PENNSYLVANIA
PUBLIC UTILITY COMMISSION

Policies to Mitigate Potential Electricity
Price Increases

Docket No. M-00061957

COMMENTS OF DUQUESNE LIGHT COMPANY

Introduction

Duquesne Light Company ("Duquesne" or "Duquesne Light") is pleased to provide comments on this very important general investigation. Duquesne Light is in a unique situation in Pennsylvania in that our collection of competitive transition charges (CTC) was completed in 2002, rate caps have expired, and we have been managing the transition to full deregulation since then in a way that has benefited customers and supported competition.

Unlike customers in other areas, Duquesne customers have not experienced rate shock, and, in fact, their rates are lower today than they were 20 years ago. Much of this success can be directly attributed to how we have managed POLR service. Duquesne has not relied on auctions and RFPs, which run the risk of being conducted at high points in the market. Rather, Duquesne, with Commission approval, has offered a fixed price service to customers, and has obtained supply through a diversified supply portfolio managed by its affiliate, Duquesne Power. Duquesne's current POLR supply arrangement expires on 12/31/07. In the near future, Duquesne will be making another POLR supply filing with the Commission to complete its transition to full statewide competition. This filing, in all likelihood, will repeat the continuation of its proven fixed price approach, and we will be seeking to again offer fixed price service for another three-year period -- with additional provisions to reflect lessons learned. The three-year period will allow Duquesne's POLR supply to match the expiration rate caps for other major Pennsylvania EDCs. To avoid the threat of rate shock to Duquesne's customers, and to place those customers on an equal footing with other customers throughout the state, it is critical that the Commission approve this filing as a final step to a fully competitive market in Duquesne's service territory.

<u>Duquesne Is Uniquely Qualified to Address the Commission's Issues</u>

Although Duquesne Light has been a POLR provider since 1999 and its rate caps have expired, the majority of electric utilities in the Commonwealth will not face generation rate cap expiration until 2011. Accordingly, while other utilities can speculate as to what might happen to their customers when rate caps expire, Duquesne speaks with the voice of experience.

This experience shows that Duquesne's POLR approach works. Specifically, our POLR products and procurement strategies have avoided rate shock, resulted in reasonable pricing for customers and have resulted in the highest level of shopping in the state. These strategies are in the best interests of our customers, and because we are out in the market purchasing the product, interested suppliers can compete for this business. Additionally, Duquesne is the only major utility in Pennsylvania whose affiliate does not own generation. We believe this process of acquiring energy by definition meets the "prevailing market price" standard.

<u>Default Service Obligation</u>

POLR service offered by Duquesne is offered currently in two distinct and separate plans which clearly illustrate what works--and what doesn't. The first plan is for residential and small commercial customers who are offered fixed price service managed by Duquesne Power. This service has been very successful as noted above. The second plan is the POLR service for our large C & I customers. For customers, that plan has been a failure by any measure.

For large C & I customers, we ran an RFP process for the fixed price service. Unfortunately, RFPs and auctions can pose real timing problems due to the volatile nature of energy markets. They can also present a lack of interest from suppliers, or a lack of competitive wholesale competition. In our most recent experience, Duquesne and consumer advocates petitioned the PUC for permission to continue its fixed price default service offering to large C & I customers. (Docket No. P-00032071.) Not a single supplier made a bid in response to the first RFP this spring. In one final attempt by this Commission – and only after the elimination of various restrictions -- just <u>one</u> supplier made a bid for the POLR service. For the future, a better answer for customers is to allow fixed price POLR choice supplied through a portfolio of contracts that is managed by Duquesne. Customers should be provided meaningful choices, and these choices should include a reasonable default service.

Another problem with the large customer plan is that our large C & I customers have been forced to receive hourly price service (HPS) as their default service. We have learned that our customers, by and large, do not want hourly pricing.

While hourly service can be a viable option for a few sophisticated customers, Duquesne Light has found that probably less than 10 % of its large C & I customers have the sophistication and financial wherewithal to administer it effectively. Hourly priced service exposes customers to price volatility and financial uncertainty that most are unwilling to tolerate. For the most part, Duquesne has found that customers want certainty. They need to budget for expenses, and they don't want to be surprised by rapidly escalating prices or extreme volatility. Volatile hourly prices are not a necessary or desirable part of a competitive market. For example, cell phone service now offers a fixed price to customers for monthly service rather than individual call and roaming charges.

Volatile hourly prices also are clearly not necessary to meet the prevailing market price standard in Section 2807 of the Public Utility Code. Hourly spot prices are one market price at a particular point in time. There are also daily, monthly, yearly and longer-term market prices, all of which fully comply with Section 2807.

In addition, hourly default service pricing has not affected Duquesne's load profile and shows no indication of managed load shifting. Only a few very large customers can manage their operations to shift load on an hourly basis, and those customers are now not generally taking POLR service from Duquesne. The total peak load contribution of the 66 customers that do take hourly price service from Duquesne is only 30 MWs. So with a mean of less than one-half of a megawatt per customer, the incentive, expertise and convenience is just not present to meaningfully change their business operations. Only 13 of Duquesne customers have been on hourly priced service for more than one year. Therefore, if hourly price service is to be an option for large C & I customers, it should be only one such option and should not be the service that is defaulted to automatically by customers who do not elect an alternative.

Commissioner Shane is absolutely correct: The current POLR III service for Duquesne's large C & I customers is "ugly". This result is not required by law and benefits no one but marketers who have seen an artificial and unnecessary competitive advantage at customers' expense. De-regulation was supposed to create meaningful competition in the interest of the public good. By requiring hourly price service to be the default, and by prohibiting Duquesne from offering long-term fixed price contracts to its C&I customers, those customers have been forced to leave Duquesne and enter into contracts with marketers at higher prices. The RFP process can result in an uncertain and high price and under those conditions, marketers can simply wait until the RFP process has set an inflated "market price" and then to offer prices just below that ceiling price in order to enroll customers. This has harmed customers and placed them at a disadvantage to similar businesses in other parts of the Commonwealth and in other states. Instead of promoting competition, the current C & I plan has simply created artificially high prices and jeopardized economic development in Duquesne's service territory.

Today's "Market" & Price Shock

The Commission called this investigation to seek opinions on how to address the "rate shock" some customers in our Commonwealth have begun to experience. An examination of where rate shock has occurred – and where it hasn't – is eye opening.

In Pike County, PA, the wholesale auction resulted in approximately a 70% increase over prior rates for Pike County's retail customers and a 119% increase in the generation portion of the rates. The wholesale auction was devastating to the public, resulting in special hearings to understand and address the impact of this price spike on consumers and businesses in this area. Even after the adoption of an aggregation plan, customers of Pike County saw minimal assistance to mitigate the 119% increase in generation rates.

Other states have seen similar results. For example, in Maryland, Baltimore Gas & Electric customers face a 72% rate increase. How did that happen? Deregulation resulted in the sale of power plants by regulated utilities that are now forced to buy back power at higher and more volatile market prices in an RFP process. Many of the new unregulated generation owners then have turned around and sold the output of those power plants elsewhere in competitive solicitations for a profit.

In Allegheny and Beaver Counties where Duquesne Light operates, customers have not seen such increases. The Duquesne POLR III plan has worked well for our residential and small commercial customers in protecting them from the volatility of the markets. While the plan is not the six-year fixed plan that Duquesne and other parties proposed to this Commission for approval, the resulting three-year plan has produced substantial benefits to customers, shielding them from the recent escalation and fluctuations in short-term energy prices. Additionally, this stability has promoted economic development, by providing electric price certainty.

Based on recent events surrounding RFP and auction results, this Commission understandably asks, should we phase in huge increases? Duquesne respectfully suggests the better questions are "what can be done to avoid substantial increases?" "What should we be doing to ensure that customers are provided reliable electric service at affordable rates?" and " What should we be doing to keep our large C&I customers from relocating to areas where energy is cheaper?" The answer lies in long-term fixed contracts.

Long-Term Contracts

Duquesne Light supports multi-year contracts as an incentive to both stabilize volatile energy prices and to engage and support existing and new generation sources. But current or proposed POLR rules/policies prevent this economic opportunity. New power plants need the certainty of cost recovery over a long-term to obtain financing. This was certainly true when utilities were building generation themselves, and it continues to be true today. The Commission needs to embrace policies that would permit construction of economic new power plants in Pennsylvania. The assurance of cost recovery is critical to this development of new generation in Pennsylvania. Moreover, this new generation will increase supply and thereby help avoid further rate shock in the future.

Utilities providing POLR service should not be forced into the short-term market – that may be higher in price and more volatile – under the auspices of an interpretation of "prevailing market prices." In fact, since Duquesne doesn't own generation, it will purchase multi-year contracts at the prevailing market price. Duquesne believes long-term supply contracts meet the definition of the prevailing market price principle, and will lead to lower and more stable pricing as part of a portfolio approach to procurement.

Conservation, Education, and Reducing Peak Demand

Conservation and education programming should be supported by this Commission to help customers, especially low-income customers, to make their bills more affordable and to conserve natural resources. Conservation, on the other hand, can hurt a utility's need for growth and revenue. Conservation can mitigate, to some extent, the impact of higher energy costs on customer bills, but it is unlikely to have any significant effect on rate shock.

Time of use rates are potentially a service offering that could provide modest changes in customer usage habits. Substantial metering and IT support infrastructure improvements would be necessary, however, and there are significant costs to those capital improvements that offset the cost savings.[1] But for those customers that are truly cost-conscious, it does provide an opportunity -- and an incentive -- for them to shift nonessential load to non-peak hours. Seasonal rates, while aligning to market prices, do not seem to offer as much promise as a energy conservation does since it is difficult for customers to shift their normal usage patterns because of a season.

Importantly, Duquesne Light should be able to educate the public about POLR service just like any other supplier can. It is not helpful to customers to prohibit

---

[1] A preliminary estimate of IT/metering costs to allow Duquesne to provide time-of-use information to all customers is as much as $ 235 million. While Duquesne is willing to invest those monies, it can only do so if it is assured full recovery of those costs. The current model of spending the money and then seeking reimbursement is too risky to justify such spending.

dissemination of information regarding POLR service as a potential supply option. One overarching goal of good public policy should be to provide benefits to customers. Duquesne Light cannot educate its customers if it is prohibited from promoting its services. The PUC needs to level the playing field so that the rules are the same for all and so that POLR service is a viable, reasonably priced option for customers.

Conclusion

In summary, Duquesne Light believes that there are proposals that this Commission can adopt to assist in mitigating potential electricity price increases. They are:

1. The Commission can adopt Duquesne's managed POLR plan as a successful model, especially during the transition period to 2010. Duquesne customers have not experienced rate shock. In fact their total rates are lower than 20 years ago. One of the main reasons is that Duquesne has offered a long-term-fixed price POLR service to its residential and small commercial customers that are supplied by diversified, negotiated and actively managed contracts with various suppliers. It has provided stability and protected customers from the escalation of energy prices.
2. The Commission can allow a fixed (POLR) price service offering for large customers. POLR service for large C & I customers has not worked well. The default service (HPS) is ugly and the RFP process sets an artificially inflated "market price" that encourages third party suppliers to offer prices at just below that ceiling. Consequently,

almost all large C & I customers have left Duquesne. It has not been a viable and competitive option.

3. The Commission can level the playing field to encourage customer education and allow the POLR service provider to disseminate information and promotion about POLR services to the public.

4. The Commission can allow/encourage long-term fixed POLR rates -- and long-term supply for those POLR rates. This would enhance investment in generation facilities and to provide customers with rate stability. POLR supply should include multi-year contracts, like other deliverers of commodities. These contracts meet the prevailing market price principle.

5. The Commission can allow/encourage multi-year contracts to support development of new generation. The PUC should provide assurance of cost recovery of multi-year contracts for suitable projects.

6. The Commission can continue with hourly pricing service as a POLR option, but not as the default. Hourly service, while an option, is not one that many customers, especially small to medium size and most Large C & I customers, desire to participate in due to the high risk, complexity and likelihood of price volatility. Fixed price offerings, rather than hourly pricing, should be the default offering for large C & I customers; and

7. The Commission should encourage and incent conservation and demand side management programs. Time of use rates, if cost effective, and other demand side management initiatives could be considered.

Duquesne Light appreciates the opportunity to comment.

Respectfully submitted,

Duquesne Light Company

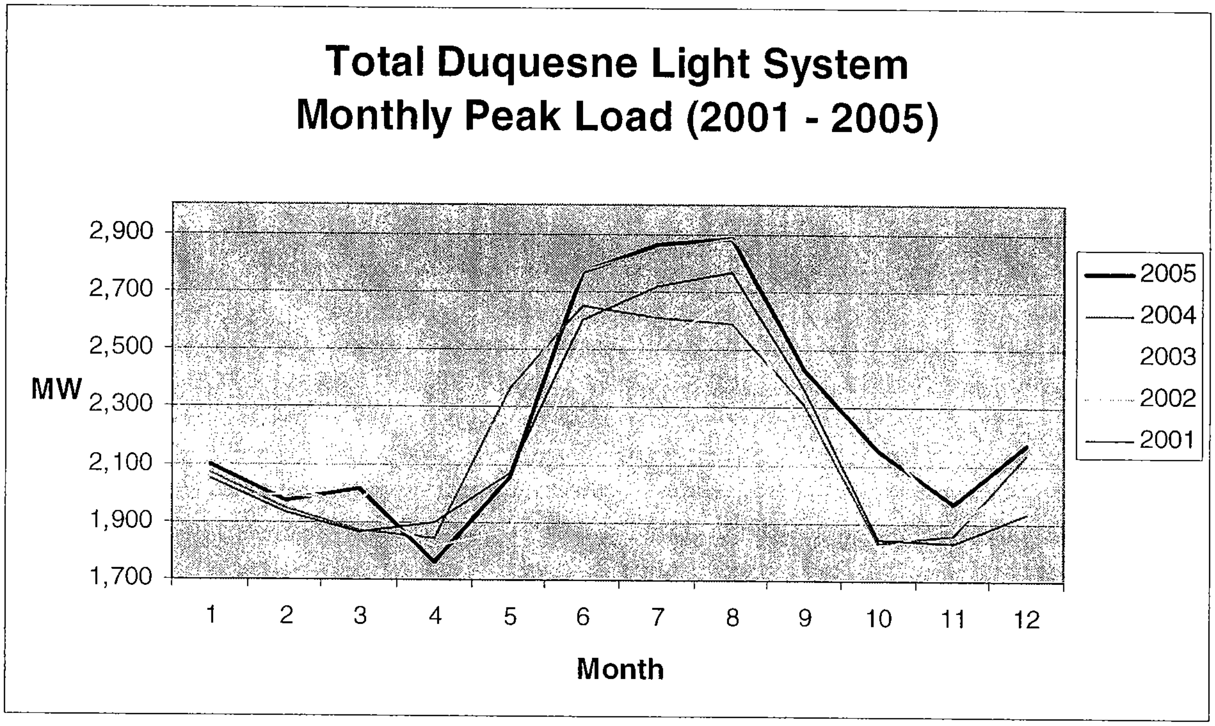
Frederick J. Eichenmiller

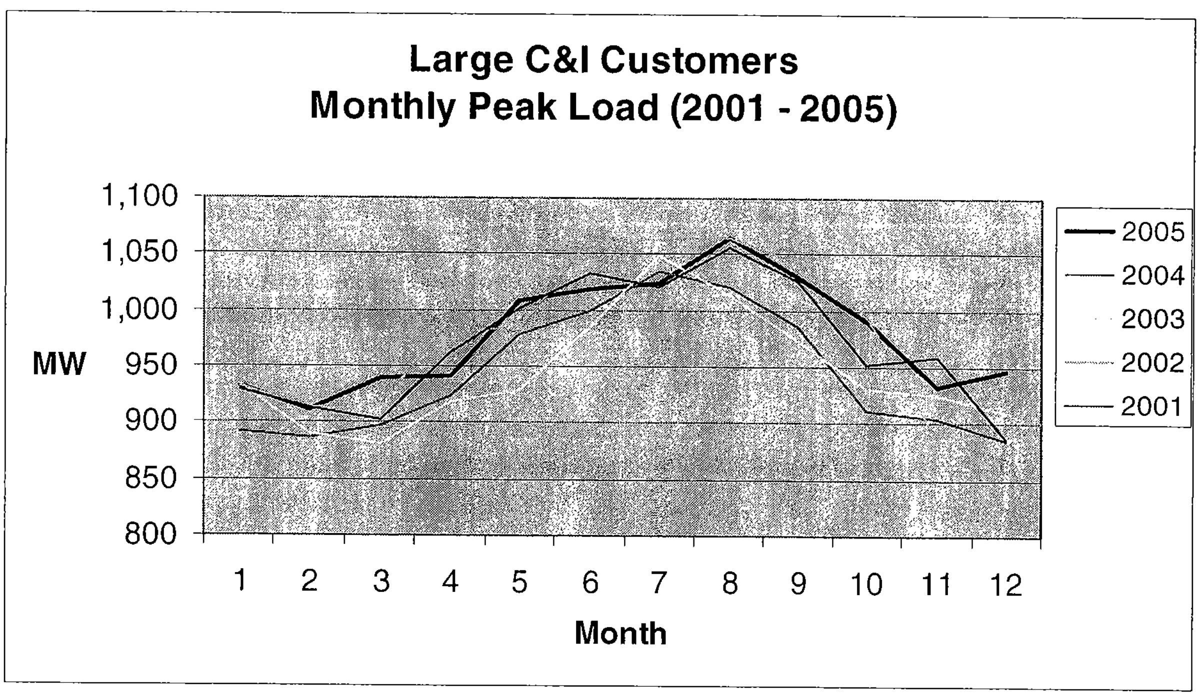
Frederick J. Eichenmiller, Director
Rates & Regulatory Affairs

Attachment A

In response to Commissioner Shane's statements – "I would welcome comments, particularly from Duquesne Light Company, concerning the impact of hourly default service rates on a utility's load profile. I am curious to see if the imposition of hourly default service rates has resulted in meaningful shifts in energy consumption, which have had an impact on marginal generation costs. It may be the case that default hourly rates have only caused customers to buy fixed price service from other suppliers".

Duquesne offers the following information





Attachment B

In response to Commissioner Shane's statement, "I would like the utilities to take a shot at estimating the marginal cost of air conditioning, in July, August and September", Duquesne offers the following:

The marginal cost of air conditioning is indeed difficult to estimate, but one calculation estimates the cost to the approximately 11.56 cents kwh for generation only for residential customers in the Duquesne zone. This calculation assumes Duquesne had to buy power in 2005 at July, August and September 2005 LMP prices in the Duquesne zone weekdays from 2:00 PM to 6:00 PM to serve residential air conditioning load. The calculation includes average charges for ancillary service charges, capacity related charges, line losses, the PJM surcharge defined in Duquesne's retail tariff Rider 1, and Pennsylvania gross receipts tax. The actual charge in a specific hour may vary significantly from the calculated figure.