

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Pennsylvania Public Utility Commission	:	Docket Nos. R-2010-2179522
Office of Small Business Advocate	:	C-2010-2193322
Office of Consumer Advocate	:	C-2010-2194660
Linda L. Sullivan	:	C-2010-2153066
Janet Vento	:	C-2010-2196479
Mary M. Chestnut	:	C-2010-2196790
Donald W. Killmeyer	:	C-2010-2199926
Sarah Divilly	:	C-2010-2199945
Delores D. White	:	C-2010-2200548
Vicki Courie	:	C-2010-2201179
Rebecca Nesvet	:	C-2010-2202732
Marie Rubottom	:	C-2010-2202837
Duquesne Industrial Intervenors	:	C-2010-2203197
Carolina Ursitti	:	C-2010-2203912
Donald J. Gilbert	:	C-2010-2204100
NRG Energy Center Pittsburgh, LLC	:	C-2010-2206586
Jay Folkens	:	C-2010-2213076
John and Sherry Urban	:	C-2010-2214197
	:	
Complainants,	:	
	:	
v.	:	
	:	
Duquesne Light Company,	:	
	:	
Respondent	:	

**DUQUESNE LIGHT COMPANY
STATEMENT IN SUPPORT OF THE
JOINT PETITION FOR SETTLEMENT OF ALL ISSUES**

TO ADMINISTRATIVE LAW JUDGES MARK A. HOYER AND CONRAD A. JOHNSON:

I. INTRODUCTION

Duquesne Light Company (“Duquesne Light” or “Company”) hereby submits this Statement in Support of the Joint Petition for Settlement of all Issues (“Settlement”) entered into

by the Office of Trial Staff (“OTS”) of the Pennsylvania Public Utility Commission (“Commission”), the Office of Consumer Advocate (“OCA”), the Office of Small Business Advocate (“OSBA”), the Duquesne Industrial Intervenors (“DII”), NRG Energy Center Pittsburgh LLC (“NRG”) and Duquesne Light (collectively, the “Joint Petitioners”).¹ The Settlement, if approved, will resolve all issues in the above-captioned proceeding. Duquesne Light believes that the Settlement achieved in this proceeding is in the best interests of the Company, its customers and the parties.

Initially, the complete Settlement among all active parties in this major electric rate proceeding, in and of itself, provides strong evidence that the Settlement is reasonable and in the public interest, particularly given the diverse interests of these parties and the active role they have taken in this proceeding.

Moreover, the Settlement was achieved only after a comprehensive investigation of Duquesne Light’s operations and finances. In addition to informal discovery, Duquesne Light responded to more than 435 formal discovery requests, many of which had multiple subparts. Parties filed five rounds of testimony, including the Company’s direct testimony, Company’s supplemental testimony to respond further to Commission-identified matters, other parties’ direct testimony, rebuttal testimony and surrebuttal testimony. Moreover, the parties participated in numerous settlement discussions and formal negotiations which ultimately led to the Settlement.

Finally, the parties in this proceeding, and their counsel, have considerable experience in rate proceedings. Their knowledge, experience and ability to evaluate the strengths and weaknesses of their litigation positions provided a strong base upon which to build a consensus in this proceeding for a settlement of all issues.

¹ Citizen Power, Inc. (“Citizen Power”) and the International Brotherhood of Electrical Workers, Local 29 (“IBEW”), parties in this proceeding, do not oppose this Settlement and will submit letters of non-opposition contemporaneously with the filing of this Settlement.

The Settlement reflects a carefully balanced compromise of the interests of all of the Joint Petitioners. For these reasons and the reasons set forth below, the Settlement is just and reasonable and should be approved.

Duquesne Light notes that the Commission identified several matters to be addressed in the proceeding in its Order suspending (“Suspension Order”) the Company’s base rate filing entered on September 16, 2010. In addition, in the Prehearing Order issued by Administrative Law Judges Mark A. Hoyer and Conrad A. Johnson (the “ALJs”) on October 4, 2010, the ALJs directed parties to address the matters identified by the Commission in its Suspension Order in parties’ Statements in Support in the event that parties reached a settlement in this proceeding. Duquesne Light submitted supplemental testimony to address the matters noted in the Commission’s Suspension Order and the ALJs’ Prehearing Order. Duquesne Light will summarize its responses to the matters identified by the Commission in its Suspension Order in Section III below.

II. SPECIFIC SETTLEMENT TERMS

A. Revenue Requirement

The Settlement provides for a distribution revenue increase of \$45.7 million which includes future test year universal service costs that will be recovered through the implementation of the Company’s proposed Universal Service Charge (“Rider No. 5”) and consumer education costs to be recovered through the Consumer Education Surcharge (“Rider No. 1”).² The distribution revenue increase of \$45.7 million is approximately 52% of the Company’s original request of \$87.3 million.

² In addition, the Settlement provides that the initial charge under Rider No. 5 will also reflect projected increases in universal service costs subsequent to the future test year, and be subject to annual reconciliation.

As explained by the Company's Director of External Affairs, Mr. Frederick J. Eichenmiller, the combination of the recent financial crisis/economic downturn and new funding rules under the Pension Protection Act of 2006 ("PPA") require Duquesne Light to make significant contributions to its pension plan in the future test year of this case, as well as in subsequent years. Duquesne Light St. No. 1, p. 4. The financial crisis/economic downturn also is increasing the Company's costs for providing assistance to low-income customers under the Company's Customer Assistance Program ("CAP"). Moreover, as of the end of the future test year, Duquesne Light will have increased its net utility distribution plant by approximately \$263 million since its last base rate proceeding in 2006. Duquesne Light St. No. 1, p. 4. Duquesne Light filed its last distribution rate case in the spring of 2006.

Due to these factors, the Company's overall rate of return on rate base was decreasing over the past several years. As explained by Mr. Eichenmiller, the Company's overall return on rate base for the future test year ending March 31, 2011 was projected to be only 5.48%. Duquesne Light St. No. 1, p. 8. This is lower than the Company's long-term debt cost rate of 6.07%. Duquesne Light St. No. 12, p. 20. The \$45.7 million increase, although less than requested by the Company, will provide Duquesne Light recovery of its expenses, including the expense component of pension contributions, and provides the Company with the reasonable opportunity to earn a fair return. The revenue increase should allow the Company to attract capital on reasonable terms and allow the Company to continue to provide safe and reliable service to customers.

In this proceeding, Duquesne Light, OTS, OCA and OSBA presented testimony on revenue requirement issues. During the course of the proceeding, the difference between the parties litigation positions narrowed. In rebuttal testimony, the Company revised its claim down

from its original position of \$87.3 million to \$75.6 million. Duquesne Light St. No. 6-R, p. 3. In surrebuttal, both OTS and OCA increased their litigation positions with regard to the Company's revenue requirement. See OTS St. No. 2-SR; OCA St. No. 1-S. Through negotiations, the Joint Petitioners were able to compromise their competing litigation positions.

The revenue requirement under the Settlement is generally a "black box" number. Under a "black box" settlement, parties do not specifically identify revenues and expenses that are allowed or disallowed. The Company has found that the "black box" concept often facilitates settlement agreements because parties are not required to identify a specific return on equity ("ROE") or identify revenues and/or expenses that are allowed or disallowed. This process allows a settlement without requiring parties to abandon or reverse their positions on important issues, which could impact their positions in later cases.

Exceptions to the "black box" concept under this Settlement were made to specify universal service costs to be recovered under Rider No. 5 and consumer education costs to be recovered under Rider No. 1. The parties had to specify the amounts to be recovered under Rider No. 5 and Rider No. 1 in order to develop the Settlement rates. In addition, the Settlement specifies that Duquesne Light agrees to withdraw its proposed adjustment to book reserve, addition to rate base and depreciation expense that was claimed by the Company as an unrecovered depreciation reserve adjustment. Settlement ¶ 26.³ The settling parties also specified a return on equity and an equity component for purposes of the Smart Meter Recovery, as directed by the Commission. Finally, as explained in the following section of this Statement, the Settlement also contains important provisions to provide for funding of the Company's pension plan.

³ This adjustment related to the Company's request to complete the conversion to amortization accounting that was presented in the last base rate case at Docket No. R-00061346. Duquesne Light St. No. 8-R, p. 2. OTS objected to this adjustment in its testimony. OTS St. No. 3, p. 7.

B. Pensions.

The Settlement includes key provisions concerning the amount of Duquesne Light's ongoing pension contributions. As explained by the Company's Director of Finance and Treasurer, Mr. Bordo, the Company's cash contributions to pensions are expected to be over \$178 million for calendar years 2011 through 2013. Duquesne Light St. No. 3-S, Ex. DBB-2. The Company is required to make these significant contributions due to increased funding requirements under the PPA and declines in asset values as a result of the recent economic downturn.

Under the Settlement, Duquesne Light has agreed to contribute to its pension trusts an amount equal to \$55 million per year commencing with calendar year 2011. If contributions are made in any year in excess of the \$55 million, Duquesne Light may use the cumulative excess to satisfy future contribution obligations under the Settlement. Settlement ¶ 36. Duquesne Light will annually report contributions to the Commission and OTS, OCA and OSBA to allow monitoring of the commitment. Duquesne Light believes that this Settlement provision is important because it will ensure that adequate funds are contributed to the Company's pension plans.

The Settlement also will allow Duquesne Light to include in rate base the capitalized amount of actual pension contributions (50%), net of related accumulated deferred income taxes, for ratemaking purposes. Settlement ¶ 36. However, depreciation expense will be based on the amounts capitalized under SFAS 87 recorded on the Company's books. This approach allows the Company to maintain its books in accordance with Generally Accepted Accounting Principles ("GAAP") and also reflect in rate base the excess of cash contributions to be capitalized over amounts of pension costs capitalized per books, net of deferred taxes.

The pension Settlement provisions represent a significant compromise by the Company in this proceeding. In testimony, it was Duquesne Light's position that it should be permitted to include the full capitalized component of actual pension contributions in rate base and to depreciate such additions to rate base on a current basis, without any adjustment for deferred taxes. Duquesne Light St. No. 6-R, p. 15. The Company is required to make significant cash contributions to its pension plans and proposed that it be permitted to recover both a return on its capitalized pension contributions through rate base and a return of its capitalized pension contributions through depreciation expense. OCA disagreed with this analysis and argued that the Company should only include the lower SFAS 87 capitalized amounts and related depreciation expense. OCA St. No. 1, pp. 5-6. In rebuttal testimony, the Company explained that the OCA position would result in an unreasonable amount of regulatory lag on its cash investment in pensions due to: (1) the significant difference between the Company's actual cash contributions and the SFAS 87 amounts, and (2) the fact that the SFAS 87 amount will not catch up to the Company's actual cash contributions in the near future. Duquesne Light St. No. 3-R, p. 17. As a compromise in this proceeding, the Joint Petitioners agreed that the Company could earn a return on the capitalized amount of its actual cash contributions in base rates but that the Company's depreciation expense for book and ratemaking purposes would be based on the SFAS 87 capitalized amounts. Duquesne Light believes that this is a reasonable compromise of this issue.

C. OPEBS.

The Settlement contains specific provisions for meeting the Company's Other Post Employment Benefits ("OPEB") requirements. Under the Settlement, the Company's rate allowance is based on an OPEB cost of \$5.035 million. The expense component included in rates is approximately 50% of this cost. In addition, under the Settlement, the Company has

agreed to deposit into its Voluntary Employee Beneficiary Associated (“VEBA”) trust the full amount of annual OPEB costs calculated by the Company’s actuary pursuant to SFAS 106. The Company accounts for the difference between the net periodic post-retirement benefit expense determined annually by the actuary in accordance with SFAS 106 and the amount of SFAS 106 post-retirement benefit expense used to establish rates. That difference is recorded as a regulatory asset or liability and will be expensed or credited in future rate proceedings in determining OPEB expense included in rates. The Settlement provisions related to OPEBs provide clarity regarding the ratemaking and accounting treatment of OPEBs, provide for funding of the VEBA trust and provide that the Company will be able to recover its expected OPEB costs. Further, any over or under recovery of costs is to be amortized in future base rate proceedings.

D. Smart Meters.

Under the Settlement, the Joint Petitioners have agreed that Duquesne Light will use a 10% ROE and a capital structure with no more than 46% common equity for establishing the Company’s smart meter charge (“SMC”) for a three-year period following the effective date of rates in this proceeding. Settlement ¶ 47. In the Commission’s Order approving the Company’s smart meter filing, the Commission held that in the event parties settle future Company base rate proceedings, parties are to establish capital structure ratios and an ROE for the Company to use in calculating its SMC. *Petition of Duquesne Light Company for Approval of Smart Meter Technology Procurement and Installation Plan*, Docket No. M-2009-2123948, Order entered May 11, 2010, pp. 19, 25. Consistent with the Smart Meter Order, the Joint Petitioners have agreed to a capital structure ratio and ROE for the Company’s SMC. Duquesne Light notes that these numbers were agreed to for settlement purposes only and do not reflect the Company’s or

any party's position with respect to the current cost of common equity or capital structure to be used in determining base rates for Duquesne Light.

E. Universal Service.

In this proceeding, Duquesne Light proposed to recover its universal service costs through a Universal Service Charge, Rider No. 5. In recent years, Duquesne Light has experienced increasing CAP participation levels and increasing universal service costs. Duquesne Light St. No. 10, p. 3. In order to provide certainty with regard to cost recovery, Duquesne Light proposed to recover its universal service costs through a reconcilable rider.

Duquesne Light believes that allowing the Company to recover its universal service costs through a reconcilable rider is in the public interest because it will allow the Company to fully recover its actual universal service costs. Under the Electricity Generation Customer Choice and Competition Act, the Company is entitled to fully recover its universal service costs. 66 Pa. C.S. § 2802. In addition, many other utilities, such as PPL Electric Utilities Corporation, Columbia Gas of Pennsylvania, UGI Penn Natural Gas, Inc. and UGI Central Penn Gas, Inc. have reconcilable riders for recovering universal service costs. Duquesne Light St. No. 14-R, p. 19.

Under the Settlement, the Joint Petitioners have agreed to adopt the Company's proposal to recover universal service costs through a reconcilable rider, with certain modifications as to how the Company will project costs under the Rider. The Settlement also provides that Duquesne Light will provide a credit to reduce the CAP customer discounts to be recovered under the Rider if the monthly CAP enrollment exceeds the current level of 35,700 customers. Specifically, the recoverable CAP discounts will be reduced by the number of CAP customers in excess of 35,700 times the average CAP credit and arrearage forgiveness cost times 10.43%. Settlement ¶ 41. This provision resolves OCA's contention that the Company's level of

uncollectible accounts expense recovered in base rates will decline when additional customers enroll in the CAP program.

In addition, the Settlement provides that Duquesne Light will propose to the Commission a CAP Plus Program with respect to its application of LIHEAP grants. OCA and OTS proposed that Duquesne Light should implement a "CAP Plus" approach in conjunction with implementing a Department of Welfare change in the application of LIHEAP grants. As explained in the rebuttal testimony of Michele Sandoe, Duquesne Light had reservations about implementing a CAP Plus Plan given the effects on CAP customers. Duquesne Light St. No. 10-R, pp. 10-16. Moreover, in the Company's Submittal of its Three Year Universal Service Plan, Docket No. M-2010-2161220, while Duquesne Light did not submit a CAP-Plus plan, Commissioner Coleman, in a separate Statement, asked for comment on whether Duquesne Light should adopt such a CAP-Plus program. The Company was willing to adopt such a program for settlement purposes and will submit such a plan by April 1, 2011.

In this proceeding, OTS argued that the Company should limit eligibility for its CAP program to customers at or below 150% of the Federal Poverty Level ("FPL"). While Duquesne Light applies this income limit to most participants, Duquesne Light currently allows senior citizens to join the CAP program if their income levels are at or below 200% of the FPL. Duquesne Light St. No. 10-R, pp. 15-16. Under the Settlement, Duquesne Light will not extend CAP eligibility to seniors with incomes above 150% of the FPL. However, existing seniors currently on the CAP program will not be removed from the program as long as their income levels do not exceed 200% of the FPL. This Settlement provision aligns the Company's CAP program eligibility with the Commission's CAP policy statement. Duquesne Light believes that this is a reasonable compromise of this issue.

F. IRS Repair Allowance.

In this proceeding, OCA requested that the Company specify how it will account for changes in income tax accounting for repairs if the Company were to adopt the changes in the method for determining tax deductions for repairs under Revenue Procedure 2009-39. The Company notes that there are currently significant uncertainties associated with IRS rules for such an election. Duquesne Light St. No. 9-R, pp. 5-12. Nevertheless, the Company has agreed to specific rules for how it will reflect changes in its regulated books of account and for ratemaking if it implements the changes in income tax accounting for repairs under proposed IRS regulations issued in March 2008 and Revenue Procedure 2009-39. Settlement ¶ 49.

G. Revenue Allocation and Rate Design

1. Revenue Allocation.

The revenue allocation under the Settlement is based, in large part, on a scaleback of the Company's original proposed revenue allocation. The principal revision to the Company's original proposal was to eliminate proposed decreases for the lighting classes. To achieve the Settlement revenue allocation, the revenue reduction at the lower Settlement revenue increase and the elimination of the proposed rate decreases to the lighting classes were initially allocated to each of the other rate schedules to reduce the increase as proposed by the Company in proportion to their share of the increase. The settling parties then agreed to minor modifications of the amounts allocated among the classes. In addition, the settling parties agreed to move revenue increase dollars within certain classes, from GM \geq 25kW to rates GS, GM<25kW and GMH, to lower the increase to customers served under GM \geq 25kW. Since customers under the GS, GM<25kW and GMH rate schedules were paying less than cost of service under the Company's cost of service study and rate GM \geq 25kW customers were paying more than cost of service, the movement of dollars within the small commercial class moved all of these rate

schedules closer to cost of service under the Company's study. In addition, the settling parties agreed to increase Rate SM revenue (the largest street lighting class) by 5.3%, less than half of the 11.7% system average revenue increase.

The revenue allocation under the Settlement is reasonable for several reasons. First, the revenue allocation initially proposed by the Company moved all classes closer to the system average return. See Duquesne Light St. No. 14, pp. 5-6; OSBA St. No. 1, p. 6. The Settlement allocation continues to do this and moves the commercial classes closer to cost of service than originally proposed by the Company.

Second, the Company's proposed revenue allocation was within the range proposed by all parties. Duquesne Light St. No. 14-R, p.7, lines 28-30, page 8 lines 1-2. In testimony, OCA proposed to allocate substantially less of the overall increase to the residential class and more to the small C&I and large C&I classes than what Duquesne Light proposed. OCA St. No. 2, p. 26. OSBA proposed to allocate more of the increase to the residential class and less to the small C&I and large C&I classes than what Duquesne Light proposed. OSBA St. No. 1, Schedules BK-3, BK-5. DII proposed to allocate more of the increase to the residential and small C&I classes and less to the large C&I class than what Duquesne Light proposed. DII St. No. 1, p. 8. The Company's initially proposed revenue allocation balanced the interests of all parties. In addition, as explained above, the revenue allocation under the Settlement is based, in large part, on a scale-back of the Company's proposed revenue increase of \$87.3 million to \$45.7 million.

Moreover, it was reasonable to eliminate the proposed rate decreases to the lighting classes for purposes of achieving the Settlement. In testimony, OCA and OSBA proposed no rate decreases for the lighting classes. OCA St. No. 2, p. 25; OSBA St. No. 1, p. 7. Generally, classes that are above cost of service have been moved closer to cost of service over time by

increasing class rates less than the system average while rates for other classes below system average have been moved closer to cost of service over time by increasing class rates more than the system average.

Given all of these considerations, Duquesne Light believes that the revenue allocation under the Settlement is fully consistent with the Commonwealth Court's decision in *Lloyd v. Pa. P.U.C.*, 904 A.2d 1010 (Pa. Cmwlth. 2006) ("*Lloyd*") and prior Court precedent regarding revenue allocation. In compliance with *Lloyd*, the Settlement moves all rate classes closer to a system average return based Duquesne Light's class cost of service study.

In addition, in considering the *Lloyd* decision, it is important to recognize that *Lloyd* did not overturn prior judicial precedent with regard to revenue allocation and the applicability of cost of service studies. When allocating revenues to the rate classes, the Commission is not required to adopt a single cost of service study or strictly allocate revenues according to the study's results. In *Executone of Philadelphia, Inc. v. Pa. P.U.C.*, 52 Pa. Cmwlth. 74, 79, 415 A.2d 445, 448 (1980), the Court stated as follows:

[T]here is no single correct cost study or methodology that can be used to answer all questions pertaining to costs; there are only appropriate and inappropriate cost analyses depending upon the type of service under study and the management and regulatory decision in question.

Likewise, in *Peoples Natural Gas Co. v. Pa. P.U.C.*, 47 Pa. Cmwlth. 512, 409 A.2d 446, 456 (1979), ("*Peoples*"), the Court stated as follows with respect to rate design:

. . . there is no set formula for determining proper ratios among the rates of different customer classes. *Natona Mills v. Pennsylvania Public Utility Commission*, 179 Pa. Super. 263, 116 A.2d 876 (1955). What is reasonable under the circumstances, the proper difference among rate classes, is an administrative question for the commission to decide. This court's scope of review is limited.

In addition, the Commission has broad discretion in establishing a rate structure. In *Peoples*, the Court also stated:

It is well settled that the establishment of a rate structure is an administrative function peculiarly within the expertise of the Commission. *Pittsburgh v. Pennsylvania Public Utility Commission*, 168 Pa. Super. 95, 78 A.2d 35 (1951). Further, this court has continually recognized that the findings of the Commission, if supported by competent evidence, will not be disturbed. *United States Steel Corp. v. Pennsylvania Public Utility Commission*, 37 Pa. Cmwlth. 173, 390 A.2d 865 (1978); *Philadelphia Suburban Transportation Co. v. Pennsylvania Public Utility Commission*, 3 Pa. Cmwlth. 184, 192-94, 281 A.2d 179, 185 (1971).

Peoples, 47 Pa. Cmwlth., *supra* at 533, 409 A.2d at 456.

As *Lloyd* and the other cases cited above demonstrate, the Commission retains considerable discretion in designing rates, is not required to follow any particular cost of service study, and can consider other factors, including gradualism, in designing just and reasonable rates. The agreed to revenue allocation under the Settlement reflects a movement towards cost of service for all rate classes under Duquesne Light's class cost of service study. As such, the Settlement's proposed revenue allocation is fully consistent with the *Lloyd* decision and other relevant precedent regarding revenue allocation.

2. Rate Design.

Under the Settlement, the Joint Petitioners agreed that the customer charge for all residential customers, taking service under rate Schedules RS, RH and RA, would remain at \$7.00 per month. Settlement ¶ 28. The Company originally proposed to increase the Residential customer charges to \$8.50 per month. Duquesne Light St. No. 14, p. 7. However, both OCA and OTS proposed no increase to the current residential customer charges of \$7.00 per month. The Settlement adopts the OCA and OTS positions. While Duquesne Light believes that its cost of service study supports higher residential customer charges, Duquesne Light recognizes the

impact that a higher customer charge may have on customers at this time and has accepted the OCA and OTS position for Settlement purposes.

Under the Settlement, the Joint Petitioners also agreed to keep the monthly customer charges for Rate GS customers at \$7.00 per month and for Rate GM customers with less than 25 kW of demand at \$30.00 per month. In addition, the Joint Petitioners agreed to increase the customer charge for Rate GM customers with demand equal to or greater than 25 kW from \$30.00 per month to \$43.00 per month. Duquesne Light had originally proposed customer charges of \$8.50 per month for Rate GS customers and \$56.35 per month for all Rate GM customers. Duquesne Light St. No. 14, Exhibit WVP-1. The Settlement adopts the customer charges for Rate GS and Rate GM customers proposed by the OTS in this proceeding. OTS St. No. 3, pp. 33-36. While Duquesne Light does not agree with OTS' calculation of customer charges, Duquesne Light has accepted the OTS position for Settlement purposes.

In this proceeding, DII disagreed with several of the Company's proposed rate design changes for large C&I customers. Specifically, DII disagreed with the Company's proposal to eliminate declining block demand charges for Rates L and GL. DII St. No. 1, p. 3. DII also requested that the Untransformed Service Credit under Rate L be increased by the same percentage as Rate L distribution rates. In addition, DII requested that the Company retain Tariff Rule 4 which allows the Company to enter into special contracts with industrial or commercial customers having loads of at least 100 kW. DII St. No. 1, p. 3. The Company has accepted DII's proposed rate design changes for settlement purposes. These rate design changes will benefit larger C&I customers with high demands. Duquesne Light believes that this is reasonable. In addition, retaining Tariff Rule 4 will give Duquesne Light additional flexibility to retain or increase load from C&I customers with demands of 100 kW or greater.

Under the Settlement, the Joint Petitioners also have agreed that Duquesne Light will recover all of its consumer education costs through Rider No. 1. Currently, Duquesne Light recovers certain of its consumer education costs in base rates and the remainder through Rider No. 1. Duquesne Light St. No. 14-R, p. 13. In this proceeding, OTS argued that the Company should recover all of its consumer education costs through Rider No. 1 and none through base rates. OTS St. No. 2, p. 24. Duquesne Light believes that this is a reasonable position and has agreed to accept it for settlement purposes. As of April 21, 2011, the effective date of rates in this proceeding, all consumer education costs will be removed from base rates, and the Company will recover these costs through Rider No. 1.

III. RESPONSE TO MATTERS IDENTIFIED IN THE COMMISSION'S SUSPENSION ORDER

As explained above, in the Commission's Suspension Order, the Commission identified several specific matters for parties to address in this proceeding. In addition, the ALJs directed parties to address these matters in their respective Statements in Support in the event parties reached a Settlement in this proceeding. Prehearing Order dated October 4, 2010, p. 10. Duquesne Light notes that it provided detailed responses to the matters identified by the Commission in the Suspension Order in the Company's Supplemental Direct Testimony submitted on October 8, 2010. Below, Duquesne Light lists each of the matters identified by the Commission and explains how these matters were addressed in the proceeding.

1. **The Commission's analysis of Duquesne's proposed general rate increase has identified an additional issue, "ring fencing," that may have a significant impact on the rates to consumers of the utility. Ring fencing protections allow the risks associated with the jurisdictional utility to be isolated from the risks associated with its affiliates of the consolidated entity. The Commission has encouraged such protections in the past and would like the parties to this proceeding to address the ring fencing impact on rates.**

In its Supplemental Direct Testimony, the Company explained that it had multiple ring-fencing measures in place, including the following:

- The Company is a separate legal entity from Duquesne Light Holdings, Inc., maintains stand alone financial statements, receives its own credit rating from Standard & Poor's and Moody's and is able to independently raise capital via external markets.
- The Company's Articles of Incorporation limit it from declaring or paying dividends on any shares of capital stock ranking junior to Duquesne Light's Preferred Stock if the Common Stock equity of Duquesne Light is less than 25% of total capitalization.
- DQE Holdings, the ultimate parent company, recently appointed a locally based, independent director to Duquesne Light's Board of Directors in order to ensure that the organization models best practices in Corporate governance and that Corporate decisions reflect the interests of our local community.
- The Company does not participate in the cash concentration system (cash pool) with Duquesne Light Holdings or other affiliates that are not regulated by the Commission. As a result, nonregulated entities cannot use the Company's surplus cash for their operations.

Duquesne Light St. No. 3-S, pp. 2-3.

The Company also explained that the Commission had recently reviewed the Company's ring-fencing measures in 2006 in connection with the acquisition of Duquesne Light Holdings and its subsidiary, Duquesne Light, by a consortium of investors. In the settlement of that proceeding, the Company agreed to additional ring-fencing measures to isolate Duquesne Light from the activities of its parent and affiliates. Duquesne Light St. No. 3-S, p. 3. Therein, the Company agreed that:

- It will not guarantee the debt or credit instruments of Duquesne Light Holdings, Inc. or any affiliate not regulated by the Commission, except as approved by the Commission.
- It will not grant a mortgage or lien on any property used and useful by the Company in providing retail utility service to the public subject to the Commission's jurisdiction, except for the financing needs of the Company.
- It will not make a loan or otherwise extend credit to Duquesne Light Holdings, Inc. or any affiliate not regulated by the Commission, except as approved by the Commission.
- It shall notify the Commission of any intention to declare a special dividend to Duquesne Light Holdings, Inc. at least 30 days before declaring the dividend.
- Its long term debt ratio as a percentage of total capitalization would not exceed 60%, absent approval from the Commission.

In addition, the Company further explained its ring-fencing measures in the rebuttal testimony of Mr. Bordo. Duquesne Light St. No. 3-R, pp. 28-30. Duquesne Light has clearly demonstrated in this proceeding that it has reasonable and adequate ring-fencing protections in place that protect Duquesne Light from the risks incurred by its Parent and its Parents' unregulated affiliates.

In approving recent settlements of base rate proceedings for PECO Electric Company and PECO Gas Company ("PECO"), Commissioner Wayne E. Gardner commended PECO for putting various ring-fencing measures in place including:

- assurances that PECO will not guarantee any debt for its parents or affiliates;
- maintenance of reasonable accounting controls for allocating costs and shared personnel;
- assurances that it issue its own long term debt and use reasonable efforts to maintain a separate credit rating; and
- maintenance of separate books and records.

Statement of Commissioner Wayne E. Gardner dated December 16, 2010, *Pa. P.U.C. v. PECO Energy Company – Electric and PECO Energy Company – Gas*, Docket Nos. R-2010-2161575,

R-2010-2161592. As explained above and in Duquesne Light St. Nos. 3, 3-S and 3-R, Duquesne Light has implemented all of the ring-fencing measures noted by Commissioner Gardner in his December 16 Statement in the PECO cases.

2. **Duquesne's test year revenue and expense claims must be closely examined to determine their accuracy and the extent to which they support the requested revenue increase.**

As explained above, the parties have thoroughly investigated Duquesne Light's revenue and expense claims in this proceeding through informal and formal discovery, testimony and settlement negotiations. After this extensive investigation, the Joint Petitioners have reached a settlement of all issues, including the revenue increase and revenue requirement, which all of the Joint Petitioners have deemed to be a reasonable outcome.

3. **The level of capital investment appearing in Duquesne's rate base claim must be closely reviewed to ensure that it was prudently made, and that any utility plant acquired is necessary, used and useful to the provision of electric distribution service.**

In this proceeding, the Company fully supported its level of capital investment and explained that its utility plant is used and useful to the provision of electric distribution service. In testimony, the Company described its capital investment, including capital additions during the FTY. Duquesne Light St. No. 5, pp. 7-21. In addition, the Company explained how it maintains its property, plant and equipment accounting records on the Power Plan fully integrated asset accounting system and that the Company records all construction and retirements of electric plant by means of work orders. Duquesne Light St. No. 3, pp. 4-5. No party raised any issue with regard to capital investment.

4. Duquesne's proposed revenue allocation must be carefully examined to determine whether or not it is just and reasonable.

In this proceeding, parties extensively investigated both the Company's class cost of service study and proposed revenue allocation. OTS, OCA, OSBA and DII all filed testimony on class cost of service study and revenue allocation issues. See, e.g., OTS St. No. 3; OCA St. No. 2; OSBA St. No. 1; DII St. No. 2. Based upon this extensive investigation, the Joint Petitioners were able to amicably resolve all revenue allocation issues in this proceeding, which resulted in an outcome that was reasonable for all of the Joint Petitioners and meets appellate standards as explained previously in the Statement in Support.

5. Duquesne's proposal to redesign the rate structure of residential heating and add-on heat pump customers must be carefully examined to determine whether or not it is just and reasonable.

Duquesne Light explained its proposal to redesign the rate structure of residential heating and add-on heat pump customers in the Direct Testimony of William V. Pfrommer. Duquesne Light St. No. 14, p. 8. In that testimony, the Company explained why it was reasonable to keep the seasonal rate differential for heating customers due to their high usage and lower existing rates, but also reasonable to eliminate the declining blocks for these customers. The Company notes that the OCA agreed with these rate design changes for residential heating customers. OCA St. No. 2, pp. 30-31, and no other party opposed the changes. Duquesne Light will contact these customers to advise them of the rate design changes and to educate them on energy efficiency opportunities and ways to manage usage and bills by conserving energy.

6. Duquesne's proposal to separate rate schedule GSGM into three new rate schedules must be carefully reviewed to determine whether or not it is just and reasonable.

Duquesne Light explained its proposal to separate Rate Schedule GS/GM into separate rate schedules in Duquesne Light St. No. 13, pp. 4-6 and Duquesne Light St. No. 14, pp. 9-11.

Therein, the Company explained that there are meaningful differences in the costs to serve Rate Schedule GS, Rate Schedule GM<25kW and Rate Schedule GM ≥25kW customers. Duquesne Light St. No. 14, pp. 9-11. The Company notes that the OSBA agreed with these rate design changes for GS and GM customers, and that no other party objected to the conclusions made by the Company's evaluation of these schedules. OSBA St. No. 1, pp. 3-4.

7. **Duquesne's proposals to redesign the rate schedules for large commercial and industrial customers through the conversion to demand only rates, the elimination of variable demand charges and/or the elimination of declining block demand charges must be carefully reviewed to determine whether or not they are just and reasonable.**

Duquesne Light explained its proposals to redesign the rate schedules for large C&I customers in Duquesne Light St. No. 14, pp. 12-14. In testimony, DII disagreed with certain of these changes and argued that the Company should keep the current demand rate structure for Rates GL and L and should retain a monthly customer charge for Rate GLH customers. In the Settlement, the Joint Petitioners have agreed to these requests by DII. See Settlement Paragraphs 30-32.

8. **The cost allocation methodologies utilized in Duquesne's class cost-of-service study must be thoroughly scrutinized in order to ensure that the results of the study are reasonably accurate, and to determine whether or not they support the Company's proposed revenue allocation.**

As explained in response to number 4 above, OTS, OCA, OSBA and DII all submitted extensive testimony addressing the Company's class cost of service study and revenue allocation. OTS, OSBA and DII all supported the Company class cost of service study. See OTS ST. No. 3; OSBA St. No. 2; DII St. No. 1. In addition, all parties, including OCA, have agreed to the revenue allocation under the Settlement.

9. The cost allocation methodologies utilized in Duquesne's class cost-of-service study must be thoroughly scrutinized to determine whether or not they support the Company's proposed rate design changes.

As explained in response to Numbers 4-8 above, the parties in this proceeding thoroughly investigated the Company's cost allocation methodologies and proposed rate design changes. Numerous discovery requests were made by parties scrutinizing the cost of service study, and testimony was provided by many parties on the study and proposed rate design changes. The Settlement resolves all cost allocation and rate design changes in a manner that is acceptable to all of the Joint Petitioners.

10. Duquesne's proposed updates to its tariff to clarify certain provisions and eliminate other provisions must be reviewed to determine whether or not such changes are appropriate.

Duquesne Light explained its proposed updates to its tariff in Duquesne Light St. No. 14, pp. 17-22. In testimony, DII argued that the Company should retain tariff Rule 4 to allow the Company the ability to enter into special contracts with customers whose load exceeds 100 kW. DII St. No. 1, pp. 13-14. Under the Settlement, Duquesne Light has agreed to retain Tariff Rule 4. There was also extensive review of the proposed Universal Service Charge and adjustments made thereto in the Settlement, as explained previously. Other tariff clarifications or eliminations were reviewed by the parties and found to be acceptable.

11. Duquesne's methodology for calculating its health care expenses must be closely examined.

In its original filing, Duquesne Light stated that the recently enacted Patient Protection and Affordable Care Act ("PPACA") would increase the Company's health care costs and that the Company would update its projected health care costs in this proceeding. Duquesne Light St. No. 6, p. 10. In rebuttal testimony, the Company further explained and supported its health care expense claim, and the modest increase of \$500,000 related to the PPACA related primarily to

having to cover children of employees to the age of 26. See Duquesne Light St. No. 6-R, pp. 7-8 and Duquesne Light Exhibit RLO-9. The Company explained that it calculated its increased health care costs with the assistance of Hewitt Associates, an outside consulting firm. Duquesne Light St. No. 6-R, p. 8.

12. The Company's allocation methodology for pension contributions must be carefully examined in order to insure that costs are divided appropriately between expenses and capitalization. Suspension Order, p. 5.

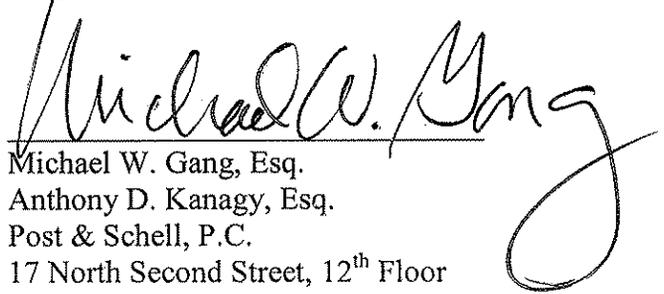
Duquesne Light fully explained in testimony that it allocates pension costs to expense or capital in proportion to the percentage of employee labor that is expensed or capitalized. Duquesne Light St. No. 3-S, p. 6. The Company also explained that this methodology was reviewed by the parties in the Company's last base rate proceeding and included in the Settlement that was approved by the Commission. See Settlement at Docket No. R-00061346, ¶ 17(b)(2); Duquesne Light St. No. 2-R, p. 15 at Docket No. R-00061346. As explained previously, the Settlement confirms and clarifies these procedures.

IV. CONCLUSION

The Settlement is the result of detailed examination of Duquesne Light's proposed rate increase, extensive discovery by numerous parties, multiple rounds of testimony and reasonable compromise by knowledgeable Joint Petitioners. Duquesne Light believes that a fair and reasonable compromise has been achieved in this case, as is evident by the fact that all non-customer complainants have agreed to join in or not oppose the Settlement. With regard to customer participants, Duquesne Light would note that at the two public hearings held in its service territory in this proceeding, only two customers raised objections to the rate increase and much of the testimony from the public was supportive of Duquesne Light's customer service, its reliability of electric service, its positive impact on local employment and economy, and its extensive community involvement. Tr. 37-116. Duquesne Light fully supports this Settlement

and respectfully requests that Administrative Law Judges Mark A. Hoyer and Conrad A. Johnson and the Pennsylvania Public Utility Commission review and approve the Settlement in its entirety.

Respectfully submitted,



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