

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Application of Duquesne Light Company )  
for a Certificate of Public Convenience )  
Under Section 1102(a)(3) of the Public ) Docket No. A-110150F0035  
Utility Code Approving the Acquisition )  
of Duquesne Light Holding, Inc. by Merger )

Application of DQE Communications )  
Network Services LLC for a Certificate )  
of Public Convenience under Section ) Docket No. A-311233F0002  
1102(a)(3) of the Public Utility Code )  
Approving the Acquisition of Duquesne )  
Light Holding, Inc. by Merger )

DIRECT TESTIMONY OF

BARBARA R. ALEXANDER

Consumer Affairs Consultant

**(Customer Service, Service Quality, and Universal Service)**

ON BEHALF OF THE

OFFICE OF CONSUMER ADVOCATE

DECEMBER 21, 2006

RECEIVED  
2007 FEB 27 PM 3:29  
PA PUC  
SECRETARY'S BUREAU

1 Q. PLEASE STATE YOUR NAME AND ADDRESS.

2 A. My name is Barbara R. Alexander. My office is located at 83 Wedgewood Dr., Winthrop,  
3 Maine 04364. I use the title of Consumer Affairs Consultant for my consulting practice.

4 Q. ON WHOSE BEHALF DO YOU PROVIDE TESTIMONY IN THIS PROCEEDING?

5 A. I am testifying on behalf of the Office of Consumer Advocate (OCA).

6 Q. PLEASE DESCRIBE YOUR BACKGROUND AND QUALIFICATIONS FOR YOUR  
7 TESTIMONY IN THIS PROCEEDING.

8 A. I opened my consulting practice in March, 1996, after nearly ten years as the Director of the  
9 Consumer Assistance Division of the Maine Public Utilities Commission. While there, I  
10 managed the resolution of informal customer complaints for electric, gas, telephone, and  
11 water utility service, and testified as an expert witness on consumer protection, customer  
12 service and low-income issues in rate cases and other investigations before the Commission.  
13 My current consulting practice is directed to consumer protection, customer service and low-  
14 income issues associated with both regulated utilities and retail competition markets. My  
15 recent clients include the Pennsylvania Office of Consumer Advocate, Maryland Office of  
16 People's Counsel, Maine Office of Public Advocate, Vermont Department of Public Service,  
17 Citizens Utility Board in Wisconsin and in Illinois, and various AARP state offices  
18 (Montana, New Jersey, Maine, California, and the District of Columbia). I have published  
19 widely on consumer protection, service quality, universal service, and Default Service  
20 policies and programs.

21 I have assisted the Pennsylvania OCA in its restructuring activities concerning  
22 electricity and natural gas since 1997, numerous rulemaking proceedings relating to customer  
23 service, reliability of service, and consumer protection regulations, as well as the OCA's

1 participation in recent merger proceedings involving Pennsylvania electric and natural gas  
2 distribution companies, including Exelon and PECO Energy in 2000, FirstEnergy and GPU  
3 Energy in 2001, the Exelon-PSE&G proceeding in 2005, the merger of UGI Utilities and PG  
4 Energy (Southern Union) in 2006, and the pending application of Equitable Resources to  
5 purchase Dominion Peoples (2006).

6 I am also an attorney, and a graduate of the University of Michigan (1968) and the  
7 University of Maine School of Law (1976).

8 I attach my Resume as BA-Exhibit 1.

9 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

10 A. The purpose of my testimony is to respond to the filing by Duquesne Light Co. (Duquesne)  
11 seeking approvals from the PUC to transfer the control of Duquesne's parent to a holding  
12 company that will be owned and controlled by Macquarie Consortium (Macquarie), an  
13 investment fund based in Australia. My testimony will address those aspects of the  
14 acquisition that may affect customer service, reliability and service quality, and compliance  
15 with universal service mandates. Specifically, I will review Duquesne's service quality and  
16 universal service programs and policies and the promises made by the Applicants in this  
17 proceeding, and will propose conditions with respect to these issues that should be imposed  
18 if the Commission approves this acquisition.

19 Q. PLEASE SUMMARIZE YOUR CONCLUSIONS AND RECOMMENDATIONS.

20 A. The following summary is a high level presentation of my conclusions and  
21 recommendations, all of which are discussed in more detail in my testimony:

1 **I. Introduction and Reasons Why Customer Service, Reliability of Service, Universal**  
2 **Service, and Community Impact Policies and Programs Should be Carefully**  
3 **Considered in this Proceeding**  
4

- 5 ○ As part of the Application for approval of this transaction submitted to the  
6 Pennsylvania PUC, Duquesne's filing and testimony in support of the application did  
7 not specifically propose any quantifiable impact on service quality, customer service,  
8 or programs that respond to the needs of low-income customers that might result  
9 from the acquisition. Duquesne's vague statements concerning the potential benefits  
10 to Duquesne's customers are insufficient to assure that any benefits will accrue to  
11 Pennsylvania electric customers as a result of this transaction.
- 12 ○ *In an acquisition and merger of this type, customers bear significant risks that the*  
13 *forces set in motion in order to achieve the savings and generate the earnings that*  
14 *accompany an acquisition and merger may adversely impact customer service and*  
15 *service reliability. These risks can have particularly adverse consequences for low-*  
16 *income and other payment troubled customers.*

17  
18 **II. Pennsylvania's Customer Service and Reliability Policies**  
19

- 20 ○ In general, Pennsylvania has adopted a system of reporting key indicators of  
21 reliability and service quality by natural gas and electric distribution companies, but  
22 has not adopted specific performance standards that are applicable to all natural gas  
23 or electric distribution utilities.
- 24 ○ However, the Commission has approved or imposed specific performance standards  
25 on several utilities as a condition of a request for a merger or transaction of this type,  
26 in order to respond to the potential for service quality and customer service  
27 deterioration and to secure promised improvements.

28  
29 **III. Duquesne's Recent Customer Service Performance**  
30

- 31 ○ In general, Duquesne has reported performance above the average of other  
32 Pennsylvania electric distribution companies in most performance areas. However,  
33 Duquesne has reported the highest residential customer termination rate compared to  
34 other EDCs in recent years, a development that cannot be explained by the

1 implementation of statutory changes to the Commission's Chapter 56 credit and  
2 collection policies.

- 3 ○ Based on 2004-2005 customer satisfaction survey results, Duquesne's survey results  
4 have shown recent improvement.
- 5 ○ Duquesne's recent commitment to a \$500 million infrastructure improvement plan  
6 for 2005-2007 is not a substitute for measuring and assuring the actual performance  
7 of customer service and reliability of service for customers.

8 **IV. Proposed Reliability and Service Quality Standards and Customer Improvement Plan**  
9 **as a Condition for Approval of the Merger**

- 10 ○ I recommend that the Commission order Duquesne to adopt performance standards  
11 for a representative number of indicators for reliability and customer service quality  
12 as a condition of any approval of this acquisition. Duquesne's customers should be  
13 assured that service quality and customer service performance will remain at the  
14 generally high quality of the last several years and will not deteriorate as a result of  
15 this acquisition. This objective can be met by adopting specific performance areas,  
16 performance standards, and an enforcement mechanism that will return "service  
17 compensation dollars" to customers in the event of a failure to meet the annual  
18 performance standard.
- 19 ○ I have proposed 11 performance standards to measure the service quality and  
20 customer service for Duquesne's interactions with its retail customers, as well as the  
21 Lost Time Accident Rate, a measure of worker safety. My recommended  
22 performance standards reflect the historical performance of Duquesne, as well as a  
23 consideration of other Pennsylvania EDC performance results and typical industry  
24 standards. In other words, my proposed performance standards have been routinely  
25 met by one or more Pennsylvania utilities.
- 26 ○ Since Duquesne's historical performance with my recommended performance  
27 standards has already been demonstrated, I recommend that these standards be  
28 applicable beginning in the 2007 calendar year, for at least a four-year period that  
29

1 conforms to the recommendation for a cap on distribution rates by Mr. Kahal on  
2 behalf of the OCA.

- 3 ○ I propose that Duquesne be required to provide “service compensation dollars” to  
4 customers in the form of a one-time credit on the distribution portion of the bill when  
5 or if the company fails to meet any of these annual performance standards. These  
6 *performance areas primarily reflect interactions with residential customers and so I*  
7 *recommend that the credit be returned to residential customers. However, I would*  
8 *not object to the division of any applicable service compensation credits among*  
9 *residential and non-residential customers when the performance standard reflects*  
10 *interactions with non-residential customers. Where such division is applicable, I*  
11 *recommend that the compensation dollars for that particular metric be returned to*  
12 *each customer class in the pro-rata share of their percentage of the underlying*  
13 *interactions that are measured in the performance standard. I recommend that each*  
14 *percentage point in deterioration from the annual baseline performance standard be*  
15 *worth \$100,000. I recommend that 1% of Duquesne’s 2005 distribution revenues or*  
16 *a total of \$2.8 million be at risk for the failure to meet the annual performance*  
17 *standards. However, none of these dollars will be at risk if Duquesne and its new*  
18 *owners take steps to assure compliance with the annual performance standards and*  
19 *assure the continuation of the high level of historical service quality and implement*  
20 *the “best practices” that have been promised as a result of this acquisition.*
- 21 ○ Duquesne should report the results of its service quality and reliability performance  
22 to the Commission and to its customers annually. This report should include  
23 performance in all categories, both where the Company performed better and worse  
24 than the baseline standards, as well as any service compensation credits being  
25 returned to customers.

26  
27 **V. Implementation of Universal Service Programs**

- 28  
29 ○ Duquesne operates a number of Universal Service programs designed to respond to  
30 the needs of its low-income electric customers. These programs consist of a  
31 Customer Assistance Program (bill payment assistance in the form of percentage of

1 income discounts), Low-Income Usage Reduction Program or LIURP (energy  
2 conservation programs and weatherization), CARES (special counseling and  
3 assistance to help low-income households pay their energy bills), and Hardship Funds  
4 (ratepayer and shareholder contributions for local crisis assistance grants to eligible  
5 customers). In addition, in 2005 Duquesne initiated five new "Stay Warm" programs  
6 for customers whose needs were not met by these traditional programs.

- 7 ○ Both Duquesne's CAP and LIURP programs have demonstrated increased enrollment  
8 and an increased spending level was reflected in the recently negotiated base rate case  
9 Settlement approved by the Commission.
- 10 ○ Duquesne sponsors a Hardship Fund to provide crisis assistance to low-income,  
11 payment-troubled customers and has contributed utility and shareholder contributions  
12 of \$390,000 in 2004-2005.
- 13 ○ Duquesne relies on Dollar Energy to administer its hardship funds and its Stay Warm  
14 benefit programs. In addition, the company has a working relationship with other  
15 community-based organizations with respect to the operation of its CAP and LIURP  
16 programs.
- 17 ○ The Filing provided little or no information on the impact of this proposed  
18 acquisition on Duquesne's universal service programs and credit and collection  
19 programs that are crucial to the ability of low-income customers to obtain and  
20 maintain essential electric services.

21  
22 **VI. Proposed Universal Service Program Conditions for Approval of the Merger**

- 23 ○ The Commission should require Duquesne to continue its current level of funding  
24 and administrative support for universal service programs (CAP, LIURP, Hardship  
25 funding) for the four-year stay out period recommended by Mr. Kahal on behalf of  
26 the OCA, without any further customer contributions or change in the method of  
27 funding these programs.
- 28 ○ Second, Duquesne should form a collaborative or committee composed of local  
29 representatives of the low-income community, community-based organizations, and  
30 the OCA and commit to bringing forward any proposed changes to its universal  
31

1 service programs and policies for discussion prior to implementation of changes.  
2 Such an approach has worked well in the PECO Energy service area.

- 3 ○ Third, during the stay out period, Duquesne should commit to the *incremental*  
4 *funding* required for the five new Stay Warm programs identified in its recent base  
5 *rate case filing* (\$1.2 million) as a direct merger benefit. If the need for these Stay  
6 *Warm programs declines*, any excess amounts can be used to respond to CAP  
7 *program enrollment*. This benefit should be in addition to Duquesne's and  
8 *Macquarie's* commitment to continue its current level of spending for community and  
9 *charitable giving* for a five-year period, a commitment that should be accompanied by  
10 *an annual growth rate of at least 5%* to reflect the annual growth in charitable  
11 *contributions reflected in Duquesne's* recent history.

1 **I. INTRODUCTION: WHY CUSTOMER SERVICE, SERVICE QUALITY,**  
2 **RELIABILITY OF SERVICE, AND UNIVERSAL SERVICE POLICIES AND**  
3 **PROGRAMS SHOULD BE CAREFULLY CONSIDERED IN THIS PROCEEDING**  
4

5 Q. PLEASE DESCRIBE THE TRANSACTION BEING PROPOSED IN THIS PROCEEDING  
6 AND HOW THIS CHANGE RAISES CONCERNS ABOUT SERVICE QUALITY,  
7 RELIABILITY, AND UNIVERSAL SERVICE PROGRAMS.

8 A. Duquesne is a regulated electric distribution company (EDC). If the acquisition is approved,  
9 the EDC will be owned by a consortium of investment interests based in Australia, the  
10 *Macquarie Consortium*. The Application states that Duquesne will remain subject to the  
11 regulatory jurisdiction of the PUC and will be managed by locally-based managers.  
12 According to Macquarie, their main interest is in acquiring entities that have the potential for  
13 long term and stable rates of return. This is the first U.S.-based electric utility that  
14 Macquarie has sought to acquire, although Macquarie has recently bought a water utility that  
15 operates in several New England states and a natural gas utility based in Hawaii. Macquarie  
16 affiliates own transmission and distribution utilities in Australia, New Zealand, and the U.K.  
17 Macquarie has not made any promises with respect to specific levels of customer service and  
18 reliability nor has any specific promise been made with respect to the operation of the current  
19 universal service programs. Mr. Matthew Kahal, on behalf of the OCA, describes the  
20 transaction in more detail.

21 The lack of specificity with respect to the impact of this transaction on customer  
22 service, service quality, and low-income programs and the failure to identify any specific  
23 goals and objectives that will guide the operations of Duquesne by its Australian-based  
24 investment owners increases the risk of a degradation of service quality and reliability of  
25 service, as well as threatens the ability of vulnerable lower income customers to maintain and

1 retain affordable service. These risks must be considered in light of the obligation for the  
2 proponents of this transaction to demonstrate substantial affirmative benefits for  
3 Pennsylvania customers.

4 Q. WHAT DO THE APPLICANTS SAY ABOUT THE CUSTOMER SERVICE  
5 IMPLICATIONS OF THE PROPOSED ACQUISITION OF DUQUESNE LIGHT BY THE  
6 MACQUARIE CONSORTIUM?

7 A. As part of the Application for approval of this transaction submitted to the Pennsylvania  
8 PUC, Duquesne submitted the testimony of Mr. Morgan K. O'Brien, its President and Chief  
9 Operating Officer. [Statement No. 1] Mr. O'Brien explained the rate case settlement and  
10 Duquesne's plan to invest more than \$500 million in capital expenditures for the Company's  
11 electric distribution and transmission infrastructure in the 2005-2007 period. He also  
12 explained the Company's "Best in Class" initiative to focus on reducing costs and improving  
13 customer satisfaction and service quality. Mr. O'Brien stated that, "Our ability to provide  
14 safe, reliable and efficient service will be maintained and enhanced by this transaction as we  
15 will have improved access to local and global resources for raising capital, for information  
16 sharing and the ability to share best practices between Duquesne Light and the Macquarie  
17 Group members" and stated that Macquarie would fund the necessary maintenance and  
18 infrastructure upgrades so as to continue to provide "high levels of service and reliability" to  
19 Duquesne's customers. [Statement No. 1, at 14-15] Mr. Christopher J. Leslie on behalf of  
20 Macquarie Group echoed these commitments concerning service quality and reliability of  
21 service. [Statement No. 2, at 15]

22 However, the Applicants have not identified any specific performance goals or  
23 objectives to back up this vague set of commitments. When asked when the new

1 “initiatives” would be identified and implemented, Macquarie responded that these initiatives  
2 would be identified by senior management from Duquesne and Macquarie after the merger  
3 was approved.<sup>1</sup> There is no specific timetable or process to identify or implement “best  
4 practices.”<sup>2</sup> Both Duquesne and Macquarie acknowledge that any commitments can be  
5 tracked or monitored through the PUC annual reports on service quality and reliability of  
6 service.<sup>3</sup>

7 Q. DID THE APPLICANTS STATE ANY SPECIFIC LOW-INCOME PROGRAM  
8 IMPLICATIONS ASSOCIATED WITH THE MERGER?

9 A. There is no mention of specific improvements or changes with respect to credit and  
10 collection programs or Universal Service programs in the Filing. However, Mr. O’Brien  
11 made a commitment to maintain Duquesne’s headquarters in Pittsburgh, continue the current  
12 management, honor the current collective bargaining agreement and provide wage and  
13 benefit protections for non-represented employees. [Statement No. 1, at 15] Mr. Christopher  
14 J. Leslie on behalf of Macquarie Group testified that they would commit, “at a minimum, to  
15 maintaining Duquesne’s active role in supporting the community” and the holding company  
16 would agree to provide “corporate contributions and community support in Southwestern  
17 Pennsylvania for a period of at least five years at the levels comparable to those provided by  
18 Duquesne in its 2006 budget.” [Statement No. 2, at 14]

---

1 Response to OCA-I-37 and 41.

2 Response to OCA-I-35.

3 Response to OCA-I-34, 36 and 40.

1 Q. DID DUQUESNE OR MACQUARIE COMMIT TO ANY LEVEL OF SAVINGS OR  
2 SYNERGIES AS A RESULT OF THIS TRANSACTION?

3 A. No. Macquarie views this transaction as an investment to benefit its privately owned  
4 investment companies and alleges that since two utilities are not being combined, there are  
5 no “synergies” or “merger savings” as such. [Statement No. 2, at 16]

6 Q. WHY ARE YOU CONCERNED ABOUT THE IMPACTS OF THIS TRANSACTION ON  
7 DUQUESNE’S RESIDENTIAL CUSTOMERS IN LIGHT OF THESE STATEMENTS?

8 A. *There are a number of reasons why this proposed acquisition does not adequately respond to*  
9 *the needs of residential customers or demonstrate any benefits to these customers:*

10 First, both Duquesne’s description of the benefits to its customers and Macquarie’s  
11 commitments are vague promises without any enforceable mechanism or performance  
12 standards to track and assure compliance in the future. While these general statements may  
13 be positive, they are not accompanied by any specific financial commitments or performance  
14 targets, and do not carry with them any risk to Macquarie or its investors if they are not met.  
15 On the contrary, all the risks associated with the failure to meet these commitments remain  
16 with Duquesne’s Pennsylvania customers.

17 Second, some of the public benefits identified by Mr. O’Brien and Mr. Leslie relate to  
18 activities, such as economic development initiatives that are limited to new business loads,  
19 *i.e., there are no residential customer benefits.*

20 Third, customers will bear significant risks associated with the transfer of ownership  
21 from a Pennsylvania-based utility with publicly traded stock and shareholders responsive to  
22 Pennsylvania regulatory policies to an Australian-based investment vehicle that is privately  
23 owned. While the public commitments concerning maintaining Duquesne’s high level of

1 service quality and reliability are welcome, the lack of specific enforceable commitments is  
2 *disturbing*. This is because the urge to generate the return on the substantial investment  
3 made to acquire Duquesne may result in pressure to cut costs and reduce expenses, thus  
4 adversely impacting customer service and service reliability. Furthermore, the vague  
5 suggestion that this transaction will result in “best practices” suggests that changes, however  
6 well intentioned, may carry the risk of unintended consequences. I am not suggesting that  
7 adverse results are necessarily inevitable as a result of this transaction. However, it is only  
8 appropriate to point out the potential for such actions that have occurred when utilities have  
9 been acquired by new owners in the past and that could occur when management is striving  
10 to demonstrate lower costs and savings to its investors. Of course, it may be possible to  
11 reduce costs, increase efficiency, increase profits, and improve customer service and service  
12 quality performance. My recommendations are designed to make it more likely that these  
13 “win-win” results do occur and that the risk of their non-occurrence is shifted from  
14 Duquesne’s customers to Macquarie’s investors.

15 Finally, the risks I have described above can have particularly adverse consequences  
16 for low-income and other payment troubled customers. These customers rely heavily on the  
17 ability to reach customer service representatives in a timely manner, respond to threats of  
18 discontinuance of service, negotiate reasonable payment arrangements, and make use of their  
19 rights under the Commission’s credit and collection and consumer protection rules. This is  
20 particularly true because of the enactment of Chapter 14 of the Public Utility Code, which  
21 made a number of statutory changes to the PUC’s Chapter 56 customer protection  
22 regulations, specifically concerning restrictions on access to payment arrangements,  
23 application for service and deposit practices, and criteria for disconnection of service. More

1 so than other residential customers, low-income, vulnerable, and payment troubled customers  
2 rely on access to customer call centers to negotiate payment arrangements, respond to  
3 disconnection notices, and enroll in various low-income programs. Low-income customers  
4 (defined as those with household income at or below 150% of Federal Poverty Level) are  
5 typically disconnected more frequently than non low-income customers and experience a  
6 higher rate of nonpayment.<sup>4</sup> The receipt of timely and accurate bills and disconnection  
7 notices with a well-understood and efficient collection routine is crucial to such customers'  
8 ability to manage their monthly payments and seek financial assistance. These activities are  
9 at risk when a utility with a historically "good" service quality is subjected to pressures to  
10 assure adequate profits to absentee owners.

---

4 According to the U.S. Department of Energy-Energy Information Administration 1997 Residential Energy Consumption Survey, over 5% of low-income households experienced an electric shutoff in 1997 compare to less than 2% of those over 150% of poverty. Those with very low-income (less than \$5,000 annual household income) experience disconnection at an even higher rate, about 8%.

1 **II. PENNSYLVANIA'S CUSTOMER SERVICE AND RELIABILITY POLICIES**

2  
3 **Q. DOES PENNSYLVANIA HAVE CUSTOMER SERVICE QUALITY AND RELIABILITY**  
4 **STANDARDS APPLICABLE TO ALL ELECTRIC UTILITIES?**

5 **A.** In general, Pennsylvania has adopted a system of reporting key indicators of reliability and  
6 service quality by natural gas and electric distribution companies, but has not adopted  
7 specific performance standards by rule that are applicable to all natural gas or electric  
8 distribution utilities.<sup>5</sup> With respect to customer service, the Commission, pursuant to 52 Pa.  
9 Code Section 54.151, requires EDCs to report performance for a wide variety of customer  
10 service metrics that reflect customer call center performance, complaint handling, billing,  
11 meter reading, and transaction surveys. EDCs must also report on key indicia for reliability  
12 of service, namely Customer Average Interruption Duration Index (CAIDI), System Average  
13 Interruption Frequency Index (SAIFI), and System Average Interruption Duration Index  
14 (SAIDI) pursuant to 52 Pa. Code Section 57.195. The Commission also requires all larger  
15 electric utilities to report on key indicators of credit and collection programs on a monthly  
16 basis pursuant to 52 Pa. Code Section 56.231. These credit and collection indicators include  
17 information on customer payments, payment plans, overdue amounts, uncollectible expense,  
18 termination, and reconnection activities. Finally, the PUC's Bureau of Consumer Services  
19 publishes an annual report on utility complaint handling and termination activities for electric  
20 and natural gas utilities.

---

5        However, the PUC has approved utility-specific performance standards as a condition of transfers of ownership and mergers, e.g., PECO Energy (Exelon merger), GPU Energy companies (FirstEnergy merger), and, most recently, UGI-Gas and PG Energy (UGI acquisition).

1 Q. HAS THE COMMISSION APPROVED OR ORDERED SERVICE QUALITY  
2 PERFORMANCE STANDARDS FOR OTHER PENNSYLVANIA UTILITIES AS A  
3 CONDITION OF TRANSACTIONS OF THIS TYPE?

4 A. Yes. In both contested cases and settlements, the Commission has approved specific service  
5 quality assurance plans as a condition of approval of a merger or acquisition similar to that  
6 pending in this proceeding. For example, in the GPU/FirstEnergy merger proceeding, the  
7 Commission imposed a service quality assurance plan over the objections of FirstEnergy.  
8 [Re: GPU, Inc., 96 Pa. P.U.C. 1, 16-19 (Order Entered June 20, 2001)] In that case the  
9 Commission stated that the "OCA's SQI [Service Quality Index] is designed to ensure that  
10 the merger does not result in deterioration in safety, reliability or customer service." [Id. at  
11 18] In addition, the Commission recognized that there was a need to establish specific and  
12 enforceable<sup>6</sup> performance standards:

13 Furthermore, without the SQI or some other customer service and  
14 reliability measurement and enforcement mechanism, the Applicants'  
15 claimed public benefit of improved customer service would be  
16 illusory. [Id. At 19]  
17

18 Other recent merger and acquisition cases of this type have also resulted in negotiated service  
19 quality performance standards and reporting requirements. See, e.g., the recent settlement in  
20 the UGI-PG Energy merger (2006), the PECO Energy merger with Exelon in 2000, and the  
21 proposed merger between Exelon and PSEG in 2005.

---

6 I recognize that the Commission has not approved the automatic or predetermined service compensation dollar approach I have recommended in those cases and in this testimony, but my point here is to emphasize that the Commission has made the connection between inchoate promises in merger and acquisition applications and the need for performance standards and reporting mechanisms to prevent deterioration and monitor for improvement.

1 **III. DUQUESNE'S SERVICE QUALITY AND CUSTOMER SERVICE PERFORMANCE**

2  
3 Q. PLEASE DISCUSS DUQUESNE'S CUSTOMER SERVICE PERFORMANCE AS  
4 REPORTED TO THE PUC IN RECENT YEARS.

5 A. The following chart shows the performance of Duquesne Light and compares its performance  
6 to the average of other Pennsylvania EDCs where such an average has been calculated in the  
7 PUC reports. The information below is drawn from the PUC's annual reports on Credit and  
8 Collection, Reliability of Service, and Service Quality performance.

1 **HISTORICAL CUSTOMER SERVICE AND RELIABILITY PERFORMANCE: DUQUESNE<sup>7</sup>**

Performance Indicator	2002	2003	2004	2005	Comments
1. Call Center: % calls answered w/in 30 seconds	69%	76%	80%	80.20%	Above average EDC performance in 2004 and 2005
2. Call Center: Average Busy-out Rate	7.0%	0%	0%	0.02%	Significant improvement since 2002
3. Call Center: Average Call Abandonment Rate	15%	4%	3%	3.10%	Same
4. Percent of residential bills not rendered once every billing period	0%	0%	0%	0%	Best performance.
5. # of res. Customer disputes not issued a report within 30 days	164	34	3	19 (1.6 monthly average)	Above average
6. Residential Termination Rate (terminations per 1000 residential customers)	1.77%	1.74%	2.03%	4.22%	Historically higher than average; highest termination rate for confirmed low-income in 2005, a 100% increase from 2004 <sup>8</sup>
7. Justified Residential Payment Arrangement Request Rate	3.39	2.05	2.45		
8. Justified Residential Consumer Complaint Rate	0.11	0.12	0.06		
9. CAIDI	92	85	92	98	Consistently below or better than the "benchmark"; best among Pennsylvania EDC's for 2005
10. SAIFI	1.32	1.30	1.03	0.98	Above or worse than the "benchmark" in 2002 and 2003, but below or better than in 2004 and 2005; second best for 2005
11. Lost Time Accident Rate (LTAR)	Not available	Not available	Not available	Not available	

7 The performance data in this chart is from PUC annual reports and the Duquesne responses to OCA-I-1.

8 This increased use of terminations in Duquesne's collection program may be linked to the 33% reduction in percent of revenue in debt for its residential electric customers from 2004 to 2005. The 2.8% of residential revenues in debt is among the lowest of Pennsylvania EDCs. See page 10 and page 31 of the 2005 Report on Universal Service Programs and Collection Performance.

1 Q. DID YOU REVIEW CUSTOMER SATISFACTION SURVEY DATA FOR DUQUESNE?

2 A. Yes. The PUC supervises a uniform customer satisfaction survey that reflects quarterly  
3 results for all electric and gas utilities. Based on the 2004 customer satisfaction survey  
4 results, Duquesne's performance is in the bottom third of the other EDCs with regard to  
5 "ease of reaching the EDC" and "using an EDC's automated phone system." However, the  
6 difference between Duquesne's result and the best performers was not large. When  
7 considering the satisfaction with how a representative has handled the contact with the  
8 customer, Duquesne's performance is 92% compared to the 93% average. In terms of overall  
9 satisfaction, Duquesne's performance was 90%, the average of all EDCs and only slightly  
10 below the top performer of 93%. Based on 2005 results, Duquesne showed further  
11 improvement and its overall customer satisfaction approval rating of 91% was only slightly  
12 below the 92% rating enjoyed by two other EDCs.

13 Q. WHAT IS YOUR OVERALL CONCLUSION CONCERNING SERVICE QUALITY AND  
14 CUSTOMER SERVICE PERFORMANCE AT DUQUESNE BASED ON THIS  
15 PERFORMANCE DATA?

16 A. In general, Duquesne's reliability and service quality performance ranks among the highest  
17 level of all Pennsylvania EDCs in most categories. The only troubling statistic is the very  
18 high termination rate for Duquesne's residential customers compared to other EDCs. This  
19 trend was evident prior to the enactment of the Chapter 14 changes to the PUC's Chapter 56  
20 termination and payment plan regulations in 2004. In 2005, Duquesne's residential  
21 termination rate took another substantial jump, exceeding that of other Pennsylvania EDCs,  
22 all of whom increased termination somewhat in response to the implementation of Chapter  
23 14. Furthermore, Duquesne's 2005 residential termination rate for confirmed low-income

1 customers was also the highest compared to other EDCs. In 2006, Duquesne moderated its  
2 frequency of termination somewhat, recording a 7% drop from October 2005 to October  
3 2006.<sup>9</sup>

4 Q. WHAT RELEVANCE IS THIS PERFORMANCE INFORMATION AND YOUR  
5 CONCLUSION TO THIS PROCEEDING?

6 A. *It would not be appropriate to approve this transaction without setting in motion a plan for*  
7 *making sure that the reliability and customer service performance that ratepayers have*  
8 *financed through the current base rates continues after the merger. Based on these historical*  
9 *performance results, Macquarie's ability to deliver on its promise to assure excellent service*  
10 *quality should be made specific and enforceable.*

11 Q. WHAT CONSIDERATION SHOULD BE GIVEN TO THE PROMISE TO CONTINUE TO  
12 FUND AND SUPPORT DUQUESNE'S MULTI-YEAR TRANSMISSION AND  
13 DISTRIBUTION INFRASTRUCTURE IMPROVEMENT PROGRAM?

14 A. Duquesne initiated a \$500 million infrastructure improvement plan in 2005 and Duquesne  
15 has promised to support and continue this plan as a result of the approval of the merger. I  
16 have not reviewed the details of this improvement plan or its linkage to retail service quality  
17 *and reliability. The promise to invest in capital improvements at Duquesne is important, but*  
18 *a regulatory focus on actual service quality and reliability results as reflected in Duquesne's*  
19 *performance as reported to the PUC is necessary to ensure the achievement of service*  
20 *quality. Therefore, the commitment to fund improvements should not be viewed as a*  
21 *substitute for commitments to achieve actual results that will assure a high level of actual*  
22 *performance on an annual basis.*

---

9 PUC, Terminations and Reconnections-Year-to-Date 2005 vs. 2006 through October.

1 **IV. PROPOSED SERVICE QUALITY ASSURANCE PLAN FOR DUQUESNE AS A**  
2 **CONDITION OF APPROVAL OF THIS ACQUISITION BY MACQUARIE GROUP**

3  
4 Q. DO YOU HAVE A RECOMMENDATION IN RESPONSE TO THE CONCERNS YOU  
5 RAISED ABOUT THE RISKS ASSOCIATED WITH THIS TRANSACTION'S IMPACT  
6 ON QUALITY OF SERVICE FOR DUQUESNE'S RESIDENTIAL CUSTOMERS?

7 A. Yes, I recommend that the Commission order Duquesne to adopt performance standards for a  
8 representative number of indicators for customer service quality as a condition of any  
9 approval of this acquisition. Duquesne's customers deserve the continuation of their  
10 relatively high level of service quality performance as a condition of approval of this  
11 transaction. These historical performance results should be protected and not allowed to  
12 deteriorate with the transfer of ownership to Macquarie Group. This can best be done by  
13 adopting specific performance areas, performance standards, and an enforcement mechanism  
14 that will return "service compensation dollars" to customers in the event of a failure to meet  
15 the annual performance standard.

16 Q. PLEASE GIVE AN OVERALL SUMMARY OF THE SERVICE QUALITY ASSURANCE  
17 PLAN THAT YOU PROPOSE AS A CONDITION OF THE COMMISSION'S  
18 APPROVAL OF THE ACQUISITION.

19 A. In general, the Commission should establish a *Service Quality Assurance Plan* that measures  
20 the key attributes of reliability and customer service. The adoption of a Service Quality  
21 Assurance Plan will enhance the likelihood that promises made by the applicants in this  
22 proceeding will be achieved and that customers will receive benefits from this transaction in  
23 the form of continued high service quality. The Plan should measure customer call center  
24 performance, customer complaint handling, billing accuracy and timeliness, meter reading,

1 reliability of service, and other key attributes of customer service that are routinely reported  
2 and monitored by the PUC. In addition, the plan should include a key measurement of  
3 worker safety, the Lost Time Accident Rate. Performance in each area should be compared  
4 to a pre-established baseline performance standard and when performance falls below the  
5 standard, Duquesne should be required to compensate customers for lower service quality in  
6 the form of a “service compensation” credit.

7 Q. WHAT SPECIFIC PERFORMANCE AREAS SHOULD BE INCLUDED IN THE PLAN  
8 AND WHAT SPECIFIC BASELINE PERFORMANCE STANDARDS SHOULD BE  
9 ESTABLISHED FOR EACH INDICATOR?

10 A. I recommend that the Commission include the 11 items that I have set forth in my  
11 presentation of historical performance in Part III of this testimony. These performance areas  
12 represent a wide range of representative reliability of service and customer service  
13 performance areas that are already routinely tracked and monitored and do not, therefore,  
14 require the development of new reporting requirements or data tracking protocols.

15 Q. WHY HAVE YOU INCLUDED THE LOST TIME ACCIDENT RATE (LTAR) IN YOUR  
16 PROPOSED SERVICE QUALITY ASSURANCE PLAN?

17 A. A number of state regulatory commissions have included a broad measurement of employee  
18 safety in a service quality index such as I have proposed here. The purpose of such an  
19 inclusion is to make sure that the utility delivers its reliability and service quality in such a  
20 manner that employees are the focus of safety policies and practices. In other words, utilities  
21 must assure that their customers experience good service quality and customer service, but  
22 not at the expense of their workers. In addition, the Commission’s recent Focused  
23 Operations and Management Audit of Duquesne Light recommended that the utility adopt

1 performance goals to improve its worker safety programs. While I do not have the historical  
2 performance by Duquesne with respect to LTAR, I have included Duquesne's annual goals  
3 for this performance area as reflected in its Implementation Plan submitted in May 2006 in  
4 response to the Management Audit.

**SERVICE QUALITY ASSURANCE PLAN**

1  
2

<b>Performance Indicator</b>	<b>Proposed Annual Performance Standard</b>
1. Call Center: % calls answered w/in 30 seconds	80% (2004 and 2005 performance)
2. Call Center: Average Busy-out Rate	0.05% (reflects recent performance of essentially 0%)
3. Call Center: Average Call Abandonment Rate	3% (2004 performance)
4. Percent of residential bills not rendered once every billing period	0% (recent performance)
5. # of Res. Customer disputes not issued a report within 30 days	Average of 1/month (reflects 2004 and 2006 performance)
6. Residential Termination Rate (terminations per 1000 residential customers)	3% (EDC average in 2005)
7. Justified Residential Payment Arrangement Request Rate	2.45 (2004 performance)
8. Justified Residential Consumer Complaint Rate	0.1 (2004 performance)
9. CAIDI	98 minutes (highest level in 2002-2005 period)
10. SAIFI	1.16 incident (average of 2002-2005 period)
11. Lost Time Accident Rate (LTAR)	0.26-2006 and 2007 0.20-2008 and 2009 0.13-2010

3

4 Q. PLEASE EXPLAIN YOUR APPROACH IN ESTABLISHING THE PROPOSED  
5 PERFORMANCE STANDARDS.

6 A. Except for LTAR, I have proposed performance standards that reflect Duquesne's actual  
7 performance in the recent past. Duquesne has met the proposed performance standards in

1 2004-2005 for all metrics except Customer Disputes Not Issued a Report within 30 Days  
2 (*Company has already taken steps to achieve the 2004 performance*) and Residential  
3 Termination Rate (Duquesne's performance is below average, i.e., terminates a higher rate of  
4 residential customers than other Pennsylvania EDCs). Therefore, there is no significant  
5 increase in expenditures required to meet these performance standards and there is room for  
6 improvement due to the promise to implement "best practices."

7 Q. SHOULD CUSTOMERS BE COMPENSATED DIRECTLY FOR SERVICE QUALITY  
8 PERFORMANCE THAT DOES NOT MEET THE ANNUAL PERFORMANCE  
9 STANDARDS?

10 A. Yes. I propose that Duquesne be required to provide "service compensation dollars" to  
11 customers in the form of a one-time credit on the distribution portion of the bill when or if  
12 Duquesne fails to meet any of these annual performance standards. The purpose of the  
13 "compensation credits" is to make sure that the risk of deterioration of service quality and  
14 customer service is transferred from Duquesne's customers to the new owners. I recommend  
15 that each percentage point in deterioration from the performance standard based on the  
16 annual average results be worth \$100,000. I recommend that a total of \$2.8 million be at risk  
17 for service compensation dollars. This amount represents 1% of Duquesne's regulated  
18 distribution revenues for 2005.<sup>10</sup> My proposal reflects the Massachusetts approach in which  
19 1% of distribution revenues are put at risk for the failure to comply with annual service  
20 quality, reliability, and worker safety performance standards by electric utilities. If each  
21 percentage point of deterioration is worth \$100,000 in service compensation credits,

---

10 Obtained from the 2005 Annual Reports filed by Duquesne Light to the PUC. See Schedule 402.

1 Duquesne would have to suffer a 28% deterioration spread over the 11 performance metrics  
2 to trigger the maximum credit. Therefore, the maximum amount of compensation credits is  
3 only triggered if there is a massive deterioration in customer service and reliability in all  
4 indicators, an extremely unlikely event. By triggering compensation credits based on the  
5 percentage deterioration in annual performance, the mechanism I have proposed equitably  
6 links the level of deterioration with the level of compensation credits required to be paid to  
7 customers.

8 Q. HOW SHOULD THE COMPENSATION DOLLARS BE RETURNED TO CUSTOMERS?

9 A. Where the performance area reflects interactions with residential customers, the  
10 compensation dollars should be returned to residential customers in the form of a one-time  
11 credit. Where the performance area reflects interactions with both residential and non-  
12 residential customers, the compensation dollars should be returned to all customers in a pro-  
13 rata method that reflects the degree to which the residential and non-residential customer  
14 activity is reflected in the performance area. The determination of the level of activity by  
15 residential and non-residential customers in a particular performance area can be determined  
16 by a simple analysis of a valid sample of underlying interactions for a representative period.

17 Q. PLEASE PROVIDE AN EXAMPLE OF HOW THE SERVICE COMPENSATION  
18 DOLLARS WOULD BE CALCULATED UNDER YOUR PROPOSED MECHANISM.

19 A. The actual annual performance result should be compared to the Performance Standard. The  
20 deviation of the actual performance compared to the Performance Standard is expressed as a  
21 percent deviation from the Standard. This percent deviation should be expressed as points by  
22 multiplying the percent (as expressed as a decimal) by 100 so that each point equals a one  
23 percent deviation from the baseline. No points are assigned if Duquesne achieves results

1 equal to or better than the Performance Standard. When Duquesne performs worse than the  
2 Performance Standard, the applicable points are calculated for each Performance Area and  
3 totaled and then multiplied by \$100,000 to obtain the applicable service compensation  
4 credits. For example, if the company achieves a 75% Call Answer Performance Standard  
5 (annual average of answering calls within 30 seconds), this would represent a deterioration of  
6 6.25% from the Performance Standard of 80%.<sup>11</sup> The service compensation credits would be  
7 calculated by multiplying 6.25 by \$100,000 for a total of \$625,000. When a performance  
8 standard is 0.00%, the measurement should reflect the difference between a positive value  
9 and zero. For example, if Duquesne reported that 1% of its residential bills were not issued  
10 once every billing period, this deterioration of 1% should be equal to one point and result in a  
11 compensation credit of \$100,000. The failure to meet any of the performance areas will be  
12 calculated separately, but the compensation credits incurred for each performance area  
13 should be totaled in determining whether or how much will be returned to customers in the  
14 form of a one-time bill credit.

15 Q. HOW SHOULD DUQUESNE REPORT THE SERVICE ASSURANCE PLAN RESULTS  
16 TO THE COMMISSION AND OTHER INTERESTED PARTIES?

17 A. The Company should submit its reliability and service quality results with either an  
18 *independent verification by a third party or an affidavit signed by a senior officer who attests*  
19 *that the information is accurate and verifiable.* This information should be submitted  
20 annually to the Commission, the OCA, the OSBA, OTS, and other interested parties.

---

11 By way of further explanation, if the standard is 80% and the Company achieves 75% there is an apparent 5% reduction. However, we are interested in the deviation from that standard, not the simple numerical reduction. The deviation is found by calculating what part of 80 (easier to think of as 1 or 100%) is 75, or  $75 \div 80 = .9375$ . The difference between 1 and .9375 is the deviation, here that is .0625, or 6.25%.

1 Q. HOW SHOULD THE COMPANY REPORT THE RESULTS OF THE SERVICE  
2 QUALITY ASSURANCE PLAN TO CUSTOMERS?

3 A. Duquesne should report the results of its service quality and reliability performance to its  
4 customers annually in a bill insert or other comparable means. This report should include  
5 performance in all categories, both where the Company performed better or worse than the  
6 baseline, as well as any service compensation credits being returned to customers.

1 **V. IMPLEMENTATION OF UNIVERSAL SERVICE PROGRAMS**

2 Q. PLEASE DESCRIBE DUQUESNE'S UNIVERSAL SERVICE PROGRAMS.

3 A. Duquesne implements a number of Universal Service programs designed to respond to the  
4 needs of its low-income electric customers. These programs consist of a Customer  
5 Assistance Program (bill payment assistance in the form of percentage of income discounts),  
6 Low-Income Usage Reduction Program or LIURP (energy conservation programs and  
7 weatherization), CARES (special counseling and assistance to help low-income households  
8 pay their energy bills), and Hardship funds (ratepayer and shareholder contributions to local  
9 crisis assistance agencies in the community). The following table shows the spending profile  
10 for several of the universal service programs for Duquesne Light in 2005.

11 **UNIVERSAL SERVICE PROGRAM SPENDING PROFILE: 2005<sup>12</sup>**

12

	CAP Costs	CAP Participation	CAP Part. Rate	Avg. CAP Credit	Avg. Arrears Forgiveness	Cost Recovery	LIURP
Duquesne Light	\$6,948,175 (\$362/customer)	23,093 (as of 12/30/05)	65%	\$190	\$119	Base rates	\$1,092,425

13  
14  
15 Q. DISCUSS THE TRENDS IN DUQUESNE'S CAP ENROLLMENT.

16 A. Duquesne recorded a significant increase in CAP enrollment in 2005, up 4,600 from 2004.  
17 The 65% CAP participation rate in 2005 is the highest of the other EDCs, where the average  
18 is a 39% penetration rate. The average CAP credit increased from \$105 to \$190. In addition,  
19 Duquesne's CAP customers show the highest rate of payment of the CAP bill compared to  
20 other EDCs, ranging from 94%-96% in the last two years.

---

12 The information in this chart and in the following discussion of Duquesne's universal service program is from the PUC's 2005 Report on Universal Service Programs and Collection Performance.

1 Q. WHAT IS THE STATUS OF THE BUDGETS AND FUNDING FOR DUQUESNE'S CAP  
2 AS A RESULT OF THE RECENT BASE RATE CASE SETTLEMENT?

3 A. Duquesne's base rate case has resulted in a settlement. Under the settlement, rates were set  
4 with a CAP enrollment at 27,000 and LIURP funding of \$1.8 million. Both of these aspects  
5 of the settlement reflect higher enrollment levels compared to 2005. These programs will  
6 continue to be funded through distribution rates pursuant to the settlement.

7 Q. PLEASE EXPLAIN THE HISTORICAL FUNDING LEVEL FOR LIURP AND THE  
8 STATUS OF ITS CURRENT FUNDING LEVEL.

9 A. Duquesne spent approximately \$1 million for LIURP in 2005, but projected a budget of \$1.7  
10 million for 2006. The settlement for the base rate case includes a LIURP budget of \$1.8  
11 million, a slight increase in the previously provided budget.

12 Q. PLEASE EXPLAIN DUQUESNE'S NEW "STAY WARM" INITIATIVES.

13 A. In 2005-2006, Duquesne voluntarily funded five new "Stay Warm" initiatives for customers  
14 who were having difficulty in maintaining essential electricity services.<sup>13</sup> These new  
15 programs were targeted to customers who traditionally did not seek to participate in low-  
16 income programs (such as seniors) or who had household income that was just over the  
17 eligibility criteria for existing low-income programs, but who were having difficulty in  
18 making bill payments due to rising prices for other heating fuels so that payment of  
19 Duquesne's electricity bill was at risk. The programs provided one-time bill credits and were  
20 administered by Dollar Energy. The Company indicated that the estimated cost of continuing  
21 these programs in 2006-2007 was \$1.2 million.

---

13 These programs were described in detail by Ms. Michele Sandoe on behalf of Duquesne Light in the base rate case, Docket No. R-00061346 (Statement No. 13).

1 Q. WHAT IS THE STATUS OF DUQUESNE'S HARDSHIP FUNDING AND  
2 INVOLVEMENT WITH LOCAL COMMUNITY ACTION PROGRAMS AND NON-  
3 PROFIT AGENCIES?

4 A. Duquesne reported ratepayer contributions of \$266,049 and utility and shareholder  
5 contributions of \$390,000 in 2004-2005. The average ratepayer contribution per customer  
6 was \$.51, the highest of all the EDCs. The total customer benefits disbursed was \$650,000  
7 for an average grant of \$314. Duquesne relies on Dollar Energy to implement its hardship  
8 fund program and has contracts with other community organizations to administer the CAP  
9 and CARES programs. Duquesne has also traditionally donated \$65,000 in administrative  
10 costs to implement its customer contribution program.

11 Q. WHAT IS THE STATUS OF THE IMPLEMENTATION OF THE UNIVERSAL SERVICE  
12 PROGRAMS IN LIGHT OF THIS PROPOSED ACQUISITION BY MACQUARIE?

13 A. There have been no specific benefits identified by Duquesne or Macquarie with respect to the  
14 operation or funding of the universal service programs as part of this proposed transaction.<sup>14</sup>  
15 While there has been a commitment that the overall level of community or charitable giving  
16 will continue for a five-year period, this commitment is generic and does not reflect  
17 commitments to individual organizations or specific programs.<sup>15</sup>

---

14 "There have been no discussions or decisions concerning universal service programs as part of this acquisition." Response to OCA-I-27. Also, "There have been no discussions or decisions concerning credit and collection programs and policies as part of this acquisition." Response to OCA-I-28.

15 Response to OCA-IV-3.

1 Q. WHAT ARE YOUR CONCERNS ABOUT DUQUESNE'S UNIVERSAL SERVICE  
2 PROGRAMS AS A RESULT OF THIS MERGER?

3 A. The Application and supporting testimony has provided little or no information on the impact  
4 of this proposed acquisition on Duquesne's universal service programs and credit and  
5 collection programs that are crucial to the ability of low-income customers to obtain and  
6 maintain essential electricity services. Neither Duquesne nor Macquarie has made any  
7 specific promised benefit for these customers. Furthermore, Macquarie's statements about  
8 future charitable giving does not reflect any specific spending level for low-income  
9 customers or commitment for its hardship funds.

1 VI. RECOMMENDED CONDITIONS CONCERNING DUQUESNE'S UNIVERSAL  
2 SERVICE PROGRAMS  
3

4 Q. PLEASE SUMMARIZE WHY YOU ARE RECOMMENDING SPECIFIC BENEFITS BE  
5 DIRECTED TO UNIVERSAL SERVICE PROGRAMS AND LOW-INCOME  
6 CUSTOMERS AS A CONDITION OF THIS MERGER.

7 A. As I described in my Introduction, the risks associated with this acquisition by a private  
8 investment firm are likely to have the most adverse impacts on low-income customers.  
9 These customers are the most vulnerable to any degradation in service quality and reliability  
10 of service, particularly with regard to the performance of the customer call centers which are  
11 relied upon to contact the utility to respond to disconnection notices, negotiate payment  
12 arrangements, notify the utility of medical emergencies, and access and apply for universal  
13 service programs. My concern has only been exacerbated by the directives and restrictions  
14 with respect to payment arrangements and increased disconnection of service that has already  
15 resulted from the implementation of Chapter 14 of the Public Utility Code, which is of  
16 particular concern because of Duquesne's recent and significant increase in its termination  
17 rate.

18 Q. DO YOU HAVE SUGGESTED MERGER CONDITIONS RELATING TO THE  
19 UNIVERSAL SERVICE PROGRAMS?

20 A. Yes. I have several specific recommendations:

- 21 o The Commission should require Duquesne, at a minimum, to continue its current level of  
22 funding and administrative support for universal service programs (CAP, LIURP,  
23 Hardship funding) for the four-year stay out period recommended by Mr. Kahal on

1           behalf of the OCA, without any further customer contributions or change in the method  
2           of funding these programs.

3           ○ Second, Duquesne should form a collaborative or committee composed of local  
4           representatives of the low-income community, community-based organizations, and the  
5           OCA and commit to bringing forward any proposed changes to its universal service  
6           programs and policies for discussion prior to implementation of changes. Such an  
7           approach has worked well in the PECO Energy service area.

8           ○ Third, during the stay out period, Duquesne should commit to the incremental funding  
9           required for the five new Stay Warm programs identified in its recent base rate case filing  
10          (\$1.2 million) as a direct merger benefit. If the need for the Stay Warm programs  
11          declines, any excess amounts can be used to respond to CAP program enrollment. This  
12          commitment concerning the Stay Warm programs should be in addition to the  
13          Company's stated promise to continue its 2006 level of community and charitable giving  
14          for a five-year period, with a modest annual growth rate of 5% to reflect Duquesne's  
15          historical pattern of charitable giving.

16    Q.     DOES THIS COMPLETE YOUR DIRECT TESTIMONY AT THIS TIME?

17    A.     Yes, it does.

18    00091999.DOC

COMMONWEALTH OF PENNSYLVANIA  
BEFORE THE PUBLIC UTILITY COMMISSION

Application of Duquesne Light Company )  
for a Certificate of Public Convenience )  
Under Section 1102(a)(3) of the Public ) Docket No. A-110150F0035  
Utility Code Approving the Acquisition )  
of Duquesne Light Holding, Inc. by Merger )

Application of DQE Communications )  
Network Services LLC for a Certificate )  
of Public Convenience Under Section ) Docket No. A-311233F0002  
1102(a)(3) of the Public Utility Code )  
Approving the Acquisition of Duquesne )  
Light Holding, Inc. by Merger )

EXHIBIT TO THE  
DIRECT TESTIMONY OF  
BARBARA R. ALEXANDER  
Consumer Affairs Consultant  
**(Customer Service, Service Quality, and Universal Service)**  
ON BEHALF OF THE  
OFFICE OF CONSUMER ADVOCATE

DECEMBER 21, 2006

# **BARBARA R. ALEXANDER**

## **Consumer Affairs Consultant**

83 Wedgewood Dr.  
Winthrop, ME 04364

Voice and FAX: (207)395-4143

E-mail: [barbalex@ctel.net](mailto:barbalex@ctel.net)

### **Recent Clients:**

AARP (Montana, Maine, New Jersey, California, Vermont, District of Columbia)  
Pennsylvania Office of Consumer Advocate  
Maryland Office of People's Counsel  
Citizens' Utility Board (Illinois)  
Texas Office of Public Utility Counsel  
New Jersey Division of Ratepayer Advocate  
Maine Office of Public Advocate  
Colorado Office of Consumer Counsel  
Vermont Department of Public Service  
Delaware Division of the Public Advocate  
*The Utility Reform Network (TURN) (California)*  
Oak Ridge National Laboratory, DOE  
Regulatory Assistance Project  
Citizens' Utility Board (Wisconsin)

### **Areas of Expertise:**

- Default Service, Consumer Protection, Service Quality, and Universal Service policies and programs associated with the move to competition in the electric, natural gas, and telecommunications industries;
- Consumer Protection and Service Quality policies and programs associated with the regulation of competitive energy and telecommunications providers;
- The regulatory policies associated with the regulation of Credit, Collection, Consumer Protection, and Service Quality programs and policies for public utilities; and
- Code of Conduct and affiliated interest rules applicable to regulated utilities and their affiliates.

## Prior Employment

DIRECTOR 1986-96  
*Consumer Assistance Division*  
*Maine Public Utilities Commission* *Augusta, Maine*

One of five division directors appointed by a three-member regulatory commission and part of commission management team. Direct supervision of 10 employees, oversight of public utility consumer complaint function, appearance as an expert witness on customer services, consumer protection, service quality and low income policy issues before the PUC. Chair, NARUC Staff Subcommittee on Consumer Affairs.

SUPERINTENDENT 1979-83  
*Bureau of Consumer Credit Protection*  
*Department of Professional and Financial Regulation* *Augusta, Maine*

Director of an independent regulatory agency charged with the implementation of Maine Consumer Credit Code and Truth in Lending Act. Investigations and audits of financial institutions and retail creditors, enforcement activities, testimony before Maine Legislature and U.S. Congress.

## Education

JURIS DOCTOR 1973-76  
*University of Maine School of Law* *Portland, Maine*

Admitted to the Bar of the State of Maine, September 1976.

B.A. (WITH DISTINCTION) IN POLITICAL SCIENCE 1964-68  
*University of Michigan* *Ann Arbor, Michigan*

## Publications and Testimony

“How to Construct a Service Quality Index in Performance-Based Ratemaking”, The Electricity Journal, April, 1996

“The Consumer Protection Agenda in the Electric Restructuring Debate”, William A. Spratley & Associates, May, 1996

Direct Testimony on behalf of the Telecommunications Workers Union, Telecom Public Notice 96-8, Price Cap Regulation and Related Issues, Canadian Radio-Television and Telecommunications Commission, September, 1996. [Analysis of and recommendations concerning the need to regulate service quality in move to price cap regulation]

Direct Testimony on behalf of Public Counsel Section, Office of Attorney General, Docket No. UE-960195, Application by Puget Sound Power and Light Co. And Washington Natural Gas Co. For Approval of Merger), Washington Utilities and Transportation Commission, September, 1996 [Need for and design of a Service Quality Index for both electric and gas business units as part of a multi-year rate plan]

Consumer Protection Proposals for Retail Electric Competition: Model Legislation and Regulations”, Regulatory Assistance Project, Gardiner, ME, October, 1996

Direct and Rebuttal Testimony on behalf of the Citizens Utility Board (IL), Docket 96-0178, Illinois Commerce Commission, CUB v. Illinois Bell Telephone Co., January 22, 1997; July, 1997. [Analysis of recent service quality performance and recommendations for changes in current service quality performance plan]

Direct and Surrebuttal Testimony on behalf of the Pennsylvania Office of Consumer Advocate, Restructuring Proceedings before the Pennsylvania PUC: PECO Energy; Pennsylvania Power and Light Co.; GPU Energy; Duquesne Light Co.; West Penn Power Co., UGI-Electric, Pennsylvania Power Co., Pike County Light and Power Co. (1997 and 1998). [Specific consumer protection, consumer education and supplier-utility-customer interactions necessary for move to electric restructuring]

“The Transition to Local Telecommunications Competition: A New Challenge for Consumer Protection”, Public Counsel Section, Washington Attorney General, October, 1997. [Reprinted in part in NRRI Quarterly Bulletin, Vol. 19, N0.1, Spring, 1998]

Direct and Surrebuttal Testimony on behalf of the New Jersey Division of Ratepayer Advocate, Restructuring Proceedings before the New Jersey Board of Public Utilities: Public Service Electric and Gas, Jersey Central (GPU), Rockland Electric Co., Atlantic Electric Co., March-April, 1998. [Phase-in and customer enrollment, Code of Conduct, consumer protections associated with the provision of Provider of Last Resort service]

Oppenheim, Gerald (NCLC) and Alexander, Barbara, Model Electricity Consumer Protection Disclosures, A Report to the National Council on Competition and the Electric Industry, April, 1998.

Direct and Reply Testimony on behalf of the Maryland Office of People’s Counsel, Investigation into Certain Unauthorized Practices (*Slamming and Cramming*), Case. No. 8776, before the Maryland Public Service Commission, 1998 and 1999.

Direct Testimony on behalf of the Maryland Office of People’s Counsel, Universal Service Issues, Case No. 8745, before the Maryland Public Service Commission, November 20, 1998.

“Cramming is the Last Straw: A Proposal to Prevent and Discourage the Use of the Local Telephone Bill to Commit Fraud,” NRRI Quarterly Bulletin, Fall, 1998.

Alexander, Barbara, Retail Electric Competition: A Blueprint for Consumer Protection, U.S. Department of Energy, Office of Energy and Renewable Energy, Washington, D.C., October, 1998. Available at [http://www.eren.doe.gov/electricity\\_restructuring](http://www.eren.doe.gov/electricity_restructuring).

Alexander, Barbara, "Consumer Protection Issues in Electric Restructuring for Colorado: A Report to the Colorado Electricity Advisory Panel," on behalf of the Colorado Office of Consumer Counsel, February, 1999.

Testimony on Proposed Interim Rules (Consumer Protection, Customer Enrollment, Code of Conduct, Supplier Licensing) on behalf of the New Jersey Division of Ratepayer Advocate before the New Jersey BPU, May, 1999.

Direct Testimony on behalf of AARP, West Virginia PUC Investigation into Retail Electric Competition (consumer protection, universal service, Code of Conduct), June 15, 1999.

Direct and Surrebuttal Testimony on behalf of the Pennsylvania OCA, Gas Restructuring proceedings (8 natural gas utilities): consumer protection; consumer education; code of conduct, before the Pennsylvania PUC, October, 1999-April, 2000.

Comments on Draft Rules addressing slamming and cramming (Docket No. RMU-99-7) on behalf of the Iowa Office of Consumer Advocate, before the Iowa Utilities Board, October, 1999.

Alexander, Barbara, "Door to Door Sales of Competitive Energy Services," LEAP Letter, January-February, 2000 [Wm. A. Spratley & Associates, Columbus, OH]

Direct Testimony on behalf of the Maine Office of Public Advocate, Central Maine Power Company Alternative Regulation Plan [Docket 99-666] on service quality issues, before the Maine PUC, May, 2000.

Direct Testimony on behalf of AARP, Universal Service Programs and Funding of low-income programs for electric and natural gas service, before the New Jersey Board of Public Utilities, Docket No. EX000200091, July, 2000.

Comments (on behalf of NASUCA and AARP) on Uniform Business Practices Reports, May and September, 2000.

Direct Testimony on behalf of the Pennsylvania OCA, Verizon-Pennsylvania Structural Separation Plan on service quality, customer service and consumer protection issues [Docket No. M-00001353] before the Pennsylvania PUC, October, 2000.

Direct and Rebuttal Testimony on behalf of the Maine Office of Public Advocate, Verizon-Maine Alternative Form of Regulation on service quality issues [Docket No. 99-851] before the Maine PUC, January and February, 2001.

Direct and Rebuttal Testimony on behalf of the Citizens Utility Board, Nicor Gas Customer Select Pilot Program, on consumer protection and regulation of competitive natural gas suppliers [Docket Nos. 00-0620 and 00-0621] before the Illinois Commerce Commission, December, 2000 and February, 2001.

Direct and Surrebuttal Testimony on behalf of the Pennsylvania Office of Consumer Advocate on consumer protection and service quality issues associated with the pending merger between GPU Energy and FirstEnergy, before the Pennsylvania PUC, Docket Nos. A-110300F0095 and A-110400F.0040 (February and March, 2001)

Direct and Surrebuttal Testimony on behalf of the New Jersey Division of Ratepayer Advocate on consumer protection, service quality, and universal service issues associated with the pending merger between GPU Energy and FirstEnergy, before the New Jersey Board of Public Utilities, Docket No. EM00110870 (April, 2001).

Alexander, Barbara, "Default Service: What Should be Done when the Experiment Goes Awry?", April 2001

Responsive Testimony on behalf of the New Jersey Division of Ratepayer Advocate on service quality issues associated with a Plan for Alternative Regulation by Verizon-New Jersey, before the New Jersey Board of Public Utilities, Docket No. To01020095 (May 2001).

Direct and Surrebuttal Testimony on behalf of the New Jersey Division of Ratepayer Advocate on service quality, consumer protection, and universal service issues associated with the pending merger between Conectiv and Pepco, before the New Jersey Board of Public Utilities, BPU Docket No. EM101050308 (September and November 2001).

Direct Testimony on behalf of the Public Interest Advocacy Centre (and others) on service quality regulation in the context of price cap rate plans, before the Canadian Radio-Television and Telecommunications Commission, Docket No. CRTC 2001-37 (August 2001).

Alexander, Barbara, "Default Service: What Should be Done when the Experiment Goes Awry?", An Update to the April 2001 paper, October 2001.

Expert Witness Report, Sparks v. AT&T and Lucent Technologies, October 2001 [National class action lawsuit concerning the leasing of residential telephones]

Expert Witness Report, Brown v. Reliant Energy, November 2001 [Claim of negligence in death of elderly resident after disconnection of electric service]

Comments on behalf of the Pennsylvania Office of Consumer Advocate on consumer protection, disclosure, and education program Guidelines applicable to local exchange telephone competition, before the Pennsylvania PUC, January 2002.

Alexander, Barbara, "Default Service for Retail Electric Competition: Can Residential and Low-Income Customers be Protected When the Experiment Goes Awry?" (April 2002) Available at [www.ncat.org/liheap/pubs/barbadefault3.doc](http://www.ncat.org/liheap/pubs/barbadefault3.doc)

Comments on behalf of AARP before the California PUC on CARE (low income program) concerning Rapid Deployment, Rulemaking 01-08-027 (2001 and 2002).

Comments on behalf of Citizens Utility Board before the Illinois Commerce Commission on Proposed Rule to Allow the Use of Credit Scoring to Determine When a Deposit May be Required, ICC Docket No. 01-0644, June 24, 2002.

Comments on behalf of Consumer Groups before the Texas PUC on Rulemaking Proceeding to Amend Requirements for Provider of Last Resort Service, Docket No. 25360, June 28, 2002.

Direct Testimony on behalf of the New Jersey Division of Ratepayer Advocate before the Board of Public Utilities on Joint Petition of New Jersey-American Water Co. and Thames Water Aqua Holding for Approval of a Change in Control of New Jersey-American Water Co., Docket No. WM01120833, July 18, 2002.

Alexander, Barbara, Consumer Education Programs to Accompany the Move to Retail Electric Competition, prepared for the National Association of State Utility Consumer Advocates (NASUCA), July 2002. Available at [www.nasuca.org](http://www.nasuca.org)

Direct Testimony on behalf of New Jersey Division of Ratepayer Advocate before the Board of Public Utilities on Petition of NUI Utilities d/b/a Elizabethtown Gas Co. for Approval of Increased Base Tariff Rates and Charges for Gas Service, Docket No. GR02040245, September 6, 2002.

Alexander, Barbara, [An Analysis of Residential Energy Markets in Georgia, Massachusetts, Ohio, New York, and Texas](#), prepared for the National Energy Affordability and Accessibility Project, National Center for Appropriate Technology, September 2002. Available at [www.ncat.org/neaap](http://www.ncat.org/neaap)

Direct and Surrebuttal Testimony on behalf of the Pennsylvania Office of Consumer Advocate before the Pennsylvania PUC on Philadelphia Gas Works' Gas Restructuring Filing, Docket No. M-00021612, September 2002 and November 2002.

Direct Testimony on behalf of Consumer Groups before the Texas PUC on Notice and Request of Mutual Energy CPL and Mutual Energy WTU for Approval of Changes in Ownership and Affiliation, Docket No. 25957, October 15, 2002.

Comments on behalf of the Pennsylvania Office of Consumer Advocate before the Pennsylvania PUC, Advanced Notice of Proposed Rulemaking for Revision of Chapter 54 Pertaining to Electric Generation Supplier Licensing, Docket No. L-00020158, March 5, 2003.

Direct and Surrebuttal Testimony on behalf of the New Jersey Division of Ratepayer Advocate before the New Jersey BPU on Jersey Central Power & Light's base rate case proceeding (service quality and reliability of service), Docket No. ER02080506, ERT02080507, and ER02070417, December 2002 and February 2003.

Alexander, Barbara, "Managing Default Service To Provide Consumer Benefits In Restructured States: Avoiding Short-Term Price Volatility" (National Center for Appropriate Technology, June 2003). Available at: <http://neaap.ncat.org/experts/defservintro.htm>

Comments and Reply Comments on behalf of New Jersey AARP before the New Jersey Board of Public Utilities on Basic Generation Service, Docket No. EO03050394, August and September 2003.

Direct and Surrebuttal Testimony on behalf of the New Jersey Division of the Ratepayer Advocate before the New Jersey BPU on rate case proceedings for New Jersey-American Water Co., Elizabethtown Water Co., and Mt. Holly Water Co. (service quality and low-income programs and policies), Dockets Nos. WR03070509-WR03070511 (December 2003).

Comments on behalf of the Texas Legal Services Center and other Consumer Groups before the Public Utility Commission of Texas, Proposed Revisions to Chapter 25, Substantive Rules Applicable to Electric Service Providers, Project No. 27084 (December 2003).

Alexander, Barbara, "Natural Gas Price Volatility: Regulatory Policies to Assure Affordable and Stable Gas Supply Prices for Residential Customers," (2004), available at <http://www.ncat.org/liheap/news/Feb04/gaspricevol.htm>

Alexander, Barbara, "Montana's Universal Systems Benefit Programs and Funding for Low Income Programs: Recommendations for Reform: A Report to AARP" (January 2004).

Comments and Reply Comments on behalf of the Colorado Office of Consumer Counsel before the Public Utilities Commission of Colorado, In the Matter of the Proposed Repeal and Reenactment of all Rules Regulating Gas Utilities (Docket No. 03R-520G) and Electric Utilities (Docket No. 03R-519E) (February and September 2004).

Direct, Rebuttal, and Supplemental Testimony on behalf of the Pennsylvania Office of Consumer Advocate before the Pennsylvania PUC, Petition of Duquesne Light Co. for Approval of Plan for Post-Transition Period POLR Services, Docket No. P-00032071 (February-April 2004).

Comments on behalf of AARP before the California PUC, Order Instituting Rulemaking on the Commission's Own Motion to Establish Consumer Rights and Consumer Protection Rules Applicable to All Telecommunications Utilities, R. 00-02-004 (March 2004).

Comments and Reply Comments on behalf of AARP before the Maine PUC, Inquiry into Standard Offer Supply Procurement for Residential and Small Commercial Customers, Docket No. 2004-147 (April 2004).

Comments on behalf of Wisconsin Citizens' Utility Board before the Wisconsin Public Service Commission's Gas Service Standards, Docket No. 1-AC-210 (July 2004).

Comments on behalf of the Colorado Office of Consumer Counsel before the Public Utilities Commission of Colorado, In the Matter of the Proposed Repeal and Reenactment of all Rules Regulating Telephone Utilities and Providers (Docket No. 03R-524T) (September 2004).

Direct Testimony on behalf of the Pennsylvania Office of Consumer Advocate before the Pennsylvania PUC, Investigation of Metropolitan Edison Co., Pennsylvania Electric Co. and Pennsylvania Power Co. Reliability Performance, Docket no. I-00040102, [customer service and reliability performance] (June 2004).

Direct and Surrebuttal Testimony on behalf of the Vermont Department of Public Service before the Vermont Board of Public Utilities, Investigation into Successor Alternative Regulatory Plan for Verizon Vermont, Docket 6959 [Service Quality] (November 2004 and March 2005).

Alexander, Barbara, "Vermont Energy Programs for Low-Income Electric And Gas Customers: Filling The Gap" (November 2004), Prepared for AARP Vermont.

Direct and Surrebuttal Testimony on behalf of Wisconsin Citizens' Utility Board before the Wisconsin Public Service Commission, Application of Wisconsin Power and Light Co. for Authority to Increase Retail Electric, Natural Gas and Ripon Water Rates, Docket No. 6680-UR-114 [customer service, credit and collection programs and expenses, low income programs, fixed bill program] (April 2005).

Comments on behalf of the Maine Office of Public Advocate before the Maine Public Utilities Commission, Inquiry into Revisions to Chapter 81, Residential Utility Service Standards for Credit and Collection Programs, and Chapter 86, Disconnection and Deposit Regulations for Nonresidential Utility Service, Docket No. 2005-005 (April and May 2005).

Direct and Rebuttal Testimony on behalf of AARP Montana before the Montana Public Service Commission, Northwestern Energy Electric Cost Tracker, Docket No. D2004.6.90 [Default Service cost recovery policies and integration with low income programs] (December 2004 and July 2005).

Direct Testimony on behalf of the Pennsylvania Office of Consumer Advocate before the Pennsylvania Public Utilities Commission, Joint Application of PECO Energy Co. and Public Service Electric and Gas Co. for Approval of the Merger of Public Service Enterprise Group, Inc. with and into Exelon Corporation, Docket No. A-110550F0160 [customer service, reliability of service, low income programs] (June 2005).

Direct Testimony on behalf of Illinois Citizens' Utility Board, City of Chicago, and Community Action for Fair Utility Practice, before the Illinois Commerce Commission, Petition to Initiate Rulemaking with Notice and Comment for Approval of Certain Amendments to Illinois Administrative Code Part 280 Concerning Deposit Requests and Deposit Refunds by Utilities, Docket No. 05-0237 (June 2005).

Direct Testimony on behalf of The Utility Reform Network (TURN) before the California Public Utilities Commission, Order Instituting Rulemaking on the Commission's Own Motion to Establish Consumer Rights and Consumer Protection Rules Applicable to All Telecommunications Utilities, Docket R-00-02-004 (August 2005).

Alexander, Barbara, Red Flags for Consumer Protection Policies Governing Essential Electric and Gas Utility Services: How to Avoid Adverse Impacts on Low-Income Consumers, prepared under contract with Oak Ridge National Laboratory Energy Division (October 2005).

Comments on behalf of Texas Office of Public Utility Counsel, Texas Legal Services Center, Texas Ratepayers' Organization to Save Energy and AARP Texas, before the Texas PUC, Evaluation of Default Service for Residential Customers and Review of Rules Relating to the Price to Beat and Provider of Last Resort, Project No. 31416 (March 2006) [Default service policies]

Rebuttal and Surrebuttal Testimony on behalf of the Pennsylvania Office of Consumer Advocate before the Pennsylvania PUC, In the Matter of the Petition of the Pennsylvania Power Co. for Approval of an Interim Provider of Last Resort Supply Plan, Docket No. P-00052188 [Default or POLR Electric Service policies] (December 2005 and January 2006).

Direct and Rebuttal Testimony on behalf of the Maine Office of Public Advocate before the Maine PUC, Investigation into Verizon Maine's Alternative Form of Regulation, Docket No. 2005-155 [Retail Service Quality] (January and May 2006).

Alexander, Barbara, "State Developments Changing for Default/Standard Retail Electric Service," Natural Gas & Electricity, September 2006.

Direct and Rebuttal Testimony on behalf of the Government and Consumer Parties (CUB, Attorney General of Illinois) before the Illinois Commerce Commission, Petition to Initiate Rulemaking with Notice and Comment for Approval of Certain Amendments to Illinois Administrative Code Part 280, Docket No. 06-0379 (May and September 2006). [Consumer Protection rules]

Direct Testimony on behalf of the Pennsylvania Office of Consumer Advocate before the Pennsylvania PUC, In Re Application of UGI Utilities, Inc., UGI Utilities Newco, Inc., and Southern Union Co., Docket Nos. A-120011F2000, A-125146, A-125146F5000 (June 2006). [Customer Service, Service Quality, and Universal Services]

Direct and Rebuttal Testimony on behalf of the Maryland Office of People's Counsel before the Maryland PSC, In The Competitive Selection of Electricity Supplier/Standard Offer or Default Service for Investor-Owned Utility Small Commercial Customers and, Delmarva Power and Light and Potomac Electric Power Residential Customers, Case No. 9064 (August and September 2006). [Default Service policies]

Direct and Rebuttal Testimony on behalf of the Maryland Office of People's Counsel before the Maryland PSC, In The Matter of the Optimal Structure of the Electric Industry of Maryland, Case No. 9063 (October and November 2006). [Default service policies]

Comments on behalf of AARP Maine before the Maine PUC on various dockets and notices concerning the implementation of Standard Offer Service for residential customers, Docket Nos. 2006-314, 2006-557, and 2006-411 (July-November 2006). [Default service policies]

Comments on behalf of AARP District of Columbia before the District of Columbia PSC, In the Matter of the Development and Designation of Standard Offer Service in the District of Columbia, Case No. 1017 (2006). [Default service policies]

Comments on behalf of AARP New Jersey before the New Jersey Board of Public Utilities, In the Matter of the Establishment of A Universal Service Fund Pursuant to Section 12 of the Electric Discount and Energy Competition Act of 1999, Docket No. EX00020091 (August 2006) [Recommendations for USF program changes]

Direct and Rebuttal Testimony on behalf of the Pennsylvania Office of Consumer Advocate before the Pennsylvania PUC, Joint Application of Equitable Resources, Inc. and the People's Natural Gas Co., d/b/a Dominion Peoples, for Approval of the Transfer of All Stock Rights of the Latter to the Former and for the Approval of the Transfer of All Stock of Hope Gas, Inc., d/b/a/ Dominion Hope to Equitable Resources, Inc., Docket No. A-122250F5000 (September and October 2006). [Customer Service, Service Quality, and Universal Service issues]

Direct Testimony on behalf of Pennsylvania Office of Consumer Advocate before the Pennsylvania PUC, Pennsylvania PUC v. Natural Fuel Gas Distribution Corp., Docket No. R-00061493 (September 2006) [Supplier Purchase of Receivables Program]

## Presentations and Training Programs:

- *National Low Income Energy Consortium (NLIEC) Annual Conference*
- NARUC
- NASUCA
- State Legislatures: New Jersey, Texas, Kentucky, and Maine
- Commissions: Pennsylvania, Georgia, Kentucky, Illinois, New Jersey
- DOE-NARUC National Electricity Forum
- AIC Conference on Reliability of Electric Service
- Institute of Public Utilities, MSU (Camp NARUC) [Instructor since 1996]
- Training Programs on customer service and service quality regulation for international regulators (India and Brazil) on behalf of Regulatory Assistance Project
- *Georgia Natural Gas Deregulation Task Force [December 2001]*
- Mid Atlantic Assoc. of Regulatory Utility Commissioners [July 2003]
- Illinois Commerce Commission's Post 2006 Initiative [April 2004]
- Delaware Public Service Commission's Workshop on Standard Offer Service [August 2004]

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Application of Duquesne Light Company )  
for a Certificate of Public Convenience )  
Under Section 1102(a)(3) of the Public ) Docket No. A-110150F0035  
Utility Code Approving the Acquisition )  
of Duquesne Light Holding, Inc. by Merger )

Application of DQE Communications )  
Network Services LLC for a Certificate )  
of Public Convenience under Section ) Docket No. A-311233F0002  
1102(a)(3) of the Public Utility Code )  
Approving the Acquisition of Duquesne )  
Light Holding, Inc. by Merger )

SURREBUTAL TESTIMONY OF

BARBARA R. ALEXANDER

Consumer Affairs Consultant

**(Customer Service, Service Quality, and Universal Service)**

ON BEHALF OF THE

OFFICE OF CONSUMER ADVOCATE

JANUARY 23, 2007

SECRETARY'S BUREAU  
2007 FEB 27 PM 3:29  
RECEIVED

1 Q. PLEASE STATE YOUR NAME AND ADDRESS.

2 A. My name is Barbara R. Alexander. My office is located at 83 Wedgewood Dr., Winthrop,  
3 Maine 04364. I use the title of Consumer Affairs Consultant for my consulting practice.

4 Q. ON WHOSE BEHALF DO YOU PROVIDE TESTIMONY IN THIS PROCEEDING?

5 A. I am testifying on behalf of the Office of Consumer Advocate (OCA).

6 Q. HAVE YOU PREVIOUSLY TESTIFIED IN THIS PROCEEDING?

7 A. Yes. I submitted Direct Testimony on behalf of the OCA on December 21, 2006.

8 Q. WHAT IS THE PURPOSE OF THIS TESTIMONY?

9 A. I am submitting Surrebuttal Testimony in response to the Rebuttal Testimony of Brian  
10 Kalcic, on behalf of the Office of Small Business Advocate (OSBA), and Rebuttal Testimony  
11 of Morgan O'Brien and Frederick J. Eichenmiller, on behalf of Duquesne Light Company  
12 (DLC). Specifically, I will respond to the statements of these witnesses concerning my  
13 proposed service quality and low income program conditions that should be imposed by the  
14 Commission should it approve this acquisition of DLC by the Macquarie Consortium.

15 Q. DO YOU HAVE ANY RESPONSE TO THE REBUTTAL TESTIMONY OF MS.  
16 MICHELE SANDOE ON BEHALF OF DLC CONCERNING YOUR PROPOSED  
17 UNIVERSAL SERVICE CONDITIONS?

18 A. It appears that Ms. Sandoe has accepted my recommended conditions associated with  
19 universal service programs. As a result, I have no further testimony on these topics to offer  
20 at this time.

1 Q. AS A RESULT OF THIS REBUTTAL TESTIMONY CONCERNING SERVICE  
2 QUALITY AND CUSTOMER SERVICE, HAVE YOU CHANGED ANY OF YOUR  
3 RECOMMENDATIONS CONCERNING YOUR PROPOSED CONDITIONS  
4 CONTAINED IN YOUR DIRECT TESTIMONY?

5 A. In general, I do not suggest any recommended changes in my proposals. I have proposed one  
6 additional aspect of the Service Quality Customer Improvement Plan concerning the ability  
7 of DLC to seek a waiver for its failure to meet an annual performance standard under certain  
8 conditions. However, this change does not affect my overall approach and does not impact  
9 the intent or design of my conditions.

10 Q. PLEASE SUMMARIZE MR. KALCIC'S REBUTTAL TESTIMONY CONCERNING THE  
11 DESIGN OF YOUR PROPOSED SERVICE QUALITY IMPROVEMENT PLAN.

12 A. Mr. Kalcic states that five of the proposed eleven service quality metrics will reflect service  
13 provided to residential customers only. As a result, he is concerned that DLC would have an  
14 incentive to give priority to residential customers at the expense of non-residential customer  
15 service. He then proposes to cap the total service compensation dollars that could be  
16 provided to residential customers so that presumably some of the service compensation  
17 dollars would be "available" to non-residential customers if DLC failed to meet the annual  
18 performance standards of the other six metrics that apply to both residential and non-  
19 residential customers.

1 Q. DO YOU AGREE WITH MR. KALCIC'S CONCERN AND HOW DO YOU RESPOND  
2 TO HIS PROPOSED CHANGE TO YOUR SERVICE QUALITY IMPROVEMENT  
3 PLAN?

4 A. Mr. Kalcic's concern is unfounded. It is correct that five of the eleven metrics reflect service  
5 provided to residential customers only<sup>1</sup>: percent of residential bills not rendered once every  
6 billing period; number of residential customer disputes not issued a report within 30 days;  
7 residential termination rate; justified residential payment arrangement request rate; and,  
8 *justified residential consumer complaint rate. The other six metrics reflect service quality*  
9 *provided to all customers. Mr. Kalcic recognizes that it would be fair to allocate the failure*  
10 *to achieve the performance standard for one or more "residential" customer metrics to*  
11 *residential customers, but fears that somehow DLC would want to make sure that it did not*  
12 *fail to meet these standards and give more weight to efforts to meet these standards to avoid*  
13 *customer compensation credits. Mr. Kalcic does not offer a reason why DLC would have*  
14 *such an incentive, since the service compensation dollars, if triggered, would have a negative*  
15 *impact on DLC whether or not the dollars resulted from the failure to perform a "residential*  
16 *only" metric or a "mixed metric" that reflects both residential and non-residential customer*  
17 *service. In other words, Duquesne's incentive should be to avoid the imposition of any*  
18 *service compensation dollars and it should not matter to DLC's shareholders or owners if the*  
19 *failure results in dollars paid to residential or to residential and non-residential customers.*  
20 As a result, Mr. Kalcic's concern does not come into play under my proposed service quality  
21 plan. I have worked with the design and implementation of service quality compensation

---

<sup>1</sup> My proposed service quality metrics reflect the emphasis of the Commission's service quality and customer service reporting requirements that are aimed primarily at interactions between the utilities and their residential customers. In other words, *my proposed metrics do not reflect any bias against measuring or tracking performance for non-residential customers, but rather a reflection of the performance data that is already measured and reported.*

1 plans in many states and for many years. In my experience there is no basis for his concerns.  
2 In fact, it is the exact opposite. Most utilities routinely perform at a higher level of customer  
3 service for their non-residential customers so as to assure their loyalty to the utility and to  
4 market to new non-residential customers because those customers often result in expanded  
5 business opportunities and higher profits to the utility.

6 Q. PLEASE DESCRIBE THE CONCERNS RAISED BY MR. O'BRIEN AND MR.  
7 EICHENMILLER IN THEIR REBUTTAL TESTIMONY CONCERNING SERVICE  
8 QUALITY ON BEHALF OF DLC.

9 A. *Mr. O'Brien and Mr. Eichenmiller oppose my recommendation that the Commission*  
10 *establish service quality and reliability performance standards that reflect DLC's actual*  
11 *historical performance, measure the compliance with those standards on an annual basis, and*  
12 *provide "service compensation dollars" to customers if one or more of the performance*  
13 *standards are not met. Mr. Eichenmiller's Rebuttal testimony sets forth the following*  
14 *reasons to oppose my recommendations:*

- 15 • There is no basis for being concerned about DLC's future intent or ability to achieve  
16 its current high level of service quality and reliability as a result of this acquisition by  
17 Macquarie [Rebuttal at 3-4];
- 18 • DLC should not be held to enforceable performance standards that reflect recent  
19 actual performance because DLC might not comply with these standards through no  
20 fault of its management or operations [Rebuttal at 8 and 10];
- 21 • It is unfair to impose higher standards on DLC compared to the average performance  
22 results of other Pennsylvania EDCs and imposing such higher performance standards

1 on DLC would stimulate other EDCs to avoid achieving such high performance  
2 levels [Rebuttal at 9];

3 • The current PUC reporting and enforcement mechanisms are entirely sufficient to  
4 assure good service quality and the PUC could reflect any deterioration of service  
5 quality in rate decisions [Rebuttal at 8] ;

6 • There should not be any automatic penalties because the imposition of financial  
7 penalties for events beyond the control of DLC would be unfair and irrational. DLC  
8 should have the opportunity to explain the reasons for any decline in service quality  
9 and be required to comply with remedial measures only when it is proven that the  
10 utility is “affirmatively responsible for any sustained decline in service quality.”  
11 [Rebuttal at 10-11]

12 • The proposal to make 1% of revenues at risk for failure to maintain service quality  
13 performance and assign \$100,000 service compensation dollars for each percentage  
14 point decline is arbitrary [Rebuttal at 11]; and

15 • The proposal fails to reward DLC for higher levels of service quality and only allows  
16 for penalties for the failure to keep its current service quality levels [Rebuttal at 11]

17 Q. PLEASE PROVIDE YOUR RESPONSE TO EACH OF THESE CONCERNS.

18 A. Mr. Eichenmiller’s reasons for opposing my recommendations concerning service quality  
19 and reliability conditions that should be imposed for this transaction fail to reflect the nature  
20 of the transaction or the “promises” made by the applicants in this proceeding. I will discuss  
21 each of these concerns below.

1 Q. PLEASE RESPOND TO THE STATEMENTS BY BOTH MR. O'BRIEN AND MR.  
2 EICHENMILLER THAT THERE IS NO BASIS FOR SUGGESTING THAT DLC'S  
3 SERVICE QUALITY AND RELIABILITY WILL DETERIORATE AS A RESULT OF  
4 THIS MERGER.

5 A. The applicants, both DLC and Macquarie representatives, make vague and unsupported  
6 promises and descriptions of benefits associated with this proposed transaction. Both Mr.  
7 O'Brien and Mr. Eichenmiller continue to state that this transaction will not threaten DLC's  
8 high level of service quality and reliability and that recent service quality performance will  
9 continue and perhaps continue to improve as a result of the potential for using "best  
10 practices" from other Macquarie companies. They portray Macquarie as an investment  
11 vehicle that will not interfere with local distribution operations and that the "regulatory  
12 compact" that requires reasonable service quality will be honored. These are vague and  
13 unenforceable statements. As a result, this approach, if adopted, will transfer the risk of any  
14 deterioration in service quality or reliability of service to DLC's customers and not its new  
15 privately held owners. If DLC and Macquarie truly believe that their historically high levels  
16 of service quality will continue, they should make a promise that is in fact enforceable and  
17 transfer the risk of any future failure to its owners and not its customers. Therefore, I do not  
18 characterize the statements made by the applicants to date as actual, enforceable  
19 commitments.

1 Q. WITH REGARD TO MR. EICHENMILLER'S CONCERN ABOUT IMPOSING  
2 PERFORMANCE STANDARDS THAT ARE TOO STRICT OR THAT WOULD NOT  
3 ALLOW FOR UNFORSEEN EVENTS, PLEASE EXPLAIN YOUR RESPONSE.

4 A. The performance standards that I recommended reflect DLC's actual historical performance.  
5 They are annual average performance standards that reflect a wide range of daily and  
6 monthly service quality performance results throughout DLC's service territory. As a result,  
7 they already reflect a wide range of external events and weather. The purpose of the  
8 performance standard that is based on DLC's actual recent performance is that DLC has  
9 already demonstrated that it has managed its service quality and reliability operations to  
10 achieve these standards. The fact that the standards are an average of annual performance  
11 and reflect actions or events throughout the entire DLC service territory means that they  
12 already reflect ongoing variability in weather and other external events. It is unlikely that any  
13 one event will have such a dramatic effect as to cause the annual average to fail to meet the  
14 annual performance standard. Furthermore, the reliability performance measures already  
15 allow the utility to exclude "major events"<sup>2</sup> so that reliability results associated with any  
16 significant storm or other external event are already excluded from the annual results and the  
17 performance standard evaluation.

18 Q. DO YOU HAVE A SUGGESTION AS TO HOW TO HANDLE "MAJOR EVENTS" FOR  
19 SERVICE QUALITY RESULTS OTHER THAN THE RELIABILITY STANDARDS?

20 A. Yes. A number of service quality performance plans in other states contain a provision that  
21 allows the utility to seek a waiver or exemption from the annual results of a specific  
22 performance area if they can demonstrate that the failure to meet the standard was due to an

---

<sup>2</sup> See the definition of "major event" in 52 Pa. Code §57.192.

1 anomalous event, such as a major storm, strike, national or local emergency, or similar  
2 significant event over which the utility had no control or which could not have been reflected  
3 in the historical performance data. For example, a major storm or other catastrophic event  
4 that caused extensive outages and delayed restoration for DLC's customers would probably  
5 be excluded from the annual performance standard for CAIDI and SAIFI under the current  
6 reliability regulations, but this event would also have an equally adverse impact on DLC's  
7 ability to meet its call center performance standards for that same time period. I propose that  
8 my recommended Service Quality and Customer Improvement Plan contain a provision to  
9 allow DLC to file a request for waiver with the Commission to exclude specific service  
10 quality performance data that it identified in the waiver petition for external and anomalous  
11 events not within the control of the utility. This petition should then be subject to a prompt  
12 review and decision after public notice, and opportunity to comment.

13 Q. PLEASE EXPLAIN YOUR RESPONSE TO MR. EICHENMILLER'S CONCERN THAT  
14 IT WOULD BE UNFAIR TO IMPOSE HIGHER PERFORMANCE STANDARDS ON  
15 DLC COMPARED TO OTHER PENNSYLVANIA ELECTRIC UTILITIES.

16 A. As I explain later in this Surrebuttal testimony concerning the actual performance standards  
17 that Mr. Eichenmiller proposes be applied to DLC in the post-merger period, this proceeding  
18 is not about the performance of the other Pennsylvania EDCs. Rather, this proceeding is  
19 about a proposal that DLC has made to transfer ownership of the public utility to Macquarie.  
20 As a result, the Commission and the public will naturally focus on DLC's actual performance  
21 and quality of service in evaluating the potential impact of this transaction. Therefore, the  
22 purpose of my proposals is to "lock in" DLC's actual performance and make that  
23 performance a condition of any approval that may be given to this transaction. In such a

1 situation, it is only reasonable to evaluate DLC's historical performance. In other  
2 proceedings, I have proposed improvement in actual performance where such performance  
3 fails to meet at least the average EDC or NGDC performance, but that approach is not  
4 necessary in this case due to DLC's relatively high level of performance. It is not unfair for  
5 customers who have paid for this high level of performance to expect that it continues.

6 Q. PLEASE EXPLAIN YOUR RESPONSE TO MR. EICHENMILLER'S OPPOSITION TO  
7 ANY AUTOMATIC PENALTIES AND A RELIANCE ON CURRENT COMMISSION  
8 REPORTING AND ENFORCEMENT TOOLS, INCLUDING THE USE OF RATE CASES  
9 TO RESPOND TO SERVICE QUALITY DETERIORATION.

10 A. The purpose of my proposed Service Quality and Customer Improvement Plan is not to  
11 criticize the Commission's monitoring and enforcement tools for EDCs in general. Rather,  
12 my proposals reflect the fact that the applicants have filed for permission to transfer  
13 ownership of DLC to a privately-held investment consortium. It is the applicants who have  
14 the burden of demonstrating that this transaction will benefit Pennsylvania consumers. Since  
15 they have failed to do so, I have proposed specific and enforceable commitments concerning  
16 service quality, reliability of service, and universal service programs that affect vulnerable  
17 low income customers. I acknowledge that other Pennsylvania mergers and acquisitions  
18 have not been accompanied by the service quality compensation attributes I have proposed.  
19 However, it is reasonable to propose such an approach because DLC has demonstrated a  
20 relatively high level of service quality performance and the Commission should put in place  
21 a mechanism that assures the continuation of such service quality without the risk of lengthy  
22 investigations, reports, and ongoing deterioration of service. In addition, it important to point  
23 out that Mr. Eichenmiller's suggestion that the Commission can use a base rate case to

1 investigate and respond to poor service quality is not a practical or effective substitute for an  
2 enforceable set of standards that will become effective immediately upon the consummation  
3 of the proposed merger. My approach is far preferable to waiting until the next base case to  
4 investigate and respond to problems that may have already become evident, particularly  
5 when, as in this proceeding, the parties and DLC have proposed a stay out provision to  
6 capture certain merger benefits for customers.

7 Q. PLEASE EXPLAIN YOUR RESPONSE TO MR. EICHENMILLER'S CRITICISMS OF  
8 THE DESIGN OF THE SERVICE COMPENSATION DOLLARS BOTH IN TERMS OF  
9 THE AMOUNT AT RISK AND THE LACK OF ANY REWARD FEATURE IN YOUR  
10 PROPOSAL.

11 A. My proposals in this regard reflect regulatory policies in response to mergers and acquisitions  
12 of this type that are in effect in Massachusetts (where 2% of the distribution revenues of the  
13 electric utilities are at risk for service quality failures)<sup>3</sup>, Maine, Vermont, Connecticut, New  
14 York, California, and other states. In each state, the amount at risk for the failure to meet  
15 service quality performance standards varies and there is no "formula" that I can propose that  
16 reflects the variations adopted by the various parties and state regulators. The amount at risk  
17 that I have proposed in this proceeding is small when compared to the percentage at risk in  
18 some states or for some companies.<sup>4</sup>

---

<sup>3</sup> My Direct Testimony incorrectly stated that the amount at risk in Massachusetts for the failure to meet annual service quality and reliability performance standards was 1%. The correct amount is 2% (see Massachusetts G.L. c. 164, §1E), but I do not seek to amend my recommendation that 1% of distribution revenues should be at risk in this proceeding involving DLC.

<sup>4</sup> For example, Verizon Vermont's service quality index puts 7% of the intrastate local exchange revenues at risk for deterioration of service. The service quality index for Maine's electric distribution utilities with multi-year rate plans is between 1%-2% of distribution or regulated revenues. See, e.g., Maine PUC, Order Approving Stipulation, Central Maine Power Co. Request for Approval of Alternate Rate Plan, Docket No. 99-666 (November 16, 2000).

1 Q. WHAT ABOUT MR. EICHENMILLER'S CRITICISM THAT YOUR PROPOSAL ONLY  
2 PUNISHES THE UTILITY FOR SERVICE QUALITY FAILURES AND DOES NOT  
3 REWARD THE UTILITY FOR SERVICE QUALITY PERFORMANCE THAT IS  
4 HIGHER THAN THE PERFORMANCE STANDARDS?

5 A. Mr. Eichenmiller's criticism is unfounded and reflects a misunderstanding of the purpose of  
6 my proposal. The purpose of my Service Quality Plan is to maintain a reasonable level of  
7 service quality and reliability that DLC has already achieved and that its customers have paid  
8 for through the recent base rate case revenue decision. My conditions will transfer the risk of  
9 deterioration in the key indicia of service quality and reliability from customers to DLC's  
10 management and owners. Under Mr. Eichenmiller's approach, customers would have to pay  
11 higher rates if DLC exceeded its required service quality performance standards. Customers  
12 should not have to pay higher rates for better service quality performance. Rather, their  
13 primary interest is to assure that the service quality and reliability they have already funded  
14 and that are reflected in current rates will not deteriorate as a result of this merger and  
15 transfer of ownership. Furthermore, DLC (and Macquarie) have publicly promised that this  
16 merger and acquisition will not threaten the current high service quality and customer service  
17 that is provided by DLC. As a result, the purpose of my proposal is to translate that inchoate  
18 promise into an enforceable promise. Therefore, it is only appropriate that the Commission  
19 approve a condition that attaches some financial consequence to the new owners of DLC by  
20 means of customer credits if the promises are not met.

1 Q. MR. EICHENMILLER THEN PROPOSES SERVICE QUALITY STANDARDS THAT  
2 ARE MUCH LOWER THAN DLC'S CURRENT PERFORMANCE AND THEY  
3 REFLECT THE AVERAGE PERFORMANCE OF OTHER EDCs. ARE THESE  
4 PROPOSED STANDARDS APPROPRIATE IN YOUR OPINION?

5 A. No. Mr. Eichenmiller proposes that if the Commission determines that service quality and  
6 reliability should be measured, that DLC should be held accountable to performance  
7 standards that are far lower than those I have recommended and that address fewer  
8 performance areas. The following chart compares my recommendations with that of DLC:

1

<b>Performance Indicator</b>	<b>Proposed Annual Performance Standard</b>	<b>DLC's Proposed Performance Standard</b>
1. Call Center: % calls answered w/in 30 seconds	80% (2004 and 2005 performance)	75% (6.25% deterioration)
2. Call Center: Average Busy-out Rate	0.05% (reflects recent performance of essentially 0%)	2% (300% deterioration)
3. Call Center: Average Call Abandonment Rate	3% (2004 performance)	4% (33% deterioration)
4. Percent of residential bills not rendered once every billing period	0% (recent performance)	Eliminate
5. # of Res. Customer disputes not issued a report within 30 days	Average of 1/month (reflects 2004 and 2006 performance)	Eliminate
6. Residential Termination Rate (terminations per 1000 residential customers)	3% (EDC average in 2005)	Eliminate
7. Justified Residential Payment Arrangement Request Rate	2.45 (2004 performance)	1.43 (Requires a more strict performance level than recommended by OCA)
8. Justified Residential Consumer Complaint Rate	0.1 (2004 performance)	0.26 (160% deterioration)
9. CAIDI	98 minutes (highest level in 2002-2005 period)	Proposes to use SAIDI with a standard of 153 minutes
10. SAIFI	1.16 incident (average of 2002-2005 period)	1.29 incidents
11. Lost Time Accident Rate (LTAR)	0.26-2006 and 2007 0.20-2008 and 2009 0.13-2010	Eliminate

2

3

4

5

6

7

8

9

As can be seen in this chart, the proposed performance standards would fail to keep the promise that DLC has repeatedly made in this proceeding that this merger will not threaten DLC's high level of customer service quality and reliability. Under Mr. Eichenmiller's approach, DLC's actual performance could substantially deteriorate and still meet his proposed standards. As a result, the basic purpose of assuring the continuation of DLC's current high level of service quality and reliability as a result of this merger and acquisition would be thwarted by Mr. Eichenmiller's approach. It would not be fair to DLC's customers

1 if DLC's current management uses its high level of customer service and quality as a mark of  
2 their good management and to promise to its customers and the Commission that this high  
3 level of quality will not be threatened by the new ownership structure and then suggest that  
4 any reporting mechanism (without any financial risk attached to actual results) should reflect  
5 a much lower level of required performance compared to actual performance. This  
6 transaction is not designed to merge the "average" EDC with Macquarie. Rather, the purpose  
7 of this transaction is to allow DLC to be acquired by Macquarie and so it is only proper that  
8 we focus on DLC's actual service quality and reliability performance when considering the  
9 "promises" that have been made by DLC's management in this proceeding.

10 Q. DO YOU HAVE COMMENTS WITH RESPECT TO THE PERFORMANCE AREAS  
11 THAT MR. EICHENMILLER APPEARS TO REJECT IN ANY FUTURE MONITORING  
12 OF DLC'S SERVICE QUALITY AND RELIABILITY?

13 A. I certainly acknowledge that there are a wide variety of potential metrics that could be  
14 included in a service-quality plan of the type I have recommended. I have included those that  
15 appear to have been agreed to in prior settlements or litigation of service quality performance  
16 plans attached to recent mergers of electric and natural gas utilities in Pennsylvania. Of  
17 course, the fact that these performance areas (with the exception of LTAR) are already  
18 measured and reported in Pennsylvania suggests that they have importance to both regulators  
19 and customers. With respect to LTAR, a similar metric was negotiated as part of the PECO  
20 Energy merger with Unicom in 2000 and was reported to the PUC as part of the conditions

1 approved in that proceeding.<sup>5</sup> A similar metric is also included in service quality plans in  
2 effect in Washington (Puget Sound Energy) and California (most electric and gas utilities).  
3 The Company's safety record can be adversely impacted in an environment in which cutting  
4 costs in order to improve financial results becomes paramount and the drive to maintain  
5 service quality can be imposed on a smaller or less qualified workforce. It is important that  
6 the Company's recently improved safety record be continued at a very high level even after  
7 this acquisition. I continue to recommend that all the performance areas reflected in my  
8 Direct Testimony be included in any plan ordered by the Commission in this proceeding.

9 Q. DOES THIS COMPLETE YOUR TESTIMONY AT THIS TIME?

10 A. Yes.

11 92333.doc

---

<sup>5</sup> The specific metric was OSHA Lost Work Days and the performance target was to equal or better the performance of the top 10% of EEl company results. *Application of PECO Energy Company Pursuant to Chapters 11, 19, 21, 22 and 28 of the Public Utility Code for Approval of (1) a Plan of Corporate Restructuring, Including the Creation of a Holding Company and (2) the Merger of the Newly Formed Holding Company and Unicom Corporation*, Docket No. A-110550F0147, (Order entered June 22, 2000) (Approving the Joint Petition for Settlement filed March 24, 2000). See Settlement at paragraph 24.

RECEIVED  
2007 FEB 27 PM 3:25  
PA PUC BUREAU  
SECRETARY'S BUREAU

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Docket No. A-110150F0035

Docket No. A-311233F0002

RECEIVED

SEP 15 2006  
PA PUBLIC UTILITY COMMISSION  
SECRETARY'S BUREAU

Duquesne Light Company  
DQE Communications Network Services, LLC

Statement No. 1

DIRECT TESTIMONY OF MORGAN K. O'BRIEN

**DIRECT TESTIMONY OF MORGAN K. O'BRIEN**

1 **Q. Please state your full name and business address.**

2 A. My name is Morgan K. O'Brien. My business address is 411 Seventh Avenue,  
3 Pittsburgh, Pennsylvania 15219.

4 **Q. What is your position at Duquesne Light Company ("Duquesne Light" or**  
5 **"Company")?**

6 A. I am President and Chief Executive Officer.

7 **Q. How long have you worked at Duquesne Light?**

8 A. I have worked at the Company for the past 14 years in various executive positions in  
9 the Finance and Corporate Development areas. I have been Chief Executive Officer  
10 of Duquesne Light since 2001.

11 **Q. What are your qualifications, work experience and educational background?**

12 A. These are attached as Exhibit MKO-1.

13 **Q. Please briefly describe the subject matter for your testimony in this proceeding.**

14 A. The purpose of my testimony is to provide an overview of Duquesne Light and the  
15 company's operations. I will also describe internal programs employed by Duquesne  
16 Light in response to current market conditions and what led to our decision to find a  
17 strategic partner. I will then provide the reasons for Duquesne Light's decision to  
18 secure the Macquarie Consortium as its long-term strategic partner and outline the  
19 terms of the proposed acquisition. Next I will discuss Duquesne Light's management  
20 and operations after the completion of the transaction including our ongoing  
21 infrastructure capital construction program. Finally, I will explain the benefits to be

1           gained through the approval of this transaction and its importance to Duquesne Light,  
2           its employees, its customers and to Southwestern Pennsylvania.

3           **Q.   Mr. O'Brien, please provide a brief description of Duquesne Light and its role in**  
4           **the Pittsburgh region.**

5           A.   Duquesne Light has a 125-year history with the Pittsburgh region. Duquesne Light  
6           has experienced and been an important part of the Pittsburgh economy through the  
7           rise and eventual decline of the steel industry. The importance of Duquesne Light  
8           and its operations remaining in Pittsburgh can not be overstated. Pittsburgh is a city  
9           still recovering form the loss of the steel industry. When we look back on how much  
10          of the region's economy was directly tied to the steel industry, it is not surprising that  
11          it has been such a long and challenging climb back. However, as a region, we have  
12          made incredible economic progress. In the areas of health care and with our  
13          universities, we are recognized as a national leader. At the same time, the importance  
14          of Duquesne to this community has grown larger as the region's overall corporate  
15          citizenship has greatly been reduced. Historically, large corporations have not only  
16          been the backbone of the economy of the region but also critical support for social  
17          and human services. With losses of large multi-national companies, such as Gulf Oil,  
18          Rockwell International and Westinghouse, there are fewer and fewer good corporate  
19          citizens that serve and support our community's needs.

20                 At a time when fewer corporations were available to address the community's  
21                 needs, Duquesne was stepping up its commitment. We have established Duquesne as  
22                 one of the leading companies in the region in proactively dealing with important

1 social and human-services and economic development issues. Our dollars, our people  
2 and our energy truly go to serving this community.

3 Duquesne and its employees are committed community partners that support a  
4 wide array of community activities designed to strengthen the economic and cultural  
5 vitality of its service territory. These efforts have included sponsoring Pittsburgh  
6 traditions, such as Light Up Night and the Arts Festival. The approval of this  
7 transaction will benefit the Pittsburgh region by ensuring the future viability of a  
8 Pennsylvania-based good corporate citizen and its employees.

9 **Q. Mr. O'Brien, please provide a brief description of Duquesne Light's current**  
10 **operations.**

11 A. Duquesne's restructuring plan pursuant to the Electricity Generation Customer  
12 Choice and Competition Act was approved by the Commission on December 17,  
13 1998. The centerpiece of Duquesne's restructuring plan was the divestiture of our  
14 generation to mitigate stranded costs. Our successful divestiture resulted in  
15 substantially reduced stranded costs. However, to ensure that we met our obligations  
16 as Provider of Last Resort ("POLR") for customers, we entered into supply  
17 arrangement to ensure that Duquesne and its customers would be protected from the  
18 volatility of wholesale markets and the risk of Duquesne being unhedged for its  
19 POLR obligations.

20 The success of Duquesne's divestiture reduced stranded costs to be collected  
21 and the effect of shortening the "transition period" by five years from 2007 to 2002  
22 for most rate classes. The elimination of stranded costs recovery reduced rates to  
23 customers and Duquesne became the first major utility in the Commonwealth to

1 address post-transition period POLR service. In fact Duquesne currently is working  
2 on its POLR IV plan. Our principal objective in developing our earlier POLR plans  
3 was to lock in a substantial portion of the generation rate savings to be realized by  
4 customers from earlier termination of CTC payments by fixing generation costs to  
5 customers. Since that time Duquesne has striven to ensure that our POLR customers  
6 receive reliable generation supply at reasonable rates.

7 Prior to our base rate filing earlier this year, Duquesne had not had a rate case  
8 since 1987. Despite the lack of transmission and distribution ("T&D") rate increases,  
9 Duquesne has continued to invest in its system to ensure that we maintain our historic  
10 high levels of service and reliability. To this end, in 2004 we initiated a significant  
11 and ongoing T&D capital investment program to enhance our electric infrastructure  
12 which I will discuss later. In response to these financial pressures, Duquesne also  
13 undertook a critical look at its operations to identify ways to manage our costs.

14 **Q. Please explain the actions taken to ameliorate Duquesne's declining financial**  
15 **condition and support the infrastructure development program?**

16 A. On April 7, 2006, Duquesne filed tariffs proposing to increase distribution rates by  
17 \$143.7 million and to pass through to customers approximately \$19 million in  
18 transmission costs. On September 14, 2006, Duquesne and all other active parties in  
19 this proceeding filed a Joint Petition for Settlement of all issues in this proceeding.  
20 Some of the solvent features of this Settlement are as follows:

- 21 • Duquesne's distribution rates will be increased to produce \$117 million  
22 increase in revenues per year.

- 1 • Duquesne will be permitted to employ a Transmission Service Charge  
2 Mechanism which will adjust retail rates charged to POLR customers for  
3 recovery of transmission costs.
- 4 • Duquesne's CAP customers will see no increase in their bills as a result of the  
5 T&D increase.
- 6 • Duquesne has committed to continue to work with Electric Generation  
7 Suppliers to further enhance what is by far the most successful customer  
8 choice program in the Commonwealth and one of the most successful in the  
9 nation.
- 10 • Duquesne has committed to contribute \$1.5 million for four years  
11 commencing in 2007 to the Pennsylvania Energy Development Agency to  
12 support sustainable energy and conservation projects.

13 The Settlement is subject to review by the presiding Administrative Law Judge and the  
14 Commission. Nevertheless, achieving a settlement in a major electric rate proceeding  
15 among OTS, OCA, OSBA, industrial customers, electric generation suppliers and public  
16 interest groups is an extraordinary achievement by Duquesne and all major stakeholders.  
17 The Settlement demonstrates Duquesne's and the Parties' continuing commitment to  
18 work together to advance the interests of our customers and the communities that we  
19 serve.

1 Q. What will be the effect of the Settlement on the bills to a typical residential  
2 customer?

3 A. To illustrate the effect on the total bill to typical residential customers, I will assume  
4 that the customer (600 kw/month) receives generation service from Duquesne under  
5 POLR services.

Typical Monthly Bill in 1991	Typical Monthly Bill Before Rate Increase	Typical Monthly Bill After Rate Increase
\$85.65/month	\$63.87/month	\$74.23/month

6  
7 The rate case will cause the bills of customers to increase to support the  
8 significant infrastructure improvements necessary to maintain Duquesne's very high  
9 levels of service. However, despite the increase, the first since 1987, Duquesne's  
10 actions have produced about an 11% reduction in bills in nominal terms since 1991.  
11 The reduction in real dollars (inflation adjusted) is, of course, even more significant,  
12 and is in the range of a 50% reduction.

13 Q. Please describe the Company's infrastructure improvement plan.

14 A. Utility infrastructure is all around us, but most people do not really think about it or  
15 even realize it is there, unless they are experiencing a problem. However, recent  
16 events, such as the water main break in downtown Pittsburgh last summer, the bridge  
17 collapse on Interstate 70 in Washington County in December, and the  
18 Northeast/Midwest Blackout in 2003, dramatically illustrate the importance of utility  
19 infrastructure. Last summer's major water main break in downtown Pittsburgh  
20 resulted in flooding, extensive damage to property, closed many businesses for more  
21 than a week, and displaced residents for an even longer period of time. Similarly, this

1 Commission is well aware of the economic and personal toll resulting from the  
2 Blackout of 2003, which reinforced the need for adequate electric infrastructure and  
3 proper vegetation control.

4 Governor Rendell has stated that one of the critical elements of his Plan for a  
5 New Pennsylvania is economic development. Critical to the state's economic  
6 development is its infrastructure. We live and work in a state that is aging – both in  
7 terms of our people and our infrastructure. To address this issue, the governor has set  
8 aside significant funding to support needed upgrading of the state's infrastructure.  
9 However, he also recognizes that the private sector must provide a significant portion  
10 of the required investment. Our plan is to invest more than \$500 million in our  
11 electrical infrastructure and supporting facilities for our employees during the three-  
12 year period 2005 through 2007. We believe this will provide Allegheny and Beaver  
13 counties with the electric delivery system required to serve our customers and support  
14 economic development.

15 Duquesne Light's customers rely on continuous and efficient utility service.  
16 To meet that commitment, we systematically analyze circuits that carry electricity  
17 across our service territory. Through the years, the Company has regularly replaced  
18 existing wires, poles and other equipment with new facilities in order to keep  
19 customers connected to a secure, reliable source of electricity.  
20  
21

1           While Duquesne Light's transmission and distribution system has served  
2 customers well for decades, significant capital investment is necessary to meet the  
3 following service obligations:

- 4           •       to replace equipment that is damaged by factors such as wind, ice or heat,  
5                   and to replace equipment that fails in service;
- 6           •       to add or modify our system as a result of specific requests by customers  
7                   and to meet our obligations to local, state and federal agencies to relocate  
8                   our facilities;
- 9           •       to ensure distribution system service capacity and reliability to meet the  
10                  needs of our customers, including circuit conversions, the installation of  
11                  new equipment to replace deteriorated, obsolete, or failed equipment, and  
12                  additions that may be necessary to improve operations; and
- 13          •       to provide supporting infrastructure, such as new vehicles, information  
14                  technologies and a new service center and training facility being built in  
15                  Pittsburgh to ensure our customers will continue to be served by a highly  
16                  skilled, properly trained and efficient workforce in the future.

17       These and other projects also will help to meet growing concerns about safety and  
18 security, which have become even more important after September 11, 2001, and the  
19 Blackout of 2003.

20       To address these service obligations, we have instituted a plan that will invest  
21 more than \$500 million in capital expenditures during the 2005 through 2007 period  
22 in our infrastructure in order to ensure that Duquesne Light continues to provide the

1 levels of service and reliability our customers expect. This capital investment will  
2 take place throughout our service territory. Major projects include:

- 3 • upgrading underground lines and equipment that have been in service in  
4 some suburban neighborhoods as far back as the 1960s;
- 5 • improving power capacity to serve the expanding electricity needs of  
6 hospitals and universities in the Oakland area;
- 7 • refurbishing and reinforcing the aging underground systems that provide  
8 service to sections of downtown Pittsburgh and surrounding urban and  
9 commercial areas;
- 10 • upgrading transmission lines that will improve the flow of electricity in  
11 the eastern part of our service territory, better balance the load throughout  
12 our service territory, and provide voltage support to this part of our  
13 system; and
- 14 • converting older distribution circuits to make use of newer technology to  
15 improve reliability.

16 Investing in our infrastructure not only provides the necessary services and reliability  
17 to meet our obligation as a regulated utility, but also will result in new employment,  
18 wages, tax receipts and spin-off economic development for our area. To help us  
19 complete these projects, we added approximately 150 full-time employees to the  
20 Duquesne Light workforce. In addition, approximately 150 project-specific positions  
21 will be available to skilled trades people in the region over the next several years.  
22 Increased employment resulting from the infrastructure work will have a positive  
23 impact on the economy of Pennsylvania.

1                    Since 1880, Duquesne Light has been part of the fabric of Pittsburgh, working  
2                    hard to enhance the quality of life for our customers. Maintaining the integrity and  
3                    strength of the electrical service we provide through the infrastructure investment  
4                    program is the latest example of that commitment.

5                    **Q.    Please describe Duquesne Light's response to these increased cost of service.**

6                    A.    We have been proactive and aggressive in managing our costs while maintaining and  
7                    improving reliability and customer service. We have implemented significant process  
8                    improvements, most notably our "Best in Class" initiative. This initiative entailed  
9                    Duquesne undertaking an aggressive review and restructuring of key internal  
10                    operating processes which focused on costs, reliability, customer satisfaction and  
11                    safety. The initiative resulted in significant changes in how we do business and with  
12                    corresponding reductions in costs and improvements in customer satisfaction.

13                    **Q.    Mr. O'Brien, please describe the Company's "Back to Basics" strategy.**

14                    A.    Over the past several years, Duquesne Light has implemented a "Back to Basics"  
15                    strategy, which was designed to tighten our focus around our electric utility business  
16                    while resolving a number of legacy issues by divesting our non-core businesses. The  
17                    strategy required the alteration in management philosophy to accurately reflect our  
18                    new role as a "wires" company. One of the primary drivers for implementing this  
19                    strategy was the recognition that the success of Duquesne Light directly tied to the  
20                    success of the communities where we serve. By realigning our focus on our role as  
21                    the electric service provider for the Pittsburgh region, we are now better positioned to  
22                    continue to provide safe, reliable and efficient electric service, remain as a well  
23                    respected employer and serve as an active community partner.

1           The Back to Basics strategy accomplished several key goals including  
2           reducing our business risk, providing a platform for future growth, and further  
3           enhancing customer satisfaction and shareholder value.

4           **Q.    What factors led to Duquesne's determination that securing a strategic partner**  
5           **was necessary?**

6           A.    Through the development and implementation of our Back to Basics strategy, we  
7           reviewed a broad range of strategic alternatives. The process led to our determination  
8           that in a consolidating electric utility industry, and with current competitive electric  
9           and financial market environments, Duquesne does not possess sufficient size and  
10          financial strength to remain independent and to attract ample capital on attractive  
11          terms. In this regard, I note that Lehman Brothers' fairness opinion, as contained in  
12          the Proxy Statement filed as a result of the transaction, concludes that the implied  
13          equity value of DLH stock, based upon a Companies Analysis, was in the range of  
14          \$15.24 to \$18.71. In addition, Lehman Brothers performed a comparable transaction  
15          Analysis, which looked at other utility transactions, and concluded that the range of  
16          implied value per share was \$17.54 to \$21.00. Lehman Brothers observed that  
17          DLH's stock price had declined by approximately 13% from the period March 2,  
18          2004 through June 29, 2006 to about \$16 per share. Given the implicit value of the  
19          shares relative to this settling price, it is clear that DLH was a potential acquisition  
20          target for entities seeking to expand their holdings of operating utilities. Investor  
21          analysts have believed that Duquesne was an acquisition target due to its size. JP  
22          Morgan, in a February 14, 2006 analysis of Duquesne, stated, "DQE may be  
23          perceived as an acquisition candidate, although we believe it is unlikely that the

1 company will be acquired at current price levels.” At the time of this report,  
2 Duquesne Light Holdings was trading at \$17.51. In the months that followed there  
3 was a steady decline in Duquesne Light Holdings’ stock price levels, reaching a low  
4 of \$15.67 during the Second Quarter of 2006.

5 To ensure that we remain a Pittsburgh based utility, Duquesne sought to find a  
6 strategic partner to provide it with the ability to access capital at reasonable terms  
7 while maintaining its 125 year connection to Pittsburgh. The Macquarie Consortium  
8 was identified as the right partner at the right time to secure our current position as  
9 committed public service providers, key employers and long-time community  
10 partners.

11 **Q. What led to Duquesne Light to determine that the Macquarie Consortium was**  
12 **the right strategic partner?**

13 A. As part of our ongoing evaluation of our business, Duquesne has regularly considered  
14 our long-term strategic alternatives and prospects for continued operations as an  
15 independent company. Duquesne and Macquarie had engaged in discussions in 2003  
16 regarding Duquesne’s transmission assets. While that sale was never consummated,  
17 subsequent discussions between the companies ensued about other potential projects  
18 ultimately leading to the present transaction.

19 From our discussions with the Macquarie Group, we identified that they  
20 would be a strong, long-term partner for Duquesne going forward. The Macquarie  
21 Group is one of the world’s largest owners and managers of infrastructure assets,  
22 managing more than \$27 billion in infrastructure equity and has significant  
23 experience managing numerous energy and utility investments around the world.

1 Further, the general philosophy of the Macquarie Group's infrastructure funds is to  
2 focus its efforts on owning, operating and investing in a diversified group of  
3 infrastructure businesses for the long-term. These funds generally seek out  
4 investments on behalf of investors that produce steady, long-term cash flow streams  
5 and do not require a sale or defined exit strategy to achieve their investment goals.  
6 These types of investments are consistent with the often long-term liabilities of public  
7 sector corporate pension plans who are large investors in the Macquarie infrastructure  
8 funds. Duquesne was not interested in a partner that was looking for a private equity  
9 investment to achieve a quick return. Instead, we sought a partner that was looking  
10 for a long-term investment and would commit to investing in Duquesne, its  
11 employees and the Pittsburgh region. We found such a partner in the Macquarie  
12 Group.

13 **Q. Please describe the proposed transaction.**

14 A. On July 5, 2006, DLH announced that it had entered into an Agreement and Plan of  
15 Merger ("Merger Agreement"), with a consortium led by Macquarie Infrastructure  
16 Partners and Diversified Utility and Energy Trusts and DQE Holdings LLC a  
17 Delaware limited liability company and DQE Merger Sub, Inc., a Pennsylvania  
18 corporation and wholly owned subsidiary of DQE Holdings LLC. Under the terms of  
19 the Merger Agreement, the Macquarie Consortium will cause DQE Merger Sub, Inc.  
20 to merge with and into DLH with DLH continuing as the surviving corporation and as  
21 the sole wholly-owned subsidiary of DQE Holdings LLC.

22 Pursuant to the Merger Agreement, the merger consideration will be \$20.00  
23 per share in cash, representing a 21.7% premium based upon DLH's closing share

1 price on July 3, 2006 and a premium of 24.0% over DLH's average 30-day closing  
2 price ending July 3, 2006. The transaction has a total equity market value of  
3 approximately \$1.59 billion, based on the approximately 79.6 million of Duquesne  
4 Light Holdings' common shares currently outstanding. At closing, the Macquarie  
5 Consortium through DQE Holdings LLC, also will assume \$148 million of Duquesne  
6 Light Company's outstanding preferred and preference shares as well as assuming  
7 approximately \$1.26 billion of Duquesne Light Holdings' long-term debt (estimated).

8 Certain members of the Macquarie Consortium, namely DUET and IFM, have  
9 already invested approximately \$141 million in newly issued Duquesne Light  
10 Holdings' equity, under private placement, priced at \$16 per share. The proceeds  
11 were used to repay bank borrowings used for capital expenditures, working capital  
12 requirements and for Duquesne Light's infrastructure investment program. The  
13 equity sale was a prerequisite for obtaining the loan used to finance the acquisition of  
14 a minority interest in the Keystone and Conemaugh generation stations.

15 **Q. Please describe the benefits you see for Duquesne Light, its employees, its**  
16 **customers and the Pittsburgh region from this transaction.**

17 **A.** Duquesne Light is a well-run public utility that provides excellent service to its  
18 customers through its plant, equipment and operations. Our ability to provide safe,  
19 reliable and efficient service will be maintained and enhanced by this transaction as  
20 we will have improved access to local and global resources for raising capital, for  
21 information sharing and the ability to share best practices between Duquesne Light  
22 and the Macquarie Group members.

1           The Macquarie Consortium will also pursue new and existing strategic  
2 initiatives with us to further drive ratepayer satisfaction; continue to focus on product  
3 quality and operational efficiency, and continually improve Duquesne Light over  
4 time, including by way of additional capital investment. Specifically, the Macquarie  
5 Consortium is committed to fund necessary maintenance and infrastructure upgrades  
6 to Duquesne Light's electric system. Continuing to provide high levels of service and  
7 reliability to customers throughout Allegheny and Beaver counties will remain a  
8 priority.

9           As I noted earlier, the Macquarie Consortium has already demonstrated its  
10 commitment to Duquesne Light's future, as its investments paved the way for our  
11 continued infrastructure investment program and our working capital needs.

12           Finally, and perhaps most importantly, this transaction will maintain  
13 Duquesne's role as a committed public service provider, a key employer and a long-  
14 time community partner in the Pittsburgh region. The transaction maintains  
15 Duquesne Light's headquarters in Pittsburgh. The Macquarie Consortium also has  
16 agreed to maintain Duquesne Light's long-standing commitment to providing  
17 reliable, safe and efficient electric service its more than 580,000 customers. Finally,  
18 the Macquarie Consortium has committed to continue the current management of  
19 Duquesne and to honor the current collective bargaining agreement in place for the  
20 Company's represented employees. The transaction also provides wage and benefit  
21 protections for non-represented employees. These commitments provide additional  
22 substantial benefits to be realized by the approval of this transaction.

1       **Q.    What protections are provided to union employees under the current union**  
2       **contract?**

3       A.    The union contract provides as follows:

4                   No regular full time employee hired on or before June 1, 2005,  
5                   shall be laid off except under extraordinary circumstances, such as  
6                   acts of God, catastrophic events, bankruptcy, sale or shut down of  
7                   a plant, revocation of a nuclear operating license, or shut down of a  
8                   portion of the transmission or distribution business.

9       I note that current term of the union contract continues through September 30, 2010,  
10       and that 70% of all full-time employees are union and thereby covered by the above  
11       quoted contract provision.

12       **Q.    How will your role as CEO of Duquesne and DLH change as a result of the**  
13       **transaction?**

14       A.    The Macquarie Consortium is committed to Duquesne's Back to Basics strategy, as  
15       it fits very well with the goals of Consortium members to invest in long-lived assets  
16       that produce secure income streams. I believe that the Back to Basics strategy and  
17       our execution of the strategy was one of the reasons the Macquarie Consortium was  
18       attracted to our company. As a result, I do not think there will be any significant  
19       change in the direction of our business.

20                   As to my role on an operating basis, I currently report to the Board of  
21       Directors of DLH, who sets the direction of DLH and Duquesne and approve capital  
22       and operating budgets within which I am expected to manage the Company. The  
23       current Board of DLH will be replaced by representatives of the Consortium members  
24       and led by Chris Leslie of MIP who will be Chairman of the Board of DLH. As a  
25       result, my role will not change dramatically, and I will continue to have direct access  
26       to the representatives of the owners of our business.

1       **Q.    Mr. O'Brien, please explain the reasons that Duquesne and the Macquarie**  
2       **Consortium are committing funds to the proposed economic development**  
3       **program.**

4       A.    The rising cost of electricity and the volatility of the wholesale energy markets  
5       significantly impact the economic viability of Southwestern Pennsylvania. This is  
6       particularly true as Duquesne's retail competition transition period has concluded and  
7       our commercial and industrial customers need to acquire their generation in the  
8       competitive markets. While the vast majority of Pennsylvania's electric utilities  
9       remain under transition period rate caps, Duquesne's commercial and industrial  
10      customers find themselves seeking generation service in a competitive market place  
11      with escalating wholesale prices. During Pennsylvania's continued transition to  
12      competitive retail markets, it is imperative for our region, that Duquesne have the  
13      ability to offer competitively priced electricity prices to encourage existing  
14      manufacturers and to attract new industries to the service area.

15                To this end, Duquesne, as further justification for approval of this transaction,  
16      will establish an economic development program that utilizes the reliable, low cost  
17      generation from its share of the Keystone and Conemaugh units to attract and support  
18      expanding Pennsylvania industrial employers. The framework of this economic  
19      development plan is as follows:

- 20               • Duquesne will offer a flat 50 MW block (7 days by 24 hours) of energy  
21               delivered to the Duquesne Zone within PJM sourced from the Keystone and  
22               Conemaugh power plants or alternative sources. This flat block of 50 MW  
23               can be sliced into smaller blocks for different economic development projects.

- 1 • The economic development offering will be a \$3 per MWh discount below  
2 market.
- 3 • Offering will be for 3 years per project.
- 4 • Offered to those commercial/industrial customers on Duquesne's Schedule  
5 HVPS or Schedule L in order to create new load or plan to expand existing  
6 load by at least 10 MW demand.
- 7 • Associated with such increased load, such expanded project must create at  
8 least two (2) new full-time jobs per MW of economic development power  
9 granted. For example, if a 10 MW industrial expansion is proposed, it must  
10 create at least 20 new full-time jobs to be eligible for the economic  
11 development discount program.
- 12 • Duquesne will meet with prospective candidates to discuss each project so as  
13 to tailor this offering to each customer's needs. Duquesne would be willing to  
14 consider enhancements to the economic development rider, on a case-by-case  
15 basis, if the expansion could utilize off peak power to a greater extent than on  
16 peak power and its load factors and power factors for the expansion were  
17 attractive for load management.
- 18 • Termination of program would be March 1, 2013.

19 This Duquesne economic development program would terminate earlier in the event  
20 of a state-wide economic development program is implemented.

21 This program will serve as a means to provide long-term price offerings to all  
22 new industrial customers and existing customers significantly expanding their load.

23 These customers will be able to obtain price offerings for a portion of their load

1 requirements at a discount to the prices available in the volatile wholesale market.  
2 The establishment of such a program will enable Pennsylvania to compete with  
3 neighboring states that currently are able to avail themselves of opportunities to  
4 enhance their economic competitiveness through access to economical energy  
5 resources.

6 Through the transaction Duquesne Light will continue to provide reliable, safe  
7 and efficient electric service, maintain its role as key employer and a long-time  
8 community partner thus ensuring not only Duquesne Light's continued success, but  
9 also add to the ongoing success of the Pittsburgh region.

10 **Q. Do you believe that the economic development program or the transaction will**  
11 **harm the competitive market for generation service?**

12 A. No, I do not. First let me explain, that Duquesne Light is supportive of the  
13 competitive market for generation service. In this regard, I note that Duquesne Light  
14 has, by far, the most successful competitive generation market in this  
15 Commonwealth. Specifically, 17.96% of Duquesne Light's residential customers,  
16 15.84% of small commercial customers and 40.85% of large commercial and  
17 industrial customers are receiving service from electric generation suppliers as of July  
18 1, 2006, resulting in 56% of Duquesne Light's total load being served via the  
19 competitive market. To place these statistics into context, currently shopping  
20 residential customers in Duquesne Light's service territory represent 93.5% of all  
21 shopping residential customers in Pennsylvania; while Duquesne Light's shopping  
22 industrial customers represent nearly 98% of all shopping industrial customers in the

1 Commonwealth. This is remarkable, especially when noting that Duquesne has  
2 10.5% of the total number electric customers in Pennsylvania.

3 While we do not contend that Duquesne Light deserves all the credit for this  
4 success, clearly the results show that Duquesne Light's actions have assisted in  
5 developing competition for generation service on its system. Neither the transaction  
6 nor the Economic Development program will reverse that support or impede  
7 competition.

8 As to the Economic Development program, I note several additional points.  
9 The program is focused on developing new sources of load from existing or new  
10 manufacturers, with resulting addition of jobs to our service area. If the Economic  
11 Development program is not approved, it is highly likely that this load will not  
12 materialize. It is proposed as a means to help solve an ongoing problem in trying to  
13 keep our industrial customers, and their related employment and tax base, here in  
14 Pennsylvania, rather than their moving to competing states.

15 As a result, servicing this new load or a portion of the new load through the  
16 program does not disadvantage competitive suppliers, Duquesne will not condition  
17 receipt of the discounted power on use of POLR service. Second, Duquesne is  
18 agreeing to sell power at less than market up to 50 MW for incremental load. It is  
19 Duquesne's intention to limit the discount to the amount of power necessary to make  
20 the project economic. Accordingly, projects may generate the demand for  
21 incremental power over and above the amounts served at the discounted rate. This  
22 additional incremental load can be served by competitive suppliers or POLR service  
23 under the terms of the current POLR plan. Third, retail suppliers should support this

1 proposal as it creates additional business opportunities (new load) that would not  
2 otherwise be available but for the Economic Development Program proposed as part  
3 of this proceeding.

4 **Q. In addition to these benefits, do you anticipate the transaction to result in**  
5 **synergy savings for Duquesne Light?**

6 A. Because the transaction does not involve a combination of operating utilities, it is not  
7 expected that synergy savings will be realized as a result of the transaction. However,  
8 ratepayers will benefit in the future as a result of the Macquarie Group's ability to  
9 attract capital on a reasonable basis through enhanced access to capital markets,  
10 increased stability and enhanced financial strength, and a greater and continuous  
11 access to equity capital through the Macquarie Consortium and from institutional  
12 investors.

13 **Q. Will the merger result in fewer financial reporting requirements for Duquesne**  
14 **since it will not have public common stock outstanding?**

15 A. No. Both Duquesne Light Company and Duquesne Light Holdings have and hold  
16 public debt such as first mortgage bonds and unsecured notes. Also, Duquesne Light  
17 has publicly held preferred stock. As long as these securities remain outstanding and  
18 publicly held, both Duquesne Light Company and Duquesne Light Holdings will  
19 continue to be subject to public reporting requirements of the Securities and  
20 Exchange Commission, including the requirement to file 10-Ks, 10-Qs, 8-Ks, etc.  
21 Thus, there will be no reduction in the financial records and reports available to the  
22 public or state and federal regulation commissions, as a result of the transaction.  
23

1       **Q.     Please summarize the benefits of this transaction.**

2       A.     The transaction will combine the resources of Duquesne Light, a first class provider  
3           of electric transmission and distribution service, with the world-wide capital and  
4           technical resources of the Macquarie Group and the Macquarie Consortium. The  
5           transaction will enable the continuation of Pittsburgh management and operation of  
6           critical infrastructure and a continuation of a critical community partner while  
7           providing Duquesne with access to investors around the world that are focused on  
8           investments in our business. It is the right transaction at the right time for Duquesne  
9           and the Pittsburgh region that we serve.

10      **Q.     Does this conclude your testimony?**

11      A.     Yes.

Morgan K. O'Brien

Education

B.S. Business Administration – Accounting, Robert Morris College, 1982  
M.S. Taxation – Robert Morris College, 1984  
Certified Public Accountant, 1984

Employment History

Duquesne Light Holdings, Inc. (DQE) – President and CEO since September 14, 2001. Chief Operating Officer from August 2000 to September 14, 2001. Executive Vice President – Corporate Development from January 2000 to August 2000. Vice President – Corporate Development from July 1999 to January 2000. Vice President, Controller and Treasurer from November 1998 to July 1999. Vice President and Controller from October 1997 to November 1998. Controller from October 1995 to October 1997. Assistant Controller from December 1993 to October 1995.

Duquesne Light Company – President and CEO from August 2003. Vice President – Finance from November 1998 to May 2000; Vice President – Finance, Treasurer & Controller in November 1998; Vice President & Controller from October 1997 to November 1998; Controller from September 1996 to October 1997; Controller and Principal Accounting Officer from October 1995 to April 1996; Assistant Controller from December 1993 to October 1995; Manager, Corporate Taxes from September 1991 to December 1993. Director since June 1999.

PNC Bank – Assistant Vice President, Taxes, 1990-1991.

Deloitte & Touche – Senior Manager, 1986-1990.

Coopers & Lybrand – Staff Accountant and Manager, 1982-1986.

Outside Affiliations

United Way of Allegheny County – Director  
Catholic Charities of Pittsburgh – Director  
Allegheny Conference on Community Development – Director  
Edison Electric Institute – Director  
Association of Edison Illuminating Companies – Director

**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

RECEIVED  
2007 FEB 27 PM 3:25  
PA PUC  
SECRETARY'S BUREAU

**Docket No. A-110150F0035**

**Docket No. A-311233F0002**

**DQE Holdings LLC**

**Statement No. 2**

RECEIVED  
SEP 15 2006  
PA PUBLIC UTILITY COMMISSION  
SECRETARY'S BUREAU

**DIRECT TESTIMONY OF CHRISTOPHER J. LESLIE**

## DIRECT TESTIMONY OF CHRISTOPHER J. LESLIE

1 **Q. Please state your full name and business address.**

2 A. My name is Christopher J. Leslie. My business address is Level 22, 125 West 55<sup>th</sup> Street,  
3 New York, New York 10019.

4 **Q. By whom are you employed and in what capacity?**

5 A. I am the Chief Executive Officer of Macquarie Infrastructure Partners and Executive  
6 Director of both Macquarie Investment Management (USA) Inc. and Macquarie Holdings  
7 (USA) LLC.

8 **Q. What are your qualifications, work experience and educational background?**

9 A. These are attached as Exhibit CJL-1.

10 **Q. What is the purpose of your testimony?**

11 A. My testimony provides a brief history of the Macquarie Group ("Macquarie"), which  
12 consists of Macquarie Bank Limited, its affiliates and investment vehicles managed by  
13 those affiliates, and its current operations, describes our investment philosophy, our  
14 experience and expertise in infrastructure investments and the development and  
15 management of these investments. I then provide a description of the proposed  
16 acquisition of Duquesne Light Holdings ("DLH") by DQE Holdings LLC (DQE  
17 Holdings), describe the investors involved in the transaction, explain how the transaction  
18 will be financed and set forth the proposed corporate governance after the transaction is  
19 closed. I next describe Macquarie's plans for the future management and operations of  
20 Duquesne Light Company ("Duquesne Light"). Finally, I present a summary of the

1 expected benefits from the transaction for Duquesne Light, its customers and the Greater  
2 Pittsburgh region.

3 **Q. Please provide a brief history of the Macquarie Group.**

4 A. The Macquarie Group is headquartered in Australia, where we are a leading provider of a  
5 full range of investment banking, financial markets and financial services. The  
6 Macquarie Group consists of Macquarie Bank Limited, its affiliates and investment  
7 vehicles managed by those affiliates. Macquarie Bank can trace its origins to the  
8 merchant bank Hill Samuel Australia (HSA), a wholly-owned subsidiary of Hill Samuel  
9 & Co. Limited, London. Established in Australia in 1969, HSA was organized to offer a  
10 full range of financial services of the highest quality in terms of service, knowledge and  
11 skill.

12 In 1985, HSA was restructured as a new Australian trading bank. Following a  
13 successful proposal to the Australian Federal Government, Macquarie Bank Limited was  
14 established. The Bank is named after Australia's most successful early governor,  
15 Governor Lachlan Macquarie (1761 - 1824). Governor Macquarie was instrumental in  
16 the establishment of Australia's first bank and was also responsible for introducing  
17 Australia's first coinage, the "Holey Dollar." The Bank's logo is a stylized version of  
18 the "Holey Dollar," which Governor Macquarie introduced in 1813 to overcome an acute  
19 currency shortage by purchasing Spanish silver dollars, punching out the centres and  
20 creating two new coins - the "Holey Dollar" and the "Dump". This single move not only  
21 doubled the number of coins in circulation but increased their total worth by 25 per cent  
22 and prevented the coins from leaving the colony.

1 Governor Macquarie's creation of the "Holey Dollar" was a creative solution to a  
2 difficult problem and for this reason it was chosen as the symbol of the Macquarie Group.  
3 Today, the Macquarie Group provides a range of specialist investment, advisory, trading  
4 and financial services in select markets around the world. The Macquarie Group has  
5 been closely associated with a number of major financial innovations, which have  
6 underpinned its reputation as a market leader.

7 One of the principal services provided by the Macquarie Group is the  
8 management of infrastructure funds. These infrastructure funds in general seek out low-  
9 risk, long-term investments that offer stable and predictable returns, which reflect the  
10 investment objectives of the investors in those funds, a large portion of which consists of  
11 pension funds which seek long term stable assets to match their long dated liabilities. For  
12 over a decade, Macquarie has been highly successful in identifying financially stable  
13 infrastructure assets that offer predictable returns to investors over the long-term.

14 **Q. Please describe the Macquarie Group's investment philosophy.**

15 **A.** The Macquarie Group is recognized as a global leader in infrastructure investment and  
16 the management and development of important infrastructure assets, including regulated  
17 utilities. The general philosophy of the Macquarie Group's infrastructure funds is to  
18 focus on owning, operating and investing in a diversified group of infrastructure  
19 businesses globally, including in the United States, for the long term. Specifically, we  
20 seek out investments that produce steady, long-term cash flow streams which do not  
21 require a sale or defined exit strategy to achieve the investment goals of the investors'  
22 funds that we manage. To this end, our infrastructure funds seek out long-term  
23 investments with highly competent and established management teams and then support

1 them with financial, operational and technical expertise as well as greater access to  
2 capital for their ongoing needs. This philosophy is consistent with our co-investors in  
3 DQE Holdings LLC who also manage pension fund money and are significant investors  
4 in infrastructure assets.

5 **Q. Please describe the Macquarie Group's business operations today.**

6 A. Currently, the Macquarie Group employs over 8,600 people in 24 countries. While the  
7 Macquarie Group as a whole is involved in a wide variety of financial activities, our  
8 infrastructure funds have become a large part of the organization's overall business. We  
9 currently employ over 700 infrastructure specialists around the world and manage over  
10 \$27 billion in equity invested in infrastructure and similar assets globally. The asset  
11 portfolio managed by Macquarie's IB Funds division now includes 99 assets in 25  
12 countries across 27 different investment funds, companies and vehicles. By following the  
13 philosophy described above, these funds have developed a track record as long term  
14 holders of infrastructure businesses and investments.

15 **Q. Please provide examples of the Macquarie Group's infrastructure investments.**

16 A. Through its investments, the Macquarie Group is responsible for serving customers in the  
17 following sectors around the world:

18	Gas distribution	+3.4 million households
19	Water	+4.0 million households
20	Electricity distribution	+550,000 households
21	Electricity transmission	Serve +4 million people
22	Airports	+110 million passengers per annum
23	Toll Roads	+1.2 million cars per day (on average)

1 Rail +3.9 million passengers per annum

2 In the United States, the Macquarie Group's energy and utility investments to date  
3 include: Aquarion Company, a New England water utility (regulatory approval and  
4 financial close pending); The Gas Company, a Hawaiian full service gas company; and  
5 Thermal Chicago, district energy businesses operating in Chicago and Las Vegas, as  
6 shown on Exhibit CJL-2.

7 **Q. Please describe the proposed transaction?**

8 A. Under the terms of the agreement, the Macquarie Consortium will acquire all of the  
9 outstanding common shares of Duquesne Light Holdings for \$20.00 per share in cash.  
10 This will result in Macquarie managed funds holding 64.3% of the equity in DQE  
11 Holdings LLC. The transaction has a total equity market value of approximately \$1.59  
12 billion, based upon the approximately 79.6 million Duquesne Light Holdings common  
13 shares currently outstanding. The Macquarie Consortium also will assume \$148 million  
14 of Duquesne Light Company's preferred and preference shares on issue as well as  
15 assuming approximately \$1.26 billion of Duquesne Light Holdings' long-term debt  
16 (estimated at closing). The offer represents a premium of 21.7% based upon Duquesne  
17 Light Holdings' closing share price on July 3, 2006 and a premium of 24.0% over  
18 Duquesne Light Holdings' average 30-day closing price ending July 3, 2006.

19 **Q. Why has the Macquarie Consortium decided to acquire DLH?**

20 A: Duquesne Light is a well-run public utility that provides safe, reliable and efficient  
21 service to its customers through its plant, equipment and operations. Duquesne Light is  
22 recognized for its consistent track record of providing exceptional service in its  
23 certificated service territory. Duquesne Light also has a strong commitment to

1 customers, the environment and to the communities it serves. The Macquarie Group was  
2 particularly attracted to Duquesne Light's "Back to Basics" program, in which Duquesne  
3 Light is focusing primary attention on its core transmission and distribution utility  
4 business. Finally, Duquesne Light is subject to regulation by the Pennsylvania Public  
5 Utility Commission, which has a strong reputation for balanced and fair regulatory  
6 policies. These are some of the primary reasons the Macquarie Group was attracted to  
7 DLH and Duquesne Light in particular.

8 As explained above, the Macquarie Group seeks to invest in infrastructure assets  
9 that provide stable returns, and particularly stable utility systems that are managed by a  
10 locally based, highly competent, management team and are subject to reasonable and fair  
11 regulation. Duquesne fits this model exceptionally well.

12 **Q. How will the transaction be financed?**

13 A. As explained in the Application, the transaction will be funded and financed by the  
14 Macquarie Consortium, a group of six investment funds, including: (1) Macquarie  
15 Infrastructure Partners Canada, L.P., Macquarie Infrastructure Partners A, L.P.  
16 (collectively "MIP") (both acting through CLH Holdings, GP, a Delaware General  
17 partnership, (2) DUET Investment Holdings Limited ("DUET"), (3) Industry Funds  
18 Management, investing through IFM (International Infrastructure) Wholesale Trust, (4)  
19 GIF2 - MFIT United Pty. Limited, (5) Motor Trades Association Super and (6) State  
20 Super.

21 The purchase price will be funded by the Consortium at closing from the following  
22 financing sources:

- 23 • \$954 million in Consortium cash equity;

- 1           • \$141 million in newly issued shares of DLH contributed by members of the
- 2           Consortium; and
- 3           • \$638 million of term loan bank debt facilities.

4           The Macquarie Consortium will also assume:

- 5           • \$148 million of Duquesne Light preferred and preference shares; and
- 6           • \$1.26 billion in assumed long term debt (estimated at closing).

7           Further debt facilities totaling \$807 million will be available to the Macquarie  
8           Consortium for the repayment of existing debt and Duquesne Light preference shares  
9           (approximately \$424 million), capital expenditure and general corporate purposes  
10          (approximately \$275 million) plus transaction and other costs.

11       **Q.    What effects will the transaction and its financing have on DLH and Duquesne**  
12       **Light capital structures?**

13       A.    The transaction, at closing, will produce a stronger balance sheet for Duquesne Light and  
14       comparable leverage at DLH. Specifically, before the transaction, Duquesne Light's  
15       projected capital structure, as of December 31, 2006, is expected to comprise  
16       approximately 44.3% common equity, 9.6% preferred and preference stock and 46.1%  
17       total debt. After the transaction is completed, the comparable figures will be 69.1%  
18       common equity, 8.7% preferred and preference stock and 22.2% total debt. However, as  
19       the Pollution Control Revenue Bonds of Duquesne Light, currently held "on the shelf",  
20       are issued over time, the capital structure of Duquesne Light is anticipated to return to a  
21       more equal ratio of equity and debt. Comparable figures for DLH before and after the  
22       transaction, respectively, will be 35.8% and 33.3% common equity, 6.7% and 4.2%  
23       preferred and preference stock, and 57.5% and 62.5% total debt. There is also an

1 intention to divest certain non-core assets of the Company, the after-tax proceeds of  
2 which would be used to repay debt and or preferred shares. Therefore, the transaction  
3 will result in providing Duquesne Light with a stronger equity position while largely  
4 maintaining DLH's current leverage position.

5 **Q. Will the transaction result in increased rates for Duquesne Light's customers?**

6 A. No. DQE Holdings will not cause the transaction premium to be recorded on either  
7 Duquesne Light's or DLH's books and there will be no claim for a return on or recovery  
8 of the premium in a future base rate case by Duquesne Light. Duquesne Light also will  
9 not claim a return on or recovery of the transaction costs in a future rate proceeding.

10 **Q. Please describe the Macquarie Consortium's access to capital, both to finance this  
11 transaction and in providing for the future capital needs of Duquesne Light.**

12 A. Access to capital markets is one of the key attributes of successful infrastructure  
13 management. The Macquarie Group is a recognized as a global leader in the  
14 infrastructure sector with recognized strength in both infrastructure funds management  
15 and infrastructure advisory services, and will be a strong strategic partner for DLH. The  
16 Macquarie Group is one of the world's largest owners and managers of infrastructure  
17 assets, managing more than \$27 billion in infrastructure equity around the world. The  
18 other members of the Macquarie Consortium also have significant capital to invest in  
19 infrastructure assets.

20 Duquesne Light has already benefited from the Macquarie Consortium's financial  
21 commitment. On August 11, 2006, members of the Macquarie Consortium, DUET and  
22 IFM invested approximately \$141 million in newly issued DLHs' equity which has  
23 enabled DLH to acquire a minority interest in the Keystone and Conemaugh generation

1 stations and provide support for Duquesne Light's ongoing Infrastructure Improvement  
2 Program. In addition, if the transaction is approved, Macquarie's infrastructure advisory  
3 business will play an important role in identifying future opportunities to access  
4 efficiently priced capital through arranging additional debt facilities to enable further  
5 investment in the Infrastructure Improvement Program and refinancing existing debt.

6 As for future capital requirements, the Macquarie Consortium's investment goal  
7 is to identify and invest in assets that produce steady, long-term cash flow streams and  
8 that do not require a sale to achieve its investment goals. As I noted previously, the  
9 Macquarie Consortium is paying a premium to invest in DLH as it is an infrastructure  
10 asset that fulfills our mandate by providing us with the opportunity to employ capital to  
11 purchase a long-term asset and earn a stable return on our investment.

12 For DLH's and Duquesne Light's future capital needs, the Macquarie Consortium  
13 members have a continuing need to invest capital in long lived assets and the Macquarie  
14 Group has access to numerous global sources of capital.

15 **Q. Please compare and contrast the Macquarie Group's investments and investment  
16 philosophy with that of a so called "private equity" fund.**

17 **A.** The infrastructure sector consists of long-lived assets and entities with sustainable  
18 business advantage which produce stable and predictable revenue streams. Included in  
19 this sector are gas, water and electric utilities, toll roads, airports, broadcast networks,  
20 select rail assets and various other public/private partnerships. The general philosophy of  
21 the Macquarie Group's infrastructure funds is to focus on owning, operating and  
22 investing in a diversified group of infrastructure businesses globally, including in the  
23 United States and other developed countries for the long-term. These funds generally

1 seek out investments that produce steady long-term cash flow streams and do not require  
2 a sale or defined exit strategy to achieve their investment goals. For this reason, the  
3 Macquarie Group and our co-investors, view the nature of the infrastructure funds and  
4 infrastructure generally, as being fundamentally different from traditional “private  
5 equity” investments, which generally operate on a much shorter time horizon and often  
6 achieve expected returns only upon sale of underlying assets.

7 **Q. Do you have any evidence to support your position regarding the Macquarie**  
8 **Group’s “buy and hold” investment strategy?**

9 A. Yes. Since inception of our infrastructure funds business in 1996, the Macquarie Group  
10 has invested in approximately 100 infrastructure and infrastructure-like assets. Of these,  
11 we have sold only three of these investments. In those three incidents the Macquarie-  
12 managed investment was only a minority interest in the infrastructure asset. Increasingly,  
13 the Macquarie Group now targets investments where it holds a majority position. These  
14 figures provide strong support for the proposition that the Macquarie Group is  
15 fundamentally different from general private equity funds.

16 **Q. Please describe the proposed ownership and corporate governance of DQE Holdings**  
17 **LLC.**

18 A. As a limited liability company, DQE Holdings will have members rather than  
19 shareholders as its equitable owners. The members of DQE Holdings will be the six  
20 investments funds who are funding and financing the proposed transaction.  
21 Representatives of these six members also will comprise the Board of Directors of DQE  
22 Holdings. I will be the board representative for Macquarie Infrastructure Partners and

1 will be Chairman of the Board. The Chief Executive Officer of DQE Holdings will be  
2 Duquesne Light's and DLH's current CEO, Morgan O'Brien.

3 The Board of Directors of DQE Holdings sole purpose is to supervise the  
4 operations of DLH and Duquesne Light. Thus, Duquesne Light and its operations will  
5 benefit from a board dedicated to ensuring its success over the long-term. There is  
6 currently no intention to merge the operations of DLG with any other investment of the  
7 Macquarie Group. Any such future transaction would be based on an analysis by DQE  
8 Holdings at that point in time.

9 **Q. What are Macquarie Consortium's plans regarding future management and**  
10 **operation of Duquesne Light?**

11 A. As explained in the Joint Application, the Macquarie Consortium provides financial and  
12 technical expertise, and supports existing management in the day-to-day operation of its  
13 investments. These activities will be within the purview of existing management, as they  
14 are today. While DQE Holdings will seek to become more involved in the business  
15 planning process, and will provide DLH and Duquesne Light with access to a wide  
16 variety of global expertise, in many respects, the operation and management of Duquesne  
17 Light and DLH will be very much the same before and after the transaction. Today, DLH  
18 and Duquesne Light are run on a day-to-day basis by senior management, subject to  
19 supervision by the DLH Board of Directors. The current board establishes overall  
20 corporate goals and policies, reviews financial and operating data at periodic board  
21 meetings, reviews and approves annual capital and operating budgets, reviews the  
22 performance and sets compensation for senior management. After the transaction, the

1 DQE Holdings' Board will perform these functions and senior management will continue  
2 in its present role.

3           Regarding future plans, as I mentioned earlier, one of the things that particularly  
4 attracted the Macquarie Consortium to this transaction is the quality and commitment of  
5 senior management, particularly the current CEO, Morgan O'Brien. We intend to retain  
6 existing senior management, including Mr. O'Brien, and indeed, this is a very important  
7 part of our investment strategy.

8 **Q. Please describe the anticipated business relationship between the members of**  
9 **Macquarie Consortium and Duquesne Light.**

10 **A.** As noted in the Application, Duquesne Light is currently party to an Amended and  
11 Restated Administration Services Agreement by and among Duquesne Light, DLH and  
12 the affiliates of each for the provision and receipt of services at cost among affiliates. In  
13 conjunction with this transaction, this existing agreement will be amended to include  
14 DQE Holdings and Macquarie Bank Limited, its subsidiaries and affiliates where  
15 relevant.

16           Again, one of the primary attractions of DLH and Duquesne Light as an  
17 investment for the Macquarie Consortium is the existing senior management and its  
18 skilled workforce. While the Macquarie Consortium will not provide personnel for  
19 Duquesne's daily operations, our significant experience managing energy and utility  
20 investments will enable Duquesne Light to benefit from the assistance of experienced  
21 personnel with relevant industry background.

1 To address the provision and receipt of Macquarie Group services at cost, the  
2 aforementioned affiliate investment agreement will require amendment to reflect the new  
3 resources at Duquesne Light's disposal.

4 **Q. Please describe Macquarie's commitment to the communities in which it makes**  
5 **infrastructure investments.**

6 A. One of the beliefs around which the fledgling Macquarie Group formed its philosophy in  
7 the early 1970s was that a company is a member of the society in which it operates. It  
8 follows that one of its duties is to work in different ways for the betterment of that  
9 society. Recognizing that the infrastructure investments it manages involve both  
10 environmental and societal responsibilities, the Macquarie Group and the Macquarie  
11 Consortium, like DLH and Duquesne Light, understand the importance of its role as a  
12 responsible corporate citizen. The transaction ensures the fulfillment of the important  
13 role of corporate citizen through responsible management, through encouraging and  
14 supporting community activities of its staff and financial support to various charities.  
15 Some U.S. examples of the Macquarie Group's activities include:

- 16 • In Chicago, IL, where the Macquarie Group manages investments such as the Chicago  
17 Skyway toll road, Thermal Chicago Corporation, Avistar Airport Parking at O'Hare  
18 airport and Atlantic Aviation FBO at Midway airport, it is engaged as an active member  
19 of the community. Led by the efforts of the Macquarie Foundation since 2004,  
20 Macquarie has been a committed supporter of *After School Matters (ASM)*, the largest  
21 after-school initiative of its kind for teenagers in the U.S. Currently the Macquarie Group  
22 is working with *ASM* by funding a six month glass mosaic community partnerships

1 program empowering Chicago teenagers to develop their creativity and expressiveness;  
2 and

- 3 • In May 2006 the Dulles Greenway, a toll road owned by Macquarie Infrastructure Group  
4 (MIG), conducted its inaugural “*Drive For Charity*” day, where during 24 hours the net  
5 proceeds from tolls collected on the road were donated to five charities with three year  
6 funding commitments. The *Drive For Charity* initiative is held in Australia, the United  
7 Kingdom, and the United States on roads where MIG holds a controlling interest.

8 The Macquarie Consortium is committed, at a minimum, to maintaining Duquesne’s  
9 active role in supporting the community and DQE Holdings LLC has agreed to provide  
10 corporate contributions and community support in Southwestern Pennsylvania for a  
11 period of at least five years at the levels comparable to those provided in Duquesne  
12 Light’s budget for 2006.

13 **Q. Please summarize the benefits you see to Duquesne Light, its customers and the**  
14 **Pittsburgh community from acquisition by Macquarie.**

15 A. The many benefits of the proposed transaction are set forth in the Application, and I will  
16 not repeat them in detail in my testimony. I will only add that the Macquarie Group is  
17 very excited about the opportunity to acquire DLH and Duquesne Light. We believe the  
18 proposed transaction is an excellent example of a “win-win” transaction that is both fully  
19 consistent with our long-term investment strategy and will provide substantial benefits to  
20 Duquesne Light it customers and the communities it serves. We look forward to a long  
21 and mutually beneficial relationship with Duquesne Light, the Commission and the  
22 Commonwealth of Pennsylvania. Duquesne Light is a well-run public utility that  
23 provides excellent service to its customers through its plant, equipment and operations.

1 Duquesne Light's ability to provide safe, reliable and efficient service will be maintained  
2 and enhanced by this transaction, as the transaction will result in DLH and Duquesne  
3 Light having improved access to financial resources from the Macquarie Consortium.  
4 Specifically, DLH and Duquesne Light will now have access to local and global  
5 resources for raising capital, and for information sharing to develop best practices  
6 between DLH and Duquesne Light and the Macquarie Group. Also, the Macquarie  
7 Consortium and Duquesne Light share a strong commitment to customers, the  
8 environment and to the communities they serve.

9 In addition, the Macquarie Consortium is committed to pursuing new and existing  
10 strategic initiatives with Duquesne Light's current management to further improve  
11 ratepayer satisfaction and continue to focus on product quality and operational efficiency.  
12 Specifically, the Macquarie Consortium is committed to fund necessary maintenance and  
13 infrastructure upgrades to Duquesne Light's system. Continuing to provide high levels of  
14 service and reliability to customers throughout Allegheny and Beaver counties will  
15 remain a priority.

16 The Macquarie Consortium has demonstrated its commitment to Duquesne  
17 Light's future as two of its members have already invested \$141 million in newly issued  
18 DLH equity prior to the closing of this transaction. The proceeds were used to repay  
19 DLH's bank borrowings used for capital expenditures, working capital requirements and  
20 for Duquesne Light's infrastructure investment program. The equity sale was a  
21 prerequisite for obtaining the loan used to finance the acquisition of a minority interest in  
22 the Keystone and Conemaugh generation stations.

1           Securing access to these reliable, low cost units was also identified as a means to  
2 provide additional benefits to Duquesne Light and to Southwestern Pennsylvania. Rising  
3 and volatile electricity prices have a significant impact on the economic viability of  
4 Southwestern Pennsylvania. It is imperative that Pennsylvania be able to offer  
5 competitively priced electricity to maintain its existing manufacturers and to attract new  
6 industries to the Commonwealth.

7 **Q. Does Macquarie anticipate realizing “synergy savings” as a result of this**  
8 **transaction?**

9 A. As I understand the term “synergy savings”, it refers to savings that can be achieved  
10 when two operating utilities combine. These savings are primarily achieved through lost  
11 jobs, usually at the entity being acquired and through consolidation of management  
12 functions, usually by reducing the presence of the acquired utility in its current  
13 headquarters location. These types of savings are not part the proposed transaction. As I  
14 indicated, Macquarie is recognized as a global leader in infrastructure investments and  
15 the management of infrastructure investments, but we do not have nor do we provide  
16 personnel to operate our investments. For this reason, Macquarie seeks out long-term  
17 investments with highly competent and established management teams and employees  
18 and then supports them with its financial and technical expertise. Here, we identified  
19 Duquesne Light as a strong potential partner based upon its consistent track record of  
20 providing exceptional service to the Greater Pittsburgh region. This fact is underscored  
21 by our commitment to maintain senior management, particularly the current chief  
22 executive officer, to honor the current collective bargaining agreement for Duquesne  
23 Light’s represented employees and provide wage and benefit protections for non-

1 represented employees. Therefore, while we do not anticipate that the transaction will  
2 result in synergy savings, it will ensure that Duquesne Light and its customers will  
3 continue to benefit from the expertise of the existing management and employees in  
4 addition to gaining access to the local and global resources of the Macquarie Consortium.

5 **Q. Does this conclude your testimony?**

6 **A. Yes, it does.**

# PROPRIETARY INFORMATION

Docket Number A-110 150.F-0035

Name of Document Exhibit CJL-1  
and Exhibit CJL-2

Date Document Received 2-27-2007

**DOCUMENT CONTAINS**

**PROPRIETARY INFORMATION**

James J. McNulty  
February 27, 2007  
Page 2

Respectfully submitted,



Andrew S. Tubbs

AST/jl  
Enclosures

cc: Honorable Robert P. Meehan (letter only)  
Certificate of Service (letter only)

NON-PROPRIETARY (PUBLIC) VERSION

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

DIRECT TESTIMONY OF  
RICHARD J. HUDSON JR.

On Behalf of Strategic Energy, LLC and  
The Retail Energy Supply Association

PA PUC  
SECRETARY'S BUREAU

2007 FEB 27 PM 3:25

RECEIVED

Application of Duquesne Light Company and DQE Communications Network  
Services, LLC For Certificates of Public Convenience Under Section 1102(a)(3) of the  
Public Utility Code Approving the Acquisition of Duquesne Light Holdings, Inc. by Merger

Docket Nos. A-110150F0035 and A-311233F3002

December 21, 2006

1 Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND BUSINESS  
2 RESPONSIBILITIES.

3 A. My name is Richard J. Hudson Jr. I am the Market Manager-Regulatory Affairs  
4 for Strategic Energy, LLC ("Strategic" or "Strategic Energy"). My business  
5 address is 2 Gateway Center, Pittsburgh, Pennsylvania, 15222. My  
6 responsibilities include managing the regulatory activities of Strategic Energy in  
7 the Commonwealth of Pennsylvania.

8 Q. PLEASE DESCRIBE YOUR EDUCATIONAL AND EMPLOYMENT  
9 HISTORY.

10 A. I received a bachelor's degree in business and economics from the University of  
11 North Carolina at Greensboro. Prior to my employment at Strategic Energy, I  
12 was employed by the Federal Energy Regulatory Commission ("FERC") for  
13 approximately four years. At FERC, my responsibilities included analyzing  
14 FERC jurisdictional regulatory proposals and drafting recommended decisions on  
15 these proposals. In this capacity I was immersed in a wide variety of regulatory  
16 matters related to the wholesale electricity industry that presented complex  
17 technical, legal, and public policy issues. My case work in these matters involved  
18 topics such as, but not limited to, the following:

- 19 • The development of Regional Transmission Organizations (RTOs),  
20 Independent System Operator (ISOs) and independent transmission  
21 companies.
- 22 • Inter-RTO and cross-border seams issues including transmission cost  
23 allocation and cross-border rate design issues.
- 24 • Infrastructure reliability issues, including cost-recovery for reliability  
25 enhancements.
- 26 • Affiliate transactions and affiliate abuse issues.

- 1 • Allocation of Federal Power Act Section 205 filing rights between
- 2 transmission owners and RTOs/ISOs.
- 3 • Incentive ratemaking policies to encourage transmission investment.

4 **Q. HAVE YOU EVER TESTIFIED BEFORE THIS COMMISSION?**

5 A. No, but in my prior employment at FERC, I advised senior agency management  
6 and FERC Commissioners on a wide variety of contested regulatory proceedings,  
7 similar in subject matter and complexity to the matters that come before the  
8 Pennsylvania Public Utility Commission ("PUC" or "Commission").

9 **Q. ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS PROCEEDING?**

10 A. I am testifying on behalf of Strategic Energy and the Retail Energy Supply  
11 Association.

12 **Q. PLEASE DESCRIBE STRATEGIC ENERGY AND ITS ACTIVITIES IN**  
13 **THE DUQUESNE SERVICE AREA.**

14 A. Strategic Energy is a licensed electric generation supplier ("EGS"), competing to  
15 supply generation service to customers in the Duquesne Light Company  
16 ("Duquesne" or "DLC") service area. Strategic Energy competes with other  
17 licensed EGSs, including DLC's unregulated affiliated EGS, Duquesne Light  
18 Energy ("DLE"). Strategic Energy has actively served commercial and industrial  
19 customers in the Duquesne service area since 1999. Strategic Energy is  
20 headquartered in Pittsburgh and employs over 250 employees in sales, energy  
21 management, legal, regulatory, customer service and operational functions.

22 **Q. PLEASE DESCRIBE THE RETAIL ENERGY SUPPLY ASSOCIATION.**

23 A. The Retail Energy Supply Association ("RESA") is a nonprofit organization and  
24 trade association that represents the interests of a broad and diverse group of retail  
25 energy suppliers who share the common vision that competitive retail energy

1 markets deliver a more efficient, customer-oriented outcome than the regulated  
2 utility structure.<sup>1</sup> We are devoted to working with all stakeholders to promote  
3 vibrant and sustainable competitive retail energy markets for residential,  
4 commercial and industrial consumers. RESA members currently serve  
5 residential, commercial and industrial customers in Pennsylvania and throughout  
6 jurisdictions in North America that have enacted retail choice.

7 **Q. WHAT IS STRATEGIC ENERGY'S AND RESA'S POSITION WITH**  
8 **RESPECT TO THE PROPOSED ACQUISITION OF DUQUESNE BY THE**  
9 **MACQUARIE CONSORTIUM?**

10 A. We oppose the merger as it is currently proposed. We are concerned with how  
11 the proposed acquisition will impact the competitive retail marketplace in the  
12 Duquesne service territory. Without substantiated protections and assurances that  
13 the acquisition will not result in a material reduction in retail competition, we  
14 cannot support it. Although I am not an attorney, it is my understanding that the  
15 Electric Competition Act requires that a merger proposal must not result in  
16 anticompetitive effects that will prevent retail electricity customers from  
17 obtaining the benefits of a properly functioning and workable competitive retail  
18 electricity market. Our position is that the merger, as currently proposed, may  
19 have anticompetitive effects that will frustrate the continued development of a  
20 competitive retail market for electricity in Duquesne's service territory. My  
21 testimony examines these potential anticompetitive effects and recommends  
22 measures for the Commission to consider to mitigate these effects so that the

---

<sup>1</sup> RESA member companies include Consolidated Edison Solutions, Inc.; Direct Energy Services, LLC; Hess Corporation; Reliant Energy Retail Services, LLC; Sempra Energy Solutions; Strategic Energy, LLC; SUEZ Energy Resources, NA, Inc.; and U.S. Energy Savings Corporation. The opinions expressed in this filing may not represent the views of all members of RESA.

1 merger complies with the requirements of the Electric Competition Act and  
2 Section 1103 of the Public Utility Code.

3 **Q. PLEASE SUMMARIZE YOUR TESTIMONY.**

4 A. I first present an overview of the potential anticompetitive effects of the proposed  
5 merger. Next, I address issues regarding the anticompetitive effects of the direct  
6 or indirect cross-subsidization of DLE by other Duquesne companies, and the  
7 extent to which the proposed merger may exacerbate these effects. Then, I address  
8 the anticompetitive effects of Duquesne's proposed economic development  
9 discounted rate program. Finally, I suggest steps the Commission should take to  
10 address and mitigate these anticompetitive effects.

11 **I. OVERVIEW OF POTENTIAL ANTICOMPETITIVE EFFECTS**

12 **Q. PLEASE DESCRIBE THE PROPOSED ACQUISITION OF DUQUESNE**  
13 **BY THE MACQUARIE CONSORTIUM.**

14 A. According to the Application, Duquesne requests Commission approval for a  
15 certificate of public convenience approving the acquisition of the Duquesne  
16 companies by a group of investors called the Macquarie Consortium  
17 ("Macquarie"). Under the proposed transaction, the Macquarie Consortium will  
18 purchase all outstanding shares of Duquesne Light Holdings' ("DLH") common  
19 stock for \$20.00 per share, and will also assume DLH's consolidated preferred  
20 and preference shares along with DLH's short- and long-term debt.

21 **Q. PLEASE PROVIDE AN OVERVIEW OF THE POTENTIAL**  
22 **ANTICOMPETITIVE EFFECTS OF THE PROPOSED MERGER**

23 A. According to the Application, the Macquarie Consortium is acquiring the  
24 Duquesne companies at a premium of over 21 percent above the DLH share price

1 reported at the time that the transaction was announced.<sup>2</sup> The equity market value  
2 of the merger consideration of \$1.592 billion (as of July 3, 2006) is nearly 2.5  
3 times the book value of the stock of \$644 million (as of June 30, 2006). Because  
4 revenue growth related to Duquesne's core utility business as a "wires company"  
5 is likely to be limited for the immediate future as a result of the recently  
6 concluded rate case, we are concerned that Macquarie intends to rely on growing  
7 Duquesne's generation supply business in order to produce the returns necessary  
8 to justify its acquisition of Duquesne at a significant premium.

9 Therefore, we submit that the proposed transaction is predicated on a  
10 business strategy that is likely to have anticompetitive effects with respect to  
11 Duquesne's Provider of Last Resort ("POLR") pricing plans, and the operations  
12 of Duquesne's unregulated affiliated EGS – DLE. Furthermore, the economic  
13 development discounted rate program proposed by Duquesne/Macquarie is  
14 inherently anticompetitive because the proposed discount would be available only  
15 to those customers taking at least a portion of their generation supply from  
16 Duquesne, thus limiting the ability of competitive suppliers to serve these  
17 customers.

18 **Q. HOW IS THE PROPOSED TRANSACTION LIKELY TO RESULT IN**  
19 **ANTICOMPETITIVE EFFECTS WITH RESPECT TO DLE?**

20 A. As discussed in more detail below, we have reason to believe that Duquesne is  
21 supporting the competitive operations of DLE through cross-subsidies from other  
22 Duquesne companies, thus enabling DLE to consistently undercut its competitors'  
23 prices. We are concerned that Duquesne, either directly or indirectly, is cross-

---

<sup>2</sup> Application at p. 13.

1 subsidizing the operations of DLE in order to retain its large commercial and  
2 industrial ("C&I") customer base and recapture the margin it has lost due to the  
3 current POLR design for that segment. In its 2005 Form 10-K, Duquesne states  
4 that it no longer earns a margin on its POLR supply to large C&I customers, and  
5 also states that:

6 "In response to the change in large customer POLR service, DLE  
7 has begun to offer competitive electric generation (EGS) service to  
8 customers in the Duquesne Light service territory."<sup>3</sup>

9 Therefore, it appears that Duquesne is utilizing DLE to retain the customer base it  
10 lost due to the transition to a pro-competitive POLR design for large C&I  
11 customers within its service territory. As noted in Duquesne's 2005 Form 10-K,  
12 DLC has articulated a strategic priority to "[m]aximize large commercial and  
13 industrial customer retention through our unregulated retail electric generation  
14 supplier, DLE."<sup>4</sup> While Strategic fully support open competition from other  
15 EGSs, that competition must be on a level playing field – and no EGS should be  
16 subsidized by the regulated distribution or POLR rates of an affiliated utility.

17 **Q. HOW IS THE PROPOSED TRANSACTION LIKELY TO RESULT IN**  
18 **ANTICOMPETITIVE EFFECTS WITH RESPECT TO DUQUESNE'S**  
19 **POLR PLANS?**

20 A. In order to meet return targets required by the premium built into the acquisition  
21 price Duquesne/Macquarie have an incentive to propose a POLR IV plan that  
22 protects the margin Duquesne receives from its POLR supply business. In fact,  
23 according to a Highly Confidential response to a RESA interrogatory, **\*\*BEGIN**

---

<sup>3</sup> SE/RESA Exhibit RH-1 at 1 (excerpts from DLH/DLC 2005 Form 10-K); the entire document can be found at:  
<http://www.sec.gov/Archives/edgar/data/30573/000095015206001802/j1863601c10vk.htm>

<sup>4</sup> *Id.* at 3.



1 **II. CROSS-SUBSIDIZATION OF DLE BY OTHER DUQUESNE COMPANIES**

2 **Q. WHY DO YOU SUSPECT THAT DLE IS BEING SUBSIDIZED BY**  
3 **OTHER DUQUESNE COMPANIES?**

4 The attached testimony of Ronald Carrier submitted Duquesne's recent  
5 distribution rate case at in Docket No. R-00061346 provides an introduction to the  
6 cross-subsidization issues that we are raising here.<sup>10</sup> As discussed in that  
7 testimony, it is questionable how DLE has managed to acquire a substantial  
8 amount of large C&I load in the Duquesne service territory despite having only a  
9 few employees. As noted in DLH's 10-Q for the quarter ended September 30,  
10 2006, DLE served 1,346,000 MWhs for the first nine months of 2006.<sup>11</sup> This is  
11 up from 639,000 MWhs for the first nine months of 2005. Yet DLE has only five  
12 employees.<sup>12</sup>

13 By way of comparison, it was reported in the KEMA Retailer Yearbook  
14 for 2005 that a similarly situated supplier that also targets large C&I customers as  
15 DLE, and serves approximately half the amount of load as DLE, has 35  
16 employees.<sup>13</sup> In my experience, and having reviewed trade publications and  
17 industry assessments, most suppliers of similar size and operations as DLE  
18 require significantly more than 5 employees to carry out the day-to-day operations  
19 of a competitive supply business. Therefore, the logical question is how has DLE  
20 been able to obtain and manage its sizeable customer load obligation with such

---

<sup>10</sup> Mr. Carrier's direct and surrebutal testimony from that proceeding are attached as SE/RESA Exhibits RH-3 and RH-4, respectively.

<sup>11</sup> SE/RESA Exhibit RH-5 (excerpt from DLH Form 10-Q).

<sup>12</sup> SE/RESA Exhibit RH-6 (Duquesne Response to Strategic I-3).

<sup>13</sup> SE/RESA Exhibit RH-7 (excerpt from 2005 KEMA Retailer Yearbook).

1 few resources without receiving direct or indirect financial or operational support  
2 from other Duquesne companies?

3 **Q. CAN YOU QUANTIFY THE SPECIFIC PRICE ADVANTAGE ENJOYED**  
4 **BY DLE AS A RESULT OF THIS APPARENT CROSS-SUBSIDIZATION?**

5 A. While I cannot provide a concrete quantification of the value of the direct cross-  
6 subsidization of DLE, the need for further examination of this issue cannot be  
7 understated. The U.S. Department of Justice's Guidelines on non-horizontal  
8 mergers specifically recognize that some instances of cross-subsidization can be  
9 hard to prove but are nonetheless a cause for concern. These guidelines state:

10 "The use of common facilities and managers may create an  
11 insoluble cost allocation problem and provide the opportunity to  
12 charge utility customers for non-utility costs, consequently  
13 distorting resource allocation . . . ."<sup>14</sup>

14 As the record in this case shows, DLE shares office space and employees with  
15 DLC,<sup>15</sup> so many of the cost and resource allocation problems discussed in the  
16 Department of Justice guidelines may be present here. As discussed earlier, it is  
17 questionable how DLE manages its operations with so few employees and,  
18 according to interrogatory responses, DLE only compensates DLC minimally for  
19 the support functions it provides.<sup>16</sup>

20 In addition, academic papers have examined this issue and determined that  
21 there inherently exists a profit maximization motive than can lead to direct or  
22 indirect cross-subsidization and/or cost shifting between regulated utilities and

---

<sup>14</sup> U.S. Department of Justice Non-Horizontal Merger Guidelines at n. 35; this document is available at: <http://www.usdoj.gov/atr/public/guidelines/2614.htm>.

<sup>15</sup> SE/RESA Exhibit RH-3 (Direct Testimony of Ronald Carrier from Docket No. R-00061346, specifically the attachments to the testimony) and SE/RESA Exhibit RH-8 (DLC/Macquarie Response to Strategic I-4).

<sup>16</sup> SE/RESA Exhibit RH-8 (DLC/Macquarie Response to Strategic I-4).

1 their unregulated marketing affiliates, and that these occurrences can be difficult,  
2 if not impossible to identify and rectify.<sup>17</sup>

3 **Q. CAN YOU PROVIDE ANY EXAMPLES OF POSSIBLE CROSS-**  
4 **SUBSIDIES BETWEEN DLE AND OTHER DUQUESNE COMPANIES?**

5 A. Yes. As discussed below, there are two clear examples of areas in which other  
6 Duquesne companies are likely subsidizing DLE, either directly or indirectly.

7 These are power procurement functions and credit support.

8 **Q. HOW ARE DLE'S POWER PROCUREMENT FUNCTIONS LIKELY**  
9 **BEING CROSS-SUBSIDIZED?**

10 A. With only five employees it is highly unlikely that DLE is performing all the  
11 necessary power procurement functions to meet its customer load obligation.

12 Strategic Energy employs dozens of people to perform all of the forecasting,  
13 scheduling, hedging and Regional Transmission Organization settlement and  
14 reconciliation functions necessary to fulfill its load service obligations.

15 According to interrogatory responses and other evidence, it appears that DLE  
16 purchases substantially all of its power supply from its affiliate, Duquesne  
17 Power.<sup>18</sup> Duquesne Power also supplies DLC's residential and small commercial  
18 POLR load. Consequently, it appears that Duquesne Power manages the load  
19 obligations of DLE together with those of DLC. In fact, Duquesne's 2005 Form  
20 10-K confirms this, stating:

---

<sup>17</sup> "An economic analysis of marketing affiliates in a deregulated electric power industry" by Jason Abel for the National Regulatory Research Institute; this document is available at: <http://www.nrri.ohio-state.edu/dspace/bitstream/2068/565/1/98-07.pdf>

<sup>18</sup> SE/RESA Exhibit RH-9 (Duquesne Responses to Strategic I-5 and I-7); SE/RESA Exhibit RH-1 at 2 (excerpts from DLH/DLC 2005 Form 10-K).

1 "Duquesne Power manages the DLE supply requirements together  
2 with the Duquesne Light residential and small commercial  
3 customer POLR supply requirements."<sup>19</sup>

4 First, it is questionable how Duquesne Power, with only 2 employees itself,<sup>20</sup> is  
5 able to perform all of the necessary procurement functions to fulfill DLE's load  
6 service obligations, let alone those of DLC, without some type of support from  
7 DLC resources or staff. Second, even assuming that Duquesne Power is  
8 legitimately managing DLE's and DLC's load, and assuming that DLE is actually  
9 charged the prevailing market price for the power that Duquesne Power provides,  
10 DLE – solely as a result of its relationship to DLC-- is given an inherent  
11 competitive advantage over other suppliers in the Duquesne service area. By  
12 pooling the load obligations associated with DLE's unregulated business with  
13 DLC's POLR load, Duquesne Power is able to achieve economics of scale that are  
14 not available to other suppliers in the Duquesne market.

15 Finally, the fact that Duquesne Power manages all of DLE's load along  
16 with DLC's POLR load, presents a complicated cost allocation problem. How  
17 does Duquesne Power appropriately measure and allocate the costs and risks  
18 associated with meeting the load obligations of both DLC and DLE without some  
19 level of cost shifting? It is apparent that DLE possesses an unfair competitive  
20 advantage with respect to its power procurement functions over other retail  
21 suppliers because of its relationship to DLC. And this unfair advantage is likely  
22 due to direct or indirect cross-subsidies from DLC's regulated distribution or  
23 POLR rates. An example of an indirect subsidy would be if Duquesne Power is

---

<sup>19</sup> SE/RESA Exhibit RH-1 at 1 (excerpts from DLH/DLC 2005 Form 10-K).

<sup>20</sup> SE/RESA Exhibit RH-6 (Duquesne Response to Strategic I-3).

1 providing or paying for a service (such as scheduling, forecasting, balancing, or  
2 RTO/ISO settlement or reconciliation) for both DLC and DLE, but charging or  
3 allocating the cost of that service only to DLC.

4 **Q. HOW ARE DLC AND/OR OTHER DUQUESNE COMPANIES LIKELY**  
5 **SUBSIDIZING DLE THROUGH CREDIT SUPPORT?**

6 A. First, DLH provides direct credit support to DLE in the form of a guarantee to  
7 support DLE's RTO membership activities.<sup>21</sup> Second, it appears that DLE is able  
8 to avoid posting credit for its wholesale power purchases because Duquesne  
9 Power manages DLE's load along with that of DLC, and Duquesne Power's  
10 wholesale supply contracts are backed by guarantees from their mutual parent,  
11 DLH.<sup>22</sup> This alone gives DLE a significant advantage because other suppliers  
12 typically have to provide collateral or post some type of credit to back their power  
13 purchases. To date, there is no record evidence that DLE posts collateral with  
14 Duquesne Power, or compensates DLH for the value of its corporate guarantees.

15 In addition, DLH/DLC 2005 Form 10-K shows that DLH guarantees  
16 Duquesne Power's ability to deliver energy associated with its supply contracts.<sup>23</sup>  
17 Presumably, this guarantee covers Duquesne Power's supply contract with DLE.  
18 Therefore, it seems that not only does DLE receive the benefit from the avoided  
19 cost of posting credit for its wholesale supply purchases, but it also bears no risk  
20 from having Duquesne Power as its only supplier because DLH has provided  
21 guarantees that support Duquesne Power's ability to delivery contracted power to  
22 DLE.

---

<sup>21</sup> SE/RESA Exhibit RH-10 (Duquesne Response to Strategic I-6).

<sup>22</sup> SE/RESA Exhibit RH-1 at 4-5 (excerpts from DLH/DLC 2005 Form 10-K).

<sup>23</sup> SE/RESA Exhibit RH-1 at 6 (excerpts from DLH/DLC 2005 Form 10-K).

1           Finally, it is important to note that the value of these parental guarantees  
2           from DLH is ultimately derived from the secure revenue stream associated with  
3           DLC's regulated operations. Thus, the direct and indirect credit support from  
4           which DLE benefits is yet another example of an anticompetitive advantage that  
5           DLE has due solely to its relationship to DLC.

6 **Q. HAS STRATEGIC ENERGY OR RESA RAISED ANY OF THESE ISSUES**  
7 **BEFORE?**

8 A. Yes. In Duquesne's most recent distribution rate case at Docket No. R-00061346,  
9 Strategic Energy witness Ronald Carrier presented direct, rebuttal and surrebuttal  
10 testimony on the possible cross-subsidization of DLE by DLC or other Duquesne  
11 affiliate companies.

12 **Q. WHAT WAS THE RESULT OF THAT PROCEEDING WITH RESPECT**  
13 **TO THE DLE CROSS-SUBSIDIZATION ISSUES?**

14 A. The parties to the proceeding reached a comprehensive settlement that was  
15 accepted, or not opposed, by all parties. The settlement provides that Duquesne,  
16 in its upcoming POLR IV filing to establish POLR rates to be effective January 1,  
17 2008, will submit an analysis addressing whether any portion of DLC's operations  
18 is subsidizing its affiliates, including DLE. Both Strategic Energy and RESA are  
19 signatories to the settlement.

20 **Q. WHY ARE STRATEGIC ENERGY AND RESA RAISING THE SAME**  
21 **ISSUES HERE?**

22 A. While we still support the submittal of an analysis of these issues in Duquesne's  
23 upcoming POLR filing, it is important that this issue be addressed in the context  
24 of this proceeding because, as discussed earlier, it appears that Duquesne and  
25 Macquarie have an incentive to rely on Duquesne's generation supply segment,

1 including DLE, to produce the returns necessary to justify the premium built into  
2 the merger price. This presents the potential that any pre-existing cross-subsidies  
3 could be exacerbated as a result of the merger. Additionally, other jurisdictions  
4 have recognized the importance of addressing issues of cross-subsidization in  
5 merger and acquisition proceedings. For example, the Energy Policy Act of 2005  
6 specifically requires FERC to consider issues of cross-subsidization in exercising  
7 its merger review authority.<sup>24</sup>

8 **Q. WHAT ARE THE ANTICOMPETITIVE EFFECTS OF THIS CROSS-**  
9 **SUBSIDIZATION?**

10 A. The anticompetitive effects of these cross-subsidies are clear. They create an  
11 unfair competitive advantage that enables DLE to undercut competitors prices,  
12 possibly at the expense of DLC's POLR and distribution ratepayers. This  
13 competitive advantage could clearly be enhanced and expanded if  
14 Duquesne/Macquarie had an opportunity to do so. The short and long term  
15 effects of this will be to stifle the development of a competitive electricity market  
16 in the Duquesne service territory, essentially re-monopolizing the retail generation  
17 supply market for the benefit of the incumbent utility.

18 **III. ECONOMIC DEVELOPMENT RATE PROGRAM**

19 **Q. PLEASE DESCRIBE THE SO CALLED "ECONOMIC DEVELOPMENT**  
20 **RATE PROGRAM."**

21 A. In its Application, Duquesne states that it will establish an economic development  
22 program to provide discounted electricity to support new, or expanded, industrial

---

<sup>24</sup> Section 203 (a)(4) of the Federal Power Act now provides that, when reviewing applications for the transfer of jurisdictional assets, FERC will consider "whether the transaction will result in cross-subsidization of non-utility affiliate companies or the encumbrance of or pledge of utility assets for the benefit of associate companies."

1 operations in the Duquesne service territory. Duquesne proposed to offer a 50  
2 MW block of energy, sourced from its ownership interests in the Keystone and  
3 Conemaugh power plants, to support a \$3/MWh discount below market prices to  
4 industrial projects that increase load by 10 MW demand and create at least 2 new  
5 full-time jobs per MW.

6 **Q. IS THIS PROGRAM ANTICOMPETITIVE?**

7 A. Yes. While Strategic Energy and RESA fully support and are vigorously  
8 committed to the promotion of economic development in the greater Pittsburgh  
9 region, it is imperative that any economic development programs are structured in  
10 a competitively neutral way. As proposed by Duquesne, customers planning to  
11 locate new industrial facilities, or expand existing ones, in the Duquesne service  
12 area will be required to take at least the discounted portion of their generation  
13 service from Duquesne. This inhibits the ability of competitive suppliers, like  
14 Strategic Energy and other RESA members, to compete for new industrial load on  
15 the Duquesne system, and it restricts customer choice. Furthermore, my  
16 understanding is that one of the legal standards for approving a merger transaction  
17 is a showing of affirmative public benefits. It appears that Duquesne is  
18 attempting to satisfy this standard with an economic development rate program  
19 that violates the other merger approval standard, which is that the transaction not  
20 result in anticompetitive effects that prevent retail electricity customers from  
21 obtaining the benefits of a properly functioning and workable competitive retail  
22 electricity market.

23

1 **IV. RECOMMENDED MEASURES TO MITIGATE THE**  
2 **ANTICOMPETITIVE EFFECTS OF THE MERGER**

3 **Q. HOW SHOULD THE COMMISSION ADDRESS AND MITIGATE THE**  
4 **ANTICOMPETITIVE EFFECTS OF THE PROPOSED TRANSACTION**  
5 **WITH RESPECT TO DUQUESNE'S POLR PLANS?**

6 A. In order to comply with applicable legal requirements and the Commonwealth's  
7 clear policy goals of protecting and ensuring the development of competitive  
8 markets, merger approval must be conditioned on Duquesne submitting a POLR  
9 IV plan which provides an open and transparent competitive procurement process  
10 that results in market responsive pricing. In addition, Duquesne Power should be  
11 precluded from participating in that process. As discussed earlier, Duquesne  
12 expects to propose a POLR IV plan that does not allow for a competitive  
13 procurement process as envisioned by the Electric Competition Act and in the  
14 Commission's proposed POLR regulations.<sup>25</sup>

15 In the alternative, the Commission should hold its consideration of the  
16 proposed merger in abeyance until Duquesne submits its upcoming POLR IV  
17 filing, which Duquesne has stated publicly it expects to file within the 1st quarter  
18 of 2007. At that time the Commission should consolidate the instant proceeding  
19 with Duquesne's POLR IV case. It is imperative that the Commission  
20 understands Duquesne/Macquarie's intentions with respect to Duquesne's  
21 upcoming POLR plan before acting on the proposed merger. The only way to be  
22 able to fairly judge whether Duquesne/Macquarie will be able to exercise market  
23 power and act anti-competitively in the POLR IV period is to know what the  
24 POLR pricing structure will be. If the POLR market design enhances competitive

---

<sup>25</sup> Page 6, line 11 – p. 7, line 11.

1 opportunities (such as market responsive pricing plan for all customers), then the  
2 combined company will have far less opportunity to use its position as POLR to  
3 increase market share and harm competition. Conversely, if Duquesne  
4 successfully implements long-term point-in-time pricing, with Duquesne Power  
5 as the sole procurement source for DLC's POLR supply, Duquesne's ability to  
6 harm competition will be enhanced.

7 **Q. HOW SHOULD THE COMMISSION ADDRESS THE**  
8 **ANTICOMPETITIVE EFFECTS OF THE CROSS-SUBSIDIZATION**  
9 **ISSUES?**

10 A. My understanding is that Pennsylvania law requires a level playing field for  
11 competitors and that certain Code of Conduct rules specifically address cross-  
12 subsidization.<sup>26</sup> Therefore, we recommend that the Commission initiate an  
13 investigation into the relationships between and among the Duquesne companies  
14 to determine the extent to which DLE's unregulated operations are being  
15 supported, either directly or indirectly, by other Duquesne companies, specifically  
16 DLC. The Commission should condition its approval of the proposed merger on  
17 the outcome of this investigation. Once these issues have been thoroughly  
18 evaluated, there are a number of remedies that the Commission should consider,  
19 including: (i) requiring the structural and/or functional separation of DLE's  
20 operations from the other Duquesne companies; (ii) implementing stricter Code of  
21 Conduct rules; and (iii) requiring that DLE be barred from transacting with its  
22 affiliates, including Duquesne Power, for its wholesale power procurement.

---

<sup>26</sup> "The purpose of these competitive safeguards is to . . . prevent the cross subsidization of service . . . between related electric distribution companies and electric generation suppliers . . . and to establish and maintain an effective and vibrant competitive market in the purchase and sale of retail electric energy in this Commonwealth." 52 Pa. Code § 54.121.

1 Q. **HOW SHOULD THE COMMISSION ADDRESS THE**  
2 **ANTICOMPETITIVE EFFECTS OF THE ECONOMIC DEVELOPMENT**  
3 **RATE PROGRAM?**

4 A. One clear way to modify the program to make it competitively neutral would be  
5 to require Duquesne to offer either a rebate to qualifying customers or to provide  
6 the \$3/MWh discount on the "wires" charges of the customer's bill. If structured  
7 this way, any qualifying industrial customer would be free to shop for electric  
8 generation service from competitive suppliers and still receive the benefit of the  
9 economic development program. Such an arrangement would be revenue neutral  
10 to Duquesne as it would allow Duquesne to sell the 50 MW blocks of energy  
11 sourced from the Keystone and Conemaugh generation plants into the market at  
12 full market value and fund the economic development rebates or discounts from  
13 these revenues.

14 Q. **DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

15 A. Yes it does.

Table of Contents

Under the POLR II arrangement that ended December 31, 2004, Duquesne Light earned a margin on each MWh sold to its large commercial and industrial customers. During the twelve months ended December 31, 2004, Duquesne Light earned net income of \$4.6 million in the supply business related to sales to its large commercial and industrial customers. Under the POLR III arrangement that became effective January 1, 2005, Duquesne Light no longer earns a margin in the supply business on these sales.

In response to the change in large customer POLR service, DLE has begun to offer competitive electric generation (EGS) service to customers in the Duquesne Light service territory. Duquesne Power manages the DLE supply requirements together with the Duquesne Light residential and small commercial customer POLR III supply requirements.

*2006 Supply Business Realignment.* Effective December 31, 2005, Duquesne Power was transferred from Duquesne Light to another Holdings subsidiary. The operations of Duquesne Power will only be reported as part of the Holdings electricity supply segment beginning January 1, 2006. The transfer of Duquesne Power was completed to strategically align our unregulated businesses outside of Duquesne Light in order to provide flexibility to capitalize on future supply opportunities. The transfer will effectively eliminate the net income included in Duquesne Light's supply segment.

If this transfer had taken place on January 1, 2003, the net effect to Duquesne Light's earnings would have been an increase of \$0.1 million in 2003 and \$6.0 million in 2004. Earnings in 2005 would have decreased \$27.2 million. In 2003, Duquesne Power was just being formed and had minimal activity. The 2003 increase would have been caused by a decrease in other operating and maintenance expense. The 2004 increase would have been caused by the removal of the acquisition termination cost associated with the cancelled Sunbury acquisition and other costs. The 2005 decrease would have been caused primarily by the removal of some revenue and an increase in operating expenses, the effect of which would eliminate Duquesne Power's margin on its sales to Duquesne Light and DLE.

Changes to the balance sheets would have been immaterial in 2003 and 2004. There would be no change to the 2005 balance sheet as the transfer took place at close of business on December 31, 2005.

*Landfill Gas Business.* Our landfill gas business (a part of our Financial business segment) is comprised of investments in 20 landfill sites around the country and the ownership of Waste Energy Technologies, LLC (WET), which was acquired in the fourth quarter of 2004. WET has provided landfill gas collection system engineering, design and construction services to the landfill business for over 20 years. Our 20 sites are comprised of three that currently produce pipeline quality gas sold at market rates; five sites where unprocessed landfill gas production is currently sold at significantly lower unit prices than pipeline quality gas, but due to lower operating costs and capital requirements, still provide the opportunity to earn modest returns, and 12 passive investment sites we do not project to be involved with beyond 2007 due to the scheduled expiration of Section 29 tax credits.

We have made small, strategic capital investments to maximize our existing production capacities and improve the throughput of the landfill gas processing sites we expect to continue to operate, and have focused our efforts to streamline and minimize our operating costs. These sites also have sufficient quantities of available gas to remain viable beyond the expiration of Section 29 tax credits on December 31, 2007.

We are a significant producer of pipeline quality landfill gas in the United States. The majority of our earnings from our landfill gas business are derived from the three pipeline quality production sites. Our contract at one of these sites located in New York City is scheduled to terminate on June 30, 2006; our earnings for 2005 included \$7.4 million related to this site. We expect to operate our other two pipeline quality landfill gas sites for approximately 15 more years. In December 2005, we have also entered into a price swap agreement for approximately 60% of our anticipated 2006 pipeline quality landfill gas sales in order to lock in the recent unprecedented increases in natural gas prices.

## Table of Contents

select an alternative generation supplier pay for generation charges set by that supplier, and pay Duquesne Light both transmission and distribution charges. In connection with these POLR III transactions, Duquesne Light retains the risk that such customers will not pay for the POLR generation supply. Duquesne Light procures the energy and capacity needed to serve these residential and small commercial customers under a full-requirements contract with Duquesne Power. Failure or delay by Duquesne Power to provide the energy and capacity anticipated in the contract could require Duquesne Light to incur additional expenses to meet the needs of its POLR III customers.

**We are subject to risks associated with procuring energy and capacity for Duquesne Light's small customers and DLE's customers.**

In addition to supplying the energy and capacity needs of Duquesne Light's small customers, Duquesne Power also has a full-requirements contract with its affiliate DLE to provide all of its large commercial and industrial customers' energy and capacity needs. During 2004 and 2005, Duquesne Power entered into wholesale power purchase contracts that have been structured primarily to begin and end during the POLR III time period. The net result of these transactions is that, as of December 31, 2005, Duquesne Power has secured a substantial portion of the combined expected load obligation for its full-requirements contracts with Duquesne Light and DLE through 2007.

Actual load may differ from expected load due to weather, customer switching, economic and other factors. If Duquesne Power did not have sufficient supplies, Duquesne Power would be required to procure the requirements in the energy markets. If market prices were higher than the rates to be paid by Duquesne Light and DLE to Duquesne Power under the full-requirements contracts, Duquesne Power could potentially be acquiring the energy or capacity at a loss, and any such losses could have a material adverse effect on our consolidated results of operations and financial condition. Likewise, if Duquesne Power has contracted for supplies in excess of its needs, Duquesne Power could potentially be selling energy or capacity at a loss, and any such losses could have a material adverse effect on our consolidated results of operations and financial condition. Duquesne Power's energy commodity contracts contain provisions designed to mitigate potential losses by requiring that Duquesne Power post collateral depending on changes in energy or capacity prices. Because Holdings guarantees these contracts, any such collateral postings would reduce cash and/or the availability under Holdings' credit facility.

**The pending acquisition of ownership interests in the Keystone and Conemaugh generation stations will subject us to risks that we do not currently face.**

The acquisition and ownership of an interest in a generation station involves numerous risks, including:

- the plants' ability to operate at expected capacity factors;
- unforeseen operating problems and capital and other expenditures, including unforeseen environmental compliance costs;
- equipment failures;
- the ability to comply with applicable regulations;
- unanticipated cost increases;
- labor force matters;
- weather-related incidents;
- the impact of changes in environmental laws and regulations; and

## Table of Contents

- File a distribution rate case with the PUC.
- File a transmission rate case with the FERC.

### Energy Supply Opportunities:

- Continue to actively manage supply requirements for both Duquesne Light's residential and small commercial POLR III customers and DLE's customers, through Duquesne Power or our other unregulated subsidiaries, using sound risk management policies.
- Maximize large commercial and industrial customer retention through our unregulated retail electric generation supplier, DLE.
- Strategically align our unregulated energy supply subsidiaries outside Duquesne Light to provide greater flexibility to capitalize on opportunities that may arise.
- Proceed with closing the planned acquisition of the interests in the Keystone and Conemaugh power plants, providing a physical hedge to complement our portfolio of energy commodity contracts for our supply plan.
- Continue to evaluate additional power plant acquisitions.

### Complementary Businesses:

- Focus on expanding landfill gas and related businesses to capitalize on current market conditions utilizing our existing position within the marketplace, while helping to solve a growing environmental challenge.
- Identify and develop other unregulated investments that are both closely aligned with our business strategy and that provide reasonable prospects for a fair return and moderate growth.
- Continue to divest non-core investments that are not consistent with our overall business strategy, while maximizing sale proceeds.

### Financing:

- Use the most cost efficient sources of funds to finance the continued infrastructure investment, proposed acquisition of power plant interests, landfill gas investments and general corporate purposes.
- Continue to improve credit quality and maintain acceptable levels of liquidity.

## **OVERVIEW OF BUSINESS SEGMENTS**

Duquesne Light reports the following business segments: (1) transmission and distribution of electricity (electricity delivery business segment), (2) supply of electricity by Duquesne Light (Duquesne Light supply business segment), and (3) collection of transition costs (which were fully collected as of December 31, 2005) (CTC business segment).

Holdings reports the following business segments: (1) transmission and distribution of electricity (electricity delivery business segment), (2) supply of electricity (which includes the Duquesne Light supply business segment and, beginning in 2005, supply by DLE) (electricity supply business segment), (3) collection of transition costs (which were fully collected as of December 31, 2005) (CTC business segment), (4) DES' development, operation and maintenance of energy facilities and, for a single customer, synthetic fuel facilities (Energy Solutions business segment), (5) DQE Financial's collection and processing of landfill gas and management of structured finance and alternative energy investments (Financial business segment), and (6) DQE Communications' operation, maintenance and leasing of its fiber optic based network (Communications business segment). We also report an "all other" category to include our other subsidiaries below the quantitative threshold for disclosure. These subsidiaries provide corporate administrative functions, financing, and insurance

## Table of Contents

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following Notes present information on both Duquesne Light Holdings, Inc. (Holdings) and Duquesne Light Company (Duquesne Light). Information on Holdings and its subsidiaries (not including Duquesne Light and its subsidiaries) shall not be deemed to be included as part of Duquesne Light's Notes. Specifically, information on the Energy Solutions, Financial and Communications business segments, the all other category, and discontinued operations is not so included.

References in the Notes to "we," "us" and "our" are to Holdings and its subsidiaries, collectively.

#### 1. Accounting Policies

##### CONSOLIDATION

Holdings is an energy services holding company. Our subsidiaries include those discussed below.

The consolidated financial statements of Holdings and Duquesne Light include their accounts and their wholly and majority owned subsidiaries. The equity method of accounting is used for 20% to 50% interests in other companies. Under the equity method, original investments are recorded at cost and adjusted by our share of undistributed earnings or losses of these companies. All material intercompany balances and transactions have been eliminated in the consolidation.

In addition, effective March 31, 2004, we consolidate variable interest entities for which we are the primary beneficiary in accordance with Financial Accounting Standards Board (FASB) Interpretation No. 46R, "Consolidation of Variable Interest Entities" (revised December 2003) (FIN 46R), regardless of the ownership percentage held by us.

##### Continuing Operations

Duquesne Light is an electric utility engaged in the supply (through its provider-of-last-resort service (POLR)), transmission and distribution of electric energy.

Duquesne Power, LLC (formerly Duquesne Power, L.P.), an unregulated subsidiary, maintains a portfolio of energy commodity contracts to provide full-requirements energy supply contracts for both (i) Duquesne Light's residential and small commercial POLR customers and (ii) Duquesne Light Energy, LLC's large commercial and industrial customers. These energy commodity contracts are with unrelated parties and include payment guarantees from Holdings. This entity was a subsidiary of Duquesne Light until December 31, 2005, at which time ownership was transferred to another Holdings subsidiary. The transfer of Duquesne Power, at recorded book value, was completed to strategically align our unregulated businesses outside of Duquesne Light in order to provide flexibility to capitalize on future supply opportunities. The transfer will effectively eliminate the net income included in Duquesne Light's supply segment. The Holdings supply segment will not be affected by the realignment.

Duquesne Light Energy, LLC (DLE) is an unregulated, competitive, retail electric generation supplier that offers customized solutions tailored to meet its customers' specific electricity needs. DLE's primary focus is on the large commercial and industrial customer market segment in Duquesne Light's service territory.

Duquesne Energy Solutions, LLC (DES) is an energy facilities management company that provides energy outsourcing solutions including operation and maintenance of synthetic fuel and energy facilities. During 2005, DES sold three investments in on-site energy facility management projects.

DQE Financial Corp. owns, operates and maintains landfill gas collection and processing systems, and is an investment and portfolio management organization focused on structured finance and alternative energy

Guarantee is reduced daily, based on the passage of time, through January 1, 2016, at which time the Repayment Guarantee expires. The estimated liability for the fair value of the Repayment Guarantee is not material.

Holdings has guaranteed portions of the obligations of Duquesne Power under its energy commodity contracts in order to use Holdings' stronger credit profile to obtain better pricing and contract terms for Duquesne Power. In general, if Duquesne Power is required to make a payment under these contracts and fails to do so, Holdings would be required to make such payment. The notional value of the contracts (and consequently the guarantee amounts) changes as additional energy commodities are bought or sold, and as Duquesne

## Table of Contents

Power pays for its energy commodity deliveries. As of December 31, 2005, the maximum amount of Holdings' payment guarantee related to the purchase and capacity obligations totaled \$687.1 million, or approximately 86%, of the total remaining notional value under these contracts. In addition, Holdings guarantees Duquesne Power's obligations to deliver energy under the energy sales contracts, to the extent that Duquesne Power would be obligated to compensate the counterparty for the difference in the counterparty's cost to procure the energy and the contract price. As of December 31, 2005, no guarantee amount has been recorded as a liability on the consolidated balance sheets. In addition, Holdings posts collateral on behalf of Duquesne Power as needed under the energy commodity contracts. As of December 31, 2005, no collateral was outstanding.

In conjunction with certain transactions, primarily divestitures, we provide routine indemnifications (e.g., retention of previously existing environmental, tax and employee liabilities) whose terms range in duration and often are not explicitly defined. Where appropriate, an obligation for such indemnifications is recorded as a liability. Because the obligated amounts of these types of indemnifications often are not explicitly stated, the overall maximum amount of the obligation under such indemnifications cannot be reasonably estimated. Other than obligations recorded as liabilities at the time of divestiture, historically we have not made significant payments for these indemnifications.

### EMPLOYEES

Duquesne Light is a party to a labor contract with the International Brotherhood of Electrical Workers, which represents more than 71% of Duquesne Light's approximately 1,400 employees. This contract expires in September 2010.

### LEGAL PROCEEDINGS

*Shareholder Class Action.* In October and November 2001, a number of putative class action lawsuits were filed by purported shareholders of Holdings against Holdings and David Marshall, our former chairman, chief executive officer and president, in the United States District Court for the Western District of Pennsylvania. These cases were consolidated under the caption *In re DQE, Inc. Securities Litigation*, Master File No. 01-1851 (W.D. Pa.), and the plaintiffs filed a second consolidated amended complaint on April 15, 2002. The complaint alleged violations of Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rule 10b-5 promulgated thereunder, and Section 12(a)(2) of the Securities Act of 1933 (the "Securities Act"). The complaint also alleged controlling person liability under Section 20(a) of the Exchange Act and Section 15 of the Securities Act. The complaint alleged that between December 6, 2000 and April 30, 2001, the defendants issued a number of materially false and misleading statements concerning investments made by our subsidiary, DQE Enterprises, Inc., and the impact that these investments would have on our current and future financial results.

In March 2005, we reached an oral agreement in principle with counsel for the plaintiffs to settle all claims of the class and sub-class. In October 2005, the court approved a settlement of all claims of the class and sub-class. The settlement was covered in full by our insurance.

### SECTION 29 TAX CREDITS AND SYNTHETIC FUEL

Holdings recognizes Section 29 credits from DQE Financial's landfill gas operations and an investment in a synthetic fuel partnership. DES operates synthetic fuel facilities for a single customer, earning fees based on production.

Section 29 tax credits are subject to a phase-out provision that could reduce tax credits as the average annual wellhead price per barrel of domestic crude oil increases into an inflation-adjusted phase-out range. For 2004, the tax credit would have begun to phase-out if the annual average wellhead price per barrel of domestic crude oil exceeded \$51.35 per barrel and would have been completely phased out if the annual average wellhead price of

62

SE/RESA EXHIBIT RH-3

Strategic Energy St. No. 1

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

DIRECT TESTIMONY OF  
RONALD CARRIER

On Behalf of Strategic Energy, LLC

Duquesne Light Company Base Rate Case  
Docket No. R-00061346

July 7, 2006

1 Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND BUSINESS  
2 RESPONSIBILITIES?

3 A. My name is Ronald Carrier. I am the Manager of Regulatory and Legislative Affairs for  
4 Strategic Energy, LLC ("Strategic" or "Strategic Energy"). My business address is 2316  
5 Anchor Court, Holt, Michigan, 48842. My business responsibilities include managing  
6 the legislative and regulatory activities of Strategic Energy in the states of Illinois,  
7 Michigan and Pennsylvania.

8 Q. PLEASE DESCRIBE YOUR EDUCATIONAL AND EMPLOYMENT HISTORY.

9 A. I received a mechanical engineering degree from the University of Michigan and an  
10 MBA from Central Michigan University. Prior to my employment at Strategic Energy,  
11 Consumers Energy/CMS Energy employed me for over 20 years. At Consumers and  
12 CMS, my responsibilities ranged from a plant engineer at a nuclear facility to the  
13 Program Manager for their Electric Customer Choice program. I have been employed by  
14 Strategic Energy for two and a half years, serving as the Manager of Regulatory Affairs  
15 for their Mid-American region.

16 Q. HAVE YOU EVER TESTIFIED BEFORE THIS COMMISSION?

17 A. No, but I have testified as an expert before the Michigan Public Service Commission on  
18 several cases pertaining to customer choice issues.

19 Q. ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS PROCEEDING?

20 A. I am testifying on behalf of Strategic Energy, LLC ("Strategic Energy" or "Strategic").

21 Q. PLEASE DESCRIBE STRATEGIC ENERGY AND ITS ACTIVITIES IN THE  
22 DUQUESNE SERVICE AREA.

23 A. Strategic Energy is a licensed electric generation supplier ("EGS"), competing for the  
24 generation supply business of Duquesne Light Company ("Duquesne" or "DLC")  
25 customers along with other licensed EGSs such as Duquesne Light Energy ("DLE").

1 Q. WHAT ISSUES DOES STRATEGIC RAISE IN THIS CASE?

2 A. Strategic is raising issues of cross-subsidies to Duquesne Light Energy ("DLE") from  
3 Duquesne's distribution service and rates.

4 Q. WHY DOES STRATEGIC RAISE THESE ISSUES IN THIS CASE?

5 A. Strategic has been in business in DLC's service territory as an EGS since 1999. Strategic  
6 operates an energy management center in Pittsburgh twenty four hours a day, seven days  
7 a week, and employs approximately 200 people in its Pittsburgh office as sales  
8 representatives, traders, lawyers, regulatory staff, billing and pricing staff, and computer  
9 support technicians, among other functions. Strategic competes with DLE for DLC's  
10 large commercial and industrial ("C&I") customers. However, despite having only a few  
11 employees and limited work area (DLE occupies only a small percentage of Duquesne's  
12 headquarters),<sup>1</sup> and providing EGS service since January 1, 2005, DLE has been able to  
13 obtain, as far as we can determine, a substantial share of DLC's large C&I customer load,  
14 in many cases, by consistently undercutting Strategic's (and, we believe, other EGSs')  
15 prices. The question raised is how has DLE been able to do so much in such a short time  
16 with so little? While it can be said that Strategic Energy serves customers in several  
17 states, so it requires a larger staff, the disparity between the relative size of the two  
18 companies is too large to ignore. Strategic embraces retail electric competition, but it  
19 must be on a level playing field if EGSs are going to be able to deliver the benefits of  
20 competition to customers. I am also advised by counsel that a level playing field is  
21 required in the post-transition period by the Electric Competition Act requirement that the  
22 competitive activities of the incumbent utilities must be fair. One manifestation of this

---

<sup>1</sup> Strategic Energy Exh. RC-1 (DLC answer to Direct Energy Set II-7 (Revised)).

1 requirement is the Code of Conduct that Duquesne is required to adhere to in its dealings  
2 with its affiliate EGS as well as other EGSs operating in its service territory. Among  
3 other things, the Code of Conduct generally seeks to prevent the utility from subsidizing  
4 the activities of its affiliated EGS.<sup>2</sup> To the extent that DLC's distribution rates include  
5 costs that – either directly or indirectly – benefit and, therefore, should be paid for by  
6 other DLC affiliates, such as Duquesne Light Holdings ("DLH"), Duquesne Power  
7 ("DP"), the playing field is not level. The customers utilizing DLC's distribution system,  
8 both POLR and choice, should not subsidize the marketing efforts of DLE.

9 **Q. IS THERE ANY EVIDENCE THAT THE COSTS THAT DUQUESNE IS**  
10 **SEEKING TO INCLUDE IN ITS DISTRIBUTION RATES MAY BE**  
11 **OVERSTATED BECAUSE OF DLE COSTS?**

12 A. Yes, here is one example. Duquesne's 2005 Form 10-K states that POLR supply  
13 *procurement for DLC and supply for DLE's customers is performed by DP, and that DP*  
14 *"has secured a substantial portion of the combined expected load obligation for its full-*  
15 *requirements contracts with Duquesne Light and DLE through 2007."*<sup>3</sup> It appears  
16 therefore that power purchasing, scheduling and coordination and planning are done  
17 jointly by Duquesne Power for both DLE and Duquesne's POLR load. As Direct Energy  
18 witness Lacey explains, Duquesne's distribution revenue requirement includes all costs  
19 associated with providing POLR service other than the actual purchased power costs and

<sup>2</sup> "The purpose of these competitive safeguards is to . . . prevent the cross subsidization of service . . . between related electric distribution companies and electric generation suppliers . . . and to establish and maintain an effective and vibrant competitive market in the purchase and sale of retail electric energy in this Commonwealth." 52 Pa. Code § 54.121. "An electric distribution company which is related as an affiliate or division of an electric generation supplier . . . ; and any electric generation supplier which is related as an affiliate or division of any electric distribution company . . . , shall insure that its employees function independently of other related companies." 52 Pa. Code § 54.122(11).

<sup>3</sup> DLC Attachment DFR-IJI-F-1b, pp. 5-6, 11.

1 related taxes. This means that all other costs that are charged to DLC distribution from  
2 DP (or which DLC incurs directly) related to planning, scheduling and coordinating its  
3 POLR supply are being claimed in its distribution rates. So far, we have not been  
4 provided with any evidence that DP is allocating to DLE any of the costs of procuring  
5 power (other than the cost of the power itself). If these costs are being claimed in  
6 distribution rates, it would give DLE a distinct and unfair cost advantage in the  
7 competitive retail market. We agree with Direct Energy witness Lacey that all costs of  
8 providing POLR service should be removed from distribution rates and allocated to the  
9 appropriate service.

10 Another example of a clear potential subsidy to DLE is raised by Duquesne  
11 Holding's 2005 Form 10-K. It states that DP's supply procurements are backed by  
12 guarantees from DLH. This guarantee is sufficient because generators know that,  
13 through its utility operation, DLH has a steady and secure revenue stream that secures  
14 any liability DP might incur. Such a guarantee is tremendously valuable, as it eliminates  
15 the need for DP, and, indirectly, DLE, to post credit when it purchases power to serve its  
16 customers. I am confident that the ability of DLE to avoid having to post credit for its  
17 power purchases provides it with yet another cost advantage when it competes with  
18 companies like Strategic, who are usually required to post credit for such purchases. Yet  
19 it is not clear that DLE ever compensates any DLC affiliate, including the utility, for this  
20 guarantee. In our view, if DLE does not compensate DLC for the "avoided cost" of not  
21 having to post credit, Duquesne and its customers are subsidizing DLE's competitive  
22 operations.

1 Examples like this are ways that DLC may be using its regulated cost recovery  
2 mechanisms to pay for DLE procurement costs in order to subsidize its retail affiliate and  
3 keep competitive EGSs out of the market. The logical end result of this would be an  
4 unregulated monopoly serving all of the customers in the market.

5 Q. DOES STRATEGIC HAVE EVIDENCE THAT CROSS-SUBSIDIZATION BY  
6 DUQUESNE DISTRIBUTION CUSTOMERS IS DEFINITELY OCCURRING?

7 A. At this point we have only the circumstantial evidence mentioned above, because we  
8 have not received answers to all relevant discovery requests and because the timeline on  
9 which a base rate case like this is tried makes an in-depth exploration of this issue  
10 extremely difficult. We reserve the right to supplement this testimony based upon receipt  
11 of answers.

12 Q. DOES DLC OR DLH HAVE A REASON TO USE CROSS-SUBSIDIES TO ITS  
13 ADVANTAGE AND TO THE DETRIMENT OF RETAIL COMPETITION?

14 A. Yes, as disclosed in their 10-K filing. This filing lists as DLC's first Business Strategy  
15 under the "Energy Supply Opportunities" heading to "[c]ontinue to actively manage  
16 supply requirements for both Duquesne Light's residential and small commercial POLR  
17 III customers and DLE's customers, through Duquesne Power or our other unregulated  
18 subsidiaries . . ."<sup>4</sup> DLC's second strategic priority under the "Energy Supply  
19 Opportunities" heading is to "[m]aximize large commercial and industrial customer  
20 retention through our unregulated retail electric supplier, DLE." I also note that DLC  
21 has budgeted an increase in its purchased power expense for 2006 "due to higher  
22 budgeted POLR retention for both residential and commercial customers."<sup>5</sup> Since DLC

---

<sup>4</sup> *Id.* (emphasis added).

<sup>5</sup> DLC Attachment DFR-II-D-8, p. 4 of 8.

1 made no attempt in this case to allocate POLR costs to POLR, the same relevant costs are  
2 not going to be allocated to DLE. I conclude that DLC and DLH are going to use a cross-  
3 subsidy from regulated rate recovery to help fund both the POLR and the DLE  
4 businesses.

5 **Q. WHAT SHOULD THE COMMISSION DO ABOUT THIS PROBLEM?**

6 A. The Commission should fully investigate cross-subsidies that occur in any way – directly  
7 or indirectly – by requiring DLC to do a study that discloses all instances of cost or risk  
8 sharing among all the DLC affiliates and DLE. Then the Commission and interested  
9 stakeholders would be in a position to fully allocate all costs of the DLH companies' to  
10 the appropriate services. This would produce a level playing field for retail competition  
11 as envisioned by the Electric Competition Act. An example of an indirect subsidy would  
12 be if DP is providing or paying for a service (such as scheduling, or balancing and  
13 ancillary services) for both DLC and DLE, and charging only DLC. This arrangement  
14 could appear appropriate on the surface, but either DP should also charge DLE or DLE  
15 should compensate DLC for DLE's portion of the costs.

16 I recommend that the Commission order Duquesne to produce such a study within  
17 sixty (60) days following the issuance of the Commission's order in this case, which  
18 study should be circulated for analysis, further discovery and review in an on-the-record  
19 hearing by all interested parties. If the end result of the investigation is an identification  
20 of costs included in Duquesne's distribution rates which should either be recovered in its  
21 POLR charges or recovered in the prices charged by DLE, the Commission should order  
22 the appropriate adjustments in DLC's distribution and/or POLR rates.

23 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

24 A. Yes, subject to receipt of discovery answers as stated above.

Duquesne Light Company  
Docket No. R-00061346

DES-11-7 (Revised)  
Clare Ott  
Page 1 of 1

Direct Energy Services, LLC  
Interrogatories Set II

7. Please provide copies of the floor plans for the premises occupied by Duquesne Light Company and its affiliates at 411 Seventh Avenue in Pittsburgh and indicate and describe the portions of the premises occupied by Duquesne Light Company and each affiliate.

Response:

DQE Communications LLC	15 <sup>th</sup> Floor, 3,720 sq. ft.
DQE Energy Solutions	15 <sup>th</sup> Floor, 6,536 sq. ft.
DQE Financial Corporation	15 <sup>th</sup> Floor, 3,184 sq. ft.
Duquesne Light Energy	15 <sup>th</sup> Floor, 3,136 sq. ft.
Duquesne Power	15 <sup>th</sup> Floor, 2,629 sq. ft.
Duquesne Light Holdings	13,029 sq. ft.

Also see DFR II-D-8f.

Also see the three attached floor plans. As a description, Duquesne Light Company occupies the remainder of the leased premises at 411 Seventh Avenue except for the space occupied by the five affiliates of Duquesne Light Company noted herein.



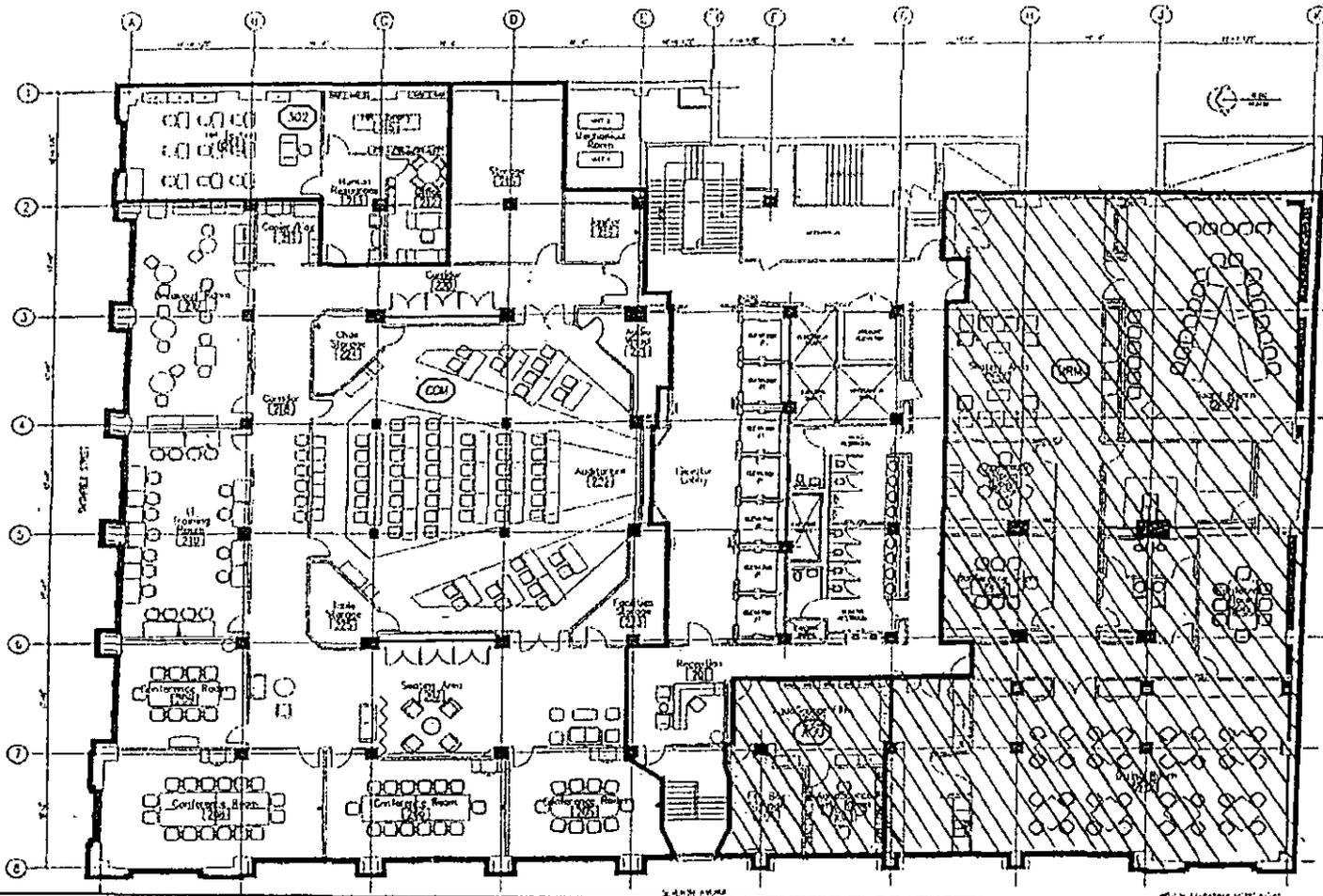


EXHIBIT B-1

(XXX) DEBRIS COST CENTER

EXHIBIT B-1  
 4TH FLOOR PLAN  
 AND FURNITURE PLAN  
 SCALE: 1/8" = 1'-0"  
 4/20/80

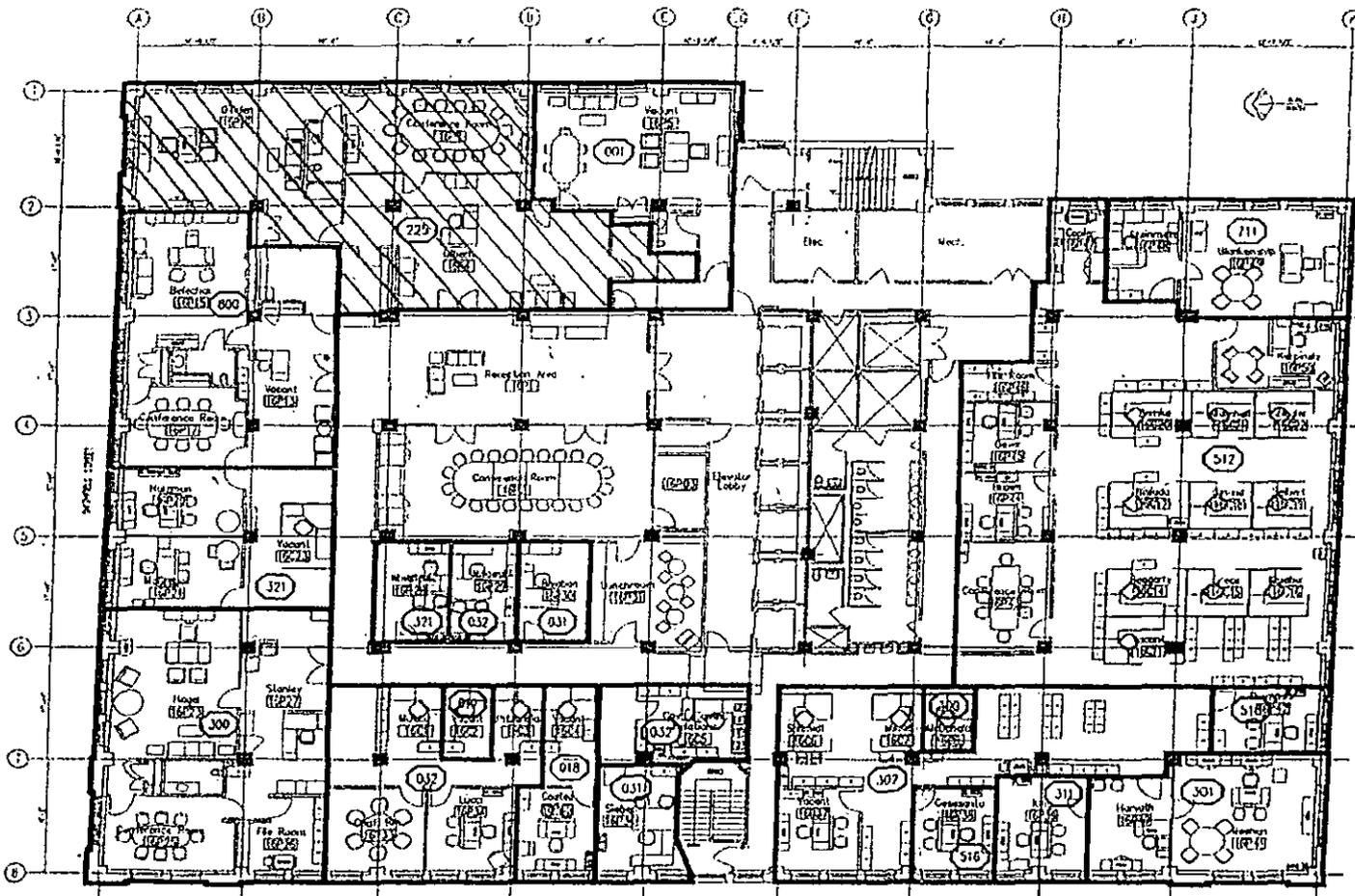


EXHIBIT B-2

200 MARKET ST. S.C.  
 411 ENGINEER AVE.  
 10777 LINDEN BLVD.  
 216 S. 4TH ST.  
 68115-0001

XXX DENOTES COST CENTER

SE/RESA EXHIBIT RH-4

Strategic Energy St. No. ISR

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

SURREBUTTAL TESTIMONY OF  
RONALD CARRIER

On Behalf of Strategic Energy, LLC

Duquesne Light Company Base Rate Case  
Docket No. R-00061346

August 16, 2006

1 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

2 A. Ronald Carrier. My business address is 2316 Anchor Court, Holt, Michigan, 48842.

3 Q. ARE YOU THE SAME RONALD CARRIER WHO SUBMITTED DIRECT AND  
4 REBUTTAL TESTIMONY ON BEHALF OF STRATEGIC ENERGY IN THIS  
5 PROCEEDING?

6 A. Yes.

7 Q. WHAT IS THE SUBJECT OF YOUR SURREBUTTAL TESTIMONY?

8 A. I am responding to Duquesne Light Company ("Duquesne" or "DLC") witness Neil  
9 Fisher's rebuttal testimony that Strategic Energy, LLC's ("Strategic") allegations of  
10 potential cross-subsidies to Duquesne's electric generation supplier ("EGS") affiliate,  
11 Duquesne Light Energy ("DLE"), are unsupported and not credible.

12 Q. DO YOU AGREE WITH MR. FISHER THAT THERE IS NO SUPPORT FOR  
13 STRATEGIC'S CROSS-SUBSIDY CLAIMS?

14 A. No. Part of the problem is that Mr. Fisher apparently misreads my testimony as claiming  
15 only cross-subsidies from Duquesne's distribution rates, when my claims also include  
16 direct and indirect cross-subsidies from Duquesne's POLR (generation) rates, Duquesne  
17 Power's ("DP") supply procurement activities and Duquesne Light Holding's ("DLH")  
18 credit or performance guarantees. This may explain why Mr. Fisher does not address my  
19 claims that DLE can receive competitive cost advantages from DLH and its subsidiaries  
20 to the extent that DLE does not pay for: 1) costs incurred on its behalf by DP, but  
21 included in DLC's POLR rates or absorbed by DP; or 2) credit guarantees provided by  
22 DLH to support DP's supply procurement activities on behalf of DLE. Mr. Fisher simply  
23 asserts that the charge for services between Duquesne's unregulated affiliates, DP and  
24 DLE, is not relevant in this proceeding and not subject to regulatory review.

25 Q. DO YOU AGREE WITH MR. FISHER'S ASSERTIONS?

1 A. No, and I note that Duquesne has not disclosed whether there are any such charges.  
2 Although I am not a lawyer it seems to me that Mr. Fisher's assertions present the  
3 "chicken and egg" dilemma. If DLE does not pay for costs DP incurs on DLE's behalf  
4 (because either DLC pays for them in its distribution or POLR rates, or DP absorbs  
5 them), or if DLE does not pay for credit guarantees provided by DLH either directly (to  
6 DLH) or indirectly (to DP), then DLE is receiving a subsidy – from DLC, DP and/or  
7 DLH. However, if the cost allocations and charges, if any, for the service arrangements  
8 between and among DP, DLE, DLC and DLH are not relevant and not subject to  
9 Commission review in this proceeding, then how can information to establish the extent  
10 and amounts of such cross-subsidies be uncovered?

11 **Q. HOW HAS DUQUESNE'S POSITION ON THIS ISSUE AFFECTED**  
12 **STRATEGIC'S PROOF TO SUPPORT ITS CLAIMS?**

13 A. As I stated in my initial testimony, the tight time frame for litigating this case has  
14 hampered Strategic's efforts to uncover this information over Duquesne's objections.  
15 Fortunately, Mr. Fisher's testimony and admissions by Duquesne actually support our  
16 claims that DLE is receiving unlawful subsidies from either DLC, DP and/or DLH, by  
17 tagging along with DLC on DP's supply procurement activities or riding the coattails of  
18 DLC's distribution or POLR service.

19 **Q. HOW DOES MR. FISHER'S TESTIMONY SUPPORT STRATEGIC'S CLAIMS**  
20 **OF UNLAWFUL CROSS-SUBSIDIES?**

21 A. Mr. Fisher does not dispute my initial testimony that DP's power purchasing, scheduling,  
22 coordination and planning are done by DP for both DLE's load and DLC's POLR load,  
23 but he asserts that DLC's full service requirements supply agreement with DP covers all  
24 DP's costs associated with DLC's POLR service but does not include DP costs related to  
25 DLE load. But Direct Energy witness Lacey's initial testimony shows that DLC's POLR

1 rates include only actual purchased power costs and related taxes.<sup>1</sup> And Duquesne's 2005  
2 Form 10-K shows some \$28.4 million in profit from DLC's "POLR/Supply" ("Electricity  
3 Supply" business segment, supposedly including the results of DLE), comprising \$19  
4 million cash earnings from POLR service to residential and small commercial customers  
5 and \$9.4 million non-cash earnings from derivative energy contracts.<sup>2</sup> As Duquesne's  
6 2005 Form 10-K states that DLE provides service to Duquesne's large commercial and  
7 industrial customers, this means that DLE did not contribute any earnings in 2005 to  
8 Duquesne's \$19 million Electricity Supply business segment profit. In other words, DLE  
9 had no profit on its power sales in 2005. This means that DLE is selling power at or  
10 below cost – i.e., "dumping" power or engaging in predatory pricing by not pricing its  
11 power to cover all costs – because some of the costs are covered by either DLC or DP.  
12 Mr. Fisher could be considered to have admitted as much, even as he professes not to be  
13 familiar with DLE's pricing strategy, when he asserts that DLE's ability to undercut  
14 Strategic's retail prices and successfully capture market share "could be explained by a  
15 variety of factors" – but then he mentions only two: 1) as a new EGS, DLE may have  
16 "had a strategy to price low in order to capture market share;" and 2) it's possible DLE  
17 "chooses to earn lower margins than those required by Strategic's management."<sup>3</sup> DLE  
18 apparently had both strategies in 2005, and was able to price low because it didn't have to  
19 pay for some of its costs.

20 Q. DOES MR. FISHER'S TESTIMONY INCLUDE ANY OTHER EXAMPLES OF  
21 UNLAWFUL CROSS-SUBSIDIES AMONG THE DUQUESNE COMPANIES?

---

<sup>1</sup> Direct Energy St. No. 1 at 10-11.

<sup>2</sup> Strategic Energy Exh. RC-2 (DLC response to DE III-3).

<sup>3</sup> Duquesne St. No. 15-R (Fisher) at 28-29.

1 A. The most obvious one is parent company credit or performance guarantees, which Mr.  
2 Fisher admits provides competitive advantages to a retail subsidiary. Mr. Fisher quotes  
3 the Form 10-Ks of the parent companies of EGSs in this case (Strategic, Constellation  
4 NewEnergy) which disclose that these EGSs receive credit or performance guarantees  
5 from their corporate parents. These quotes readily admit that the parent company  
6 guarantees provide support for their EGS subsidiaries' operations. Strategic's parent  
7 company's 10-K states that these corporate guarantees "support or enhance the  
8 creditworthiness otherwise attributed to [Strategic] for a stand-alone basis, thereby  
9 facilitating the extension of sufficient credit to accomplish [Strategic's] intended business  
10 purposes."<sup>4</sup> Constellation NewEnergy's parent company's 10-K states that its corporate  
11 guarantees are given "in support of the growth of our merchant energy business."<sup>5</sup> Credit  
12 support from Centrica, Direct Energy's parent company, "reduces costs and gives  
13 competitive advantage" to its subsidiaries.<sup>6</sup> Mr. Fisher's analogy thus supports my initial  
14 testimony that DLH's credit guarantees provide DLH's subsidiaries with either direct or  
15 indirect competitive cost advantages. Mr. Fisher's assertions that "it is not at all clear  
16 who [among the EGSs and their parent companies and regulated/unregulated affiliated  
17 companies] has a competitive disadvantage with respect to credit and security costs," and  
18 that "[o]ne could easily argue DLE is at a competitive disadvantage" are completely at  
19 odds with his analogy, unsupported and counterintuitive. He does not provide any

---

<sup>4</sup> *Id.* at 27 (quoting Great Plains Energy, Inc. 2005 Form 10-K).

<sup>5</sup> *Id.* (quoting Constellation Energy, Inc. 2005 Form 10-K).

<sup>6</sup> *Id.* (quoting "Centrica in North America").

1 explanation as to how a parent company's guarantees puts its subsidiaries at a competitive  
2 disadvantage.

3 **Q. WHY DO YOU VIEW DLH'S CREDIT SUPPORT AS AN UNLAWFUL CROSS-**  
4 **SUBSIDY WHEN STRATEGIC AND OTHER EGSs ALSO RECEIVE CREDIT**  
5 **SUPPORT FROM THEIR CORPORATE PARENTS?**

6 A. It's an "apples to oranges" comparison because there are fundamental differences between  
7 the two situations. First, DLE and DP are operating in DLC's service territory, and the  
8 Electric Choice and Competition Act, as well as Duquesne's Code of Conduct, require  
9 that these affiliates function independently of each other and not provide cross-subsidies.  
10 There are no such comparable limitations on the operations of Strategic (or Constellation  
11 NewEnergy and Direct Energy) and their affiliates in DLC's service territory. Second,  
12 Strategic pays its corporate parent for the credit guarantees.

13 **Q. DOES MR. FISHER'S TESTIMONY REVEAL ANY OTHER CROSS-SUBSIDY**  
14 **PROBLEM?**

15 A. Yes. He asserts that whatever costs DP incurs to fulfill its supply obligations to DLC's  
16 POLR service are reflected in the total charges paid by DLC to DP – and thus reflected in  
17 DLC's POLR rates – and that those charges were determined by the PUC to represent  
18 "prevailing market prices" for the Small Customer fixed price POLR product over the  
19 POLR III period.

20 **Q. WHY IS THIS A CROSS-SUBSIDY PROBLEM?**

21 A. Because rates for post-transition POLR service are to reflect the prevailing market prices  
22 for the power plus all reasonable costs. By ignoring the cost component, Mr. Fisher's  
23 analysis and conclusion that the total price paid by DLC to DP for power supply and  
24 related services reflects prevailing market prices misses the mark. By ignoring the other  
25 half of the post-transition POLR pricing standard, Mr. Fisher summarily, and

1 erroneously, dismisses the possibility of a cross-subsidy from DP's power procurement  
2 activities. Mr. Fisher also asserts that the failure of the DP/DLC power supply contract to  
3 break out the individual cost components is no different from the manner in which EGSs  
4 such as Strategic and their wholesale suppliers contract. However, again, this is an  
5 invalid "apples to oranges" comparison because DLC and its affiliates operating in DLC's  
6 service territory are subject to restrictions and limitations to prevent anticompetitive  
7 activities and cross-subsidies that are not applicable to unaffiliated EGSs such as  
8 Strategic.

9 **Q. WHAT SHOULD THE COMMISSION DO TO ADDRESS THESE CROSS-**  
10 **SUBSIDY PROBLEMS?**

11 A. The Commission should investigate DLC's operations vis-à-vis DLE and DP to uncover  
12 and quantify the apparent cross-subsidies among these companies and DLH. I note that  
13 the Michigan Public Service Commission's Code of Conduct specifically prohibits the  
14 types of cross-subsidies we claim are present among the DLH companies: "An electric  
15 utility's or alternative electric supplier's regulated services shall not subsidize in any  
16 manner, directly or indirectly, the unregulated business of its affiliates or other separate  
17 entities."<sup>7</sup> In addition, the Michigan Public Service Commission's Code of Conduct  
18 spells out how services provided from one corporate affiliate to another should be  
19 priced.<sup>8</sup> Once the extent and amounts of the cross-subsidies are identified, the  
20 Commission should require Duquesne to make appropriate adjustments to its distribution  
21 rates and to its POLR rates to ensure that these rates reflect all the reasonable costs of  
22 providing the respective services – and only the reasonable costs of providing the

<sup>7</sup> Strategic Energy Exh. RC-3 (Section II (Separation), Subsection B).

<sup>8</sup> *Id.* (Section III (Discrimination), Subsection C).

1           respective services. For example, any costs incurred by DP on behalf of DLE but  
2           included in DLC's distribution or POLR rates should be returned to DLC in the form of  
3           reduced charges. This Commission should also consider amending its Code of Conduct  
4           along the lines of the Michigan PSC's Code of Conduct to more specifically address  
5           cross-subsidy issues.

6    Q.    DOES THIS COMPLETE YOUR SURREBUTTAL TESTIMONY?

7    A.    Yes.

Direct Energy Services  
Interrogatories Set III

Answer to Direct I-10: Investor Presentation "Executing on the Basics" (Feb. 14, 2006).

p. 8: "Electricity Supply business earned \$19M in 2005 excluding derivative gains."

3. a. Provide all calculations associated with the conclusion that the "Electric Supply business" earned \$19M, including a detail of the expenses, revenues, taxes and other items allocated to "Electricity Supply" on which this calculation is based.
- b. Confirm that "Electricity Supply" referenced there includes POLR service. If the service includes any other service, please specify the other services and identify the portion attributable to POLR service.
- c. Explain the "adjustment" which reduced actual 2005 POLR/supply earnings from \$28.4M to \$19M. (p. 15)
- d. Explain the main drivers for the projected increase in earnings from POLR/supply from \$19M in 2005 to \$33-36M in 2006.

## Response:

- 3.a. Refer to the attached excerpts from the Duquesne Light Holdings and Duquesne Light Company combined Form 10-K for the year ended December 31, 2005 for the detail of the revenue, expenses and taxes used to calculate the earnings for the electricity supply segment for the year ended December 31, 2005. The first excerpt shows the earnings of the Duquesne Light Supply segment (\$28.4 million in total) segregated between earnings from the residential and small commercial customers (\$19.0 million) and non-cash earnings from derivative energy contracts (\$9.4 million). The second excerpt shows the detail of the revenue, expenses and taxes used to calculate the total earnings of \$28.4 million from the Electricity Supply segment. The net income effect of the derivative energy contracts is reflected on a pre-tax basis as an offset to purchased power expense.
- 3.b. The Electricity Supply segment includes POLR service. As disclosed in the Form 10-K referenced above, it also includes the results of Duquesne Light Holdings' unregulated retail electric generation supplier, Duquesne Light Energy. The additional information you requested is non-public information, and will not be provided.
- 3.c. Please refer to the response to question 3.a.
- 3.d. As referenced in slides 30 and 32 of this same presentation, the 2006 estimated earnings from the supply segment were to include approximately \$9 million of earnings from the projected June 2006 acquisition of the Keystone and Conemaugh power stations. This is the primary reason for the projected increase in earnings from the supply segment.

## CODE OF CONDUCT

*This code of conduct is intended to promote fair competition by establishing measures to prevent cross-subsidization, information sharing, and preferential treatment between the regulated and unregulated operations of electric utilities, alternative electric suppliers, and their affiliates. An electric utility or alternative electric supplier is prohibited from taking punitive action against any individual (including an employee) or entity who files a complaint with the electric utility, the alternative electric supplier, or the Commission, or otherwise causes an alleged violation of this code of conduct to come to the attention of the Commission.*

### I. Applicability

This code applies to all electric utilities as defined by MCL 460.562 and to alternative electric suppliers, as defined by MCL 460.10g, who, together with their affiliates, provide regulated services in Michigan and unregulated services. As used in this code of conduct, a service is "regulated" if the commission has authority to set the price for the service as of the effective date of this code.

### II. Separation

An electric utility or alternative electric supplier that offers, itself or through its affiliates, both regulated and unregulated services shall do so with the structural or functional separation needed to prevent cross-subsidization, information sharing, and preferential treatment between the regulated and unregulated services. This includes, but is not limited to, the following:

- A. An electric utility shall not offer unregulated services or products except through one or more affiliates or through other entities within the corporate structure, such as divisions.
- B. An electric utility's or alternative electric supplier's regulated services shall not subsidize in any manner, directly or indirectly, the unregulated business of its affiliates or other separate entities.
- C. An electric utility or alternative electric supplier shall maintain its books and records separately from those of its affiliates or other entities within its corporate structure. An electric cooperative offering unregulated services shall maintain an accounting system that allocates costs between its regulated and unregulated ventures on a fully allocated embedded cost basis, and any transfers of services, products, or property must be in compliance with the provisions of Section III, paragraph C.
- D. An electric utility or alternative electric supplier and its affiliates or other entities within its corporate structure shall not share facilities, equipment, or operating employees, but may share computer hardware and software with documented protection to prevent discriminatory access to competitively sensitive information.

- E. An electric utility's or alternative electric supplier's operating employees and the operating employees of its affiliates or other entities within its corporate structure shall function independently of each other and maintain separate offices.
- F. An electric utility or alternative electric supplier shall not finance or co-sign loans for affiliates.
- G. An electric utility may transfer employees between the electric utility and any of its affiliates or other entities within the corporate structure as long as the electric utility documents those transfers and files semi-annually with the Commission a report of each occasion on which an employee of the electric utility became an employee of an affiliate or other entity within its corporate structure and/or an employee of an affiliate or other entity within its corporate structure became an employee of the electric utility.
- H. An electric utility and its affiliates or other entities within the corporate structure and an alternative electric supplier and its affiliates or other entities within the corporate structure offering both regulated and unregulated services or products in Michigan shall not engage in joint advertising, marketing, or other promotional activities related to the provision of regulated and unregulated services, nor shall they jointly sell regulated and unregulated services.
- I. An electric utility or alternative electric supplier offering regulated service in Michigan shall not suggest that it will provide any customer with preferential treatment or service by doing business with the electric utility or the alternative electric supplier, affiliates, or other entities within the corporate structure offering unregulated services or products, nor shall the electric utility or alternative electric supplier suggest that any customer will receive inferior treatment or service by doing business with an unaffiliated supplier.
- J. An electric utility or alternative electric supplier offering regulated service in Michigan shall not condition or otherwise tie the provision of a regulated service or the availability of discounts, rates, other charges, fees, rebates, or waivers of terms and conditions for regulated service to the taking of any unregulated goods or services from the electric utility or alternative electric supplier, affiliates, or other entities within the corporate structure.
- K. An electric utility or alternative electric supplier offering regulated service in Michigan shall not allow its affiliates to use its logo unless the affiliate includes, in a clearly visible position and easily readable by customers, the following statement:  
    “(Affiliate name) is not regulated by the Michigan Public Service Commission.”

- L. If an electric utility, its affiliate, or other entity within the corporate structure offers an unregulated service, any use of its logo shall include, in a clearly visible position and easily readable by customers, the following statement:  
“(Service) is not regulated by the Michigan Public Service Commission.”
- M. None of the provisions of this code shall be interpreted to require a cooperative electric utility or an independent investor-owned utility with fewer than 60 employees to maintain separate facilities, operations, or personnel, used to deliver electricity to retail customers, provide retail electric service, or to be an alternative electric supplier.

### III. Discrimination

An electric utility or alternative electric supplier that offers, itself or through its affiliates, both regulated and unregulated services shall not unduly discriminate in favor of or against any party, including its affiliates. This includes, but is not limited to, the following:

- A. An electric utility or alternative electric supplier that offers, itself or through its affiliates, both regulated and unregulated service shall not provide any affiliate or other entity within its corporate structure, preferential treatment or any other advantages that are not offered under the same terms and conditions and contemporaneously to other suppliers offering services or products within the same service territory or to customers of those suppliers. This provision includes, but is not limited to, all aspects of the electric utility's or alternative electric supplier's service, including pricing, responsiveness to requests for service or repair, the availability of firm and interruptible service, and metering requirements.
- B. If an electric utility provides to any affiliate or other separate entity, or customers of an affiliate or other separate entity within its corporate structure, a discount, rebate, fee waiver, or waiver of its regulated tariffed terms and conditions for services or products, it shall contemporaneously provide notice of and offer the same discount, rebate, fee waiver, or waiver to all alternative electric suppliers operating within the electric utility's service territory or all alternative electric suppliers' customers.
- C. If an electric utility or alternative electric supplier offering regulated service in Michigan provides services, products, or property to any affiliate or other entity within the corporate structure, compensation shall be based upon the higher of fully allocated embedded cost or market price. If an affiliate or other entity within the corporate structure provides services, products, or property to an electric utility or alternative electric supplier offering regulated service in Michigan, compensation for services and supplies shall be at the lower of market price or 10% over fully allocated embedded cost and transfers of assets shall be based upon the lower of fully allocated embedded cost or market price.

- D. *If an electric utility provides a customer or potential customer with the names of its affiliates or other entities within the corporate structure that are alternative electric suppliers, it shall do so only by distributing their names along with the names of all licensed alternative electric suppliers.*
- E. *An electric utility or alternative electric supplier offering regulated service in Michigan shall not provide information or consultation to an affiliate or other entity within the corporate structure offering unregulated electric service in Michigan regarding a potential business arrangement between that affiliate or other entity within the corporate structure and a potential customer.*
- F. *An electric utility or alternative electric supplier offering regulated service in Michigan shall not refer a customer or potential customer to an affiliate or other entity within the corporate structure offering unregulated electric service in Michigan, nor steer a potential customer away from a non-affiliated entity offering unregulated electric service in Michigan, nor shall the electric utility or alternative electric supplier offering regulated service in Michigan provide a customer or potential customer with advice or assistance regarding the selection of or relationship with an affiliate, other entity within the corporate structure, or other service provider offering unregulated electric service in Michigan.*

#### IV. Disclosure of Information

Information obtained by an electric utility or alternative electric supplier in the course of conducting its regulated business in Michigan shall not be shared directly or indirectly with its affiliates or other entities within its corporate structure unless that same information is provided to competitors operating in the state on the same terms and conditions and contemporaneously. This provision includes, but is not limited to, the following:

- A. *Customer specific names and addresses shall not be provided to an affiliate or other entity within the corporate structure unless the same information is offered on the same terms and conditions, and contemporaneously, to all competitors.*
- B. *Customer specific consumption or billing data shall not be provided to any affiliate or other entity within the corporate structure or alternative electric supplier without prior written approval of the customer. Once each calendar year a request for up to 12 months of historic usage or billing data may be made at no cost.*
- C. *If an electric utility or alternative electric supplier offering regulated service in Michigan provides non-customer specific, or aggregated, customer information to its affiliate or other entity within its corporate structure, it must offer the same information on the same terms and conditions, in the same form and manner, and contemporaneously to all competitors.*

- D. An electric utility shall not provide its affiliates or other entities within its corporate structure with information about the distribution system, including operation and expansion, without offering the same information under the same terms and conditions, in the same form and manner, and contemporaneously to all licensed alternative electric suppliers.
- E. An electric utility or alternative electric supplier offering regulated service in Michigan shall not provide any information received from or as a result of doing business with a competitor to an affiliate or other entity within its corporate structure without the written approval of the competitor.

V. Electric Utility – Alternative Electric Supplier Relationship

Except for instances covered by Section 10a(3) of 2000 PA 141 or other instances approved by the Commission, an electric utility shall not in any way interfere in the business operations of an alternative electric supplier. This provision includes, but is not limited to, the following:

- A. An electric utility shall not give the appearance in any way that it speaks on behalf of any alternative electric supplier.
- B. An electric utility shall not interfere in any manner in the contractual relationship between the alternative electric supplier and its customers unless such involvement is clearly permitted in the contract between the customer and the alternative electric supplier or in tariffs approved by the Commission.

VI. Compliance Plans

Each electric utility or alternative electric supplier shall file a code of conduct compliance plan within 60 days of the order on rehearing on this code of conduct by the Commission. The compliance plan shall:

- A. Designate a corporate officer of the electric utility or alternative electric supplier who will oversee compliance with the code of conduct and be available to serve as the Commission's primary contact regarding compliance with the code.
- B. Include an affidavit signed by the designated corporate officer certifying that the electric utility or alternative electric supplier will comply fully with the code of conduct.
- C. Include a clear organization chart of the parent or holding company showing all regulated entities and affiliates and a description of all services and products provided between the regulated entity and its affiliates.

The electric utility or alternative electric supplier shall file revisions to its compliance plan needed to keep the information contained therein current.

In the compliance filing, the electric utility or alternative electric supplier may request a waiver from one or more provisions of this code of conduct. The electric utility or alternative electric supplier carries the burden of demonstrating that such a waiver will not inhibit the development or functioning of the competitive market.

VII. Oversight, Enforcement, and Penalties

- A. An electric utility or alternative electric supplier shall maintain documentation needed to investigate compliance with the code of conduct. All documentation shall be kept at a designated company office in Michigan. The electric utility or alternative electric supplier shall make this information available for review upon request by the Commission or its Staff. The designated officer will either be available or make personnel available who are knowledgeable to respond to inquiries by the Commission or its Staff regarding compliance with the provisions of the code of conduct.
- B. The electric utility or alternative electric supplier shall use a documented dispute resolution process separate from any process that might be available from the Commission. This dispute resolution process shall address complaints arising from application of the code of conduct. The electric utility or alternative electric supplier shall keep a log of all complaints, including: (1) the name of the person or entity filing the complaint, (2) the date the complaint was filed, (3) a written statement of the nature of the complaint, and (4) the results of the resolution process.
- C. Each electric utility or alternative electric supplier shall file an annual report with the commission summarizing the number and types of complaints received and their resolution.
- D. Penalties for violations of the code of conduct will be as provided in Section 10c of the Customer Choice and Electricity Reliability Act, MCL 460.10c.

Table of Contents

interests purchased in the Keystone and Conemaugh power plants on September 1, 2006.

The following table sets forth the MWh supplied to the electricity supply business segment customers.

Third Quarter	MWh Supplied (In Thousands)		
	2006	2005	Change
<b>Retail:</b>			
Duquesne Light	1,803	1,860	(3.1%)
DLE	549	301	82.4%
<b>Total Retail</b>	<b>2,352</b>	<b>2,161</b>	<b>8.8%</b>
<b>Wholesale:</b>			
Duquesne Light	10	4	
Generation	72	—	
<b>Total Wholesale</b>	<b>82</b>	<b>4</b>	

Operating expenses increased \$29.1 million, or 25.6%, compared to the third quarter of 2005. During the third quarter of 2006, purchased power expense included a net \$20.3 million increase over the same period in 2005 related to the change in fair value of certain derivative energy contracts and increased purchased power expense as a result of the increase in MWh supplied at current market rates. Operating expenses for the third quarter of 2006 also include \$1.5 million of fuel and other operating expenses incurred from the interests purchased in the Keystone and Conemaugh power plants on September 1, 2006.

Depreciation and amortization expense in the third quarter of 2006 represents the depreciation and amortization associated with the interests purchased in the Keystone and Conemaugh power plants discussed above.

Nine months ended September 30, 2006. The following table summarizes the income from this segment.

First Nine Months	Earnings (In Millions)	
	2006	2005
Electricity Supply	\$ 22.7	\$ 13.8
Derivative energy contracts	(11.1)	13.1
<b>Net income</b>	<b>\$ 11.6</b>	<b>\$ 26.9</b>

Operating revenues increased \$28.9 million, or 8.3% in the first nine months of 2006. There was a \$43.7 million increase in the revenue recognized by DLE and the \$2.5 million in wholesale revenue generated from the interests purchased in the power plants discussed above. These increases were partially offset by the \$16.4 million decrease in Duquesne Light's retail sales from the first nine months of 2005 as previously discussed.

The following table sets forth the MWh supplied to the electricity supply business segment customers.

MWh Supplied (In Thousands)
--------------------------------

First Nine Months	2006	2005	Change
<b>Retail</b>			
Duquesne Light	4,730	5,391	(12.3%)
DLE	1,346	1,639	(10.6%)
<b>Total Retail</b>	<b>6,076</b>	<b>6,030</b>	<b>0.8%</b>
<b>Wholesale</b>			
Duquesne Light	46	47	
<b>Generation</b>	<b>72</b>		
<b>Total Wholesale</b>	<b>118</b>	<b>47</b>	

Operating expenses increased \$54.2 million, or 18.0%, compared to the first nine months of 2005. During the first nine months of 2006, purchased power expense reflected a net \$41.5 million increase over the same period in 2005 related to the change in the fair value of certain derivative energy contracts and increased purchased power expense as a result of the increase in MWh supplied at current market rates. Operating expenses also include the \$1.5 million in fuel and other operating expenses incurred from the interests purchased in the power plants discussed above.

*Energy Solutions Business Segment.*

Three months ended September 30, 2006. This segment reported income of \$5.1 million in the third quarter of 2006, compared to \$19.1 million in the third quarter of 2005, a decrease of \$14.0 million, or 73.3%. This is primarily due to a 2005 after-tax gain of \$11.7 million on the sale of an investment in a energy facility management project and a \$3.4 million decrease in earnings from the management of synthetic fuel facilities.

Operating revenues decreased \$4.0 million, or 18.4%, compared to 2005. This was primarily due to a \$4.3 million decrease in revenue from the synthetic fuel facilities related to production and price concessions.

Other income decreased \$18.4 million, or 98.9%, compared to 2005 primarily as a result of the \$18

Duquesne Light Company and  
DQE Communications Network Services LLC  
Docket No. A-110150F0035 and A-311233F0002

STRATEGIC- 1-3  
Sponsor: John Howells  
Page 1 of 1

**RESPONSES TO STRATEGIC ENERGY  
INTERROGATORIES – SET I**

- 3 Please provide the total number of employees employed by the Duquesne Companies. Please provide a breakdown of the number employed by each affiliate or subsidiary company, specifically including the number employed by Duquesne Light Energy, Duquesne Light Company, Duquesne Power and DLH.

**RESPONSE:** See attached. Please also see response to Strategic 1-4.



[REDACTED]

Overview

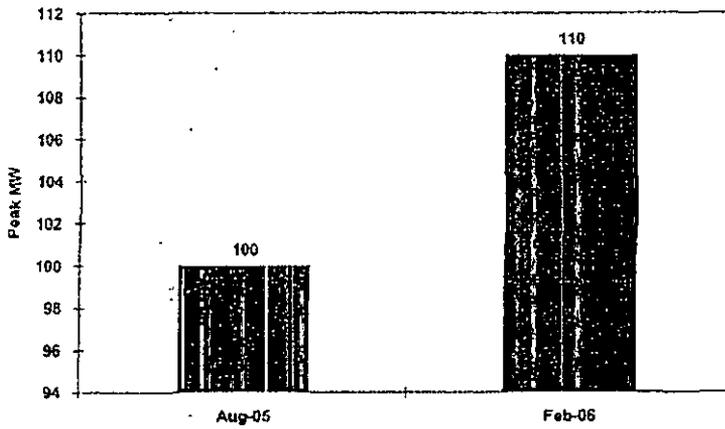
- Offices
  - Headquarters: [REDACTED]
  - Additional Offices: [REDACTED]
- Customers Targeted: commercial and industrial
- State(s) of Operation:
  - Electric: IL, MD

Market Share

- Non-Residential Peak Load: 110 MW<sup>17</sup>

Figure 2- 5

[REDACTED] Non-Residential Peak MW Load, 2005-2006



<sup>17</sup> Kema Estimate, Feb. 2006.

Table of Contents

interests purchased in the Keystone and Conemaugh power plants on September 1, 2006.

The following table sets forth the MWh supplied to the electricity supply business segment customers.

Third Quarter	MWh Supplied (In Thousands)		
	2006	2005	Change
<b>Retail:</b>			
Duquesne Light	1,803	1,860	(3.1%)
DLE	549	301	82.4%
<b>Total Retail</b>	<b>2,352</b>	<b>2,161</b>	<b>8.8%</b>
<b>Wholesale:</b>			
Duquesne Light	10	4	
Generation	72		
<b>Total Wholesale</b>	<b>82</b>	<b>4</b>	

Operating expenses increased \$29.1 million, or 25.6%, compared to the third quarter of 2005. During the third quarter of 2006, purchased power expense included a net \$20.3 million increase over the same period in 2005 related to the change in fair value of certain derivative energy contracts and increased purchased power expense as a result of the increase in MWh supplied at current market rates. Operating expenses for the third quarter of 2006 also include \$1.5 million of fuel and other operating expenses incurred from the interests purchased in the Keystone and Conemaugh power plants on September 1, 2006.

Depreciation and amortization expense in the third quarter of 2006 represents the depreciation and amortization associated with the interests purchased in the Keystone and Conemaugh power plants discussed above.

Nine months ended September 30, 2006. The following table summarizes the income from this segment.

First Nine Months	Earnings (In Millions)	
	2006	2005
Electricity Supply	\$ 22.7	\$ 13.8
Derivative energy contracts	(11.1)	13.1
<b>Net income</b>	<b>\$ 11.6</b>	<b>\$ 26.9</b>

Operating revenues increased \$28.9 million, or 8.3% in the first nine months of 2006. There was a \$43.7 million increase in the revenue recognized by DLE and the \$2.5 million in wholesale revenue generated from the interests purchased in the power plants discussed above. These increases were partially offset by the \$16.4 million decrease in Duquesne Light's retail sales from the first nine months of 2005 as previously discussed.

The following table sets forth the MWh supplied to the electricity supply business segment customers.

MWh Supplied (In Thousands)
--------------------------------

First Nine Months	2006	2005	Change
<b>Retail:</b>			
Duquesne Light	4,730	5,391	(12.3%)
DLE	1,346	1,639	(10.6%)
<b>Total Retail</b>	<b>6,076</b>	<b>6,030</b>	<b>0.8%</b>
<b>Wholesale:</b>			
Duquesne Light	46	47	
Generation	72		
<b>Total Wholesale</b>	<b>118</b>	<b>47</b>	

Operating expenses increased \$54.2 million, or 18.0%, compared to the first nine months of 2005. During the first nine months of 2006, purchased power expense reflected a net \$41.5 million increase over the same period in 2005 related to the change in the fair value of certain derivative energy contracts and increased purchased power expense as a result of the increase in MWh supplied at current market rates. Operating expenses also include the \$1.5 million in fuel and other operating expenses incurred from the interests purchased in the power plants discussed above.

#### *Energy Solutions Business Segment.*

Three months ended September 30, 2006. This segment reported income of \$5.1 million in the third quarter of 2006, compared to \$19.1 million in the third quarter of 2005, a decrease of \$14.0 million, or 73.3%. This is primarily due to a 2005 after-tax gain of \$11.7 million on the sale of an investment in a energy facility management project and a \$3.4 million decrease in earnings from the management of synthetic fuel facilities.

Operating revenues decreased \$4.0 million, or 18.4%, compared to 2005. This was primarily due to a \$4.3 million decrease in revenue from the synthetic fuel facilities related to production and price concessions.

Other income decreased \$18.4 million, or 98.9%, compared to 2005 primarily as a result of the \$18

Duquesne Light Company and  
DQE Communications Network Services LLC  
Docket No. A-110150F0035 and A-311233F0002

STRATEGIC- 1-4  
Sponsor: Susan Betta  
Page 1 of 2

**RESPONSES TO STRATEGIC ENERGY  
INTERROGATORIES – SET I**

4. Please indicate the number of employees whose time, duties and/or responsibilities are shared between Duquesne Light Energy, and any other of the Duquesne Companies. For those employees whose time, duties and/or responsibilities are shared between Duquesne Light Energy and any other Duquesne Company, please provide a description of the role and function the employee serves for each Duquesne Company and an estimation of time allocated to each Duquesne Company.

**RESPONSE:**

The following page provides the number of employees whose time is shared between Duquesne Light Company (DLC) and Duquesne Light Energy (DLE), as only DLC and DLE employees provide services to DLE. In addition, it also shows additional budgeted charges that are allocated to DLE from DLC, including rent, finance charges, and information technology (IT) related charges.

For some individuals who do not perform a daily function that is directly related to an affiliate, but rather perform general oversight functions, they allocate their time out of DLC to the parent company, Duquesne Light Holdings (DLH). Those charges are captured at DLH, and have not typically been re-allocated to the various affiliates, such as DLE, but stay at the holding company level. Therefore there are additional employees who do provide minor amounts of services to DLE beyond what is shown in the attachment. Those charges to DLH are about \$925,000 for 2006.

	Duq. Light Energy %	\$\$\$
<b>Legal</b>		
Director Legal	3%	5,190
Assistant General Counsel	5%	6,641
Assistant General Counsel	3%	4,486
Assistant General Counsel	3%	4,597
		20,915
<b>Corporate Secretary</b>		
Corporate Secretary	2%	3,435
Corporate Records Analyst	3%	2,266
Executive Assistant	1%	546
		6,247
<b>Human Resources</b>		
Director Human Resources	1%	1,897
Manager Human Resources	5%	5,914
		7,810
<b>Finance</b>		
Manager Tax Accounting	1%	669
Tax Specialist	1%	404
Lead Tax Coordinator	1%	501
Staff Accountant	5%	3,085
Coordinator, Accounts Payable	5%	3,016
Supervisor, Disbursements	3%	2,771
Payroll Analyst	10%	6,649
Manager, Disbursements	2%	2,265
Manager, Structured Finance	5%	6,515
Manager Treasury Operations	1%	1,522
Sr. Financial Consul	1%	966
Sr. Financial Consul	1%	980
Sr. Accountant	40%	27,420
Assistant Controller	5%	6,987
		63,752
<b>Corporate Development</b>		
Vice President Corporate Development	10%	34,034
Dir Corporate Development	70%	116,779
		150,813
<b>Susidiary Charges</b>		
<b>IT</b>		
Intel Server Analyst	0%	240
Enterprise Support Center Analyst	1%	1,064
Supplier & Regulatory Systems Support	3%	3,000
EDI Transaction Processing		500
Software Infrastructure		242
Hardware Infrastructure		340
Voice & Data (Ongoing Monthly Charge)		1,000
		6,386
<b>Corporate Development</b>		
Rent	20%	15,784
		15,784
<b>Finance</b>		
Mellon		2,170
Misc.		307
		2,477
<b>Total</b>		<b>274,184</b>

Duquesne Light Company and  
DQE Communications Network Services LLC  
Docket No. A-110150F0035 and A-311233F0002

STRATEGIC- I-5  
Sponsor: John Howells

**RESPONSES TO STRATEGIC ENERGY  
INTERROGATORIES – SET I**

5. Please describe Duquesne Power's wholesale power supply procurement functions. Please indicate all DLH affiliate or subsidiary companies for which Duquesne Power performs any power procurement functions. Does Duquesne Power conduct wholesale power supply procurement for Duquesne Light Energy?

**RESPONSE:**

Duquesne Power has entered into a full requirements service agreement with Duquesne Light Company to serve POLR III supply at a fixed price. Duquesne Power is responsible for arranging for supply, scheduling the delivery of energy and managing the risk associated with POLR service.

Duquesne Power and Duquesne Light Energy have entered into a Master Power Purchase and Sale Agreement that governs wholesale power supply.

Duquesne Light Company and  
DQE Communications Network Services LLC  
Docket No. A-110150F0035 and A-311233F0002

STRATEGIC- 1-7  
Sponsor: John Howells

**RESPONSES TO STRATEGIC ENERGY  
INTERROGATORIES – SET I**

7. Please indicate whether DLH, Duquesne Power, or Duquesne Light Company perform any sales, marketing, forecasting, customer service, power procurement, or other support functions related to the provision of unregulated generation supply service to customers of Duquesne Light Energy. If yes, please provide a detailed description of the functions provided on behalf of Duquesne Light Energy.

**RESPONSE:**

Duquesne Light Energy does not receive sales, marketing, forecasting, customer service, or power procurement related to the provision of unregulated generation supply service from any of the Duquesne companies. Rather than have Duquesne Power act as an agent to procure power for Duquesne Light Energy, Duquesne Light Energy has a full requirements supply agreement with Duquesne Power to serve its customer load obligation. Duquesne Power manages this full requirements load obligation independent of Duquesne Light Energy. Other support functions are charged pursuant to the Administrative Services Agreement approved by the PUC. Please see response to Strategic 1-4 for further detail on those charges.

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

SURREBUTTAL TESTIMONY OF  
RICHARD J. HUDSON JR.

On Behalf of Strategic Energy, LLC and  
The Retail Energy Supply Association

Application of Duquesne Light Company and DQE Communications Network  
Services, LLC For Certificates of Public Convenience Under Section 1102(a)(3) of the  
Public Utility Code Approving the Acquisition of Duquesne Light Holdings, Inc. by Merger

Docket Nos. A-110150F0035 and A-311233F3002

January 23, 2007

RECEIVED  
2007 FEB 27 PM 3:25  
PA PUC  
SECRETARY'S BUREAU

1 Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND BUSINESS  
2 RESPONSIBILITIES.

3 A. My name is Richard J. Hudson Jr. I am the Market Manager-Regulatory Affairs  
4 for Strategic Energy, LLC ("Strategic" or "Strategic Energy"). My business  
5 address is 2 Gateway Center, Pittsburgh, Pennsylvania, 15222. My  
6 responsibilities include managing the regulatory activities of Strategic Energy in  
7 the Commonwealth of Pennsylvania.

8 Q. ARE YOU THE SAME RICHARD HUDSON WHO PREVIOUSLY  
9 SUBMITTED DIRECT TESTIMONY IN THIS MATTER ON BEHALF OF  
10 STRATEGIC ENERGY AND THE RETAIL ENERGY SUPPLY  
11 ASSOCIATION?

12 Yes.

13 Q. ON WHOSE BEHALF ARE YOU PROVIDING THIS SURREBUTTAL  
14 TESTIMONY?

15 A. I am testifying again on behalf of Strategic Energy and RESA.<sup>1</sup>

16 Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

17 A. In my surrebuttal testimony, I respond to the rebuttal testimony of Duquesne  
18 Light Company/Macquarie Consortium ("Duquesne/Macquarie") witnesses Neil  
19 S. Fisher, Morgan K. O'Brien, Christopher J. Leslie and Susan S. Betta.

20 Q. PLEASE SUMMARIZE YOUR DIRECT TESTIMONY SUBMITTED IN  
21 THIS PROCEEDING.

22 A. In my direct testimony, I describe the concerns of Strategic and RESA that the  
23 proposed acquisition is likely to result in anticompetitive effects that will prevent  
24 retail electricity customers from obtaining the benefits of a properly functioning

---

<sup>1</sup> RESA member companies include Consolidated Edison Solutions, Inc.; Direct Energy Services, LLC; Hess Corporation; Reliant Energy Retail Services, LLC; Sempra Energy Solutions; Strategic Energy, LLC; SUEZ Energy Resources, NA, Inc.; and U.S. Energy Savings Corporation. The opinions expressed in this filing may not represent the views of all members of RESA.

1 and workable competitive retail electricity market. My direct testimony describes  
2 three areas of concern: 1) the proposed transaction will facilitate or exacerbate  
3 the direct or indirect subsidization of DLE by other Duquesne companies; 2) the  
4 proposed transaction creates a stronger incentive for Duquesne to submit a POLR  
5 IV plan that is not in the best interest of promoting a competitive market in the  
6 Duquesne service territory; and 3) the proposed economic development rate  
7 program, if not properly implemented in a competitively neutral fashion, may  
8 frustrate competitive supplier's ability to compete for new industrial load in the  
9 Duquesne service territory.

10 **I. RESPONSE TO REBUTTAL TESTIMONY OF NEIL S. FISHER**

11 **Q. WHAT IS YOUR RESPONSE TO MR. FISHER'S ARGUMENTS THAT**  
12 **STRATEGIC'S AND RESA'S CLAIMS ARE UNSUPPORTED AND**  
13 **BASED ON SPECULATION?**

14 **A.** Mr. Fisher's assessment that our claims regarding the potential cross-  
15 subsidization of DLE are unsupported and without merit ignores the record  
16 evidence and his own statements, which raise significant concerns regarding the  
17 appropriateness of DLE's arrangements and relationships with other Duquesne  
18 companies. In attempting to justify how DLE is able to operate as an electric  
19 generation supplier ("EGS") and fulfill a substantial load obligation with as few as  
20 five employees, Mr. Fisher admits that DLE outsources many of the functions it  
21 needs to operate to other Duquesne companies.<sup>2</sup> Mr. Fisher states that "DLE is  
22 provided legal and administrative services from other DLH companies" and that  
23 "DLE outsources a significant portion of its supply portfolio management

---

<sup>2</sup> *DLC St. No. 6R (Fisher) at 7, lines 2-5.*

1 activities (including planning, procuring, scheduling, and hedging) and has  
2 contracted with DP for full requirements supply.”

3 Mr. Fisher explicitly acknowledges that if other Duquesne companies did  
4 not provide these functions for DLE, DLE would be “responsible for managing  
5 these obligations and risks, and would *require* more in-house employees to do so.”  
6 Admittedly, a retail supplier could legitimately operate by outsourcing many  
7 portfolio management and other business functions to other parties. However, as  
8 discussed in more detail in my response to Ms. Betta’s testimony, the fact that  
9 DLE appears to be outsourcing every essential business operation and function  
10 (except for sales and marketing) to an affiliate raises a very reasonable concern as  
11 to whether DLE is actually compensating its affiliates for the true market value of  
12 the services and the benefits it receives.<sup>3</sup> Under Duquesne’s view, compensation  
13 is a loose term. As shown below, Ms. Betta attempts to show that DLE is not  
14 subsidized by its affiliates, but she sets forth no evidence of “true” compensation  
15 for the value of such services, employees and benefits, focusing entirely on “costs  
16 incurred” rather than more expansively examining whether DLE receives indirect  
17 or implicit benefits from its affiliate relationships.

18 Finally, I must point out that Mr. Fisher’s argument is replete with  
19 statements about what is “possible” that DLE does or what DLE “could” be doing

---

<sup>3</sup> As discussed later in my response to Ms. Betta’s rebuttal testimony, Duquesne appears to have a history of affiliate cost allocation issues and, although it currently has affiliate cost allocation procedures in place, there appears to be no mechanism to account for the indirect benefits that DLE receives from the services provided by other affiliates, such as Duquesne Power.

1 to justify how DLE operates with only five employees.<sup>4</sup> Such conjecture provides  
2 no support for Mr. Fisher's argument.

3 **Q. PLEASE RESPOND TO MR. FISHER'S STATEMENT THAT "DLE**  
4 **RECEIVES NO UNFAIR ADVANTAGE BECAUSE DP PROVIDES POLR**  
5 **SUPPLY TO DUQUESNE."**

6 A. In my direct testimony I pointed out that because Duquesne Power manages  
7 DLE's load obligations along with DLC's POLR load, DLE benefits from  
8 economies of scale and other efficiencies achieved by Duquesne Power's  
9 combining DLE's load with DLC's POLR load. Mr. Fisher's criticism of my  
10 testimony on this point shows that he appears to have misunderstood my  
11 statements. Mr. Fisher also appears to ignore the obligations with respect to  
12 affiliate relationships imposed by the Public Utility Code on Duquesne as a public  
13 utility, and the scope of the PUC's merger review authority, as both have been  
14 explained to me by counsel.

15 I agree with Mr. Fisher that many wholesale suppliers, not just Duquesne  
16 Power, achieve economies of scale and scope, and that DLE's competitors are  
17 free to contract with wholesale suppliers that may have built economies of scale  
18 and scope through existing supply arrangements. However, no other entity in the  
19 Duquesne market is able to achieve the same or similar economies of scale for  
20 power delivered into *the Duquesne service territory*. DLC's POLR load makes  
21 up 53% of the total load within Duquesne's service territory.<sup>5</sup> Including DLE's  
22 load notably increases the Duquesne companies' market share. Thus, because of

---

<sup>4</sup> DLC St No. 6R (Fisher) at 7, lines 15-22.

<sup>5</sup> Based on the Pennsylvania Office of Consumer Advocates recent publication of customer shopping statistics available at:  
<http://www.oca.state.pa.us/Industry/Electric/elecstats/Stat0107.pdf>

1 its affiliate relationship with the dominant generation service provider in the  
2 control area (DLC), DLE obtains significant advantages - advantages that are not  
3 available to any of DLE's competitors. This clearly sets apart the DLE affiliate  
4 *relationship from any other participant in the Duquesne market.*

5 Furthermore, there are other areas in which DLE may receive an  
6 advantage due to Duquesne Power's joint management of its load with DLC's  
7 POLR load. As discussed in more detail in my responses to Ms. Betta's  
8 testimony, it is likely that DLE essentially receives a "free ride" with respect to  
9 power procurement functions that are likely paid for through DLC's POLR rates  
10 and/or distribution rates.

11 Mr. Fisher's assumption that DLE could not possibly be subsidized  
12 through the DP/DLC full requirements POLR supply contract developed in 2003  
13 because "DLE did not even exist" in 2003 belies full knowledge of DLE's history.  
14 The Commission's records establish that: 1) DLE, then named "ValuSource  
15 Energy Services, LLC," was licensed by the PUC on September 13, 2000 at  
16 Docket No. A-110142; 2) ValuSource was wholly-owned by Monongahela Light  
17 & Power Company, which in turn was wholly-owned by DLC; 3) ValuSource on  
18 June 30, 2004, prior to the Commission's POLR III Order on August 2004,  
19 requested that the name on its license be changed to "Duquesne Light Energy,  
20 LLC"; and 4) the PUC approved that request by Secretarial Letter dated  
21 September 2, 2004. A copy of this Secretarial Letter is attached.<sup>6</sup>

---

<sup>6</sup> SE/RESA Exhibit RH-11.

1 Even if no DLE-related costs were considered in the development of the  
2 DP/Duquesne POLR supply contract, this does not mean that DP is not  
3 subsidizing DLE. As noted in my response to Ms. Betta's testimony, all of DP's  
4 upfront costs for power procurement and portfolio management functions may be  
5 recovered through DLC's POLR rates, and DLEs use of these services is provide  
6 for free.

7 And, while FERC did grant a waiver to DP of the prohibition on sales to  
8 affiliates as Ms. Betta states, in that proceeding Duquesne told FERC that the  
9 affiliate sale "is not actually a sale but a corporate structure designed to insulate  
10 [DLC's retail] ratepayers from the risks undertaken by Duquesne Power."<sup>7</sup>  
11 Because DP is providing supply to DLE under the same type of full requirements  
12 contract as with DLC, DLE is also insulated from bearing the full risk and  
13 associated costs of meeting its load obligation.

14 Finally, Mr. Fisher's argument that other suppliers may achieve similar  
15 economies of scale, wholly ignores the fact that the Public Utility Code  
16 limitations on DLC's conduct and relationships with its affiliates due to its  
17 monopoly retail position are not at all applicable to non-public utilities such as  
18 Strategic Energy (and its affiliates) or other RESA members and their affiliates  
19 operating in Pennsylvania.

20 **Q. WHAT IS YOUR RESPONSE TO MR. FISHER'S ARGUMENT THAT**  
21 **DLE HAS NO COMPETITIVE ADVANTAGE DUE TO CREDIT**  
22 **SUPPORT IT RECEIVES?**

---

<sup>7</sup> FERC Order Authorizing Disposition of Jurisdictional Facilities and Accepting Market Based Rate Tariff, Docket No. EC04-36-000, August 6, 2004 ("FERC 8/04 Order"). ¶ 34.

1 A. Mr. Fisher goes to great lengths to try to demonstrate that other competitive  
2 suppliers also receive credit support from their parent companies. Mr. Fisher  
3 even notes that Strategic receives support from its parent, Great Plains Energy.  
4 However, Mr. Fisher wholly ignores record evidence that indicates that Strategic  
5 compensates its parent for the credits support it receives.<sup>8</sup> As noted in RESA's  
6 responses to Duquesne's interrogatories to RESA in this proceeding, Strategic:

7 "In addition to an annual capacity payment to cover the maximum amount  
8 of credit support available, Strategic Energy reimburses GPE for all of the  
9 direct costs related to credit instruments issued by third parties for  
10 Strategic Energy."

11  
12 Currently there is no record evidence to demonstrate that DLE compensates DLH  
13 for the direct credit support it receives or for the value of the credit support  
14 provided for Duquesne Power that ultimately supports DLE's load service  
15 obligations.<sup>9</sup> This value includes relieving DLE of the need to post credit to  
16 counter-parties. Moreover, Mr. Fisher's comparison of the credit support received  
17 by competitive suppliers with parent companies in other service territories to the  
18 credit support received by DLE for its operations in its public utility affiliate's  
19 monopoly service territory is an apples-to-oranges comparison. This is an attempt  
20 to turn the scrutiny away from the true conduct at issue, and it ignores the fact  
21 that, as stated above, Duquesne and its affiliates are subject to different

---

<sup>8</sup> See, SE/RESA Exhibit RH-3 (Surrebuttal Testimony of R. Carrier from Docket No. R-00061346) attached to my direct testimony.

<sup>9</sup> Ms. Betta's rebuttal testimony states: "A portion of the fees associated with DLH's revolving credit agreement is allocated to the affiliates, who benefit from its availability." DLC St. No. 5R at 7, lines 17-18. Notably absent from Ms. Betta's testimony are any statements explicitly indicating that DLE compensates DLH or its affiliates for the credit support it receives, or for the value of the credit support provided to Duquesne Power that ultimately supports DLE's load obligation.

1 requirements in Duquesne's service territory than is Strategic, or other retail  
2 suppliers, who do not have the dominant market share and is not serving in its  
3 public utility affiliate's territory.

4 **Q. PLEASE RESPOND TO MR. FISHER'S ARGUMENT THAT THE**  
5 **POTENTIAL ANTICOMPETITIVE EFFECTS DISCUSSED IN THE**  
6 **STRATEGIC/RESA DIRECT TESTIMONY ARE UNRELATED TO THIS**  
7 **PROCEEDING.**

8 A. Mr. Fisher essentially argues that the issues presented in my direct testimony  
9 regarding the exploitation of the Duquesne companies' cross-subsidization of  
10 DLE, and Duquesne/Macquarie's incentive (and apparent intention) to propose an  
11 anticompetitive POLR plan, should not be addressed in this proceeding because  
12 such anticompetitive effects would exist regardless of the proposed merger.

13 First, Mr. Fisher ignores the fact that Duquesne/Macquarie will have a  
14 significant incentive to maximize profits from all possible sources, including  
15 Duquesne's generation services, in order to seek to enhance Macquarie's  
16 substantial investment in Duquesne.

17 Second, the issues discussed in my direct testimony are entirely relevant to  
18 this proceeding. As discussed in my direct testimony, I understand that under  
19 Electric Competition Act, the Commission must find that a merger proposal must  
20 not result in anticompetitive effects that will prevent retail electricity customers  
21 from obtaining the benefits of a properly functioning and workable competitive  
22 retail electricity market. Even under Mr. Fisher's assessment that any  
23 anticompetitive effects would exist regardless of the approval of the merger, the  
24 fact remains that if DLE is being subsidized by its affiliates and  
25 Duquesne/Macquarie intends to submit an anticompetitive POLR plan, the

1 proposed merger transaction is predicated either intentionally or unintentionally  
2 on the existence and/or persistence of these anticompetitive effects. Even if  
3 Duquesne intended to continue these anticompetitive effects regardless of the  
4 merger, the merger provides even more incentive for Duquesne to do so because it  
5 now must produce the returns built into the acquisition price and expected by  
6 Macquarie.

7 Third, even assuming *arguendo* that Mr. Fisher is correct that the issues  
8 presented in my direct testimony are entirely unrelated to this proceeding, it is  
9 very surprising that Mr. Fisher would suggest that the Commission turn a blind  
10 eye to such anticompetitive behavior merely for procedural correctness. The  
11 arguments of all the other Duquesne witnesses is that, without this transaction,  
12 Duquesne is likely to be a very different company in future years.<sup>10</sup> This  
13 transaction that preserves present anti-competitive activities plainly deserves  
14 careful review under the PUC's merger review authority, in my opinion.

15 **II. RESPONSE TO REBUTTAL TESTIMONY OF SUSAN S. BETTA**

16  
17 **Q. DO YOU AGREE WITH MS. BETTA'S ASSERTION THAT THE**  
18 **DUQUESNE COMPANIES PROPERLY ALLOCATE COSTS?**

19 A. No. Ms. Betta's testimony essentially argues that because Duquesne has procedures  
20 in place to allocate costs among the various Duquesne companies, then there must  
21 not be any inappropriate cost allocation occurring. In fact, there are several ways  
22 in which Duquesne is likely not accurately allocating to DLE the costs and/or fair

---

<sup>10</sup> See, e.g., DLC St. No. 1R (O'Brien) at 7, lines 9-23; 8, lines 12-24; 9, lines 15-21.

1 market value of the services and benefits provided to it by other Duquesne  
2 companies.

3 It appears that DLE does not compensate its affiliates for all of the costs  
4 and/or full market value of the credit support, portfolio management, power  
5 procurement, and other business functions provided by other Duquesne  
6 companies. Based on Ms. Betta's testimony it appears to be Duquesne's policy to  
7 allocate costs out to an affiliate only when there is an incremental or specifically  
8 incurred cost associated with the provision of service for an affiliate. Specifically  
9 with respect to credit support, Ms. Betta states that Duquesne does not allocate  
10 costs to affiliates for the use of parental guarantees because, "since there is no  
11 specifically incurred cost related to the issuance of this guarantee, no cost  
12 allocation is appropriate."<sup>11</sup> Yet Ms. Betta does not deny my testimony that there  
13 is clearly a value and benefit to DLE associated with such guarantees, and her  
14 statement ignores the real cost in such guarantees – the opportunity cost of tying  
15 up the capital required to post the parental guarantee.

16 There is a similar concern with respect to credit support provided for  
17 Duquesne Power that ultimately supports DLE's load service obligations. Ms.  
18 Betta's testimony indicates that costs associated with the issuance of letters of  
19 credit and surety bonds, as well as a portion of the cost of DLH's revolving credit  
20 facility, are allocated to affiliates that receive this credit support. However, this  
21 allocation procedure most likely does not allocate costs for credit support to  
22 affiliates, like DLE, that indirectly benefit from such credit support.

---

<sup>11</sup> DLC St. No. 5R (Betta) at 7, lines 17-20.

1           There is also a similar concern for the costs associated with the power  
2 procurement and portfolio management functions that Duquesne Power performs  
3 for both DLC and DLE. First, it is important to note that since Duquesne Power  
4 only has two (2) employees itself, it is unclear who actually performs the portfolio  
5 management activities (scheduling, hedging, forecasting, etc.,) that it does for  
6 DLE and DLC. As most employees in the Duquesne companies are within DLC,  
7 it appears that DLC employees perform these functions. However, it is evident  
8 that, no matter which Duquesne company actually performs these functions, these  
9 functions are done jointly for both DLE and DLC. It is likely that DLC's POLR  
10 rates cover all of the upfront costs of Duquesne Power's provision or arrangement  
11 of these power procurement functions because DLE is not allocated any portion of  
12 these power procurement costs. As Duquesne Power only has two employees, it  
13 is highly unlikely that it is performing all of these functions itself.

14           Duquesne Power may be outsourcing these functions to a wholesale  
15 counterparty, to DLC, or to another entity, but because Duquesne Power's full  
16 requirements agreement for DLC's POLR load was established *prior* to DLE's  
17 agreement with Duquesne Power, it is likely that all of the costs associated with  
18 the provision of these portfolio management services are recovered through  
19 DLC's POLR rates.<sup>12</sup> While there may be no incremental cost incurred by  
20 Duquesne Power to also provide these power procurement functions for DLE's

---

<sup>12</sup> If these power procurement services are ultimately being performed by DLC employees, then DLC's distribution rates are recovering the costs of (and unlawfully subsidizing) DLE's portfolio management functions.

1 load, there are very real benefits and value to DLE by the provision of these  
2 services for DLE, as explained above.

3 As discussed above, DLE outsources a substantial amount of its business  
4 functions to its affiliates. If DLE were outsourcing power procurement and other  
5 business functions to a non-affiliate, there would be less concern because a non-  
6 affiliate has the appropriate business incentive to price those services, functions  
7 and benefits at their true market value. As noted in my direct testimony and not  
8 rebutted by the Duquesne witnesses, there exists an inherent profit maximization  
9 motive than can lead to direct or indirect cross-subsidization and/or cost shifting  
10 between regulated utilities and their unregulated marketing affiliates.<sup>13</sup> It is not  
11 Strategic's or RESA's position that affiliate transactions necessarily result in  
12 cross-subsidies. However, in this situation, where DLE's affiliates perform  
13 essentially all necessary business functions for DLE's service in DLC's service  
14 territory (except for sales and marketing), there are substantially more  
15 opportunities and incentives for inappropriate cross-subsidies and affiliate  
16 arrangements to occur.

17 **Q. DO THE FERC AND PA PUC AUDITS SUPPORT MS. BETTA'S**  
18 **CONCLUSION THAT FERC AND THE PA PUC FOUND NO**  
19 **INSTANCES OF CROSS-SUBSIDIZATION WITH RESPECT TO RETAIL**  
20 **COMPETITION?**

21 **A.** No. The FERC audit cannot be verified because the final audit report is not  
22 available but, regardless, as explained below, FERC's cross-subsidization inquiry  
23 is narrowly focused and does not address the effects of cross-subsidization on

---

<sup>13</sup> "An economic analysis of marketing affiliates in a deregulated electric power industry" by Jason Abel for the National Regulatory Research Institute; this document is available at: <http://www.nrri.ohio-state.edu/dspace/bitstream/2068/565/1/98-07.pdf>.

1 retail competition. According to FERC's August 2004 order granting DP market  
2 based rate authority, FERC has allowed sales by a power marketer to its affiliated  
3 public utility (and has waived code of conduct requirements) when there are no  
4 captive wholesale customers and when retail ratepayers are protected by a rate  
5 freeze or the availability of retail choice.<sup>14</sup> And, as FERC stated in its December  
6 2006 order authorizing the merger (and as I note below), whether retail customers  
7 are actually protected by the availability of retail choice is an issue for the  
8 respective state commission.

9 The PUC audit is not an effective evaluation of DLH's current affiliate  
10 relationships. Most of the information reviewed in the audit is for earlier periods  
11 before (even as DLC's witnesses state) DLE had significant operations.  
12 Therefore the PUC could not possibly have reached any conclusions regarding the  
13 cross-subsidization and affiliate relationship concerns presented in my direct  
14 testimony. Also, DLH's corporate family has changed dramatically since then, as  
15 the description of the Duquesne companies in the FERC orders referenced by  
16 DLC demonstrates.<sup>15</sup> Even in the report, the audit noted serious concerns  
17 regarding DLC's affiliate relationships -- "Affiliate Relationships" are rated as  
18 "Significant Improvement Necessary." And currently Ms. Betta's rebuttal

---

<sup>14</sup> FERC 8/04 Order, ¶ 39. I also note that in this order, FERC expressed increased concern with the potential adverse impact affiliate transactions may have on wholesale customers and wholesale competition, and FERC initiated a generic rulemaking to address these concerns. *Id.*, ¶ 41.

<sup>15</sup> For example, in the August 2004 FERC Order granting market based rate authority to Duquesne Power, the Sunbury generation station is owned by Duquesne Power. FERC 8/04 Order, ¶s 18, 34. In FERC's December 2006 Order authorizing the Duquesne Macquarie merger, the Sunbury generation station is owned by Duquesne Keystone, LLC, which is owned by Duquesne Generation Company. FERC Order Authorizing Merger, Docket No. EC06-160-000 ("FERC 12/06 Order"), ¶s 1 n. 1; 2 n. 8; 3.

1 testimony admits there are problems with Duquesne's present cost allocation  
2 methods.

3 The FERC approval of the merger contemplates PA PUC review of these  
4 issues in this proceeding because FERC essentially deferred to the PUC on cross-  
5 subsidy issues. FERC's order noted that the PA PUC has the authority to approve  
6 mergers and review cross-subsidization and affiliate abuse concerns, and that any  
7 ratepayer protections FERC would impose would "complement, and not nullify,  
8 those imposed by state commissions." FERC's order essentially deferred the  
9 issue to the PA PUC because Pennsylvania is a retail choice state and there are no  
10 captive (as defined by FERC) retail customers for FERC to protect from affiliate  
11 abuse concerns. In rejecting the argument that Duquesne's Retail customers are  
12 effectually "captive" and therefore at high risk for cross-subsidization abuses,  
13 FERC expressly stated that "it is not the role of this Commission to evaluate the  
14 success or failure of a state's retail choice program."<sup>16</sup> Therefore, it is clear that  
15 FERC deferred to the PA PUC's authority on this issue.

16 **Q. WHAT IS YOUR RESPONSE TO THE RECOMMENDATIONS OF MS.**  
17 **BETTA AND MR. FISHER THAT THERE ARE NO AFFILIATE ABUSE**  
18 **OR CROSS- SUBSIDIZATION ISSUES TO ADDRESS IN THIS CASE?**

19 **A.** I disagree, as explained above, and recommend that to provide a level playing  
20 field for Duquesne's competitors to enable them to provide Duquesne's retail  
21 customers with the benefits of a properly functioning and workable competitive  
22 retail electricity market, we recommend that the Commission initiate an  
23 investigation into the relationships between and among the Duquesne companies

---

<sup>16</sup> FERC 12/06 Order, ¶ 38.

1 to determine the extent to which DLE's unregulated operations are being  
2 supported, either directly or indirectly, by other Duquesne companies, and in  
3 particular DLC and DP. The Commission should condition its approval of the  
4 proposed merger on the outcome of this investigation. Once these issues have  
5 been thoroughly evaluated, the Commission should choose from the following  
6 remedies: (i) requiring the structural and/or functional separation of DLE's  
7 operations from the other Duquesne companies; (ii) implementing stricter Code of  
8 Conduct rules; and (iii) requiring that DLE be barred from transacting with its  
9 affiliates, including Duquesne Power, for its wholesale power procurement.

10 **III. RESPONSE TO REBUTTAL TESTIMONY OF CHRISTOPHER J.**  
11 **LESLIE**

12  
13 **Q. PLEASE SUMMARIZE MR. LESLIE'S RESPONSE TO YOUR**  
14 **TESTIMONY.**

15 A. Mr. Leslie, who is an executive of the Macquarie Group, claims that because  
16 Duquesne/Macquarie is allegedly not anticipating increased profits from  
17 Duquesne's POLR service or DLE in the next few years, RESA's concerns are  
18 unfounded. Mr. Leslie did not understand my testimony. I pointed out that  
19 because the new Duquesne/Macquarie entity will have a need to try to realize a  
20 new, higher required return on its investment in order to make the transaction a  
21 success (in light of Macquarie's above book value purchase price), it will have an  
22 incentive to use its existing retail generation market power to increase its market  
23 share or profitability in the generation market.

24 Mr. Leslie has not presented any information that would relieve me of that  
25 concern. First, Macquarie's projections for POLR and DLE revenues may be  
26 higher than that which Duquesne **would** have realized without the merger, even if

1 they are lower than present levels, due to a Macquarie direction to Duquesne to  
2 exploit its dominant market position. Second, while Macquarie has not projected  
3 increased revenues from Duquesne's generation services, after it takes control of  
4 the Company its continuing need to meet its income targets could give it the  
5 incentive to consider ways to maintain or grow its profits from this part of  
6 Duquesne's business, including the exploitation of Duquesne's dominant retail  
7 generation market position and control of bottleneck facilities to expand its  
8 market share.

9 Finally, the use of anticompetitive behavior does not necessarily have to  
10 produce business growth or profit. Indeed, some techniques (such as pricing  
11 below true cost) could reduce profits in the short-term – but eliminate competitors  
12 and increase profitability of the dominant firm in the longer term. This is  
13 precisely why Mr. Leslie's statements of assurance, based upon Macquarie's  
14 revenue projections for the next 3-4 years, is not particularly relevant to the  
15 Commission's inquiry. Since the merger is proposed for the long-term, the  
16 Commission's inquiry should also look to the longer term potential  
17 anticompetitive effects.

#### 18 **IV. RESPONSE TO REBUTTAL TESTIMONY OF MORGAN K. O'BRIEN**

19 **Q. DO YOU SUPPORT MR. O'BRIEN'S COMMITMENT THAT THE**  
20 **ECONOMIC DEVELOPMENT PROGRAM WILL BE IMPLEMENTED**  
21 **IN A COMPETITIVELY NEUTRAL MANNER?**

22 **A.** Yes. Strategic and RESA are very encouraged by Mr. O'Brien's commitment that  
23 the economic development program be implemented in a competitively neutral

1 manner and that participation in the program will not be conditioned on  
2 customer's purchase of energy from Duquesne or DLE.

3 **Q. DO YOU HAVE ANY RECOMMENDATIONS AS TO HOW THE**  
4 **PROGRAM COULD BE IMPLEMENTED IN A COMPETITIVELY**  
5 **NEUTRAL MANNER?**

6 A. Yes. As noted in my direct testimony, one very simple way to make the  
7 economic development program competitively neutral would be for Duquesne to  
8 offer the discount on eligible customers' distribution rates or for Duquesne to sell  
9 its 50 MW block of power reserved for the program on the open market and use  
10 the proceeds to provide the rebates to eligible customers.

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

12 A. Yes.



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

SEPTEMBER 2, 2004

A-110142

MARTIN L RYAN  
DUQUESNE LIGHT ENERGY LLC  
MAIL DROP 8-2  
411 7<sup>TH</sup> AVENUE  
PITTSBURGH PA 15219

Re: Electric Generation Supplier Services License A-110142

Dear Mr. Ryan:

On September 13, 2000, the Commission issued a license at Docket No. A-110142, authorizing ValuSource Energy Services, LLC the right to begin to offer, render, furnish, or supply electric generation supplier services to commercial, industrial and governmental customers within the Commonwealth of Pennsylvania.

On June 30, 2004, ValuSource Energy Services, LLC filed a request that the Commission change the name on its license to provide electric generation supplier services from ValuSource Energy Services, LLC to Duquesne Light Energy, LLC.

Duquesne Light Energy, LLC has provided proper documentation as required by this Commission.

Therefore, the Commission approves, by this Secretarial Letter, the change of ValuSource Energy Services, LLC's name on its license for the provision of electric generation supplier services to commercial, industrial and governmental customers within the Commonwealth of Pennsylvania at Docket No. A-110142 to Duquesne Light Energy, LLC.

Sincerely,

James J. McNulty  
Secretary

**LICENSE ENCLOSED**

cc: Kerry Klinefelter, Bureau of Fixed Utility Services  
Scott Rhodes, Secretary's Bureau

**OSBA STATEMENT NO. 1**

**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Application of Duquesne Light Company for a Certificate of Public Convenience Under Section 1102(a)(3) of the Public Utility Code Approving the Acquisition of Duquesne Light Holdings, Inc. By Merger	:	:	Docket No. A-110150F0035
Application of DQE Communications Network Services LLC for a Certificate of Public Convenience Under Section 1102(a)(3) of the Public Utility Code Approving the Acquisition of Duquesne Light Holdings, Inc. By Merger	:	:	Docket No. A-311233F0002

**Direct Testimony of**

**BRIAN KALCIC**

**On Behalf of the**

**Office of Small Business Advocate**

**RECEIVED**  
**2007 FEB 27 PM 3:28**  
**FA PUC**  
**SECRETARY'S BUREAU**

**Date Served: December 21, 2006**

**Date Submitted for the Record: \_\_\_\_\_**

**Direct Testimony of Brian Kalcic**

1  
2  
3 **Q. Please state your name and business address.**

4 A. Brian Kalcic, 225 S. Meramec Avenue, St. Louis, Missouri 63105.  
5

6 **Q. What is your occupation?**

7 A. I am an economist and consultant in the field of public utility regulation, and  
8 principal of Excel Consulting. My qualifications are described in the  
9 Appendix to this testimony.  
10

11 **Q. On whose behalf are you testifying in this case?**

12 A. I am testifying on behalf of the Office of Small Business Advocate  
13 (“OSBA”), which is representing small business customers served by  
14 Duquesne Light Company (“Duquesne”).  
15

16 **Q. What is the subject of your testimony?**

17 A. I will examine select aspects of the “proposed acquisition by merger”  
18 (“merger”) of Duquesne Light Holding, Inc. (“DLH”) by the Macquarie  
19 Consortium (“Macquarie”) (collectively, the “Applicants”). In **Section I** of  
20 my testimony, I provide a brief summary of the alleged benefits associated  
21 with the merger. **Section II** discusses potential issues related to service  
22 quality. **Section III** of my testimony examines a potential issue related to the  
23 Applicants’ post-merger corporate structure. Finally, in **Section IV**, I  
24 propose a distribution rate case stay-out as a means of providing an  
25 affirmative public benefit in this proceeding.  
26

27 **Q. Please summarize your recommendations.**

28 A. Based upon my analysis of the Applicants’ filing, I recommend that the  
29 Commission:

- 30
- 31 • require the Applicants to complete Duquesne’s current  
32 infrastructure improvement plan as a condition of the proposed  
33 merger;  
34

- 1 • hold Duquesne to an additional service quality metric standard in  
2 order to insure that service quality is not compromised as a result  
3 of the merger;  
4
- 5 • condition approval of the merger on the Applicants' assurance  
6 that Duquesne would not be responsible for any debt instrument,  
7 unless such debt were to serve an electric distribution company  
8 purpose; and  
9
- 10 • approve a distribution rate case stay-out period for Duquesne, as  
11 a condition of the proposed merger, in order to insure that the  
12 merger provides affirmative benefits to all of Duquesne's  
13 ratepayers.  
14

15 The specific details associated with my recommendations are discussed  
16 below.  
17

18 **I. Claimed Merger Benefits**  
19

20 **Q. Mr. Kalcic, what is your understanding of the legal standard for**  
21 **approval of public utility mergers and acquisitions?**

22 A. Counsel informs me that the relevant standard was determined by the  
23 Pennsylvania Supreme Court in *City of York v. Pa. P.U.C.*, 449 Pa. 136, 295  
24 A.2d 825 (1972), wherein the court stated, in relevant part:  
25

26 *[A] certificate of public convenience approving a merger is not to*  
27 *be granted unless the Commission is able to find affirmatively that*  
28 *public benefit will result from the merger . . . . [T]hose seeking*  
29 *approval of a utility merger [are required to] demonstrate more*  
30 *than the mere absence of any adverse effect upon the public . . . .*  
31 *[T]he proponents of a merger [are required to] demonstrate that*  
32 *the merger will affirmatively promote the 'service,*  
33 *accommodation, convenience, or safety of the public' in some*  
34 *substantial way.*

1 **Q. Do the Applicants identify any affirmative public benefits that would**  
2 **result from the proposed merger?**

3 A. Yes. Briefly, the Applicants claim that the acquisition would:

- 4
- 5 a) provide Duquesne with improved access to capital resources, allowing it
  - 6 to maintain and enhance service to ratepayers;
  - 7 b) provide for the sharing of best practices between DLH and Macquarie;
  - 8 c) maintain Duquesne's role as a committed public service provider,
  - 9 employer and community partner in the Pittsburgh region; and
  - 10 d) fund an economic development program applicable to large commercial
  - 11 and industrial ("C&I") customers, with the intent of creating new jobs in
  - 12 Southwestern Pennsylvania.<sup>1</sup>
- 13

14 **Q. Are the above benefits sufficient to satisfy Pennsylvania's affirmative**  
15 **public benefit standard?**

16 A. I can't say, since counsel informs me the question calls for a legal conclusion.  
17 However, the OSBA will address whether or not the Applicants' proposed  
18 merger satisfies the required affirmative public benefit standard in its briefs.

19

## 20 **II. Potential Service Quality Issues**

21

22 **Q. The Applicants claim that the proposed merger would provide Duquesne**  
23 **with improved access to capital resources, allowing it to maintain and**  
24 **enhance service to ratepayers. How is Duquesne planning to address its**  
25 **service obligations?**

26 A. As discussed by Mr. O'Brien, Duquesne is presently in the middle of  
27 executing a transmission and distribution service plan that includes over \$500  
28 million in capital expenditures on infrastructure improvements over the 2005  
29 through 2007 period.

30

31 **Q. Do the Applicants specifically commit to completing Duquesne's current**  
32 **infrastructure improvement plan, if the proposed merger is approved?**

33 A. No.

---

<sup>1</sup> The economic development program would be applicable to C&I customers taking service on Duquesne's Rate Schedules HVPS or L, who intend to create new load (or expand existing load) by at least 10 MW.

1  
2 **Q. Would it be appropriate for the Commission to condition approval of the**  
3 **merger on the completion of Duquesne's infrastructure improvement**  
4 **plan?**

5 A. Yes. If the proposed merger is intended to facilitate Duquesne's commitment  
6 to quality service, the Commission should require the plan to be completed,  
7 and hold the Applicants to Duquesne's previously stated timetable.  
8

9 **Q. Would the completion of Duquesne's current infrastructure**  
10 **improvement plan be sufficient to insure that Duquesne's service**  
11 **standards are not compromised as a result of the merger?**

12 A. No. Service reliability is also a function of system maintenance. If, for  
13 example, Duquesne's earnings were to be employed to pay dividends rather  
14 than fund critical system maintenance, Duquesne's overall service quality  
15 could decline despite the completion of the current infrastructure  
16 improvement plan.  
17

18 **Q. How is a utility's reliability performance typically measured?**

19 A. An electric utility's reliability performance is measured by a number of  
20 performance indices, including the Customer Average Interruption Duration  
21 Index ("CAIDI"), the System Average Interruption Frequency Index  
22 ("SAIFI") and the System Average Interruption Duration Index ("SAIDI").  
23 Counsel informs me that the above indices, along with the formulae that are  
24 used to compute a utility's score on each index, are defined in 52 Pa. Code  
25 §57.192.  
26

27 **Q. How could the Commission utilize the above performance measures to**  
28 **insure that ratepayers do not suffer an erosion in service quality as a**  
29 **result of the merger?**

30 A. I would recommend that a 10% worsening (year-to-year) in either the CAIDI,  
31 SAIFI or SAIDI performance measure *automatically* trigger a Commission  
32 investigation to determine: a) the cause(s) of such a worsening; b) the steps  
33 necessary to remediate the situation; and c) an appropriate financial penalty.  
34

1 **Q. Mr. Kalcic, doesn't the Commission already possess the authority to open**  
2 **an investigation pertaining to service quality if a utility's performance**  
3 **measures worsen over time?**

4 A. Yes. However, while the Commission *may* begin an investigation, it is not  
5 required to do so. Under my recommendation, if any of Duquesne's service  
6 quality metrics deteriorate by more than 10% in one year, a Commission  
7 investigation would automatically be opened.  
8

9 **Q. Would the Commission retain its authority to review Duquesne's service**  
10 **quality if Duquesne's performance measures were to worsen by less than**  
11 **10%?**

12 A. Certainly. The intent of my recommendation is to hold Duquesne to an  
13 additional standard, not to replace an existing standard (or to limit a potential  
14 remedy).  
15

16 **Q. How long should Duquesne be subject to the OSBA's additional**  
17 **performance standard?**

18 A. At a minimum, I would recommend that the additional standard be in force  
19 until Duquesne's next base rate proceeding, at which time the parties could  
20 present their arguments regarding whether or not the enforcement period  
21 should be extended.  
22

### 23 **III. Corporate Structure**

24

25 **Q. Mr. Kalcic, how would Duquesne and DLH fit within the Macquarie**  
26 **corporate structure post-merger?**

27 A. Duquesne is currently a subsidiary of DLH, and would remain a subsidiary of  
28 DLH if the proposed merger were to be approved. However, DLH would  
29 become a direct, wholly-owned subsidiary of DQE Holdings LLC ("DQE"),  
30 which would, in turn, be wholly-owned by Macquarie.  
31

32 **Q. Would DLH control any subsidiaries other than Duquesne?**

33 A. Yes. For example, it is my understanding that DLH would also control any  
34 number of unregulated subsidiaries.  
35

1 **Q. Would it be otherwise possible for the Applicants to use Duquesne assets**  
2 **to secure debt that was unrelated (or unnecessary) to the provision of**  
3 **safe, reliable and efficient service by the electric distribution company**  
4 **("EDC")?**

5 A. I believe it would.  
6

7 **Q. Would that be appropriate?**

8 A. No. The Applicants claim that one of the primary benefits of the proposed  
9 merger is providing Duquesne with improved access to capital. If that were  
10 indeed the case, it would make no sense to permit the Applicants to saddle  
11 Duquesne and its ratepayers with responsibility for debt that does not serve an  
12 EDC-related purpose.  
13

14 **Q. What do you recommend?**

15 A. I recommend that the Commission condition approval of the merger on the  
16 Applicants' assurance that Duquesne would not be responsible for any debt,  
17 unless such debt were to serve an EDC-related purpose.  
18

#### 19 **IV. Distribution Rate Case Stay-out**

20  
21 **Q. Mr. Kalcic, as previously discussed, the Applicants claim that the**  
22 **proposed merger would provide Duquesne with "improved access" to**  
23 **capital resources. What do you interpret "improved access" to mean?**

24 A. I assume that the Applicants are referring to Duquesne being able to acquire  
25 needed capital on more favorable terms, post-merger, than would have been  
26 possible, pre-merger.  
27

28 **Q. When did the Commission issue its order in Duquesne's last base rate**  
29 **case proceeding?**

30 A. The Commission entered its order in Docket No. R-00061346 on December 1,  
31 2006.  
32

33 **Q. If Duquesne's post-merger capital costs are indeed lower than those**  
34 **reflected in Docket No. R-00061346, would any of such capital cost**  
35 **savings be passed on to ratepayers?**

1 A. No, since Duquesne's distribution rates have been set.

2  
3 **Q. If the proposed merger were to provide Duquesne with access to capital**  
4 **at lower rates, how could the Commission insure that ratepayers share in**  
5 **such benefits?**

6 A. A simple and straightforward approach would be for the Commission to  
7 condition approval of the merger on Duquesne's not filing a distribution rate  
8 case for the duration of a defined stay-out period. During the stay-out period,  
9 Duquesne would be able to use any capital cost savings for infrastructure  
10 improvements, or to offset operation and maintenance cost increases. At the  
11 same time, ratepayers would benefit from a defined period of stable  
12 distribution rates.

13  
14 **Q. How long a stay-out period would you recommend?**

15 A. I recommend that the Commission require a distribution stay-out that would  
16 freeze distribution rates through December 31, 2010.

17  
18 **Q. Why until December 31, 2010?**

19 A. Duquesne's current Provider of Last Resort ("POLR III") generation rates are  
20 set to expire on January 1, 2008. As such, Duquesne will soon be submitting  
21 a POLR IV plan to establish generation rates for its next POLR period. In  
22 POLR III, the Commission approved a three (3) year POLR period.  
23 Assuming another three year POLR period were to be approved by the  
24 Commission, POLR IV generation rates will go through December 31, 2010.  
25 A four (4) year distribution rate freeze would coincide with the end of POLR  
26 IV, and would help to mitigate the generation rate increase that is expected to  
27 occur over that period.

28  
29 **Q. Mr. Kalcic, the Applicants have offered to fund an economic**  
30 **development program in conjunction with the proposed merger. Why do**  
31 **you recommend that the Commission require a distribution stay-out,**  
32 **given the economic development program offered by the Applicants?**

33 A. The Applicants' proposed economic development program would be limited  
34 solely to large C&I customers. In contrast, the proposed merger should  
35 provide affirmative benefits to *all* of Duquesne's ratepayers. A distribution

1 stay-out would be a straightforward and efficient way of providing  
2 affirmative public benefits to Duquesne's residential and small C&I  
3 ratepayers.

4

5 **Q. Does this conclude your direct testimony?**

6 A. Yes.

7

8

## APPENDIX

### Qualifications of Brian Kalcic

Mr. Kalcic graduated from Illinois Benedictine College with a Bachelor of Arts degree in Economics in December, 1974. In May, 1977 he received a Master of Arts degree in Economics from Washington University, St. Louis. In addition, he has completed all course requirements at Washington University for a Ph.D. in Economics.

From 1977 to 1982, Mr. Kalcic taught courses in economics at both Washington University and Webster University, including such subjects as Microeconomic and Macroeconomic Theory, Labor Economics and Public Finance.

During 1980 and 1981, Mr. Kalcic was a consultant to the Equal Employment Opportunity Commission, St. Louis District Office. His responsibilities included data collection and organization, statistical analysis and trial testimony.

From 1982 to 1996, Mr. Kalcic joined the firm of Cook, Eisdorfer & Associates, Inc. During that time, he participated in the analysis of electric, gas and water utility rate case filings. His primary responsibilities included cost-of-service and economic analysis, model building, and statistical analysis.

In March 1996, Mr. Kalcic founded Excel Consulting, a consulting practice which offers business and regulatory services.

Mr. Kalcic has previously testified before the state regulatory commissions of Delaware, Kansas, Kentucky, Maine, Massachusetts, Minnesota, Missouri, New Jersey, New York, Ohio, Oregon, Pennsylvania, Texas, and the Bonneville Power Administration.

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Application of Duquesne Light Company for	:	
a Certificate of Public Convenience Under	:	Docket No. A-110150F0035
Section 1102(a)(3) of the Public Utility Code	:	
Approving the Acquisition of Duquesne Light	:	
Holdings, Inc. By Merger	:	
Application of DQE Communications Network	:	
Services LLC for a Certificate of Public	:	
Convenience Under Section 1102(a)(3) of the	:	Docket No. A-311233F0002
Public Utility Code Approving the Acquisition	:	
of Duquesne Light Holdings, Inc. By Merger	:	

Rebuttal Testimony of

BRIAN KALCIC

On Behalf of the

Office of Small Business Advocate

RECEIVED  
 2007 FEB 27 PM 3:28  
 PA PUC  
 SECRETARY'S BUREAU

Date Served: January 10, 2007

Date Submitted for the Record: \_\_\_\_\_

1 Rebuttal Testimony of Brian Kalcic

2  
3  
4 **Q. Please state your name and business address.**

5 A. Brian Kalcic, 225 S. Meramec Avenue, St. Louis, Missouri 63105.

6  
7 **Q. Have you previously submitted direct testimony in this proceeding?**

8 A. Yes, I have.

9  
10 **Q. What is the subject of your rebuttal testimony?**

11 A. My rebuttal testimony responds to certain issues raised in the direct testimony  
12 of the following witnesses: 1) Mr. Kevan L. Deardorff on behalf of OTS; 2)  
13 Mr. Matthew I. Kahal and Ms. Barbara R. Alexander on behalf of OCA; and  
14 3) Mr. David Hughes on behalf of Citizens Power, Inc. ("Citizens Power").<sup>1</sup>  
15

16 Cost of Capital

17  
18 **Q. On pages 4-5 of his direct testimony, Mr. Deardorff notes that**  
19 **Duquesne Light Holdings ("DLH") has been "placed on**  
20 **CreditWatch with negative implications in response to the**  
21 **announced merger." Similarly, on pages 31-32 of his direct**  
22 **testimony, Mr. Kahal discusses the possibility of Duquesne Light**  
23 **Company ("Duquesne") experiencing an increase in its cost of debt**  
24 **and/or equity as a result of the merger. Are such cost-of-capital**  
25 **views consistent with the scenario presented in your direct**  
26 **testimony?**

27 A. No. In my direct testimony, I simply discussed the *Applicants'*  
28 position, which is that the proposed merger would provide Duquesne  
29 with "improved access" to capital resources.<sup>2</sup>  
30

---

<sup>1</sup> Note that my rebuttal testimony is organized by subject matter rather than by party.

<sup>2</sup> However, I did interpret "improved access" to mean that Duquesne would be able to acquire needed capital on more favorable terms, post-merger, than what would have been available to it, pre-merger.

1 **Q. Do you agree with Mr. Deardorff and Mr. Kahal that ratepayers should**  
2 **be protected from any potential detrimental impact of the merger on**  
3 **Duquesne's cost of capital?**

4 A. Yes, I do.  
5

6 **Q. On pages 6-7 of your direct testimony, you recommend a distribution**  
7 **rate case stay-out as a means of sharing the Applicants' claimed merger**  
8 **benefit of "improved access" to capital resources with ratepayers.**  
9 **Would the possibility that the merger might have a detrimental impact**  
10 **on Duquesne's cost of capital cause you to alter your recommendation in**  
11 **any way?**

12 A. No. My recommended distribution rate case stay-out would remain  
13 appropriate, albeit for a different reason.  
14

15 **Q. Please explain.**

16 A. As I discussed in my direct testimony, in the case where the merger  
17 results in a lower overall cost of capital, Duquesne would be able to use  
18 any capital cost savings for infrastructure improvements, or to offset  
19 operation and maintenance cost increases, during the stay-out period.  
20 Ratepayers would benefit from having a defined period of stable  
21 distribution rates.

22 In the opposite situation (i.e., where the merger has a detrimental  
23 impact on Duquesne's cost of capital), it is equally important that the  
24 Commission condition approval of the merger on Duquesne agreeing to  
25 a distribution rate case stay-out. In this scenario, however, the purpose  
26 of the stay-out would be to *protect* ratepayers from paying for any  
27 merger-related increase in capital costs via higher distribution rates.  
28

### 29 Universal Service Programs

30  
31 **Q. On page 33 of her direct testimony, Ms. Alexander recommends**  
32 **that Duquesne be required to commit to incremental funding for its**  
33 **Stay Warm program in the amount of \$1.20 million, as a condition**  
34 **for approval of the merger. Similarly, on pages 9-11 of his direct**  
35 **testimony, Mr. Hughes recommends that Duquesne be required to**

1 provide: a) incremental funding for its existing LIURP program in  
2 the amount of \$1.17 million per year; and b) financing for a new  
3 (i.e., expanded) LIURP program in the amount of \$2.70 million per  
4 year.<sup>3</sup> Both witnesses argue, in part, that their proposals should be  
5 adopted in order to ensure that low-income customers receive a  
6 direct merger benefit. Do you have any comments?

7 A. Yes. None of the Universal Service proposals advocated by the above  
8 witnesses would provide any benefit to Duquesne's small commercial  
9 and industrial ("C&I") customers. If the Commission deems it  
10 appropriate to approve such proposals in order to ensure that low-  
11 income residential customers receive a direct merger benefit, it should  
12 also approve the OSBA's distribution rate case stay-out (as a condition  
13 of the merger), since the stay-out provision is necessary to ensure that  
14 small C&I customers receive a like merger benefit.

15  
16 **Service Quality**

17  
18 **Q. On pages 20-27 of her direct testimony, Ms. Alexander discusses her**  
19 **proposal to establish a Service Quality Assurance Plan ("Plan") as a**  
20 **condition for approval of the merger. In her proposed Plan, Ms.**  
21 **Alexander incorporates eleven (11) performance standards, coupled with**  
22 **penalties for failure to meet the proposed standards. More specifically,**  
23 **Ms. Alexander recommends that Duquesne be required to provide**  
24 **"service compensation dollars" to residential and non-residential**  
25 **customers, as applicable, for failure to meet any of her proposed annual**  
26 **performance standards. Are any of Ms. Alexander's proposed**  
27 **performance standards or metrics residential-only in nature?**

28 A. Yes. Five (5) of the 11 proposed performance standards would apply to  
29 residential customers only.<sup>4</sup>

30  
31 **Q. Would the service compensation penalties assessed to Duquesne for**  
32 **failing to meet any of the proposed residential-only performance**

---

<sup>3</sup> Citizen Power's expanded LIURP program would target residential customers with household incomes between 150% and 250% of the federal poverty level.

<sup>4</sup> See the performance metrics numbered 4-8 on page 23 of OCA Statement No. 2.

1 standards be distributed solely to residential customers under Ms.  
2 Alexander's proposal?

3 A. Yes.

4  
5 **Q. Is there any danger in establishing an overall performance**  
6 **standard that is heavily weighted toward residential service**  
7 **commitments?**

8 A. Yes, I believe so. If Duquesne were to be subject to a quality assurance plan  
9 wherein it would be penalized in five areas for missing only residential  
10 service commitments, one might expect that such a plan could create an  
11 incentive for Duquesne to give priority to residential customer service at the  
12 expense of non-residential customer service. While unintended, such an  
13 outcome would be entirely inappropriate.

14  
15 **Q. How might the OCA's proposed Plan be amended to inhibit a**  
16 **dichotomy from arising with respect to the manner in which**  
17 **Duquesne responds to residential versus non-residential customer**  
18 **service issues?**

19 A. I would recommend that a cap or limit be placed on the total service  
20 compensation dollars available to compensate residential customers in  
21 connection with the OCA's proposed residential-only metrics. Such a  
22 restriction would ensure that Duquesne would have service compensation  
23 dollars at risk in the event that it failed to meet any of the remaining (i.e.,  
24 non-residential-only) customer service metrics contained in the OCA's  
25 proposed Plan.

26  
27 **Q. Do you have a recommendation regarding an appropriate size for**  
28 **the above cap?**

29 A. Yes. Since the OCA's proposed Plan would put Duquesne at risk for a total  
30 of \$2.80 million, I would recommend that the penalty revenue applicable to  
31 the five residential-only service performance standards be capped at \$1.27  
32 million, or five-elevenths (i.e., a pro-rata share) of the total \$2.80 million.

1 Solar Energy Initiatives

2  
3 **Q. On pages 6-7 of his direct testimony, Mr. Hughes recommends that**  
4 **Duquesne be required to evaluate the potential benefits of implementing**  
5 **a utility-driven solar energy program in its service territory, as a means**  
6 **of complying with Act 213. If the Commission were to determine that**  
7 **such a program “would be a cost-effective approach to complying with**  
8 **Act 213, Duquesne would be required, as a condition of the merger**  
9 **approval, to implement such a program.” Do you have any comment?**

10 A. Yes. While Mr. Hughes states that the purpose of his proposal is to ensure  
11 that the merger provides affirmative public benefits, it is not clear how the  
12 proposal would provide such benefits.

13 Consider that Mr. Hughes’ utility-driven solar energy program would  
14 be implemented only if it were to be shown to be “cost-effective.” Even so,  
15 such a determination would ensure only that the program could compete with  
16 other sources of solar energy power. Unless Duquesne’s ratepayers could be  
17 assured that the program would allow them to satisfy their Act 213 solar  
18 requirements at a *below-market* cost, ratepayers would be no better off with  
19 Citizens Power’s proposed utility-driven solar energy program than without.

20  
21 **Q. Does the Commission have the authority to require that: a)**  
22 **Duquesne invest in a solar energy program; and b) Duquesne sell**  
23 **the associated solar output at a below market cost?**

24 A. No. Counsel has advised me that the Commission does not have the authority  
25 to set the price of generation services below market.

26  
27 **Q. On pages 7-8 of his direct testimony, Mr. Hughes recommends that**  
28 **Duquesne be required to finance a customer-driven solar energy**  
29 **program via a shareholder-funded \$4.0 million dollar grant. Do you**  
30 **have any comment?**

31 A. Yes. Mr. Hughes indicates that his recommended solar grant program might  
32 assist with the development of approximately 170 solar-energy installations  
33 in Duquesne’s service territory. Currently, Duquesne has more than 580,000  
34 customers, which means that Mr. Hughes’ recommended customer-driven  
35 solar energy program would direct benefits to less than 0.03% of Duquesne’s

1 customer base. In my opinion, the Commission should strive to ensure that  
2 affirmative public benefits flow to all of Duquesne's customers, rather than  
3 provide an average benefit (i.e., subsidy) of approximately \$23,500 to a select  
4 170 customers.<sup>5</sup>

5  
6 **Q. Do you recommend that the Commission adopt Mr. Hughes'**  
7 **recommended solar energy initiatives as a condition for approval**  
8 **of the proposed merger?**

9 A. No, since neither initiative could be expected to provide affirmative  
10 public benefits to all of Duquesne's customers.

11  
12 **Q. Does this conclude your rebuttal testimony?**

13 A. Yes.

---

<sup>5</sup> Spreading a \$4.0 million grant over 170 customer installations would equate to an average grant of \$23,529.

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Application of Duquesne Light Company for	:	
a Certificate of Public Convenience Under	:	Docket No. A-110150F0035
Section 1102(a)(3) of the Public Utility Code	:	
Approving the Acquisition of Duquesne Light	:	
Holdings, Inc. By Merger	:	
Application of DQE Communications Network	:	
Services LLC for a Certificate of Public	:	
Convenience Under Section 1102(a)(3) of the	:	Docket No. A-311233F0002
Public Utility Code Approving the Acquisition	:	
of Duquesne Light Holdings, Inc. By Merger	:	

Surrebuttal Testimony of

BRIAN KALCIC

On Behalf of the

Office of Small Business Advocate

RECEIVED  
2007 FEB 27 PM 3:28  
PA PUC  
SECRETARY'S BUREAU

Date Served: January 23, 2007

Date Submitted for the Record: \_\_\_\_\_

1 Surrebuttal Testimony of Brian Kalcic

2  
3  
4 **Q. Please state your name and business address.**

5 A. Brian Kalcic, 225 S. Meramec Avenue, St. Louis, Missouri 63105.

6  
7 **Q. Have you previously submitted direct and rebuttal testimony in this**  
8 **proceeding?**

9 A. Yes.

10  
11 **Q. What is the subject of your surrebuttal testimony?**

12 A. My surrebuttal testimony responds to certain issues raised in the rebuttal  
13 testimony of the following Company witnesses: 1) Mr. Morgan K. O'Brien;  
14 2) Mr. Christopher J. Leslie; 3) Mr. Joseph G. Sauvage; 4) Mr. Frederick J.  
15 Eichenmiller; and 5) Ms. Michele Sandoe.

16  
17 Mr. O'Brien

18  
19 **Q. Mr. Kalcic, in your direct testimony, you recommend that the**  
20 **Commission condition approval of the merger on the completion of**  
21 **the Company's current Infrastructure Improvement Program.**  
22 **Has the Company agreed to this condition?**

23 A. Yes, it has. On pages 17-18 of his rebuttal testimony, Mr. O'Brien  
24 states that Duquesne is willing to commit to completing its  
25 infrastructure improvement plan by the end of 2007, as originally  
26 scheduled.

27  
28 **Q. You also recommend that the Commission condition approval of the**  
29 **merger on Duquesne agreeing to a distribution rate freeze through**  
30 **December 31, 2010. Has the Company also agreed to this condition?**

31 A. No. On page 20 of his rebuttal testimony, Mr. O'Brien states that the  
32 Company is only willing to accept a distribution rate freeze for a two-  
33 year period, i.e., through December 31, 2008.

1 **Q. Is a two-year rate freeze acceptable to the OSBA?**

2 A. No. As I indicated in my direct testimony, the Commission just  
3 approved a distribution rate increase for Duquesne on December 1,  
4 2006. While Duquesne is not (formally) prohibited from filing a new  
5 rate case at this time, one would not normally expect to see a utility file  
6 its next base rate case for at least twelve months following the  
7 implementation of new rates. Assuming that to be the case here, and  
8 that Duquesne were to file its next rate case on or about January 1,  
9 2008, the Commission's decision would be due approximately October  
10 1, 2008. In such circumstances, the actual benefit to ratepayers implicit  
11 in Duquesne's offer of a "two-year" stay-out might be on the order of a  
12 three-month rate freeze. Such a result would do little to help mitigate  
13 an expected January 1, 2008 increase in generation rates for  
14 Duquesne's POLR customers.

15  
16 **Q. Do you have any other comment on Duquesne's offer of a two-year rate  
17 freeze?**

18 A. Yes. As previously discussed, a two-year rate freeze is unlikely to  
19 provide any meaningful public benefit. Therefore, if the Commission  
20 were to approve the merger subject to a two-year rate freeze, I would  
21 recommend that the Commission also adopt OTS witness Kevan  
22 Deardorff's proposed condition that Duquesne not be awarded a higher  
23 cost of capital for rate making purposes if such costs were to stem from  
24 a credit rating downgrade caused by the merger.<sup>1</sup> In that way,  
25 ratepayers would at least be held harmless from a market-perceived  
26 deterioration in Duquesne's credit worthiness.

27  
28 **Mr. Leslie**

29  
30 **Q. On page 5 of his rebuttal testimony, Mr. Leslie indicates that the  
31 Company's proposed economic development plan will be funded solely  
32 by shareholders. Do you have any comment?**

---

<sup>1</sup> See page 8 of OTS Statement No. 1.

1 A. Yes. I would note that Mr. Leslie's comment confirms the OSBA's  
2 previous understanding as to who would be responsible for the cost of  
3 the economic development program. Nevertheless, in order to insure  
4 that ratepayers are not responsible for the costs of the program, the  
5 Commission should condition approval of the merger on Duquesne  
6 explicitly agreeing *not* to seek recovery of such costs in future rates.  
7

8 **Mr. Sauvage**  
9

10 **Q. On page 1 of his rebuttal testimony, Mr. Sauvage states that it is**  
11 **your testimony that the proposed merger would not provide**  
12 **affirmative public benefits to Duquesne's ratepayers. Is that an**  
13 **accurate representation of your testimony in this proceeding?**

14 A. No. I never stated that the proposed merger would fail to provide any  
15 affirmative public benefits. Instead, I testified that I could not offer an  
16 opinion as to whether or not the Company's claimed merger benefits  
17 were sufficient to satisfy Pennsylvania's legal or affirmative benefit  
18 standard, and that the OSBA would address this issue in its briefs.<sup>2</sup>  
19

20 **Q. On pages 10-12 of his rebuttal testimony, Mr. Sauvage discusses**  
21 **why, in his opinion, the merger will result in Duquesne having**  
22 **improved access to capital and lower debt financing costs. Do you**  
23 **have any comment?**

24 A. Yes. As I indicated in my direct testimony, since Duquesne's base rate  
25 proceeding at Docket No. R-00061346 was just completed, any post-  
26 merger reduction in Duquesne's capital costs would not be shared with  
27 ratepayers until the Company's next rate proceeding. In my opinion,  
28 such "interim" capital cost savings can and should be shared with  
29 ratepayers though the imposition by the Commission of a *meaningful*  
30 distribution rate freeze as a condition of approving the merger.<sup>3</sup>  
31  
32

---

<sup>2</sup> See page 3, lines 14-18 of OSBA Statement No. 1.

<sup>3</sup> See page 7, lines 3-27 of OSBA Statement No. 1.

1 **Mr. Eichenmiller**

2  
3 **Q. On page 12 of his rebuttal testimony, Mr. Eichenmiller argues that there**  
4 **is no valid reason to impose additional service standards on Duquesne in**  
5 **this proceeding. He goes on to state “if any stiffer standards were to be**  
6 **adopted, they should be the ones I will explain below. Finally, and**  
7 **perhaps most importantly, any exceedence of those standards should be**  
8 **followed by a report from the Company explaining the reasons for the**  
9 **departure from the standard and the actions the Company is taking to**  
10 **improve service.” Do you have any comments?**

11 A. Yes. First, it is not clear if the report required of Duquesne for exceeding any  
12 of Mr. Eichenmiller’s proposed service standards would provide any  
13 information beyond that already supplied by the Company in complying with  
14 the Commission’s current reporting requirements. Second, Mr.  
15 Eichenmiller’s proposal offers no specific trigger for Commission action.  
16

17 **Q. Is it important that such a trigger be put in place?**

18 A. Yes. As I discussed in my direct testimony, while the Commission already  
19 possesses the authority to open an investigation pertaining to service quality  
20 if a utility’s performance worsens over time, it is not required to do so. In  
21 order to insure that ratepayers do not suffer an erosion in service quality as a  
22 result of the merger, I continue to recommend that a Commission  
23 investigation into Duquesne’s service performance automatically be opened if  
24 the Company’s performance standards deteriorate by more than 10% in any  
25 given year.  
26

27 **Q. Mr. Kalcic, you also previously recommended that Duquesne should be**  
28 **subject to the OSBA’s 10% trigger mechanism until at least the**  
29 **Company’s next base rate proceeding. Do you wish to modify that**  
30 **recommendation at this time?**

31 A. Yes, I do. My previous recommendation as to the length of the period that  
32 Duquesne should be subject to the trigger mechanism was based upon the  
33 assumption that Duquesne would be subject to a distribution rate freeze  
34 extending through December 2010. If the Commission were to approve the  
35 merger subject to Duquesne’s offer of a two-year rate freeze, it is not clear

1 that any potential deterioration in service quality would be evident in the data  
2 available for review during the course of an implicit 2008 rate proceeding.<sup>4</sup>  
3 Accordingly, I wish to modify my previous recommendation in this area.  
4 Specifically, I now recommend that Duquesne be subject to the OSBA's 10%  
5 trigger mechanism through at least the conclusion of the Company's next two  
6 base rate proceedings.

7  
8 **Q. Do you have any general comments on Mr. Eichenmiller's**  
9 **proposed alternative (i.e., stiffer) service standards?**

10 A. Yes. Under Mr. Eichenmiller's proposal, Duquesne would be required to  
11 submit a report to the Commission if the Company's SAIFI or SAIDI scores  
12 in any year deteriorate to the point that they would fail to meet the three-year  
13 average performance standards set by the Commission for Duquesne.  
14 However, the Company's current performance measures are so much better  
15 than the Commission's three-year standards that a deterioration in  
16 Duquesne's current performance of that magnitude would certainly be  
17 noteworthy, *whether or not such deterioration occurred in a twelve month*  
18 *period.*

19  
20 **Q. Do you have a recommendation in the event that the Commission**  
21 **accepts Mr. Eichenmiller's alternative service standards?**

22 A. Yes. In such circumstances, I would recommend that the Commission  
23 automatically open an investigation into Duquesne's service performance if  
24 the Company's current performance should at any time deteriorate to the level  
25 of the Commission's three-year performance standards.

26  
27 **Ms. Sandoe**

28  
29 **Q. On page 3 of her rebuttal testimony, Ms. Sandoe discusses certain**  
30 **concessions that Duquesne would be willing to agree to in the area of**  
31 **universal service. Ms. Sandoe states that Duquesne will agree to continue**  
32 **“at least its current level of funding and administrative support for its**  
33 **universal services programs through 2010.” She goes on to state that**

---

<sup>4</sup> There is often a significant lag between the period for which data is collected and the time when such information becomes available.

1       **Duquesne will agree to “continue its current level of funding for the four**  
2       **year period ending December 2010 without any further customer**  
3       **contributions or change in the method of funding these programs.” Mr.**  
4       **Kalcic, how was the current level of funding for Duquesne’s universal**  
5       **service programs determined?**

6       A. It is my understanding that Duquesne agreed to its current funding levels as  
7       part of the settlement in Docket No. R-00061346.

8  
9       **Q. How are the costs associated with Duquesne’s current universal**  
10       **service programs recovered?**

11       A. The costs are recovered in the Company’s distribution rates.

12  
13       **Q. Would the Company’s universal service concessions, as detailed by Ms.**  
14       **Sandoe, provide any affirmative benefits to Duquesne’s non-residential**  
15       **customers?**

16       A. No.

17  
18       **Q. Could any of the Company’s universal service concessions actually**  
19       **turn out to be detrimental to Duquesne’s non-residential classes?**

20       A. Yes. All else equal, the Company’s agreement to continue its current  
21       level of funding for the four year period ending December 2010  
22       without any further customer contributions, or change in the method of  
23       funding these programs, could result in higher distribution rates for  
24       Duquesne’s non-residential classes at the conclusion of the Company’s  
25       next base rate proceeding.

26  
27       **Q. Please explain how that outcome could occur.**

28       A. As previously mentioned, the Company is presently recovering its  
29       universal service costs in base rates, as opposed to through a specific  
30       universal service surcharge. As a result, the costs of such programs,  
31       even if properly allocated to (only) residential customers in the  
32       Company’s cost-of-service study (“COSS”), will likely impact the  
33       degree of movement that classes make toward cost-based *distribution*  
34       rates in the Company’s next rate proceeding. Specifically, if  
35       Duquesne’s residential classes are shown to be under-contributing in

1 the Company's next rate case,<sup>5</sup> one may expect that the continuation of  
2 base-rate funding for the Company's universal service programs would  
3 otherwise limit the degree of movement (i.e., progress) toward cost-  
4 based residential distribution rates that is possible in that proceeding.  
5 Correspondingly, Duquesne's non-residential classes would see *less*  
6 movement toward cost, i.e., higher distribution rates, at the conclusion  
7 of the proceeding.  
8

9 **Q. What do you recommend?**

10 A. If the Commission determines that it is appropriate to adopt the  
11 Company's universal service concessions, I recommend that the  
12 Commission take all necessary steps to insure that the Company's non-  
13 residential customers will not be negatively impacted.  
14

15 **Q. How could the Commission insure that Duquesne's non-residential  
16 customers would be held harmless?**

17 A. The Commission could insure the above outcome by either: 1)  
18 requiring that Duquesne unbundle its current residential distribution  
19 rates in its next base rate proceeding, in order to provide for the  
20 recovery of the Company's universal service program costs in a  
21 separate rider; or 2) requiring that Duquesne move all rate classes to  
22 full cost of service in its next rate proceeding.  
23

24 **Q. Does this conclude your surrebuttal testimony?**

25 A. Yes.

---

<sup>5</sup> Note that residential distribution rates were shown to be below cost of service in the COSS filed by the Company in Docket No. R-00061346.