Duquesne Light
Our Energy... Your Power

March 23, 2007

VIA OVERNIGHT MAIL

James J. McNulty, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building, 2nd Floor
400 North Street
Harrisburg, PA 17120

Re: Rulemaking Re Electric Distribution Companies' Obligation to Serve Retail Customers at the Conclusion of the Transition Period Pursuant to 66 Pa. C.S. § 2807(e)(2)
Docket No. L-00040169

Default Service Retail Electric Markets
Docket No. L-00070183

Dear Secretary McNulty:

Enclosed are an original and fifteen (15) copies of Duquesne Light Company's Reply Comments in the above-referenced proceedings.

Sincerely yours,

Gary A. Jack

Enclosures

c: Shane Rooney (via e-mail)

PENNSYLVANIA
PUBLIC UTILITY COMMISSION

Rulemaking Re Electric Distribution Companies' Obligation to Serve Retail Customers at the Conclusion of the Transition Period Pursuant To 66 Pa. C.S. § 2807(e)(2)	Docket No. L-00040169
Default Service and Retail Electric Markets	Docket No. L-00070183

REPLY COMMENTS OF DUQUESNE LIGHT COMPANY

Dated this 23rd day of March 2007.

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REPLY COMMENTS OF DUQUESNE LIGHT COMPANY

Pursuant to the Pennsylvania Public Utility Commission's ("Commission's") Advance Notice of Final Rulemaking Order ("ANOFR") and Proposed Policy Statement ("Policy Statement"), issued in these proceedings on February 9, 2007, Duquesne Light Company ("Duquesne" or the "Company"), along with other parties, submitted comments on March 2, 2007. Duquesne hereby submits the following reply comments in response to other parties.

EXECUTIVE SUMMARY

A. Duquesne's Default Service Plans Have Proven Successful

Duquesne currently has the fifth highest percentage of customer load shopping of any electric utility in the United States. Duquesne has the single highest percentage of large commercial and industrial ("C&I") load shopping in the United States, and the ninth highest level of residential load shopping in the country. At the same time, Duquesne provides residential and small C&I customers stable rates that are still below the regulated rates in effect prior to its restructuring.

Many parties in this proceeding cite Duquesne as an example of a proven, successful default service plan that is workable for both retail customers and electric generation suppliers ("EGSs"). With respect to Duquesne's small customer plan, Dominion Retail ("Dominion") submits as a final point "that it would be far more productive and wiser for the Commission to base its rules on the success of the Duquesne POLR program that affects over 500,000 customers, and not based upon over-reaction of one obvious failure – Pike County – with comparably few customers." (Dominion at 11-

12.) The Office of Consumer Advocate ("OCA") comments that the greatest level of shopping in Pennsylvania has resulted in Duquesne's service territory while customers are offered multi-year fixed rates as part of its default service. With known rates over a period of time, customers are able to make an informed choice. Duquesne's program demonstrates the value of a stable fixed price for the customer in making an informed choice. (OCA at 46.) In Duquesne's current default service proceeding, the OCA submits that Duquesne follows its successful prior POLR models[1] where Duquesne, an electric distribution company ("EDC") that has divested its generation, contracts with its affiliate to procure supply at prevailing market prices, and allows Duquesne to provide reasonable, stable rates for residential customers.[2]

With respect to Duquesne's large C&I customer plan, Hess comments that "the Duquesne retail market has demonstrated that a default service structure based on market-reflective price signals fosters a robust and sustainable competitive retail electric market structure...where competitive EGSs are serving 98% of the load for customers with peak demands of 300 kW and higher." (Hess at 4.) Several other parties also remark on the notable success in Duquesne's service territory. (Allegheny Energy at 3-4, Strategic Energy or "Strategic" at 7-8, Direct Energy or "Direct" at 10-11, and Reliant Energy or "Reliant" at 8.) While any party could pick a particular aspect of Duquesne's default service plan that does not meet their liking, these comments support the fact that Duquesne has been able to develop over a prolonged period of time default service plans that represent a reasonable and balanced approach to default service. While parties in this proceeding continue to speculate about what features of future default service plans

[1] Duquesne has successfully implemented three default service plans and currently has a fourth default service plan pending before the Commission.
[2] Answer of the Consumer Advocate, Docket P-00072247, February 22, 2007, at 2-3.

may or may not work in Pennsylvania, Duquesne has a plan that has been tested and works. It continues to be puzzling to Duquesne that a successful plan well received by the competitive market and its customers would not be permitted under the Commission's proposed rulemaking.[3] While the Commission need not adopt the Duquesne model as the only default service model, the successful results of the Duquesne model strongly suggest that the Commission should at least allow that model to be an option for future consideration.

B. The Commission's Plan May Have Serious Unintended Consequences

Duquesne applauds the Commission for attempting to balance many competing interests in its ANOFR and Policy Statement. From its experience in developing multiple default service plans, Duquesne appreciates that balancing these diverse interests is tremendously difficult. On the one hand, consumer groups generally support reasonably priced, stable and reliable default service (OCA at 3) and tend to encourage default service providers ("DSPs") to use longer-term contracts procured at different points in time in order to provide more stable default service rates. On the other hand, EGSs generally support monthly or hourly pricing with no laddering, no reconciliation, and no or very limited use of long-term contracts. On yet another hand, wholesale suppliers, typically owners of generation, tend to support structured, standardized, statewide procurements for load following products that give them (and not DSPs) the opportunity to manage supply portfolio risks and to earn a profit. Finally, DSPs require adequate compensation for the risks (if any) they assume on behalf of retail customers in their

[3] The Commission states that the experience of Duquesne shows that retail markets can work (ANOFR at 21), and then proceeds to require Duquesne to procure power and adjust rates in a manner that would undermine its successful development of a retail market.

service area. Some DSPs are not willing to assume any risks; they argue for full reconciliation, and want a guarantee from the Commission that there will be no after-the-fact cost recovery disallowances regarding their approved procurement plans.[4] In some instances, DSPs (or their affiliates) are willing to assume supply risks on behalf of customers and are willing to fix retail rates with no reconciliation.

In developing the ANOFR and Policy Statement, the Commission has attempted to balance these diverse and competing interests. In these documents the Commission articulates important policy goals, including mitigating rate shocks (for customers), promoting retail competition (for EGSs), relying on competitive procurements (for wholesale suppliers), and avoiding an overly prescriptive regulatory approach (for DSPs). However, Duquesne submits that there may be significant inconsistencies between the stated goals of the Commission and the provisions of the proposed default service regulations. (Also see UGI at 2-3.) Duquesne is concerned that the proposed rules may have serious unintended consequences that will frustrate the Commission's objectives to facilitate retail choice and hinder the ability to provide customers with reasonable rates that mitigate rate shock. The comments of the parties, when considered in their entirety, raise fundamental concerns with the proposed ANOFR and Policy Statement. In particular, Duquesne is concerned that the Commission's plan, despite its best intentions, unexpectedly could result in a "perfect storm" for customers in the form of:

1. Volatile retail rates (with quarterly adjustments, reliance on short-term market prices, and reconciliation),
2. Little or no retail competition (per the comments of most EGSs), and

[4] These DSPs also tend to have generation affiliates that are interested in being wholesale suppliers in structured solicitations.

3. Unanticipated consequences from structured competitive bid procurement processes that may artificially restrict wholesale supplier participation and/or may result in high bid prices.

The combination of volatile electric rates, little or no retail competition, and unanticipated negative results from structured solicitations would be extremely detrimental to customers in the Commonwealth.

C. Three Key Changes Are Necessary

Duquesne respectfully requests that the Commission carefully consider the key messages presented by the respective parties in their comments and proceed with great caution in order to avoid a "perfect storm." Duquesne agrees with the OCA that the regulations and policies regarding default service are the most critical that the Commission will implement under the Electricity Generation Customer Choice and Competition Act ("Competition Act"). (OCA at 1-2.) Unintended consequences could be devastating to Pennsylvania consumers. Duquesne believes that the comments of the various parties highlight the need for three major changes:

1. *Clarify that the Effective Date Should Be January 1, 2011*

Duquesne agrees with the Office of Small Business Advocate ("OSBA") that the regulations should apply for the first time to default service programs for the period beginning January 1, 2011. (OSBA at 3.) This is when the vast majority of electric customers in the state transition from their generation rate caps to a post-transition period default service offering. Duquesne recognizes the importance of increasing regulatory certainty for future default service plans, but time is needed to design appropriate bid

products, bid rules, and procurement procedures. As the Commission is aware, there is an ongoing effort in Pennsylvania to determine to what extent it is possible to develop standardized bid documents and processes. Many parties in this proceeding also emphasize the importance of developing a state-wide or multi-jurisdictional solicitation process. (Pennsylvania Power & Light or "PPL" at 8 and10, Philadelphia Electric Company or "PECO" at 4, First Energy or "FE" at 6, Constellation Energy or "Constellation" at 7.) All this further supports an effective date of January 1, 2011 when all electric utilities might participate in such a process. Structured solicitations, if not designed properly, could result in high bid premiums and/or the lack of supplier participation. Many parties raise issues related to the structure of the competitive procurement process and product specification that could impact both supplier participation and the resulting bid prices.[5] This effort to develop appropriate bid documents and processes should not be rushed or treated lightly. Default service regulations should not be implemented prematurely. Furthermore, given the successes cited earlier, there is no pressing reason why the Commission should require Duquesne,

[5] PPL comments that there are approximately 12 DSPs in Pennsylvania that could be seeking to obtain a variety of generation supply products on different, and perhaps conflicting procurement schedules. (PPL at 7-8.) PPL also argues that differences in products may result in less participation by wholesale generation supplier and less competitive prices for default service customers. (PPL at 11.) UGI suggests that DSPs may want to consider blocks of power instead of load following contracts, or include options or financial instruments in the portfolio. (UGI at 5-6). Both Constellation and PPL recommend that the Commission eliminate the requirement to purchase spot energy suggesting that this will force DSPs to manage this risk either by establishing a trading operation or obtaining this service from the competitive market, and can create large energy rate adjustments. (PPL at 12 and Constellation at 12-13.) Allegheny Energy claims that artificially setting price targets or restricting the amount of load that a qualified bidder can serve may impede access to the wholesale market and drive prices up. (Allegheny Energy at 6.) PECO asserts that experience in other states has shown that the absence of reasonable switching rules will compel wholesale suppliers to build substantial risk premiums into their competitive bids, thereby increasing the price-to-compare ("PTC") for all members of the class. (PECO at 16 and Energy Association or "EA" at 9.) Industrial Energy Consumers of Pennsylvania ("IECPA") claims that if congestion charges are included in the PTC, this may result in a DSP accepting non-economic bids in its competitive procurement program. (IECPA at 16.) Finally, FE claims that there is need for additional flexibility in bid evaluation criteria to address unforeseen circumstances, such as a supplier that goes bankrupt or the disclosure of accounting irregularities after qualifications have been met. (FE at 4.)

on a stand-alone basis, to implement the proposed rules prior to when the vast majority of electric customers in the state transition from their generation rate caps to a post-transition period default service offering. Accordingly, the regulations should not apply to plans until January 1, 2011.

2. *Eliminate the Requirement for Quarterly (Or More Frequent) Adjustments to Residential and Small C&I Customer Rates*

Most parties (including consumer advocates, EGSs, and EDCs) do not support the required quarterly (or more frequent) adjustments to residential and small C&I customer rates as currently designed. Numerous reasons are provided in the comments. Parties argue that the proposed adjustments a) will not reflect market prices, b) will not send customers the proper price signals for consumption choices, c) will not promote retail competition, and d) will not provide customers with stable rates that mitigate rate shock. While different commentators have alternative solutions to these problems, it should be readily apparent to the Commission that the proposed rulemaking, as currently structured, simply will not work as intended. Duquesne agrees with the comments of virtually all of the parties on this point. For the reasons explained later in these Reply Comments, Duquesne agrees with EGSs that the proposed structure is unlikely to promote retail competition and encourage EGS entry into Pennsylvania markets. Therefore, the Commission cannot rely on EGSs to provide fixed prices to small customers under the current structure. Duquesne also agrees with the OCA and Strategic that the proposed structure will not provide customers with stable rates. Based on the comments received, the Commission should not assume that frequent rate adjustments as proposed will necessarily track market prices better than less frequent price adjustments. It is telling

that while Dominion supports monthly price adjustments with no laddering of contracts and no reconciliation, it would prefer Duquesne's long-term fixed prices for residential customers to the Commission's proposed quarterly adjustments. (Dominion at 11-12.) Therefore, Duquesne strongly encourages the Commission to eliminate the proposed quarterly adjustment requirement from the proposed rulemaking and policy statement.

3. *Provide DSPs Discretion in Procuring Supply at Prevailing Market Prices*

Duquesne recommends that the Commission provide DSPs discretion in how they choose to procure default service supply at prevailing market prices. Duquesne believes that the Commission should not administratively prescribe the particular method of procurement, nor should it mandate a "prudent mix" of supply resources. Several parties express concern that wholesale suppliers may be reluctant to participate or may include high premiums in structured procurements if the bid process or products are not designed properly. Parties cite numerous issues regarding the timing of and differentiation of bids across DSPs, bid rules (e.g., load caps and price targets), product specification (e.g., block products vs. load following, spot energy requirements, contract term, etc.), risk allocation (e.g., due to customer switching, regulatory uncertainty, congestion charges, etc.), and the need for flexibility in bid evaluation criteria (e.g., if a supplier goes bankrupt or there is disclosure of accounting irregularities after qualifications have been met). In sum, potential participants in these solicitations stress the importance of a well designed bid process and product specifications. There is no guarantee that a structured solicitation, even if tested in another jurisdiction, will be successful in attracting

reasonable bids in all situations for all types of customers.[6] Many of the contract terms and bid processes used in Duquesne's POLR III competitive solicitations in March and May of 2006 for large C&I customers were modeled after those used in New Jersey and Maryland. Clearly, these solicitations in Duquesne's service area were not successful at attracting bids from multiple suppliers. (Duquesne's Initial Comments at 10.) Furthermore, several parties suggest that the Commission should not limit the use of other methods to establish prevailing market prices – including bilateral contracts (OCA, IECPA, UGI, Citizens Electric and Wellsboro) or a visible market price (Reliant at 3 and Strategic at 5). Parties also argue that the Commission should not prescribe the "prudent mix" of supply products. For example, Constellation argues against DSP requirements to use spot energy and states that long-term contracts also can represent prevailing market prices. Therefore, Duquesne requests that the Commission provide DSPs with discretion in how they choose to procure default service supply at prevailing market prices. Procurement methods should not be mandated administratively. DSPs should be able to utilize alternative procurement methods to satisfy the requirements in the Competition Act. The Commission should not arbitrarily dismiss through regulatory mandates the possibility of potential customer benefits without hearing and due consideration. Duquesne's comments are described more fully below.

[6] Default service products typically differ between states, within states, and sometimes even within service areas. Often different jurisdictions and default suppliers choose to allocate risks differently among wholesale suppliers, DSPs, and retail customers (e.g., some contracts offer retail customers more or less price certainty than others. Some plans adjust prices more often and vary by customer type and size.) It is also true that not all service areas are starting from the same position (e.g., some service areas have more retail shopping than in other service areas.)

GENERAL COMMENTS

A. Clarify that the Effective Date Should Be January 1, 2011

The proposed rules should apply to POLR service provided in 2011 and thereafter when the vast majority of electric customers in the state transition from their generation rate caps to a post-transition period default service offering. Under this approach, all customers in the state would be affected by the rule changes at the same time and customer education and communication efforts can be effectively coordinated on a statewide basis.

Many parties also emphasize the importance of developing a state-wide or multi-jurisdictional solicitation process. FE comments that if DSPs individually conduct their own separate solicitations at different points in time, disincentives are created for suppliers to bid their best prices. (FE at 6.) (See also the comments of PPL at 8 and 10, PECO at 4, FE at 6, and Constellation at 7.) For these and other reasons cited earlier (at 7-8), Duquesne recommends that the Commission provide that the default service regulations will not become effective until the major EDCs have completed their transition periods.

In the alternative, Duquesne agrees with the OSBA that regulations should be made applicable to each default service program filed on or after a specified date, which is after a final order on the regulations and review. (OSBA at 3.) Duquesne also would add that the regulations should not become effective prior to a final order related to the ongoing Commission effort to develop bid documents and procedures for the

Commonwealth.[7] Other parties also seek clarification that the proposed regulations will not interfere with existing Commission approved Orders and/or settlements and/or wholesale supplier contracts. (EA at 10, UGI at 9, and Constellation at 7.) Duquesne agrees that this type of retroactive Commission review should not occur and would damage the market.

Given Duquesne's unique situation, the Company is also concerned that its planning and litigation process for default service rates effective January 1, 2008, is occurring at the same time as these rulemakings, making the regulatory and timing uncertainties even greater.[8] In fact, on March 12, 2007 Duquesne received notice from the Duquesne Industrial Intervenors ("DII") that it wanted to sever and postpone consideration of Duquesne's proposed large C&I customer default service plan because DII alleges the plan to be in conflict of what is permitted in the Commission's proposed regulations and proposed Policy Statement. Therefore, Duquesne requests that the Commission further clarify in the regulations that the regulations do not interfere with interim plans filed prior to the effective date of the Commission's order. Prior to the effective date of the default service regulations, EDCs should be permitted to present interim default service plans that will remain in effect until the beginning of 2011. The

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[7] As noted in the comments in that proceeding, there are numerous issues to resolve, including operational (e.g., scheduling, forecasting, information sharing, congestion management, payment, interaction with RTO, etc.), legal (e.g., force majeure, events of default, termination, indemnification, dispute resolution, contract assignment, confidentiality, etc.), financial (e.g., credit and security provisions, switching risk, regulatory risk, default risk, interruptions risk, accounting impacts, etc.), product definition (e.g., seller obligations, buyer obligations, term, price re-openers, inclusion of transmission, renewables, ancillary services, etc.), regulatory approval (e.g., level of scrutiny, length of review period, etc.), and other issues.

[8] As a practical matter, even if final Commission orders were completed later this year on both the default service regulations and the competitive procurement process and documents, it would be extremely difficult, if not impossible, for Duquesne to conduct multiple solicitations at different points in time to establish retail rates effective for January 1, 2008.

Commission also should acknowledge that each interim plan will stand on its own and will not bind parties that later litigate plans offered by other EDCs.

If the Commission decides to make the default service regulations effective at some earlier date than 2011, then Duquesne urges the Commission to clarify in the draft rules themselves (and not the Policy Statement) that interim plans filed or approved prior to the effective date of final regulations will not be subject to the regulations. This regulatory certainty is needed so that utilities will know that their filed or approved plan will not have to be altered in midstream or their submitted plan may be rejected due to finalization of these pending rules.

B. Eliminate the Requirement for Quarterly (Or More Frequent) Adjustments to Residential and Small C&I Customer Rates

The Commission claims that quarterly (or more frequent) adjustments to default service rates will ensure that rates track prevailing market prices and customers will not experience large changes in rates. (ANOFR at 4). However, most parties (including EGSs, consumer groups, and EDCs) do not support the required quarterly (or more frequent) adjustments to residential and small C&I customer rates as currently designed. The comments filed make it clear that the proposed frequent rate adjustments will not reflect market prices, will not send customers the proper price signals, will not promote retail competition, and will not provide stable rates for customers.

1. *Proposed Adjustments Will Not Reflect Market Prices*

It appears that the initial comments from most parties agree with Duquesne's initial comments (at 15) where it stated "that the laddering of contracts at different points in time and blending them into default service rates when coupled with reconciliation of costs and revenues from prior periods will mean that at any point in time retail rates likely will not reflect current market prices." The Retail Energy Supply Association ("RESA") argues that the market structure created by the ANOFR and proposed Policy Statement "essentially guarantees that Default Service will not reflect prevailing market prices on a current and continuing basis" and will fall far short of compliance with the Competition Act. (RESA at 8, 2-3.) Hess considers the Commission's structure as an "adoption of a synthetic and fatally flawed PTC mechanism" due to a "misalignment between the EGS product prices and the PTC." (Hess at 10.) The National Energy Marketers Association ("NEMA") further notes that rate reconciliations could skew the PTC so as not to be reflective of current market conditions thereby making it more difficult for competitive suppliers to offer a comparable or better rate. (NEMA at 4.) Dominion states reconciliation of default service rates will return the setting of those rates to an administrative process complete with prudence review and the risk with disallowances. Default service rates could exclude the cost of certain switching and weather-related usage risks, and reconciliation will create a distortion between the real market price and the default service rate. (Dominion at 2.) These parties argue that the combination of contract laddering, reconciliation, and long-term contracts will make it impossible for retail rates to represent prevailing market prices at a particular point in

time. Duquesne agrees that the proposed rates will not reflect market prices at a particular point in time.

2. ***Proposed Adjustments Will Not Send the Proper Price Signals to Customers***

Similarly, several parties question the price signals that will be sent to customers. Dominion claims that reconciliation will send customers confusing market price signals. (Dominion at 6.) PECO comments that multiple procurements and quarterly (or more frequent) rate adjustments are unlikely to send consumers meaningful price signals. While this may be reasonable for larger, more sophisticated customers, PECO questions the wisdom of such an approach for residential and smaller customers, who prefer price stability and who depend on the DSP to mitigate their exposure to wide price swings. (PECO at 9.) PECO surmises that such adjustments could lead to customer confusion and unnecessary administrative costs. (PECO at 15.) For example, if a DSP under-collected its costs in the summer due to high market prices and then attempted to recover those costs in the fall, this could send customers false price signals. While some parties may argue, in theory, that customers should experience frequent rate adjustments for economic efficiency reasons, virtually all parties agree that there is little benefit to sending customers volatile market price signals that adjust frequently if the proposed rate structure does not accurately reflect market prices. Furthermore, in the absence of EGSs willing to serve that market, there is little customers can do to mitigate the impact of volatile market prices, except for longer term default service offerings.

3. *Proposed Adjustments Will Not Promote Retail Competition*

The Commission assumes that EGSs will respond to the proposed structure by entering the market and offer customers fixed prices. (ANOFR at 22.) This is a huge assumption with grave consequences if this does not occur as anticipated. It simply is not true that frequent adjustments of retail rates necessarily will result in EGSs offering reasonable fixed prices to residential and small C&I customers and more shopping.[9]

The OCA submits that there is no obvious benefit from the use of quarterly price changes in the stimulation of retail competition. The natural gas experience actually demonstrates that the quarterly changes do not stimulate competition, but may actually make shopping more difficult because the PTC varies so often. Customers are unable to determine how to compare the utility price to the competitive supplier's offer. The customer, particularly the residential customer, has no means of assessing whether they will be better off or worse off under the competitive offering. (OCA at 19). In Duquesne's service area, customers have a fixed-price benchmark which allows EGSs to market "known savings" off of that benchmark. In contrast, if variable default service rates are unknown in the future, then it becomes difficult for EGSs to guarantee savings while providing customers price security. Richards Energy, a broker/marketer in Pennsylvania, supports the OCA's claim, stating that allowing the PTC to change monthly makes the customer's choice more "guessed" or "hoped for" than "informed." (Richards Energy at 1.) UGI also highlights the importance of a known default service

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[9] In Massachusetts, default service rates were adjusted frequently yet there is very little shopping among residential customers. In New York, while rates adjust monthly for most customers and there have been extensive efforts on the part of the Public Service Commission to encourage retail choice, still residential shopping is lower than in Duquesne's service territory in many cases. In this proceeding, EGSs argue that the proposed default service structure, despite frequent rate adjustments, will prevent EGSs from entering the Pennsylvania market.

rate as a benchmark for shopping decisions. (UGI at 2.) In New York, where most utilities change retail rates monthly based on a portfolio of supply contracts, the New York Consumer Advocate describes how it is almost impossible for ordinary customers to compare competitive electric service company (called "ESCO") prices with monthly utility default service rates. "Fluctuating rates make it impossible for ordinary consumers to compare ESCO rates with default service rates. This lack of price transparency allows ESCOs to market their service based on short-term 'bait and switch' techniques, brand name attraction, or in protest to unreasonable price spikes from the current provider."[10]

The comments from the EGSs in this proceeding are even more striking. Dominion states that if the current proposal is adopted, it is unlikely that marketers will participate at all. Dominion believes that variable price alone will not encourage participation. (Dominion at 9.) If the Commission continues down its present course with its proposed procurement methodology, the other programs being considered (i.e., purchase of receivables, customer referral, rate ready, etc.) will be "mere window dressing" and will not spur competition if EGSs cannot compete on price. (Dominion at 11.) RESA comments that "EGSs will not have the incentive to commit, or to continue to commit, the considerable resources necessary to develop the competitive retail electric market because they will not have the market structure or regulatory certainty required for sustained, robust retail competition." (RESA at 8.) RESA further supports Dominion's claim that the Commission's proposed changes to facilitate retail choice will not be sufficient to overcome the anti-competitive effects of the long-term laddered portfolio procurement approach. (RESA at 5.)

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[10] Public Utility Law Project Comments in its Opposition to the Motion to Dismiss at 10, Case 05-E-1222, 2006.

In response, Duquesne agrees with the comments of EGSs that the Commission's proposed structure will not support retail competition.

4. *Proposed Adjustments Will Not Mitigate Rate Shock*

The OCA comments that quarterly, or more frequent, adjustments should not be utilized (OCA at 17-18, 44-45) and will not provide the rate stability for customers that is needed.[11] (OCA at 4.) The OCA points out that the Commission fails to address the wide swings in the prices to residential customers under the Orange and Rockland ("O&R") plan. For example, in the O&R plan, prices paid by residential customers can swing significantly from month to month. A review of the monthly PTC for O&R residential customers shows that the price in June was 6.2 cents, but increased to 10.7 the next month in July 2006. In February 2007, the price was 7 cents and now for March 2007 is 11.12 cents. (OCA at 46.) The OCA concludes that prices that change frequently can introduce significant problems of affordability and bill management for customers (OCA at 19) and that the Commission's proposals are unnecessarily complicated and unlikely to lead to the results the Commission anticipates. (OCA at 18.) Strategic also argues that the Commission's approach based on more frequent rate adjustments with laddered contracts will not provide price stability for customers nor will it result in retail competition. (Strategic at 3-4.) In its comments, Duquesne noted that attempts to frequently adjust retail rates for residential customers (e.g., in New York and Massachusetts) have in many instances resulted in more rate shock for customers and less retail shopping than experienced in Duquesne's service area. (See Attachment B in

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[11] Rather than eliminate the quarterly adjustment, the OSBA requests that DSPs be permitted to propose a fixed-rate option for non-residential customers with a peak demand of 500 kW or less (OSBA at 13) and be allowed to rely on long-term supply contracts beyond one year. (OSBA at 6.)

Duquesne's initial comments.) In addition to the O&R experience cited by the OCA, Duquesne also referenced the experience in Massachusetts. "Massachusetts based the generation portion of the POLR service on the price of supply procured in wholesale markets through fixed-priced, short-term (three or six months) supply contracts. Rates for the generation portion of POLR service in the Boston Edison (north) territory increased from 7.5 to 12.7 cents per KWh from 2005 to 2006."[12] Meanwhile, very few EGSs are providing residential customers with fixed price offerings and the level of shopping is substantially below that in Duquesne's service area. This market evidence from other jurisdictions indicates that retail customers have experienced significant changes in their default service rates when they have been exposed to frequent rate adjustments.

By comparison, Duquesne has reset its supply rates to market levels every few years as it moved from POLR I to POLR II to POLR III and in its most recent POLR filing. This frequency of resetting rates has resulted in manageable rate impacts for customers at each reset and relatively high levels of customer shopping. Unlike other utilities both within and outside Pennsylvania that have abruptly moved from long-term generation rate caps to solicitations, Duquesne has successfully avoided sharp rate increases and provided customers with stable rates over time.

In summary, Duquesne agrees with the comments of virtually all of the EGSs that the proposed structure is unlikely to promote retail competition and encourage EGS entry into Pennsylvania markets. Duquesne also agrees with the OCA and Strategic that the proposed rate structure will not provide customers with stable rates. Based on the

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[12] Draft Report to Congress on Competition in the Wholesale and Retail Markets for Electric Energy, Docket No. AD05-17-000, Electric Energy Market Competition Task Force and the FERC, June 2006, at 71.

comments received, the Commission should not assume that frequent rate adjustments as proposed will necessarily track market prices better than less frequent price adjustments. The Commission should not force customers onto rates that adjust quarterly when residential and small C&I customers have limited competitive opportunities to mitigate their exposure to volatile market prices. Therefore, Duquesne strongly encourages the Commission to eliminate the proposed quarterly adjustment requirement from the proposed rulemaking and Policy Statement.

A DSP should establish market-based default service rates and be allowed to propose a frequency of rate adjustment that is tailored to the customer needs and market circumstances at the time of its filing. The Commission should not ignore the market evidence, and should allow for longer term default service rates for residential and small C&I customers, as long as those default service rates are based on prevailing market prices.[13] In general, more sophisticated customers in a more developed retail market should be exposed to more frequent rate adjustments. But given the volatility of electric prices, the uncertain development of competitive retail markets for smaller customers, and the customers' preference for fixed prices, residential and small C&I customers should continue to be able to be offered a fixed rate default service. The proposed rulemaking appears to have gone from one extreme (e.g., fixed rate caps for ten years as was approved as part of utility restructuring) to another (i.e., quarterly rate adjustments). Duquesne's past POLR plans demonstrate that a more moderate approach may better achieve the Commission's objectives of mitigating rate shocks for customers and facilitating a competitive retail market.

[13] Retail rates should represent the prevailing market price levels at the time they are proposed, taking into account all of the costs and risks associated with providing default service to retail customers for the time period those rates are in effect, be it monthly, yearly, three years, etc.

C. Provide DSPs Discretion in Procuring Supply at Prevailing Market Prices

Duquesne recommends that the Commission provide DSPs discretion in how they choose to procure default service supply at prevailing market prices.[14] Duquesne believes that the Commission should not administratively prescribe the particular method of procurement, nor should it mandate the use of only short-term products, nor should it dictate the "prudent mix" of supply resources. These mandates when combined with the requirement to frequently adjust rates for small customers under the Commission's proposed structure will harm retail customers and retail competition.

1. *The Commission Should Not Mandate the Method of Procurement*

The comments of numerous parties suggest that the Commission should not mandate, or even prefer, a particular method of supply procurement.

UGI claims that "the proposed procurement rules should not be overly prescriptive and should preserve the Commission's ability to consider all supply options and arrangements" (UGI at 4), noting that structured auctions may initially seem appealing, but "may not produce optimal results in real world conditions."[15] (UGI at 2.) Reliant believes that the competitive market would be advanced if a competitive affiliate

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[14] Duquesne supports the Commission's recognition of the risk of being too prescriptive in its approach to this rulemaking. Accordingly, the Commission states it has not attempted to dictate the exact manner by which every DSP will acquire electricity. (ANOFR, at 5.) Duquesne also agrees that reserving some aspects of the regulation to a policy statement allows for greater flexibility as markets continue to change and represents sound public policy.

[15] The contract terms, conditions, and bid procedures can have a significant impact on the success or failure of the solicitation. They can affect the number of suppliers willing to participate, the resulting price levels, and the risks allocated to retail customers and winning bidders. A solicitation also requires time and funds to implement, and customers are exposed to market price movements during the regulatory proceedings and implementation period leading up to the solicitation. Market evidence also suggests that reliance on wholesale solicitations may severely limit the ability of retail EGSs to enter the market to provide the rate stability that small customers' desire. Experience in neighboring states demonstrates that structured solicitations may not always foster a robust retail market for electricity. In many cases, EGSs have been unable to compete in markets where solicitations are used to determine default service rates (e.g., Maryland, New Jersey, and Massachusetts).

of the EDC served as the default service provider and was allowed to procure supply without regulatory mandates. (Reliant at 4.) Both Reliant and Strategic also suggest that a market index mechanism, rather than mandated structured solicitations, may be used to establish prevailing market prices. (Reliant at 3 and Strategic at 5.) The OCA comments that "the methods of procurement should not be limited to only bid processes or spot market purchases" (OCA at 11) and the proposed regulations "may unduly restrict procurement strategy, unduly restrict the forms of competitive procurement processes that can be used, and unduly restrict the ability of DSPs to respond to contingencies that arise."[16] (OCA at 9-10.)

In particular, the proposed rulemaking would forbid the use of bilateral contracts. Duquesne believes that this is an overly prescriptive approach. The Commission's logic for excluding the use of bilateral contracts does not apply to Duquesne. The Commission notes in a footnote "that most Pennsylvania EDCs have wholesale energy supply affiliates with substantial generation assets" and that "permitting the routine use of bilateral contracts would allow an EDC to negotiate a contract with its affiliate, with all the potential risk and conflicts this would entail." (ANOFR, Footnote 4, at 14, emphasis added.) In response, Duquesne notes that it is not in the same situation as "most Pennsylvania EDCs" since it does not have energy supply affiliates that possess substantial generation assets. The Commission should permit alternative supply procurement methods, especially methods that have already proven to be successful in benefiting customers and retail competition. Duquesne notes that other states allow DSPs

[16] The OCA also states that EDCs should have the flexibility in the plan to take advantage of market opportunities. They should be able to move the scheduled auction or RFP if the date happens to coincide with a catastrophic world event or serious market perturbation. (OCA at 44.) The OCA also asserts that the criteria for selecting a winning bidder may be too narrowly focused on price, precluding consideration of other criteria that may be appropriate in bidding some resource. (OCA at 40.)

discretion in how they obtain electric supply.[17] Section 2807(e) of the Competition Act does not expressly mandate that competitive bidding be used to procure electric generation supply for default service customers. Bilateral contracts are used by gas companies and electric utilities in Pennsylvania, New York, and in many other jurisdictions.

Several other parties (including the OCA, IECPA, UGI, Citizens Electric and Wellsboro) also are very supportive of permitting bilateral contracts as part of supply procurement. The OCA states that bilateral contracts may be appropriate and indeed necessary (OCA at 12) arguing that bilateral contracts are an integral part of the competitive wholesale markets and are not inherently anti-competitive.[18] (OCA at 41.) IECPA supports bilateral contracts by stating, "To ensure that DSPs are able to obtain electricity for POLR customers at just and reasonable rates, DSPs must be permitted to include the use of long-term contracts with affiliates in their procurement toolbox." (IECPA at 19.) Several smaller utilities, like Citizen's Electric and Wellsboro, noted they do not believe they can implement (jointly or independently) a competitive bid process. These companies supply default service with bilateral contracts and request clarification that it can continue that practice. Bilateral contracts have been a cornerstone of Duquesne's successful POLR plans and should be permitted as an option.

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[17] For example, DSPs in Texas and in New York, which have relatively high levels of retail shopping, do not rely on a mandated type of procurement process and have allowed DSPs discretion in how they obtain supply to meet their default service obligations.

[18] The OCA mentioned concern with bilateral contracts with affiliates; but reading its comments further, their concern, Duquesne believes, is with affiliates with significant generation. (OCA at 12.) That is not the situation with Duquesne as it divested its generation assets in 2000 and must procure its supply in the competitive wholesale market at prevailing market prices. Therefore, Duquesne believes it is important for the Commission to make the distinction between affiliates that own significant quantities of generation and non-generation affiliates, to the extent any limits are placed on procurements from affiliated companies. IECPA correctly points out that the Commission has the power to review any affiliated interest agreement to ensure that ratepayers are not disadvantaged and FERC also has a process to review these contracts. (IECPA at 18.)

The Commission should not adopt and mandate a competitive supply procurement method. Requiring DSPs to rely solely on structured solicitations to procure supply and ignoring other available methods leaves the Commission and the Commonwealth's consumers exposed to potentially significant price increases,[19] the possibility that the procurement method may not be successful at attracting bids,[20] and the chance that the development of retail competition will be stymied.[21]

Prevailing market prices may be established using several methods. The Commission even acknowledges "these bilateral contracts may very well reflect 'prevailing market prices.'" (ANOFR at 14). If a bilateral contract properly reflects prevailing market prices, there is no basis in the Competition Act to prohibit such an approach. Retail rates may be established at prevailing market prices by comparisons with other market prices in the region, through a market price index formula (as suggested by Reliant and Strategic), or by a structured solicitation. In fact, Duquesne already has experience establishing default service rates deemed to be in compliance with the Competition Act using each of these different methods.[22] The Commission explicitly

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[19] In Maryland, the results from a March 2006 RFP resulted in significant rate increases for customers. PEPCO's residential customers faced an increase of 39% for a typical bill, for Delmarva Power & Light a 35% annual increase, and for Baltimore Gas & Electric, 72%. In Delaware, Delmarva Power & Light's proposed rates for residential customers resulting from a structured solicitation process increased the total annual bill by about 59% on average. In Illinois, the legislature is currently considering whether to reverse the rate impact from its most recent structured solicitation. In Pennsylvania, Pike County Light & Power customers faced a 129% increase in rates from their structured solicitation process.

[20] For example, Duquesne did not receive any bids from wholesale suppliers at any price in its structured supply procurement process completed in March 2006 and only one bid in its procurement process completed in May 2006.

[21] In many instances, alternate retail suppliers have been unable to compete in markets where structured solicitations are used to determine default service rates (e.g., Maryland, New Jersey, and Massachusetts).

[22] The Company started serving default service customers from its owned generation. Duquesne subsequently divested its generating assets and served its default service customers by means of negotiated full-requirements supply contracts with a non-affiliate during the POLR I and POLR II periods. In POLR III, Duquesne treated Large C&I customers differently from residential and small C&I customers. Large C&I customers were supplied with a PJM hourly market index formula rate. Alternatively, Large C&I customers could elect a fixed rate established by a solicitation. Meanwhile, POLR III residential and small C&I customers on default service were supplied at a three-year fixed price based on an agreement with

recognized in Duquesne's POLR III proceeding that "a competitive procurement process is not the exclusive method to arrive at a prevailing market price."[23]

Given the potential customer benefits of allowing various supply procurement methods and the ability to determine whether the proposed retail rates represent prevailing market prices using any of a variety of methods, the Commission should clarify that the "prevailing market price" standard in the Competition Act can be satisfied through a variety of supply procurement methods rather than restrict the Commonwealth to a single or dual supply acquisition approach.[24] The DSP should have discretion in how it chooses to obtain its supply and how supply risks are most effectively allocated among the DSP, wholesale suppliers, and retail customers.

2. *Prevailing Market Prices Should Not Be Limited to Short-Term Prices*

Many parties comment that the Commission's interpretation of prevailing market prices incorrectly limits it to short-term market products and ignores the fact that prevailing market prices may exist for longer term products. On this issue, Duquesne

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Duquesne's affiliate, where the rate levels were established based on comparisons with recent solicitations. Each of these methods to supply and establish default service rates was approved by the Commission, and, considered consistent with establishing rates at "prevailing market" prices per the Competition Act.

[23] Reconsideration Order at 26.

[24] Virtually all of the EGSs oppose the Commission's recommendation to ladder contracts. RESA argues that permitting reliance primarily upon long-term, laddered supply contracts will negate the positive changes adopted or proposed by the Commission. It represents a huge weakness. (RESA at 2.) (See also the comments of Strategic at 3, Dominion at 6, Reliant at 11, and Direct at 4.) Most parties recognize that states such as New Jersey that rely on laddered contracts have not been successful at developing a competitive retail market for residential and small C&I customers. In addition, it is not clear that the requirement to conduct multiple procurements over the course of the year will be beneficial. Duquesne agrees with PECO that the benefits of semi-annual procurements must be weighed against their costs. (PECO at 9.) Duquesne also agrees with PPL that twelve DSPs conducting multiple solicitations in the course of the year at different times, for different rate classes, and different products certainly may be administratively burdensome and disrupt the wholesale market. (PPL at 7-8.) This could result in a negative impact on supplier participation and the resulting bids.

agrees with the comments of the OCA, Constellation, IECPA, EA, and PPL. The OCA submits that the Commission's focus on quarterly adjustments continues to rely on the mistaken assumption that prevailing market prices are short term prices. (OCA at 18.) Constellation argues that "if a wholesale supplier bids on a one-year or a three-year default service product, for instance, it is including in its bid price its expectations of where the market is and will be over the term of the product. In doing so, the bidder provides a fixed price that achieves a reasonable amount of price stability, but also is reflective of the market. Importantly, it shifts risk management to the parties that are best equipped to do so: the wholesale suppliers." (Constellation at 11.) IECPA states that "multiple products exist in the wholesale market with differing duration and price stability. Each product has its own 'prevailing market price' at a given time." (IECPA at 6.) IECPA concludes that "a long-term contract satisfies Section 2807(e)(3) as long as it reflects the prevailing market price for similar contracts of like character and duration at the time of execution." (IECPA at 18.) Both the EA and PPL suggest that the prevailing market price definition should be interpreted to recognize that, at any point in time, the wholesale market includes many electric generation supply products available over many time periods. The price for each of these different products over the agreed-upon term is a prevailing market price at the time the generation supply is purchased. (EA at 5 and PPL at 5.) Duquesne agrees.

The Competition Act clearly does not specify the term of potential default service products, and it should not be interpreted by the Commission to force all default service customers in the Commonwealth onto rates that expose these customers to short-term market price volatility with little opportunity to mitigate this exposure in an immature

competitive retail market. The Commission should acknowledge that prevailing market prices may include the prices of long-term fixed price default service products, and should not be limited only to short-term market prices.

3. *The Commission Should Not Prescribe a "Prudent Mix" of Resources*

Duquesne also believes that DSPs should have discretion on the products they choose to acquire at prevailing market prices.[25] That is, the Commission should not mandate contract lengths or a mix of particular supply resources (e.g., spot, block products, load following products, etc.). Several other parties appear to share similar concerns as Duquesne, or at least do not like the Commission's specific requirements and recommendations. These positions support the need for greater flexibility in the regulations.

PECO expresses concern that the guidelines are overly prescriptive, staking out positions on "prudent mix" of generation supply. PECO correctly points out that the "prudence" of a particular supply mix will vary over time depending upon market conditions and a utility's specific circumstances. (PECO at 2, 6, 7.) The OCA asserts that the Commission's proposals unnecessarily restrict the use of long-term contracts and may unnecessarily favor short-term load following contracts. (OCA at 13.) The OCA submits that load following contracts from wholesale suppliers may come with a large

[25] Electricity supply may be procured in the form of fixed-price load following (full requirements) contracts that involve an all-in price for all of the customers' electricity needs, or supply could be procured in the form of standard wholesale electric energy "block" products for a defined quantity in each hour. These block products are traded frequently in a liquid commodity market, but they do not cover certain risks associated with serving retail customers, such as uncertain customer usage and switching. In addition to the different product types (i.e., spot, on-peak and off-peak block products, load following full requirements products, option products, financial hedges, etc.), most products may also vary in contract length. Different procurement methods allocate risks differently between the DSP, wholesale suppliers, and retail customers, and no single method may be preferable in all cases for all customer types.

risk premium and may help to explain the extremely high prices that continue to be seen in wholesale auctions in states like New Jersey and Maryland. (OCA at 15.) The OCA claims that a reasonable portfolio may include the purchase of blocks of power and the use of short-term or spot markets for load balancing.[26] (OCA at 15-16.) Contrary to the OCA's position, Constellation supports the use of load following contracts provided by expert wholesale suppliers, suggesting that DSPs should not assume the risks associated with a supply portfolio and DSPs should not utilize spot market purchases. (Constellation at 12-13.) The OSBA does not support limiting contracts to one year or less for 25-500 kW customers (OSBA at 6), and similarly US Steel believes the DSP should be permitted to exercise discretion to enter into prudent and reasonable long-term supply contracts. (US Steel at 4.)

In response, Duquesne believes the appropriate mix of supply resources will likely depend on the competitive market and utility situation. Duquesne concurs that the Commission should not mandate or prohibit the use of long-term contracts.[27] (Policy Statement at 5.) Duquesne also supports the concept that a "DSP may propose procurement approaches that vary from those outlined in this Policy Statement." (Policy Statement at 4.) Fixed term contracts should be tailored towards what is appropriate given the needs of the customer, the level of customer education (market understanding) and the level of market development.

[26] This is essentially what Duquesne's affiliate, Duquesne Power, does to supply default service in Duquesne's service area, since Duquesne does not possess the necessary supply purchasing and risk management expertise within the Company.

[27] However, Duquesne does not agree with the statement that "long-term contracts should only be used when necessary and required for DSP compliance with alternative requirements, and should be restricted to covering a relatively small portion of the default service load." (§69.1805).

OTHER SPECIFIC COMMENTS

A. Eliminate Multiple and Potentially Conflicting Procurement Standards

The OSBA and many EDCs express concerns about multiple, conflicting procurement standards that may expose DSPs to after-the-fact disallowances and have negative effects on their business. FE's overarching area of concern is the multiple and subjective standards of review to which the actions and costs incurred by the DSP will be subjected. Throughout the ANOFR and Policy Statement, there is the use of words such as "prudent", "lowest cost", "reasonable cost", "lowest reasonable long-term cost" in relation to default service recovery. FE is concerned that the DSP will be continually subjected to after-the-fact second guessing, creating financial uncertainty and risk for the DSP. This may result in increased capital costs and perhaps decreased access to capital necessary for investment in the wires business. Additionally, it appears that DSPs could be subjected to potential disallowances of costs incurred even though it followed a procurement plan approved by the Commission creating an untenable situation for the DSP. (FE at 2.) FE considers this as "unduly risky for EDCs and fundamentally unfair." (FE at 4.) PPL correctly points out that including a new and undefined standard to be met, "lowest reasonable long-term costs", adds a criterion for evaluating default service prices not found in the Competition Act and may lead to after-the fact review of an approved procurement plan. (PPL at 10-11). PPL believes it is essential that the Commission approve each DSP's default service program in advance with no possibility of an after-the-fact review of that program. (PPL at 8.) The parties recommend that these references to multiple procurement standards be removed from the regulations and Policy Statement. Similar comments also are made by the OSBA at 4-5, PECO at 6, EA

at 8, and UGI at 10. Duquesne agrees with these commentators that multiple, new and undefined standards could result in litigation and paralyze procurement, especially if prospective bidders thought that DSPs could abrogate contracts that later turned out not to represent the lowest long-term cost. Duquesne believes that these newly injected requirements may create additional confusion and uncertainty and should be eliminated throughout the regulations and Policy Statement.

B. The Commission Should Not Mandate the Delineation of Customer Groups

Duquesne agrees that the Commission should tailor default service to reflect the market situation faced by different types of customers. Duquesne supports the Commission's suggestion that different procurement strategies may be necessary for different customer classes, consistent with the level of energy knowledge, financial resources, and their opportunity to shop in the competitive market. (Policy Statement at 5.) Reliant, as well as other parties, support this view stating that "different default service adjustment frequencies are appropriate for different customer classes." Reliant comments that "residential and small business customers…may face slower transition to robust competitive offers than large customers due to lower consumption patterns, less financial incentive, and less technological ability to respond to hourly market prices. Therefore, at this stage of development, compared to large customers, a less frequently adjustable default price may be appropriate." (Reliant at 6.) Duquesne agrees.

Furthermore, Duquesne agrees with PECO that the Policy Statement is overly prescriptive by delineating certain "customer groupings." (PECO at 2, 6.) Both the regulations and the Policy Statement should make it clear that DSPs should have discretion on how best to group customers. For Duquesne's service territory, Duquesne

supports PPL's position that customers should be divided into three categories: 1) residential, 2) small C&I, and 3) large C&I. (PPL at 16.)

C. Shifting Costs From Distribution to Default Service Rates Should Proceed Cautiously, If At All

Duquesne agrees with the OCA that further reallocation of costs from distribution rates to default service rates should be undertaken cautiously. (OCA at 21.) Only avoidable or incremental costs should be assigned to the PTC and each cost element must be analyzed to determine exactly what is avoided when a customer leaves the system, and should take into account that the DSP must stand ready to serve any returning customer. (OCA at 24.) Similarly, the OSBA comments that the only costs to be shifted to the default service rates are those which the EDC would be able to avoid if it were not the DSP. (OSBA at 9.) Previous efforts to unbundle these costs in California and New York have proven to be time consuming, litigation-intensive, and controversial.[28] Further, they have resulted in very little benefit in terms of retail competition. Given this, Duquesne questions whether such a difficult and contentious process as unbundling is fruitful at this time. In any event, if the Commission does proceed with this effort, the Commission should clarify that only avoidable and incremental costs will be considered.

[28] Duquesne strongly opposes NEMA's position that such costs should be unbundled on an embedded cost basis. (NEMA at 5.) This will result in stranded utility costs and not send customers proper economic price signals for switching decisions.

D. The Requirement to Eliminate Demand Charges and Declining Energy Blocks Should Be Clarified Or Removed

Duquesne currently supports eliminating declining block rates and demand charges from generation rates over time.[29] Other parties also appear to support this position (OSBA at 8, Dominion at 10, Constellation at 2, Penn Future at 3, PPL at 14, and FE at 11), while some parties oppose the elimination of demand charges and declining block rates (IECPA at 11, AE at 9, and PECO at 11). First, Duquesne wants to clarify its position in support of FE's and IECPA's comments. FE interprets the proposal to eliminate demand charges as applying only to the generation component of retail rates. If this is incorrect, and the intent of the Commission is to eliminate the demand charge component of retail transmission rates, then FE opposes this and Duquesne agrees with FE. (FE at 11). Duquesne also agrees with IECPA that transmission and ancillary service cost allocations to customer classes and retail charges, to the extent possible, should recover transmission and ancillary services costs from retail customers in a manner that mirrors PJM's allocation methodology and billing procedures. (IECPA at 13-14.) That is, the PTC may not be entirely recovered on a per kWh basis. Accordingly, Duquesne recommends that the Commission not mandate in its rules, at this time, the total elimination of either demand charges or declining blocks. Duquesne has proposed the elimination of these rate structures in its POLR IV generation rates, but other utilities may have valid reasons to continue that rate design or phase it out over longer periods of time.

[29] If capacity costs, which are primarily demand related, were to increase significantly in the future, then it may make economic sense to reinstitute a demand component in the generation rate.

E. The Commission Should Allow But Not Prefer Reconciliation

While the Commission recommends reconciliation, it does not mandate it. (ANOFR at 4.) In response, many parties have very strong opinions about reconciliation. Most EGSs oppose reconciliation viewing it as anti-competitive and distorting price signals. (Dominion at 2, RESA at 10, Strategic at 8, Direct at 13, NEMA at 4.) Meanwhile, some parties support making reconciliation mandatory. (OSBA at 11, PPL at 13, FE at 11.) The OCA comments that there are advantages and disadvantages to reconciliation and both are permissible under the Competition Act. (OCA at 20-21.) The OCA correctly notes that whether or not there is reconciliation could also influence the supply resources chosen.[30]

In response, Duquesne agrees with UGI that the Commission should allow reconciliation but consider removing any preference for reconcilable default service rates at this time.[31] (UGI at 7.)

Duquesne also agrees with PECO that the regulations should be made clear that a customer cannot avoid reconciliations by switching to an alternative supplier. (PECO at 15.)

F. The Commission Should Not Mandate EDC Exit as DSP At This Time

Duquesne agrees that the EDC should be the initial default service supplier (ANOFR at 8) as do most parties. However, Strategic asserts that EDCs should

[30] For instance, a DSP that reconciles costs and revenues but has concerns about future cost recovery disallowances associated with entering into term contracts that could later be deemed uneconomic by the Commission, may chose to rely solely on spot purchases in order to minimize the DSP's risks.
[31] As the Commission is aware, Duquesne, as the DSP, simply passes through its affiliate contract costs, dollar for dollar, while its unregulated affiliate, Duquesne Power, assumes the market price risks associated with its fixed price contract without any reconciliation.

eventually exit the role as DSP. (Strategic at 10.) Duquesne does not support either the conclusion that it should exit as DSP or prescribing a date certain for this to occur.

G. The Commission Should Not Adopt Monthly Pricing For Small Customers With No Laddering and No Reconciliation

EGS generally support short-term (monthly or quarterly) pricing for small customers with no laddering of contracts and no reconciliation. (RESA at 3, Strategic at 5, NEMA at 3, Dominion at 5, Direct at 3, Hess at 5). Duquesne believes this would be a serious mistake at this stage of market development. Few EGSs are serving small customers and short-term pricing would expose these customers to volatile rates with little opportunity to mitigate rate shock.

H. Other Programs To Facilitate Retail Choice Should Not Be Mandated

RESA proposes that EDCs be required to offer EGSs rate ready and bill ready capabilities. (RESA at 13.) Hess supports both, claiming that companies that offer only "rate-ready" plans, like Duquesne, harm competition for large C&I customers. (Hess at 12-14.) Given that Duquesne has the highest percentage of large C&I customer load shopping of any electric utility in the United States, it is hard to support RESA and Hess' assertions that retail competition is somehow harmed by the lack of a "bill ready" option. However, Duquesne is currently reviewing the possibility of a "bill ready" option, which is somewhat expensive to design and implement. In any event, a "bill ready" requirement should not be mandated without consideration of the cost and a means for recovery of such cost.

In addition, Strategic recommends that the Commission require rate ready billing, purchase of receivables programs, and customer referral programs for each EDC. (Strategic at 9.) While Duquesne already has rate ready billing and has proposed a purchase of receivables program in its POLR IV filing, Duquesne believes a blanket requirement to implement these programs is not warranted without careful consideration of the benefits and costs.[32] In fact, many EGSs argue that under the Commission's proposed rulemaking to establish rates, these programs have little value and will not encourage EGS entry into the market. This further supports Duquesne's position that it is premature for the Commission to mandate such programs absent proper consideration of the benefits and costs.

CONCLUSION

Many parties in this proceeding cite Duquesne as an example of a proven, successful default service plan that is workable for both retail customers and electric generation suppliers. Duquesne has maintained stable rates for residential and small C&I customers, and yet has one of the highest percentages of retail shopping load in the country. Duquesne's experience is truly a success story. What is rather discouraging is that despite this success, Duquesne's default service plans would not have been permitted under the Commission's proposed rules.

Duquesne applauds the Commission for attempting to balance many competing interests in its ANOFR and Policy Statement. However, Duquesne is concerned that the

[32] Duquesne has concerns that customer referral programs do not have ample customer protections and rely on a "bait and switch" approach, whereby customers get minimal savings for a two-month introductory period (less than $3/month) and then are assigned to an unregulated rate not subject to Commission oversight. The OCA also states that customer referral programs could be harmful to customers referring to the O&R program as little more than a "gimmick." (OCA at 72.)

proposed rules may have serious unintended consequences that will frustrate the Commission's objectives. Parties in this proceeding submitted numerous and important comments. These comments, when considered in their entirety, convey several fundamental themes. In particular, consumer advocates express concerns that the proposed rules will result in volatile retail rates with frequent adjustments and over reliance on short-term market prices. EGSs cite fundamental problems with the proposed structure that will result in little or no retail competition in Pennsylvania. Potential wholesale suppliers warn that structured solicitations may suffer from lack of supplier participation and/or may result in high bid prices if the Commission is not careful and a number of issues are not addressed properly. EDCs express concerns that the proposed rules impose multiple and conflicting procurement standards that they may lead to cost disallowances and harm their wires business. Duquesne finds all of these arguments to be compelling and encourages the Commission to proceed with caution. The combination of volatile electric rates, little or no retail competition, and unanticipated negative results from structured solicitations would be extremely detrimental to customers in the Commonwealth.

To remedy this outcome, three changes are necessary: (1) Duquesne respectfully requests that the Commission clarify the effective date of the proposed rulemaking and define it as January 1, 2011, (2) the proposed rules should not mandate a quarterly rate adjustment for residential and small C&I customers, and (3) the proposed rules should provide DSPs discretion in procuring supply at prevailing market prices.

Duquesne appreciates this opportunity to participate and comment.

Dated this 23rd day of March 2007.

Respectfully submitted,

Duquesne Light Company

Fred Eichenmiller, Director
External Affairs