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March 1, 2010

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

VIA HAND DELIVERY

RE: Petition of Duquesne Light Company for Approval of its Smart Meter Procurement and Installation Plan; Docket No. M-2009-2123948

Dear Secretary McNulty:

Enclosed for filing with the Pennsylvania Public Utility Commission are the original and nine (9) copies of the Reply Exception of the Duquesne Industrial Intervenors ("DII") in the above-referenced proceeding.

As shown by the attached Certificate of Service, all parties to this proceeding are being duly served. Please date stamp the extra copy of this transmittal letter and Reply Exception, and kindly return them to our messenger for our filing purposes.

Very truly yours,

McNEES WALLACE & NURICK LLC

By 
Carl J. Zwick

Counsel to the Duquesne Industrial Intervenors

CJZ/sds
Enclosures

- c: Administrative Law Judge Robert P. Meehan (via E-mail and First-Class Mail)
- Cheryl Walker Davis, Director, Office of Special Assistants (via E-mail and Hand Delivery with diskette in Word format)
- Certificate of Service

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**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Petition of Duquesne Light Company :
for Approval of its Smart Meter : **Docket No. M-2009-2123948**
Procurement and Installation Plan :

**REPLY EXCEPTION OF THE
DUQUESNE INDUSTRIAL INTERVENORS**

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Dated: March 1, 2010

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I. INTRODUCTION

On January 21, 2010, Administrative Law Judge ("ALJ") Robert P. Meehan issued his Initial Decision ("I.D.") in this proceeding. Among other things, the I.D. recommended that the Pennsylvania Public Utility Commission ("PUC" or "Commission") reject both Duquesne Light Company's ("Duquesne" or "Company") and the Office of Consumer Advocate's ("OCA") common cost allocation approaches and adopt the Office of Small Business Advocate's ("OSBA") alternative cost allocation proposal. Because the Duquesne Industrial Intervenors ("DII") supported the Company's cost allocation approach, DII filed a limited Exception urging the Commission to reject the I.D.'s determination that the common costs of the Company's Smart Meter Technology Procurement and Installation Plan ("Smart Meter Plan" or "Plan") should be allocated among customer classes in the same proportion as the Company's direct meter costs.

DII received Exceptions from the OCA, the OSBA, the Office of Trial Staff ("OTS"), the Pennsylvania Department of Environmental Protection ("DEP"), and Citizen Power, Inc. ("Citizen Power"). DII's Reply Exception responds specifically to OCA Exception No. 4/Citizen Power Exception No. 1 raised by the OCA and Citizen Power. In summary, DII submits that none of the arguments presented by the OCA and Citizen Power would require the Commission to deviate from PUC precedent requiring meter costs to be allocated to customers in accordance with well-established cost of service principles, which require common costs to be allocated on a customer basis. As discussed more fully herein, none of the arguments raised in the OCA's and Citizen Power's Exceptions adequately justify any deviation from sound ratemaking precedent. For that reason, DII respectfully request that OCA Exception No. 4/Citizen Power Exception No. 1 be denied.

II. REPLY EXCEPTION

1. *Reply to OCA Exception No. 4 (p. 14)/Citizen Power Exception No. 1 (p. 5): The Administrative Law Judge Correctly Rejected the OCA's and Citizen Power's Approach to the Allocation of Smart Meter Common Costs.*

The OCA and Citizen Power oppose Duquesne's reasonable and rational approach for assigning the non-direct, or common, costs of the Smart Meter Plan based on the number of customers in each class. See OCA Exceptions, pp. 14-26; Citizen Power Exceptions, pp. 5-6. Rather, the OCA and Citizen Power claim that the Company should assign these costs to customers "based on energy and demand." OCA Exceptions, p. 15; see also Citizen Power Exceptions, p. 5. According to the OCA, such an allocation proposal "recognizes the purpose of Act 129 and the cause of the incurrence of costs." Id. The OCA and Citizen Power except to the ALJ's rejection of the demand/energy allocation of common costs. The Exceptions of the OCA and Citizen Power should be denied.

As explained in detail by DII throughout this proceeding, the OCA's proposed cost allocation approach, which is supported by Citizen Power, is unsubstantiated and would require Duquesne to allocate common costs based on a "value of service" approach (i.e., according to a customer's energy or demand consumption). See DII Main Brief ("M.B."), pp. 8-11; DII Reply Brief ("R.B."), pp. 2-9. This is true even though no nexus exists between the cost to the Company for the Smart Meter Plan and a customer's energy or demand consumption, particularly with respect to the non-direct costs of administering the smart meter communication network and other back office systems. Id. Accordingly, the I.D. properly rejected the OCA's cost allocation proposal, ruling that "[t]he OCA's proposal . . . is both theoretical and speculative as to which and how customers in the various classes will 'benefit' from the [Smart Meter Plan] and . . . is not

based on reasonable cost of service practices, and results in an unreasonable allocation of the common costs to the multi-phase customer group." I.D., p. 19.

A. The OCA and Citizen Power Misinterpret the Implementation Order and Offer No Reasonable Justification in Fact or Law for Assigning Costs to Customer Classes on a "Value of Service" Basis.

As Duquesne, the OSBA, and DII explained during the briefing stage of this proceeding, the Company's approach for allocating both the direct and common costs of the Smart Meter Plan is squarely within the Commission's long-standing precedent for establishing rates based on a utility's cost of providing the service. See Duquesne M.B., pp. 22-23; OSBA M.B., pp. 8-9; DII M.B., pp. 5-6. The Commonwealth Court of Pennsylvania ("Commonwealth Court") and the Commission have clearly held that a utility's cost of providing service must be the guiding principle – or "polestar" – in utility ratemaking. DII M.B., pp. 5-6 (citing Lloyd v. Pa. Pub. Util. Comm'n, 904 A.2d 1010, 1020 (Pa. Commw. Ct. 2006)); see also, e.g., Pa. Pub. Util. Comm'n v. Philadelphia Gas Works, Docket Nos. R-2008-2073938, 2009 WL 884424 *5 (Order entered Mar. 26, 2009) (upholding natural gas utility rates as consistent with Lloyd by reason of the rates being properly derived from a cost of service analysis and subject to cost of service review in future base rate case). The Commission has since applied the Court's directive in Lloyd by recognizing that, while other factors may be considered, cost of service should be the primary consideration for ratemaking purposes. See, e.g., Pa. Pub. Util. Comm'n v. PPL Elec. Utilities Corp., Docket No. 00049255, 2007 WL 2198189 *7-10 (Order entered Jul. 25, 2007) (PUC order citing Lloyd in support of settlement of distribution rate increase based on cost of service principles).

In accordance with the Commonwealth Court's and Commission's ratemaking mandate, the Company is required to observe cost causation principles when developing customer rates,

including rates associated with such measures as the Smart Meter Plan. See Lloyd, 904 A.2d at 1020; Smart Meter Procurement and Installation, Docket No. M-2009-2092655 (Order entered June 24, 2009) ("Implementation Order"), p. 32. The Commission expressly confirmed this cost of service mandate in its Implementation Order. Id. The Implementation Order clearly establishes two distinct means by which the Company is required to allocate costs: (1) direct costs are to be assigned to the customers who receive the direct benefits from those costs; while (2) costs whose benefits are not directly assignable to a specific customer class are to be assigned using "reasonable cost of service practices." Id. The OCA's attempt to shift common costs from the Residential class to the Commercial and Industrial ("C&I") classes on the basis of alleged "benefits" that customers might receive from the Smart Meter Plan represents an allocation based on "value of service" principles, which is contrary to reasonable cost of service ratemaking practices.

The OCA has not provided any legal support for deviating from this long-standing precedent, except to cite Illinois Commerce Commission v. FERC, 576 F.3d 470, 476 (7th Cir. 2009) ("ICC"), which is an appeal of a Federal Energy Regulatory Commission ("FERC") order regarding the allocation of transmission network improvement and enhancement costs. See OCA Exceptions, pp. 19-20. Initially, it should be noted that the case is not binding precedent in this situation because it was decided by a federal court that exercises no jurisdictional authority over the Commonwealth of Pennsylvania and because it addresses costs that are not similar to the smart meter costs at issue here. See ICC, 576 F.3d at 476. Specifically, in ICC, the Seventh Circuit ruled that a utility, which was situated in the western part of the PJM Interconnection, L.L.C. ("PJM") region, should not be allocated network enhancement and improvement costs, on a pro rata basis, because such costs were incurred to upgrade the grid in the eastern portion of the

PJM. Id. at 476-77. As such, according to the Seventh Circuit, the upgrades and associated costs could not be shown to provide "benefit" to the westerly-situated utility. Id. The ICC decision deals only with the first step of the cost allocation inquiry (i.e., determining what groups of customers benefit from the investment). DII and other parties advocating for the use of reasonable cost of service principles in this proceeding do not contest that the common costs benefit both customers with single-phase meters and customers with poly-phase meters. The ICC decision does not address the second step of the cost allocation inquiry, which is contested here, regarding how costs are allocated among the groups or classifications of customers that benefit (i.e., using reasonable cost of service principles as supported by DII or using the OCA's "value of service"/"relative benefits" theory). Thus, the OCA's reliance on the ICC case to support its preferred methodology to allocate the common costs between the two customer classifications is misplaced. As such, the ICC case offers no support for the OCA's and Citizen Power's position.

The OCA also attempts to discount the I.D.'s reliance on Lloyd in rejecting the OCA's "benefits"-based allocation proposal, arguing that, aside from requiring a utility's cost of providing service to be the "polestar" in utility ratemaking, Lloyd upheld the energy-based allocation of Sustainable Energy Fund ("SEF") program costs to all distribution ratepayers on the basis that all ratepayers benefited from SEF activities. See OCA Exceptions, p. 19. The SEF costs referenced in Lloyd, however, were social programming costs that the Court determined provided a public benefit to all customers. Lloyd, 904 A.2d at 1026-27. Unlike the SEF costs at issue in Lloyd, the common costs of the Smart Meter Plan do not provide a public, or societal, benefit to customers; rather, these common costs are required for the development and installation of smart meter infrastructure. These infrastructure costs are no different from the

infrastructure costs that are addressed in every distribution base rate proceeding. Thus, the OCA's argument that Lloyd somehow supports its "value of service" ratemaking approach is misplaced and must be rejected by the Commission.

Moreover, the method of allocating SEF costs among classes of ratepayers was not contested in the Lloyd proceeding – the parties in that proceeding contested the mere inclusion of the social programming costs in any customer distribution rates. Id. at 1024-25. The Commission and the Court were not asked to decide among competing allocation methodologies, which is the central issue here. Thus, the OCA's reliance on the Lloyd decision to support the use of a kWh allocation in this proceeding is again misplaced.

Furthermore, by attempting to assign non-direct costs to C&I customers based on "value of service," the OCA misinterprets (or obfuscates) the Commission's clear directive to Duquesne in the Implementation Order to assign such costs on reasonable cost of service principles. See generally DII M.B., pp. 8-11; see also Implementation Order, p. 32. As noted above, the Implementation Order specifically states that "[a]ny costs that can be clearly shown to benefit solely one specific class should be assigned wholly to that class." Implementation Order, p. 32 (emphasis added). The OCA, however, attempts to extend this language to convince the Commission that all costs, even those that provide benefit across multiple classes, should be assigned to all customers according to speculative and unknown "benefits." See OCA Exceptions, p. 16. In making its argument, the OCA completely ignores the Implementation Order's clear mandate that "[t]hose costs that provide benefit across multiple classes should be allocated among the appropriate classes using reasonable cost of service practices." Implementation Order, p. 32 (emphasis added). The Implementation Order does not state that

common costs are to be allocated on the basis of the relative benefits that various customer classes may achieve after the infrastructure is installed.

In addition, the OCA asserts that "[t]he common costs at issue in this proceeding do not benefit one class solely nor do they benefit all classes equally." OCA Exceptions, p. 23. In an attempt to substantiate this claim, the OCA references Duquesne's American Reinvestment and Recovery Act ("ARRA") grant application in which Duquesne attempted to generically identify the benefits that may accrue to customers as a result of smart meter technology. Id. at 24. The OCA's reliance on this "generic" data is misplaced. As the Company stated in its Main Brief:

Importantly, OCA's theory regarding benefits allocation was based in part upon . . . an assessment of benefits that Duquesne submitted in conjunction with its U. S. DOE Stimulus application for grants. OCA failed to take into account that the benefits only took into account the first year of smart meter installation, which was only 8,000 meters. Further, Witness Swan incorrectly presumed that the stimulus filing, and associated exhibits, would have the same implementation plan as the [Smart Meter] Plan. To the contrary, the criteria examined in the stimulus filing were different than that examined for the [Smart Meter] Plan. Thus, the underlying data on which OCA relies for its theory is not appropriate. In summary, Duquesne reaffirms its desire to allocate common costs based upon meters.

Duquesne M.B., pp. 23-24 (citations omitted).

Moreover, by erroneously basing its "value of service" allocation proposal on the assertion that common costs do not "benefit" all classes equally, the OCA completely disregards the cause of the common costs. As Duquesne accurately explained in its Main Brief:

Duquesne's position is that the common costs should be allocated based upon cost causation, using reasonable cost of service practices. This is appropriate because all of the functions of the common infrastructure (collect, back haul, store and maintain data) are required equally for each meter, regardless of the benefits realized or the size of the customer. Cost allocation based upon number of meters, as opposed to benefits as the OCA suggests, is

appropriate as the costs are established based upon the number of meters, not hypothetical or proposed benefits.

Duquesne M.B., pp. 22-23 (citations omitted); see also Duquesne Exhibit D-R, Rebuttal Testimony of William V. Pfrommer ("Duquesne Ex. D-R"), pp. 5-6; DII Statement 1-R, Rebuttal Testimony and Exhibit of Richard A. Baudino ("DII St. 1-R"), pp. 4-5. As Duquesne properly recognizes, the common costs of the Smart Meter Plan – which are incurred to develop and install the smart meter common infrastructure – do benefit all classes equally. As such, a customer allocation is appropriate.

Accordingly, the OCA's proposed allocation approach, which is supported by Citizen Power, does not adhere to the cost causation principles applied by the Company in its filing. Moreover, the OCA proposes an unsubstantiated "value of service" methodology that is inappropriate for the costs at issue. For these reasons, OCA Exception No. 4/Citizen Power Exception No. 1 should be firmly rejected by the Commission.

B. The OCA's and Citizen Power's Analyses of the "Benefits" of the Smart Meter Plan Misinterpret Act 129 and Are Otherwise Inapplicable to the Large C&I Class.

In addition to the fact that the OCA and Citizen Power have provided no valid legal support or justification for the proposal to require Duquesne to assign non-direct costs on an energy and demand basis, the OCA's and Citizen Power's arguments are incurably flawed for a number of other reasons. See generally DII M.B., pp. 8-11. Primarily, the OCA's "value of service" proposal not only obfuscates the Commission's clear cost of service mandate, but also mischaracterizes the actual benefits that the General Assembly and the Commission anticipate will result from the Smart Meter Plan. See id. at 9-11. Moreover, the OCA and Citizen Power fail to provide reasonable support and justification to substantiate the energy and demand "benefits" that will purportedly result from the Smart Meter Plan and fail to explain how C&I

customers will experience such "benefits" to a greater degree than Residential customers. In short, the OCA and Citizen Power provide no factual basis for the attempt to shift a large portion of non-direct, common costs from the Residential class to the Large C&I class.

The OCA's "cost of service" analysis boils down to the argument that because the purpose of Act 129 of 2008 ("Act 129" or "Act") is to encourage demand and energy reductions, and because Large C&I customers use more energy and have higher demands, Large C&I customers should pay a higher portion of the common implementation costs than would occur under standard cost allocation methodologies. If taken to its logical conclusion, the OCA's theory would result in the allocation of all distribution-related common costs on an energy basis because the distribution system exists to deliver electricity to customers, and larger customers "benefit" from it more because they use more energy. This conclusion, and the OCA's proposal, contradicts decades of cost of service precedent, which requires the Commission to look at the nature of the costs, rather than the theoretical benefit that a particular customer obtains from the service, in determining how to allocate costs.

The OCA and Citizen Power attempt to disguise its "value of service" ratemaking proposal as a cost of service approach by claiming that the common costs of the Smart Meter Plan, for each customer class, are derived from the "benefits" that each class will receive and that these "benefits" are somehow related to energy and demand reductions. See generally OCA Exceptions, pp. 14-26; Citizen Power Exceptions, pp. 5-6. To support this "value of service" cost allocation proposal, the OCA concludes that "the benefits realized by the two meter groups identified by the Company would be in proportion to the amount of energy and capacity used by the two groups." OCA Exceptions, p. 9; see also Citizen Power Exceptions, p. 6. The OCA and

Citizen Power, however, fail to provide any reasonable support for this categorical conclusion.¹ In fact, because the current Large C&I meters have provided access to dynamic pricing options such as time-of-use and real-time pricing, as well as PJM demand response programs, the relative incremental benefit to Large C&I customers may be minimal in comparison to the benefits to other customer classes that do not currently have access to dynamic pricing and demand response options. For this reason alone, the OCA's proposal, which is supported by Citizen Power, must be rejected by the Commission.

Even assuming, arguendo, that the OCA is correct that "[common] costs should be allocated to customer classes in some reasonable proportion to the benefits received by each class from the planning and implementation of the smart meter system,"² the OCA fails to properly identify the actual benefits of the Smart Meter Plan. DII M.B., p. 34. The OCA suggests that the "benefits" caused by the common costs of the Plan are related to speculative energy and demand savings that customers may realize.³ In making this argument, the OCA is essentially claiming that the expected benefits of the Smart Meter Plan are the same as the overarching policy goals of Act 129 (i.e., to provide energy and demand savings to customers). See 66 Pa. C.S. § 2806.1(a). While the Smart Meter Plan is required by Act 129, its purposes and expected benefits are distinctly different. Of fundamental importance, the primary benefits of the Plan to customers, as clearly set forth and anticipated by Act 129, are not the actual reduction in energy and demand consumption, but the provision of "access to and use of price and consumption information," the provision of "hourly consumption" data, the enablement of

¹ As noted above, the OCA inappropriately relies on the Company's ARRA grant application to support its conclusion.

² OCA Exceptions, p. 16.

³ The speculative nature of these benefits is especially true in the Duquesne service territory, because larger customers have been exposed to market prices for many years now.

"time-of-use and real-time price programs," and the potential for "automatic control" of electricity consumption. 66 Pa. C.S. § 2807(g)(1)-(3) (emphasis added). The installation of smart meters throughout the Commonwealth, in and of itself, cannot and will not directly produce any energy or demand savings, nor will such measures compel customers to behave differently with respect to energy consumption. See, e.g., Duquesne M.B., p. 23 (noting that "OCA's assumptions about customer participation in dynamic pricing programs, and associated benefits that will follow . . . are unfounded. No evidence is provided to support this statement, and in fact, Duquesne's experience proves that assumptions cannot be made regarding customer behavior."). At most, the identifiable benefits of the Smart Meter Plan (i.e., access to and use of price and consumption information) are pursued only in support of the overarching policy goals of Act 129. The Smart Meter Plan ensures that the infrastructure and equipment are in place, while the Company's Energy Efficiency & Conservation ("EE&C") Plan, PJM's Load Response Programs, and pricing options that competitive suppliers may offer to customers provide the impetus for the actual demand and energy reductions.

The OCA also contends that the smart metering benefits will "derive from customer participation in dynamic pricing programs, including time-of-use, real time and critical peak time pricing options." OCA Exceptions, p. 24. The OCA argues that Large C&I customers will experience a "greater benefit" than other classes of customers because Large C&I customers will have "greater response" to dynamic pricing programs. Id. at 24-25. This position is clearly speculative. As correctly recognized by Duquesne witness, Mr. Pfrommer:

because [large C&I] customers already have an interval meter [that meets the minimum requirements of Act 129], and they are much more sophisticated electricity consumers[,] they have already achieved much of the benefits anticipated from a smart meter and there is not much to gain from the installation of a smart meter required by the Act. Therefore, their expected benefits would be

lower for large C&I customers than those expected benefits of other customer classes without interval meters *since they have already received those benefits.*

Duquesne Ex. D-R, p. 7 (emphasis added); see also DII St. 1-R, pp. 6-7; Duquesne Exhibit C, Direct Testimony of Ruth Ann DeLost ("Duquesne Ex. C"), p. 9. Since Duquesne's rate caps expired, Large C&I default service customers have had the types of price responsive generation products that smart meters will enable for other customer classes, including time-of-use rates, hourly real-time pricing, and now a day-ahead hourly price. Initial Hearing Transcript ("Tr."), pp. 86-87; see also DII St. 1-R, pp. 6-7. If these were benefits to be gained by Large C&I customers from the Smart Meter Plan, those benefits have already been achieved (or at least achievable) under Duquesne's current metering system. Large C&I customers should not be required to pay a disproportionate share of the costs to install infrastructure to extend similar pricing options to other customer classes.

The OCA also fails to recognize that access to information – the core purpose of smart meter technology – is useless unless a customer is provided with an internal and/or external motivation to change its consumption pattern (e.g., rate options that reward efficient energy usage or that penalize inefficient energy usage). As discussed above in Mr. Pfrommer's testimony, more than 93% of the Company's Large C&I customers currently shop and have for years. See Duquesne Ex. D-R, p. 7. As such, for many years now, most larger customers have already received service from electric generation suppliers ("EGSs") at rate options other than Duquesne's default service rate. In addition, it is also important to recognize that EGSs, unlike electric distribution companies ("EDCs"), have no obligation, under the Act or any Commission directive, to offer time-of-use or critical peak pricing options to customers. Tr. at 162. As acknowledged by OCA witness, Dr. Swan, on cross examination, an EGS will not structure such

a rate option to produce a loss. Tr. at 161. Because an EGS will structure any rate option with some percentage of profit margin, the amount of savings, if any, that may be realized by customers that participate in such pricing programs is speculative and unknown. As such, basing the allocation of non-direct, common costs upon such tenuous and unsubstantiated "value of service" principles is unreasonable and should be rejected. As noted by Duquesne witness, Mr. Pfrommer, the Company recognizes that "[a]ttempting to allocate costs by customer type and predicted customer reaction is speculative and not appropriate for cost allocation." Duquesne Ex. D-R, p. 7.

Admittedly, the use of the proper cost of service based customer allocator to assign responsibility for common costs associated with the Smart Meter Plan results in Residential customers bearing a greater share than the use of an energy and/or demand allocator would. However, given the types of costs at issue, and the ability of Duquesne's current metering system to meet the data access goals of Act 129 for Large C&I customers, it is appropriate for the Residential class to bear its appropriate share of the smart meter costs through the use of a customer allocator. As Duquesne noted in its Main Brief:

Duquesne's current meter environment for Large C&I customers meets all of the requirements of Section 2807(g) and the Implementation Order, with the exception of remote connect and disconnect and billing functionality. However, Duquesne does not have the network, communications, bandwidth and systems in place to expand this zone-wide, thus Duquesne will be required to undergo significant analysis during the Grace Period.

Duquesne M.B., p. 12 (citations omitted). In other words, if smart meters were being implemented only to benefit larger customers, the current system is largely compliant and a portion of the significant work in the Plan would not be necessary. Because, however, Duquesne is implementing smart meters for all classes so it can provide new options and functionalities to

Residential and Small Commercial customers, the costs are greater and the customers obtaining the new services must pay their fair share. A cost of service based allocation of the common costs, as proposed by Duquesne and supported by DII and OSBA, achieves this just and reasonable result.

The OCA's proposed "value of service" allocation methodology, which Citizen Power supports, is inappropriate and inapplicable to this proceeding. In addition, even assuming, arguendo, that such a methodology could be used, neither the OCA nor Citizen Power has provided any quantification of the energy and demand "benefits" that would purportedly result from this rate allocation. Accordingly, OCA Exception No. 4/Citizen Power Exception No. 1 must be denied.

III. CONCLUSION

WHEREFORE, the Duquesne Industrial Intervenors respectfully request that the Pennsylvania Public Utility Commission deny the Office of Consumer Advocate's Exception No. 4 and Citizen Power, Inc.'s Exception No. 1, and grant DII's Exception No. 1 supporting a customer allocation of the common costs for Duquesne's Smart Meter Plan.

Respectfully submitted,

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Dated: March 1, 2010

CERTIFICATE OF SERVICE

I hereby certify that I am this day serving a true copy of the foregoing document upon the participants listed below in accordance with the requirements of Section 1.54 (relating to service by a participant):

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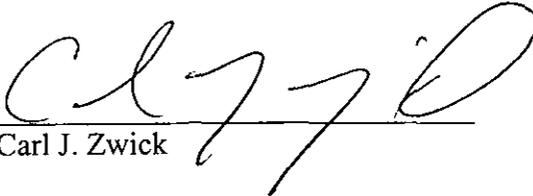
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Dated this 1st day of March, 2010, in Harrisburg, Pennsylvania.