



Duquesne Light

Our Energy...Your Power

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VIA OVERNIGHT DELIVERY

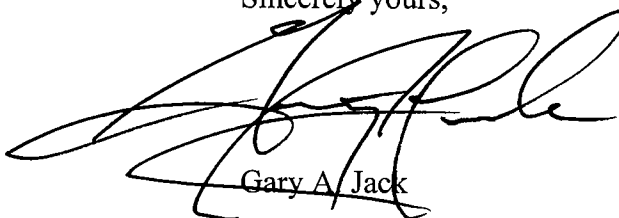
James J. McNulty, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building, 2nd Floor
400 North Street
Harrisburg, PA 17120

Re: Policies to Mitigate Potential
Electricity Price Increases
Docket No. M-00061957

Dear Secretary McNulty:

Enclosed for filing are one original and fifteen copies of Duquesne Light Company's Reply Comments regarding the above-referenced proceeding. Should you have any questions, please do not hesitate to contact me.

Sincerely yours,



Gary A. Jack

Enclosures

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

POLICIES TO MITIGATE POTENTIAL :
ELECTRICITY PRICE INCREASES : **Docket No. M-00061957**

**REPLY COMMENTS OF
DUQUESNE LIGHT COMPANY**

On May 24, 2006, the Pennsylvania Public Utility Commission ("PUC" or the "Commission") entered an Order establishing an *en banc* hearing to address policies to mitigate potential electricity price increase anticipated when long-term generation price caps expire. Pursuant to the schedule established in that Order, Duquesne Light Company ("Duquesne Light" or the "Company") filed written comments on June 15, 2006, and presented testimony at the June 22 *en banc* hearing. At the hearing, Duquesne Light was asked to respond in its reply comments to certain questions asked by Vice-Chairman James Cawley. The Company provides the following response and summary of its position on these issues.

As explained in its Initial Comments, Duquesne Light is uniquely qualified to address the issues raised in the Commission's Order. Duquesne Light's generation rate caps expired much earlier than other major Pennsylvania EDCs. Duquesne Light, unlike many other parties to this proceeding, has had extensive real world experience in providing default service in a post-rate cap environment. This experience has provided critically important information as to what works, and what does not work, in providing default service to customers. For residential and small commercial customers, Duquesne Light currently offers fixed price service to customers with the generation supply obtained in the competitive wholesale market by Duquesne Power. This program has been highly successful, producing the highest level of small customers

shopping in the Commonwealth and reasonable default service at rate levels below those in effect at the time of restructuring. By contrast, for large commercial and industrial customers, Duquesne has been forced to offer hourly pricing as the default service with an optional fixed price service supplied through an RFP process. This program has been very unsuccessful in that it has failed to produce reasonable fixed prices that customers want and does not provide a reasonable default service choice to customers.

Duquesne Light's current default service plan expires at the end of 2007, roughly three years before the generation rate caps expire for the other major Pennsylvania EDCs. Duquesne Light plans to file with the Commission a new 3-year proposal that meets the objectives of promoting competition and providing reasonable service for customers through 2010. This will allow Duquesne to "match up" with the other major Pennsylvania EDCs, so that retail competition can be fully implemented on a statewide basis. In his statement in the UGI default service proceeding, Commissioner Fitzpatrick stated," despite this, I will vote to approve the maximum prices for the practical reason that, due to UGI's small size and the fact that most customers in Pennsylvania continue to pay capped rates, it is unlikely that retail competition will develop in UGI's territory (or in Pennsylvania as a whole) unless and until pro-competitive default service rules are in effect throughout Pennsylvania". Duquesne Light agrees with this statement, and therefore believes that the best approach is to propose a transitional default service plan for three years. This will properly align Duquesne Light with the rest of the state and provide the best framework for implementing statewide retail competition.

During the course of the hearing, Duquesne Light was asked by Vice-Chairman Cawley whether Duquesne Light Company wants to be the "provider of first resort" or the "provider of last resort." (Tr. 104 lines 16-20). While this question may have been asked, at least in part,

rhetorically, it provides an important opportunity to address the EDCs proper role in providing default service to its customers.

First, an EDC's obligation to serve (commonly referred to as "provider of last resort") is specifically defined in Section 2807(e)(3) of the Public Utility Code:

[3] If a customer contracts for electric energy and it is not delivered or if a customer does not choose an alternative electric generation supplier, the electric distribution company or commission-approved alternative supplier shall acquire electric energy at prevailing market prices to serve that customer and shall recover fully all reasonable costs.

Pursuant to this provision, an EDC has an obligation to supply service to customers where the EGS fails to deliver power or where the customer, for whatever reason, does not choose an alternative electric supplier. Nothing in Section 2807, or anywhere else in the Competition Act or the Public Utility Code, says that the terms and conditions of default service should be established in a way that artificially forces customers to choose an alternative supplier. Indeed, the statute itself says that the EDCs shall acquire power at prevailing market prices and recover all "reasonable" costs. This, along with the general obligation to provide service and "just and reasonable" rates under Chapter 13 of the Public Utility Code, demonstrates that the terms and conditions of default service should be reasonable to customers and not artificially manipulated or constrained to promote retail competition at all costs. While the term "provider of last resort" may be a useful description of EDCs obligations under Section 2807, the term should not be used as the basis for any policy decisions as to the appropriate terms and conditions of default service.

Second, while retail competition was clearly a goal of the Customer Choice and Competition Act, it is not the only goal and clearly not the only factor to be considered. For example, Item (6) of the Act's Declaration of Policy, 66 Pa.C.S. § 2802(6), notes that: "The cost

of electricity is an important factor in decisions made by businesses concerning locating, expanding and retaining facilities in this Commonwealth.” Here, the Legislature clearly considered job retention and expansion to be important purposes of the Act, and the provision of default service should also advance this purpose.

Similarly, Item 9 of the Customer Choice Act’s Declaration of Policy, states: “Electric service is essential to the health and well-being of residents, to public safety and to orderly economic development, and electric service should be available to all customers on reasonable terms and conditions.” (66 Pa.C.S. § 2802(9); emphasis added). Under this provision, the Commission clearly should approve Default Service energy acquisition strategies that further the goal of reasonably priced electric service while the market develops. The legislature certainly did not envision or desire competition "at all cost," including huge price increases for customers, and onerous and unattractive terms and conditions for default service in order to artificially force customers to choose an alternative supplier and thereby create the false appearance of true competition.

Nor does the phrase "prevailing market prices" require the Commission to set default service rates based solely on short-term market conditions, as some have argued. First, the term "prevailing market prices" should not be read in isolation. Section 2807(e)(3) goes on to say that the EDC shall be allowed to recover all "reasonable" costs. Thus, the EDC must act "reasonably" in procuring supply for default service. For example, simply purchasing all default service supply in the volatile hourly spot market and seeking to pass all costs along to customers is not "reasonable" and cannot be supported simply because it might promote retail competition. Instead, the EDCs must have the discretion to acquire supply under a portfolio approach and to offer pricing options to customers. This is consistent not only with the "reasonableness"

requirement of Section 2807, but also the reference to prevailing market prices, in the plural, rather than a single specified short-term market price. The legislature, by requiring the Commission to promulgate regulations on this issue, clearly expected the Commission to exercise its discretion and to establish a default service that was "reasonable" as to cost and that produced "just and reasonable" rates to customers.

To answer, Vice-Chairman Cawley's question directly, Duquesne Light wants to provide default service to customers on reasonable terms and conditions, consistent with its obligations under the Competition Act and the Public Utility Code, as a whole. Duquesne Light believes that its default service program and the proposed program for 2008-2010 outlined at the June 22 hearing will fully meet these requirements.

In Duquesne Light's view, the appropriate role for the Commission is to balance the interests of customers, suppliers and EDCs, along with the public interest, and develop default service regulations, which fairly balance these interests. Such regulations should certainly promote retail competition, but they also should carefully consider the impact on customers, economic development and the EDCs who retain the statutory obligation to provide default service. Many factors obviously should be involved in making these determinations. However, these determinations should not and need not be based on mistaken notions that that Chapter 28 mandates competition at all costs and without regard to the Commission's other and equally important obligations under the Public Utility Code.

For these reasons and as set forth in its Initial Comments, Duquesne Light believes that its current fixed rate default service program achieves this balancing of interests in a fair and reasonable way. It provides reasonable fixed prices to customers, based on prevailing market conditions at the time rates are established thereby avoiding the risks and volatility of spot

market prices. It also promotes competition. Vice-Chairman Cawley also asked, “why is it that companies like U. S. Steel want to go with Duquesne Light”. (Tr.105 lines 2-3). The short answer is that C& I customers are not choosing Duquesne Light Company. Especially large Commercial and Industrial customers where 88% of customers and 96% of the load (KWhs) have switched to an EGS. Additionally, over 20% of residential and small commercial customers have switched to EGS’s. It is apparent, however, that many large C & I customers are not being offered the type of contracts they need to run their business efficiently. As Mr. Chris Navetta, Senior Vice President of U. S. Steel states, “Large industrial customers require an electrical supply that is not only available and reliable, but also predictable in cost in order for these customers to efficiently operate and compete in their markets. Hourly price service frequently results in abrupt and arbitrary price increases and this volatility is not acceptable or competitive for large customers. The Commission should permit electric distribution companies or EDCs to offer long-term, fixed price electrical supply contracts to industrial customers as a form of default service”. Tr. at page 41, lines 7-17.

Overall, Duquesne clearly has the most successful retail competition program in Pennsylvania and one of the most successful in the country, clearly demonstrates that in addition to promoting competition, a fair and reasonable default service offering to customers should remain a part of an effective retail competition program.

Respectfully submitted,
Duquesne Light Company



Frederick J. Eichenmiller, Director
Rates & Regulatory
July 20, 2006