)	$ (71,183)

THE POTOMAC EDISON COMPANY

ADJUSTMENTS TO TEST PERIOD

Adjustment No.	Description	Total Company	Allocated to Virginia
	Income Taxes Deferred		
9	To adjust deferred taxes for the normalization effect of adjustment 7.	$ (421,300)	$ (66,350)
	Rate Base - Cash Working Capital		
10	Decrease due to adjustments to operation and maintenance expenses	$ (142,659)	$ (15,755)

THE POTOMAC EDISON COMPANY - VIRGINIA JURISDICTION

RATE OF RETURN

TWELVE MONTHS ENDED SEPTEMBER 30, 1976

Line No.		Column 1 Per Books[1]	Column 2 Adjustments[2]	Column 3 Adjusted Total	Column 4 Increase Needed To Earn 8.75% Rate of Return	Column 5 Pro-Formed To Earn 8.75% Rate of Return
	Adjusted Net Operating Income					
1	Electric operating revenues	$28,504,811	$ (290,762)	$28,214,049	$1,092,574[3]	$29,306,623
	Operating expenses:					
2	Operation and maintenance	$16,083,386	$ (141,795)	$15,941,591	$	$15,941,591
3	Depreciation and amortization	2,509,475		2,509,475		2,509,475
4	Taxes other than Federal income	1,882,345	109,251	1,991,596	42,985	2,034,581
5	Investment credit deferred, net	483,084		483,084		483,084
6	Income taxes deferred	606,135	(66,350)	539,785		539,785
7	Amortization of deferred taxes	(166,291)		(166,291)		(166,291)
8	Total	$21,398,134	$ (98,894)	$21,299,240	$ 42,985	$21,342,225
9	Federal income taxes	1,064,721	(71,183)	993,538	503,803	1,497,341
10	Total operating expenses	$22,462,855	$ (170,077)	$22,292,778	$ 546,788	$22,839,566
11	Operating income	$ 6,041,956	$ (120,685)	$ 5,921,271	$ 545,786	$ 6,467,057
12	Charitable contributions after income taxes	(2,776)		(2,776)		(2,776)
13	Adjusted net operating income	$ 6,039,180	$ (120,685)	$ 5,918,495	$ 545,786	$ 6,464,281
	Rate Base - End of Period					
14	Electric plant	$90,951,586	$	$90,951,586	$	$90,951,586
15	Accumulated provision for depreciation	(22,357,424)		(22,357,424)		(22,357,424)
16	Net electric plant	$68,594,162	$	$68,594,162	$	$68,594,162
17	Fuel in stock	1,748,845		1,748,845		1,748,845
18	Materials and supplies	837,192		837,192		837,192
19	Prepaid Virginia gross receipts tax	925,521		925,521		925,521
20	Working capital	1,787,043	(15,755)	1,771,288		1,771,288
21	Total Rate Base	$73,892,763	$ (15,755)	$73,877,008	$	$73,877,008
22	Rate of Return	8.17%		8.01%		8.75%

(1) From Exhibit 1, Column 4
(2) From Exhibit 6
(3) From Exhibit 8

THE POTOMAC EDISON COMPANY

COMPUTATION OF RATE SURCHARGE BASED ON
12 MONTHS ENDED SEPTEMBER 30, 1976

Schedule	12 Months Va. Jurisdictional Revenue Excl. Fuel	Rate Surcharge Percentage	Increased Revenue From Application of Surcharge
Schedule R	$ 5,960,135	4.274%	$ 254,736
Schedule A (Monterey)	94,812	8.548%	8,105
Schedule TE (Monterey)	49,204	8.548%	4,206
Schedule R-A	3,364,165	8.548%	287,569
Schedule C	2,199,086	4.274%	93,989
Schedule C-A	657,525	8.548%	56,205
Schedule C-A (Schools & Churches)	93,458	8.548%	7,989
Schedule PL	2,395,817	4.274%	102,397
Schedule PH	3,023,541	4.274%	129,226
Schedule PP	1,008,102	4.274%	43,086
Schedule W	988,315	8.548%	84,481
Schedule OL	247,176	4.274%	10,564
Schedule AL	45,334	4.274%	1,938
Schedule SL	22,978	4.274%	982
Schedule MSL	166,135	4.274%	7,101
Total	$20,315,783		$1,092,574

RATE SURCHARGE

I - A surcharge of 4.274% is applicable to all Rate Schedules except Schedules "R-A", "C-A", "W", "A" and "TE".

II - A surcharge of 8.548% is applicable to Rate Schedules "R-A", "C-A", "W", "A" and "TE".

The above Rate Surcharge applies to the basic rate excluding Fuel Cost Adjustment.

THE POTOMAC EDISON COMPANY

First Revision of
Original Page No. 3-1
S. C. C. Va. No. 12
Canceling
Original Page No. 3-1

INDEX

	SCHEDULE	PAGE
Front Page		1
Towns Served		2
Index		3
Rules and Regulations		4
Extension of Company's Facilities		5
Fuel Cost Adjustment		6-1
Rate Surcharge		6-2
Residential Service	R	7
Residential Service - All Electric (Restricted)	R-A	8
General and Commercial Service	C	9
Light and Power Service (Low Load Factor)	PL	10
Light and Power Service (High Load Factor)	PH	11
Power Service - Large Primary	PP	12
Water Heating Service (Restricted)	W	13
Outdoor Lighting Service	OL	14
Private Outdoor Area Lighting Service	AL	15
Mercury Vapor Street and Highway Lighting Service	MSL	16
Street and Highway Lighting Service (Restricted)	SL	17
General Service - All Electric (Restricted)	C-A	18
Residential Service (Restricted)	A	19
Residential Service - All Electric (Restricted)	T-E	20

ISSUED BY JOHN M. McCARDELL, EXECUTIVE VICE PRESIDENT AND GENERAL MANAGER

Issued January 13, 1977 Effective March 1, 1977

THE POTOMAC EDISON COMPANY

Capital Structure and Cost of Capital
At September 30, 1976

Line No.		Amount Outstanding Col. 1 ($000's)	Percentage Col. 2	Cost (%) Col. 3	Return Component (%) Col. 4
1	Long-Term Debt	$ 229,500	48.5	7.56	3.67
2	Long-Term Unsecured Lease Obligation	5,406	1.1	5.25	.06
3	Long-Term Purchase Obligation	2,419	.5	5.00	.03
4	Total Debt	$ 237,325	50.1		3.76
5	Preferred Stock	58,048	12.3	7.54	.93
6	Common Equity	152,834	32.3	12.00 (a)	3.88
7	Job Development Credits	10,166	2.2	12.00 (a)	.26
8	Tax Deferrals	14,649	3.1	-	-
9	Total Capital	$ 473,022	100.0		8.83

(a) Allowed in prior Case No. 19410

OTHER EXHIBITS IN REPORT

The Income Statement (Staff Exhibit AR-8) and Balance Sheet (Staff Exhibit AR-9) are self-explanatory and need no further explanation.

SUMMARY AND CONCLUSION

In its opinion handed down in Case No. 19410, this Commission concluded that a just and reasonable return on equity capital was 12.00%, resulting in an overall cost of capital of 8.75% at September 30, 1974. The 8.75% was then applied to the net rate base at September 30, 1974 to determine revenue requirements. Based on that calculation, a $2,673,868 rate increase was granted.

For this annual review, the Staff has used the 12.00% as the return on equity capital for the purpose of calculating the cost of capital. Doing so, results in an overall cost of capital of 8.83%, as shown by Staff Exhibit AR-6.

By applying the 8.83% return to the Virginia rate base at September 30, 1976, the Company's earnings requirements for Virginia operations are computed as follows:

Virginia Jurisdictional Year-End Rate Base (From Staff Exhibit AR-2)	$73,735,028
	8.83%
Net Earnings Requirements	$ 6,510,803
Less: Net Operating Income - Adjusted (From Column (4) of Staff Exhibit AR-1)	5,970,870
Net Revenue Deficiency	$ 539,933
Gross Revenue Deficiency (Based on Net Income Conversion Factor of .4995)	$ 1,080,947

Based on the above calculation, it appears that the Company experienced a net deficiency in Virginia earnings of $539,933 for the

annual review period. This translates into a gross deficiency of $1,080,947.

In its calculation of the amount of annual review "shortfall," the Company used the 8.75% overall cost of capital established in the last rate case. The Staff believes that under current annual review policy, any deficiency in earnings must be determined using year-end annual review capitalization with the cost of equity capital being based on the rate authorized in the last rate case. As shown in Column (4) of Staff Exhibit AR-6, this results in an 8.83% cost as compared to the 8.75% used by the Company. However, should the Commission decide to use the 8.75% return instead of 8.83%, the net deficiency would be $480,945, which translates into a gross deficiency of $962,853.

In conclusion, it appears that the Company's "shortfall" in annual review earnings of $1,080,947, as calculated by the Staff above, is material enough to warrant the Commission's consideration of the Company's request for rate relief.

Edward M. Vassar

Edward M. Vassar, Director
Division of Public Utility Accounting

ECB/eln

THE POTOMAC EDISON COMPANY

Rate of Return Statement
For The Twelve Months Ended September 30, 1976

	Total Company - Per Books Col. (1)	Virginia Jurisdictional Col. (2)	Staff Adjustments Col. (3)	After Staff Adjustments Col. (4)	Effect of Company's Proposed Increase Col. (5)	After Effect. of Company's Proposed Increase Col. (6)
Operating Revenues	$201,408,883	$28,504,811	$(1,002,377)	$27,502,434	$1,092,574	$28,595,008
Operating Revenue Deductions						
Operation and Maintenance Expenses	$121,724,959	$16,083,386	$ (853,410)	$15,229,976	$	$15,229,976
Depreciation and Amortization	15,912,500	2,509,475		2,509,475		2,509,475
Taxes Other Than Income Taxes	11,553,600	1,868,924	8,744	1,877,668	38,240	1,915,908
State Income Taxes - Pennsylvania	259,025	13,421	(215)	13,206	4,745	17,951
Federal Income Taxes - Current	7,683,900	1,064,721	(22,836)	1,041,885	503,803	1,545,688
Federal Income Taxes - Deferred	2,639,030	439,844	(66,350)	373,494		373,494
Investment Tax Credits - Net	3,067,300	483,084		483,084		483,084
	$162,840,314	$22,462,855	$ (934,067)	$21,528,788	$ 546,788	$22,075,576
Net Operating Income	$ 38,568,569	$ 6,041,956	$ (68,310)	$ 5,973,646	$ 545,786	$ 6,519,432
Less: Charitable Contributions (Net of F.I.T.)	18,125	2,776		2,776		2,776
Net Operating Income - Adjusted	$ 38,550,444	$ 6,039,180	$ (68,310)	$ 5,970,870	$ 545,786	$ 6,516,656
Year-End Rate Base (From Staff Exhibit AR-2)	$478,807,714	$73,829,851	$ (94,823)	$73,735,028		$73,735,028
Rate of Return - Year-End Basis	8.05%	8.18%		8.10%		8.84%
13-Month Average Rate Base (From Staff Exhibit AR-3)	$456,578,177	$70,731,652	$ (94,823)	$70,636,829		$70,636,829
Rate of Return - Average Basis	8.44%	8.54%		8.45%		9.23%

( ) Denotes negative amount

THE POTOMAC EDISON COMPANY

Rate of Return Statement
For The Twelve Months Ended September 30, 1976

	Total Company - Per Books Col. (1)	Virginia Jurisdictional Col. (2)	Staff Adjustments Col. (3)	After Staff Adjustments Col. (4)	Effect of Company's Proposed Increase Col. (5)	After Effect of Company's Proposed Increase Col. (6)
Operating Revenues	$201,408,883	$28,504,811	$(1,002,377)	$27,502,434	$1,092,574	$28,595,008
Operating Revenue Deductions						
Operation and Maintenance Expenses	$121,724,959	$16,083,386	$ (853,410)	$15,229,976	$	$15,229,976
Depreciation and Amortization	15,912,500	2,509,475		2,509,475		2,509,475
Taxes Other Than Income Taxes	11,553,600	1,868,924	8,744	1,877,668	38,240	1,915,908
State Income Taxes - Pennsylvania	259,025	13,421	(215)	13,206	4,745	17,951
Federal Income Taxes - Current	7,683,900	1,064,721	(22,836)	1,041,885	503,803	1,545,688
Federal Income Taxes - Deferred	2,639,030	439,844	(66,350)	373,494		373,494
Investment Tax Credits - Net	3,067,300	483,084		483,084		483,084
	$162,840,314	$22,462,855	$ (934,067)	$21,528,788	$ 546,788	$22,075,576
Net Operating Income	$ 38,568,569	$ 6,041,956	$ (68,310)	$ 5,973,646	$ 545,786	$ 6,519,432
Less: Charitable Contributions (Net of F.I.T.)	18,125	2,776		2,776		2,776
Net Operating Income - Adjusted	$ 38,550,444	$ 6,039,180	$ (68,310)	$ 5,970,870	$ 545,786	$ 6,516,656
Year-End Rate Base (From Staff Exhibit AR-2)	$478,807,714	$73,829,851	$ (94,823)	$73,735,028		$73,735,028
Rate of Return - Year-End Basis	8.05%	8.18%		8.10%		8.84%
13-Month Average Rate Base (From Staff Exhibit AR-3)	$456,578,177	$70,731,652	$ (94,823)	$70,636,829		$70,636,829
Rate of Return - Average Basis	8.44%	8.54%		8.45%		9.23%

( ) Denotes negative amount

As can be seen from page 4 substantial disparities would continue to exist and in some instances, although few, the magnitude of the disparity would increase. An example of this would be customers with monthly consumptions in excess of 4000 KWH. Even though the surcharge applied to Schedule "TE" is twice that applied to Schedule "R" the magnitude of the difference between the proposed total charge is greater than that under the present rates.

10. Q. Will not these special rates be phased out eventually because of customer turnover?

A. No. Schedules "R-A" and "TE" are closed as to locations (residences) served, but the rates are available to new customers moving into those locations. Schedule "A", although restricted, remains open to any new connections located within the former service area of Monterey Utilities Corporation. The only way these special rates will be eliminated is through the application of higher increases to the customers under special rates versus any increases which may be applied to Schedule "R." If future treatment of these special rates remains the same as was done over the last several years it could very well be 10 to 15 years before all of the special rates were eliminated. This time span, in my opinion, is unsatisfactory.

11. Q. Do you have any specific proposals which will eliminate these disparities?

A. The objective of my testimony is to offer guidance as to the direction in which future rates should move so as to reduce and/or eliminate special rates rather than to make specific recommendations to be considered for adoption in this proceeding. The several proposals which I shall discuss should be given further consideration by the Company prior to its application for a permanent increase in rates.

12. Q. Please proceed with your first proposal.

A. The first proposal which I considered was the elimination of Schedules "A" and "TE". Those customers presently served under Schedule "A" would be shifted to Schedule "R" and those customers served under "TE" would be shifted to Schedule "R-A".

Attachment JRW-2, which consists of two (2) pages, has been prepared to demonstrate the revenue impact and percentage increase in the total charge to those customers who would be shifted. Page 1 demonstrates the amount and percentage by which the present total charge under Schedule "TE" would have to be increased in order to bring it up to the level of the present total charge rendered under Schedule "R-A". The average monthly consumption for Schedule "TE" customers is approximately

1800 KWH thus, the total present charge would be increased from $42.55 to $51.74 or $9.19. I would like to point out that this increased charge of $51.74 is still $11.56 below the charge of $63.30 that another customer with like consumption would pay under the present Schedule "R".

Page 2 of Attachment JRW-2 shows the amount and percentage by which the total charge under Schedule "A" would have to be increased in order to bring it up to the level of the total charge rendered under Schedule "R". The average monthly consumption for Schedule "A" customers is approximately 460 KWH thus, the total present charge would be increased from $16.53 to $19.08 or a $2.55 increase.

13. Q. Would you please discuss your second proposal.

A. As an alternative to the proposal discussed above I would suggest consideration of the elimination of Schedules "R-A", "A" and "TE" and a redesign of Schedule "R".

The revenue impact on individual customers of this proposal is shown on Attachment JRW-1, page 2 of 4. As an example, a customer with a monthly consumption of 3,000 KWH under Schedule "R-A" would pay $25.36 more when shifted to Schedule "R", $15.25 more if presently billed under Schedule "A" and $38.75 more if presently billed under Schedule "TE". Attachment JRW-3 shows the percentage

increase in the total present charge these customers would receive if all were billed under Schedule "R".

14. Q. Are not the percentage increases a customer would receive under this proposal rather drastic?

A. Yes, however, there is an additional matter which must be taken into consideration. If Schedules "R-A", "A" and "TE" were eliminated and all customers were billed under Schedule "R" there would be a dramatic increase in the total test year revenue level from this customer class; Residential. As a result, the block charges under Schedule "R" would have to be reduced and/or the rate redesigned to conform to the test year total revenue level of the residential class. This would in fact reduce the percentage increases shown on Attachment JRW-3.

15. Q. How would you resolve the issue of excess revenue for the residential class?

A. This can be accomplished by use of one of the following two (2) methods:

a. Maintain the existing rate format and structure of Schedule "R" however, reduce each of the block charges by that percentage necessary to eliminate the revenue excess. (See Attachment JRW-4, Proposal a.)

b. Change the rate format and structure of Schedule "R" so as to increase the number of steps in the declining block rate structure and decrease the tail block charge below the present tail block rate level of 2.5¢/KWH. (See Attachment JRW-4, Proposal b.)

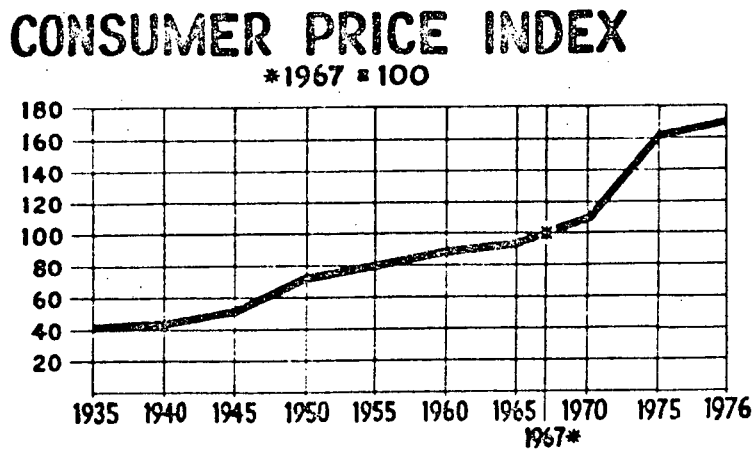
Attachment JRW-5

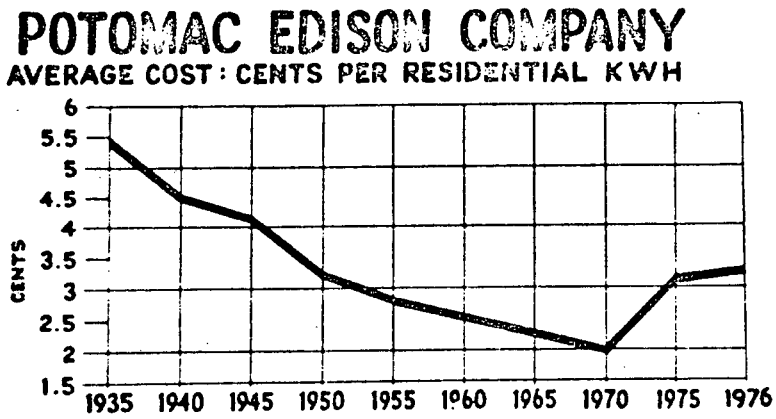
POTOMAC EDISON COMPANY

SPECIFIC CUSTOMER STATISTICS*
VIRGINIA JURISDICTIONAL

Rate Schedule	Average No. of Customers	MWH Sold	Total Revenue Test Year	Rate Surcharge Revenue
"R"	32,621	181,009	7,254,708	254,736
"A"	637	3,508	119,564	8,105
"TE"	154	3,220	72,169	4,206
"R-A"	8,566	165,340	4,551,936	287,569
"C"	5,413	69,889	2,699,423	93,989
"C-A"	453	34,630	988,010	64,194

*All data obtained from Potomac Edison Company


CONSUMER PRICE INDEX
*1967 = 100
180
160
140
120
100
80
60
40
20
1935
1940
1945
1950
1955
1960
1965
1970
1975
1976
1967*


POTOMAC EDISON COMPANY
AVERAGE COST: CENTS PER RESIDENTIAL KWH
CENTS
6
5.5
5
4.5
4
3.5
3
2.5
2
1.5
1935
1940
1945
1950
1955
1960
1965
1970
1975
1976

POTOMAC EDISON'S KWH PRICE
CUSTOMER USE & AVERAGE MONTHLY BILL SINCE 1935

Year	Average Price Cents Per Residential KWH		Average Yearly Residential Use Kilowatthours Per Customer	Avg. Monthly Residential Bill	
1935	5.44¢	(13.2¢)	634	$2.88	($ 7.01)
1940	4.61	(11.0¢)	898	3.45	(8.21)
1945	4.24	(7.9¢)	1,141	4.03	(7.48)
1950	3.27	(4.5¢)	1,910	5.21	(7.23)
1955	2.86	(3.6¢)	2,966	7.07	(8.82)
1960	2.58	(2.9¢)	4,095	8.82	(9.94)
1965	2.30	(2.4¢)	5,414	10.37	(10.97)
1970	2.06	(1.8¢)	8,024	13.78	(11.85)
1975	3.27*	(2.0¢)	10,021	27.29*	(16.93)*
1976	3.40*	(2.0¢)	10,382	29.43*	(17.26)*

* Includes fuel charge
( ) Adjusted for the purchasing power of the dollar 1967 = 100

NEWER POWER STATION COST COMPARISONS

Station	Completed	Total Costs	Cost/KW
Fort Martin	1968	$140 Million	$126
Hatfield's Ferry	1971	244 Million	147
Harrison	1974	393 Million	205
Pleasants	1980	662 Million *	529 *

* Estimated

THE POTOMAC EDISON COMPANY

RATE OF RETURN

TWELVE MONTHS ENDED DECEMBER 31, 1976

Line No.		Column 1	Virginia Jurisdictional Column 2	Column 3	Column 4	Column 5	Column 6
		Total Company	Total Company Allocated	Adjustments	Pro Forma	Proposed Rate Increase	Pro Forma After Proposed Rate Increase
	Operating Income						
1	Operating revenues	$208,993,481	$ 29,146,002	$(894,998)	$ 28,251,004	$ 3,825,380	$ 32,076,384
	Operating expenses						
2	Operation and maintenance	$129,423,406	$ 16,845,014	$(183,323)	$ 16,661,691	$	$ 16,661,691
3	Depreciation and amortization	15,977,200	2,518,913		2,518,913		2,518,913
4	Taxes other than income	12,616,155	1,964,821		1,964,821	133,888	2,098,709
5	Total operating expenses	$158,016,761	$ 21,328,748	$(183,323)	$ 21,145,425	$ 133,888	$ 21,279,313
6	Operating income before income taxes	$ 50,976,720	$ 7,817,254	$(711,675)	$ 7,105,579	$ 3,691,492	$ 10,797,071
	Income taxes						
7	State	$ 298,300	$ 15,834	$ (3,203)	$ 12,631	$ 16,612	$ 29,243
8	Federal	5,648,100	1,096,043	(340,067)	755,976	1,763,942	2,519,918
9	Investment credit deferred	3,727,000	585,407		585,407		585,407
10	Income taxes deferred	5,348,510	586,792		586,792		586,792
11	Amortization of investment credits	(475,100)	(74,801)		(74,801)		(74,801)
12	Amortization of deferred taxes	(1,654,350)	(260,467)		(260,467)		(260,467)
13	Total income taxes	$ 12,892,460	$ 1,948,808	$(343,270)	$ 1,605,538	$ 1,780,554	$ 3,386,092
14	Net operating income	$ 38,084,260	$ 5,868,446	$(368,405)	$ 5,500,041	$ 1,910,938	$ 7,410,979
15	Charitable contributions net of income taxes	(18,392)	(2,820)		(2,820)		(2,820)
16	Return	$ 38,065,868	$ 5,865,626	$(368,405)	$ 5,497,221	$ 1,910,938	$ 7,408,159
	Rate Base - End of Period						
17	Electric plant	$602,651,099	$ 93,595,948	$	$ 93,595,948		$ 93,595,948
18	Accumulated depreciation	(139,823,103)	(22,756,025)		(22,756,025)		(22,756,025)
19	Net electric plant	$462,827,996	$ 70,839,923	$	$ 70,839,923		$ 70,839,923
20	Fuel in stock	11,587,378	1,547,414		1,547,414		1,547,414
21	Materials and supplies	5,372,237	860,141		860,141		860,141
22	Prepaid Virginia gross receipts tax	924,974	890,915		890,915		890,915
23	Working capital	14,380,378	1,871,668	(20,369)	1,851,299		1,851,299
24	Customer advances for construction	(653,816)	(4,750)		(4,750)		(4,750)
25	Rate Base	$494,439,147	$ 76,005,311	$ (20,369)	$ 75,984,942		$ 75,984,942
26	Rate of Return		7.72%		7.23%		9.75%

Exhibit No. JWN-2
Schedule 3

THE POTOMAC EDISON COMPANY

ADJUSTMENTS TO TEST PERIOD

TWELVE MONTHS ENDED DECEMBER 31, 1976

Adjustment No.	Description	Total Company	Virginia Jurisdiction
	Operating Revenues		
1	To eliminate the abnormal sales to the General Public Utilities System	$(7,214,738)	$(894,998)
	Operation and Maintenance Expense		
2	To remove costs associated with sales in Adjustment No. 1 and to reflect the substitution of economy transactions with other utilities representing a portion of reduced short term sales that would be sold as economy energy	$(5,967,745)	$(736,869)
3	To annualize expenses associated with wage increases during test year and to reflect level of wages for ensuing twelve month period	1,253,462	211,243
4	To annualize expenses associated with reduction of personnel	(273,029)	(47,574)
5	To annualize change in labor expense distribution due to engineering time study	445,918	85,690
6	To reflect 1977 level of capacity charge under the Power Supply Agreement	68,333	9,125
7	To reflect Power Supply Agreement charges with a fixed charge rate based on 9½% rate of return	2,049,990	273,762
8	To reflect one-half of estimated expenses of this rate case	21,300	21,300
	Total Operation and Maintenance Expense	$(2,401,771)	$(183,323)

THE POTOMAC EDISON COMPANY

ADJUSTMENTS TO TEST PERIOD

TWELVE MONTHS ENDED DECEMBER 31, 1976

Adjustment No.	Description	Total Company	Virginia Jurisdiction
	Income Taxes		
9	State income tax on Adjustments 1 through 8	$ (62,569)	$ (3,203)
10	Federal income tax on Adjustments 1 through 9	(2,280,191)	(340,067)
	Total Income Taxes	$(2,342,760)	$(343,270)
	Rate Base		
11	Cash working capital charge due to Adjustments 2 through 8	$ (266,863)	$ (20,369)

THE POTOMAC EDISON COMPANY

PROJECTED RATE OF RETURN

TWELVE MONTHS ENDED DECEMBER 31, 1977

Line No.		Column 1	Virginia Jurisdictional Column 2	Virginia Jurisdictional Column 3	Virginia Jurisdictional Column 4
		Total Company	Total Company Allocated	Proposed Rate Increase	Pro Forma After Proposed Rate Increase
			(Thousands of Dollars)		
	Operating income				
1	Operating revenues	$ 196,855	$ 30,908	$ 3,825	$ 34,733
	Operating expenses				
2	Operation and maintenance	$ 120,921	$ 17,532	$	$ 17,532
3	Depreciation and amortization	16,759	2,904		2,904
4	Taxes other than income	12,761	2,231	134	2,365
5	Total operating expenses	$ 150,441	$ 22,667	$ 134	$ 22,801
6	Operating income before income taxes	$ 46,414	$ 8,241	$ 3,691	$ 11,932
	Income taxes				
7	State	$ 74	$ 13	$ 17	$ 30
8	Federal	332	135	1,764	1,899
9	Investment credit deferred	7,268	1,259		1,259
10	Income taxes deferred	4,059	703		703
11	Amortization of investment credits	(633)	(110)		(110)
12	Amortization of deferred taxes	(1,362)	(236)		(236)
13	Total income taxes	$ 9,738	$ 1,764	$ 1,781	$ 3,545
14	Net operating income	$ 36,676	$ 6,477	$ 1,910	$ 8,387
15	Charitable contributions net of income taxes	(20)	(4)		(4)
16	Return	$ 36,656	$ 6,473	$ 1,910	$ 8,383
	Rate Base - End of Period				
17	Electric plant	$ 683,218	$ 116,936		$ 116,936
18	Accumulated depreciation	(148,764)	(27,263)		(27,263)
19	Net electric plant	$ 534,454	$ 89,673		$ 89,673
20	Fuel in stock	17,170	2,514		2,514
21	Materials and supplies	5,488	951		951
22	Prepaid Virginia gross receipts tax	1,009	970		970
23	Working capital	13,436	1,948		1,948
24	Customer advances for construction	(907)	(5)		(5)
25	Rate Base	$ 570,650	$ 96,051		$ 96,051
26	Rate of Return		6.74%		8.73%

Exhibit No. JWN-2
Schedule 5

Exhibit No. JWN-2
Schedule 6

THE POTOMAC EDISON COMPANY

CAPITAL STRUCTURE

DECEMBER 31, 1976 - DECEMBER 31, 1977 PROJECTED

Line No.		December 31, 1976	Projected December 31, 1977
		(Thousands of Dollars)	
1	Long-term debt	$ 229,500	$ 255,000
2	Short-term debt	-	11,300
3	Other long-term obligations	7,643	14,073
4	Preferred stock including premium	58,048	57,973
5	Common equity	152,126	179,889
6	Job development credits	10,777	17,960
7	Income tax deferrals	14,332	18,277
8	Total	$ 472,426	$ 554,472

Schedule 8

THE POTOMAC EDISON COMPANY

Adjustment Annualizing Final Determination of
Capacity Billing Under Power Supply Agreement

Subsequent to the Company's filing, a final determination was made of the effect of the change in the Power Supply Agreement reflecting a fixed charge rate based on 9 1/4% rate of return. The effect of annualizing the final determination would be to increase the Company's Adjustment No. 7 and Staff's Adjustment No. 6 by $214,447 so that the total of these adjustments would be $488,209. This increase is due to the recognition of normalization of accelerated depreciation and construction work in progress covering pollution control facilities. The Company was actually billed on this basis for the months of July and August 1977. The increase would have the following effect on the tabulation shown on Page 17 of Colonel Leis' testimony using Dr. Weaver's rate of return computations. The column at the right shows the computation at the Company's 9.75% proposed rate of return.

	Cost of Capital Range (Weaver) Low	Cost of Capital Range (Weaver) High	P. E. Company Rate of Return
Virginia Jurisdictionsl Year-End Rate Base - From Staff Schedule A to State I - Col. (4)	$ 75,218,671	$ 75,218,671	$ 75,218,671
Effect of above adjustment on cash working capital - 1/9 of $214,447	23,827	23,827	23,827
Total	$ 75,242,498	$ 75,242,498	$ 75,242,498
Rate of Return (Weaver Statement 18)	9.18%	9.43%	9.75%
Revenue Requirements	$ 6,907,261	$ 7,095,368	$ 7,336,143
Less: Net Operating Income (Adjusted) - From Statement I - Co. (4)	$ 5,447,215	$ 5,447,215	$ 5,447,215
Effect on return of the above adjustment	111,011	111,011	111,011
Total	$ 5,336,204	$ 5,336,204	$ 5,336,204
Net Revenue Deficiency	$ 1,571,057	$ 1,759,164	$ 1,999,939
Gross Revenue Deficiency (Based on Net Income Conversion Factor of .4995)	$ 3,145,259	$ 3,521,850	$ 4,003,882

CASE NO. 19810
EXHIBIT NO. JWN-2
MAR 28 1977
J. W. Nicol
D. R. Harrison

THE POTOMAC EDISON COMPANY
VIRGINIA
Revenue and Proposed Increase by Schedules
12 Months Ended December 31, 1976

Schedule	Actual Base Rate Revenue	Actual FCA Revenue	Actual Total Revenue	Proposed Increase	% Increase Over Total Revenue
R	$ 6,184,788	$1,359,056	$ 7,543,844	1,136,745	12.65
W - Res. Mtd.	959,718	357,834	1,317,552	~~$1,137,704~~	~~12.66%~~
A	97,893	26,007	123,901		
R-A	3,516,757	1,274,073	4,790,830	735,916	15.12
TE	51,386	24,672	76,058	~~777,027~~	~~15.97~~
C	2,107,147	479,894	2,587,041		
C-A	681,614	216,534	898,148	528,641	15.17
CSH Provision	94,835	41,255	136,090	36,922	27.13
PL	2,457,666	884,213	3,341,879	462,387	13.84
PH	3,182,357	1,445,309	4,627,666	596,801	12.90
PP	1,000,940	630,543	1,631,484	189,783	11.63
W - Com. & Ind. Mtd.	33,918	12,645	46,563	8,212	17.64
OL	247,647	25,217	272,861	45,463	16.66
AL	46,277	5,925	52,202	8,473	16.23
MSL	169,441	19,885	189,327	31,063	16.41
SL	22,603	4,926	27,529	4,160	15.11
TOTAL	$20,854,987	$6,807,988	$27,662,975	~~$3,826,636~~ 3,784,566	~~13.83%~~ 13.68%

Charles S. Mu...

1976 CSM-4

-123-

Exhibit No. CSM-4
Table 1

THE POTOMAC EDISON COMPANY
VIRGINIA

COMPARISON OF PROPOSED RATES INCLUDING FUEL COST ADJUSTMENT

	Present With Fuel	Proposed With Fuel	% Increase
SCHEDULE R			
Minimum Charge	$2.97	$3.35	12.79%
First 50 Kwh	.07249	.07820	7.88
Next 100 Kwh	.04849	.05232	7.90
Over 150 Kwh	.03049	.03338	9.48
SCHEDULE R-A			
Minimum Charge and First 150 Kwh or Less	$8.31	9.20 ~~$9.66~~ 10292	~~16.25%~~ 10.71
Next 770 Kwh	.02549	~~.02919~~ 10259	~~14.52~~ 14.55
Next 730 Kwh	.02249	~~.02588~~	~~15.07~~ 15.06
Over 1,650 Kwh	.01899	~~.02319~~ 10233	~~22.12~~ 22.70
SCHEDULE C			
Minimum Charge	$3.07/Cust.	$3.27/Cust.	6.51%
Minimum Charge	1.33/Kw	1.49/Kw	12.03
First 50 Kwh	.07049	.07329	3.97
Next 300 Kwh	.05229	.05549	6.12
Next 350 Kwh	.04199	.04649	10.72
Over 700 Kwh	.02529	.02909	15.03
SCHEDULE C-A			
Minimum Charge	$6.86/Cust.	$3.27/Cust.	(52.33)%
Minimum Charge	1.40/Kw	1.49/Kw	6.43
First 50 Kwh	.07549	.07329	(2.91)
Next 300 Kwh	.04949	.05549	12.12
Next 350 Kwh	.03899	.04649	19.24
Over 700 Kwh	.02019	.02909	44.08

Exhibit No. CSM-4
Table 2
Page 2 of 3

THE POTOMAC EDISON COMPANY
VIRGINIA

COMPARISON OF PROPOSED RATES INCLUDING FUEL COST ADJUSTMENT

	Present With Fuel	Proposed With Fuel	% Increase
SCHEDULE CA-CSH			
Schedule Minimum	$1.11	$3.27	194.59%
Minimum Kw	-	-	-
All Kwh	.02249	.02909	29.35
SCHEDULE A			
Minimum Charge	$2.05	$3.35	63.41%
First 50 Kwh	.06049	.07820	29.28
Next 100 Kwh	.04449	.05232	17.60
Over 150 Kwh	.02549	.03338	30.95
SCHEDULE TE			
First 125 Kwh	$6.68	9.20 ~~$9.66~~	37.92 ~~44.61%~~
Next 125 Kwh	.02749		
Next 400 Kwh	.02049		
Next 950 Kwh	.01749		
Over 1,600 Kwh	.01549	~~.02319~~ .02233	~~49.71~~ 50.42
SCHEDULE PL			
Demand			
Kw at Minimum	$1.70	$2.00	17.65%
All Kwh	1.92	2.37	23.44
Rkva Charge	.25	.25	-
Energy			
First 100,000 Kwh	.02109	.02349	11.38
Next 100,000 Kwh	.01699	.01899	11.77
Over 200,000 Kwh	.01509	.01699	12.59
Voltage Discount	.07	.07	-

THE POTOMAC EDISON COMPANY
VIRGINIA

COMPARISON OF PROPOSED RATES INCLUDING FUEL COST ADJUSTMENT

	Present With Fuel	Proposed With Fuel	% Increase
SCHEDULE PH			
Demand			
Kw at Minimum	$1.87	$2.17	16.04%
First 500 Kw	3.46	4.76	37.57
Over 500 Kw	3.12	4.42	41.67
Rkva Charge	.25	.25	-
Energy			
First 45,000 Kwh	.01639	.01649	0.61
Next 55,000 Kwh	.01389	.01399	0.72
Over 100,000 Kwh	.01279	.01289	0.78
Voltage Discount	.07	.07	-
SCHEDULE PP			
Demand			
First 20,000 Kw	$3.01	$4.12	36.88%
Over 20,000 Kw	2.54	3.65	43.70
Rkva Charge	.25	.25	-
Energy			
First 10,000,000 Kwh	.01099	.01109	0.91
Over 10,000,000 Kwh	.01029	.01039	0.97
SCHEDULE W			
Minimum Charge	3.00 ~~$3.60~~	$3.60	-
All Kwh	~~.02449~~ .020	.02909	18.78%

THE POTOMAC EDISON COMPANY

Calculation of Fuel Clause Base
12 Months Ended December 31, 1976

Line No.		Account 151 Fossil Fuel Cost	Plus Intra-System Purchases	Less Fuel In NAT* and Suspense	Less Demurrage and Miscellaneous Credits	Total Cost Fm	Total Sales Sm
		(a)	(b)	(c)	(d)	(e)	(f)
1	January 1976	$ 6,863,042	$ 1,971,818	$ (1,618,287)	$ -	$ 7,216,573	713,402,000
2	February	6,246,207	1,364,449	(1,506,931)	-	6,103,725	713,936,000
3	March	6,896,075	1,671,233	(2,316,837)	-	6,250,471	690,869,000
4	April	6,170,087	1,651,625	(1,846,063)	-	5,975,649	673,830,000
5	May	5,750,905	1,707,767	(1,560,625)	-	5,898,047	663,579,000
6	June	5,983,113	1,691,505	(1,772,928)	-	5,901,690	639,564,000
7	July	6,732,093	1,537,578	(1,958,893)	-	6,310,778	646,115,000
8	August	7,476,214	1,408,088	(2,118,733)	-	6,765,569	657,197,000
9	September	6,281,145	1,542,989	(1,804,841)	-	6,019,293	640,558,000
10	October	6,462,815	1,906,631	(1,224,654)	-	7,144,792	650,309,000
11	November	6,596,351	2,225,086	(1,248,845)	-	7,572,592	684,457,000
12	December	7,108,309	2,609,811	(822,039)	(84,919)	8,811,162	757,216,000
13	TOTAL - (12 Months Ended December 1976)	$78,566,356	$21,288,580	$(19,799,676)	$(84,919)	$79,970,341	8,131,032,000
14	Average Fuel Cost per Kwh of Sales for 1976						0.984¢/Kwh
15	Fuel Cost per Kwh to be Included in Base Rates						0.800¢/Kwh

*NAT = Transactions with Non-Associated Utilities

Exhibit No. CSM-4
Table 3

Potomac Edison Company - Virginia
Comparison of Present R (with reference to W) and Proposed R

CSM-4
Table 4

	Present R					Present W					Total R and W	Proposed R						
	Kwh	Base Cost	Surcharge Fuel Cost 2.390¢	Fuel Cost 1.117¢	Total R	Kwh	Base Cost	Surcharge 2.54¢	Fuel Cost 1.117¢	Total W	Kwh	Kwh	Base Cost	Fuel Cost 1.117¢	Total		
	150	3.65	.26	1.17	5.08	300	3.30	.54	1.56	5.68	450	11.74	250	12.42	1.39	16.91	2.15	19.57
	300	8.30	.30	1.56	10.76	300	3.30	.54	1.56	5.64	600	16.14	300	13.99	1.64	17.73	2.09	19.82
	200	11.40	.39	2.23	14.14	200	3.30	.54	1.56	5.68	500	19.82	500	20.83	1.55	23.38	2.50	25.88
	150	7.65	.26	1.17	9.08	250	4.25	.41	1.96	7.12	400	16.20	400	17.44	1.24	18.73	2.22	20.95
	300	8.30	.30	1.56	10.76	250	4.25	.41	1.96	7.12	450	17.42	450	18.15	1.40	20.56	2.28	22.84
	200	11.40	.39	2.23	14.14	250	4.25	.41	1.96	7.12	500	21.26	500	22.09	1.71	24.80	2.5[illegible]	27.33
	400	13.30	.47	3.12	17.50	250	4.25	.41	1.96	7.12	650	24.62	650	25.93	2.00	27.93	2.93	30.86
	500	16.40	.56	3.91	20.87	250	4.25	.41	1.96	7.12	750	27.99	750	29.17	2.22	31.50	3.51	35.01
	700	22.65	.77	5.27	28.69	250	4.25	.41	1.96	7.12	1000	35.81	1000	37.52	2.93	40.45	4.21	44.66
	1250	35.15	1.19	8.72	44.12	250	4.25	.41	1.96	7.12	1500	51.26	1500	54.21	4.25	58.46	5.46	63.92
	150	7.65	.26	1.17	9.08	300	5.70	.49	2.35	8.54	450	17.62	450	19.16	1.40	20.56	2.94	23.50
	300	8.30	.30	1.56	10.76	300	5.70	.49	2.35	8.54	600	17.30	600	20.83	1.55	22.38	3.19	25.57
	400	13.30	.47	2.13	17.50	300	5.70	.49	2.35	8.54	700	26.04	700	27.50	2.07	29.57	3.45	33.02
	500	16.40	.56	3.91	20.87	300	5.70	.49	2.35	8.54	800	29.41	800	30.84	2.21	33.05	3.91	36.96
	700	22.65	.77	5.27	28.69	300	5.70	.49	2.35	8.54	1050	37.23	1050	39.18	2.86	42.04	4.81	46.85
	1250	35.15	1.19	8.72	44.12	300	5.70	.49	2.35	8.54	1550	54.66	1550	55.87	4.31	60.18	6.02	66.20
	300	8.30	.30	1.56	10.76	400	7.60	.65	3.13	11.38	700	20.14	700	21.16	1.86	23.02	3.17	26.19
	400	13.30	.47	2.13	17.50	400	7.60	.65	3.13	11.38	800	20.91	800	22.54	2.42	24.96	3.74	28.70
	500	16.40	.56	3.91	20.87	400	7.60	.65	3.13	11.38	900	23.25	900	24.16	2.71	26.87	4.32	31.19
	700	22.65	.77	5.27	28.69	400	7.60	.65	3.13	11.38	1150	30.07	1150	31.50	3.57	35.07	5.46	40.53
	1250	35.15	1.19	8.72	44.12	400	7.60	.65	3.13	11.38	1650	57.50	1650	59.21	5.12	64.33	6.35	70.68

First Revision of
Original Page No. 7-1
S. C. C. Va. No. 12
Canceling
Original Page No. 7-1
Schedule-5

RESIDENTIAL SERVICE

SCHEDULE "R"

(Rate Code No. 200)

AVAILABILITY

Available for single phase residential service through one meter.

MONTHLY RATE

First	50 kilowatt hours	7.820 cents per kilowatt hour
Next	100 kilowatt hours	5.232 cents per kilowatt hour
All over	150 kilowatt hours	3.338 cents per kilowatt hour

FUEL ADJUSTMENT

Adjustment applies to all kilowatt-hours served under this schedule.

MINIMUM CHARGE

$3.35 per month.

LATE PAYMENT CHARGE

Applies to this schedule as set forth in Company Rule No. 22 of this tariff.

GENERAL

Service supplied is subject to the Rules and Regulations Covering the Supply of Electric Service, and Rules and Regulations for Meter and Service Installations of the Company as filed with the Commission.

This schedule includes service to a residence which has a commercial enterprise or office within it, provided the total installation used for purposes other than residential is not greater than 500 watts.

When two or more dwelling units including two or more houses on a farm are supplied through a single meter, each shall be classed as a single residence with the rate blocks increased proportionately to number of dwelling units. This provision restricted to those Customers and locations served in this manner on December 1, 1972.

Customers with average monthly use in excess of 1,500 kilowatthours will have the option of using the Company's Uniform Payment Plan. Uniform monthly payment will be established by the Company as 1/12 of the total estimated revenue for the 12 months.

The Potomac Edison Company
Capital Structure and Related Ratios Based Upon Investor Provided Capital
Actual at December 31, 1976 and Estimated at December 31, 1977

	December 31, 1976 (Actual)		December 31, 1977 (Estimated)	
	Amount Outstanding ($Thous.)	Ratios	Amount Outstanding ($Thous.)	Ratios
Long-Term Debt:				
First Mortgage Bonds	$229,500		$255,000(1)	
Long-Term Unsecured Lease Obligation-Harrison	5,288		6,473(2)	
Long-Term Installment Purchase-Albright	2,355		2,100(2)	
Long-Term Pollution Control-Hatfield	-		5,500(3)	
Total Long-Term Debt	237,143	53.0%	269,073	51.9%
Preferred Stock	57,983		57,908	
Premium on Preferred Stock	65		65	
Total Preferred Stock	58,048	13.0	57,973	11.2
Common Equity:				
Common Stock	107,500		132,500(4)	
Other Paid-In Capital	2,940		2,940	
Retained Earnings	41,686		44,449(5)	
Total Common Equity	152,126	34.0	179,889	34.7
Total Permanent Capital	447,317	100.0	506,935	97.8
Short-Term Debt	-	-	11,300(5)	2.2
Total Capital Employed	$447,317	100.0%	$518,235	100.0%

Ratios at 12-31-77 (Estimated) Excluding Short-Term Debt:

Long-Term Debt	53.1%
Preferred Stock	11.4
Common Equity	35.5
	100.0%

Comment: The Company's actual construction expenditures for the year ended 12-31-76 were $66,251,000. The construction budget for 1977 totals $88,305,000.

Notes:
(1) Includes $35,000,000 of First Mortgage Bonds projected for November 1977.
(2) Reflects principal repayments during 1977 and the Pennsylvania property transfer of January 1, 1977.
(3) Pollution Control Note issued January 31, 1977 due February 1, 2002 at an interest rate of 6.30%.
(4) Reflects proposed sale of $25,000,000 of Common Stock in 1977.
(5) Company provided estimates.

Source of Information: Company provided data

The Potomac Edison Company
Capital Structure and Related Ratios for Rate Making Purposes
Actual at December 31, 1976 and Estimated at December 31, 1977

	December 31, 1976 (Actual)		December 31, 1977 (Estimated) (1)	
	Amount Outstanding ($Thous.)	Ratios	Amount Outstanding ($Thous.)	Ratios
Debt:				
First Mortgage Bonds	$229,500		$255,000(2)	
Lease Obligation - Harrison	5,288		6,473(3)	
Installment Purchase - Albright	2,355		2,100(3)	
Pollution Control - Hatfield	-		5,500(4)	
Short-Term Debt	-		11,300	
Total Debt	237,143	50.2%	280,373	50.6%
Preferred Stock (Including Premium)	58,048	12.3	57,973	10.4
Common Equity:				
Common Stock	107,500		132,500(5)	
Other Paid-In Capital	2,940		2,940	
Retained Earnings	41,686		44,449	
Accum. Deferred Job Development Tax Credit	10,777		17,960	
Total Common Equity	162,903	34.5	197,849	35.7
Cost Free Capital:				
Accum. Deferred Investment Tax Credit (pre-1971)	3,088		2,787	
Accum. Deferred Income Taxes Arising from Accelerated Amortization and Liberalized Depreciation (Net)	11,244		15,490	
Total Cost Free Capital	14,332	3.0	18,277	3.3
Total Capital	$472,426	100.0%	$554,472	100.0%

Note: (1) Estimates include Pennsylvania property transfer of 1/1/77.
(2) Includes $35,000,000 of First Mortgage Bonds projected for November 1977.
(3) Reflects principal repayments during 1977.
(4) Pollution Control Note issued January 31, 1977 due February 1, 2002 at an interest rate of 6.30%.
(5) Reflects proposed sale of $25,000,000 of common stock in 1977.

Source of Information: Company provided data

The Potomac Edison Company
Capitalization and Financial Statistics
1972-1976, Inclusive

	1976	1975 (3)	1974 (3)	1973	1972	Percent Increase 1976 over 1972
		(Thousands of Dollars)				
Amount of Capital Employed						
Total permanent capital	$447,318	$393,486	$357,134	$362,814	$339,913	
Short-term debt notes payable	-	14,700	47,881	4,500	2,000	
Total capital employed	$447,318	$408,186	$405,015	$367,314	$341,913	30.8%
Indicated Average Actual Capital Cost Rates (1)						
Long-term debt	7.4%	6.6%	6.6%	6.0%	5.9%	25.4%
Preferred stock	7.5	6.8	6.8	6.8	7.1	5.6
						5 Year Average
Dividend Payout Ratio	89.0%	89.3%	82.2%	86.3%	69.0%	83.2%
Capital Structure Ratios						
Based on total permanent capital:						
Long-term debt	53.0%	53.4%	50.6%	54.5%	53.3%	53.0%
Preferred stock	13.0	11.0	12.1	11.9	12.8	12.1
Common equity	34.0	35.6	37.3	33.6	33.9	34.9
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Based on total capital:						
Total debt, including short-term	53.0%	55.1%	56.4%	55.0%	53.6%	54.6%
Preferred stock	13.0	10.6	10.7	11.8	12.7	11.8
Common equity	34.0	34.3	32.9	33.2	33.7	33.6
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Rate of Return on Average Book Common Equity	12.5%	12.5%	5.7%	10.8%	9.9%	10.3%
Rate of Return Earned on Average Book Common Equity Over Indicated Average Long-Term Debt Cost Rate	5.1%	5.9%	(0.9%)	4.8%	4.0%	3.8%
Coverages (2)						
Before income taxes: All interest charges	3.0	2.8	1.6	2.6	2.5	2.5
After income taxes: All interest charges	2.3	2.2	1.7	2.3	2.3	2.2
Overall coverage (sum of interest and preferred dividends)	1.9	1.9	1.4	1.9	1.8	1.8

Notes: (1) Computed by relating actual interest or preferred dividends booked to average of beginning and ending debt or preferred stock reported to be outstanding.
(2) Coverage calculations based upon AFC (allowance for funds used during construction) as reported in its entirety included as income.
(3) 1975 and 1974 are based on restated financial statements of the Company reflecting the West Virginia Revenue Refund ordered March 5, 1976.

Source of Information: Company's Annual Reports.

The Potomac Edison Company
Calculation of the Composite Cost Rate of Debt
Actual at December 31, 1976 and Estimated at December 31, 1977

	Amount Outstanding ($ 000's)	Percent to Total	Cost Rate	Weighted Cost Rate
ctual at December 31, 1976				
irst Mortgage Bonds	$229,500	96.78%	7.56% (1)	7.32%
ong-Term Lease Obligation - Harrison	5,288	2.23	4.875 (2)	0.11
ong-Term Installment Purchase - Albright	2,355	0.99	5.00 (3)	0.05
Total Long-Term Debt	$237,143	100.00%		7.48%
otal Long-Term Debt	$237,143	100.00%		7.48%
otal Short-Term Debt	-	-		-
Total Debt Outstanding at 12-31-76 (Actual)	$237,143	100.00%		7.48%
stimated at December 31, 1977				
irst Mortgage Bonds	$255,000	94.77%	7.87% (4)	7.46%
ollution Control Bonds - Hatfield	5,500	2.04	6.54 (5)	0.13
ong-Term Lease Obligation - Harrison	6,473	2.41	5.50 (6)	0.13
ong-Term Installment Purchase - Albright	2,100	0.78	5.25 (7)	0.04
Total Long-Term Debt	$269,073	100.00%		7.76%
otal Long-Term Debt	$269,073	95.97%	7.76	7.45%
otal Short-Term Debt	11,300	4.03	7.50 (8)	.30
Total Debt Outstanding at 12-31-77 (Estimated)	$280,373	100.00%		7.75%

ee page 2 for Notes and Source of Information.

The Potomac Edison Company
Calculation of the Composite Cost Rate of Debt
Actual at December 31, 1976 and Estimated at December 31, 1977

Notes:

(1) Composite cost rate for First Mortgage Bonds as developed on page 3 of this schedule.

(2) Interest rate is one-half the difference between 5% and the prime interest rate charged by Mellon Bank, plus 4 1/4%. At December 31, 1976, the Company experienced an actual cost of 4.875% (1/2 (6.25 - 5.00) + 4.25).

(3) Interest rate is one-half the difference between 7% and the prime interest rate charged by Chemical Bank, plus 5.00%. At December 31, 1976 the Company experienced an actual cost of 5.00% (1/2 (6.25 - 7.00) + 5.00).

(4) Composite cost rate for First Mortgage Bonds as developed on page 3 of this schedule.

(5) Effective cost rate for 6.30% Pollution Control Bonds as developed on page 4 of this schedule.

(6) Same calculations as note 2 except the estimated prime rate of 7.50% at year end 1977 is used. Hence, the effective interest rate is 5.50% (1/2 (7.50 - 5.00) + 4.25).

(7) Same calculations as note 3 except the estimated prime rate of 7.50% at year end 1977 is used. Hence, the effective interest rate is 5.25% (1/2 (7.50 - 7.00) + 5.00).

(8) Prime rate estimated at December 31, 1977.

Source of Information: Company provided data

The Potomac Edison Company

Calculation of the Effective Cost of First Mortgage Bonds

Actual at December 31, 1976 and Estimated at December 31, 1977

Series	Nominal Date of Issue	Date of Maturity	Principal Amount Outstanding ($ Thous)	Premium or (Discount) at Issuance	Company Issuance Expenses	Net Proceeds	Net Proceeds Ratio	Cost Rate to Maturity (1)	Percent to Total	Weighted Cost Rate
First Mortgage Bonds										
3 1/4% due 1977	12/1/48	12/1/77	$ 5,500	$102,740	$55,700	$5,547,040	100.86%	3.20%	2.40%	0.08%
3 1/8% due 1978	1/1/48	1/1/78	4,000	12,764	62,000	3,950,764	98.77	3.18	1.74	0.06
3 3/8% due 1981	4/1/51	4/1/81	10,000	55,900	85,000	9,970,900	99.71	3.39	4.36	0.15
4 5/8% due 1987	5/1/57	5/1/87	14,000	135,000	75,369	14,059,631	100.43	4.59	6.10	0.28
4 5/8% due 1994	3/16/64	3/1/94	16,000	233,120	76,200	16,156,920	100.98	4.56	6.97	0.32
5 7/8% due 1996	5/1/66	5/1/96	18,000	271,800	58,636	18,213,164	101.18	5.79	7.85	0.45
7 % due 1998	4/18/68	4/18/98	25,000	295,000	75,741	25,219,259	100.88	6.92	10.89	0.75
7 5/8% due 1999	5/1/69	5/1/99	15,000	118,050	61,995	15,056,055	100.37	7.59	6.54	0.50
9 1/2% due 2000	5/1/70	5/1/2000	20,000	222,200	67,467	20,154,733	100.77	9.42	8.71	0.82
8 3/8% due 2001	5/1/71	5/1/2001	20,000	54,600	78,356	19,976,244	99.88	8.38	8.71	0.73
7 1/2% due 2002	12/1/72	12/1/2002	12,000	28,440	78,330	11,950,110	99.58	7.53	5.23	0.39
8 5/8% due 2003	12/1/73	12/1/2003	15,000	99,000	102,694	14,996,306	99.98	8.62	6.54	0.56
11 % due 2005	10/1/75	10/1/2005	30,000	(43,500)	133,628	29,822,872	99.41	11.06	13.07	1.45
9 1/4% due 2006	6/1/76	6/1/2006	25,000	(205,000)	93,382	24,701,618	98.81	9.37	10.89	1.02
Total First Mortgage Bonds Outstanding at December 31, 1976			$229,500						100.00%	7.56%
Total First Mortgage Bonds Outstanding at December 31, 1976			$229,500					7.56%	90.00%	6.80%
Maturity - 3 1/4% Series due 12-1-77			(5,500)					3.20	(2.16)	(.07)
Maturity - 3 1/8% Series due 1-1-78			(4,000)					3.18	(1.57)	(.05)
Proposed New First Mortgage Bonds @ assumed 8 5/8% due 2007			35,000	-	140,000 (2)	34,860,000	99.60	8.66	13.73	1.19
Total First Mortgage Bonds Estimated at December 31, 1977			$255,000						100.00%	7.87%

Notes: (1) The effective cost rate for each issue is the cost rate to maturity using as inputs the term of issue, coupon rate and net proceeds.

(2) Issuance expense is estimated for this issue.

Source of Information: The Company's Annual Report to the FPC (Form 1) and data provided by Company upon request

Potomac Edison Company

Calculation of the Effective Cost Rate of Pollution Control Revenue Bonds, Series A

	Nominal Date of Issue	Date of Maturity	Principal Amount Issued	Underwriting Discount	Estimated Issuance Expenses	Net Proceeds	Net Proceeds Ratio	Cost Rate to Maturity (1)	Annualized Cost	Effective Cost Rate
6.30% Bonds due February 1, 2002										
	2-1-77	2-1-96	$ 700,000	$ 8,750	$10,790	$ 680,460	97.21%	6.56%	$ 45,920	
	2-1-77	2-1-97	800,000	10,000	12,335	777,665	97.21	6.55	52,400	
	2-1-77	2-1-98	800,000	10,000	12,335	777,665	97.21	6.54	52,320	
	2-1-77	2-1-99	800,000	10,000	12,335	777,665	97.21	6.54	52,320	
	2-1-77	2-1-00	800,000	10,000	12,335	777,665	97.21	6.53	52,240	
	2-1-77	2-1-01	800,000	10,000	12,335	777,665	97.21	6.53	52,240	
	2-1-77	2-1-02	800,000	10,000	12,335	777,665	97.21	6.52	52,160	
			$5,500,000	$68,750	$84,800	$5,346,450			$359,600	6.54%

Note: (1) The effective cost rate for each issue is the cost rate to maturity using as inputs the term of issue, coupon rate, and net proceeds ratio.

Source of Information: The Prospectus for this issue dated 1-31-77.

The Potomac Edison Company

Calculation of the Composite Cost Rate by Series of Outstanding Preferred Stock at December 31, 1976 (Actual)

Series	Date of Issue	Nominal Dividend Rate	Principal Amount Outstanding	Premium Outstanding Per Balance Sheet	Company Issuance Expenses	Net Proceeds	Net Proceeds Ratio	Cost Rate	Percent to Total	Weighted Cost Rate
Cumulative Preferred Stock										
3.60%	1/18/46	3.60%	$ 6,378,400	$33,184	$104,000	$6,307,584	98.89%	3.64%	11.00%	0.40%
4.70% Series B	12/ 8/48	4.70	1,604,700	-	69,000	1,468,500	95.51(1)	4.92	2.77	0.14
$5.88 Series C	6/13/67	5.88	10,000,000	6,900	27,000	9,979,900	99.80	5.89	17.25	1.02
$7.00 Series D	4/18/68	7.00	5,000,000	7,550	17,000	4,990,550	99.81	7.01	8.62	0.60
$9.40 Series E	5/ 7/70	9.40	5,000,000	1,000	11,000	4,990,000	99.80	9.42	8.62	0.81
$8.32 Series F	5/ 6/71	8.32	5,000,000	3,300	15,000	4,988,300	99.77	8.34	8.62	0.72
$8.00 Series G	5/18/72	8.00	10,000,000	12,600	37,000	9,975,600	99.76	8.02	17.25	1.38
$9.64 Series H	6/17/76	9.64	15,000,000	450	44,000	14,956,450	99.71	9.67	25.87	2.50
Total Preferred Stock Outstanding - Actual at December 31, 1976			$57,983,100						100.00%	7.57%

Note: (1) The net proceeds ratio has been calculated based upon net proceeds on average principal amount outstanding. The average principal amount outstanding for Series B is $1,537,500, less issuance expenses of $69,000 equals $1,468,500 (net proceeds on average principal amount outstanding) $1,468,500 ÷ $1,537,500 = 95.51%.

Source of Information: Data provided by Company upon request

The Potomac Edison Company

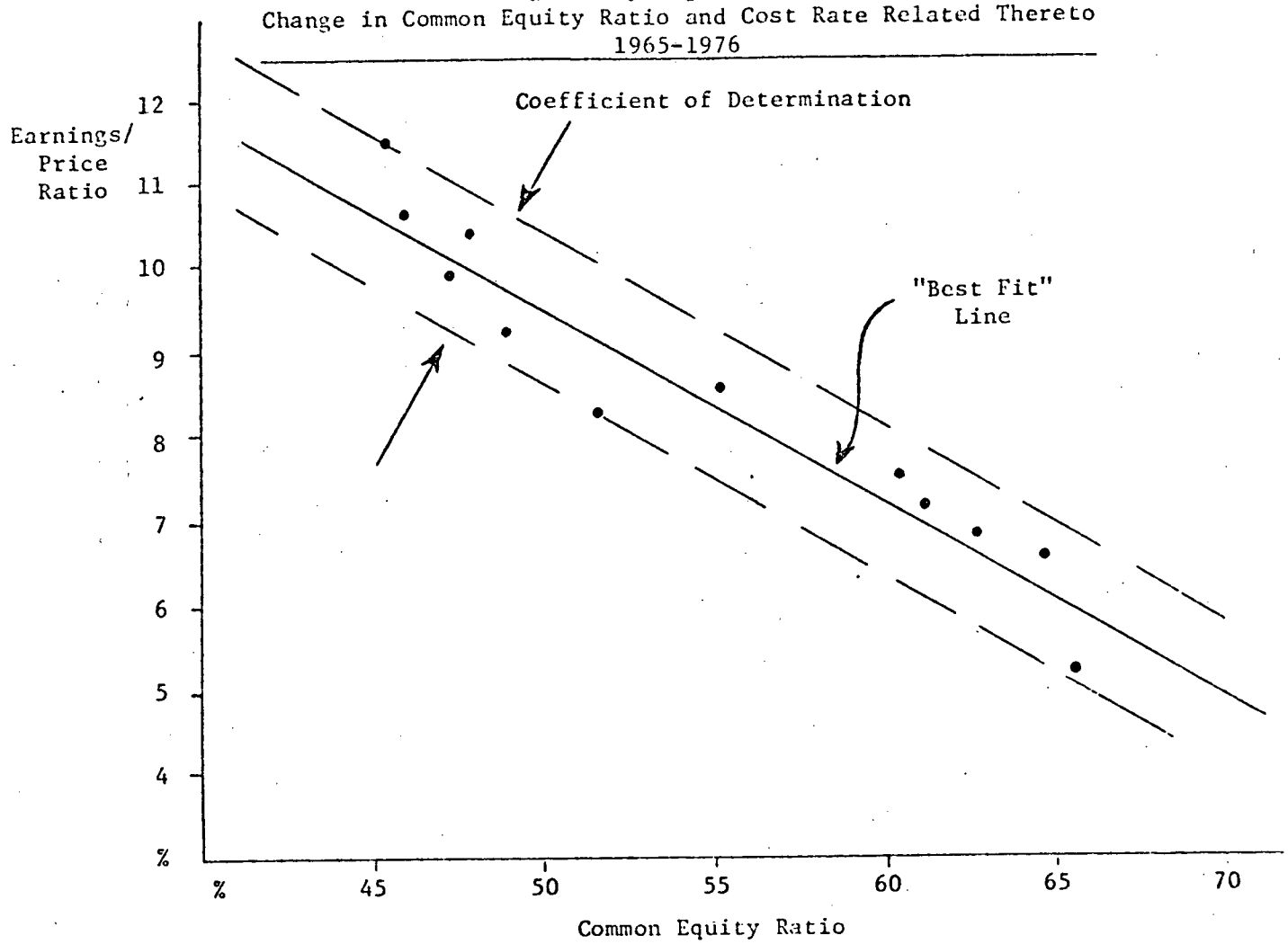
Calculation of the Composite Cost Rate by Series of Outstanding Preferred Stock at December 31, 1977 (Estimated)

Series	Date of Issue	Nominal Dividend Rate	Principal Amount Outstanding	Premium Outstanding Per Balance Sheet	Company Issuance Expenses	Net Proceeds	Net Proceeds Ratio	Cost Rate	Percent to Total	Weighted Cost Rat
Cumulative Preferred Stock										
3.60%	1/18/46	3.60%	$ 6,378,400	$33,184	$104,000	$6,307,584	98.89%	3.64%	11.02%	0.40%
4.70% Series B	12/ 8/48	4.70	1,529,700	-	69,000	1,468,500	95.51(1)	4.92	2.64	0.13
$5.88 Series C	6/13/67	5.88	10,000,000	6,900	27,000	9,979,900	99.80	5.89	17.27	1.02
$7.00 Series D	4/18/68	7.00	5,000,000	7,550	17,000	4,990,550	99.81	7.01	8.63	0.60
$9.40 Series E	5/ 7/70	9.40	5,000,000	1,000	11,000	4,990,000	99.80	9.42	8.63	0.81
$8.32 Series F	5/ 6/71	8.32	5,000,000	3,300	15,000	4,988,300	99.77	8.34	8.63	0.72
$8.00 Series G	5/18/72	8.00	10,000,000	12,600	37,000	9,975,600	99.76	8.02	17.27	1.39
$9.64 Series H	6/17/76	9.64	15,000,000	450	44,000	14,956,450	99.71	9.67	25.91	2.51
Total Preferred Stock Outstanding - Estimated at December 31, 1977			$57,908,100						100.00%	7.58%

Note: (1) The net proceeds ratio has been calculated based upon net proceeds on average principal amount outstanding. The average principal amount outstanding for Series B is $1,537,500, less issuance expenses of $69,000 equals $1,468,500 (net proceeds on average principal amount outstanding) $1,468,500 ÷ $1,537,500 = 95.51%.

Source of Information: Data provided by Company upon request

American Telephone & Telegraph Company
Illustration of Results of Linear Regression Analysis
Demonstrating a Very High Correlation Between
Change in Common Equity Ratio and Cost Rate Related Thereto
1965-1976



A common way to determine whether there is a significant relationship between two sets of data is to plot this data on a graph. If the points are randomly scattered over the graph, then no relationship can be discerned. If, however, a pattern appears, then a line can visually be drawn through the points to represent the pattern. Another method of "drawing" this line is by means of a regression analysis. (See Appendix B for definition of linear regression analysis.)

Indicated on the above graph is the line best representing these points as developed in a linear regression analysis. In addition, dotted lines are shown which represent a band around the regression line within which are contained all the points of actual data. The Coefficient of Determination is also defined in Appendix B. Based on these data, the Coefficient of Determination is 0.93, indicating a high degree of correlation between the movement in common equity ratio as it affected the earnings/price ratio during the period studied.

The mathematically measured percent change in earnings/price ratio for each percent change in common equity ratio is -0.235% and is often referred to as a beta factor (defined in Appendix B). The beta is negative as it indicates an inverse relationship, i.e., as the common equity ratio rises, the cost rate falls and vice versa.

Comparison of Representative Issues of Rated Long-Term Debt
Issued by Similar Utilities at Same Approximate Points in Time
1975 and 1976

Company	Type of Issue	Moody's Rating	Date of Issue	Date of Maturity	Term of Issue	Principal Amount ($ Thous)	Interest Rate	Type of Industry	Cost to Company	Total Debt Ratio (2)	Cost Rate Movement Factor (3)
1975											
Commonwealth Edison	First Mtg.	Aaa	8- 4-75	8-83	8 yrs.	$125,000	9.00%	Elec	8.99%	53.0%	
Ohio Electric (1)	First Mtg.	Baa	8- 7-75	8-83	8	75,000	11.00	Elec	11.17	60.1	
								Spread	2.18%	7.1%	0.307
Arizona Public Service	First Mtg.	Baa	6- 5-75	6-80	5	75,000	9.80	Elec	10.04%	53.4%	
Texas Electric Service	First Mtg.	Aaa	6-10-75	6-2005	30 (4)	50,000	8.875	Elec	9.01	50.0	
								Spread	1.03%	3.4%	0.303
Commonwealth Edison	First Mtg.	Aaa	2-18-75	2-2005	30	125,000	8.75	Elec	8.78%	52.2%	
Arizona Public Service	First Mtg.	Baa	2-19-75	2-82	7 (4)	100,000	9.50	Elec	9.80	55.7	
								Spread	1.02%	3.5%	0.291
									Total Factor		.901
								1975 Average Factor			.300
1976											
Louisiana Power & Light	First Mtg.	Baa	12-14-76	12-2006	30 yrs.	$ 40,000	8.75%	Elec	8.71%	57.5%	
Pennsylvania Power & Light	First Mtg.	Aa	12-14-76	12-2006	30	150,000	8.25	Elec	8.33	51.9	
								Spread	.38%	5.6%	.068
Pacific Power & Light	First Mtg.	Baa	12- 9-76	12-2006	30	50,000	8.625	Elec	8.66%	58.5%	
S. Carolina Elec & Gas	First & Ref. Mtg.	A	12- 9-76	12-2006	30	50,000	8.40	Elec	8.48	55.1	
								Spread	.18%	3.4%	.053
Dayton Power & Light	First Mtg.	A	11-16-76	11-2006	30	50,000	8.75	Elec	8.74%	51.9%	
Ohio Power	First Mtg.	Baa	11-17-76	11-2006	30	80,000	9.25	Elec	9.24	56.7	
								Spread	.50%	4.8%	.104
Kentucky Power	First Mtg.	A	10-26-76	10-2006	30	30,000	8.875	Elec	8.81%	57.7%	
Louisville Gas & Elec	First Mtg.	Aaa	10-27-76	10-2006	30	25,000	8.50	Elec	8.41	52.3	
								Spread	.40%	5.4%	.074
Cincinnati Gas & Elec	First Mtg.	Aa	10-20-76	10-2006	30	75,000	8.55	Elec	8.63%	53.0%	
Puget Sound Power & Light	First Mtg.	Baa	10-20-76	10-2006	30	40,000	8.875	Elec	9.05	56.1	
								Spread	.42%	3.1%	.135
Appalachian Power	First Mtg.	Baa	9- 8-76	9-2006	30	70,000	9.50	Elec	9.59%	61.8%	
Public Svc Elec & Gas	First & Ref. Mtg.	Aa	9- 9-76	9-2006	30	60,000	8.45	Elec	8.53	48.0	
								Spread	1.06%	13.8%	.077

Comparison of Representative Issues of Rated Long-Term Debt
Issued by Similar Utilities at Same Approximate Points in Time
1975 and 1976

Company	Type of Issue	Moody's Rating	Date of Issue	Date of Maturity	Term of Issue	Principal Amount ($ Thous)	Interest Rate	Type of Industry	Cost to Company	Total Debt Ratio (2)	Cost Rate Movement Factor (3)
Wisconsin Electric Power	First Mtg.	Aa	7- 7-76	7-2006	30 yrs.	$ 60,000	8.75%	Elec	8.81%	50.7%	
Consumers Power	First Mtg.	Baa	7- 7-76	7-2006	30	60,000	9.75	Elec	9.85	55.3	
								Spread	1.04%	4.6%	.226
Rochester Gas & Elec	First Mtg.	A	6-15-76	6-2006	30	50,000	9.25	Elec	9.23%	49.2%	
Potomac Edison	First Mtg.	A	6-17-76	6-2006	30	25,000	9.25	Elec	9.33	53.0	
								Spread	.10%	3.8%	.026
Central Maine Power	Gen-Ref Mtg.	Baa	4-27-76	4-76	30	35,000	9.625	Elec	9.74%	55.4%	
Kansas Power & Light	First Mtg.	Aa	4-29-76	4-76	30	45,000	8.625	Elec	8.78	49.2	
								Spread	.96%	6.2%	.155
Utah Power & Light	First Mtg.	A	4-21-76	4-2006	30	32,000	8.75	Elec	8.82%	50.2%	
Appalachian Power	First Mtg.	Baa	4-22-76	4-2006	30	60,000	9.75	Elec	9.71	61.1	
								Spread	.89%	10.9%	.082
Iowa-Illinois Gas & Elec	First Mtg.	Aa	3-24-76	3-2006	30	20,000	8.75	Elec	8.73%	51.3%	
Portland General Electric	First Mtg.	Baa	3-25-76	3-2006	30	50,000	9.50	Elec	9.62	54.5	
								Spread	.89%	3.2%	.278
Iowa Power & Light	First Mtg.	Aa	2-24-76	2-2006	30	30,000	8.75	Elec	8.74%	49.5%	
Philadelphia Electric	First & Ref.Mtg.	A	2-25-76	2-2006	30	100,000	9.125	Elec	9.21	52.5	
								Spread	.47%	3.0%	.157
Jersey Central Power & Light	First Mtg.	Baa	2-18-76	2-2006	30	60,000	9.625	Elec	9.71%	55.7%	
Utah Power & Light	First Mtg.	A	2-18-76	2-2006	30	35,000	9.00	Elec	9.08	50.5	
								Spread	.63%	5.2%	.121
Taxas Power & Light	First Mtg.	Aaa	1-20-76	1-2006	30	100,000	8.60	Elec	8.68%	49.7%	
Pacific Power & Light	First Mtg.	Baa	1-21-76	1-2006	30	75,000	10.00	Elec	10.00	56.9	
								Spread	1.32%	7.2%	.183
										Total Factor	1.739
										1976 Average Factor	.124

Notes: (1) Ohio Electric debt ratio reflects Ohio Power Consolidated.
(2) Total debt includes long-term, short-term, and current maturities where applicable.
(3) Calculated by taking the spread between the cost to the Company of the debt issue divided by the spread between debt ratios for each pair studied.
(4) An important element used in determining the cost rate of any debt issue is the specific term of the issue. Therefore, ideally in computing the cost rate movement factor, the term of each issue compared should be of similar duration. It should be noted that in some of the pairings, the terms of issuance differ. However, in these pairings the higher rated bond has a longer term of issue than the lower rated issue, insuring that the results are conservative in that the cost rate movement factor may be understated.

Source of Information: Ebasco Services, Moody's Bond Survey

MOODY'S 24 PUBLIC UTILITIES
Capitalization and Financial Statistics (1)
1972 - 1976, Inclusive

	1976	1975	1974 (5)	1973	1972	Percent Increase 1976 over 1972
		(Thousands of Dollars)				
Amount of Capital Employed						
Total permanent capital	$2,179,218	$2,016,451	$1,843,983	$1,657,417	$1,495,789	
Short-term debt notes payable	42,465	49,684	81,730	61,045	47,127	
Total capital employed	$2,221,683	$2,066,135	$1,925,713	$1,718,462	$1,542,916	44.0%
Indicated Average Capital Cost Rates (2)						
Long-term debt	7.0%	6.8%	6.3%	5.9%	5.7%	22.8%
Preferred stock	7.5	7.1	6.8	6.4	6.0	25.0
Financial Ratios - Market Based						
Earnings/price ratio (3)	14.2%	16.3%	15.0%	11.4%	10.4%	36.5%
Market/average book ratio	91.8	77.3	79.9	112.5	135.6	(32.3)
Dividend yield	8.4	9.9	9.4	6.9	5.9	42.4
						5 Year Average
Percent change in earnings per share yearly	7.3	6.6	(4.5)	(2.5)	12.6	3.9%
Dividend payout ratio	68.8	70.9	72.3	66.8	62.6	68.3
Capital Structure Ratios						
Based on total permanent capital:						
Long-term debt	52.1%	53.0%	53.6%	52.5%	53.1%	52.9%
Preferred stock	13.0	13.1	13.1	12.5	12.2	12.8
Common equity	34.9	33.9	33.3	35.0	34.7	34.3
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Based on total capital:						
Total debt, including short-term	53.2%	54.4%	56.1%	54.8%	54.8%	54.7%
Preferred stock	12.7	12.7	12.4	11.9	11.8	12.3
Common equity	34.1	32.9	31.5	33.3	33.4	33.0
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Rate of Return on Average Book Common Equity	11.4%	10.9%	10.5%	11.5%	12.5%	11.4%
Rate of Return Earned on Average Book Common Equity Over Indicated Average Long-Term Debt Cost Rate	4.4%	4.1%	4.2%	5.6%	6.8%	5.0%
Coverages (4)						
Before income taxes: All interest charges	2.9	2.6	2.5	2.9	3.2	2.8
After income taxes: All interest charges	2.3	2.2	2.1	2.4	2.6	2.3
Overall coverage: Sum of interest and preferred dividends	1.8	1.8	1.7	2.0	2.1	1.9

See page 2 for Notes.

MOODY'S 24 PUBLIC UTILITIES
Capitalization and Financial Statistics (1)
1972 - 1976, Inclusive

Notes:

(1) All Capitalization and Financial Statistics for Moody's 24 Public Utilities are the arithmetic average of the achieved results for each individual company in the group.

(2) Computed by relating actual interest or preferred dividends booked to average of beginning and ending debt or preferred stock reported to be outstanding.

(3) Adjusted to reflect assumed 10% for market pressure, issuance and selling expenses.

(4) Coverage calculations based upon AFC (allowance for funds used during construction) as reported in its entirety included as income.

(5) 1974 financial ratios are calculated excluding nonrecurring cumulative effect of accounting change and extraordinary items to be consistent with preceding years.

Source of Information:
Moody's Public Utility Manual and Supplements
Company's Annual Reports to Stockholders

The names of the companies are:

Baltimore Gas & Electric Company
Boston Edison Company
Carolina Power and Light Company
Central Hudson Gas & Electric Corp.
Central Maine Power Company
Cincinnati Gas & Electric Company
Cleveland Electric Illuminating Co.
Commonwealth Edison Company
Consolidated Edison Company of New York, Inc.
Dayton Power & Light Company
Delmarva Power & Light Company
Detroit Edison Company
Florida Power Corporation
Houston Industries Incorporated (formerly Houston Lighting & Power Co.)
Idaho Power Company
Indianapolis Power and Light Company
Northeast Utilities Company
Pacific Gas and Electric Company
Pennsylvania Power & Light Company
Philadelphia Electric Company
Public Service Company of Colorado
Southern California Edison Company
Tampa Electric Company
Utah Power & Light Company

Pertinent Financial Statistics Pertaining to
Moody's 24 Public Utilities
Broken Down by Rating Groups (1)

Period or Date	Pre-Tax Int. Covrg.	Post-Tax Int. Covrg.	Overall Covrg.	Ach. Ret. Rate on Avg. Book Com. Eq.	Cap. Struc. Ratios Based on Total Cap. Debt	Pfd. Stock	Com. Eq.	Effective Income Tax Rate	AFC % of Net to Com. Eq.	Market/ Average Book Ratio	Market Det. Div. Yield	Div. Yield Spread Over Aaa	Aa
Aaa Rated (2)													
6-30-77 (3)										109.4%	7.8%		
1976	3.4	2.4	1.9	11.6%	55.0%	11.5%	33.5%	40.6%	34.5%	105.7	8.1		
1975	3.4	2.4	1.8	11.0	53.1	13.4	33.5	41.2	29.4	99.1	8.4		
1974	3.1	2.4	2.0	12.5	56.3	10.7	33.0	33.3	23.7	97.9	8.3		
1973	3.5	2.7	2.2	12.9	53.0	10.9	36.1	30.2	26.9	133.1	6.5		
1972	3.7	2.8	2.3	13.9	54.0	10.8	35.2	31.5	27.1	164.6	5.6		
Aa Rated													
6-30-77 (3)										110.7%	7.3%	(.5)	
1976	2.9	2.4	1.9	12.0%	52.7%	12.7%	34.6%	26.6%	29.9%	98.9	7.8	(.3)	
1975	2.7	2.2	1.8	11.4	54.8	12.0	33.2	26.5	28.9	85.5	8.9	.5	
1974	2.7	2.3	1.8	11.2	55.5	12.7	31.8	18.5	33.0	83.0	9.1	.8	
1973	2.9	2.4	1.9	11.5	54.7	12.8	32.5	24.9	34.9	110.3	6.8	.3	
1972	3.1	2.5	2.0	12.5	55.4	12.0	32.6	26.8	31.5	132.5	5.9	.3	
A Rated													
6-30-77 (3)										106.6%	7.9%	.1	.6
1976	2.8	2.3	1.8	11.1%	53.3%	12.3%	34.4%	28.8%	36.0%	89.7	9.0	.9	1.2
1975	2.7	2.2	1.8	10.7	52.9	13.2	33.9	25.6	31.5	75.2	10.5	2.1	1.6
1974	2.2	2.1	1.7	9.6	55.3	13.5	31.2	12.9	57.3	78.3	9.9	1.6	.8
1973	2.5	2.2	1.8	10.0	55.8	10.8	33.4	15.5	33.7	98.7	7.2	.7	.4
1972	2.9	2.4	2.0	10.9	53.4	12.2	34.4	18.1	29.6	112.0	6.2	.6	.3
Baa Rated													
6-30-77 (3)										88.8%	8.1%	.3	.8
1976	2.8	2.2	1.7	10.2%	53.1%	13.8%	33.1%	34.4%	37.0%	74.4	9.2	1.1	1.4
1975	2.3	2.0	1.7	9.7	55.2	13.3	31.5	26.5	51.2	56.1	11.4	3.0	2.5
1974	1.9	1.6	1.4	7.8	61.2	9.4	29.4	27.8	57.5	66.4	11.3	3.0	2.2

Notes: (1) Financial and market based ratios have been broken down by rating groups based upon rating in each year in which the ratios were achieved. Northeast Utilities Co. has been excluded from this analysis since its operating subsidiaries have various ratings. Consolidated Edison of NY was excluded from this analysis in 1974 since its bond rating was suspended. By 1975, however, its rating of Baa had been restored.

(2) By 1975, only one company (Commonwealth Edison) remained Aaa rated by Moody's (and AA by Standard & Poor's). Thus, there exists little, if any, difference between the Aaa and Aa group.

(3) Spot data based upon year end 1976 book value per share, 6-30-77 market price and current dividend per share.

Source of Information: Moody's Public Utility Manual and Supplements
Company's Annual Report to Stockholders
The Wall Street Journal

Moody's 24 Public Utilities
Bond Ratings at Years' End 1972-1976

Moody's 24 Public Utilities	1976	1975	1974	1973	1972
Baltimore Gas & Electric Company	Aa	Aa	Aa	Aaa	Aaa
Boston Edison Company	Baa	Baa	Baa	A	Aa
Carolina Power & Light Company	Baa	Baa	A	A	A
Central Hudson Gas & Electric Corp.	A	A	Aa	Aa	Aa
Central Maine Power Company	A	A	A	A	A
Cincinnati Gas & Electric Company	Aa	Aa	Aa	Aaa	Aaa
Cleveland Electric Illuminating Co.	Aa	Aa	Aaa	Aaa	Aaa
Commonwealth Edison Company	Aaa	Aaa	Aaa	Aaa	Aaa
Consolidated Edison Company of NY	Baa	Baa	--(2)	A	A
Dayton Power & Light Company	A	A	A	Aa	Aa
Delmarva Power & Light Company	A	A	A	Aa	Aa
Detroit Edison Company	Baa	Baa	Baa	Aa	Aa
Florida Power Corporation	A	A	A	Aa	Aa
Houston Lighting and Power Company	Aa	Aa	Aaa	Aaa	Aaa
Idaho Power Company	Aa	Aa	Aa	Aa	Aa
Indianapolis Power & Light Company	Aa	Aa	Aa	Aa	Aa
Northeast Utilities Company (1)	---	---	---	---	---
Pacific Gas & Electric Company	Aa	Aa	Aa	Aa	Aa
Pennsylvania Power & Light Company	Aa	Aa	Aa	Aa	Aa
Philadelphia Electric Company	A	A	A	Aa	Aa
Public Service Company of Colorado	Aa	Aa	Aa	Aa	Aa
Southern California Edison Company	Aa	Aa	Aa	Aa	Aa
Tampa Electric Company	Aa	Aa	Aa	Aa	Aa
Utah Power & Light Company	A	A	A	A	A

Notes: (1) Northeast Utilities, a holding company, does not have bonds which are rated by Moody's. The operating subsidiaries of Northeast Utilities have various bond ratings.
(2) Bond rating suspended by Moody's.

Source of Information: Moody's Bond Survey, Moody's Public Utility Manual

Averages for Eight Barometer Group Electric Companies
Capitalization and Financial Statistics
1972-1976, Inclusive

	1976	1975	1974 (4)	1973	1972	Percent Increase 1976 over 1972
			(Thousands of Dollars)			
Amount of Capital Employed						
Total permanent capital	$831,218	$725,847	$626,371	$553,330	$477,227	
Short-term debt notes payable	10,665	17,475	66,545	33,558	23,976	
Total capital employed	$841,883	$743,322	$692,916	$586,888	$501,203	68.0%
Indicated Average Actual Capital Cost Rates (1)						
Long-term debt	7.2%	6.6%	6.4%	6.1%	5.9%	22.0%
Preferred stock	7.3	7.2	7.0	6.2	6.4	14.1
Financial Ratios - Market Based						
Earnings/price ratio (2)	14.1%	17.9%	14.9%	11.9%	10.9%	29.4%
Market/average book ratio	95.4	77.8	78.7	111.4	130.8	(27.1)
Dividend yield	8.6	10.3	9.9	6.9	5.9	45.8
						5 Year Average
Percent change in earnings per share yearly	1.0	22.8	(9.1)	-	22.5	7.4%
Dividend payout ratio	64.1	70.0	76.1	65.1	61.5	67.4
Capital Structure Ratios						
Based on total permanent capital:						
Long-term debt	52.0%	52.6%	52.6%	53.7%	53.2%	52.8%
Preferred stock	13.1	13.1	14.2	13.0	12.5	13.2
Common equity	34.9	34.3	33.2	33.3	34.3	34.0
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Based on total capital:						
Total debt, including short-term	52.6%	53.5%	57.8%	56.6%	55.6%	55.2%
Preferred stock	12.9	12.8	12.6	12.2	11.9	12.5
Common equity	34.5	33.7	29.6	31.2	32.5	32.3
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Rate of Return on Average Book Common Equity	12.1%	12.3%	10.7%	11.9%	12.5%	11.9%
Rate of Return on Average Book Common Equity Over Indicated Average Long-Term Debt Cost Rate	4.9%	5.7%	4.3%	5.8%	6.6%	5.5%
Coverages (3)						
Before income taxes: All interest charges	2.8	2.6	2.1	2.6	3.1	2.6
After income taxes: All interest charges	2.3	2.2	2.0	2.3	2.5	2.3
Overall: Sum of interest and preferred dividends	1.9	1.8	1.6	1.9	2.0	1.8

See page 2 for Notes.

Averages for Eight Barometer Group Electric Companies
Capitalization and Financial Statistics
1972-1976, Inclusive

Notes:

(1) Computed by relating actual interest or preferred dividends booked to average of beginning and ending debt or preferred stock reported to be outstanding.

(2) Adjusted to reflect 10% for market pressure, issuance and selling expenses.

(3) Coverage calculations based upon AFC (allowance for funds used during construction) as reported in its entirety included as income.

(4) 1974 financial ratios are calculated excluding nonrecurring cumulative effect of accounting change and extraordinary items to be consistent with prior years.

Basis of Selection:

The criteria used in the selection of this barometer group of operating electric companies were to include those companies which operate in the continental United States, whose common stock is actively traded, whose bonds are presently (as of year end 1976) rated A by Moody's Investor Service, Inc., have a permanent capitalization between $350 million and $1.5 billion, and have at least 75 percent of their total 1976 revenues as electric and no more than 35 percent of their electric revenues as industrial sales.

The names of the companies who comprise the group include:

Central Maine Power Company
Columbus & Southern Ohio Electric Company
Delmarva Power & Light Company
Florida Power Corporation
South Carolina Electric & Gas Company
Tucson Gas & Electric Company
United Illuminating Company
Utah Power & Light Company

Further items of comparison between the barometer group and The Potomac Edison Company are shown below:

	Average for Eight Barometer Group Companies*	The Potomac Edison Company
1976 Operating Revenues ($ Millions)	$286.4	$209.0
1976 Operating Revenues, Percent Distribution		
Electric	93.4%	100.0%
Gas	6.0	-
Other	0.6	-
	100.0%	100.0%
Percent of Electric Revenues as Industrial Sales	23.9%**	33.8%

* There is only one company other than the eight listed that met this criteria for inclusion in the barometer group. New York State Electric & Gas Company met the criteria; however, its bonds were rated Aa by Moody's until May 5, 1976 when they were downgraded to an A rating. Therefore, the Company's historical financial profile is more representative of an Aa rated company than an A rated utility. It was for this reason that the New York State Electric & Gas Company was not included in the barometer group.

**Seven Company average for 1976. Data for Central Maine Power is unavailable. The eight company average for 1975 including Central Maine Power was 24.0% industrial.

Source of Information: Moody's Public Utility Manual and Supplements
Companies' Annual Reports to Stockholders

Allegheny Power System, Inc. and Subsidiaries
Capitalization and Financial Statistics
1972-1976, Inclusive

	1976	1975	1974	1973 (4)	1972 (4)	Percent Increase 1976 over 1972
		(Thousands of Dollars)				
Amount of Capital Employed						
Total permanent capital	$1,783,221	$1,613,646	$1,513,373	$1,422,396	$1,363,238	
Short-term debt notes payable	-	45,400	90,781	48,950	40,475	
Total capital employed	$1,783,221	$1,659,046	$1,604,154	$1,471,346	$1,403,713	27.0%
Indicated Average Capital Cost Rates (1)						
Long-term debt	7.1%(5)	6.6%	6.2%	6.2%	6.1%	16.4%
Preferred stock	7.0 (5)	6.5	6.5	6.2	6.5	7.7
Financial Ratios - Market Based						
Earnings/price ratio (2)	14.8%	17.6%	12.0%	12.6%	11.7%	26.5%
Market/average book ratio	97.3	82.5	88.3	113.3	128.6	(24.3)
Dividend yield	8.3	9.7	9.2	7.0	6.3	31.7
						5 Year Average
Percent change in earnings per share yearly	3.6	41.6	(23.6)	(0.9)	9.3	6.0%
Dividend payout ratio	63.1	61.2	86.8	61.7	59.5	66.5
Capital Structure Ratios						
Based on total permanent capital:						
Long-term debt	51.0%	54.7%	53.3%	54.0%	54.9%	53.6%
Preferred stock	13.6	12.0	12.8	13.6	12.7	12.9
Common equity	35.4	33.3	33.9	32.4	32.4	33.5
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Based on total capital:						
Total debt, including short-term	51.0%	56.0%	56.0%	55.6%	56.2%	55.0%
Preferred stock	13.6	11.6	12.0	13.1	12.3	12.5
Common equity	35.4	32.4	32.0	31.3	31.5	32.5
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Rate of Return on Average Book Common Equity	13.5%	13.1%	9.8%	12.8%	13.6%	12.6%
Rate of Return on Average Book Common Equity Over Indicated Average Actual Long-Term Debt Cost Rate	6.4%	6.5%	3.6%	6.6%	7.5%	6.1%
Coverages (3)						
Before income taxes: All interest charges	3.5	3.2	2.5	2.8	3.0	3.0
After income taxes: All interest charges	2.5	2.3	2.1	2.3	2.5	2.3
Overall coverage: Sum of interest and preferred dividends	2.0	1.9	1.7	1.9	2.1	1.9

See page 2 for Notes.

Allegheny Power System, Inc. and Subsidiaries
Capitalization and Financial Statistics
1972-1976, Inclusive

Notes:

(1) Computed by relating actual interest or preferred dividends booked to average of beginning and ending debt or preferred stock reported to be outstanding.

(2) Based on reported earnings per share and average high/low market price of stock adjusted to reflect assumed 10% for market pressure, issuance and selling expenses.

(3) Coverage calculations based upon AFC (allowance for funds used during construction) as reported in its entirety included as income.

(4) Capitalization and financial statistics for the years 1972 and 1973 based on financial statements as originally reported in each year.

(5) Annualized cost at year end 1976 to reflect issuance of new securities late in the year.

Source of information:
Company's Annual Reports to Stockholders
Moody's Investors Service, Inc.

Allegheny Power System, Inc.
Analysis of Public Offerings of Common Stock
Years 1974 to Date

Date of prospectus	2-19-76	2-20-74
Number of shares offered	3,500,000	2,500,000
Price to public	$19.500	$19.750
Underwriting discounts and commissions	.563	.530
Gross proceeds to Company	18.937	19.220
Estimated Company expenses	.037	.037
Net proceeds to Company	$18.900	$19.183
Latest available EPS as revealed in each prospectus (before new issue) for twelve months ended	$2.52 (12-31-75)	$2.33 (12-31-73)
Book value per common share as calculated from each prospectus (before new issue) at	$19.70 (12-31-75)	$18.58 (12-31-73)
Earnings/net proceeds ratio	13.3%	12.1%
Net proceeds/book ratio	95.9%	103.2%
Pro forma capital structure based on total permanent capital (after new financing)		
Long-term debt	52.5%	52.2%
Preferred stock	11.5	13.1
Common equity	36.0	34.7

Source of Information: Prospectus of each offering

Comparison of The Potomac Edison Company, Allegheny Power System, Inc., Eight Barometer Group Companies, and Moody's 24 Public Utilities Relative to Factors Which Influence Quality of Earnings Years 1972-1976, Inclusive

	1976	1975	1974	1973	1972	Average 1976-1972 Inclusive
Allowance for Funds Used During Construction as a Percent of Income Available for Common Equity						
The Potomac Edison Company	4.9%	4.7%(1)	24.7%(1)	17.5%	30.8%	16.5%
Allegheny Power System, Inc. and Subsidiaries	9.9	8.5	17.3	17.7	26.9	16.1
Average for Eight Barometer Group Companies	35.9	32.3	46.9	35.4	27.4	35.6
Average for Moody's 24 Public Utilities	33.0	34.3	41.1	33.2	30.5	34.4
Effective Income Tax Rate						
The Potomac Edison Company	36.8%	33.8%(1)	(13.9%)(1)	16.1%	12.2%	17.0%
Allegheny Power System, Inc. and Subsidiaries	41.7	41.5	27.4	25.6	22.6	31.8
Average for Eight Barometer Group Companies	24.7	19.8	3.6	15.3	24.6	17.6
Average for Moody's 24 Public Utilities	28.7	25.7	18.7	23.2	25.3	24.3

Source of Information: Moody's Public Utility Manual and Supplements
Companies' Annual Reports to Stockholders

Note: (1) Calculations based upon restated financial statements of the Company for 1975 and 1974 reflecting the West Virginia revenue refund ordered March 5, 1976.

Spot Indication of Market Based Common Equity
Cost Rate of Similar Risk Enterprises
Without Regard to Impact of Growth

	Latest Twelve Months Reported Earnings Per Share	Current Dividend Per Share	7-6-77 Market Price	1976 Year End Book Value	Adjusted Earnings/ Price Ratio (1)	Earnings/ Book Ratio	Dividend Yield	Market/ Book Ratio
Allegheny Power System, Inc.	$2.68 (3-31-77)	$1.68	$21.625	$20.51	13.8%	13.1%	7.8%	105.4%
Moody's 24 Public Utilities (2) (6-30-77 Market Prices)					12.9%	11.9%	7.7%	105.0%
Barometer Group of Eight Operating Electric Companies:								
Central Maine Power Company	$1.81 (3-31-77)	$1.40	$16.50	$16.44	12.2%	11.0%	8.5%	100.4%
Columbus & Southern Ohio Elec. Co.	3.54 (5-31-77)	2.20	27.50	25.46	14.3	13.9	8.0	108.0
Delmarva Power & Light Company	1.45 (3-31-77)	1.20	14.50	15.01	11.1	9.7	8.3	96.6
Florida Power Corporation	3.70 (4-30-77)	2.28	33.375	31.01	12.3	11.9	6.8	107.6
South Carolina Electric & Gas Co.	2.17 (5-31-77)	1.56	20.00	17.11	12.1	12.7	7.8	116.9
Tucson Gas & Electric Company	1.84 (3-31-77)	1.16	17.00	12.85	12.0	14.3	6.8	132.3
United Illuminating Company	3.14 (3-31-77)	2.44	27.875	28.42	12.5	11.0	8.8	98.1
Utah Power & Light Company (3)	2.13 (4-30-77)	1.56	22.625	17.25	10.5	12.3	6.9	131.2
Average					12.1%	12.1%	7.7%	111.4%

Notes: (1) It is assumed that raw earnings/price ratio represents but 90% of the attraction rate since issuance, selling expenses, and market pressure is assumed to consume 10% of the pre-offering market price.
(2) Arithmetic average of individual ratios for each company in the group using latest reported earnings per share, current dividends per share, 6-30-77 market price and 1976 year end book value per share.
(3) Earnings, dividends and year end 1976 book value adjusted for a 2 for 1 stock split effective 5-17-77.

Source of Information: Moody's Public Utility Manual and Supplements
Wall Street Journal

Indication of Bare Rent Rate for the Use of Capital Exposed to the Public Utility Risk
and Sensitivity of Interest Rates to Annual Rate of Inflation
Twenty Years Ended 1972

Average for Years	COLUMN A Average Yield on Moody's Aa Rated Public Utility Bonds (1)	COLUMN B Indicated Average Rate of Inflation (2)	COLUMN C Indicated Bare Rent Rate for Use of Capital at Low Secured Risk (A-B)
1953 - 57, inclusive	3.39%	1.18%	2.21%
1958 - 62, inclusive	4.38	1.50	2.88
1963 - 67, inclusive	4.84	1.98	2.86
1968 - 72, inclusive	7.56	4.62	2.94
1973 - 76, (3)			
1977 - (4)			

(1) Distributed yields as published by Moody's Investors Services, Inc.

(2) As measured by the annual change in the Consumer Price Index as published by the United States Bureau of Labor Statistics.

(3) Average rate of inflation for the four year period was 8.0% (6.2% for 1973, 11.0% for 1974, 9.1% for 1975 and 5.8% for 1976) or well beyond the expectation of investors or forecasters. Thus, average interest rates understated the impact because the average cost rate for public utility bonds rated Aa was about 8.8% for the four years ended 1976.

(4) The average rate of inflation as indicated by the increase in the Consumer Price Index is expected to be at least 6%. Thus, it is indicated that long-term quality bond yield will average about 9%. Such a rate of inflation appears to be a floor since recent announcements of the Office of Management and Budget now indicate an increase of 6.7% in the Consumer Price Index (December 1976 over December 1977).

Comparison of Interest Rate Trends
for Investor-Owned Public Utility and Industrial Companies
Years 1970-1976 and 1977 to Date

	Aaa Rated			Aa Rated			A Rated		
Years	Public Utilities	Industrials	Spread	Public Utilities	Industrials	Spread	Public Utilities	Industrials	Spread
1970	8.31	7.77	.54	8.52	7.94	.58	8.69	8.33	.36
1971	7.72	7.05	.67	8.00	7.23	.77	8.16	7.61	.55
1972	7.46	6.97	.49	7.60	7.11	.49	7.72	7.36	.36
1973	7.60	7.28	.32	7.72	7.40	.32	7.84	7.63	.21
1974	8.71	8.42	.29	9.04	8.64	.40	9.50	8.90	.60
1975	9.03	8.61	.42	9.44	8.90	.54	10.09	8.21	.88
1976	8.63	8.23	.40	8.92	8.59	.33	9.29	8.88	.41
January 1977	8.14	7.77	.37	8.41	7.90	.51	8.61	8.28	.33
February 1977	8.21	7.86	.35	8.46	8.06	.40	8.65	8.33	.32
March 1977	8.27	7.92	.35	8.49	8.07	.42	8.70	8.40	.30
April 1977	8.21	7.86	.35	8.51	8.05	.46	8.71	8.39	.32
May 1977	8.22	7.87	.35	8.49	8.06	.43	8.71	8.39	.32
June 1977	8.12	7.77	.35	8.37	8.00	.37	8.58	8.33	.25

Note: All yields are distributed yields.

Source of Information: Moody's Investor Service, Inc.
(Public Utility Manuals and Bond Surveys)

Tabulation of Change in Earnings Per Share for S&P 400, Moody's 24, Eight Barometer Group Companies and Allegheny Power System for the Years 1976-1967

	Earnings Per Share							Percent Change in Earnings Per Share						
	S&P	Moody's 24(C)		Barometer Gp.(C)		APS (D)		S&P	Moody's 24		Barometer Gp.		APS	
Year	400 (C)	(A)	(B)	(A)	(B)	(A)	(B)	400	(A)	(B)	(A)	(B)	(A)	(B)
1976	$3.23	$2.71	$1.83	$2.71	$1.72	$2.61	$2.35	22.3%	8.0%	10.2%	(1.5%)	(3.4%)	3.6%	1.7%
1975	2.64	2.51	1.66	2.75	1.78	2.52	2.31	(11.7)	3.7	13.7	20.6	49.6	41.6	57.1
1974	2.99	2.42	1.46	2.28	1.19	1.78	1.47	18.7	(4.3)	(13.6)	(9.5)	(26.1)	(23.6)	(23.4)
1973	2.52	2.53	1.69	2.52	1.61	2.33	1.92	33.3	(2.7)	(6.6)	(1.6)	(16.1)	(0.9)	11.6
1972	1.89	2.60	1.81	2.56	1.92	2.35	1.72	18.9	10.2	5.2	21.3	20.8	9.3	4.2
1971	1.59	2.36	1.72	2.11	1.59	2.15	1.65	4.6	5.8	(1.7)	(5.4)	(14.1)	5.9	3.1
1970	1.52	2.23	1.75	2.23	1.85	2.03	1.60	(13.1)	(0.9)	(10.3)	1.4	(5.1)	6.8	6.0
1969	1.75	2.25	1.95	2.20	1.95	1.90	1.51	(1.1)	5.6	1.0	7.8	7.7	6.1	2.7
1968	1.77	2.13	1.93	2.04	1.81	1.79	1.47	9.3	0.9	(0.5)	5.2	0.6	4.1	(3.3)
1967	1.62	2.11	1.94	1.94	1.80	1.72	1.52	-	-	-	-	-	-	-
Years 1976-1967, Inclusive														
Average (1)								9.0%	2.9%	(0.3%)	4.3%	1.5%	5.9%	6.6%
Variance (2)								249.7	24.7	82.1	116.1	513.5	276.5	453.9
Standard Deviation (3)								15.8%	5.0%	9.1%	10.8%	22.7%	16.6%	21.3%
Coefficient of Variation (4)								175.6%	172.4%	3033.3%	251.2%	1513.3%	281.4%	322.7%

(1) Sum of percent change value ÷ 9.

(2) Sum of the squared differences between the actual data and the average divided by the number of items less 1, i.e., S&P 400 in 1976 shows 22.3% and subtracting the average, 9.0%, from this is 13.3% which when squared is 176.89. This is added to similarly calculated numbers for the other years, and the total squared difference for S&P 400 is 1997.83 and 1997.83 ÷ 8 = 249.7.

(3) The square root of the variance $\sqrt{249.7} = 15.8$. In a normally distributed set of data about 2/3 of the values would fall between the average plus one standard deviation (9.0 + 15.8 = 24.8) and the average minus one standard deviation (9.0 - 15.8 = (6.8)).

(4) The standard deviation divided by the average x 100 (for S&P 400 it is 15.8 ÷ 9.0 = 1.756 x 100 = 175.6): This is a "percentage dispersion" value and enables two series of data to be compared as to their variability. Simply looking at the amount of the standard deviation does not permit this. If, for example, one series of data consisted of values in the thousands, the standard deviation of this series might be 2.500. Another series of values in the hundreds might have a standard deviation of 150. Comparing the two standard deviations is not meaningful. Computing the coefficient of variation eliminates the effect of the absolute values of the data and enables a comparison.

(A) Earnings used in the calculation include AFC.

(B) Earnings used in the calculation exclude AFC.

(C) Arithmetic average of individual earnings per share of each company in the group.

(D) Earnings per share as originally reported in each year.

Historical Earnings Rate on Common Equity
Measured at Book Value for S&P 400, and the Annual Rate of
Inflation as Measured by the Change
in Consumer Price Index - 1967-1976

	Rate of Return on Average Book Common Equity S&P 400	% Change in CPI
1967	14.5%	2.9%
1968	14.3	4.2
1969	13.4	5.4
1970	11.5	5.9
1971	11.1	4.3
1972	12.0	3.3
1973	13.8	6.2
1974	14.6	11.0
1975	12.6	9.1
1976	13.6	5.8
Ten-year average	13.1%	5.8%
Five-year average, ending 1971	13.0%	4.5%
Five-year average, ending 1976	13.3%	7.1%

Source: Associated Utility Services data
U.S. Dept. of Labor Handbook of Labor Statistics
Federal Reserve Bulletin

The Potomac Edison Company - Virginia Jurisdiction
Summary of Cost of Capital
for December 31, 1977

Type of Capital	Capital Structure Ratios*	Cost Rate	Post-Income Tax Weighted Cost
Debt	50.6%	7.75%	3.92%
Preferred Stock	10.4	7.58	0.79
Common Equity*	35.7	14.50	5.18
Cost Free Capital	3.3	-0-	-0-
Cost of Capital	100.0%		9.89%
			Use 9.9%

Indicated levels of fixed charge coverage and rate of return to be experienced on common equity, if attrition would occur at a rate of 1/2 of 1% of the overall cost of capital and the Company only achieved an overall rate of return of 9.4%:

Pre-income tax coverage of interest charges (1) (14.46% ÷ 3.92%)	3.69 x
Post-income tax coverage of interest charges (9.40% ÷ 3.92%)	2.40 x
Overall coverage of interest charges and preferred dividends (9.40% ÷ 4.71%)	2.00 x
Indicated experienced rate of return on common equity (9.40% - 4.71% = 4.69% ÷ 35.7%)	13.14%

(1) Achieved overall rate of return of 9.40% less debt component of 3.92% produces a 5.48% return component for preferred stock and common equity. 5.48% ÷ 52% (the complement of a 48% statutory federal income tax rate) produces 10.54% plus the 3.92% debt component equal 14.46% pre-income tax overall rate of return.

* From Schedule 1, page 2 of 2, for December 31, 1977.

The Potomac Edison Company - Virginia Jurisdiction
Indicated Maximum Opportunity and Likely Achieved Return on Common Equity
and Maximum Likely Achieved Coverages of Fixed Charges
Based on Requested Rate of Return

Debt	50.6%	7.75%	3.92%
Preferred Stock	10.4	7.58	0.79
Common Equity	35.7	14.12 (1)	5.04 (1)
Cost Free Capital	3.3	-0-	-0-
	100.0%		9.75%*

(1) Company has requested an overall rate of return of 9.75% which, after fixed capital costs, leaves a weighted component for common equity of 5.04%. That component divided by the common equity ratio equals the opportunity cost rate of 14.12%.

Indicated maximum likely achieved levels of fixed charge coverage and return on common equity based on requested overall rate of return and attrition of only 1/2 of 1% of the overall cost of capital occurring. Thus, the maximum likely achieved overall rate of return would be 9.25%.

Pre-income tax coverage of interest charges (1) (14.17% ÷ 3.92%)	3.61 x
Post-income tax coverage of interest charges (9.25% ÷ 3.92%)	2.36 x
Overall coverage of interest charges and preferred dividends (9.25% ÷ 4.71%)	1.96 x
Indicated maximum likely achieved return on common equity (9.25% - 4.71% = 4.54% ÷ 35.7%)	12.72%

Note: (1) Achieved overall rate of return of 9.25% less debt component of 3.92% produces a 5.33% return component for preferred stock and common equity. 5.33% ÷ 52% (the complement of 48% statutory federal income tax rate) produces 10.25% plus the 3.92% debt component equals 14.17% pre-income tax overall rate of return.

POTOMAC EDISON COMPANY
RESIDENTIAL SERVICE
CUSTOMER STATISTICS [1]

Rate Schedule (a)	No. of Customers (b)	MWH Sold (c)	Average Monthly Customer Use KWH/Mo. (d)	Total Charge [2] Present [3] $ (g)	Total Charge [2] Proposed $ (f)	Percentage Increase % (g)
"R" [4]	33,552	239,521	595	23.43	25.84	10.3
"R-A"	8,588	175,484	1,702	49.32	57.08	15.7
"A"	655	3,646	463	16.53	21.02	27.2
"T-E"	155	3,418	1,838	42.90	60.67	41.4

[1] Based on 12 months ended December 31, 1976

[2] Includes those customers and KWH sales associated with Schedule "W"

[3] Total Charge computed using present and proposed fuel adjustment factor for Oct., 1976

[4] Excludes Rate Surcharge

19810
JRW-10
Linda R. Whitmore
JR Pharman

1980
SFL-9

Exhibit No.
Witness: Leis
Statement I

THE POTOMAC EDISON COMPANY

Rate of Return Statement
For the Twelve Months Ended December 31, 1976

	Total Company Per Books Col. (1)	Virginia Jurisdictional Col. (2)	Staff Adjustments Col. (3)	After Staff Adjustments Col. (4)	Proposed Rate Increase Col. (5)	After Proposed Rate Increase Col. (6)
Operating Revenues	$208,993,481	$29,146,002	$ 35,226	$29,181,228	$3,825,380	$33,006,608
Operating Revenue Deductions						
Operation & Maintenance Exp.	$129,423,406	$16,845,014	$ 548,205	$17,393,219	$	$17,393,219
Depreciation & Amortization	15,977,200	2,518,913	19,200	2,538,113		2,538,113
Taxes Other Than Income Taxes	12,616,155	1,964,821	302,174	2,266,995	133,888	2,400,883
State Income Taxes-Pennsylvania	298,300	15,834	(3,755)	12,079	16,612	28,691
Federal Income Taxes-Current	5,648,100	1,096,043	(412,187)	683,856	1,763,942	2,447,798
Federal Income Taxes-Deferred	3,694,160	324,940		324,940		324,940
Investment Tax Credit-Net	3,251,900	511,991		511,991		511,991
	$170,909,221	$23,277,556	$ 453,637	$23,731,193	$1,914,442	$25,645,635
Net Operating Income	$ 38,084,260	$ 5,868,446	$(418,411)	$ 5,450,035	$1,910,938	$ 7,360,973
Less: Charitable Contributions (net of F.I.T.)	18,392	2,820		2,820		2,820
Net Operating Income-Adjusted	$ 38,065,868	$ 5,865,626	$(418,411)	$ 5,447,215	$1,910,938	$ 7,358,153
Rate Base (From Schedule A)	$493,514,173	$75,114,396	$ 104,275	$75,218,671		$75,218,671
Rate of Return	7.71%	7.81%		7.24%		9.78%

( ) Denotes Negative Amount

THE POTOMAC EDISON COMPANY

Virginia Jurisdictional
Reconciliation of Company and Staff Adjustments

	Per Company Col. (1)	PER STAFF Adjustment No. Col. (2)	PER STAFF Amount Col. (3)	Difference Col. (4)	
Operating Revenues					
To eliminate the abnormal sales to the General Public Utilities System which occurred during the test period.	$ (894,998)	-	-	$ (894,998)	--(Similar sale occurred in 1977, to Ohio Edison, therefore, not considered by Staff to be non-recurring
To increase revenue reflecting a customer refund applicable to 1975, but booked during the test period.	-	1	$ 35,226	(35,226)	--(Staff initiated this adjustment base on audit findings.
	$ (894,998)		$ 35,226	$ (930,224)	
Operation and Maintenance Expenses					
To remove costs associated with sale of power to General Public Utilities System and to reflect the substitution of economy transactions with other utilities representing a portion of reduced short-term sales that would be sold as economy energy. See Adjustment No. 1 above.	$ (736,869)	-	-	$ (736,869	--(Staff did not make this adjustment; see explanation for Adj. No. 1.
To annualize wage increases granted during the test period and to reflect the annual amount of 1977 wage increases.	211,243	2	$ 268,921	(57,678)	--(Recent Commission policy changes recognized full annual effect of wage increases vice only the effective amount.
To annualize expenses associated with reduction of personnel during 1976 and to reflect the annual amount for 1977.	(47,574)	3	(61,322)	13,748	--(Staff initiated this adjustment base on audit findings.
To annualize change in labor expense distribution due to engineering time study.	85,690	4	85,690	-	
To reflect 1977 level of capacity charge under the Power Supply Agreement.	9,125	5	9,125	-	
To reflect Power Supply Agreement charges with a fixed charge rate based on 9 1/4% rate of return.	273,762	6	273,762	-	
To reflect one-half of estimated expenses of this rate case.	21,300	7	21,300	-	
To annualize the decrease in Part D of the Power Supply Agreement (Bulk Power Transmission Service).	-	8	(49,271)	49,271	--(Staff initiated this adjustment base on audit findings.
	$ (183,323)		$ 548,205	$ (731,528)	

THE POTOMAC EDISON COMPANY

Virginia Jurisdictional
Reconciliation of Company and Staff Adjustments

	Per Company Col. (1)	PER STAFF Adjustment No. Col. (2)	PER STAFF Amount Col. (3)	Difference Col. (4)	
Depreciation					
To reflect the annual depreciation applicable to pollution equipment included in Construction Work in Progress at 12/31/76 and the projected final cost of such pollution equipment being placed on existing stations in 1977.	$ -	9	$ 19,200	$ (19,200)	--(Adjustment recognizes non-revenue producing cost of installing pollution control equipment.
Taxes Other Than Income Taxes					
To increase state gross receipts and special taxes to reflect the above adjustment (No. 2) to revenue ($35,226 x 3.57%).	$ -	10	$ 1,258	$ (1,258)	--(Co. did not reflect revenue Adj. No. 2 above: $35,226 x 3.57%.
To increase gross receipts taxes offsetting the removal of prepaid state gross receipts tax from the rate base, and to reflect book tax expense as being based on test year (1976) revenues instead of prior year's (1975) revenues.	-	11	300,916	(300,916)	--(Co. reflected Prepaid State Gross Receipts tax in rate base in accordance with previous Commission policy.
	-		$ 302,174	$ (302,174)	
State Income Taxes - Pennsylvania					
Tax effect of above adjustments at rate of .45%.	$ (3,203)	12	$ (3,755)	$ 552	--(Due to difference in above revenue and expense adjs.: $-930,224 + 731,528 + 302,174 + 19,200 = $122,678 x .45% = $552.
Federal Income Taxes					
To decrease taxes by the amount of the tax savings resulting from the surcharge exemption.	$ -	13	$ (13,500)	$ 13,500	--(In calculating F.I.T. the Staff utilizes the surcharge exemption applicable to the first $50,000 of taxable income.
Tax effect of above adjustments at rate of 48%.	(340,067)	14	(398,687)	58,620	--(Due to difference in above revenue and expense adjs.: $-930,224 + 731,528 + 302,174 + 19,200 - 552 = $122,126 x 48% = $58,620.
	$ (340,067)		$(412,187)	$ 72,120	
Net Operating Income Effect of Above Adjustments	$ (368,405)		$(418,411)	$ 50,006	
Net Income Effect of Proposed Increase (Statement I, Col. 5)	$ 1,910,938		$1,910,938	-	
Net Operating Income per Books (Statement I, Col. 2)	$ 5,865,626		$5,865,626	-	
Net Operating Income After All Adjustments	$ 7,408,159		$7,358,153	$ 50,006	

THE POTOMAC EDISON COMPANY

Virginia Jurisdictional
Reconciliation of Company and Staff Adjustments

	Per Company Col. (1)	PER STAFF Adjustment No. Col. (2)	PER STAFF Amount Col. (3)	Difference Col. (4)	
Rate Base					
Property Held for Future Use To reduce Property Held for Future Use excluding all sites included in the account as of December 31, 1976 not scheduled for use during the four years following the end of the test period.	$ -	15	$(153,637)	$ 153,637	--(Staff initiated this adjustment based on audit findings.
Construction Work in Progress To increase C.W.I.P. by the projected final cost of pollution facilities being placed on existing stations in 1977.	-	16	197,000	(197,000)	--(See Adjustment No. 9.
Allowance for Working Capital To adjust cash working capital by one-ninth of the above adjustments to operating expenses.	(20,369)	17	60,912	81,281	--(Due to difference in above expense adjustments: $731,528 x 1/9th = $81,281
Rate Base Effect	$ (20,369)		$ 104,275	$ 37,918	

( ) Denotes Negative Amount

Exhibit No. ___
Witness: Leis
Statement V

THE POTOMAC EDISON COMPANY

Capital Structure and Cost of Capital
As of December 31, 1976

	Amount Col. (1)	Percent of Capital Structure Col. (2)	Actual Interest Col. (3)	Cost Col. (4)	Return Component Col. (5)
Long-Term Debt					
Debentures due 12/1/77 @ 3.250%	$ 5,500,000		$ 178,750		
" " 1/1/78 @ 3.125	4,000,000		125,000		
" " 4/1/81 @ 3.375	10,000,000		337,500		
" " 5/1/87 @ 4.625	14,000,000		647,500		
" " 3/1/94 @ 4.625	16,000,000		740,000		
" " 5/1/96 @ 5.875	18,000,000		1,057,500		
" " 4/18/98 @ 7.000	25,000,000		1,750,000		
" " 5/1/99 @ 7.625	15,000,000		1,143,750		
" " 5/1/2000 @ 9.500	20,000,000		1,900,000		
" " 5/1/2001 @ 8.375	20,000,000		1,675,000		
" " 12/1/2002 @ 7.500	12,000,000		900,000		
" " 12/1/2003 @ 8.625	15,000,000		1,293,750		
" " 10/1/2005 @ 11.000	30,000,000		3,300,000		
" " 6/1/2006 @ 9.250	25,000,000		1,201,215		
Amortization of Discount			54,396		
Amortization of Premium			(40,400)		
Total Funded Debt	$229,500,000	48.56	$16,263,961	7.56 %[1]	3.67%
Other Long-Term Debt					
Long-Term Lease Obligation - Harrison due 9/1/84	$ 5,288,000	1.12	$ 286,602	4.875 %[2]	.05%
Long-Term Installment Obligation - Albright due 12/1/85	2,355,000	0.50	112,438	5.000 [3]	.03
Total Other Debt	$ 7,643,000	1.62	$ 399,040		.08%
Customer Deposits	$ 213,507	0.05	$ 14,462	6.000 [4]	.00%
Total Long-Term Debt	$237,356,507	50.23	$16,677,463		3.75%
Proprietary Capital					
Preferred Stock (Including Premium)	$ 58,048,000				
Common Equity					
Common Stock	107,500,000				
Other Paid-In Capital	2,940,000				
Retained Earnings	41,686,000				
Accumulated Deferred Job Development Tax Credit	10,777,000				
Total Proprietary Capital	$220,951,000	46.75			
Accumulated Deferred Investment Tax Credit(pre-1971)	$ 3,088,000	0.65		-0-	
Accumulated Deferred Income Taxes - Accelerated Amortization and Liberalized Depreciation	$ 11,244,000	2.37		-0-	
TOTAL CAPITAL	$472,639,507	100.0			

1 The cost of debt is determined by the average yield method as used by the Commission's cost of money witness, Dr. Carl Weaver.

2 Interest rate is 1/2 the difference between 5% & the prime Int. rate charged by Mellon Bank, plus 4 1/4%. At Dec. 31, '76 the Co. experience an actual cost of 4.875% (1/2 (6.25 - 5.00) + 4.25)

3 Interest rate is 1/2 the difference between 7% & the prime Int. rate charged by Chemical Bank, plus 5.0%. At Dec. 31, '76 the Co. experienced an actual cost of 5.00% (1/2 (6.25 - 7.00) + 5.00).

4 8% rate effective February 1, 1977.

( ) Denotes Negative Amount

1 5.

2 NOTE: The matter is called to be
3 heard at 10:02 o'clock A.M. on March 28,
4 1977 and begins as follows, viz:
5
6 CHAIRMAN SHANNON: On January 10,
7 1977 Potomac Edison Company filed its
8 Annual Review data with the Commission for
9 the twelve months ending September 30th,
10 1976 and its projections for twelve months
11 to end on September 30th, '77.
12 In a cover letter, the Company,
13 pursuant to 56-240 of the Code of Virginia,
14 requested authorization to place in effect for
15 electric service rendered on and after
16 March 1, 1977 a surcharge to produce
17 additional gross revenues of a million
18 ninety-two thousand five hundred seventy-
19 four dollars.
20 The surcharge, if permitted to
21 become effective, would result in a 4.274
22 percent surcharge on existing rate schedules
23 except for space heating and water heating.
The surcharge tarrif for space and
25 water heating schedules would result in an

1 6.

2 8.548 percent surcharge.

3 Potomac Edison contends that it

4 is earning substantially less than the

5 8.75 percent increase which was authoriz-

6 ed by this Commission in its May 29th,

7 1975 Order in Case Number 19410. In that

8 case, the Commission authorized an over-

9 all rate of return of 8.75 percent, and

10 it authorized 12 percent on equity.

11 Those rates became effective, as

12 I recall, on June 9th, 1975.

13 The Commission suspended the sur-

14 charge until May 1, 1977. It directed,

15 by its Order of February 17th, 1977,

16 that a public hearing be held at this

17 time and place for the purpose of receiv-

18 ing evidence from the Commission Staff

19 and from the Company regarding the just-

20 ness and reasonableness of the proposed

21 surcharge.

22 Also, the Company was directed to

23 give Notice of the proposed surcharge,

24 and that Notice provision was spelled out

25 in the Order.

1 12.

2 shortly available in this case as a

3 result of the Staff's ongoing Ex Parte

4 investigation.

5 I believe that this information

6 should be made a part of the record in

7 this proceeding. I, therefore, request

8 that the Commission order the record in

9 this proceeding remained open until such

10 information has been filed and direct the

11 Applicant to file its report in Case

12 Number 19811 as part of this proceeding.

13 As I noted earlier, this report

14 is due to be filed no later than April the

15 1st, so the granting of this request will

16 not substantially delay this proceeding

17 and will provide the information -- excuse

18 me, and will provide the Commission with

19 the most current information available on

20 the issue of this proceeding.

21 Thank you.

22 CHAIRMAN SHANNON: Mr. Riely.

23 MR. RIELY: If it please the

24 Commission, I have very little to add.

25 I point out that the Company's figures

13.

show that an increase of a million ninety-two thousand five hundred seventy-four is required to produce a 8.75 rate of return.

Mr. Vassar's figures show that the cost of capital at September 30, 1976 is 8.83 percent, using a 12 percent rate of return on equity. And if, on his figures, the 8.83 percent produces a requirement of additional revenues of a million eighty thousand dollars -- almost a million eighty-one thousand dollars -- so that we are about ten thousand dollars apart, which is not something we propose to argue about.

It seems clear to me that the Company, under the Annual Review procedure that has been initiated by this Commission, is entitled to this rate increase of a million dollars and a little more.

And we ask that it be put into effect on that basis and as soon as possible.

Now, in a word, we are not going

1 14.

2 to argue with Mr. Vassar. And, secondly,

3 we are certainly not going to argue with

4 Mr. Wittine, who doesn't address what's

5 going on in this case but is giving us

6 some advice and guidance with what shall

7 happen in the next case.

8 And, in essence, Mr. Wittine is

9 saying that we should narrow the rates

10 between the special electric water heat-

11 ing and electric heating rate and the

12 special Monterey rates, which the Commis-

13 sion will recall is a result of the merger

14 of Monterey Utilities and Potomac Edison.

15 And we are all in favor of that.

16 The question is, as you will see

17 from Mr. Wittine's testimony, as to how

18 far to go. We want to go all the way,

19 but it seems to us that going all the

20 way in the next case may produce inequitable

21 increases on a very small number of

22 customers.

23 I don't know whether the Commission

24 has seen the testimony that we prepared

25 or not --

1 Nicol - Direct 18.

2 MR. RIELY: Eleven.

3 CHAIRMAN SHANNON: There are eleven

4 exhibits.

5 All right. Mr. Nicol's direct

6 testimony will be identified as

7 Exhibit JWN Number 1 with eleven

8 attachments.

9 MR. RIELY: All right. You mean

10 his testimony or his exhibits?

11 CHAIRMAN SHANNON: Well, the whole

12 packet has been identified as Exhibit

13 JWN-1.

14 MR. RIELY: All right, sir.

15

16 BY MR. RIELY: (Continuing)

17 Q Now, Mr. Nicol, turning to Page 3 of

18 your testimony, are there a couple of minor errors on

19 line 26 and 27 that have been changed?

20 A That is correct.

21 Q To lead you a little bit, shouldn't there

22 be periods instead of commas in line 26, three five two

23 point one seven nine; and, in line 27, five three four

24 point three two o; is that correct?

25 A That is correct.

Q Now, your testimony shows in Exhibit Number -- Attachment Number 7, they are calling it now, a million ninety-two thousand five hundred seventy-four dollars of additional revenues required to earn an 8.75 percent rate of return; is that correct?

A That is correct.

Q Now, would you turn to your Attachment 11. What does that show?

A Attachment 11 shows that if you are using the current embedded cost at September 30th, 1976, and using the return on equity which is allowed in the prior case, which is Case Number 19410, the rate of return, then, would be 8.83.

Q Now, turning back to your Attachment Number 7, the rate of return per books unadjusted for the twelve months ended September 30, 1976 was what?

A 8.17.

Q Now, Mr. Nicol, you have supplied this morning to the Staff material requested in Commission Order Number 19811, dated February 18th, 1977, have you not?

A Yes, I have.

Q Now, what does that show in Item Number 3

for the unadjusted rate of return for the twelve months ending February 28th, 1977?

A It shows a rate of return of 8.28 percent.

Q And that is the figure comparable to the 8.17 percent shown on Exhibit Number 7?

A That is correct.

Q Now, is your Company a summer-peaking company?

COMMISSIONER BRADSHAW: A what?

MR. RIELY: A summer-peaking company.

WITNESS NICOL: No, it is not. It's a winter-peaking company.

BY MR. RIELY: (Continuing)

Q What period -- when you take twelve months ending any particular period of the year, what period of the year is likely to produce the highest rate of return?

A Normally, January and February.

Q In other words, twelve months ended February would be an abnormally high period; is that

correct?

A That is correct.

Q That is because of your winter sales?

A That is right. Usually, our winter peaks, of course, exceed our prior winter peaks, realizing, of course, the twelve months ending would always be January and February the highest if you picked that period of time. But, January and February are normally our high peak months, and this is when the peaks occur, usually in January.

Q But for the twelve months ending December 1976, what was the unadjusted rate of return, as shown on Item 3?

A 7.72.

Q And that is 425 basis points below the September figure?

A That is correct.

MR. RIELY: If it please the Commission, Mr. Owens has asked that this material be filed. I don't have copies of it.

I can make copies of it.

CHAIRMAN SHANNON: Suppose you make

COMMISSIONER SHANNON: Mr. Flippen?

CROSS EXAMINATION

BY MR. FLIPPEN

Q Mr. Nichols, you have considered these two surcharges as designed to produce interim rate relief, I presume, as I read your testimony. Is that correct?

A That is correct.

Q You are in the process of preparing for a permanent rate application?

A That is correct.

Q Would you indicate to us the earliest date in which that application could be filed?

MR. RIELY: May I indicate it for you, Mr. Flippen?

MR. FLIPPEN: No, you may not.

WITNESS NICOL: As soon as we possibly can get the information together.

BY MR. FLIPPEN

Q Well, I think you must have some indication.

A Well, hopefully sometime around May would be my target date, but they seem to have a way

of alluding me.

Q Around the first of May?

A Well, not -- I can't be that definitive. I would say some time in May.

Q Your Honor, may I have just one second with Mr. Vassar?

COMMISSIONER SHANNON: Yes, you may.

BY MR. FLIPPEN

Q My concern, Mr. Nichol, is that we don't hit the rate payers with two rate increases immediately. So I will assume that May the 1st would be the earliest, and take you at your word that it would be more than likely late in May that you would file, so we would be talking about a hearing some time in the Fall.

A That would be my understanding, yes.

Q All right, fine. Mr. Nichol, for the year end 1976, over 1975, Potomac's operating expenses per Company increased about 26 percent. In fact, they increased from 102.5 million year end 1975, to 129.4 million for year end 1976, which is approximately 26 percent increased in operating expenses.

Could you indicate to the Commission generally what caused expenses -- operating expenses --

BY MR. OWENS

Q On page 12 of your testimony, you state that you elected to proceed under annual review for the proposed rate increase because you needed prompt relief, and I believe, as your prefiled testimony indicates, you give basically two reasons; one, is -- the reason given is actually your bond issue, which you anticipate to be some time in November, this bond issue will raise approximately 35 million dollars, and there will be two uses of the proceeds of this 35 million dollars. 9.5 million will be used to retire maturing debt, which comes due in December or January.

The remaining 25.5 million dollars will be applied to your construction program.

You have also advised the Commission that you may be filing for permanent rate relief as early as May.

I was curious if the Company's obviously anticipated its debt offerings for some time. When you filed your application in January, why didn't you file for permanent rate relief at that time rather than for an interim rate relief under annual review?

A Well, based on what we see our coverage to be, and that of course is based on our

1 projection as of September 1977, we see our coverage as
2 being about 2.2 times.
3 We see the possibility that the test that
4 we have to meet for the coverage as 12 months of the last
5 15 months. We figure that probably will be reduced to
6 12 months ending September. If we see that there may be
7 a possibility that our coverage would go down, so therefore,
8 we need dollars to be cranked into our income statement
9 so that our earnings would be there to stand the test
10 as of September 30, 1977, as opposed to a full-fledged
11 rate case, where probably you would see a delay or
12 effective date of the rate increase not until maybe
13 six months hence or something, or seven months from the
14 filing date.
15 Q You just state that you are project-
16 ing ahead for your earnings coverage through September.
17 When did you make that projection?
18 A I guess it was maybe a month or so
19 ago.
20 Q Have you revised that projection?
21 A No.
22 Q Has the results of January convinced
23 you that this figure should be revised? Do you anticipate
24 that?
25

what the bottom line result would be with such a revision?

A That is right.

Q I believe in response to Mr. Flippen's question, you gave him a figure on how much of your financing, your construction program financing, you expect will be financed externally.

Can you give me that figure again? I did not catch it.

A Well, I said that we anticipate that internally we will be able to generate anywhere between thirty and forty percent, so that would then leave anywhere between sixty and seventy percent to be able to -- outside financing.

Q I take it when you plan your future financing, you also plan alternative financing.

For example, with this bond offering you anticipate in November, I assume that if the bond offering should be postponed or cancelled, you've already made alternative plans for financing the retirement of the debt; is that correct, the two debt issues?

A That's a must. Of course, that has to be met.

Q Would the Company be able to finance internally the retirement of the debt coming due in January and December?

A That possibility exists. Of course, absent the bond market, absent preferred stock, and we, of course, look to the parent company for an influx of capital.

Q Uh-huh.

A As indicated, the '77 plans are that our parent company -- I think the figure is something like twenty-five million dollars that they propose to buy of common stock.

Q Right. That was in your prefiled testimony.

Is that November date pretty much fixed? Is that the near side or the far side of when you would propose to go with the offering?

A That is the date that has been earmarked. That is the month of November.

Now, of course, I would assume that as we approach that date if the market -- if the bond market is favorable, I think we may try to accelerate it. By the same token, if the bond market is not too favorable, it could be postponed.

But there are some limitations as to how much postponement you could make.

Q Do ya'll anticipate rising interest rates between now and --

A From what little I've been able to read, yes.

Q If the Company were not authorized rate relief as requested in this proceeding -- I believe you've answered this question previously -- you would be able to find alternative means of financing for retirement of the two debt issues that expire in November -- I mean, excuse me, December and January?

A Well, I wouldn't -- let me answer the question this way. I don't want to convince the Commission, or make my answer predicated if we don't get this rate relief that we won't be able to refinance those bonds; I don't think that would be a fair response.

Q So that obviously there would be some alternative to --

A That is true.

Q What I guess I'm trying to get at is, I see really two purposes of the bond offering which you use as one of your primary reasons for requesting rate relief. One is the retirement of debt, and the

1 second one is your construction program.

2 Now, both of these are anticipated

3 events. They certainly aren't sudden or unexpected.

4 Now, I was wondering, really, what the

5 urgency of the Company was in filing for a rate relief

6 under Annual Review rather than postponing or filing its

7 request for permanent rate relief at an earlier time?

8 A My response, as I made to Mr. Flippen,

9 was the fact that we need, as we see it, we need dollars

10 to start to come in, so that when we stand a test for

11 our bond finance or indenture coverage we have some

12 dollars that are in there. That will provide us the

13 coverage to sell the bonds.

14 Q Wouldn't it have been possible, though,

15 to move back your request for permanent rate relief

16 from May to, say, March, or whenever, and still have

17 adequate time to generate enough earnings to increase

18 your coverage ratio?

19 A No, I don't think so. I think that our

20 best estimate as to when we could file a full-fledged

21 rate case, number one; number two, our best estimate

22 as to when the Commission would be responsive to that

23 rate request, in other words, with a final Order as

24 to when the effective date would be.

Again, our best estimates were that was too far down the pike; that was too far down the road to have any significant effect on what we were trying to accomplish by having, you know, additional revenue made available so that we could increase our chances of passing the coverage test.

MR. OWENS: Thank you. That's all.

REDIRECT EXAMINATION

BY MR. RIELY:

Q Mr. Nicol, if you can't sell your bonds can you continue your construction program?

A No, sir.

Q Mr. Nicol, I hand you a document and ask you whether you can identify it?

A I can identify it, yes. That's the Annual Report for the Potomac Edison Company, 1976.

Q Would you please turn to Page 3, and would you state the total operating expenses for 1976?

A Total operating expenses for 1976 were one hundred seventy million nine hundred nine thousand dollars.

Q What were they for 1975?

A One hundred thirty-eight million five hundred sixteen thousand dollars.

Q Would you accept, subject to check, that is an increase of about 23.3 percent?

A I would accept that subject to check.

Q Now, what are the major items of that increase? Is not fuel one of them?

A Fuel is one.

Q How much did that increase approximately?

A Approximately six million dollars.

Q How about purchased and interchange power, net?

A That was an increase of roughly seventeen million dollars.

Q So the total increase was about thirty-two million dollars, wasn't it?

A Of those two figures, is that what you are saying?

Q Of the total operating expenses?

A Okay. Right. That is correct.

Q Those two figures increased about twenty-three of that thirty-two; is that correct?

A That's correct.

MR. RIELY: If it please the Commission, I don't have anymore copies of this thing. But, since this matter has been brought up I would like to introduce this as an exhibit.

CHAIRMAN SHANNON: All right. We will identify this as Exhibit JWN Number 4.

go ahead and identify it for the record.

Let's identify it as EMV-5. And, then, his so-called exhibits that are attached to that will be attachments, referred to as attachments rather than as exhibits.

BY MR. FLIPPEN: (Continuing)

Q Mr. Vassar, based on your Annual Review of Potomac Edison, do you have a summary statement that you would like to make?

A I have a short statement, several pages.

Q Please proceed.

A My report covers the Company's operations for the twelve months ended September 30th, 1976. The Company is requesting a temporary surcharge in the amount of a million ninety-two thousand five hundred seventy-four dollars, which it contends is necessary to increase its earnings to the level authorized in the last rate case.

In its decision of that case, the Commission authorized a return of 12 percent on equity capital and an overall return of 8.75 percent.

As a result, the Company was granted an increase of two million six hundred seventy-three thousand eight hundred sixty-eight dollars and authorized that the new rates be put into effect for service rendered on and after June the 9th, 1975.

Staff Exhibit AR-1 is the rate of return statement for the Annual Review period. Column 1 shows operating revenues, operating revenue deductions, and a rate base on total company basis.

Net operating income adjusted is thirty-eight million five hundred fifty thousand four hundred forty-four dollars, and when related to the year-end rate base of four hundred seventy-eight million eight hundred seven thousand seven hundred fourteen dollars produces an 8.05 percent rate of return.

Column 2 reflects Virginia jurisdictional amounts. Net operating income adjusted is six million thirty-nine thousand a hundred eighty dollars, and when related to the year-end rate base of seventy-three million eight hundred twenty-nine thousand eight hundred fifty-one dollars, it produces a book rate of return of 8.18 percent.

Column 3 reflects the adjustments

applicable to Virginia operations. They serve to decrease net operating income by sixty-eight thousand three hundred ten dollars and decreases the rate base by ninety-four thousand eight hundred twenty-three dollars.

After reflecting these adjustments, the adjusted Virginia rate base rate of return in Column 4 becomes 8.10 percent.

The only significant difference in the adjustments made by the Company and the Staff was a one hundred one thousand one hundred seventy-seven dollar adjustment made by the Staff to lower recorded Virginia State gross receipts taxes for the Annual Review period. These taxes were overstated by that amount.

Column 5 shows the effect of the Company's proposed increase of a million ninety-two thousand five hundred seventy-four dollars.

Net operating income would be increased by five hundred forty-five thousand seven hundred eighty-six dollars.

After reflecting the proposed rate increase, net operating income in Column 6 becomes six million five hundred sixteen thousand six hundred

fifty-six dollars. And when related to the year-end rate base of seventy-three million seven hundred thirty-five thousand and twenty-eight dollars, produces a rate of return of 8.84 percent.

This compares to a year-end cost of capital of 8.83 percent as shown at the bottom of Column 4 in Staff's Exhibit AR-6.

Q That is now Attachment 6; is that correct, Mr. Vassar?

A Attachment 6.

For informational purposes of rates of return based on thirteen months average rate basis are shown on the last line of Staff's Exhibit AR-1.

One other matter I would like to comment on is the prepaid Virginia State gross receipts taxes, a component of the rate base. The Company reflected nine hundred twenty-five thousand five hundred twenty-one dollars, compared to the Staff's amount of eight hundred sixty-seven thousand three hundred fifty-nine dollars, a difference of fifty-eight thousand one hundred sixty-two dollars.

In arriving at this amount, the Staff used the aggregate of the four prepaid installments made by the Company during the Annual Review period, 12/15/75,

4/15/76, 6/15/76 and 9/15/76. This is the method customarily used by the Staff.

The Company's amount represents a combination of these four prepayments plus twenty-five percent of the balance due payment made in May 1976, which is not considered by the Staff to be a prepayment.

In conclusion, it appears that the Company's shortfall in Annual Review earnings of a million eighty thousand nine hundred forty-seven dollars, as calculated by the Staff on Page 7 of my report, is material enough to warrant the Commission's consideration of the Company's request for rate relief at this time.

31.

JOHN M. McCARDELL, a witness called by and on behalf of the Applicant, having first been duly sworn by the Bailiff, testified as follows:

DIRECT EXAMINATION

BY MR. RIELY:

Q Mr. McCardell, would you please state your name and residence?

A John M. McCardell, 1156 Terrace, Hagerstown, Maryland.

Q What is your occupation?

A I am the Executive Vice President and General Manager of The Potomac Edison Company.

Q Mr. McCardell, has your testimony of seventeen pages and one exhibit of six pages been previously filed in the record in this case?

A Yes, it has.

Q And if I were to ask you the questions shown in that testimony, would you give me the answers shown there?

A Yes, I would.

1 A. Yes. I have testified on behalf of The Potomac Edison Company in Case
2 Nos. 19410 and 19139.
3 Q. Please outline the testimony you plan to give today.
4 A. I shall try to cover the same general subjects as I did in our prior rate
5 cases by providing an overview of The Potomac Edison Company and its request
6 for rate relief. More specifically, I shall briefly describe the Company's
7 service and area, corporate structure, the trends of electric consumption
8 in the service area and the construction program necessary to meet customer
9 needs, its rate history as a background to the present request, and finally,
10 the principal reasons for instituting these proceedings. I shall note in my
11 testimony those subjects which will be more fully described by other witnesses
12 on behalf of the Company.
13 Q. Mr. McCardell, have you prepared an exhibit which will illustrate the matters
14 you intend to discuss in the course of your testimony?
15 A. Yes, I have had prepared under my supervision an Exhibit continuing for 6
16 pages bearing the indentification "JMM-1".
17 Q. Please describe Potomac Edison's service area.
18 A. In Virginia, Potomac Edison supplies electric service to all or part of
19 Albemarle, Clarke, Culpeper, Fauquier, Frederick, Greene, Highland, Madison,
20 Orange, Page, Rappahannock, Rockingham, Shenandoah and Warren Counties, and
21 the City of Winchester. The Company served approximately 49,237 retail
22 customers at the end of 1976 in this Virginia area of approximately 2,095
23 square miles which has a population of about 115,700 people.
24 During 1976, the test year in this case, Potomac Edison also served
25 adjoining portions of Pennsylvania, Maryland and West Virginia. The entire
26 territory served by the Company for this period covered approximately 8,610
27 square miles, contained over 260,000 retail customers, and had a population

1 of about 660,000 people. Effective January 1, 1977 Potomac Edison transferred
2 its Pennsylvania service territory to West Penn Power Company, an affiliate,
3 in exchange for a portion of West Penn's ownership interest in the Harrison
4 Generating Station. This property exchange was approved by the State
5 Corporation Commission in Case No. A-459.
6 Q. Please describe Potomac Edison and the corporate structure of which it is
7 a part.
8 A. The Potomac Edison Company is a Maryland and Virginia Corporation which
9 during the test year also operated in Pennsylvania and West Virginia. As
10 mentioned, effective January 1, 1977, the Company no longer supplies electric
11 service in Pennsylvania. It is a subsidiary of Allegheny Power System, Inc.
12 Potomac and its sister operating companies, Monongahela Power Company and
13 West Penn Power Company, also subsidiaries of Allegheny Power System, Inc.,
14 operate as an integrated multi-state electric system. Bulk power supply,
15 engineering, computer, information services, and other aspects of system
16 operations more economically or better done centrally for all three
17 operating companies are functions of Allegheny Power Service Corporation,
18 an integral part of the Allegheny Power System and also a subsidiary of
19 Allegheny Power System, Inc.
20 Q. What are the advantages of operating the Allegheny Power System as an
21 integrated multi-state system?
22 A. This method of operation results in economies such as (1) pooling available
23 generating capacity to reduce operating costs, (2) planning additions to
24 generation and transmission capacity, (3) realizing economies of scale,
25 (4) augmenting the reliability of bulk power supply, (5) maximizing the
26 usefulness of specialized engineering skills, (6) making directly available
27 throughout the system technical know-how, experience and information to

1 improve methods and the quality and dependability of service, (7) attracting,
2 training and holding skilled personnel of all kinds, and (8) achieving cost
3 savings through consolidation of commonly needed services.
4 I would like to emphasize that one of the principal benefits is the
5 fact that it permits us to locate generating stations and transmission lines
6 on the basis of engineering studies of the entire Allegheny Power System
7 and best available sites without regard to state lines. Moreover, such
8 facilities can be designed to achieve an economy of scale which no single
9 participant alone could enjoy. Since, at certain times, this could result
10 in disproportionate capital investments by one participant, costs involved
11 are allocated equitably by contractual arrangements of the participants
12 through an FPC approved Power Supply Agreement which will be described by
13 Mr. Nicol. This method of operation provides significant advantages to our
14 Virginia ratepayers.
15 Q. Please describe the requirements for electricity in the Company's service
16 area.
17 A. For several decades, the pattern of use in our area has been one of growth
18 in both energy usage and demand at a level higher than national averages.
19 In late 1973 the growth rate lessened due in part to conservation of energy
20 by customers and in part to a downturn in the regional economy. The effect
21 of conservation efforts now appears to have been a temporary one-time
22 occurrence, and renewed increase in electric usage is now apparent. We
23 believe the future needs for electricity will resume the historic pattern of
24 growth at a rate slightly less than experienced in the past. However, even
25 a slackening pace in growth will require a tremendous construction program in
26 order to expand facilities if we are to meet the future electrical needs of
27 our area.

1 Q. What is the basis for your conclusions about the future requirements of
2 the area?
3 A. We conduct continuing studies forecasting usage and power demand ten years
4 into the future and recently filed with the Commission a Ten-Year Forecast
5 of our power supply needs. The forecasts are based on mathematical analyses
6 of historic trends adjusted for the demographic and economic factors of our
7 service area. In making the forecasts we consider information ranging from
8 plans of our industrial customers to appliance saturation surveys we conduct
9 every other year. We try to analyze factors that would either decrease or
10 increase past trends. For example, we have considered the probable effect
11 that conservation efforts will have in decreasing usage over the ten-year
12 period. Likewise, we have recognized the fact that shortages of new gas
13 supplies and other fuels will cause increases in the demands on electricity.
14 Our recent experience has been that an increasing number of the new housing
15 units built in our service territory are electrically heated. This trend
16 will have a tendency to increase electric usage in the future.
17 In summary our studies estimate that energy needs of Potomac Edison's
18 present service area from January 1, 1977 when the PA territory was
19 transferred through 1986 will increase by over 75%. This forecast
20 represents an average annual compound growth rate of about 6.5%, well
21 below historic trends. We forecast that the annual peak demand, which
22 is the highest one-hour demand on our system in the course of a year, is
23 expected to exceed 2,650 megawatts by 1986, representing an average
24 annual compound growth rate for the 1977-1986 period of about 7%, which is
25 also below historic trends.
26 Q. What construction will be necessary to meet these customer requirements?
27 A. To meet such needs Potomac Edison will require over 1,100 megawatts of

1 new generation as well as other transmission and distribution facilities at
2 a total present estimated cost of about $1.33 billion for the 1977-1986
3 period to assure adequate electricity to our customers.
4 Q. How does this compare with the Company's recent construction program?
5 A. During the five years ended December 31, 1976, Potomac Edison made gross
6 expenditures for plant of about $45 million per year. Expenditures were
7 lower than they should have been for the period because poor financial
8 results forced the Company to stretch out construction of our Pleasants
9 Generating Station. Expenditures are estimated at about $90 million a year
10 until 1980 when we estimate expenditures will rise to about $150 million a
11 year. Details are shown on page 1 of my exhibit.
12 Q. How does Potomac Edison pay for this construction?
13 A. We must pay for it in cash. Assuming we are able to generate 40% of such
14 requirements from internal sources, we must raise the rest from external
15 sources. This means that the Company must permanently finance electric
16 facilities by selling bonds, preferred stock and common stock. As part of
17 its Ten Year Forecast filing, Potomac Edison projected the earnings needed
18 to be able to successfully finance its construction program together with an
19 estimate of the revenues needed to achieve the target level of earnings. Mr.
20 Frank J. Hanley will supply details on our capital structure and the cost
21 of that source of capital.
22 Present earnings levels are simply not sufficient to attract at
23 reasonable cost the external capital needed to provide adequate electric
24 service to our customers. We are requesting and must receive adequate rate
25 relief in each of the jurisdictions in which the Company operates in order
26 to successfully finance our construction program.
27 Q. What will be the effect if the Company is not permitted sufficient earnings?

1 A. The result will be that the construction of new facilities will be delayed
2 or indefinitely postponed. Inevitably these construction cuts will adversely
3 affect service to our customers. In 1976, Potomac Edison experienced only
4 four (4) negative days. A negative day is a day on which Potomac Edison does
5 not have, and cannot obtain from its affiliates in the Allegheny Power System,
6 energy sufficient to provide continuous electric service to its customers.
7 As detailed in our Ten Year Forecast filing we estimate that without adequate
8 rate relief, the total of negative days for Potomac Edison by 1985 may be as
9 high as 226 if no generation after Pleasants can be financed.
10 Q. What rate relief has Potomac Edison been granted in Virginia?
11 A. The Company has only had two previous rate increases in Virginia. The most
12 recent permanent rate relief was in Case No. 19410 whereby Order issued
13 May 29, 1975, the Company was granted $2.7 of a requested $3.4 million
14 increase. Temporary rates in that case were effective August 1, 1974. More
15 than two years have elapsed since that last permanent rate increase in
16 Virginia went into effect.
17 On January 10, 1977 the Company applied for a rate surcharge pursuant
18 to Section 56-240 of the Code of Virginia. The surcharge requested was
19 designed to raise the rate of return to the 8.75% authorized by the
20 Commission in Case No. 19140. By Order entered on April 1, 1977 in Case
21 No. 19810, the Commission granted a surcharge to permit the Company to
22 collect temporary additional gross revenues not to exceed $960,000 annually.
23 This rate surcharge was placed into effect for all service rendered on and
24 after May 1, 1977.
25 Q. What rate relief do you seek in this case?
26 A. We are requesting $2,865,380 in rate relief over existing tariff levels and
27 propose to make permanent the prior temporary increase in rates of $960,000

1 for a total permanent rate increase request of $3,825,380. This request
2 amounts to a 13% increase in revenues which would actually average only
3 about 6.5% per year since our last rate increase two years ago.
4 Q. Why has this proceeding been initiated?
5 A. We continue to have the same goal as in prior cases. We are seeking rates
6 which will permit an earnings level sufficient to attract capital from
7 investors. We particularly need earnings sufficient for a fair return on
8 the common equity investment in the Company. We must achieve these goals to
9 be able to finance the construction program I have described. Without that
10 construction, we will be unable to provide for the demands of our customers
11 in the future.
12 Q. How will the requested increase in electric rates affect families in your
13 service area?
14 A. Much has been said in recent rate cases about what effect increasing costs
15 are having on the family budget. Page 2 of my exhibit shows a long-term
16 comparison of the increase in the cost of living index compared with our
17 average cost for a residential kilowatthour. While our average cost has
18 turned upward in recent years, it is obvious from this chart that increases
19 in other parts of the family budget that go into the composite cost of
20 living index have far exceeded the increases in utility costs over the
21 long run.
22 Closer scrutiny of the components of the cost of living index substantiates
23 these facts as shown on page 3 of my exhibit. All fuel and utility costs,
24 including electricity, heat, light, water and others, make up only about
25 5.4% of the average family budget. The electric bills show as only about
26 1.4%. I recognize that these are national averages and realize that for
27 many low-income customers and elderly people on limited fixed incomes the

1 percentage of utility costs may be much higher and the burden much greater.
2 To the extent such burdens should be lightened, that challenge should be
3 met by government agencies already established to provide assistance to
4 such needy persons not only for the increasing utility costs but also
5 for the much greater burden that such people are bearing due to tremendous
6 increases in the cost of food, shelter, clothing and the other necessities
7 of life.

8 Because the Bureau of Labor Statistics figures on the cost of utilities
9 in the average budget seemed so low to me, I asked our people to make
10 another comparison. They reported that the median family income in our
11 Virginia service area during 1975, the most recent figures available, was
12 about $10,592 a year. Comparing this with the average residential electric
13 bill of about $310 for the twelve months ended December 31, 1975, we find
14 that for the average Potomac Edison customer the electric bill is about
15 3% of income. Again I would point out that these are averages and should
16 not make us lose sight of the many low income people whose electric bills
17 are a much greater percentage of their income and who may need governmental
18 assistance to meet all the increased costs of living.

19 Now let us review in a little more detail the history of Potomac
20 Edison's average residential rate per Kwh as shown on page 4 of my exhibit.
21 You will note that this was 5.44 cents per Kwh in 1935 and 3.40 cents per
22 Kwh in 1976 and rising. Not many other things are lower in unit cost now
23 than they were forty years ago. Assuming a constant 1967 value of the dollar,
24 the effect is an even more dramatic change from 13.2 cents per Kwh in 1935
25 to 2.0 cents in 1975. Of course, we all know we cannot spend 1967 value
26 dollars any more, but this comparison clearly shows the present cost of
27 electricity is still lagging far behind the general inflation rate

1 as reflected in the declining value of the dollar.

2 Q. Is it your position that the rates authorized in your last rate case are

3 inadequate?

4 A. Yes. A clear illustration of this fact are the results of the Company's

5 annual review which measured Potomac Edison's financial performance for

6 the twelve months ended September 30, 1976. Adjusting book figures in a

7 manner consistent with principles established by the Commission it was

8 determined that the Company earned a jurisdictional rate of return in

9 Virginia of 8.01%. This contrasts to the rate of return authorized in

10 our most recent rate case of 8.75%. Even more important is the fact

11 that the allowed rate of return in our previous case which included

12 only a 12.0% return of equity is simply insufficient to attract capital to

13 finance future needs.

14 Financing costs remain at relatively high levels compared to our

15 present embedded cost of fixed income capital. The inevitable result is

16 that necessary financing steadily increases the Company's embedded cost

17 of fixed income capital causing an erosion of earnings. That erosion is

18 heightened by inflation which continues in almost all areas of our costs.

19 Our rate of return and earnings level were last established by the

20 Commission for a test period ending September 30, 1974. That period is

21 an unrealistic base for rates today. Our rates must be reestablished on

22 a more current test year basis if we are to meet the present-day require-

23 ments of the Company and its customers.

24 Q. What is the test period for the present case?

25 A. The test period is the calendar year 1976.

26 Q. What rate of return do you request in this proceeding and how much does

27 this require in annual rate increases?

1 A. We seek an overall rate of return of 9.75% on our terminal rate base during
2 1976. The request is near the bottom of any present day zone of reasonable-
3 ness for such returns. In fact, Mr. Hanley recommends 9.9% as a fair rate
4 of return.

5 The rates we have filed will produce an annual increase of $3.8 million.
6 Percentage-wise, this amounts to an increase of about 13% over the total
7 revenues from Virginia customers during the test year.

8 Q. What are the reasons for the Company's repetitive requests for rate relief
9 since 1970?

10 A. The principal causes continue to be the same as those which have plagued us
11 since the beginning of this decade. The chief culprit is inflation. Another
12 significant cause is the many new government regulations which require us to
13 spend dollars on items not previously necessary.

14 There have been inflationary increases in costs of materials and
15 supplies used in the daily operation of our business. There have been
16 inflationary increases in construction. The increases did not cease in 1974
17 at the end of the test period in our prior case. They have continued,
18 practically unabated, since that test period. As a result, our average cost
19 of constructing a mile of 7200 volt line in Virginia in 1974 was $5,565 and
20 it has risen to $7,274 this year. In 1970 it was $3,367.

21 Numerous other examples could be given but I am sure that the Commission
22 and our customers are aware of the impact of inflation. We have detailed
23 many of the aspects of inflation in previous cases before the Commission. I
24 would like to note, however, that the impact of inflation has been magnified
25 in capital intensive industries such as ours as a result of long-term
26 inflationary trends. When the 30-year-old bond issue with 3% interest
27 cost came due in 1974, and was replaced by a new bond issue at 11%, the

1 interest cost almost quadrupled. Likewise, every time a 30-year-old pole
2 that may have cost $10 is replaced by a new pole which may cost $50, the
3 rate base and the financial needs increase. These increases are related
4 not to the inflation rate in any one year, but to the long-range inflation
5 rate.

6 Page 5 of "Exhibit JMM-1" shows the increase in cost per kilowatt of
7 capacity of our most recent generating stations as well as our most recent
8 estimates of the cost for the Pleasants Station now under construction in
9 West Virginia. This station will cost over 2-1/2 times more per kilowatt
10 than our last station, Harrison. As new and more expensive facilities are
11 continually brought on line at higher unit costs, our previously authorized
12 rates based on lower unit costs simply will not cover the cost associated
13 with such new investment. Unlike many businesses, we can't immediately
14 increase our prices to reflect increased prices. As a regulated business,
15 we must seek Commission approval of price increases and this has resulted
16 in our repeated requests for increases to this and other Commissions.
17 Q. Have environmental protection requirements affected costs?
18 A. Certainly. They are a prime example of the new requirements I mentioned.
19 The high cost of compliance is particularly significant in construction of
20 generation stations. In addition major expenditures are necessary to make
21 older plants comply with changing pollution requirements. Through December
22 1976, Allegheny Power System had made capital expenditures of approximately
23 $206 million for environmental facilities. Potomac's share of this was
24 approximately $54 million. Details including estimates for future expendi-
25 tures are shown on page 6 of "Exhibit JMM-1." This does not take into
26 consideration the cost of operating such facilities after they are placed
27 in service. Likewise, it does not take into consideration the increased

1 expenses associated with purchases of different fuels to meet pollution
2 regulations.
3 Q. Are you implying such pollution control equipment should not be required?
4 A. No. Reasonable protection of our environment is a necessary part of our
5 everyday life. I do believe, however, that our customers should be aware of
6 the enormous costs involved and that such costs do not increase Kwh sales to
7 Potomac Edison's customers. Rather, environmental facilities frequently use
8 substantial amounts of energy themselves, thereby increasing our costs because
9 an increased portion of our generation must be used to operate such devices.
10 Also, such devices involve extra operating and maintenance costs. Even in
11 the absence of further inflation, requirements for new expeditures such as
12 these and similar ones for non-revenue producing facilities necessary to meet
13 modern standards of reliability and beautification would result in large
14 construction programs.
15 Q. Are there any major factors other than inflation and requirements for non-
16 revenue producing facilities that have led to the necessity of further rate
17 relief?
18 A. I have previously mentioned the growth in customers' power demand. I also
19 mentioned briefly the cost of capital but I would now like to highlight a few
20 aspects of capital costs.
21 Q. Please do so.
22 A. While there has been some reduction in the cost of money since the testimony
23 in our last rate case, the cost of senior securities remains at a very high
24 level as shown by our financing since that case. In June 1976 we sold $25
25 million of first mortgage bonds at competitive bidding at an annual interst
26 rate of 9½%. We also sold 150,000 shares of cumulative preferred stock at a
27 dividend rate of $9.64. In September 1975 we sold $30 million of first

1 mortgage bonds at an annual interest rate of 11%. These sales indicate that
2 our current cost of capital remains high--considerably above our embedded
3 cost for senior securities. The embedded cost is likely to increase for
4 some years ahead because maturing issues of bonds with low interest rates
5 will have to be replaced by substantially higher cost securities. Part of
6 the proceeds from the bond financing in September 1975 were used to
7 permanently refinance $17 million of 3% bonds maturing the previous year.
8 In the next five years we will have to refinance at the current interest
9 rates three issues of maturing bonds bearing interest rates ranging from
10 3-1/8% to 3-3/8%. These refinancings and the financing of our construction
11 program will force us to seek long-term capital at a time when many other
12 sectors of the economy will also be seeking increased amounts of such
13 capital. Competition for the available capital funds will be keen.
14 Investors, anticipating further inflation, will continue to demand a high
15 rate of return on fixed income securities, such as bonds and preferred stock,
16 in order to protect the value of their investment. For these reasons we
17 expect that for the foreseeable future the embedded cost for senior
18 securities will continue to be considerably higher than present embedded
19 costs.
20 Common stock capital for Potomac is actually raised by our parent,
21 Allegheny Power System, which issues offerings of its own common shares to
22 the public. Allegheny Power System has invested large amounts of common
23 stock capital in our Company during recent years. This common stock financing
24 was absolutely necessary to maintain a capitalization ratio proportional to
25 the ever increasing debt represented by senior securities. Our Company's rate
26 of earnings for this equity capital must increase so that we bear our propor-
27 tionate share in the return on equity which Allegheny Power must earn if its
28 shares are to be attractive investments for the general public. Mr. Hanley

1 will supply further details on the increasing cost of equity.

2 In the years ahead our Company and the other utilities operating in this
3 state need hundreds of millions of dollars of new capital money for construc-
4 tion benefiting Virginia customers. But the individuals who must supply
5 these millions of dollars are not missionaries. They are people just like
6 you and me from all over America, indeed from all over the world, who have
7 thousands of choices of places to invest their hard-earned savings. It is
8 sheer folly to expect that they will continue to risk their savings in any
9 regulated business unless the regulators allow them an adequate rate of
10 return. In this regard the Commission's responsibilities to the people of
11 the State of Virginia are as great as ours.

12 Q. Mr. McCardell, are you convinced that your Company is operating efficiently
13 and that your costs are under effective control?

14 A. Yes. We have continued the many stringent cost control procedures detailed
15 in testimony in our last several rate cases. In 1972 we hired Arthur
16 Andersen and Company to conduct a study of our utility operations. The
17 firm made a comprehensive study and as a result made three significant
18 suggestions, all of which involved the utilization of computers in improving
19 our management system. We are in the process of implementing these recom-
20 mendations which will require substantial time, effort, and expenditure.
21 For example, we have installed a uniform customer accounting system for
22 computer application in our Southern Division which serves our Virginia
23 customers. The system will enable us to more quickly and efficiently
24 manage our customers' accounts resulting in better service at lower cost.

25 An indication of the effectiveness of our continuing cost control efforts
26 described in the audit by Arthur Andersen and Company as "control by scarcity"
27 is shown by the productivity gains detailed on Schedule 7 of Mr. Nicol's exhibit.

1 In the efficiency of its use of fuel in generating electricity, Potomac
2 Edison and its associated companies in the Allegheny Power System ranked near
3 the top in a comparison prepared by Electric Light and Power magazine in 1975.
4 Out of 100 utilities, Allegheny Power System, of which Potomac Edison is a
5 part, was rated number 8.
6 Q. What is the most significant problem now facing your company?
7 A. Our most serious problem is the large gap between the forecasted cost of
8 electric facilities that should be constructed to meet future demands of
9 customers on the one hand and the costs we can foresee the possibility of
10 financing from regulatory decisions in recent rate cases. Rate increases
11 have simply not been large enough to cope with increasing costs.
12 The question is whether we can build the facilities needed by our
13 customers. The estimated cost of such facilities simply cannot be financed
14 by present rates. We will not have enough money unless there is a significant
15 movement toward more adequate rate relief very soon. While I dislike the
16 role of a prophet of doom and gloom, I think our Company and the Commission
17 have a mutual obligation to our customers that must be recognized clearly
18 and met head-on now. Our problem as a company is that we have the awesome
19 responsibility of providing electric service now, five years from now, and
20 ten years from now. The Commission has the responsibility to provide a
21 regulatory climate in which it is possible for us to finance the physical
22 facilities necessary to provide that electric service. Short-term palliatives
23 such as deferring construction on the Pleasants Station will not help either
24 of us to meet our responsibilities.
25 We must begin providing facilities to meet the rising electrical demand
26 now. We need six to ten years' time between the time when the need for a
7 power plant is forecast and when it actually begins producing power. The

1 Commission must begin providing rates which will enable us to finance the
2 rising construction costs for those facilities now. As I stated previously,
3 we foresee the need for a construction program costing an estimated $1.33
4 billion in the ten years following the test period to provide service to our
5 customers. We cannot finance those facilities on mere hope of obtaining
6 adequate rate relief after they are completed. The large financial commit-
7 ments that must be made now cannot be made without reasonable expectation of
8 our being able to honor those commitments. For us to do otherwise would be
9 irresponsible and unrealistic.
10 From now on, we are going to estimate what rate levels we can reasonably
11 expect in the future based on this and previous cases. By projecting the
12 funds we can then reasonably expect to have, we will match those funds with
13 the best construction program we believe they can finance. If this program
14 falls short of customers' demand, curtailment programs will become necessary.
15 Not only the public, but also the Company and the Commission must live five
16 or ten years from now with the way we discharge our mutual responsibilities
17 now. We believe prompt approval of our proposed rates by the Commission is
18 essential for both of us to meet our responsiblities successfully.
19
20
21 NOTE: Thus concludes the prefiled
22 direct testimony of John M. McCardell.
23 * * * * * * * * * *
24
25
26
27

is the way I look at it.

Q This Company was noted in opening statements by various counsel was granted rate relief under annual review effective May 1 which was approximately five months ago.

Can you state why the Company is requesting additional rate relief at this time?

A Yes. Well, first of all, we were never able to achieve the rate of return allowed in our case two years ago. That was the reason that it was allowed to be adjusted by surcharge. In addition, the rate of return allowed under conditions in 1974 is not an adequate rate of return for 1977.

And looking to the year ahead, 1978, the cost of money, the cost of our bonds embedded, and the cost of common capital have all contributed to a need for a higher rate of return now than was required two years ago.

Q I guess my question really goes to the requested rate relief under annual review, and I believe that was filed in January. Why at that time didn't you just request permanent rate relief rather than requesting annual review then, and now in the same year requesting permanent rate relief?

A But I think one of the problems was we do operate in three states. We have a limited staff. We thought that this would tide us over until we could have the time to prepare a full case, which it takes quite a bit of time as you know. And for that reason we were not prepared to go through the entire process that early.

Q Also, the rate relief that was granted effective May 1 is outside of the test year for this case. So, can you tell me if it's in the Company's testimony anywhere as to what the effect of the rate relief granted under annual review was upon the Company's operations?

A I think --

MR. RIELY: I suggest Mr. Nicol's --

WITNESS McCARDELL: I think Mr. Nicol could answer that question.

MR. RIELY: It's a figure question.

WITNESS McCARDELL: It should be the figure, whatever the figure is; that's right.

MR. OWENS: Okay. Thank you very much.

CHAIRMAN SHANNON: Mr. Smith.

MR. ROGERS: May I suggest the Commission take just a few minutes break now and take it

Line No. WITNESS: MR. NICOL Page 1

1 Q. Please state your name and address.

2 A. My name is James W. Nicol. I live at 212 Mealey Parkway,

3 Hagerstown, Maryland.

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

5 A. I am Comptroller of The Potomac Edison Company.

6 Q. What is your education and business experience?

7 A. I am a graduate of the University of Pittsburgh, having received

8 a Bachelor of Science degree in Business Administration in 1949.

9 After graduation, I was employed by the W. T. Royston Company, a

10 Certified Public Accounting firm in Pittsburgh, Pennsylvania,

11 and in 1953, I became a Certified Public Accountant in the

12 Commonwealth of Pennsylvania. In 1955, I accepted the position

13 of Senior Internal Auditor at West Penn Power Company, an affiliate

14 of The Potomac Edison Company within the Allegheny Power System.

15 During my employment at West Penn, I subsequently held positions

16 as Consolidation Accountant in the Accounting Department and

17 Senior Industrial Development Representative in the Marketing

18 Department. In 1967, I was elected Assistant Comptroller of The

19 Potomac Edison Company and on March 1, 1972, assumed my present

20 position.

21 Q. What are your principal duties and responsibilities with The

22 Potomac Edison Company?

23 A. As Comptroller, I have the overall responsibility for maintain-

24 ing the accounts of the Company in accordance with the Uniform

25 System of Accounts for Class A and B electric utilities as

1 specified by the Commissions under whose jurisdiction the company
2 operates, and the preparation and interpretation of reports and
3 statements derived from such accounts. I am also responsible for
4 the preparation of tax returns and the insurance and safeguarding
5 of assets. In addition, I am responsible for counseling and
6 advising general management on accounting and financial matters.
7 Q. Please outline the testimony you plan to give today.
8 A. I will summarize the Company's position concerning rate base, revenues
9 and expenses and revenue deficiencies. In connection with this phase
10 of my testimony, I will describe certain additional adjustments which
11 are necessary to make financial information a meaningful guide con-
12 cerning the results of the Company's operation during the test year
13 ending December 31, 1976. I will also present testimony concerning
14 the projection of certain test year figures to December 31, 1977, as
15 required by the Commission's Regulations.
16 Q. Mr. Nicol, have you prepared an exhibit which will illustrate the
17 matters which you intend to discuss in the course of your testimony?
18 A. Yes, I have prepared an exhibit marked JWN-2.
19 Q. Would you please explain the first Schedule of the exhibit just
20 identified.
21 A. This Schedule is a Balance Sheet which shows the financial condition
22 of the entire Potomac Edison Company as of December 31, 1976.
23
24
25
26
27

1 Q. Mr. Nicol, does your exhibit include a Statement of Income?

2 A. Schedule 2 of my exhibit is an Income Statement for the entire Company
3 for the year ending December 31, 1976.

4 Q. Would you please point out any figures on this Schedule which you think
5 are of particular importance.

6 A. On November 1, 1975, the Company in its Virginia and Maryland jurisdiction
7 discontinued the practice of adding Allowance for Funds Used During
8 Construction (AFUDC) to Construction Work in Progress (CWIP). Subse-
9 quent to that date the Company also has discontinued this practice in
10 its West Virginia jurisdiction on Construction Work in Progress included
11 in rate base. The AFUDC on Schedule 2 amounting to $900,321 represents
12 the allowance for Pennsylvania, the remainder of CWIP not included in the
13 rate base of West Virginia and the Federal Power Commission jurisdiction.
14 Mr. Donald V. Kane, a partner in Arthur Anderson & Company, an inter-
15 national firm of independent public accountants, will testify to the
16 advantages of discontinuing AFUDC.

17 Q. Has a separation been made between the Virginia jurisdictional and the
18 remainder of the Company's investment, revenues and expenses?

19 A. Yes, it has. Mr. Gibson, who will testify later as to its detail, has
20 made such a separation and I have used it as a basis for my remaining
21 statements.

22 Q. Mr. Nicol, does your exhibit contain a statement showing the rate of
23 return from the Company's Virginia jurisdictional operations for the
24 twelve months ending December 31, 1976?

25 A. Schedule 3 of my exhibit shows this calculation on the basis of the
26 Virginia jurisdictional service. That is, that part of service which
27 comes under the jurisdiction of this Commission.

1 Q. Would you please explain?

2 A. Schedule 3 shows the rate of return for the twelve months ending
3 December 31, 1976, on its net original cost rate base of that date. The
4 statement is divided into three sections; namely, operating income, rate
5 base, and rate of return.

6 Q. Mr. Nicol, would you please discuss the significance of these calcu-
7 lations for the Commission?

8 A. As may be seen from Column 2 of this Schedule, the Company's rate of
9 return per books, attributable to Virginia jurisdictional business
10 for the period ending December 31, 1976, was 7.72%.

11 Q. Have you calculated a rate of return for the year ending December 31,
12 1976, computed on the basis of the rates in effect before May 1, 1977,
13 adjusted for known and anticipated changes in expenses?

14 A. Yes, in column 3 of Schedule 3, I have shown a summary of adjustments for
15 known and anticipated changes in income which I will explain later.
16 Column 4 of Schedule 3 shows figures under our rates as they existed
17 prior to the surcharge which was effective May 1, 1977, pro formed for
18 adjustments in column 3. As may be seen, our rate of return on this
19 adjusted basis calculates out to 7.23 percent. Column 5 shows the
20 adjustments necessary to reflect the full effect of the proposed increase
21 which includes the May 1 surcharge. Column 6 shows pro forma test period
22 revenue, expenses, rate base and rate of return after giving affect to
23 our proposed new rates and the rate of return calculates out to 9.75 percent.

24 Q. Mr. Nicol, what do you mean that adjustments were made to the actual
25 December 31, 1976 book figures to reflect a full year's operations
26 under the conditions being experienced as of that date?

27 A. We made certain adjustments to annualize the effects of known and anticipated

1 changes in our operating income.

2 Q. Would you please explain the various adjustments which you have made in

3 this proceeding?

4 A. Column 3 of Schedule 3 of my exhibit shows a summary of the adjustments

5 just mentioned. Details of these adjustments are shown on Schedule 4.

6 It should be noted that I have shown these adjustments on a total company

7 and a Virginia jurisdictional basis. If the Commission will just follow

8 these numbered adjustments, I will now run through them and give a brief

9 explanation of each.

10 Q. Since Adjustments No. 1 and 2 are related will you please explain them

11 at this time?

12 A. Adjustment No. 1 eliminates $894,998 in jurisdictional revenues attri-

13 butable to the abnormal sale representing a single short term sales

14 transaction for the period of January to April 1976 with the General

15 Public Utilities System (GPU) for the purpose of covering the consecutive

16 outages of two nuclear generating units. This sale was abnormal because

17 of the amount of capacity requested by other utilities within such a

18 short period of time. Moreover, this situation will not occur again

19 because APS will not have the capacity to meet such a request if it

20 should occur in the future.

21 Adjustment No. 2 is a net reduction to jurisdictional expenses of

22 $736,869 consisting of two parts. First, expenses have been decreased

23 to remove those expenses associated with the revenues in Adjustment No. 1.

24 Second, we recognize that absent the sale to GPU, we would have had more

25 opportunity to make economy energy sales. We, therefore, have included

26 an amount to reflect our projection of such economy sales and associated

27 expenses.

1 Mr. Gibson will supply additional detail on these two adjustments
2 in his testimony and exhibits.
3 Adjustment 3 is made to annualize wage increases granted during the
4 test year and to reflect the level of wages for the twelve months ending
5 December 31, 1977.
6 Adjustment 4 annualizes the reduction in expenses associated with
7 the reduction in personnel during the test year.
8 Adjustment 5 annualizes changes in labor expense distribution due
9 to an engineering time study. In the early part of 1976 it became
10 apparent that an inordinate amount of the engineering payroll was being
11 charged to construction projects. A time study was initiated in May, 1976
12 to develop an equitable basis of charging the engineering payroll. As a
13 result of the study, effective August 1, 1976 changes were made in the
14 payroll distribution. This adjustment reflects the change from January 1,
15 1976 to July 31, 1976.
16 Adjustment 6 is made to pro form the capacity charges under the
17 present Power Supply Agreement to the level expected to be applied for
18 the twelve months ended December 31, 1977. The capacity charge under
19 the Power Supply Agreement is determined each year by formula set out
20 in the Agreement based on production investment. For my adjustment, I
21 applied the difference between the amount per kilowatt of capacity charge
22 billed and that which will be billed during the twelve months ending
23 December 31, 1977, to the kilowatts actually billed for the twelve months
24 ending December 31, 1976.
25 Adjustment 7 also concerns the capacity charge under the Power
26 Supply Agreement. On July 14, 1977 the Federal Power Commission approved
27 Amendment No. 3 to the Power Supply Agreement. The Amendment became

1 effective July 1, 1977 and provided for some minor clarifications in
2 language, increases the rates, after provision for federal and state
3 income taxes, so as to provide an overall rate of return of 9½% rather
4 than the 8% factor formerly included in the Power Supply Agreement.
5 This adjustment reprices 1976 capacity charges from the level
6 established in adjustment 6 to those generated by the change to a
7 9½% return level.
8 Q. Please briefly describe the Power Supply Agreement for which you have
9 made adjustments 6 and 7.
10 A. The Power Supply Agreement is an agreement among The Potomac Edison
11 Company, Monongahela Power Company and West Penn Power Company. In
12 the investment area, it provides for the equalization settlements
13 necessary to adjust the participants' ownership to that portion of
14 the Allegheny Power System generating facilities and bulk transmission
15 facilities related to the peaks of the respective companies. A similar
16 adjustment is provided to insure that each party to the Agreement
17 supplies its proportionate share of spinning reserve capacity.
18 Another important aspect of the Agreement deals with the pricing
19 of those energy interchanges necessary to insure that customers of
20 participating companies are always supplied by the lowest cost gen-
21 erating capacity available in the System. This Agreement is subject
22 to the jurisdiction of the Federal Power Commission.
23 Q. Please discuss the rest of your adjustments?
24 A. Adjustment 8 amortizes the estimated cost of this case over a
25 two year period. Two years was used because lapsed time between
26 Virginia cases has been about two years.
27 Adjustments 9 and 10 reflect adjustments 1 through 8's net effect

1 on income taxes.

2 Adjustment 11 decreased cash working capital to reflect the changes
3 in operation and maintenance expense resulting from adjustments 2 through
4 8.

5 Q. Have you prepared a projected rate of return for the twelve months ended
6 December 31, 1977?

7 A. Yes, I have shown this on Schedule 5 of my exhibit.

8 Q. Would you comment on this Schedule of your exhibit?

9 A. This Schedule shows the projected revenues and expenses for the total
10 Company and the Virginia jurisdictional operation for the twelve months
11 ended December 31, 1977 in columns 1 and 2. Column 3 shows the full
12 effect of the rate increase requested in these proceedings. Column 4
13 is the pro forma Virginia operations after reflecting column 3. It
14 will be seen that, on this basis, rate of return for the period is
15 estimated at 6.74% with no rate increase and 8.73% with the full effect
16 of the rate increase.

17 Q. Do you have any other comments concerning Schedule 5?

18 A. On January 1, 1977 the Company transferred to West Penn Power Company,
19 an affiliate, its Pennsylvania operation in exchange for 149,000 kilo-
20 watts of additional capacity in the jointly owned Harrison Power Station.
21 The Company's share of Harrison increased from 25% to 32.76% or an in-
22 crease of 7.76%. Because the Company is deficient in capacity, the
23 transfer reduces the Company's load requirements and increases its
24 capacity without the necessity of expending new capital. This will
25 decrease the Company's future capital requirements and thereby reduce
26 the amount of common equity and senior capital it must raise to con-
27 struct the facilities necessary to meet the projected requirements of

its customers.

Q. Have you prepared a Schedule showing the capital structure of the Company?

A. Schedule 6 shows the capital structure of the Company as it actually existed on December 31, 1976 and as it is projected for December 31, 1977. Mr. Hanley will testify with regard to the capital costs of the Company.

Q. Have you prepared an exhibit in connection with productivity gains?

A. I have shown on Schedule 7 of my exhibit a table indicating productivity gains between 1974, as shown in our last rate case, and 1976. This table shows that the number of customers per employee increased from 179 to 199 or 11 percent over this two-year period, that kilowatt-hours of sales per employee increased by 40 percent, that miles of transmission line per employee increased by 7 percent, and that miles of distribution line per employee increased by 9 percent. These are, in my opinion, evidence that the Company has experienced productivity gains over a two-year period and the continuance of those gains is reflected in the projections that I have presented.

NOTE: Thus concludes the prefiled direct testimony of James W. Nicol.

Q Now, Mr. Nicol, have you reviewed the testimony presented by Colonel Leis for the Staff?

A Yes, I have.

Q Since the preparation of your testimony has there been a redetermination that would cause you to make a further adjustment to the going-level of operations for the Company that was not made by Colonel Leis?

A Yes. Under the Power Supply Agreement, as amended, which has been approved by the Federal Power Commission subject to reconsideration on rehearing, we included a billing of two dollars and twenty-one cents per kw and that adjustment is my Adjustment 7.

In fact, the billing will be two dollars point four four five cents per kw, and I have supplied the Staff a worksheet showing the development of this figure.

The change from two point two one to two point four four five, which was developed after I prepared my testimony, will result in a further substantial adjustment to my figures.

Q Have you prepared an exhibit that shows the effect that this change --

A Yes, I have.

MR. RIELY: May it please the Commission, I offer Exhibit JWN-2, Schedule 8.

CHAIRMAN SHANNON: This will be received as Schedule 8, Exhibit JWN-2.

BY MR. RIELY: (Continuing)

Q Would you please explain this exhibit?

A On Page 17 of his prepared testimony, Colonel Leis includes a statement showing the gross revenue deficiency of the Company on the basis of nine point one eight percent rate of return and nine point four three percent rate of return found by Doctor Weaver to be maximum and minimum appropriate rates of return.

Schedule 8, which I have just introduced, is a restatement of that table presented by Colonel Leis to show the effect of the change in the charge under the Power Supply Agreement to which I have just referred. As will be seen from this schedule, adjustments will be required in both cash working capital and operating expenses.

The result is to increase the revenue requirements proposed by Colonel Leis to three million one

hundred forty-five thousand two hundred fifty-nine dollars at a nine point one eight percent rate of return and three million five hundred twenty-one thousand eight hundred fifty dollars at a nine point four three percent rate of return.

The column at the right shows that, at the nine point seven five percent rate of return, which is the rate of return sought by the Company, the revenue deficiency is four million dollars or one hundred seventy-five thousand more than will be produced by the rates sought by the Company.

MR. RIELY: I offer Mr. Nicol for cross-examination.

CHAIRMAN SHANNON: Mr. Smith.

MR. SMITH: Thank you, Your Honor.

1 Q. Please state your name, occupation and business address.
2 A. My name is Frank J. Hanley, and I am Senior Vice President of Asso-
3 ciated Utility Services, Inc. My business address is 510 Kings
4 Highway, North, Cherry Hill, New Jersey 08034.
5 Q. Have you prepared a summary of your educational background and pro-
6 fessional experience?
7 A. Yes, and that information is set forth in Appendix A supplementing
8 this testimony.
9 Q. What is the purpose of your testimony in this case?
10 A. My assignment has been to prepare a study of the cost of capital and
11 fair rate of return and to testify to the findings of that study.
12 Q. What general principles have you considered in your determination of
13 the cost of capital and fair rate of return?
14 A. As a rule, the operating environment of utility companies is not con-
15 ducive to competition. In order to avoid the chaos that would occur
16 as the result of competitive service lines, a monopoly is an economic
17 necessity. In unregulated industries, competition in the marketplace
18 is a principal determinant in establishing the price of a product or
19 service. In the absence of such competition, regulation must act as
20 a substitute for the competition of the marketplace. Therefore, in
21 my determination of a fair rate of return, I have made every effort
22 to evaluate data gathered from the marketplace for similar-risk en-
23 terprises. My definition of a fair rate of return can be found in
24 the Glossary supplementing this testimony designated as Appendix B.
25 Also, the definition of many other terms used subsequent hereto can
26 be found in Appendix B.
27 In my opinion, a fair rate of return should never be less than

1 the cost of capital expected to be experienced during a reasonable
2 period of time in the future when any new service rates would be in
3 effect. It is essential that the cost of capital be earned if an
4 enterprise is to compete successfully with others in the capital
5 markets on a reasonable basis. Therefore, I believe the cost of
6 capital normally is the most important single element in the de-
7 termination of a fair rate of return. However, the final conclusion
8 as to a fair rate of return is the result of informed judgment after
9 consideration of other factors such as attrition and regulatory lag.
10 Q. Have you reviewed PE's rate request and supporting exhibits filed in
11 this proceeding?
12 A. Yes, I have.
13 Q. Have you made a study as to the cost of capital and fair rate of re-
14 turn for PE?
15 A. Yes. In so doing, I reviewed PE's historical financial statements for
16 the most recent five calendar years including 1976, the test year. I
17 also reviewed the capital requirements in the near-term future. I be-
18 lieve a view of the capital structure and fixed capital cost rates at
19 a point in the near-term future is conservatively appropriate for cost
20 of capital purposes since new rates are always set for the future.
21 Therefore, I consider the expected capital structure ratios at
22 year end December 31, 1977 appropriate for use in my cost of capital
23 and fair rate of return determination. In order to ascertain that the
24 level of net operating income which is indicated by application of my
25 fair rate of return conclusion is not excessive, I employ a number of
26 techniques, rather than rely upon any single technique, in order to
27 attain a balanced view.

1 Q. Have you prepared material supporting your testimony?
2 A. Yes, I have prepared an Exhibit labeled FJH-6. I have also prepared
3 Appendices A through D supplementing my testimony.
4 Q. Please explain the approach you employ in your determination of the
5 cost of capital and fair rate of return.
6 A. I observe the past, present and test year end as guides as well as how
7 PE will be financed in the near-term future viewed as a going concern
8 seeking capital in the marketplace on a reasonable basis commensurate
9 with its business and financial risk. New rates are always set to be
10 in effect for a period of time in the future. An opportunity, not a
11 guarantee, is afforded a company to earn a fair return. Consequently,
12 rate making is prospective.
13 During that prospective period of time, as rate base increases
14 over that used in the rate proceedings, the likelihood of earning a
15 fair rate of return thereon diminishes.
16 Q. What capital structure ratios are appropriate for use in your cost of
17 capital and fair rate of return determination?
18 A. The capital structure ratios expected at December 31, 1977 are more
19 indicative of the near-term future, the period of time any new rates
20 would be in effect. On page 1 of Schedule 1 of my Exhibit, I have
21 shown the actual capital structure ratios at December 31, 1976 and
22 those expected at December 31, 1977 based upon investor-provided capital.
23 As can be seen, the expected ratios include the Hatfield Pollution Con-
24 trol Note actually issued January 31, 1977 as well as the planned is-
25 suance of $35 million First Mortgage Bonds and $25 million of com-

1 mon stock prior to December 31, 1977. Those expected ratios based
2 only on investor-provided capital, are quite similar to the average
3 permanent capital structure ratios employed by Moody's 24 Public
4 Utilities and a barometer group of eight electric utilities which
5 I studied.
6 On page 2 of Schedule 1, I have shown the investor-provided cap-
7 ital, actual and expected, at December 31, 1976 and 1977, respectively,
8 and have included the unamortized job development credit in common
9 equity. That indicated common equity is for rate making purposes
10 only and is in keeping with the intent of Congress, the IRS, and the
11 practice of this Commission. I have also reflected cost-free capital
12 resulting from the old investment tax credit, liberalized depreciation
13 and accelerated amortization. Reflecting the foregoing, the expected
14 capital structure ratios at December 31, 1977 are 50.6% debt, 10.4%
15 preferred stock, 35.7% common equity, and 3.3% cost-free capital.
16 They are the ratios I will use in my fair rate of return determination.
17 Q. Have you made a five-year study of capitalization and financial sta-
18 tistics for PE?
19 A. Yes, that data is shown on Schedule 2. Shown at the upper part of the
20 Schedule is the actual capital employed at December 31, 1972 through
21 1976, inclusive. Below that are the capital structure ratios based
22 upon permanent capital as well as total capital employed. Total cap-
23 ital employed increased by about 31% during the period while the cap-
24 ital structure ratios averaged quite close to the prospective ratios
25 at December 31, 1977 based on investor-provided capital from which
26 the rate making ratios I adopt were derived.
27 During the period, the embedded cost of long-term debt capital

1 increased substantially. It is going to increase additionally before
2 the end of 1977 as a result of the planned sale of $35 million new
3 First Mortgage Bonds and the December 1977 and January 1978 maturity
4 of $9.5 million low-cost First Mortgage bonds.
5 The average achieved return on book common equity was only 10.3%
6 which was barely similar to the returns available by investment in
7 many utility bonds during the same period. Comparison of that per-
8 formance with companies whose stocks are traded confirm that achieved
9 returns on book common equity during the period were not acceptable
10 to investors in the marketplace.
11 There is a correlation between adequate achieved returns on book
12 common equity and adequate coverage of fixed charges. The utility
13 industry has had a problem maintaining adequate coverage. PE was no
14 exception as its five-year average coverage of interest charges was
15 only 2.5 times before income taxes. Inadequate earnings levels have
16 led to the downgrading of many bond ratings and the integrity of cap-
17 ital invested by those bondholders has not been maintained. Conse-
18 quently, investors recognize that utilities are no longer much better
19 business risks than unregulated enterprises.
20 Q. What do you mean by business risk?
21 A. Business risk is the risk of an enterprise measured by the volatility
22 of earnings. A more detailed explanation can be found in Appendix B.
23 Because of a dramatic increase in business risk, together with
24 their greater financial risk, utilities have lost considerable favor
25 of investors in the marketplace.
26 Q. Please describe what you mean by financial risk.
27 A. Financial risk is the risk created by the types and amounts of capital

1 employed. See Appendix B for a more detailed explanation.
2 Utilities used to be lesser business risks than unregulated com-
3 panies. Thus, they were able to employ a greater proportion of fixed
4 capital than unregulated companies and they did. That practice was
5 a result of the business risk of the past. Inflation and other ele-
6 ments have changed the economics of the utility business. During
7 that past period, inflation was of little concern to businesses and
8 investors alike. It was that era which created the magnitude of fi-
9 nancial risk still employed by utilities. Simply stated, there is
10 an imbalance, today, between the current and prospective business
11 and financial risk of utilities. Employment of historical levels
12 of fixed capital can result in lower bond and preferred stock ratings
13 and loss of integrity of that capital if achieved returns on book
14 common equity are insufficient to result in competitive levels of
15 coverage for fixed charges.
16 Q. What cost rate will you adopt relative to a debt ratio of 50.6% in
17 your cost of capital and fair rate of return determination?
18 A. For the reasons previously mentioned, I will base my cost rate on
19 the debt capital expected to be outstanding at December 31, 1977.
20 The expected total debt ratio on that date is 50.6%, as shown on
21 page 2 of Schedule 1. On page 1 of Schedule 3, I have computed the
22 weighted cost of debt. It is expected to be 7.75% on the debt to be
23 outstanding at December 31, 1977 and it is the rate I will adopt.
24 As can be seen, the actual December 31, 1976 debt cost rate was 7.48%.
25 The bases of the cost rates for PE's Long-Term Lease Obligations at
26 both dates are explained in the designated footnotes on page 2 of
27 Schedule 3. The details of the weighted cost rate for First Mortgage

1 Bonds are shown on Page 3 of Schedule 3, while the details of the
2 effective cost rate of the new Pollution Control Bonds are shown
3 on page 4 of Schedule 3.
4 Q. I notice that in your development of the debt cost rate you include
5 annualization of interest charges and amortization of premium, is-
6 suance and selling expenses over the lives of the various issues.
7 Please explain.
8 A. The interest cost represents the greatest portion of the total cost
9 of such capital. However, there are other costs involved in con-
10 nection with borrowing such funds. They are necessary and unavoid-
11 able. They consist of issuance and selling expenses incurred in the
12 placement of the securities. If these costs are not permitted to be
13 recovered, except at the expense of the common shareholder, they
14 would then be reflected in a higher cost of equity capital. I have
15 taken these expenses into account in the development of the debt
16 cost rates on pages 3 and 4 of Schedule 3 and, also, reflect similar
17 appropriate costs with regard to PE's preferred stock issues.
18 Q. What cost rate will you adopt as proper relative to PE's preferred
19 stock ratio of 10.4% in your cost of capital and fair rate of return
20 determination?
21 A. Following the approach previously described, I calculate the embedded
22 cost of preferred stock capital to be 7.58% at December 31, 1977 as
23 shown on page 2 of Schedule 4. The December 31, 1976 composite cost
24 rate is 7.57% as shown on page 1 of Schedule 4. I will adopt the
25 7.58%.
26 Q. How did you arrive at a cost rate relative to PE's 35.7% rate making
27 common equity ratio in your cost of capital and fair rate of return

1 determination?

2 A. In my opinion, a market-determined cost rate is the most significant
3 indicator in arriving at a cost rate for common equity when properly
4 interpreted. However, there is no single method through which a
5 proper cost rate for common equity capital can be precisely deter-
6 mined. I believe that the proper cost rate is the result of in-
7 formed judgment after all possible criteria have been evaluated.

8 Since PE's stock is not publicly traded, I have chosen to ob-
9 serve several groups of utility companies whose stocks are publicly
10 traded. I will use them as guides to a proper cost rate related to
11 the common equity capital-financed portion of its Virginia juris-
12 dictional rate base.

13 Q. What periods of time have you observed in your analyses of these
14 barometer groups of companies?

15 A. I have evaluated the data for all companies studied during the most
16 recent five calendar years, i.e., 1972 through 1976, inclusive, and,
17 also, the most recent interim data available. Data at any partic-
18 ular point in time may be distorted for many reasons. For instance,
19 the price of a company's stock in one year may be higher than earn-
20 ings in that year could justify because of investor anticipation of
21 prospective rate relief. After rate relief, the price often declines
22 as attrition erodes the level of earnings allowed by the Commission,
23 much less the level which had been anticipated by investors. In the
24 final analysis, the cost of common equity must not be measured solely
25 by spot conditions.

26 Q. Did you review and consider comparable earnings in your efforts to
27 determine a proper cost rate relative to a 35.7% common equity ratio?

1 A. Yes, and in conjunction with my definition of comparable earnings
2 as shown in Appendix B, it is circular reasoning to adopt carte
3 blanche comparable earnings of other similar-risk utilities. Reg-
4 ulation is a substitute for the competition of the marketplace. It
5 is, therefore, most indicative to look at unregulated enterprises
6 operating freely in the marketplace for judgment of the propriety
7 of comparable earnings.
8 Standard & Poor's 400 Industrials represent a group which is
9 nationally recognized and representative of unregulated enterprises
10 operating freely in the marketplace. They are not hampered by an
11 obligation to serve as are utilities. As they are unregulated,
12 they are free to make instant price adjustments, production cut-
13 backs or whatever else is deemed necessary to increase the level of
14 earnings. Therefore, this group provides a proper starting point
15 for a comparable earnings-determined cost rate. That earnings rate
16 must then be adjusted for business and financial risk differences
17 which may exist in contrast to the utility. I will use this approach
18 to a comparable earnings-determined cost rate as a secondary form of
19 evidence later in this testimony.
20 Q. What studies have you made to evaluate and contrast the marketplace's
21 judgment of the financial performance of utilities versus unregulated
22 enterprises?
23 A. I have prepared Appendix C which shows that investor confidence in
24 the common stocks of utilities has deteriorated more dramatically than
25 that of unregulated enterprises. I believe that this analysis demon-
26 strates that the competitive position of utilities in the marketplace
27 has been weakened and reinforces the fact that comparable earnings of

1 similar-risk utilities are indicative only when viewed in conjunction
2 with the marketplace.
3 Q. What are some other factors which affect the cost rate of common equity
4 capital?
5 A. Some other factors are a company's size, common equity ratio and cov-
6 erage. A discussion of coverage is contained in Appendix D.
7 Q. How does a company's size affect the cost rate of its common equity
8 capital?
9 A. Larger companies generally tend to experience lower cost rates for cap-
10 ital than do smaller companies. The principal reason is greater mar-
11 ketability, or liquidity, for securities of larger companies because
12 of a greater degree of investor recognition. Also, larger companies
13 generally have a greater dispersion of revenues, expenses and earnings
14 which tends to make them less susceptible to sudden dramatic changes
15 in the economy or their own service territory.
16 Q. How does a company's common equity ratio affect the cost of its common
17 equity capital?
18 A. As a rule, companies with lower common equity ratios experience a
19 higher cost of common equity capital than those with higher common
20 equity ratios. This is generally true because those with lower com-
21 mon equity ratios have more claimants on assets and earnings ahead
22 of them, thereby making the investment more risky.
23 Q. Have you made a study which demonstrates the veracity of that proposition
24 with a high degree of statistical correlation?
25 A. Yes, and the results of that study are graphically portrayed on page 1
26 of Schedule 5. In order to measure such a relationship, it is im-
27 portant to select a utility of national stature such as American Tel-

1 ephone & Telegraph Company which has not been influenced by abnormal
2 investor speculation because of mergers and so forth. Also, the
3 price of AT&T stock is indicative of the long-term growth rate in
4 earnings per share expected of utilities by investors. Also, during
5 the last eleven years, AT&T's common equity ratio declined signif-
6 icantly from 66% in 1965 to 47% in 1976. Most utilities, whose
7 stocks are actively traded, have not experienced a significant change
8 in common equity ratio which is essential to such an analysis.
9 A study of at least ten years is essential as it takes a long
10 time to implement a significant change in common equity ratio for a
11 company the size of AT&T.
12 The graph on page 1 of Schedule 5 shows there exists a high de-
13 gree of correlation between the change in common equity ratio and
14 earnings/price ratio. Linear regression analysis produces a Coef-
15 ficient of Determination of 0.93 and indicates that for each per-
16 centage point change in the common equity ratio (e.g., 50% down to
17 49%), there is an inverse movement in cost rate of 0.235%.
18 Obviously there were other factors which also influenced the
19 change such as inflation and unwarranted investor optimism or pes-
20 simism. Use of at least a ten-year period levels these factors.
21 With the exception of 1974, the annual rate of inflation moved up-
22 ward in a relatively narrow band which causes me to believe the
23 results of this simple regression analysis are indicative. Also,
24 it is important to recognize that I have not attempted to establish
25 a new theory. Any risk between AT&T and PE other than that caused by
26 capital structure ratio differences, is business risk and is not di-
27 rectly reflected by this graph or inherent capital structure ratio dif-

1 ferences. I have merely quantified, through statistical techniques,
2 a common sense principle which the financial world recognizes as a
3 fact. Analysis of the bond markets further reinforces the principle.
4 Q. Please explain how analysis of the bond markets further reinforces
5 the principle that there is an inverse relationship in movement of
6 common equity ratio and cost of common equity.
7 A. As can be seen on pages 2 and 3 of Schedule 5, I studied the sales
8 of long-term debt issued by electric utilities during the years 1975
9 and 1976. Analysis of bond sales at similar points in time of com-
10 panies with different ratings is useful. Generally, the companies
11 with higher bond ratings have higher equity ratios, while lower-rated
12 companies have lower equity ratios. It can be discerned that the av-
13 erage cost rate movement factor of the two years is 0.212%, or quite
14 similar to the 0.235% result of the linear regression analysis on
15 page 1. In 1975, a tight-money year, the average cost rate movement
16 factor was 0.30%, while it declined to 0.124% in 1976 during a looser
17 money period.
18 The most important aspect to be recognized of the data in Schedule
19 5 is that there is an inverse change in cost rate as the common equity
20 ratio changes. As the cost of money changes from time to time, the
21 factor may vary. It may be 0.235% at one time and 0.124% at another,
22 but there is an inverse cost rate change.
23 Q. What other techniques have you considered to determine a cost rate for
24 common equity capital?
25 A. In the absence of a contractual agreement with common shareholders, it
26 is necessary to utilize expert informed judgment as to cost rate after
27 analyzing a number of techniques. Other techniques I consider are

1 earnings/price ratios, earnings/net proceeds ratios, and, to a lesser
2 extent, DCF or discounted cash flow. These techniques are defined
3 in Appendix B.
4 Q. Does the use of earnings/price ratios indicate the cost of common
5 equity at any given point in time?
6 A. Not necessarily. Earnings/price ratios, even when adjusted to reflect
7 costs of issuance, do not usually represent the full cost of common
8 equity capital since there is no way to determine precisely the level
9 of future earnings anticipated by investors. Thus, there is often an
10 imbalance in the relationship between actual reported earnings and
11 the price of the stock which reflects anticipation of future earnings.
12 However, earnings/price ratios when properly used become useful tools
13 in the exercise of informed judgment in determining the cost of common
14 equity capital.
15 Q. Will you adopt an average of the more current earnings/price ratios
16 for a group or groups of similar-risk operating electric companies?
17 A. No. I do not believe any technique is so precise as to be fully in-
18 dicative of a cost rate. I do believe, however, that the more recent
19 earnings/price ratios, reviewed with those experienced during the en-
20 tire period I studied, are useful in determining a trend.
21 It seems obvious that the upward movement in earnings/price ratios
22 in the last several years indicates a waning of investor confidence that
23 future earnings growth rates of utilities will equal those of the past.
24 Common sense dictates that investors expect future growth in earnings
25 whenever the price paid for a stock results in a dividend yield which
26 is less than the yield available from a bond of the same company. Under
27 those circumstances, an earnings/price ratio based cost rate is not ex-

1 pressive of the full cost rate.
2 Q. From the foregoing, is it proper to assume that the earnings growth
3 rate of an enterprise affects its cost of common equity capital?
4 A. If all other things were equal between two companies, the answer
5 would be no. Investors look for a total expected return. If a high
6 earnings growth rate is anticipated, they will accept more readily a
7 lower current dividend yield. Conversely, if an inadequate earnings
8 growth rate is anticipated, a higher current dividend yield will be
9 demanded. That is why it is the sum of dividend yield plus growth,
10 or the total expected return, which is important. An uninformed, or
11 strictly mathematical, approach to the DCF technique often leads to
12 an indicated total return which is ludicrous when either the dividend
13 yield or growth rate used in the computation is not indicative of
14 future economic factors such as inflation. Investors are aware that
15 utilities are more susceptible to the ravages of inflation than are
16 unregulated enterprises. Consequently, the 1976 and early 1977 bull
17 market has not effected a dramatic enough improvement for most util-
18 ities to result in market/book ratios of 1.25 times or more.
19 Q. Will you now please describe the data shown on Schedule 6?
20 A. The Moody's 24 Public Utilities Group (electric and combination gas
21 and electric companies) represents a nationally-recognized barometer.
22 The average company is considerably larger than PE. At the top of
23 page 1, it can be seen that the average amount of investor-provided
24 capital increased by 44% to $2.221 billion in 1976, and at that time
25 was about 5 times larger than PE by that measure much less its Vir-
26 ginia jurisdictional portion.
27 The average composite cost of debt and preferred stock increased

1 by about 23% and 25%, respectively, during the period while the
2 earnings/book ratio declined from 12.5% in 1972 to 11.4% in 1976.
3 That poor performance resulted in a decline in the market/book ratio
4 from about 136% in 1972 to 77% in 1975 and 92% in 1976. During the
5 same period, adjusted earnings/price ratios increased by 37% to
6 14.2% in 1976, after a high of 16.3% in 1975. The dividend/market
7 price yield increased by over 42% during the period to 8.4% in 1976,
8 after a high of 9.9% in 1975.
9 The average year-to-year change in earnings per share during
10 the five years was 3.9%. The 1976 dividend/market price yield of
11 8.4% plus the 3.9% historical growth rate indicates a DCF-based
12 cost rate of 12.3%. Many fixed income securities provided yields
13 similar to that dividend yield. No investor is willing to take a
14 current return on a stock less than that available from a bond in
15 the same company unless he can reasonably expect growth sufficient
16 to adequately hedge against inflation. A common sense approach to
17 a DCF-based cost rate indicates a total required return of at least
18 14.4% (8.4% + 6.0% for growth).
19 It is also seen on page 1 of Schedule 6 that the average spread
20 between the earnings/book ratios and the composite debt cost rate was
21 5.0%. During the period, the average annual market/book ratio was
22 about 99%. Coverage of interest charges before income taxes averaged
23 2.8 times and 2.3 times after income taxes while coverage of interest
24 charges and preferred dividends averaged 1.9 times.
25 Q. Have you also analyzed the Moody's 24 Group by bond rating to gain an
26 insight into cost rate differences?
27 A. Yes, on page 3 of Schedule 6, I have shown that the levels of coverage

1 for interest charges, both before and after income taxes, are higher
2 for companies which have higher ratings. The same is also true with
3 regard to overall interest and preferred stock dividend coverage. Cap-
4 ital cost rates paid by a company with bonds rated Baa vs. higher
5 rated bonds can be as much as 100 to 200 basis points higher. It
6 can be seen that the dividend yield for companies whose bonds are
7 rated A is now 0.6 percentage points higher than Aa-rated companies
8 while that for Baa-rated companies is 0.8 percentage points more than
9 Aa-rated companies. In tight money periods as in 1975, the spread in
10 dividend yield over Aa-rated companies was 1.6% for A-rated and 2.5%
11 for Baa-rated companies. It should be noted that, as a result of many
12 downgradings (refer to page 4 of Schedule 6), only one of the Group is
13 now rated Aaa. Thus, comparisons between Aaa and the lesser rated
14 groups should be made with discretion.

15 The foregoing demonstrates the importance of manintaining a quality,
16 investment grade bond rating such as the A rating held by PE. Mainten-
17 ance of an investment grade quality is most important as it insures
18 access to the capital markets at all times. Utilities have an obli-
19 gation to serve at all times and provide the facilities required. They
20 do not have the luxury of waiting for only the good times. Also, in
21 the long run, maintaining an investment grade rating costs the consumer
22 less. Downgrading means higher debt costs which also mean a higher cost
23 of equity.

24 Investors have become aware of the importance of quality of earn-
25 ings in the last few years. They have observed that dividends and
26 other expenses can be paid only from cash earnings, i.e., those de-
27 rived from revenues. Accordingly, when non-cash earnings such as

1 those from AFC (Allowance For Funds Used During Construction) become
2 a significant part of total earnings, investors demand greater pre-
3 miums for risk. The data also indicate a relationship between the
4 effective income tax rate and the indicated cost rate for common
5 equity capital, i.e., the lower the effective rate, the higher is
6 the apparent cost rate for common equity capital. This is logical
7 because companies with greater income tax provisions are better able
8 to withstand increases in costs and/or revenue declines as approx-
9 imately one-half of the amount of change will be absorbed by the de-
10 cline in income taxes.
11 Q. Please explain Schedule 7.
12 A. This schedule contains five-year financial data of eight other oper-
13 ating electric companies whose financial profile is similar to PE's.
14 The basis of selecting the eight barometer operating electric com-
15 panies, in addition to bonds rated A by Moody's Investors Service,
16 Inc., is set forth on page 2 of Schedule 7 as are the names of the
17 eight companies. All of the companies' common stocks are actively
18 traded. Analysis of market data is essential in order to form a
19 rational opinion of an appropriate cost rate for common equity cap-
20 ital exposed to the risk of an operating electric company.
21 Q. Please continue.
22 A. At the top of page 1, it is shown that total investor-provided cap-
23 ital increased 68% to $841.9 million in 1976 and the average composite
24 cost of long-term debt and preferred stock increased 22% and 14% re-
25 spectively, between 1972 and 1976.
26 The average earnings/book ratio was only 11.9% for the five years
27 ended 1976. That performance, together with changing market conditions,

1 resulted in a decline in market/book ratio from about 131% in 1972 to
2 95% in 1976 after a low of 78% in 1975. The adjusted earnings/price
3 ratio increased from 10.9% to 14.1% in 1976 after a high of 17.9% in
4 1975 while the dividend/market price yield increased from 5.9% to
5 8.6% in 1976 after a high of 10.3% in 1975. The five-year average of
6 year to year change in earnings per share was 7.4%. The 1976 dividend
7 yield of 8.6% plus sensibly expected growth equal to inflation of 6%
8 indicates a DCF-based cost rate of 14.6%.
9 The average spread between earnings/book ratios and the composite
10 debt cost rate was 5.5%.
11 All coverages declined between 1972 and 1976 and fluctuated sig-
12 nificantly, reflecting the combined impact of the higher composite
13 cost of fixed capital, the failure of the achieved return on common
14 equity measured at book value to increase sufficiently, and the impact
15 of rate relief. The average achieved interest coverage before income
16 taxes was 2.6 times, while after income taxes, the figures were 2.3
17 times for interest and 1.8 times for all interest and preferred div-
18 idends. That performance resulted in the downgrading of the bonds of
19 several of these companies during the five-year period.
20 Q. Since PE is a wholly-owned subsidiary of Allegheny Power System, Inc.
21 (APS), have you studied the cost of common equity to APS?
22 A. Yes. However, I must emphasize that such data must be reviewed with
23 caution. APS is comprised of three operating electric utilities. One
24 of those has bonds rated Aa while the other two, including PE, operate
25 in different regulatory climates and have A-rated bonds. There is no
26 technique of which I am aware whereby one can conclude unequivocally that
27 the common equity investment in PE's Virginia jurisdictional rate base is

1 precisely similar or not in risk to common equity investment in PE as
2 a corporation and/or APS as a whole. With that caveat in mind, I have
3 made an analysis of APS on a consolidated basis for the period 1972-
4 1976, inclusive, as shown on Schedule 8.
5 Q. Please explain Schedule 8.
6 A. Schedule 8 is a summary of the historical financial performance of
7 the system for the five calendar years ended 1976. It is seen that
8 the total capital employed increased by 27% during the period and
9 that the fixed capital cost rates also increased during the same time.
10 The market/book ratio declined from about 129% in 1972 to 97% in 1976
11 after a low of 82% in 1975 while the adjusted earnings/price ratio
12 increased from 11.7% in 1972 to 14.8% in 1976 after a high of 17.6%
13 in 1975. Likewise, the dividend/market price yield increased from 6.3%
14 to 8.3% in 1976 after a high of 9.7% in 1975. The five-year average
15 annual change in earnings per share amounted to 6.0%. That growth
16 rate is reasonable in view of prospective inflation. That rate plus
17 the 1976 dividend yield of 8.3% indicates a DCF-based cost rate of
18 14.3%. The average capital structure ratios employed are quite sim-
19 ilar to those of PE based only on investor-provided capital. The
20 average achieved earnings/book ratio was 12.6% and even though it was
21 13.5% in 1976, the market/book ratio was only 97.3%. The average cov-
22 erage of interest charges during the period was 3.0 times before income
23 taxes, 2.3 times after income taxes, and the overall coverage of in-
24 terest charges and preferred dividends was 1.9 times.
25 Q. Have you made an analysis of recent sales of common stock by APS for
26 additional insight into the cost of common equity capital?
27 A. Yes. That data is shown on Schedule 9 and covers the two most recent

1 offerings of common stock, namely in February 1974 and February 1976.
2 Data shown on the schedule was derived from each prospectus. The pro
3 forma capital structure ratios, based on investor-provided capital
4 only, were quite similar to the ratios anticipated by PE at December
5 31, 1977. As can be seen, APS experienced a 12.1% earnings/net pro-
6 ceeds ratio in 1974. The earnings of $2.33 per share were the actual
7 earnings for 1973. Information pertaining to the Rate Matters section
8 of the prospectus convince me that investors anticipated earnings in
9 excess of $2.33 per share, although there is no way to precisely quan-
10 tify how much more was expected. I believe that the early 1976 earn-
11 ings/net proceeds ratio of 13.3% is more representative of the near-
12 term future. At that time the Company netted proceeds equal to only
13 95.9% of book value. An indicated cost rate which would possibly
14 have resulted in net proceeds equal to book value would have been
15 13.8%. That indicated cost rate was based upon conditions at that
16 point in time and does not reflect investor expectation of additional
17 future earnings as a result of rate relief which had been requested,
18 but not yet granted or fully reflected. In addition, the embedded
19 costs of fixed capital at that point in time were less than those
20 currently or prospectively.
21 Q. Have you prepared a five-year comparative summary of two principal
22 quality of earnings factors, namely AFC and effective income tax
23 rates, for PE and the barometer groups?
24 A. Yes, and it is shown on Schedule 10. The Company had a five-year
25 average of AFC as a percentage of net income available for common
26 equity of 16.5% somewhat lower than the barometer groups and about
27 the same as Allegheny Power System, Inc. and Subsidiaries. From a

1 prospective viewpoint, PE's AFC as a percentage of net to common
2 will be more similar to 1975 and 1976 which is much lower than its
3 own five-year average or that of the barometer groups, including
4 APS and Subsidiaries. A lower average is favorable from a quality
5 of earnings standpoint. In contrast, PE had a lower average ef-
6 fective income tax rate than the other groups. PE's five-year
7 average effective income tax rate was 17.0%. It, too, should be
8 higher in the future than its five-year historical average. All
9 things considered, PE's prospective quality of earnings is good.
10 However, the rate of achieved earnings on common equity needs to
11 be higher.
12 Q. Please describe Schedule 11.
13 A. On this Schedule is shown July 1977 money market evidence of the risk
14 rate for common equity capital of similar-risk electric utilities.
15 As can be seen, the adjusted earnings/price ratio for APS is 13.8%.
16 Its current dividend/market price yield is 7.8%. That yield plus a
17 growth rate equal to its recent achieved five-year growth rate of
18 6.0% in EPS (Schedule 8), also about equal to prospective inflation,
19 indicates a DCF-based cost rate of 13.8%.
20 The current adjusted earnings/price ratio is 12.9% for the
21 Moody's Group and 12.1% for the eight barometer electric companies.
22 The latest earnings/book ratio is 11.9% for the Moody's Group and
23 12.1% for the eight electrics, and the dividend/market price yield
24 for both is 7.7%. Sensible DCF-based cost rates are in the 14% area
25 for both groups based on their current, or average of the very recent
26 past, dividend yields and a conservative estimate of growth equal to
27 an average prospective rate of inflation of at least 6%.

1 Use of the DCF theory assumes that the return rate be achieved.
2 Accordingly, cost rates which include investor recognition of at-
3 trition and lag must be viewed in the context of the lesser rate
4 likely to be achieved.
5 Q. Have you reached a conclusion as to the cost rate applicable to
6 Potomac Edison's prospective rate making common equity ratio of
7 35.7%?
8 A. Yes, I have. Based on the foregoing testimony and data contained on
9 Schedules 1 through 9, inclusive, I conclude that the cost rate at
10 this time and in the near future is in the area of 14 1/2% relative
11 to a common equity ratio of 35.7%. The rate would be higher if the
12 common equity ratio were much less and the rate would be lower if the
13 equity ratio were much greater, all other things being equal.
14 In arriving at my conclusion, I have given greatest emphasis to
15 market-determined data which I studied and the techniques which I have
16 discussed.
17 Q. Is there a correlation between the cost of common equity capital of
18 public utilities and changes in the rate of inflation which causes
19 you to believe that your conclusion of common equity cost rate is
20 reasonable?
21 A. Yes. The cost of common equity can be said to consist of three parts,
22 the first of which is the bare rent rate (see Appendix B) for the use
23 of capital such as Aa-rated public utility bonds.
24 The second part is an increment above the bare rent rate repre-
25 senting compensation for the reduced future purchasing power of the
26 dollar. This is so because common stock bears the risk of attrition,
27 regulatory lag, prospective volatility in earnings related to the

1 uniqueness of the company, the area served, customer mix, and so
2 forth.
3 The third part is the additional return required by investors
4 to reflect the extra degree of risk between being a secured bond-
5 holder and an unsecured common stockholder.
6 Investors often measure the rate of inflation by changes in the
7 consumer Price Index as compiled by the United States Bureau of Labor
8 Statistics. The cost of capital, both debt and equity, has proved to
9 be sensitive to the rate of inflation. When the expected rate of in-
10 flation increases, so does the cost of debt as demonstrated on Schedule
11 12. The cost of common equity then also increases as investors hope
12 to preserve their margin of protection vis-a-vis secured bondholders.
13 The sum of the bare rent rate and investors' expectation of the rate
14 of inflation is highly indicative of the prospective cost of invest-
15 ment grade quality debt, such as Aa-rated bonds, attracted in the
16 marketplace.
17 The increment above the bare rent rate will vary from time to
18 time as the expected rate of inflation changes and is keyed to quality
19 long-term debt, such as Aa-rated utility bonds. Investors seem to
20 believe that prospective inflation will be at least 6% as confirmed
21 by the bond markets, the Budget of the U. S. Government, and the con-
22 sensus of many economists. With a prospective rate of inflation of 6%,
23 the cost of equity for an A-rated company would likely approximate 15%
24 (3% bare rent + 6% inflation = 9% + 5% premium for risk at Aa rating
25 = 14% + up to 1% additional premium for additional risk below Aa).
26 My analysis of recent studies by Professors Ibbotson and Sin-
27 quefield of the University of Chicago indicates that there is a

1 4% - 5% spread between the prospective cost of long-term debt and
2 the cost of common equity for companies employing significantly less
3 financial leverage than many public utilities. Thus, a higher risk
4 premium is indicated for utilities when they employ a common equity
5 ratio significantly lower than that maintained by the companies used
6 in their studies which were largely unregulated.
7 There is no necessary spontaneous change in the cost of common
8 equity every time there is an announcement of a new annualized rate
9 of inflation. However, I do believe that investors observe inflation,
10 particularly as to the trend they believe will occur, and their beliefs
11 result in similar, though not precise, movements in the cost of debt and
12 common equity capital.
13 It is obvious to me that investors have become much more cognizant
14 of safety and have demanded a larger premium in recent years for lower-
15 rated utility bonds versus similarly-rated industrials as shown by
16 Schedule 13.
17 Q. What is necessary, in your opinion, for utilities to regain the respect
18 of investors that they once apparently had?
19 A. I believe each utility must receive an opportunity to earn a return on
20 common equity commensurate with its business and financial risks if it
21 is to be viewed as stable by investors rather than more volatile than
22 the typical industrial as has been the case recently. I believe in-
23 vestors are demanding higher earnings/book ratios for many utilities
24 than they do for industrials.
25 Therefore, the earnings/book ratios of many utilities should be
26 greater than those of industrials if the utilities' stocks are to
27 have an opportunity to sell at a proper market/book ratio in an orderly

1 market.

2 Q. What should such a market/book ratio be?

3 A. I believe it should be 1.25 times in an orderly market. The common
4 stock of an enterprise should not sell below book value if it is to
5 remain healthy and assure the integrity of invested capital. If the
6 opportunity to maintain the integrity of existing capital through
7 bull and bear markets alike is to be provided, I believe that a
8 market/book ratio of about 1.25 times is required so that in a bear
9 market the stock will, hopefully, not sell below book value. The
10 ratio may go to 1.5 times or higher in a bull market. Hopefully,
11 however, the long-term average representing an orderly, or normal,
12 market would be in the 1.25 times area and provide a reasonable op-
13 portunity for access to the capital markets at all times because of
14 the continuous obligation to serve.

15 Q. Have you employed any statistical techniques which measure the current
16 business risk of utilities compared to that of unregulated enter-
17 prises?

18 A. Yes. As I stated earlier, I believe volatility in earnings is highly
19 indicative of business risk. Thus, a comparison of the volatility in
20 earnings per share between regulated and unregulated enterprises over
21 at least a ten-year period are indicative of the difference in busi-
22 ness risk. Standard & Poor's 400 Industrials is a very diversified
23 unregulated group. It consists of many different companies and the
24 performance of the group is not biased by the performance of only a
25 few companies within the group. That group has maintained a much
26 higher average common equity ratio than most utilities, 69%.

27 As can be seen on page 1 of Schedule 14, the Coefficient of

1 Variation of percent change in earnings per share for the Industrials
2 was 175.6% compared to 172.4% for Moody's 24. However, when quality
3 of earnings is considered, i.e., non-cash AFC earnings are excluded,
4 the Coefficient of Variation for the Moody's Group is 3033.3%, in-
5 dicating a much higher degree of business risk. Similarly computed
6 Coefficients of Variation for the eight company barometer groups are
7 251.2% and 1513.3%, respectively. I have also shown similar Coef-
8 ficients of Variation for APS because the parent's stock is traded
9 while Potomac Edison's is not. The Coefficients are 281.4% and
10 322.7%, respectively. I believe, as a matter of judgment, that in-
11 vestors consider the long-term prospective business risk of operating
12 electric utilities to be about 75% of that of industrials even though
13 quantitative analysis indicates a higher risk level.
14 On page 2, it is shown that the industrials achieved earnings/
15 book ratio for the ten years ended 1976 was 13.1%. It was earned
16 relative to a 69% common equity ratio. Adjusted for about 75% of
17 the industrials' business risk, a 9.8% earnings/book ratio is indi-
18 cated if the degree of financial risk was the same. However, the
19 Company's prospective rate making common equity ratio is 35.7%, not
20 69%. Adjustment for the financial risk difference indicates that an
21 additional 5.0% should be achieved using my conservative judgment of
22 a beta factor of 0.15% as opposed to the indicated 0.235% or 0.212%
23 as indicated by Schedule 5 (69% less 36% = a 33 percentage point dif-
24 ference x 0.15%). Therefore, the indicated required earnings/book
25 ratio related to an approximate 36% common equity ratio, in a manner
26 which avoids circular reasoning, is 14.8% (9.8% + 5.0%). As indicated
27 on Schedule 15, however, the likely achieved return on common equity

1 based on my fair rate of return conclusion would be only 13.14%.
2 Q. Have you summarized your conclusion as to the cost of capital and
3 fair rate of return relative to PE's Virginia jurisdictional rate
4 base at the present time and the near-term future?
5 A. Yes, I have concluded that the bare cost of capital and fair rate
6 of return is 9.9%. I have summarized my conclusion on Schedule 15.
7 The capital structure ratios adopted are those of PE expected
8 at December 31, 1977 for rate making purposes as shown on page 2 of
9 Schedule 1. The bases of the debt and preferred stock cost rates
10 are shown in Schedules 3 and 4. The common equity cost rate is a
11 conclusion based upon my studies and is applicable to a 35.7% com-
12 mon equity financed portion of PE's Virginia jurisdictional rate
13 base. The overall weighted cost of capital is 9.89% which I have
14 rounded to 9.9%. I have made no specific allowance in recognition of
15 attrition or regulatory lag since my conclusion is primarily marketplace
16 determined and investors recognize that these elements exist. In effect,
17 my common equity cost rate is an opportunity (before attrition) rate as
18 opposed to an achieved rate which reflects the impact of attrition.
19 It is my judgment that attrition equivalent to as much as 1/2 of
20 1% of an original cost rate base can reasonably be expected by in-
21 vestors on an annual basis. On the Schedule are shown the maximum
22 likely achieved financial ratios based upon an allowed 9.9% and an
23 achieved 9.4% overall fair rate of return. As can be seen, the likely
24 achieved return on common equity would be 13.14% versus my 14 1/2%
25 opportunity cost rate which includes recognition of attrition and lag.
26 The indicated coverages are 3.69 and 2.40 times before and after income
27 taxes, respectively, for interest charges and 2.00 times overall cov-

1 erage of interest charges and preferred dividends. The before-income
2 tax interest coverage is based upon an assumed effective income tax
3 rate of 48%.
4 Q. PE has not requested a 9.9% overall rate of return which you have con-
5 cluded is fair. What are the likely maximum achieved key financial
6 indicators based upon its requested 9.75% rate of return?
7 A. I have prepared Schedule 16 which shows the maximum likely achieved
8 financial ratios related to PE's claimed rate base if PE's full rate
9 request were granted. I have used the capital structure ratios and
10 fixed capital cost rates of PE at December 31, 1977 to test the pro-
11 priety of the requested rate increase. Accordingly, I have based my
12 calculations, and made adjustments as required, in accordance with the
13 capital structure ratios and fixed capital cost rates as shown on
14 Schedule 15.
15 Assuming that PE's rate request was granted in full, it is seen
16 on Schedule 16 that the maximum opportunity for return on common equity
17 is 14.12%. I then reflected a reasonable estimate of attrition likely
18 to occur in the future of 1/2 of 1% of the rate base after income taxes.
19 As is shown, the indicated coverages are 3.61 times and 2.36 times in-
20 terest charges before and after income taxes and 1.96 times overall
21 coverage of interest charges and preferred dividends. The likely
22 <u>achieved</u> return on the common equity financed portion of the claimed
23 rate base is only 12.72%. The degree of attrition reflected is real-
24 istic in view of prospective inflation and PE's Virginia jurisdictional
25 attrition experienced since the last rate case. In the last Rate Order, a
26 rate of return of 8.75% was authorized on test year end 9/30/74 rate base.
27 Mr. Nicol's Schedule 3 indicates an earned rate of return of 7.23% on

1 12/31/76 rate base at present rates, pro forma. Thus, attrition of
2 1.52% has occurred during the 27 months between test years which is
3 0.68%, after income taxes, on an annual basis.
4 Mr. Nicol's Schedule 5 indicates that PE will likely achieve
5 only an 8.73% rate of return on its expected 12/31/77 rate base
6 based on expected operating results for 1977 even if the entire amount
7 of requested rate relief is granted. Nonetheless, my assumptions have
8 been to reflect attrition at a rate less than that which has occurred.
9 I have in no way considered the impact reflected on Mr. Nicol's Schedule
10 5.
11 In view of the foregoing and the need to maintain a competitive
12 level of coverage in order to preserve its A bond rating, the Company's
13 requested rate of return is, in my opinion, not excessive.
14 Q. Does that conclude your direct testimony at this time?
15 A. Yes.
16
17
18
19
20
21
22
23
24
25
26
27

BY MR. RIELY

Q Will you please summarize your testimony, Mr. Hanley?

A The purpose of my testimony in this proceeding is to offer my opinion of the overall cost of capital and fair rate of return which this Company should be afforded an opportunity to earn in the near-term future.

I u tilize the cost of capital approach. New rates are always put into effect relative to a period of time in the future. Therefore, a fair rate of return based upon a cost of capital approach should be applicable to that future period of time. The cost of capital approach is utilized by applying the cost rate to the relative proportion of each type of capital expected to be employed and arrive at a weighted cost for each type of capital.

The sum of the weighted cost components is equal to the cost of capital. Regulation acts as a substitute for the competition of the market place which does not exist for regulated utilities. The managements of unregulated utilities have the wherewithal

to make price adjustments on unregulated companies -- pardon me -- have the wherewithal to make price adjustments, cut back on production, or do whatever else may be necessary to attempt to earn a fair return on their investment.

Since they compete in the market place for which regulation is a substitute, the most meaningful determination of the cost rate for common equity capital is determined by analysis of market place transactions of similar risk enterprises, Appropriate capital structure and fixed capital cost rates are readily determined.

However, since there can be no contractural agreements setting returns on common stock, the exercise of informed judgment is required in order to arrive at a cost rate for common equity capital and a cost of capital determination. I do not believe that any single technique available for use in determining the cost of common equity capital is so precise as to be completely indicative of cost rate.

Consequently, I employ a number of techniques to arrive at my judgment of the cost of common equity capital. As my primary technique, I employ earnings price ratios and earnings net proceed ratios. I believe

it is essential to study this historical past in order to observe the direction of trends.

I do not believe that either primary tools at any given point in time or over relatively short spans of time is necessarily indicative of the cost rate for common equity capital. I also utilized to a lesser extent DCF or discounted cash flow techniques as a tool in arriving at the exercise of my informed judgment of a common equity cost rate.

After observing trends of my primary tools, and to a lesser extent looking at DCF indicated cost rates, I arrive at my judgment of a common equity cost rate. At that point, I utilize as a secondary technique the use of comparable earnings in a manner which avoids circular reasoning.

For reasons explained in detail in my testimony, I believe that the source of a comparable earnings base cost rate in the form of a secondary check must be derived from the achieved result of unregulated companies. I conclude that the expected capital structure ratios at December 31, 1977 are the most indicative for use in my overall cost of capital determination.

I have computed the cost rates for debt and preferred stock capital to employed at that date. Based upon the results of my study, and the exercise of informed judgment, I arrive at a cost of common equity capital. The resultant overall weighted cost of capital, after income taxes, is summarized on Schedule No. 15 of Exhibit FJH-6.

It is nine point nine percent. The cost rate for common equity capital, which I believe this Company should be afforded an opportunity to earn, is fourteen and one half percent.

Past experience and common sense tells us that attrition will occur, and that the allowed cost rate for common equity capital will not be achieved, since all of the impact of attrition is absorbed by the common shareholder.

Thus, any allowed return on common equity capital must be viewed in the context of the likely lesser achieved return. As a further check on the propriety of my overall cost of capital determination, I employ coverage tests of interest charges and also the overall coverage of interest charges and preferred dividends.

Coverages are not coverages unless they are earned. Whatever is earned reflects the impact of attrition which has occurred.

On Schedule 15 of Exhibit FJH-6, I reflect the maximum likely achieved return on common equity, and coverages of fixed charges based on the Company's requested rate of return.

The indicated opportunity cost of common equity capital is only fourteen point one two percent, which will be reduced to only twelve point seven-two percent after recognition of a conservatively realistic degree of attrition.

The maximum likely achieved coverages are in line with those required of other similar risk competitors for investors capital in the market place.

That concludes my summary.

MR. RIELY: I tender Mr. Hanley for Cross Examination.

The Staff's adjustment (No. 11) proforms this change which was inadvertently omitted by the Company.

CONSTRUCTION WORK IN PROGRESS

Staff adjustment No. 9 provides the full annual effect of air pollution control facilities which will be in service by the end of 1977. Adjustment 16 increases construction work in progress by the projected amount of pollution control equipment being placed at existing stations in 1977, thus allowing a return on the cost associated with this non-revenue producing investment.

SUMMARY AND CONCLUSION

In summary the Company is requesting $2,865,380 in rate relief over existing tariff levels and authority to make permanent the prior temporary surcharge increase of $960,000 for a total permanent rate increase of $3,825,380. This request amounts to a 13.1% increase in revenues or about 6.5% increase per year since the Company's last rate increase.

The Company contends the increase in rates is necessary to generate an earnings level sufficient for a fair return on the common equity investment in the Company and to attract additional capital from investors necessary to finance this construction program.

Dr. Carl Weaver, the Staff's cost of money expert, has determined the Company's cost of capital to be within a range of 9.18 to 9.43 percent based on a pro forma capital structure.

By applying the foregoing costs to the Staff's rate base, the Company's range of revenue requirements are computed as follows:

	Cost of Capital Range	
	Low	High
irginia Jurisdictional Year-End Rate Base - From Staff Schedule A to Statement I-Col. (4)	$75,218,671	$75,218,671
Rate of Return (Weaver Statement 18)	9.18%	9.43%
Net Revenue Requirements	$ 6,905,074	$ 7,093,121
Less: Net Operating Income (Adjusted)-From Statement I-Col. (4)	5,447,215	5,447,215
Net Revenue Deficiency	$ 1,457,859	$ 1,645,906
Gross Revenue Deficiency (Based on Net Income Conversion Factor of .4995)	$ 2,918,637	$ 3,295,107

Q. Does this conclude your testimony?

A. Yes, it does.

142 Mullett - Direct 643

CHAIRMAN SHANNON: All right. This supplemental Exhibit will be -- do you want to make it --

MR. RIELY: CSM-4, Schedule 5.

BY MR. RIELY

Q Now, Mr. Mullett, do you have any corrections in your Exhibits?

A Yes, I do. Because of some incorrect numbers being picked up in typing, and an error made in the calculation of the minimum provision in Schedule Ra, there are several changes that have to be made.

Q Will you please go through them slowly?

A All right. On Table 1 of Exhibit No. CSM-4, the first number under the column headed: Proposed Increase, should be one million, one hundred thirty-six thousand, seven hundred and forty-five dollars. That changes the percentage then from 12.66 percent to 12.65 percent.

The second number under Proposed Increase should be changed to seven hundred and thirty-five thousand, nine hundred and sixteen dollars, and the percentage increase would change from 15.97 to 15.12. This then makes a change necessary in the total. That

should read three million, seven hundred and eighty-four thousand, five hundred and sixty-six dollars. And the percentage on the total column should be 13.68.

Q All right, sir. Schedule 2, page 1 of 3.

A On Table 2, page 1 of 3, under the Proposed with Fuel column for Schedule RA, the value should be nine dollars and twenty cents for the minimum. .0292, .0259, and .0233.

CHAIRMAN SHANNON: .0232?

WITNESS MULLETT: .0233, sir.

Those changes make the percentage increase column change as follows: First value should be 10.71, the second value is 14.55, the third value is 15.16, and the fourth value is 22.70.

BY MR. RIELY

Q All right, sir. Page 2 of that Table?

A Yes. Page 2 under Schedule PE, this same error came in. The 966 under the proposed with fuel column on Schedule TE should be 9.20, and the last value should be .0233.

Q Instead of the .02319?

A That is correct. The percentages then

1 become 37.72 percent, and 50.42 percent.
2 CHAIRMAN SHANNON: 50. --
3 WITNESS MULLETT: 50.42.
4 BY MR. RIELY
5 Q And finally, I believe on page 3 of that
6 Table?
7 A On page 3, there is a typographical error
8 under the Present with fuel column, under Schedule W,
9 at the bottom of the page. It should be three dollars
10 instead of three dollars and sixty cents.
11 And that makes the percentage 20 percent.
12 Q All right, Mr. Mullett, will you now
13 summarize your testimony?
14 A My testimony consists of an explanation
15 of the changes proposed in Potomac Edison's rates,
16 and fuel clause. At the present time the Company has
17 15 rate schedules under which it provides service to
18 about 49,000 customers in Virginia. Under the tariff
19 filed in this proceeding, we are proposing to eliminate
20 three of these schedules; Schedule A, PE, and CA. We
21 will restrict the application of one Schedule,
22 Schedule W, and move closer toward the eventual
23 elimination of two others, Schedule RA and Schedule CSH.
24

1 This is in keeping with the directives of the Commission
2 in the Company's last two cases, and the Company's
3 desire to consolidate and simplify its tariffs.
4 The increases proposed by the Company
5 are generally across-the-board as to classes of
6 customers. However, in order to accomplish the
7 consolidation and simplification mentioned, it was
8 necessary to have various -- variations within a class
9 for special rates such as those for space heating and
10 water heating. As a general rule, we have increased
11 the last blocks of energy rates more than the earlier
12 blocks. In the case of demand and energy type rates,
13 most of the increase has been assigned to the demand
14 prices.
15 In addition to the foregoing, the
16 Company has also filed a revised fuel clause in this
17 case to bring the Company's clause into compliance
18 with the Commission's requirements. As a part of
19 this change, we are increasing the amount of fuel
20 costs included in the base rates of the Company.
21 And that concludes my summary.
22 CHAIRMAN SHANNON: What figure are
23 you including in your base rates in the
24

1 revised clause, Mr. Mullett?
2 WITNESS MULLETT: It is .8 cents per
3 kilowatt hour.
4 CHAIRMAN SHANNON: .8?
5 WITNESS MULLETT: That is right.
6 COMMISSIONER BRADSHAW: Eighty percent
7 of last year's test year's cost. What percentage
8 of your cost is currently in the clause?
9 WITNESS MULLETT: At the present time,
10 the clause has a base of .265 cents, which would
11 be about twenty-five percent.
12 COMMISSIONER BRADSHAW: What do you
13 anticipate that will do to the fuel adjustment
14 clause for the average consumer if he had
15 eighty percent --
16 WITNESS MULLETT: It is going to reduce
17 the amount shown in the fuel adjustment clause
18 of the customer.
19 COMMISSIONER BRADSHAW: I realize that,
20 but will it be a debit or a credit, do you
21 think?
22 WITNESS MULLETT: He is still going to
23 have an adjustment. He will still have a charge
24

on his bill.

MR. RIELY: That is why you made it .8 instead of percent. I think his testimony shows -- we thought it would be confusing to have it go up and below.

COMMISSIONER BRADSHAW: You think it would even it out more. Less fluctuations?

WITNESS MULLETT: Well, there are still going to be fluctuations, but it won't be debits and credits. We were concerned about the confusion that might exist if you have debits one month, credits next month.

CHAIRMAN SHANNON: But you will have .8 of a cent per kilowatt hour in the base rate?

WITNESS MULLETT: That's right, sir.

COMMISSIONER HARWOOD: Eight-tenths of a cent?

WITNESS MULLETT: That is right.

COMMISSIONER BRADSHAW: Well --

COMMISSIONER HARWOOD: I remember reading somewhere in your testimony -- I thought it was about one-half of one percent -- of one cent.

MR. RIELY: That is the increase from

1 the present amount of the fuel clause.
2 COMMISSIONER HARWOOD: This produced
3 a factor .00549, which we have factored into
4 each kilowatt hour price.
5 WITNESS MULLETT: That is the additional
6 amount added to the present base, that is right.
7 COMMISSIONER BRADSHAW: When was your
8 last rate case in West Virginia?
9 WITNESS MULLETT: The last rate case
10 in West Virginia? That case was concluded --
11 COMMISSIONER BRADSHAW: Let me put it
12 to you this way: What -- they don't have a
13 fuel adjustment clause any more.
14 WITNESS MULLETT: No, they do not.
15 COMMISSIONER BRADSHAW: What percentage
16 of your fuel costs is built into the base rate
17 out there?
18 WITNESS MULLETT: One hundred percent.
19 COMMISSIONER BRADSHAW: One hundred
20 percent?
21 WITNESS MULLETT: That is right.
22 COMMISSIONER BRADSHAW: Did you get an
23 over-recovery or under-recovery of fuel costs
24

BY MR. RIELY

Q Mr. Mullett, have you reviewed the testimony given by Mr. Wittine?

A Yes, I have.

Q Mr. Wittine has testified that he would recommend that Schedule W be eliminated one year from the effective date of the proposed rates, and that this deferment would reduce revenues by approximately two hundred and thirty-three thousand dollars. Are you familiar with that testimony?

A Yes, I am.

Q Have you proposed to eliminate Schedule W?

A No. We have proposed to eliminate Schedule W as it applies to residential customers, but not commercial customers. Mr. Wittine proposes to eliminate Schedule W one year from the effective date for all customers.

Q Can you conceive of a customer receiving residential service who is now served under Schedule W, and not at the same time served under Schedule R?

A There should be no such customer. If there is a customer who receives service under W, he

should, if he is a residential customer, receive service under Schedule R also.

Q Mr. Wittine says that the twenty-seven point eight percent increase for Schedule W customers is too much. Will you comment on this?

A It is unrealistic, in my view, to consider that percentage increase by itself, because as I have stated, customers receiving service on Schedule W, also receive service on Schedule R. The effective increase is the amount of the combined bill. I have prepared an exhibit on this matter.

Q If it please the Commission, I would like to offer CSM, Table 4. Would you please discuss this table?

A This table shows the increase to be received by residential customers now receiving service under Schedule W, at various levels of consumption.

For example, a residential customer who uses 150 kilowatt hours for his residential service and 200 kilowatt hours for his water heater service, would receive, as shown on line 2, an overall 14.57 percent increase over the rate that he is presently paying, including the surcharge. The average water

heater customer uses about 285 kilowatt hours per month. It will be seen that if he uses 250 water heater kilowatt hours, and 150 kilowatt hours to 1,250 kilowatt hours for his regular residential service, his overall increase would range between 15.62 percent and 10.56 percent; whereas if he uses 300 water heater kilowatt hours, and 150 to 1,250 kilowatt hours for his residential service, his increase would range from 16.69 percent to 11.01 percent.

These increases are substantially less than the 27.8 percent increase found by Mr. Wittine, and shown on page 11 of his prepared testimony.

Q This exhibit does include the present existing surcharge, doesn't it?

A Yes, it does.

Q Now, what conclusion do you draw from this exhibit?

A My conclusion is that elimination of Schedule W, as it applies to residential customers, will not result in an undo increase to our residential customers, but will, in fact, produce increases that are substantially in line with the overall increase that the Company proposes to all of its customers.

Accordingly, I think that Mr. Wittine's suggestion for Schedule W can be disregarded without untoward effect upon any customer.

Q If it please the Commission, I ask that Mr. Mullett's testimony be copied into the record, and his exhibits be received in evidence, subject to cross examination, and I tender him for cross examination.

CHAIRMAN SHANNON: It will be so done, and his exhibit will be received, together with Exhibit CSM, Schedule 5 -- Table 4, and we will take a short recess.

(3:10 p.m.)

(Prepared testimony follows.)

1 Q. Have you testified before other regulatory commissions?
2 A. Yes. I have testified before the Public Service Commission of West
3 Virginia and the Public Utilities Commission of Ohio.
4 Q. Please explain your responsibilities in this proceeding.
5 A. I was responsible for developing the rate schedules to recover the
6 revenue deficiency determined by Mr. Nicol and for making the changes
7 proposed in the tariff rules and regulations.
8 Q. Please outline the testimony you plan to give today.
9 A. My testimony will consist of an explanation of the changes proposed in
10 Potomac Edison's rates and tariff rules, and will include exhibits
11 which will show comparisons at present and proposed rates of various
12 usage levels for different classes of customers.
13 Q. Briefly define your present rates.
14 A. Schedule "R" is the basic rate available for residential service,
15 under which 33,600 customers are served. Schedule "R-A" is the rate
16 available for residential service where customers use electric space
17 heating. This schedule has been restricted to locations connected
18 prior to February 1, 1975.
19 Schedule "C" is the rate available for small general service
20 customers. Schedule "PL" is the rate available for medium-size
21 general service customers with loads in excess of 50 kilowatts.
22 Schedule "PH" is the rate available for medium-size general service
23 customers who have better load factors than customers served on
24 Schedule "PH".
25 Schedule "PP" is the schedule available for large industrial
26 customers having loads in excess of 5,000 kilowatts. Schedule "W"

is a schedule available for water heating where the service to the water heater is separately metered. This schedule has been restricted to present customers at locations served since December 1, 1972.

Schedule "OL" is an outdoor lighting service and Schedule "AL" is an area lighting service, both of which are available throughout the service area. Schedule "MSL" is a street and highway lighting service which is available for lighting public areas. Schedule "SL" is a street lighting service using incandescent lights, which has been restricted to the facilities in service as of December 1, 1972.

Schedule "C-A" is a rate under which service was provided to general service customers using electric heating for their establishments. This schedule has been restricted to locations served as of December 1, 1972.

Potomac Edison also serves an area in Highland County identified as Monterey. At the time this property was transferred from Monongahela Power Company, Potomac Edison adopted the rates then in effect and these rates have been carried as separate rates since that time. Schedule "A" is the rate available for basic residential service in this area and is restricted to this area. Schedule "TE" is the rate available for all-electric residential customers in this Monterey area. It is also restricted to this area.

Q. What were the basic objectives followed in the development of the rate changes?

A. There were several basic objectives involved in the development of our rate program. One, of course, was to develop rates which would produce the dollars needed to cover the revenue deficiency calculated by

1 Mr. Nicol. Another was to modify the fuel clause to conform to the
2 Commission's rules in Case No. 19526, while at the same time including
3 a larger part of the fuel costs in the base rates for service. In
4 addition, we also wanted to eliminate Schedules "A" and "TE", presently
5 restricted to the territory previously served by Monterey Utilities
6 Corporation, and we wanted to continue our efforts toward the eventual
7 elimination of Special Schedules "R-A", "C-A" and "W", as directed by
8 the Commission in Case No. 19139. Finally, we wanted to accomplish
9 the foregoing without causing an undue disruption in billing to cus-
10 tomers.

11 Q. Mr. Mullett, you mentioned the fact that your proposed rates reflect
12 the effect of including more of the fuel costs in the base rates.
13 Would you please explain this?
14 A. At the present time, the Company's base rates contain a portion of
15 the cost of fuel. This amount is $.00265 per kilowatt-hour of net
16 generation. This value is based on the December 1970 cost of fuel.
17 In order to put the fuel cost in the base rates on a more current
18 basis, we will include in our base rates approximately 80% of our
19 test year fuel costs determined in accordance with the fuel cost
20 adjustment clause proposed in this case.

21 Q. Why did you include only 80% of test year costs in the base rates?
22 A. We wanted to increase the amount in the base to a level more nearly
23 equal to present costs, but we wanted to avoid a situation whereby
24 the fuel cost adjustment would be a debit one month and a credit
25 the next because we felt this could cause some confusion in the minds
26 of the customers. By not rolling the complete fuel cost into the base

1 rates, we believe we will avoid this situation while, at the same time,
2 substantially reducing the amount of fuel costs being recovered through
3 the fuel cost adjustment provision.

4 Q. How did you determine the fuel increment to be added to the base price
5 of each kilowatt-hour?

6 A. The total fuel clause revenue actually received during the test year
7 was $6,807,988. From this we deducted the amount of fuel clause rev-
8 enue which we calculated would be collected under the new clause
9 (approximately $1,580,000) and the balance, which was the amount of
10 revenue being shifted from fuel clause to base rates, was then divided
11 by the total kilowatt-hour sales in Virginia during the test year.
12 This produced the factor of $.00549 which we have factored into each
13 kilowatt-hour price.

14 Q. Now, would you please generally describe the changes you are proposing
15 to make in each schedule.

16 A. As a general principle, we have tried to increase the end blocks of
17 energy on each schedule by a greater percentage than the first blocks.
18 By doing this, we have tended to flatten the rates. On the larger
19 demand and energy type schedules, we have increased energy prices by
20 the approximate amount by which production costs, exclusive of fuel,
21 have increased since the last rate case. The balance of the increase
22 required from these schedules is assigned to the demand charges. A
23 provision covering late payment charges has been added to each schedule.

24 Q. Have you made any changes in the blocks of the rate schedules?

25 A. No. The blocking will remain the same under our proposed rates.

1 Q. What schedules are you proposing to eliminate?

2 A. Under our proposal, we will eliminate Schedules "A", "TE" and "C-A"
3 and Schedule "W" will no longer be available for use by residential
4 customers. The church and school space heating provision under
5 Schedule "C-A" will be retained as a part of Schedule "C".

6 Q. Have you prepared an exhibit comparing present and proposed rates
7 and their effect on customers?

8 A. Yes, I have prepared an exhibit marked "CSM-4".

9 Q. Please describe Tables 1 and 2.

10 A. Table 1 shows a comparison of the proposed increase to present
11 total revenue under each schedule, as filed in this proceeding.
12 Table 2 of Exhibit No. CSM-4 shows the present price per block
13 compared to the proposed price after adding the fuel increment to
14 the base price to reflect the higher rolled in fuel cost.

15 Q. Please describe the manner in which you have specifically modified
16 each schedule, beginning with Schedules "R", "W" and "A".

17 A. In keeping with Commission directives in earlier cases that Special
18 Schedules be eliminated, and our desire to meld the old Monterey
19 rates into Potomac's standard rates, we are proposing to transfer
20 Schedule "A" customers and residential water heating users on
21 Schedule "W" over to the proposed Schedule "R". This results in
22 a significantly higher increase for the transferred customers, but
23 it is the only way to eliminate the schedules now restricted and
24 put all customers on the same schedule for basic residential use.

1 Q. What is the magnitude of the increase on Schedule "R"?
2 A. Overall, the changes proposed for Schedules "R", "A" and "W" will
3 produce an increase of 12.66% as may be seen from Exhibit No. CSM-4, Table 1.

4 Q. Are any changes necessary in Schedule "R" as a result of occurrences
5 subsequent to the filing of the rates proposed?
6 A. Yes. Subsequent to the filing, a review of the statistical information
7 used revealed that the kilowatt-hour spread among the billing blocks
8 as originally used was incorrect due to the inclusion of Schedule "W"
9 on Schedule "R". Correcting the spread changes revenue by only $21
10 because the differences in blocking were offset by differences in pricing.
11 However, it does require that the pricing proposed for Schedule "R" be
12 reduced as follows: the minimum will be reduced from $3.37 to $3.35.
13 The first block of 50 kilowatt-hours will be reduced from 8.239¢ per
14 kilowatt-hour to 7.820¢ per kilowatt, the second block of 100 kilowatt-
15 hours from 5.49¢ per kilowatt-hour to 5.232¢ per kilowatt-hour and all
16 consumption in excess of 150 kilowatt-hours from 3.438¢ per kilowatt-
17 hour to 3.338¢ per kilowatt-hour.

18 Q. Have any changes been proposed in the blocking on Schedule "R"?
19 A. No. The blocking at present consists of only three steps and, as
20 mentioned earlier, it is proposed to leave those as they are. We
21 have flattened the schedule somewhat by increasing the last block
22 price at a higher percentage than the earlier blocks.

23 Q. Please give us specific details of how the proposed changes for this
24 schedule were developed.
5 A. First of all, we repriced present Schedule "R". To these prices, we
26 then added the fuel increment previously described of $.00549 per

1 kilowatt-hour. The rates so determined were then applied to the
2 Schedule "R" and "A" billing determinants. The Schedule "W" usage
3 had previously been combined with Schedule "R" data, by computer, to
4 categorize it into the proper billing block. Total revenue produced
5 by such pricing was then compared to book revenue to arrive at the
6 increase.

7 Q. Does Exhibit No. CSM-4, Table 1, show the revenue increase for all
8 schedules?

9 A. Yes, this exhibit shows the actual base rate revenue, the revenue
10 obtained in the test year from the fuel clause, and the total com-
11 bined revenue, by schedule. It also shows the proposed increase under
12 the proposed rates.

13 Q. What is the effect of the rate increase proposed on "R", "A" and "W"
14 customers at various levels of use?

15 A. A customer on Schedule "R" or Schedule "A" using 500 kilowatt-hours
16 per month, which is close to the average use for these schedules,
17 would experience a monthly increase of $2.45 and $5.20, respectively,
18 which is a 12.09% increase on Schedule "R" and a 29.68% increase on
19 Schedule "A". A customer presently served on "R" using 350 kilowatt-
20 hours for water heating which is separately metered, would be billed
21 $18.17 for 500 kilowatt-hours, whereas, on Schedule "R" as proposed,
22 he would be billed $22.72 for an increase of $4.55 or 25.04%.

23 Q. How does the increase proposed for residential customers compare
24 with the other schedules?

25 A. Generally, the non-heating residential customers on Schedule "R"
26 will experience a lesser increase than the other classes of customers,

while customers on Schedules "A" and "W" will be increased at a greater rate than average. The increase sought for this class of customers is less than the overall average increase which the Company is seeking.

Q. You mentioned earlier that Schedule "W" customers were combined with Schedule "R" customers for billing. Will you please explain this?

A. At the present time, some residential water heating is served through a separate meter and the usage recorded is billed a flat rate on Schedule "W". This schedule is restricted, as explained previously. For purposes of calculating revenue on proposed "R", the metered water heating kilowatt-hours were combined with the main meter consumption and the total was billed as though they had all been used on the customer's main meter.

Q. Describe the changes proposed for Schedules "R-A" and "TE".

A. These are the residential heating schedules which the Commission has directed that we eliminate. However, because of the magnitude of the difference between these schedules and the non-heating residential schedules, it was not deemed advisable to eliminate them at this time. We have, however, combined "R-A" and "TE" into one schedule and we have reduced the differential between "R-A" and "R".

Q. What is the overall impact of the increase on residential heating customers?

A. In an effort to move closer to the total elimination of this schedule, we have proposed increases for the residential heating customers greater than the average proposed for the Company. As may be seen from Exhibit No. CSM-4, Table 1, the overall increased proposed for

1 "R-A" and "TE" customers is 15.97%. We have tried to keep "TE" at a
2 reasonable level of increase while, at the same time, increasing
3 "R-A" in such a way as to facilitate combining "R-A" with "R" as soon
4 as practicable. We believe we have accomplished this, although we
5 recognize that "TE" customers will receive a substantial increase.

6 Q. Are you proposing any block changes in Schedule "R-A"?
7 A. No. It is our intent to keep the same blocking as presently exists.
8 We have increased the tail block price of the schedule at a higher
9 percentage than the first block prices, which tends to flatten the
10 rate and also bring it more into line with Schedule "R", with the
11 goal of making the transition to a single residential rate easier
12 to accomplish in the future.

13 Q. Do the rates proposed for Schedule "R-A" act to reduce the difference
14 between its rates and those on Schedule "R"?
15 A. Yes, they do. At the present time, the difference in billing on
16 Schedule "R" and Schedule "R-A" at 500 kilowatt-hours is $1.90 in
17 favor of "R-A" compared to a proposed difference of $1.41. At
18 3,000 kilowatt-hours, the present difference is $25.36 compared to
19 a proposed difference of $22.23. The reducing difference is the
20 result of our increasing "R-A" more substantially than "R".

21 Q. What changes are proposed for Schedule "C", available for small
22 general service customers?
23 A. Here too, each block has been increased. We are not proposing to
24 make any changes in blocking. We are proposing to combine Schedule
25 "C-A" with "C" in complying with the Commission's directive.

1 Q. How have you increased "C" and "C-A" relative to the other schedules?
2 A. Schedule "C" has been increased an average of 15.17%, as is shown on
3 Exhibit No. CSM-4, Table 1. Of course, it was necessary to increase
4 the customers now served on old Schedule "C-A" considerably more
5 than the average in order to be able to accomplish the elimination
6 of Schedule "C-A".

7 Q. How have you handled the church and school provision for space heat-
8 ing that is now included in old Schedule "C-A"?
9 A. The church and school provision (CSH) was put into Schedule "C"
10 because the increase for such customers would otherwise have been
11 substantially out of proportion with increases being proposed for
12 other customers. As a result, the flat rate applicable to the 73
13 such customers now served under old Schedule "C-A" has been in-
14 creased from 2.249¢ per kilowatt-hour (including the new fuel base)
15 to 2.909¢ per kilowatt-hour, or about 29%. This is higher than the
16 overall average increase being sought but is considerably lower than
17 serving them under the proposed rates for other Schedule "C" custo-
18 mers.

19 Q. Explain the specific changes proposed for Schedule "PL", available
20 for medium-use general service customers.
21 A. Increases have been proposed for all energy and demand prices. No
22 changes are being proposed in the rate schedule blocking, nor are
23 any changes being proposed in the Rkva charge or the voltage dis-
24 count. It is estimated that "PL" revenue will increase 13.84%
25 under our proposed rates.

1 Q. Please describe the changes being proposed for Schedule "PH", which
2 is also available for medium-sized general service customers.
3 A. It is proposed to increase the energy prices of this schedule slightly,
4 in addition to the factor of 0.549¢ per kilowatt-hour which increases
5 the amount of fuel recovered in the base. The increase in energy cost
6 approximates amount by which incremental production costs, excluding
7 fuel, increased since the Company's last rate case in Virginia. The
8 balance of the increase sought from this schedule is proposed to be
9 obtained by increasing all demand prices by $1.30 per kilowatt, and
10 by increasing the minimum charge per kilowatt from $1.60 to $2.17.
11 No other changes in price are being proposed. "PH" revenue will in-
12 crease 12.90% under our proposal.
13 Q. What do you propose for Schedule "PP"?
14 A. Here, too, we propose to increase the demand charge by a substantial
15 amount relative to the increase in the energy price. Demand prices
16 will be increased by $1.11 per kilowatt. As may be seen from Exhibit
17 No. CSM-4, Table 1, the changes proposed for this schedule will pro-
18 duce an increase in revenues of 11.63% over the present rates.
19 Q. How will the non-residential water heating customers served on
20 Schedule "W" be handled under your proposal?
21 A. Since there are 161 non-residential water heating customers who have
22 no other service, it has been necessary to retain Schedule "W". It
23 has been restricted to existing installations for some time, and
24 will now only apply to non-residential customers. The flat rate
25 under this schedule will be increased from 2.449¢ per kilowatt-hour
26 (including the new fuel base) to 2.909¢ per kilowatt-hour, or about
27 17.64% under our proposal.

1 Q. Now, would you please explain the changes proposed for the lighting
2 schedules.
3 A. Generally, the lighting schedules have been increased by approximately
4 the amount of the overall average increase after adjustment for the
5 fuel rolled into the base rate.

6 Q. Now, Mr. Mullett, would you please explain the changes you are pro-
7 posing in the Company's rules and regulations.
8 A. The following rule changes are being proposed:

9 1. Rule 4(a) - a language change is proposed to clarify
10 the Company's obligation to obtain permits and ease-
11 ments.

12 2. Rule 4(f) - the charge for mobile home poles has been
13 increased from $1.35 to $1.54 per month and language
14 has been added to state that the facilities charges
15 and mobile home pole charges are subject to the late
16 payment charge.

17 3. Schedule "E" - Extension of Company's Facilities -
18 Plan "B", paragraph 4, has been modified to change
19 references to a three-year period to the contract
20 period in recognition that contracts with terms
21 longer than three years are provided for in para-
22 graph 2 of this Plan.

23 4. Schedule "E" - Extension of Company's Facilities -
24 Plan "C" has been modified (a) to delete paragraph
25 1.6 since this is covered in Rule 2(c) and new
26 paragraph 2 of Plan "C", and (b) to delete present
27 paragraph 2 and replace it with a new paragraph 2
28 which we believe will simplify the administration
29 of this provision.

30 Q. Has Potomac Edison complied with the Commission's Order governing
31 fuel clauses, as set forth in Case No. 19526?
32 A. No, we have not. We have been granted permission by the Commis-
33 sion to bring the clause into compliance in this rate case.

34 Q. Does the fuel cost adjustment clause which Potomac Edison has
35 filed in this case conform to the Commission's rules governing fuel
36 clauses?

1 A. Yes, it does.

2 Q. Would you please explain how it complies?

3 A. Rule 1 requires that the clause be in a form that provides for an
4 adjustment per kilowatt-hour of sales equal to the difference between
5 the cost of fuel in the base and the cost during the current period.
6 Potomac's clause states that the adjustment will be effective when
7 the cost in the current period exceeds or falls below the stated
8 base amount of 0.8¢ per kilowatt-hour.

9 Rule 2 provides that the adjustment factor may be modified to
10 recover state and local gross receipts taxes. Potomac's proposed
11 clause provides for the exercise of this option by including a tax
12 factor multiplier of $\frac{1}{1-T}$ where T equals the gross receipts tax rate
13 in effect during the billing month.

14 Q. How was the new base of 0.8¢ per kilowatt-hour calculated?

15 A. The costs on which the base was determined, and the final calculation,
16 are shown on Table 3 of Exhibit No. CSM-4. As may be seen, total
17 Potomac Edison costs and sales data were used since the costs asso-
18 ciated with service to Virginia customers are not readily available
19 for such a development.

20 Q. Please continue with your explanation of the Company's compliance
21 with the fuel clause rule.

22 A. Rule 3 states that we may include, in our calculation of the fuel
23 costs, those items recorded in Items 1, 2 and 3 of Account 151 trans-
24 ferred to Accounts 501 and 547, exclusive of demurrage charges.
25 Potomac's proposed adjustment clause provides that "all fuel costs
26 will be those charged to Account 501, cleared through Account 151,

1 and Account 547, as allowed by the Commission's rules."

2 Rule 4 provides for the inclusion of purchased power when such
3 purchases are made on an economic dispatch basis, and it further
4 provides for the exclusion of fuel recovered through intersystem
5 sales. Potomac Edison's fuel clause provides for the inclusion
6 and exclusion of such costs as may be seen in the definition of the
7 Fm factor.

8 Q. Does Potomac Edison presently purchase any fuel from an affiliated
9 company, as is anticipated in Rule No. 5?

10 A. No, it does not. Potomac Edison and the other companies of the
11 Allegheny Power System do have an interest in coal lands through
12 a subsidiary company (the AP Coal Company). However, at the present
13 time, no coal is being produced by this subsidiary.

14 Q. Will the Company's fuel clause automatically comply with the require-
15 ments of Rule 6?

16 A. Yes. Through the operation of the fuel clause and the accounting
17 for the fuel costs, any refunds or other recoveries or adjustments
18 will be passed on to ratepayers through the fuel clause.

19 Q. Do you have any further comments with regard to the fuel cost adjust-
20 ment?

21 A. Yes. I want to point out that the unit cost of fuel used in com-
22 puting the monthly adjustment factor will be estimated, as provided
23 for in the clause as set out on Page No. 6-1 of the tariff. The
24 clause further provides that the adjustment will be corrected in
25 the second succeeding month as the actual cost is found to vary
26 from the estimated cost. The Company has been estimating the cost

1 of fuel under its present fuel clause in Virginia since June 1975,
2 and we believe that our experience supports the fact that we can
3 make the estimates with a good degree of accuracy. During the
4 period that we have been making these estimates, the average error
5 has been only 3.9%.

for this proceeding?

A I have.

Q Do you have any additions or corrections to make to your testimony and exhibits?

A None.

CHAIRMAN SHANNON: Let's identify Mr. Wittine's attachments collectively as Exhibit JRW-10, I believe.

WITNESS WITTINE: Mr. Chairman, with your permission, I made a mistake. I do have two additions to my testimony in the form of additional attachments.

CHAIRMAN SHANNON: All right. They will be received as Attachments 9 and 10.

MR. RIELY: Rate Schedule is 9, and Table is 10?

CHAIRMAN SHANNON: I think that is correct.

BY MR. SMITH

Q Mr. Wittine, will you please briefly summarize your testimony, and explain these two exhibits you have also handed out.

A Yes. I will start by explaining the two exhibits I just handed out. Attachment JRW-9 was submitted merely for clarity purposes, so that the Commission has a better understanding of what, in fact, the Company is proposing to do.

Under the second column, entitled, Present Schedule, the Company has five rate schedules under which it provides electric service to its customers. They are designated RAW -- RA and TE. On the far right hand side, under the Proposed Schedule it can be shown, or is shown, that the Company proposes to combine RA and W and just maintain Schedule R. It also proposes to combine Schedule RA customers and TE customers, and maintain Schedule RA.

As far as general services is concerned, the Company proposes to combine customers on Schedule CA with Schedule C, and retain Schedule C. And those commercial customers presently on Schedule W will remain on Schedule W.

Attachment JRW-10 was prepared by me in response to the additional exhibit which Mr. Mullett presented today, and it is basically the same exhibit except the percentage increases which are shown were

computed by excluding the present rate surcharge from the existing total charge.

Now, the next -- the next to the last column on the right hand side will show that by excluding the surcharge which is currently applied to customers bills, the customers will experience increases anywhere in the neighborhood of approximately fourteen percent to a high of approximately twenty-one point nine percent, vs. the testimony presented by Mr. Mullett indicating the percentage increases were in the neighborhood of approximately eleven percent to about fifteen percent.

The far right hand column demonstrates the percentage increase the customer would experience if the proposal which I suggested for Schedule W customers was accepted. Those percentage increases would range anywhere from approximately fourteen point seven percent to a low of about eleven percent. Now, I will proceed with the summary of my testimony.

The purpose of my prefiled testimony was threefold: First, I reviewed the Company's present rate schedules and the Commission's staff position during the hearings on the Company's application for a rate surcharge.

Secondly, a number of attachments to my testimony were prepared so as to assist the Commission in assessing the impact the Company's application would have on the various service classifications and customers.

Thirdly, I offer specific recommendations concerning the Company's proposed tariff and future rate proceedings. During the public hearings of March 28, 1977, I testified that the Company has, and continues to have, special rate schedules under which it provides electric service. These rate schedules which have been closed and/or restricted to specific service areas, have the following designations: RA, A, W, TE, and CA. The Staff's position during the March 28, 1977 hearing was that specific action should be taken which would reduce and/or eliminate the disparities between the aforementioned special rates and the Company's open schedules R and C. My testimony demonstrates that the Company, through its application, proposes to eliminate three of the special rates for residential service. These rates are Schedules A, W, and TE.

To accomplish this, the Company proposes

to transfer present A and W customers to Schedule R, and TE customers to Schedule RA. Upon reviewing the customer impact to the Company's proposal to eliminate Schedule A, W, and TE, it is the Staff's position that the proposed increase would be too severe, and should not be permitted.

Our Attachment JRW-1 reveals that the increases would be, if the Company's application -- would be too severe if the Company's application were accepted. Specifically, a customer presently receiving service under Schedule A, would experience an increase of approximately twenty-seven percent, and Schedule TE customers would receive an increase of approximately forty-one percent.

As an alternative to the Company's proposal, I have recommended that Schedules A and TE be phased out over a period of one to two years.

Attachment JRW-3 and 5 contain the Staff's proposed schedules and rate comparison. As can be seen from Attachment JRW-3, the Staff proposal for Schedule A customers would limit the increase to approximately ten percent, or about one-half of the proposal by the Company. The Staff's proposed rate

would remain in effect for one year, after which time it will be eliminated and the customers transferred to Schedule R.

With reference to Attachment JRW-5, customers served under Schedules TE would receive approximately twelve percent increase, or less than one-half of that proposed by the Company.

Furthermore, I recommend that the Staff's proposed rates be inceased by ten percent one year from the effective date, and that the rate be eliminated one year from then, and the customers transferred to Schedule RA.

With reference to Schedule W, I recommend that the residential customers be retained on the Company's proposed schedule W, and that this schedule be eliminated for all customers one year from the effective date of the proposed rates.

I have also recommended a phasing out of Schedule CE rather than its proposed elimination. With reference to the Company's open schedules, I do not take issue with the proposed apportionment of increases.

Finally, I recommend that the following

be considered as each relates to future rate design. Specifically, the Company should perform a cost of service study for its Virginia jurisdictional service classification. Upon completion of this study, it should consider the desirability of the establishment of a separate customer charge for residential service, the elimination of Schedule RA, the establishment of separate customer demand and energy charges for Schedule C, and the combining of Schedules PL and PH.

MR. SMITH: Thank you, Mr. Wittine. Mr. Wittine is ready for cross examination.

CHAIRMAN SHANNON: Mr. Wittine's prepared testimony will be copied into the record as if the questions were asked and the answers were given.

(Prepared testimony follows.)

A. During the public hearing of March 28, 1977 the Commission Staff testified that the Company has, over the last several years, been providing service under special rate schedules. These rate schedules have the following designations:

Schedule	Description	Date Closed
"R-A"	Residential Service - All Electric	Feb. 1, 1975
"W"	Water Heating Service	Dec. 1, 1972
"A"	Residential Service	Open/ Restricted
"TE"	Residential Service - All Electric	Feb. 1, 1975
"C-A"	General Service - All Electric	Dec. 1, 1972

Schedules "W" and "C-A" were closed by Commission Order dated October 31, 1972 in Case No. 19139, and Schedule R-A was closed by Order dated July 31, 1974 in Case No. 19416. In keeping with the Commission's decision to eliminate special rates, when Monterey Utilities Corporation was acquired by the Company, Monterey Schedules "A" and "TE" were retained with the understanding that service under these schedules would be restricted. Schedule "TE" was closed and Schedule "A" was restricted to territory formerly served by Monterey Utilities Corporation.

The position taken by the Staff during the March 28, 1977 hearing was that specific steps should be considered which would reduce and/or eliminate the disparities between the aforementioned special rates and the Company's open Schedules "R" and "C".

9. Q. Have you reviewed the Company's application in this proceeding?

A. Yes. The Company, through its application is seeking approximately $3.8 M of additional permanent annual rate relief of which approximately $980,000 is, on an annual basis, presently being recovered through the Rate Surcharge which became effective May 1, 1977. As such, the attachments which I have prepared demonstrates the increase in charges that customers would experience above the current basic rates as well as the increases above total present charges including the Rate Surcharge.

10. Q. Would you first discuss the affect of the proposed rates on Residential Customers?

A. Yes, the Residential Customers, of which there are approximately 42,950, are currently served under five (5) rate schedules. Attachment JRW-1 has been prepared to detail each of these schedules.

11. Q. Has the Company proposed to eliminate any of the special residential rates?

A. Yes. The Company has proposed to eliminate three (3) of the special rates for Residential Customers. The rates which would be eliminated are Schedules "A", "TE" and "W". This would be accomplished by transferring those customers presently billed on Schedules "A" and "W" to Schedule "R" and those customers billed on Schedule "TE" would be transferred to Schedule "R-A". By so doing only one (1) of the four (4) special residential rates, Schedule

"R-A", would remain in effect.

Q. Have you analyzed the impact of these proposals on the Company's customers?

A. Yes, and I have prepared several attachments to demonstrate the effect of the proposed rates.

Attachment JRW-2 demonstrates, for various levels of monthly KWH consumption, the impact of the proposed rates on those customers presently served under Schedules "R" and "A". Columns (e) and (f) show the dollar increase above present rates, including the Rate Surcharge, which Schedule "R" and "A" customers would receive and Columns (g) and (h) demonstrate the percentage increases. It must be remembered that these increases are above and beyond those already imposed through the Rate Surcharge.

Attachment JRW-1 shows the average monthly KWH consumption under each of the various rate schedules. As can be seen the average monthly consumption for Schedule "R" is 595 KWH and should the Company's application be accepted as filed this would result in a 10.3% increase or approximately 7.3% above the present charge including the Rate Surcharge. The average monthly consumption for Schedule "A" customers is 463 KWH and based upon the Company's proposal the charge for this level of consumption would increase by 27.2% or approximately 19% above the present charge including the Rate Surcharge.

Q. Do you have any comments concerning the impact of the Company's proposal on Schedule "A" customers?

A. Yes, it is my opinion that the impact is too severe and that the Company's proposal should not be accepted as filed.

14. Q. Do you have any recommendations to make with respect to Schedule "A"?

A. Yes. It is my opinion that the Schedule should be eliminated however, as I indicated, a one step attainment of this goal is too severe. Therefore, I have prepared a Schedule which is designed to phase Schedule "A" out.

The Staff's proposed Schedule is shown on Attachment JRW-3 which also includes a rate comparison demonstrating the customer impact. The percentage increase which a customer would experience under the Staff Proposal is shown in Column (e) while the percentage increase the customer would experience under the Company's Proposal is shown in Column (f). Excluding the minimum charge the percentage increase experienced by the customer under the Staff's proposed rate would be limited to approximately 10% or about one half of that proposed by the Company.

Should the Staff's proposed rate be accepted, I would also recommend that it remain effective for one year after which time it shall be eliminated and the customers on this Schedule shall be transferred to Schedule "R".

15. Q. Will the Staff's proposed rate for Schedule "A" customers produce less revenues than the Company's proposal?

A. Yes, but only for one year. The Staff's proposal will

generate approximately $13,300 less annual revenue during the first year from this customer group than the Company's proposal.

16. Q. Do you have any comments concerning proposed Schedule "R"?

A. No. I do not take issue with the manner in which the Company has apportioned the increased revenue requirement.

17. Q. Would you please discuss Schedules "R-A" and "TE"?

A. Yes, Attachment JRW-4 demonstrates for various levels of monthly KWH consumption, the impact of the proposed rates on those customers presently served under Schedules "R-A" and "TE". Columns (e) and (f) show the dollar increase above present rates, including the Rate Surcharge, which Schedule "R-A" and "TE" customers would receive and Columns (g) and (h) demonstrate the percentage increases. Again it must be remembered that these increases are above and beyond those already imposed through the Rate Surcharge.

Referring back to Attachment JRW-1 one can see that the average monthly consumption for Schedule "R-A" is 1,702 KWH and should the Company's application be accepted as filed, this would result in a 15.7% increase or approximately 9.2% above the present charge including the Rate Surcharge. The average monthly consumption for Schedule "TE" customers is 1,838 KWH and based upon the Company's proposal, the charge for this level of consumption would increase by 41.4% or approximately 34% above the present charge including the Rate Surcharge.

18. Q. Do you have any comments concerning the impact of the Company's proposal on Schedule "TE" customers?

A. Yes, again it is my opinion that the impact is too severe and that the Company's proposal should not be accepted as filed.

19. Q. Do you have any recommendations to make with respect to Schedule "TE"?

A. Yes. It is my opinion that the Schedule should be eliminated however, a one step attainment is undesirable. Therefore, I have prepared a Schedule which is designed to phase Schedule "TE" out over a two (2) year period.

The Staff's proposed Schedule is shown on Attachment JRW-5 which also includes a rate comparison demonstrating the customer impact. The percentage increase which a customer would experience under the Staff proposal is shown in Column (e) while the percentage increase the customer would experience under the Company's proposal is shown in Column (f). The percentage increase experienced by the customer under the Staff's proposed rate would be limited to approximately 12% or less than half of that proposed by the Company.

Should the Staff's proposed rate be accepted, I would recommend that the Monthly Rate be increased by 10% one year after the effective date of proposed rate and that one year later the rate shall be eliminated and the customers on this Schedule shall be transferred to Schedule "R-A".

20. Q. Will the Staff's proposed rate for Schedule "TE" customers produce less revenues than the Company's proposal?

A. Yes, but only temporarily. The Staff's proposal will generate approximately $18,800 less revenue during the first year than the Company's proposal and approximately $10,000 less the second year.

21. Q. Do you have any comments concerning Schedule "W"?

A. Yes, the Company proposes to eliminate the special rate for residential customers and bill these customers on Schedule "R". The present charge for Schedule "W" is a flat charge of 1.9¢/KWH plus the fuel adjustment charge. If the Company's proposal were accepted this would result in an approximate 36% increase in the present charge excluding the Rate Surcharge or a 27.8% increase in the present charge including the Rate Surcharge.

An increase of the magnitude stated above is drastic and should be avoided. Therefore, I recommend that the Company's proposal for those residential customers receiving water heating service under Schedule "W" not be accepted as filed.

22. Q. Do you have any specific recommendations to make concerning Schedule "W"?

A. Yes. The Company has proposed to retain Schedule "W" for commercial customers and I recommend that the residential customers presently served under Schedule "W" not be transferred to Schedule "R".

If this proposal were accepted the residential customers would experience an approximate 11.4% increase in the present charge including the Rate Surcharge versus the Company's proposed 27.8% increase. I would further recommend that Schedule "W" be eliminated one year from the effective date of the proposed rates and that the customers served under this Schedule be transferred to the appropriate rate Schedules, either "R" or "C".

23. Q. Will your proposal relating to Schedule "W" customers result in less revenues than that requested by the Company?

A. Yes, on a temporary basis this is correct. If the Staff's proposal is accepted the rate will produce approximately $233,000 less than the Company's proposal during the first year the rate is in effect.

24. Q. Do you have any comments concerning General and Commercial Service; Schedules "C" and "C-A"?

A. Yes, the Company proposes to eliminate Schedule "C-A" and transfer these customers to Schedule "C".

Attachment JRW-6 has been prepared to demonstrate the impact of the Company's proposed Schedule "C" on those customers currently receiving service under Schedule "C" and "C-A". Columns (e) and (f) show the dollar increase a customer would experience for various levels of monthly KWH consumption and Columns (g) and (h) show the percentage increase above the present charge including the Rate Surcharge.

25. Q. Do you have any suggestions concerning Schedule "C-A"?

A. Yes, the percentage increase above the present charge excluding the Rate Surcharge which this customer class would receive on an annual basis is approximately 36%.

An increase of this magnitude in my opinion is too dramatic and should not be approved.

26. Q. What would you recommend?

A. I would recommend that Schedule "C-A" be phased out in two steps. The first step would be the implementation of an interim rate which would remain in effect for one year at the end of which time Schedule "C-A" would be eliminated and the customers on this Schedule transferred to Schedule "C".

27. Q. Have you prepared such an interim rate and if so what is the customer impact?

A. Yes, I would recommend that the monthly rate for Schedule "C-A" customers be the same as Schedule "C" customers for the first three blocks of the monthly rate. The last step of the monthly rate for Schedule "C-A" customers would be set at an interim level of 2.40¢/KWH for a period of one year following the effective date of the proposed rates. At the end of one year Schedule "C-A" would be eliminated and these customers would be transferred to Schedule "C". By so doing, the initial increase to Schedule "C-A" customers would be limited to approximately 12% above the present charge including the Rate Surcharge.

28. Q. Will your proposal relating to Schedule "C-A" result in less revenues than that requested by the Company?

A. Yes, on a temporary basis. If the Staff's proposal is accepted the rate will produce approximately $97,900 less than that requested by the Company from this service classification during the first year the rate is in effect.

29. Q. Have you reviewed the Company's Light and Power Service, Schedules "PL" and "PH"?

A. Yes and I have prepared two (2) Attachments, JRW-7 and 8 which demonstrate the impact of the proposed rates on these customers.

As can be seen from Attachment JRW-7, the percentage increase above the present charge, including the Rate Surcharge, for Schedule "PL" customers will be approximately 13%. Schedule "PH" is for those customers with high load factors and again Attachment JRW-8 reveals that the percentage increase in the present charge, including the Rate Surcharge, will be within the range of 12.5 to 13.0%.

30. Q. Do you have any comments concerning Schedule "PP", Power Service - Large Primary?

A. The Company presently serves two customers under this Schedule. Rather than prepare a rate comparison for various levels of load and load factor I have reviewed a billing analysis for these specific customers. The analysis reveals that for the test year the proposed rates would have produced an increase of approximately $155,800 or 10.2% above the present rate including the Rate Surcharge.

31 Q. Have you reviewed the Company's proposed rates concerning lighting; Schedules "OL", "AL", "MSL" and "SL"?

A. Yes. In this instance the Company proposes a fairly uniform increase to each Schedule which will result in an approximate 13% increase above the present rate including the Rate Surcharge.

32. Q. Do you have any general comments to make concerning any of the Company's proposed Schedules?

A. Yes, however the suggestions which follow pertain to future rate design and can only be implemented once a cost of service study for each service classification and sub class has been accomplished. Such a study, to date, has not been performed by the Company for its Virginia jurisdictional business.

33. Q. Please proceed with your suggestions.

A. Assuming that a cost of service study is performed before the Company would make an application for additional rate relief, I would suggest that the Company study the desirability of the following:

a. The establishment of a separate customer charge for Residential Service.
b. The elimination of Schedule "R-A".
c. The establishment of separate charges for; customer, demand and energy related costs for Schedule "C"
d. The combination into one rate of Schedules "PL" and "PH".

34. Q. Do you have any comments regarding the Company's proposed Terms and Conditions?

FRANK J. HANLEY,

a witness having previously been sworn, resumes the stand and testifies as follows:

DIRECT EXAMINATION

BY MR. RIELY

Q Mr. Hanley, will you please comment on Doctor Weaver's utilization of the discounted cash flow, DCF, technique?

A Doctor Weaver's approach to DCF assumes the growth rate in dividends and market price appreciation need be constant only for an interval between rate cases, such as two years. There is no evidence to support the proposition that investors who utilize the DCF approach in making their decision do so for such a period.

Even if such a period were appropriate, the predicted total return would not be achieved because of wide variation of price earning multiples.

Use of the DCF technique implies that the price earnings multiple upon which a stock is purchased will remain constant so that capital appreciation will occur upon sale, enabling the total

expected return to be achieved. This has just not been the case. An indication of the way utility stock prices have fluctuated during the past few years as indicated by the Dow Jones Utility Index Average, in 1971 this average was 112.22. It then declined to 58.60 in 1974, and only in 1977 has it recovered to the 112 level.

Just for three years, the average declined sharply, and it has recovered steadily over the past three years. This means that there has been a wide swing in stock prices and consequently in price earning multiples.

Q Have you prepared an exhibit to support your rebuttal testimony?

A Yes, here it is.

MR. RIELY: If it please the Commission, Exhibit FJH-11.

CHAIRMAN SHANNON: We will call it Exhibit 11.

BY MR. RIELY

Q Please explain Schedule 1 of this exhibit.

A This Schedule demonstrates how the

anticipated total return at the time that an investment is made is affected by actual market values and the price earnings multiple.

Let us assume that a share of stock is bought at nine and five-eights, at a price earnings multiple of eight times, with an expected growth rate of six point two percent, and an expected total return of 14.5 percent. Over the three years following the expected growth is in fact achieved and dividends paid are raised from eighty cents to ninety-six cents per share, at the end of the three years the share is sold. Here two different assumptions are made on the exhibit.

First, that the sales price is fourteen and three-eights, a price earning multiple of 10.1 times per share, and the second is that the sales price is eight and five-eights a share, with a price earning multiple of six times. It will be seen from the bottom of the table that on the first basis, the total return realized per annum is twenty-one point one percent compared to the expected return of fourteen and a half percent. While in the second example, the total realized return is only five point six percent. There is, therefore, a great variance between expected and achieved

1 results in the use of the DCF formula.

2 Because of this fact, primary reliance

3 cannot be placed on this formula. It is obvious,

4 however, that Doctor Weaver places considerable reliance

5 on it.

6 Q Please comment upon Doctor Weaver's use

7 of historical and current growth estimates in his DCF

8 approach?

9 A Doctor Weaver attempted to adjust for

10 differences in inflation between the two periods that

11 he utilized, namely 1971 and 1977. His methodology

12 infers that there is a precise correlation between

13 stock price movements and inflation rates. The p rice

14 an investor pays takes into account to some extent

15 his expectation of future developments.

16 However, there is no way to quantify

17 how much of a price paid at a given time relates to

18 inflation, oil embargo, watergate, or whatever.

19 Indeed the price an investor paid in

20 1971 undoubtedly reflected to some extent expectation,

21 among other things, of future inflation. Not just 1971

22 inflation.

23 Doctor Weaver has deduced no evidence

24

to support his inflation adjustments. The market price dividend yield in 1971, for the eight company barometer group is five point eight percent. He implies that a growth rate of three percent was appropriate, by multiplying 1971 average return on book common equity of ten point eight percent by the average earnings retention ratio of twenty-seven point four percent.

At that point in time, an indicated DCF total expected return of eight point eight percent would -- the resultant, namely five point eight percent dividend yield and a three percent growth rate -- which is totally unrealistic. On Statement 6 of his exhibit, it is shown that A rated companies in 1971 had an average bond yield of eight point one-six percent. An eight point eight percent DCF base cost rate allows virtually no recognition for the risk of being a last in line common shareholder.

It is obvious that investors expected a growth of much more than three percent. Otherwise, there -- they would not have been compensated adequately for their risk.

Q Please comment on Doctor Weaver's criticism of your suggestion of using the expected

1 inflation rate of about six percent as a proxy for the
2 growth rate.
3 A An investor looks toward a total expected
4 return in the context of all tentative investment
5 opportunities and difficulties facing a company or
6 industry. The price an investor pays refects a number
7 of things, including some recognition of attrition and
8 inflation. Neither I nor Doctor Weaver know precisely
9 at any given time how much of the price paid by an
10 investor is reflective of any one of the various elements
11 which may have been considered.
12 However, one thing is certain; no
13 investor will accept a market price dividend yield which
14 is less than the return available from purchase of a
15 secured bond of the same enterprise unless expected
16 growth, when added to the dividend yield, provides a
17 total return indicative of his risk. Common sense tells
18 us that a common equity investor is exposed to considerably
19 more risk than secured bond investors.
20 With dividend yields in the eight
21 percent area, and expected growth rate of six percent,
22 the indicated DCF base cost rate would be fourteen
23 percent. This is a rate that an investor expects to
24

1 achieve. It is important to note that the cost of common
2 equity capital is not what hindsight proves was achieved,
3 but rather what investors think it is during the particular
4 span of time for which the analysis is pertinent.
5 It should be noted that my eight company
6 barometer group also used by Doctor Weaver actually
7 experienced, on average, the compound growth rate of
8 four point eight percent in earnings per share during
9 the five years ending 1976. That period comprised several
10 of the leanest years in history. Thus, growth was less
11 than demanded by investors, and they discounted market
12 prices to well below book values. Thus, a growth rate
13 of about six percent is reasonable under orderly
14 economic conditions. Such a growth rate is predicted
15 and material widely dissiminated among investors.
16 Value Line Investment service is predicting a growth
17 rate in earnings per share for the Allegheny Power
18 System, whose stock is traded, of six and one-half
19 percent, and five and one half percent growth in
20 dividends per share over the next five years.
21 COMMISSIONER BRADSHAW: Who is doing
22 that?
23 WITNESS HANLEY: Value Line Investment
24 Service.

1 COMMISSIONER BRADSHAW: What method do
2 they use to get there?
3 WITNESS HANLEY: I am not sure, Your
4 Honor.
5 MR. RIELY: They don't tell you.
6 WITNESS HANLEY: All they tell us,
7 Your Honor, is that they have a number of
8 sophisticated analysts, and they do a lot
9 of in-depth analysis. One thing I do believe,
10 however, notwithstanding what hindsight will
11 tell us about how accurate their prediction
12 is, is my belief that a lot of people take
13 some credence of it in making their investment
14 decisions.
15 COMMISSIONER BRADSHAW : Have you got
16 their report with you of Value Line?
17 WITNESS HANLEY: That I do, Your Honor.
18 COMMISSIONER BRADSHAW: Do they say
19 anything about AFUDC, what the Commissions might
20 do with it or anything? Or saying how great
21 things are going to be?
22 WITNESS HANLEY: Not in that particular
23 one, Your Honor.
24

BY MR. RIELY

Q Continue, please.

A An indicated fourteen percent DCF base cost of common equity capital, less a prospective A rated bond cost of about eight point six percent, a rate Doctor Weaver obviously agrees with, indicates a spread over prospective bond yields of five point two percent to compensate for added risks of being the last in line common shareholder. That spread is reasonable based on my studies, and is supported by a study of Professor Edwardson & Sinclair Field at the University of Chicago, as I explained in my direct testimony.

Q Is Doctor Weaver's allowance for new equity flotation cost and market pressure multiplier as shown on Statement 16 of his exhibit logical?

A No. He professes to advocate a one point one to one factor to allow for such costs. Implicit in that ratio is that such costs normally amount to ten percent, which I believe is an appropriate recognition. However, his formula results in a multiplier of one point zero six. Common sense mandates that if such costs are expected to be ten percent, and an allowance

is made equal to only six percent, the hope of receiving net proceeds in an amount not less than book value diminishes. That virtually assures built-in dilution in earnings and book value.

I believe a rate of earnings on book common equity should be high enough to afford an opportunity for a market-to-book value ratio of one point two-five times in an orderly market. Great swings in market conditions in recent years have resulted in dilution and loss of financial integrity to common shareholders of many electric companies when new common stock was required to be sold.

Thus, I believe that Doctor Weaver's allowance is inadequate.

Q Please comment on the comparable earnings technique employed by Doctor Weaver and Mr. Parcell?

A Doctor Weaver removed from context the significance of my comparable earnings study. Page 9 of my direct testimony, I said, and I quote: I will use this approach as a secondary form of evidence. With regard to financial risk differences which exist between utilities and unregulated companies, I said on page 12, and I quote again: I have merely quantified ....

a common sense principle which the financial world recognizes as a fact.

Doctor Weaver and I do agree on one thing; circular reasoning must be avoided by deriving such a cost rate from analysis of a group of unregulated companies.

At page 44 of his testimony, Doctor Weaver indicates that the result of his study indicates that electric utility companies are somewhat more risky than the Dow Jones Industrial average group of companies. Doctor Weaver and Mr. Parcell totally disregard or refuse to recognize financial risk differences, common equity ratio differences, between unregulated companies and electric utilities. There is very basic college financial textbook support for the notion that financial risk is the additional riskiness which is induced by the use of financial leverage.

Analyses of before income tax overall rates of return relative to total capital employed levels out any financial risk differences between companies because the impact of interest charges from employment of debt is disregarded as is the income tax effect of the interest charges.

1 Doctor Weaver concluded that electric
2 utility companies are somewhat more risky than the Dow
3 Jones Industrial average group of companies. I analyzed
4 the pre-tax overall rates of return for the Dow Jones
5 Industrial group for the same ten year period used by
6 Doctor Weaver in his study, namely 1967 through 1976.
7 As can be seen on page 1 of Schedule 2 of Exhibit now
8 designated FJH-11, the ten year average pre-tax overall
9 rate of return for the Dow Jones Industrial group was
10 seventeen point seven zero percent. I assume that --
11 for this analysis -- more conservatively than Doctor
12 Weaver that the Dow Jones Group and electric utilities
13 are equal in risk.
14 On page 3 of Schedule 2, I have shown
15 what the indicated achieved return on common equity
16 after income taxes would be for the company had it earned
17 a similar pre-tax overall rate of return as industrials.
18 If the Company had been financed in the same manner as
19 used by Doctor Weaver in his cost of capital conclusion,
20 and with the same cost rates for debt and preferred stock
21 capital, return on common equity after income taxes would
22 have been seventeen point nine percent.
23 Such a rate is higher than the fourteen
24

point eight percent comparable earnings cost rate that I developed in my direct testimony.

Q Does your study of the DJI group provide any additional support for the bata adjustment of zero point one five percent, which you employed in development of your comparable earnings cost rate?

A Yes. The zero point one five percent was a factor that I employed as a result of informed judgment to recognize the greater financial risk of electric utilities. My studies indicated that it could range between zero point one two percent and zero point three zero percent. As shown on page 2 of Schedule 2, the average common equity ratio employed by the Dow Jones Industrial group was seventy percent. The Company's prospective common equity ratio adopted by Doctor Weaver is thirty-five point seven percent. On page 44 of his testimony, Doctor Weaver indicates that the Dow Jones I ndustrials earned an average of twelve point one percent after income taxes on common equity.

As shown on page 2 of Schedule 3, that return would have been seventeen point nine percent --

MR. RIELY: I believe that is page 3 of Schedule 2, isn't it?

WITNESS HANLEY: Thank you, Mr. Riely.

BY MR. RIELY

Q Please continue.

A That return would have been seventeen point nine percent if the Company's capital structure -- if fixed capital cost rates and effective income tax rate had been employed. The difference in the two common equity returns, namely seventeen point nine percent, had the company earned a similar pre-tax overall rate of return as the Dow Jones group vs. the twelve point one percent actually earned by the Dow Jo nes group after income taxes, is five point eight percent.

That difference, divided by the thirty-four point three percentage point difference in the common equity ratio, namely the seventy percent actually maintained by the Industrials, vs. the thirty-five point seven percent perspectively for Potomac Edison as adopted by Doctor Weaver, indicates a cost rate movement of zero point one seven percent for each percentage point decrease in common equity ratio in recognition of the increased financial risk.

This supports as conservative the judgment I made of zero point one five percent change for each percentage point movement to a common equity ratio in the development of my comparable earnings figure.

Q Please comment on the use of Doctor Weaver's earnings price ratio technique.

A I cannot believe that Doctor Weaver seriously used his earnings price ratio as the basis for his conclusion. He determined earning price ratios of his barometer group only for three days, as shown on his Statement 13. And even his three days showed that earnings price ratios are going up.

In fact, if he had taken his eight comparison companies as of September 27, 1977, his raw earnings price ratio would have increased to eleven point six percent, a substantial increase in view of the fact the period of only slightly less than three weeks had elapsed.

Earnings price ratios may be used appropriately in assisting to reach a determination of the cost of common equity capital. But only when they are considered over a substantial period of time

for purposes of observing trends under existing and prospective market conditions.

The use of spot earnings price ratios, which is essentially what Doctor Weaver did, is dangerous, and can only lead to misleading results.

It is obvious that so long as investors are accepting dividend yields in the eight percent area, they still expect future earnings growth. If they did not, it would simply not -- they would simply not purchase a bond...They simply would purchase a bond. Future earnings growth acts as a hedge against inflation. The highly respected Value Line Investment Service, as I mentioned a short ti me ago, is predicting a growth rate in earnings per share for the Allegheny Power System of six and one half percent, and a growth rate of five and one half percent in dividends per share over a five year point in the future.

The price investors paid today reflects some anticipation of future growth in earnings per share. Even if it has growth of only five percent the indicated earnings price ratio, based upon the most recent raw earnings price ratio that I have mentioned as of September 27, adjusted to reflect market pressure and

selling expenses as defined by me in the glossery of my testimony, and reflecting growth of five percent anticipated by investors, would result in an earnings price ratio based cost rate of thirteen and five-eights percent, which is far above Doctor Weaver's conclusion. And I might add that such a rate is not a rate that is appropriate directly relative to a book common equity.

Q Please comment with regard to Doctor Weaver's and Mr. Parcell's position regarding coverage.

A Both gentlemen, obviously, had mistaken ideas of the significance of indenture and preferred stock agreement requirements concerning coverage.

I explained the significance of coverage in Appendix D accompanying my direct testimony. Coverage tests are protective devices which give comfort to existing fixed capital security holders. They are in no way reflective of the levels of coverage necessary to attract capital on a reasonable basis in competition in the marketplace, with all other enterprises seeking investors capital.

Neither gentleman has ever negotiated the sale of fixed capital securities of utilities with

1 sophisticated investors.
2 COMMISSIONER BRADSHAW: Have you done
3 that?
4 WITNESS HANLEY: Yes, Your Honor.
5 Also, neither has made a comparative study
6 of coverages of similar risk companies. They
7 have ignored the realistic fact of life that
8 attrition will occur, and the coverage mirage,
9 based on their cost of capital conclusions,
10 will not be realized.
11 That is risk, as both define it, when
12 the likelihood exists that the actual return
13 will be less than the expected return. Yet,
14 they fail to recognize the reality.
15
16 BY MR. RIELY
17 Q What conclusion have you reached with
18 regard to the testimony presented by Doctor Weaver and
19 Mr. Parcell?
20 A First, to Mr. Parcell. His approach
21 is based essentially on capital earnings of other
22 utilities and he gives no recognition to the circular
23 reasoning inherent in that approach. As a result,
24

his conclusions appear to be deficient because they are based on faulty premises.

Doctor Weaver's chief reliance is on the discounted cash flow technique. I agree that the technique is a useful tool, but it should not be the principle basis in a cost of common equity determination. The record in a pending proceeding, RM 771, before the Federal Power Commission, is replete of testimony and quantitative evidence to the effect that anticipated returns computed by the use of the discounted cash flow technique have departed widely from returns actually achieved.

That evidence, together with my study, such as Schedule 1 herein, makes it clear that discounted cash flow projections have not been predictive of results achieved. On this basis I conclude that the discounted cash flow determinations should not be the chief guide to the cost of common equity. As I stated at the beginning of my direct testimony, the cost of common equity determination is a matter of judgment, and judgment must be assisted by consideration of all the available facts and techniques.

This has been my approach in this case.

I remain of the conclusion that my determination is a proper one.

MR. RIELY: I tender Mr. Hanley for cross examination.

COMMISSIONER BRADSHAW: Suppose their recommendation had been higher than yours? Would you have had the same criticism of the technique?

WITNESS HANLEY: I can honestly answer yes, Your Honor. I have studied it enough and created this schedule of my own accord, and am a believer in my principles and I think it is wrong because of its unreliability to use as a primary tool.

COMMISSIONER BRADSHAW: All right.

COMMISSIONER HARWOOD: Have you seen any studies or anything written on how many existing stockholders of electric utilities are buying the stock when issues come out that are below book value?

WITNESS HANLEY: I have not, Your Honor.

COMMISSIONER HARWOOD: If many existing