

APPEARANCE SHEET

ALJ HEARING REPORT

Docket No. R-00974104
R-00974104C0001-C0002
 Case Name Duquesne Light Company
 Location Pittsburgh
 Date December 9, 1997
 ALJ Corbett

Reporting Firm _____

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PUBLIC UTILITY COMMISSION

CHECK THOSE BLOCKS WHICH APPLY:

Prehearing held YES ___ NO

Hearing held YES ___ NO

Testimony taken YES ___ NO

Transcript due YES ___ NO

Hearing concluded YES ___ NO

Further hearing needed YES NO ___

Estimated add'l days Per schedule

RECORD CLOSED YES ___ NO

DATE _____

Briefs to be Filed YES ___ NO

DATE _____

BENCH DECISION YES ___ NO

REMARKS: Third prehearing conference cancelled at request of parties.

NAMES, ADDRESSES AND TELEPHONE NUMBERS OF PARTIES OR COUNSEL OF RECORD
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 INCOMPLETE INFORMATION MAY RESULT IN DELAY OF PROCESS

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COMMONWEALTH OF PENNSYLVANIA
PENNSYLVANIA PUBLIC UTILITY COMMISSION
P.O. BOX 3265, HARRISBURG, PA 17105-3265

IN REPLY PLEASE
REFER TO OUR FILE

December 10, 1997

In Re: **R-00974104,**
R-00974104C0001-C0002

(See letter dated 10/29/97)

Duquesne Light Company

Application for approval of a Restructuring Plan

NOTICE

This is to inform you that the Third Prehearing Conference on the above captioned case has scheduled to be held on Tuesday, December 9, 1997 at 11:00 a.m. in Pittsburgh, Pennsylvania has been canceled.

Presiding Officer: **Administrative Law Judge John H. Corbett, Jr.**
1103 Pittsburgh State Office Building
300 Liberty Avenue
Pittsburgh, PA 1522
Telephone: (412) 565-3550

Please mark your records accordingly.

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December 10, 1997

Honorable John H. Corbett, Jr.
Administrative Law Judge
Pennsylvania Public Utility Commission
1103 Pittsburgh State Office Building
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Pittsburgh, PA 15222

VIA FEDERAL EXPRESS

KJR

Re: Application of Duquesne Light Company for Approval of Restructuring Plans Under Section 2806 of the Public Utility Code; Docket No. R-00974104

Dear Judge Corbett:

Enclosed is a copy of the following surrebuttal testimony on behalf of the Duquesne Industrial Intervenor ("DII") concerning the above-referenced proceeding:

- DII Statement No. 1R — Surrebuttal Testimony of Stephen J. Baron
- DII Statement No. 2R — Surrebuttal Testimony and Exhibits of Randall J. Falkenberg
- DII Statement No. 3R — Surrebuttal Testimony of Lane Kollen

Also enclosed is a computer diskette containing the above-listed statements in WordPerfect 5.1 format and Mr. Falkenberg's exhibits. In addition, a hard copy of Mr. Falkenberg's Workpapers is enclosed. As evidenced by the attached Certificate of Service, parties to this proceeding have been duly served in accordance with your statements at the West Penn Power prehearing conference on December 9, 1997.

Very truly yours,

McNEES, WALLACE & NURICK

By *Pamela C. Polacek*
James P. Dougherty
Pamela C. Polacek

Counsel to Duquesne Industrial Intervenor

PCP:mas

Enclosures

c: ✓ James J. McNulty, Secretary (Transmittal Letter/Certificate of Service Only)
via Hand Delivery on December 11, 1997

Certificate of Service (diskettes only to ALJ Corbett and Mr. Moor)

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CERTIFICATE OF SERVICE

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

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Pamela C. Polacek,
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Dated this 10th day of December, 1997, in Harrisburg, Pennsylvania.

COMMONWEALTH OF PENNSYLVANIA



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December 11, 1997

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**Re: Application of Duquesne Light Company
for Approval of its Restructuring Plan
Under Section 2806 of the Public Utility Code
Docket No. R-00974104**

KJR

Dear Prothonotary:

Enclosed is a certificate of service pursuant to 52 Pa. Code §5.412(f) for filing the surrebuttal testimony of Mr. Brian Kalcic in the above docket labeled OSBA Statement No. 1S.

If you have any questions, please do not hesitate to contact me.

Sincerely,

Angela T. Jones
Assistant Small Business Advocate

Enclosure

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Application of Duquesne :
Light Company For Approval :
Of Its Restructuring Plan : Docket No. R-00974104
Under Section 2806 Of The :
Public Utility Code :

CERTIFICATE OF SERVICE

I certify that I am serving two copies of the Surrebuttal Testimony of Brian Kalcic, labeled OSBA Statement No. 1S, on behalf of the Office of Small Business Advocate in the manner indicated upon the persons addressed below:

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PROTHONOTARY'S OFFICE

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Angela T. Jones
Assistant Small Business Advocate

Date: December 11, 1997

COMMONWEALTH OF PENNSYLVANIA



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Bernard A. Ryan, Jr.
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December 11, 1997

Office of the Prothonotary
Pennsylvania Public Utility Commission
Room B-20, North Office Building
P.O. Box 3265
Harrisburg, PA 17105-3265

PROTHONOTARY'S OFFICE
PA PUBLIC UTILITY
97 DEC 11 PM 2:43
KJR

Re: Application of Duquesne Light Company
for Approval of its Restructuring Plan
Under Section 2806 of the Public Utility Code
Docket No. R-00974104

Dear Prothonotary:

Enclosed for filing is the original and three copies of the Praecipe to Enter Appearance of Angela T. Jones, Esquire in the above-captioned case. As evidenced by the enclosed certificate of service, a copy has been served on all parties of record.

If you have any questions, please do not hesitate to contact me.

Sincerely,

Angela T. Jones
Assistant Small Business Advocate

Enclosure

DOCUMENT
FOLDER

48

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Application of Duquesne :
Light Company For Approval :
Of Its Restructuring Plan : Docket No. R-00974104
Under Section 2806 Of The :
Public Utility Code :

PRAECIPE TO ENTER APPEARANCE

To the Secretary of the Commission:

Pursuant to 52 Pa. Code Section 1.24 et seq., please enter the appearance of Angela T. Jones, Esquire, replacing Karen Oill Moury, Esquire, as the attorney of record for the Office of Small Business Advocate in the above-captioned matter. Bernard A. Ryan, Jr., Esquire, will also continue to represent this Office in this proceeding.

The Office of Small Business Advocate is already receiving or has access to a copy of each document issued by the Commission in this matter and does not on the basis of this notice require an additional copy.

Angela T. Jones
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PROTHONOTARY'S OFFICE
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Dated: December 11, 1997

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Application of Duquesne :
Light Company For Approval :
Of Its Restructuring Plan : Docket No. R-00974104
Under Section 2806 Of The :
Public Utility Code :

CERTIFICATE OF SERVICE

I certify that I am serving a copy of the Praecipe to Enter Appearance of Angela T. Jones on behalf of the Office of Small Business Advocate in the manner indicated upon the persons addressed below:

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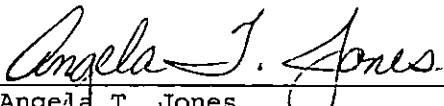
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Angela T. Jones
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Date: December 11, 1997

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December 11, 1997

Via Federal Express

James J. McNulty
Prothonotary
Pennsylvania Public Utility Commission
North Office Building, Room B-20
Harrisburg, Pennsylvania 17101

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DEC 11 1997

PA PUBLIC UTILITY COMMISSION
PROTHONOTARY'S OFFICE


Re: *Application of Duquesne Light Company
for Approval of Restructuring Plan --
Docket No. R-00974104*

KJR

Dear Mr. McNulty:

Enclosed for filing, please find the original and three copies of the attached certificate of service, which certifies that I have this day served copies of the Prepared Surrebuttal Testimony of Dr. Robert B. Weisenmiller, sponsored by Hospital Shared Services and Administrative Resources Inc., upon all parties on the attached service list pursuant to Section 5.412(f) of the Commission's regulations.

Very truly yours,



Peter J. Thompson
Attorney for Hospital Shared Services
and Administrative Resources, Inc.

Enclosures

DOCUMENT
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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION **DEC 11 1997**

Application of Duquesne Light)
Company for Approval of)
Restructuring Plan)

PA PUBLIC UTILITY COMMISSION
PROTHONOTARY'S OFFICE
Docket No. R-00974104

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a true copy of the Prepared Surrebuttal Testimony of Dr. Robert B. Weisenmiller sponsored by Hospital Shared Services and Administrative Resources, Inc. upon the participants on the attached service list in accordance with Section 5.412(f) of the Commission's regulations.

Dated this 11th day of December, 1997.

Peter J. Thompson

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Attorney for Hospital Shared Services and
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PENNSYLVANIA PUBLIC UTILITY COMMISSION
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IN REPLY PLEASE
REFER TO OUR FILE

ORIGINAL
December 11, 1997

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Re: Pennsylvania Public Utility Commission
v.
Duquesne Light Company
Docket No. R-00974104

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PA PUBLIC UTILITY COMMISSION
PROTHONOTARY'S OFFICE

Dear Judge Corbett:

Enclosed please find a copy of the Surrebuttal Testimonies and Support Exhibits of the Office of Trial Staff (OTS) witnesses in the above-captioned proceeding as follows:

Darren D. Gill
Paul J. Metro

OTS Statement No. 2-SR
OTS Statement No. 4-SR
and OTS Exhibit No. 4-SR

Copies of this testimony are being served upon all active parties of record.

Sincerely,

Kandace F. Melillo

Kandace F. Melillo
Prosecutor
Office of Trial Staff

KFM:sjh

c: Parties of Record

**DOCUMENT
FOLDER**

ORIGINAL

OTS Statement No. 2-SR
Witness: Darren D. Gill
Dated: December 11, 1997

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PENNSYLVANIA PUBLIC UTILITY COMMISSION

PA PUBLIC UTILITY COMMISSION
PROTHONOTARY'S OFFICE

v.

DUQUESNE LIGHT COMPANY

Docket No. R-00974104

Surrebuttal Testimony

of

Darren D. Gill

Office of Trial Staff

JACKETED

DEC 16 1997

DOCUMENT

FOLDER

Concerning:

Nuclear and Non-Nuclear Plant Decommissioning

1 **Q. WOULD YOU PLEASE STATE YOUR NAME AND BUSINESS**
2 **ADDRESS?**

3 A. My name is Darren D. Gill. My business address is P.O. Box 3265,
4 Harrisburg, Pennsylvania 17105-3265.

5

6 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

7 A. I am employed by the Pennsylvania Public Utility Commission in the Office
8 of Trial Staff as an Fixed Utility Valuation Engineer.

9

10 **Q. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY IN THESE**
11 **PROCEEDINGS?**

12 A. Yes. I prepared and submitted direct testimony, OTS Statement No. 2.

13

14 **Q. MR. GILL, WHAT WILL YOUR SURREBUTTAL TESTIMONY**
15 **ADDRESS?**

16 A. I will address the rebuttal testimony of Duquesne's witness Mr. LaGuardia
17 related to nuclear and fossil plant decommissioning.

18

1 **Q. PLEASE REFER TO MR. LAGUARDIA'S REBUTTAL TESTIMONY,**
2 **PAGES 9 AND 10. HOW DOES MR. LAGUARDIA CHARACTERIZE**
3 **THE BASIS FOR YOUR ELIMINATION OF CONTINGENCIES**
4 **FROM THE COMPANY'S NUCLEAR AND FOSSIL**
5 **DECOMMISSIONING ESTIMATES?**

6 A. Mr. LaGuardia believes that I am relying on Commission precedent from the
7 last PP&L rate case at Docket No. R-00943271 as the basis for my
8 recommendations.

9
10 **Q. IS MR. LAGUARDIA'S CHARACTERIZATION OF THE BASIS FOR**
11 **YOUR ELIMINATION OF CONTINGENCY FACTORS CORRECT?**

12 A. No. While it is my understanding that the Commission's treatment of
13 contingency factors in the PP&L rate case supports my position herein, it is
14 not the basis for my adjustment. At no point in my testimony do I refer to the
15 PP&L rate case discussed by Mr. LaGuardia. As I state on page 5 of my
16 direct testimony, I believe that the addition of contingencies incorporates an
17 additional estimate on top of what is already an estimate. Should new
18 information become available, the Electricity Generation Customer Choice

1 and Competition Act allows that the Company may come to the Commission
2 with further estimates.

3

4 **Q. PLEASE REFER TO PAGES 10-11 OF MR. LAGUARDIA'S**
5 **REBUTTAL TESTIMONY. HOW DOES MR. LAGUARDIA**
6 **ATTEMPT TO REFUTE YOUR POSITION THAT**
7 **DECOMMISSIONING ESTIMATES ARE INFLATED THROUGH**
8 **THE USE OF CONTINGENCIES?**

9 A. Mr. LaGuardia states on page 11, lines 5-7 of his rebuttal testimony that
10 contingencies are not an inflation of costs but "a recognition of actual costs
11 incurred in recent experience with decommissioning activities that were not
12 foreseeable in advance".

13

14 **Q. IS THERE ANY MERIT TO HIS STATEMENT?**

15 A. No. An estimate of costs which will be incurred at the point of
16 decommissioning, based on recent experience, is reflected in each line item
17 of Mr. LaGuardia's cost study. Increasing decommissioning estimates above
18 reasonably known and measurable levels, through the inclusion of
19 contingencies, is an improper inflation of costs.

1 Q. **DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

2 A. Yes, it does.

3

ORIGINAL/COPY

**OTS Statement No. 4-SR
Witness: P.J. Metro
Dated: December 11, 1997**

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DEC 12 1997

PENNSYLVANIA PUBLIC UTILITY COMMISSION
PENNSYLVANIA PUBLIC UTILITY COMMISSION
PROTHONOTARY'S OFFICE

v.

DUQUESNE LIGHT COMPANY

Docket No. R-00974104

Surrebuttal Testimony

of

Paul J. Metro

Office of Trial Staff

JACKETED
DEC 16 1997

Concerning:

Electric Rate Restructuring

**DOCUMENT
FOLDER**

1 **Q. WOULD YOU PLEASE STATE YOUR NAME AND BUSINESS**
2 **ADDRESS?**

3 A. My name is Paul J. Metro. My business address is P.O. Box 3265,
4 Harrisburg, Pennsylvania, 17105-3265.

5

6 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

7 A. I am employed by the Pennsylvania Public Utility Commission in the
8 Office of Trial Staff as a Fixed Utility Valuation Engineer.

9

10 **Q. DID YOU PREVIOUSLY SUBMIT DIRECT TESTIMONY IN THIS**
11 **PROCEEDING?**

12 A. Yes I did. I am responsible for OTS Statement No. 4.

13

14 **Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL**
15 **TESTIMONY?**

16 A. The purpose of my testimony is to rebut Duquesne Light Company's
17 (Duquesne) witness Mr. Clayton concerning its regulatory asset claim for
18 deferred caretaker costs and cold reserved units and to address the OTS
19 recommended level of total stranded costs.

20

1 **COLD RESERVE UNITS AND DEFERRED CARETAKER COSTS**

2 **Q. WHAT IS THE COMPANY'S REBUTTAL POSITION**
3 **CONCERNING THE COLD RESERVED UNITS AND THE**
4 **CARETAKER COSTS?**

5 **A.** Duquesne witness Mr. Clayton avers that the Company's claim for its cold
6 reserved units (Phillips and Brunot Island) and the associated caretaker
7 costs represents the only fair treatment for a mitigation strategy of which
8 the Commission was well aware, but that ultimately proved unsuccessful.
9 The Company also avers that it should not be penalized because it was
10 unable to make a silk purse out of a sow's ear on these particular assets
11 (See Duquesne Statement No. 2-R, page 35). The Company provides no
12 basis or explanation for its contention that the Commission was "well
13 aware" of a mitigation strategy and that such "awareness" should somehow
14 permit recovery of these costs as "stranded".

15
16 **Q. MR. METRO, BRIEFLY SUMMARIZE THE OTS POSITION**
17 **CONCERNING THE COLD RESERVED UNITS AND THE**
18 **CARETAKER COSTS?**

19 **A.** The OTS position concerning the cold reserve units is that property that is
20 not used to serve customers should not be considered stranded and its value

1 should not be recovered from customers by including the cold reserved
2 units in the stranded cost calculation. The OTS position concerning the
3 caretaker costs associated with the cold reserved units is that since these
4 plants will not be used to meet the future needs of the regulated customers,
5 there is no benefit to the ratepayers associated with these deferred costs and
6 these costs should not be permitted to be recovered.

7
8 **Q. MR. METRO, DO YOU AGREE WITH MR. CLAYTON'S**
9 **REBUTTAL TESTIMONY CONCERNING THE COLD RESERVED**
10 **UNITS AND THE CARETAKER COSTS?**

11 **A.** No. The Company had two options when it decided to place the two plants
12 into cold reserve. The first option was to take the plants out of rate base
13 and place these plants into the account classified as plant held for future
14 use. This is the option the Company chose. The alternative option was to
15 retire the units. Under this option, the Company would have credited plant
16 and debited the depreciation reserve. The Company would have recovered
17 the net book value and a return over the remaining life of these units.

18 Using 20/20 hindsight, the Company made a bad decision. Now,
19 the Company is attempting to recover from this bad decision by classifying
20 the cold reserved units as "stranded". The units are not used and useful

1 and should not be permitted to be included as stranded costs. These series
2 of events were not the result of or related to deregulation. However, the
3 Company is attempting to take advantage of the deregulation legislation to
4 rectify prior bad business decisions.

5
6 **OTS RECOMMENDED TOTAL STRANDED COST LEVEL**

7
8 **Q. MR. METRO, DID OTS RECOMMEND A LEVEL OF STRANDED**
9 **COSTS RELATED TO GENERATING PLANT IN ITS DIRECT**
10 **TESTIMONY?**

11 **A.** No. The Company made no specific claim for stranded costs related to
12 generating plant. The Company provided a schedule showing a range of
13 possible stranded costs levels at different market rates. Since the Company
14 did not make a specific claim for generating plant stranded costs and the
15 OTS agreed with the Company's market valuation approach, I did not
16 provide an estimation of the Company's generating plant stranded costs.

17 However, since the OCA and DII did provide specific stranded cost
18 levels for generating plant in their direct testimonies, the Company
19 responded in its rebuttal testimony with a alternative plan for a specific
20 claim for generating plant stranded costs.

1 **Q. SINCE THE COMPANY HAS NOW ESTIMATED A STRANDED**
2 **COST AMOUNT FOR GENERATING PLANT AS AN**
3 **ALTERNATIVE TO THE OCA AND DII, ARE YOU PREPARED TO**
4 **ADDRESS THE OTS RECOMMENDED LEVEL OF GENERATING**
5 **PLANT STRANDED COSTS?**

6 **A.** Yes. The OTS recommended level of total stranded costs is \$1,395.85
7 million. OTS Exhibit 4R, Schedule 1 shows the composition of the
8 \$1,395.85 million. The OTS recommended market value is \$159 million.
9 This amount was calculated by the Company as the plant margin under the
10 delayed entry portfolio (See Duquesne Exhibit DJC-20, page 1 of 49).

11
12 **Q. MR. METRO, WHY DID YOU UTILIZE THE DELAYED ENTRY**
13 **PORTFOLIO FOR THE MARKET VALUE?**

14 **A.** I utilized the delayed entry portfolio for two reasons. First, the delayed
15 entry portfolio provides for a plant margin between the low and high
16 market value portfolios. This provides for a fair and balanced estimation
17 for the market rate. Second, according to Duquesne witness Mr.
18 Schnitzer, the delayed entry case assesses the impact which would result if
19 new combined cycle capacity is not economic until after the year 2006 (See
20 Duquesne Statement No. 1, page 35). This is important because the market

1 rate will dictate the development of new capacity. In addition, it is unlikely
2 that new combined cycle capacity would be economic to build in the year
3 2006 based on Duquesne's results of the 1997 Solicitation, particularly if
4 the required new entry prices are at the high end of the range projected by
5 Duquesne (Ibid).

6
7 **Q. MR. METRO, YOU STATED THAT THE DELAYED ENTRY**
8 **PORTFOLIO PROVIDES FOR A FAIR AND BALANCED**
9 **ESTIMATION OF THE MARKET RATE. WHAT IS YOUR**
10 **OPINION CONCERNING THE ACCURACY OF THIS MARKET**
11 **RATE?**

12 **A.** It is my opinion that all market rate projections are inaccurate as there is
13 uncertainty regarding the future market place prices. No analyst can
14 project the market prices accurately over the long run (more than three
15 years), or even the short run (up to three years). I believe that any utility's
16 stranded cost claim is in error if it is based on long run market rate
17 projections. In my opinion, the utilities will err in their favor in the
18 calculation of the stranded cost. Given that, I recommend that the market
19 rates utilized in determining stranded generating costs, under the OCA and
20 DII alternatives, be based on the delayed entry portfolio.

1 Q. **DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

2 A. Yes.

OTS Exhibit No. 4-SR
Witness: P.J. Metro
Dated: December 11, 1997

PENNSYLVANIA PUBLIC UTILITY COMMISSION

v.

DUQUESNE LIGHT COMPANY

Docket No. R-00974104

Exhibit to Accompany the

Surrebuttal Testimony

of

Paul J. Metro

Office of Trial Staff

DOCKETED
DEC 16 1997

Concerning:

Electric Rate Restructuring

**DOCUMENT
FOLDER**

DUQUESNE LIGHT COMPANY

Summary of Stranded Cost Estimates
As of December 31, 1998
(Millions \$)

	<u>DLC</u>	<u>OTS</u>
<u>Generating Plant</u>		
Net Book Value of Generating Plant	\$ 917.61	\$ 852.03
Working Capital	-	-
M&S and Fuel-Related Sunk Costs	41.11	-
PV of BV2 Lease Expense	278.24	287.19
Net Book Value	<u>1,236.96</u>	<u>1,139.22</u>
PV of Decommissioning	123.90	45.10
PV of Costs Independent of Operation	208.23	-
Estimated Market Value	<u>(27.40)</u>	<u>(159.00)</u>
Stranded Generating Plant	1,541.69	1,025.32
 <u>Regulatory Assets</u>		
SFAS 109	\$ 179.00	\$ 179.00
Post-2005 Unamortized Debt Cost	19.04	19.04
Pre-2006 Unamortized Debt Cost	9.80	9.80
Deferred Rate Sync. Costs	30.26	30.26
Deferred Employee Costs	17.80	17.80
Deferred Nuclear Maintenance	1.90	1.90
DOE Decom and Decon.	4.19	4.19
Deferred Coal Costs	13.50	13.50
Deferred Caretaker Costs	3.92	-
BV2 Training Costs	1.58	1.58
Low Level Radioactive Waste	2.27	2.27
Coal Cost Equalization	0.12	0.12
Other	0.53	0.53
Pre-Accrue Nuclear Outages	13.25	13.25
Gain on Sale/Leaseback	55.13	55.13
Deferred Rate Sync. Costs (Tax)	0.27	0.27
BV-2 (Tax)	0.17	0.17
Deferred Fuel Costs	8.66	8.66
Transition Costs	10.59	10.59
SFAS 106	2.47	2.47
SFAS 109 Plant	<u>-</u>	<u>-</u>
Total Regulatory Assets	<u>\$ 374.45</u>	<u>\$ 370.53</u>
Total Stranded Costs	<u>\$ 1,916.14</u>	<u>\$ 1,395.85</u>
Percent of Company Claim	100.00%	72.85%

ORIGINAL
BEFORE THE

PENNSYLVANIA PUBLIC UTILITY COMMISSION

**Pennsylvania Public Utility
Commission**

v.

Duquesne Light Company

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:
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:
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:
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:
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:
:

**Docket No.
R-00974104**

CERTIFICATE OF SERVICE

I hereby certify that I am serving the foregoing, the Surrebuttal Testimonies of the Office of Trial Staff dated December 11, 1997, either personally, by first class mail, express mail or by fax upon the persons addressed below:

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Kandace F. Melillo

Kandace F. Melillo
Prosecutor
Office of Trial Staff

Dated: December 11, 1997
R-00974104

APPEARANCE SHEET

ALJ HEARING REPORT

Docket No. R-00974104
R-00974104C0001-C0002
 Case Name Duquesne Light Company
 Location Pittsburgh
 Date December 15-19, 1997
 ALJ Corbett
 Reporting Firm Holbert

CHECK THOSE BLOCKS WHICH APPLY:

Prehearing held YES NO ^{KJR}

Hearing held YES NO **DOCUMENT FOLDER**

Testimony taken YES NO

Transcript due YES NO

Hearing concluded YES NO

Further hearing needed YES NO

Estimated add'l days Per schedule

RECORD CLOSED YES NO

Briefs to be Filed YES NO

DATE _____

BENCH DECISION YES NO

DATE _____

REMARKS: No hearing held 12-19-97 per ALJ + agreement of all parties.

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OFFICE OF C.A.L.J.
PUBLIC UTILITY COMMISSION

NAMES, ADDRESSES AND TELEPHONE NUMBERS OF PARTIES OR COUNSEL OF RECORD
 PLEASE PRINT CLEARLY
 INCOMPLETE INFORMATION MAY RESULT IN DELAY OF PROCESS

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Mary Ellulwoy
REPORTER

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Telephone No.	City State Zip			
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R-00974104

Duquesne Statement No. 1-R

Pittsburgh 12-15-97
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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

DUQUESNE LIGHT COMPANY
DOCKET NO. R-00974104

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Rebuttal Testimony
of
David D. Marshall

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Contents:

Overview of Response to Intervenor Testimony Regarding
Duquesne Customer Choice Plan

REBUTTAL TESTIMONY OF DAVID D. MARSHALL

1 Q. Please state your name and position with Duquesne Light Company ("Duquesne")?

2 A. My name is David D. Marshall and I am President and Chief Executive Officer of
3 Duquesne.

4 Q. Are you the same David Marshall that previously filed direct testimony in this
5 proceeding?

6 A. Yes.

7 **I. SUMMARY OF REBUTTAL TESTIMONY**

8 Q. What issues do you address in your rebuttal testimony?

9 A. My rebuttal testimony addresses intervenor testimony on the following topics: (i) the
10 valuation of Duquesne's generating assets and the related calculation of Duquesne's
11 stranded costs; (ii) the proposed disallowance of prudently incurred investments on the
12 basis of a "sharing" of stranded costs; (iii) the appropriate methodology for calculating
13 customer generating credits ("CGCs") during the transition period; and (iv) the potential
14 early retirement of Duquesne's generating units that may not be economic.

15 Q. Before summarizing Duquesne's response on each issue, please indicate whether
16 Duquesne is proposing any significant modifications to its Customer Choice Plan?

17 A. Duquesne has sought to respond to the concerns of the intervenor parties with
18 appropriate modifications of its Customer Choice Plan. Other Duquesne witnesses
19 describe the modifications that relate to their topics. I will address two important

1 modifications here because they relate to market valuation, an issue I discuss in some
2 detail.

3 First, Duquesne will, if the Commission deems it appropriate, divest all its
4 generating units in the year 2003 to establish a final valuation for those assets. The only
5 real criticism of Duquesne's market-based proposal for valuing its generating assets was
6 that Duquesne had not committed to a sale of those assets. To eliminate unproductive
7 disputes regarding the relative accuracy of differing market-based valuation techniques,
8 Duquesne will allow the Commission to order an auction in the year 2003. The year
9 2003 was selected using the market price forecasts and operating cost assumptions of
10 the Office of Consumer Advocate ("OCA"). As explained in the testimony of Mr.
11 Schnitzer, even if Duquesne accepts the more optimistic market price assumptions of
12 the OCA (other than the proposal to "share" stranded costs), Duquesne will not fully
13 recover its stranded costs until the end of 2003. Duquesne is therefore proposing to file
14 a petition with the Commission no later than December 31, 2002 instituting a final
15 valuation and, at the Commission's option, instituting an auction of the generating
16 assets. Duquesne also is adopting a "trigger" mechanism that accelerates the date for
17 a final valuation should market prices begin to rise even higher than the levels forecast
18 by the OCA. The specifics of Duquesne's final valuation proposal, as amended, are
19 described later in my testimony.

20 Second, Duquesne is offering to modify its proposal to calculate CGCs during
21 the transition period. As most witnesses agree, it is critical that the CGC during each
22 year of the transition period accurately reflect the market price of power during that

1 year. Duquesne has proposed using the results of a competitive power sale auction (or
2 "RFP") to set the CGC during each year of the transition period. However, several
3 parties have criticized the contract terms for the proposed power sale. Duquesne's
4 response is two-fold. First, Duquesne is willing to submit its proposed power sale
5 auction (both the proposed contracts and the solicitation procedures) to the Commission
6 for prior approval. Consequently, the Commission will have the opportunity to satisfy
7 itself that the terms of the solicitation are adequate to set a market-based CGC. Second,
8 Duquesne will cease using the RFP process if an index for market clearing prices is
9 established in the Duquesne area that is representative of the market prices for
10 Duquesne-supplied generation. While such an index does not exist today, it is possible
11 that during the transition period one may develop. Should such an index be established,
12 the need for an RFP would no longer exist and Duquesne would petition the Commis-
13 sion to substitute index prices for the prices resulting from Duquesne's RFP.

14 Q. Please summarize your conclusions regarding the four major points you are addressing.

15 A. The first issue is the appropriate method by which to value Duquesne's generating
16 assets. It is a fundamental premise of Duquesne's Customer Choice Plan that this
17 valuation be made by the market, not by expert witnesses using computer models to
18 forecast market prices and operating costs twenty to forty years into the future. Most
19 parties agree that it is inappropriate to calculate stranded costs using such long-term
20 forecasts. The simple reason is that long-term forecasts have historically proven
21 inaccurate; indeed, reliance on them has greatly contributed to the stranded costs that
22 exist today, particularly the costs of above-market power purchase obligations. Yet,

1 despite the nearly unanimous agreement on this basic point, most parties oppose
2 Duquesne's final valuation procedure because it does not include divestiture. Duquesne
3 has now offered such a commitment and thereby should have eliminated most disputes
4 regarding the valuation of its assets.

5 The second issue is the proposed disallowance of Duquesne's investment in
6 generating plant. Three parties, the OCA, DII and the Environmentalists, propose that
7 the Commission disallow recovery of a portion of Duquesne's investments in its
8 generating plants. Each of these parties contends that a "sharing" of stranded costs is
9 supported, if not required, by the Customer Choice Act. As explained below, and in the
10 testimony of Messrs. Clayton and Schnitzer, Duquesne strongly disagrees. The stranded
11 cost sharing proposals find no support in the Customer Choice Act because they
12 penalize Duquesne without regard to its ability, whether past or future, to mitigate its
13 stranded costs. They are also unfair, and contrary to sound ratemaking principles,
14 because they deprive Duquesne's shareholders the opportunity to earn a fair return on
15 prudently incurred costs. Finally, these witnesses incorrectly assert that their proposed
16 disallowances are consistent with past ratemaking practice in Pennsylvania. I am not
17 aware of a single instance in which a utility's prudent investment was disallowed on the
18 basis of a comparison of its embedded generation costs to forecasts of spot market
19 purchases over the remaining lives of those assets. Mr. Clayton and Mr. Schnitzer also
20 provide a detailed rebuttal to these proposals.

21 The third issue I address is the computation of CGCs during the transition
22 period. The intervenor proposals represent polar opposites. The parties representing

1 customers (e.g., the OCA and DII) argue for a fixed CGC that is set in advance,
2 contending that this gives customers the "certainty" they need to make power purchase
3 decisions. The suppliers (e.g., MAPSA and NEV), by contrast, argue for a CGC that is
4 adjusted each year, contending that otherwise the CGC could be set too low and
5 customers would have an artificial incentive to return to Duquesne because of the rate
6 cap. Duquesne agrees with the suppliers that, because of the rate cap, the CGC must be
7 adjusted each year during the transition period to reflect changing market prices.
8 However, Duquesne disagrees with the suppliers to the extent they propose to inflate the
9 CGC above actual market prices, thereby introducing an artificial incentive to leave
10 Duquesne. This important issue also is addressed by Mr. Schnitzer and Mr. Lahtinen.

11 The fourth issue I address is the potential that one or more generating assets will
12 be uneconomic over their useful lives and therefore should be shut down prematurely
13 in an effort to mitigate costs. Several parties contend that certain units (e.g., Perry and
14 Elrama) are uneconomic and should be shut down. As discussed by Mr. Schnitzer,
15 however, these parties have not considered the costs that can, and cannot, be avoided by
16 the early retirement of a particular unit. Mr. Clayton and Mr. Schnitzer discuss this
17 factual issue in some detail in their testimonies. The purpose of my testimony, by
18 contrast, is to present Duquesne's proposal for addressing early retirement decisions in
19 a fair and comprehensive manner. Specifically, Duquesne is proposing to submit, on
20 or before January 1, 1999, a study that addresses whether particular units should be shut
21 down and, if so, the appropriate treatment of the related costs. This study can be

1 critiqued by all interested parties and any resulting modifications to rates would be made
2 retroactive to January 1, 1999.

3 **II. THE VALUATION OF DUQUESNE'S GENERATING ASSETS**

4 Q. Before responding to the intervenor testimony, please provide a brief recap of
5 Duquesne's proposal to value its generating assets.

6 A. Duquesne proposed to refer the final valuation question to an arbitration panel in the
7 year 2003. The panel would be directed to use then-existing indicia of market prices,
8 such as comparable asset sales, forward contracts, and futures prices. Duquesne
9 submitted this proposal because (i) a market-based valuation is far superior to a long-
10 range forecast based on computer models, (ii) such a final valuation was more
11 appropriately conducted at a time when power markets were more fully developed, and
12 (iii) the rate cap imposed by the Customer Choice Act limits the ability of the
13 Commission to make a one-time determination of stranded costs accompanied by a fixed
14 schedule of CTCs and CGCs.

15 Q. Is this proposal supported by other parties?

16 A. Yes. As I indicated in the summary of my testimony, Duquesne's proposal to use a
17 market-based valuation is supported by nearly all parties. Certain parties, however, have
18 criticized the nature of the valuation and, specifically, the failure of Duquesne to commit
19 to auction its assets.

20 Q. Please be more specific in describing the views of the other parties on this issue.

21 A. I will describe the testimony of the six parties that support the use of a market-based
22 valuation of Duquesne's generating assets. It is important to recite each witness'

1 position because it shows their near unanimity on this issue. The party most fully
2 supportive of Duquesne's approach is the Office of Trial Staff ("OTS"). Mr. Metro, an
3 OTS witness, agrees with Duquesne that:

4 In my opinion, Duquesne's market value approach to stranded costs is superior
5 to a "regulator administered" approach. In a regulator administered approach,
6 the *projection of market rates* over a 30 year period would be necessary to
7 attempt to determine the net present value of the company's stranded costs. The
8 regulator administered approach is not accurate by any account.

9 * * *

10 No analyst can project the market prices accurately over the long run (more than
11 three years), or even the short run (up to three years). I believe that any utility's
12 stranded cost claim is in error if it is based on 30 year market rate projections.

13 OTS Statement No. 4 at 16-17. The only modifications to Duquesne's proposal
14 recommended by Mr. Metro are (i) extending the transition period if necessary to
15 recover the stranded costs identified in the final valuation, and (ii) use of a return on
16 equity of 10.5%, rather than 11.5% as proposed by Duquesne. Id. at 14.

17 Q. Do other parties concur with Duquesne and the OTS?

18 A. Yes. With the exception of the OCA and DII, all other parties of which I am aware
19 agree with the proposition that the Commission should rely on market forces, not
20 administrative forecasts, in determining stranded costs. Notably, however, all other
21 parties believe that an auction of *Duquesne's generating assets* is the only method that
22 would provide an accurate valuation. Rather than summarizing these positions, in the
23 interest of accuracy I will continue to quote directly from the testimony of each witness.

24 I will first describe the positions of parties that represent customer interests.

1 The Environmentalists are strongly supportive of Duquesne's approach,
2 particularly the timing of the valuation (i.e., to be held in several years, rather than
3 today). Mr. Schoengold, their witness, stated:

4 We currently do not have a competitive marketplace for power. . . . Thus, we
5 cannot reliably extrapolate from current market prices to estimate future market
6 prices. While we have theoretical models of how the markets are supposed to
7 work, theoretical models do not always predict real world behavior. Small
8 differences in market prices can make large differences in stranded costs. It is
9 best to wait and see what the actual market prices are and calculate stranded
10 costs after the fact, rather than guess at market prices ahead of time and lock into
11 probable mistakes.

12 Environmentalists' Statement No. 1 at 10. On deposition, Mr. Schoengold indicated that
13 he would agree with using an auction to value the assets, provided that it is conducted
14 several years from now:

15 Q. Would an auction of all the generating assets be a reasonable procedure
16 for a true-up valuation of the assets?

17 A. . . . [I]f the auction were taking place a few years down the road, when
18 we do have a competitive market in place or when it's presumed that
19 there will be a competitive market, I would say that would be a good
20 way of doing it.

21 Schoengold Deposition at 10-11.

22 The City of Pittsburgh also agrees that long-range forecasts are unreliable and
23 that a market-based valuation is preferable. Mr. Seiple, the City's witness, stated:

24 One of the major weaknesses of administrative valuation techniques that Mr.
25 Schnitzer points out in his testimony is that it is very difficult to forecast future
26 market prices. I agree with this assertion and also agree with his claim that one
27 of the most widely ignored aspects of forecasting is that "Costs and hence prices
28 are usually projected assuming that technology never improves, costs never
29 decline, and efficiency gains are never realized. This type of 'fixed technology'
30 estimate has historically proven to be very inaccurate." (Citing Schnitzer
31 Testimony at 8.)

1 City of Pittsburgh Statement No. 1 at 7. Like Mr. Schoengold, Mr. Seiple prefers an
2 auction to any other market valuation approach: "[t]he most preferable method would
3 have Duquesne commit to selling off a substantial portion of its generating assets to
4 determine market value." Id. at 16.

5 Finally, the Hospital Shared Services witness, Mr. Weisenmiller, also is critical
6 of administrative forecasts and would support a market-based valuation if it involved
7 an auction of Duquesne's generating assets. Direct Testimony of Robert Weisenmiller
8 at 141-48.

9 Q. What about parties representing suppliers? Do they concur with Duquesne on these
10 issues?

11 A. Yes, although they focus on the related issue of calculating CGCs, not a total level of
12 stranded costs. (The two suppliers addressing this issue, MAPSA and New Energy
13 Ventures, do not take a position on the overall level of stranded costs that should be
14 recovered.) The witness for NEV is Mr. Boonin, the Commission's former Chief
15 Economist. He agrees with Duquesne that the market, not administrative forecasts,
16 should determine the level of CGC (and hence CTC) charged each year during the
17 transition period. He states:

18 For the Commission to estimate a fixed price for generation in an unbundled,
19 full service tariff it must make and lock in numerous assumptions. Generally,
20 when estimating a price, "normal" assumptions are made about weather, fuel,
21 prices, economic conditions, supply availability, etc. These assumptions are for
22 extended periods. There is almost no possibility that these normal estimated
23 costs will produce a price at prevailing market rates at every time let alone at
24 most times.

25 * * *

1 I propose that the unbundled price for generation is to be determined by the
2 market. This is necessary in order to make choice a reality for retail customers
3 while treating all affected parties equitably.

4 NEV Statement No. 1 at 5, 3. Mr. Boonin proposes that prices from a regional power
5 exchange be used to set the CGC, rather than using the RFP as proposed by Duquesne.
6 Id. (Inexplicably, however, Mr. Boonin's testimony also appears to contemplate a one-
7 time determination of total stranded costs, such that his market-based proposal would
8 apply only to the determination of the amount of stranded costs recovered each year in
9 the CTC. He thus seems concerned only that suppliers not be harmed by one-time
10 determinations used to set the CGC, but not concerned as to whether shareholders are
11 harmed by one-time determinations to set total stranded cost recovery.)

12 The MAPSA witness, Mr. Russell, also concurs with the criticisms of
13 administrative forecasts: "[o]ne could rely upon experts to project future market prices,
14 but, as noted in the Company's testimony, experts have proven remarkably unprecise
15 in predicting future energy prices" (MAPSA Statement No. 1 at 6). Unlike Mr. Boonin,
16 however, Mr. Russell is not content to set the CGC at the actual market price of power.
17 He recommends setting the CGC at the cost of constructing a new generating unit,
18 seeking to encourage customers to switch away from purchases from Duquesne.

19 Q. You have described the testimony of six parties that support market-based valuation
20 methods. Do any parties disagree with these statements?

21 A. No. While The OCA and Duquesne Industrial Intervenors ("DII") support a one-time
22 determination of stranded costs based on long-range forecasts, I note that, in deposition,
23 their witnesses agreed that an auction of Duquesne's assets would provide a more

1 accurate valuation. Mr. Baron, DII's witness, stated that "the best valuation would be
2 achieved by a divestiture and a sale of the assets." Baron Deposition at 9. Mr. Kahal,
3 OCA's witness, agreed that "a divestiture would probably produce a more reliable
4 estimate" than "the kind of price and cost forecast that the OCA has presented,"
5 although he questioned whether the sale of Duquesne's nuclear assets was possible.
6 Kahal Deposition at 31.

7 Q. I take it then that all parties agree that the best approach is to value Duquesne's
8 generating assets through an auction. Please explain Duquesne's position on this issue.

9 A. Duquesne agrees that an auction of its generating assets will provide an accurate
10 valuation for those assets and equally important it will, unlike an administrative forecast,
11 provide Duquesne compensation for those assets at the same level that is used to
12 calculate the CTC. As indicated in the summary of my testimony, Duquesne is willing
13 to commit to such an auction to narrow or eliminate unproductive disputes in this case
14 over market valuation.

15 Q. Are you aware that, under the Customer Choice Act, the Commission cannot compel
16 such an auction of Duquesne's assets?

17 A. Yes. I am aware that Section 2804(5) provides that "[t]he commission may permit, but
18 shall not require, an electric utility to divest itself of facilities or to reorganize its
19 corporate structure." Duquesne will waive this protection, provided that the auction is
20 conducted in 2003 (unless market prices rise and trigger an early valuation).

21 Q. Why is the timing of the auction important? Why not just hold it today?

1 A. As I will explain in more detail below, the timing is critically important because of
2 Duquesne's obligation to serve its customers under the rate cap throughout the transition
3 period. Moreover, given Duquesne's substantial stranded costs, there is no need to
4 perform the valuation today, and there are good reasons (as expressed by several parties)
5 to postpone that valuation until markets are more fully developed.

6 Q. Please continue.

7 A. As discussed by Messrs. Clayton and Schnitzer, Duquesne selected the year 2003 using
8 the more optimistic market value estimates of the OCA. As they explain, using OCA's
9 assumptions (with the exception of the "sharing" disallowance), Duquesne can fully
10 amortize and depreciate its stranded costs by the end of 2003. (If less optimistic
11 assumptions were used, Duquesne would not fully recover its stranded costs until after
12 2005. See Ex. DJC-21.) Mr. Schnitzer also explains that, if market prices in the next
13 few years rise above the levels predicted by the OCA, Duquesne will accelerate the
14 valuation procedure – again, with the purpose of avoiding any overrecovery of stranded
15 costs. Finally, in the unlikely event that the auction produces a value that exceeds the
16 remaining book value of Duquesne's generating assets, Duquesne will reimburse
17 customers for any overcollections through future credits to their bills.

18 Q. Please explain how the valuation process would commence.

19 A. Duquesne will petition the Commission no later than December 31, 2002 to institute the
20 a final valuation. The petition will give the Commission two options: (i) order
21 Duquesne to auction all its generating assets, or (ii) appoint an arbitration panel to
22 determine the value of those assets using the best market evidence available. Duquesne

1 is providing the Commission with both options because it is possible that the
2 Commission could chose not to order divestiture due to (i) concerns of employees
3 associated with a sale of the plants, or (ii) the difficulty in selling Duquesne's nuclear
4 assets. In any event, the choice is that of the Commission, not Duquesne. Once
5 Duquesne files its petition, all interested parties can comment on whether the
6 Commission should order Duquesne to auction its assets or, instead, to utilize a board
7 of experts.

8 Q. Please return to the issue of the timing of the auction and why that is so important to
9 Duquesne?

10 A. The reason is the rate cap imposed by Section 2804(4) and Duquesne's continuing
11 obligation to serve its customers under Section 2807(e). These two provisions, taken
12 together, create the obligation to provide generation service at rates capped at current
13 levels while the CTC is being collected.

14 There are two problems with holding an auction today that stem from this
15 obligation. The first is that, if Duquesne were to auction its generating assets today, it
16 would have no generation remaining with which to fulfill its obligation to serve. It is
17 not clear that the Commission would allow the Company to simply fulfill that obligation
18 using spot market purchases or whether, instead, the Company would have to secure
19 longer term contracts to supply customers. Duquesne would strongly oppose the latter,
20 given that customers have the option, but not the obligation, to continue purchasing
21 from Duquesne. Any such long term arrangements would risk the incurrence of
22 additional stranded costs.

1 The second, and equally serious, problem is that Duquesne would bear the risk,
2 during the transition period, that market prices would rise above the level implicit in the
3 auction price. The reason is the rate cap imposed by the Customer Choice Act. Under
4 the rate cap, Duquesne cannot charge more than currently approved rates and this limits
5 Duquesne's ability to fix, in advance, a schedule of CTCs. That is because, by doing so,
6 one also implicitly fixes a CGC schedule for each year. Yet, if market prices rise above
7 the level forecast in the CGC, Duquesne cannot pass the cost of market purchases
8 through to its customers. As an example, if the auction resulted in a CGC of 2
9 cents/kWh, but market prices rose to 2.5 cents/kWh during the transition period,
10 Duquesne would have no choice but to purchase power at 2.5 cents/kWh in the market
11 and resell it to returning customers at 2 cents/kWh. The resulting economic losses to
12 Duquesne could be substantial, presenting an unacceptable risk to Duquesne's
13 shareholders. Conversely, customers would reap the benefits if market prices turned out
14 below the levels implicit in the auction price. I will discuss the relationship between the
15 rate cap and the methodology for setting CGCs later in my testimony as well.

16 Q. What about GPU's recent announcement to divest its generating assets? How is GPU
17 addressing the rate cap issue?

18 A. I have read GPU's recent announcement, but I am not aware that GPU has set forth a
19 specific plan or timetable regarding divestiture. It may be that GPU anticipates reaching
20 a settlement with affected parties that removes its continuing obligation to serve under
21 rates capped at current levels. In the absence of any such agreement, Duquesne has no
22 choice but to propose that the valuation be conducted in later years. In addition, as Mr.

1 Schnitzer, Mr. Schoengold and Mr. Russell seem to agree, there will be more abundant
2 evidence of market values in the future and this is an additional reason to postpone the
3 valuation for several years.

4 Q. Has Duquesne considered proposing that the rate cap provisions be waived?

5 A. Yes. Duquesne made such a proposal as part of its pilot program, but the proposal was
6 rejected. To explain, Duquesne proposed an option by which customers could receive
7 a fixed CTC during the transition period if they waived their right to return to service
8 from Duquesne at the rate cap. The purpose was to address the potential that certain
9 customers would prefer a fixed CTC over one that varied each year with market prices.
10 The fixed CTC would have been set on the basis of the levelized price from a long-term
11 firm power sale by Duquesne.

12 Q. What was the reaction to Duquesne's proposal?

13 A. The proposal was uniformly criticized by intervening parties on the basis that it
14 "conflicted" with the Customer Choice Act. For whatever reason, the parties were
15 unpersuaded by the fact that it was the customer's choice to select this option. The
16 Commission agreed with those parties and rejected the proposal. Duquesne therefore
17 did not resubmit the proposal in this proceeding. I should note, however, that if the
18 parties wish to revisit this issue, Duquesne is willing to consider resubmitting this
19 proposal (or one with a similar effect). But they cannot have it both ways: a fixed CTC
20 schedule, but a right to return to service under the rate cap whenever market prices rise
21 above pre-determined levels. If they truly desire certainty, it must come with
22 accountability -- i.e., the willingness to accept the associated market price risks.

- 1 Q. I understand from Mr. Clayton's testimony that the final valuation, and hence the
2 auction, could be triggered prior to the year 2003. Would your concerns regarding the
3 rate cap arise if this occurred?
- 4 A. They would arise if the values produced from the auction were not sufficient to
5 terminate, within a short period, collection of the CTC. This could occur, for example,
6 if market prices were rising above levels predicted by the OCA, and hence an early
7 valuation was conducted, but the auction price was lower than expected, thereby leaving
8 a CTC in place for a year or more. In such an instance, a solution to the rate cap
9 problem would have to be devised. It could involve an agreement to remove the cap or
10 an arrangement with the purchaser of the assets to sell Duquesne power at a fixed price
11 (a "call option"). Duquesne's willingness to auction its assets is predicated on an
12 assurance that the Commission will fairly address this issue if and when it arises.
- 13 Q. Are there any other implementation issues associated with Duquesne's final valuation
14 proposal.
- 15 A. Yes. Duquesne is authorizing the Commission to order it to auction up to 100% of its
16 generating assets. If the Commission chooses to require Duquesne to sell less than
17 100% of its generating assets, the remaining assets would be valued pursuant to the
18 arbitration panel proposal outlined in my direct testimony. The reason is that generating
19 assets are not fungible. For example, the auction of Duquesne's fossil units would not
20 provide a fair valuation of Duquesne's nuclear units.
- 21 Q. Do you expect this aspect of the proposal to be controversial?

1 A. No. It is my understanding that the main witnesses in this case fully agree with the
2 statements in the prior paragraph. See Baron Deposition at 18; Kahal Deposition at 32;
3 Russell Deposition at 20; Weisenmiller Deposition at 4-5.

4 Q. What would happen if the Commission ordered the sale of all the units, but there was
5 not a buyer for some of the assets?

6 A. The auction would set the value of only those assets that were actually sold. For the
7 assets that could not be sold, the absence of any market interest would cap their value
8 at zero. The matter would then be referred to the arbitration panel for a determination
9 of whether there was a negative value (e.g., costs that could not be avoided by shutting
10 the unit(s) down). The panel would then submit its recommendation on that issue to the
11 Commission for review and approval.

12 Q. Is Duquesne proposing that it be permitted to submit a bid to purchase its generating
13 assets?

14 A. As a stand alone company, Duquesne is simply too small to remain in the generation
15 business. Therefore, as a stand alone company, Duquesne has no expectation of
16 submitting a bid. However, the issue need not be addressed today. If Duquesne or its
17 affiliate desires to participate in the auction, Duquesne will make such a request in its
18 petition and propose appropriate safeguards to ensure that it does not have an advantage
19 over other, nonaffiliated bidders.

20 **II. PROPOSALS TO DISALLOW STRANDED COSTS**

21 Q. Please describe the proposals of the intervenors to disallow the recovery of stranded
22 costs.

1 A. There are three main proposals. The first is the OCA proposal, which would disallow
2 any return (equity or debt) on Duquesne's stranded generating assets. The second is the
3 DII proposal, which would disallow any equity return on Duquesne's stranded
4 generating assets (i.e., would not permit a return on the equity portion of the capital
5 invested in such assets). The third is the Environmentalists proposal, which would
6 allow recovery of no more than 60% of Duquesne's stranded costs. Each, however, has
7 a common thread: the proposed "sharing" of stranded costs between ratepayers and
8 shareholders.

9 Q. What is Duquesne's response to these proposals?

10 A. Mr. Schnitzer and Mr. Clayton provide a detailed response to these proposals in their
11 rebuttal testimony. I will limit my response to the following three points.

12 First, the proposals should be rejected because they bear no relation to any cost
13 mitigation that Duquesne could have taken to reduce its cost of service. The parties
14 concede this point. DII Statement No. 1 at 15 ("I am not challenging DLC's mitigation
15 efforts in this proceeding"); Kahal Deposition at 89 (witness does not "make any
16 representations or claims with regard to the prudence of the company in incurring any
17 investments"). The proposals thus are not only arbitrary in that they bear no relation to
18 any actions that Duquesne took or could have taken, but they also conflict with the
19 Customer Choice Act. The Act specifically states that, in considering the appropriate
20 level of stranded cost recovery, the Commission may take into account the utility's
21 mitigation efforts, but it makes no reference at all to a generic "sharing" of stranded
22 costs.

1 Second, as Mr. Clayton explains in more detail, the proposals would not allow
2 Duquesne an opportunity to earn a fair return on its prudently incurred capital. The
3 parties do not seriously contend otherwise, nor have they even bothered to estimate the
4 impacts on Duquesne. For example, Mr. Kahal suggests that "Duquesne has the
5 potential to achieve earnings on its nuclear plants in the competitive market if cost
6 control and operations are successful" (OCA Statement No. 1 at 43), but Mr. Kahal has
7 not even undertaken to calculate the financial impact of his proposal on Duquesne
8 (Kahal Deposition at 45-46). Moreover, as Mr. Clayton demonstrates, the OCA
9 adjustment eliminates any return on equity even if one assumes that the operational
10 improvements to which Mr. Kahal refers (which were projected by Duquesne) are
11 achieved.

12 Mr. Schoengold's testimony also is misleading. He contends that, if his proposal
13 is accepted, "the stockholders will end up having made a reasonable return (9.0 percent
14 for Duquesne . . .) on bad investments." Environmentalists Statement No. 1. Yet Mr.
15 Schoengold does not analyze whether a 9% return is "reasonable"; he just assumes that
16 it is. Moreover, he fails to provide any support or explanation for his calculations and
17 thus, as discussed by Mr. Clayton, it is impossible even to model their impacts with any
18 accuracy to determine whether his predicted "return" is accurate. In any event, as Mr.
19 Clayton testifies, Mr. Schoengold's proposal, if adopted, would have severe economic
20 consequences for Duquesne and would not permit Duquesne to earn, on a going forward
21 basis, anything close to a 9% return on equity.

1 Third, Messrs. Baron and Kahal contend that their proposals are consistent with
2 past ratemaking practice in Pennsylvania. This is not true, although I note at the outset
3 that this issue not dispositive; the real issue is whether such a disallowance is fair and
4 reasonable on the facts of this case. Putting that aside, however, I am unaware of any
5 case (and the parties do not refer to one) in which the Commission disallowed the
6 recovery of embedded generation costs on the basis of a comparison of those costs to
7 market price forecasts, which assumed that the capacity could be replaced by purchases
8 in the spot market. No such assumption would have been appropriate, given that
9 utilities have had an obligation to serve their loads on a long-term basis. That obligation
10 has never been discharged through reliance solely on the spot market (or the "coordina-
11 tion" market as it has been called traditionally).

12 In fact, the "practice" in Pennsylvania is just the opposite of that posited by the
13 intervenors. The practice in Pennsylvania that is most relevant here is that of rate of
14 return regulation -- in which rates are set on the assumption that the utility will earn no
15 more, and no less, than its allowed return. Under this practice, it is irrelevant if the
16 utility's assets turn out to be above, or below, their market value. In each instance, rates
17 are set on the basis of allowed returns.

18 A good (and very recent) example is the Ft. Martin sale. There, Duquesne
19 reached an agreement with the OCA and the Commission regarding the appropriate
20 disposition of the sale of Duquesne's share in the Ft. Martin plant. As noted by many
21 witnesses here, the sale price exceeded the book value of Duquesne's interest, but the
22 proceeds were not used to increase the returns to shareholders beyond approved levels;

1 rather, consistent with rate of return regulation, the gain was used to accelerate the
2 amortization and depreciation of strandable assets. Thus, Duquesne's shareholders did
3 not "share" the gains. It is therefore neither fair nor consistent for the OCA (and others)
4 to contend that, for the remaining plants – where market values are below book values
5 – it is "just and reasonable" for shareholders to bear an economic loss. To the contrary,
6 provided that Duquesne has adequately mitigated its cost of service (including through
7 actions such as the sale of Ft. Martin, which was the only one of its kind in Pennsylva-
8 nia), shareholders should continue to have the opportunity to earn a fair return, no more
9 and no less.

10 **III. THE METHODOLOGY FOR DETERMINING THE CGC**

11 Q. Please describe the scope of this section of your testimony.

12 A. In this section I will briefly discuss one important policy issue: the need to set CGCs
13 during each year of the transition period on the basis of the then-prevailing market price
14 of power.

15 Q. This seems to be an intuitive result. Is it controversial?

16 A. Yes. The reason is the rate cap imposed by the Customer Choice Act. The rate cap
17 produces a situation in which customers cannot be harmed if the CGC differs from
18 actual market prices, but suppliers and the incumbent utility (Duquesne) can be
19 substantially harmed. This dynamic is the reason the Commission is presented with
20 starkly different proposals from customer and supplier groups.

21 I will first address the customer proposals. The OCA and DII propose to set
22 CGCs at a fixed level throughout the transition period, using their computer forecasts

1 of market prices. They readily concede that, under this approach, if market prices rise
2 to levels above the fixed CGC, customers will return to Duquesne and take service at
3 the rate cap. "Taking service at the rate cap" means, for purposes here, purchasing
4 unbundled generation from Duquesne at a price equal to the CGC. When market prices
5 rise above that level, purchasing from Duquesne is clearly preferable to paying a
6 marketer the actual (higher) market price. In such a scenario, the customer is protected
7 and Duquesne is protected, given that the CGC was set on the basis of a market price
8 prediction that, in retrospect, was too low. However, the suppliers are harmed (they
9 contend) because customers will have an artificial incentive to return to service from
10 Duquesne.

11 Now consider the opposite scenario -- in which market prices fall below that
12 projected in the CGC. In this situation, customers are again protected because they are
13 not required to purchase power from Duquesne at the CGC. Consequently, one would
14 expect them to purchase power in the open market at lower rates. Suppliers too will
15 benefit under this scenario, given that customers are less likely to continue purchasing
16 from Duquesne under the rate cap. The loser in this scenario, of course, is Duquesne.
17 Duquesne will fail to fully recover its stranded costs because the fixed CGC, in
18 retrospect, was set too high and, hence, the CTC was set too low.

19 As the foregoing illustrates, customers have a natural incentive to "lock in" the
20 CGC because they gain "certainty" without any adverse economic effects associated
21 with the resulting loss of accuracy in forecasting the CGC. The suppliers, on the other
22 hand, have the incentive to adjust the CGC on an annual basis to reflect actual market

1 prices. Suppliers also, however, have an incentive to fix the CGC in advance, provided
2 that it is set so far above market prices that they bear no material risk of market prices
3 exceeding the CGC in any year. The latter incentive is illustrated by Mr. Russell's
4 proposal to set the CGC on the basis of the cost of constructing a new generating unit,
5 even though he concedes that ECAR has excess capacity.

6 Q. In view of these conflicting incentives, what is Duquesne's proposal?

7 A. The only fair resolution is to set the CGC at the market price and that is precisely the
8 purpose of Duquesne's RFP proposal. I recognize that many parties have criticized the
9 RFP as producing prices that are "too low". While this is not the point -- the goal is to
10 establish a method that measures actual market prices -- I note that the market prices
11 produced by the eight-year RFP are nearly identical to those forecast by the OCA, with
12 the sole exception of an artificial "bump" in market prices that OCA predicts will occur
13 in 2003 due to the addition of new capacity. Whether or not this spike in prices actually
14 occurs is, of course, a matter of speculation, but, from the results of the eight-year RFP,
15 the market is predicting that it will not occur. More to the point, however, none of the
16 parties (with the exception of Mr. Boonin) offers any concrete alternative for calculating
17 the true market price of power in the Duquesne region. In the absence of any such
18 alternative, the Commission should accept Duquesne's proposal, modified in the manner
19 mentioned in the summary of my testimony. (I also note that Mr. Lahtinen discusses
20 this issue in greater detail in his testimony.)

1 **IV. THE POTENTIAL EARLY RETIREMENT OF GENERATING ASSETS**

2 Q. Please summarize the intervenor testimony regarding the early retirement of generating
3 facilities.

4 A. There are a range of proposals, but they each have the common thread is that a particular
5 generating unit be shutdown permanently if it is not forecast to provide an economic
6 benefit over its remaining useful life. Alternatively, the witnesses would deny
7 Duquesne the recovery of the losses associated with continued operation of such a unit
8 if Duquesne chose to keep it running.

9 Q. What is Duquesne's response to these proposals?

10 A. Duquesne agrees that a unit should not continue to operate if it is clear that it will no
11 longer provide economic benefits. However, as Mr. Schnitzer and Mr. Clayton explain,
12 the intervenors have not factored in all the costs associated with shutting down particular
13 generating units. These include current costs that cannot be avoided, or at least cannot
14 be avoided entirely in the year the unit is retired. As these witnesses explain, once all
15 such costs are factored in, it is not clear that any of Duquesne's units should be retired
16 at this time.

17 *However, Duquesne agrees that the economics of retiring these units is a*
18 *complicated issue and that it merits continued attention during the transition period.*
19 *Consequently, Duquesne is proposing to submit a detailed study, on or before January*
20 *1, 1999, regarding the economics of shutting down any of its existing units. This study*

1 will be noticed for public comment and the Commission can make the determination of
2 whether any units should be shut down.

3 Q. Does this conclude your testimony?

4 A. Yes.

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RE: Application of Duquesne Light Company for
Approval of Restructuring Plan Under Section 2806
of the Public Utility Code; Docket No. R-00974104

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Dear Mr. Berger:

Enclosed please find two copies of Enron Power Marketing, Inc.'s Interrogatories, Set I. Please send two copies of your responses to the undersigned and one copy to our consultant:

Paul Reising
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550 Congressional Boulevard, Suite 290
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If you have any questions, please contact me.

Very truly yours,

Robert J. Longwell

For WOLF, BLOCK, SCHORR and SOLIS-COHEN LLP

LRJ/jlg
Enclosures

cc: Parties of Record

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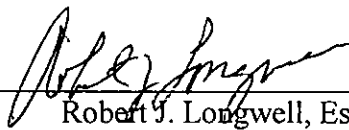
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RE: Application of Duquesne Light Company for
Approval of Restructuring Plan Under Section 2806
of the Public Utility Code; Docket No. R-00974104

Dear Pam:

Enclosed please find Enron Power Marketing, Inc.'s Interrogatories to the Duquesne Industrial Intervenors in the above-referenced matter. If you have any questions about them, please do give me a call.

Very truly yours,



Tanya C. Leshko
For WOLF, BLOCK, SCHORR and SOLIS-COHEN LLP

TCL/jlg
Enclosures

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I hereby certify that I have this day served a true copy of the foregoing document

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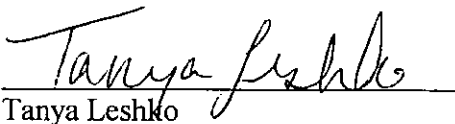
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