

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Petition of Duquesne Light Company :
For Approval of Default Service Plan :
For the Period January 1, 2008 : **Docket No. P-00072247**
Through December 31, 2010 :

1. Duquesne Statement No. 2-R – Rebuttal Testimony of Frederick J. Eichenmiller
2. Duquesne Statement No. 3-R – Rebuttal Testimony of Neil S. Fisher
3. Duquesne Statement No. 4-R – Rebuttal Testimony of William V. Pfrommer
4. Duquesne Statement No. 6-R – Rebuttal Testimony of Susan S. Betta

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Petition of Duquesne Light Company :
For Approval of Default Service Plan :
For the Period January 1, 2008 : Docket No. P-00072247
Through December 31, 2010 :

REBUTTAL TESTIMONY OF
FREDERICK J. EICHENMILLER

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Date: April 13, 2007

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

2 A. My name is Frederick J. Eichenmiller. My business address is Duquesne Light
3 Company, 411 Seventh Avenue, Pittsburgh, PA 15219.

4 **Q. What is your position with Duquesne Light Company?**

5 A. I am currently employed as the Director of External Affairs at Duquesne Light Company
6 (“Duquesne Light” or the “Company”).

7 **Q. What is the purpose of your rebuttal testimony?**

8 A. I will respond to comments of other parties on the structure of Duquesne Light’s
9 proposed default service offering for the period January 1, 2008 through December 31,
10 2010. I will also provide clarification with regard to the limited circumstances that would
11 cause Duquesne Light to seek increases in fixed prices for default service.

12 **Q. Please summarize your rebuttal testimony.**

13 A. Duquesne Light endeavored in its proposed default service plan to balance interests of
14 providing stable and predictable prices for default service to residential and small
15 commercial and industrial (C&I) customers with the goal of continuing to promote
16 competition and access to alternative suppliers. I have explained these efforts at length in
17 my direct testimony.

18 In my opinion, the responses of the various parties to Duquesne Light’s proposed default
19 service plan demonstrates that Duquesne Light has appropriately balanced these interests.
20 As I will explain further in this rebuttal, the positions of certain EGSs that more frequent
21 changes to default service rates are necessary are to be contrasted with the positions of
22 other parties that there should be less frequent changes. While arguments may be made

1 for each of these approaches, I believe Duquesne Light has presented a balanced, interim
2 plan that avoids the more extreme and potentially damaging positions advanced by some
3 of the parties.

4 I will explain the reasons that it is both incorrect and overly simplistic to conclude that
5 more frequent rate changes will necessarily support competitive markets and more
6 accurately reflect market prices. Mr. Fisher will provide additional perspective on this
7 issue in his rebuttal. I also will explain the important steps that we have taken to enhance
8 competition for residential and small commercial customers, including Duquesne Light's
9 proposal to implement the first purchase of receivables program of any major
10 Pennsylvania electric distribution company.

11 My rebuttal also explains that Duquesne Light's fixed default service rates will only be
12 changed in very limited circumstances and only after any change is approved by the
13 Commission.

14 Finally, I will respond to other proposals and provide clarification on demand side
15 response/conservation and competition issues.

16 **Q. How should the Commission view Duquesne Light's default service plan?**

17 **A.** Individual parties obviously and appropriately look at the parts of the plan that affect
18 their specific interests. However, Duquesne Light urges the Commission to look at the
19 plan **as a whole** and how, as a whole, it reflects appropriate and reasoned movement to a
20 more competitive market in 2011. For example, Duquesne Light proposes to eliminate
21 declining blocks and supply related demand charges by January 1, 2010, for all
22 applicable customer classes. In addition, Duquesne Light has developed specific plans

1 for each customer class which Duquesne Light believes appropriately balance rate
2 stability concerns for each class and the desire of some EGSs to have frequent rate
3 adjustments. As a whole, Duquesne Light's default service plan is a reasonable, interim
4 plan that is designed to further promote competition in a service territory already
5 experiencing high levels of customer shopping.

6 **Q. Please explain how the positions of the parties illustrate the balanced approach to**
7 **the Company's proposed small customer default service plan.**

8 **A.** I will start with the proposed default service plan for small C&I customers.

9 The Company proposes to move from the current small C&I plan, which provided small
10 C&I customers with a fixed price for three years, to a plan that provides a fixed price for
11 2008 followed by annual adjustments to that fixed price which would become effective
12 January 1, 2009 and January 1, 2010, with the adjustments tied directly to measurable
13 changes in market indices.

14 OSBA, through witness Kalcic, contends that small C&I customers should be provided a
15 three year fixed price. In contrast, Direct Energy Services, LLC ("Direct"), through
16 witness Lacey, and Strategic Energy, LLC ("Strategic"), through witness Hudson, argue
17 that rates for small C&I customers should be adjusted at least quarterly if not more
18 frequently. Mr. Fisher responds to the various substantive arguments made by OSBA,
19 Direct and Strategic. I note, however, that the three-year fixed rate plan for small C&I
20 customers was approved by the Commission in Duquesne Light's POLR III proceeding.
21 Duquesne Light has proposed in this proceeding to provide for adjustments in the prices
22 to small C&I customers rates in 2009 and 2010 to reflect increases or decreases in energy

1 prices as a way to gradually transition these customers to more frequent price adjustments
2 in preparation for 2011. We believe this fairly balances the desire of customers, as
3 expressed by OSBA, for reasonably stable rates with the expressed desire by Direct and
4 Strategic for more frequent rate changes, particularly when most other electric customers
5 in the Commonwealth continue to be protected from increases by generation rate caps
6 until the end of 2010.

7 With regard to residential customers, I note that, as demonstrated by its answer and direct
8 testimony, the Office of Consumer Advocate (“OCA”) is in substantial agreement with
9 Duquesne Light’s proposal and does not propose major changes to Duquesne Light’s
10 default service plan.

11 In addition, with regard to EGSs, both Reliant Energy, Inc. (“Reliant”) and Dominion
12 Retail, Inc. (“Dominion”) have signed a letter agreement with Duquesne Light supporting
13 the structure of the entire plan, including that proposed for small C&I, large C&I and
14 residential customers. A copy of this letter agreement is provided as Exhibit FJE-1R. It
15 also is important to note that Reliant and Dominion, between themselves, serve all
16 customer classes in Duquesne Light’s service territory.

17 **Q. Please respond to contentions by OSBA that small C&I customers should be**
18 **provided three-year fixed prices without annual adjustments in 2009 and 2010, as**
19 **Duquesne Light has proposed for residential customers.**

20 **A.** There are some small C&I customers that have loads similar to residential customers.
21 However, the small C&I class is not as homogeneous as the residential class and contains
22 customers that use greater amounts of energy and with different usage patterns. Equally

1 important, the electric usage by all customers in the small C&I class is predominantly for
2 business purposes. As a result, it is reasonable to conclude that such customers can
3 evaluate their energy options in the same manner as they would evaluate their other
4 business costs. More EGSs are actively serving small C&I customers in Duquesne
5 Light's service area than are serving residential customers. As Mr. Fisher describes,
6 evidence from other jurisdictions also suggests that these customers have more
7 opportunities to exercise choice.

8 **Q. Please respond to assertions of Direct and Strategic that residential customers**
9 **default service rates should be revised quarterly.**

10 **A.** Duquesne Light does not believe that it is appropriate, at this time, to adjust residential
11 rates quarterly or annually. In this regard, I note that the Commission approved three-
12 year fixed rates in POLR III for Duquesne Light's residential customers. I also note that
13 all residential customers of other major electric utilities in the Commonwealth will have
14 capped generation rates until the end of 2010, or in the case of PPL Electric Utilities
15 Corporation ("PPL"), to the end of 2009. Further, in PPL's case, it has proposed a bridge
16 plan for 2010 to provide fixed price service to customers. PPL's plan has been accepted
17 by the Administrative Law Judge.

18 **Q. Does Duquesne Light believe that quarterly adjustments to residential rates are**
19 **necessary to support the development of customer choice?**

20 **A.** No, it does not. In this regard, I note that Duquesne Light already has by far the highest
21 rate of residential customer shopping (18% of residential load as of December 2006) of
22 any major Pennsylvania electric company and one of the highest in the nation. Since

1 Duquesne Light has been offering multi-year fixed rates since 2000, it cannot be
2 concluded that this approach prevents significant shopping.

3 I also note that in his direct testimony, Mr. Lacey states that short term pricing will
4 always be the least cost option. Direct/RESA St. No. 1, p. 13. As explained by Mr.
5 Fisher, Duquesne Light does not agree with Mr. Lacey's calculations nor does it agree
6 that residential customers should be exposed to short-term market prices at this stage of
7 market development. However, assuming his statement was correct in the past and will
8 remain so in the future, Duquesne Light's plan should promote competition because the
9 fixed rates will be higher than short-term prices, and EGSs will be able to purchase power
10 in the short-term market at lower prices and offer these lower prices to customers. In any
11 event, Duquesne Light's plan provides customers with stable and reasonable rates as
12 retail markets for residential customers continue to develop.

13 **Q. Has Duquesne Light developed other solutions intended to enhance small customer**
14 **shopping?**

15 **A.** Yes, Duquesne Light, as part of recent proceedings, has developed approaches that we
16 believe should enhance residential and small C&I shopping opportunities by encouraging
17 EGSs to offer service to small customers. In conjunction with EGSs and other interested
18 parties, Duquesne Light has developed on a collaborative basis, a purchase of receivables
19 program ("POR program"). Under the POR program, Duquesne Light will purchase the
20 receivables of EGSs serving small customers. EGSs are paid for their billings, less a
21 small discount if they elect to participate. If the EGS elects to participate in the POR
22 program, the EGS must offer service to all small customers regardless of credit. The
23 POR program, therefore, expands competitive options for small customers by removing

1 disincentives for EGSs to serve these customers. Duquesne Light is the first major
2 electric company to offer such a program in the Commonwealth.

3 Duquesne Light also has enhanced its communications and working relationships with
4 EGSs, conducting more frequent meetings to discuss and resolve issues and appointing a
5 Duquesne Light contact person for EGSs to raise issues and assist EGSs in developing
6 collaborative solutions on competition issues.

7 **Q. Please summarize your conclusions as to the need for quarterly or more frequent**
8 **adjustments to small customer rates as proposed by some EGSs.**

9 **A.** *In our view, the contentions that quarterly adjustments are necessary to create*
10 *competitive markets are contrary to Duquesne Light's experience and would unduly and*
11 *unnecessarily tip the balance away from customers' desire for a fixed default service*
12 *option. Duquesne Light already has some of the highest shopping levels in the United*
13 *States, so clearly the EGSs' contentions that quarterly or more frequent adjustments are*
14 *needed to create a competitive market are not true and are not supported by the evidence.*
15 *It would do so without any clear demonstration, as explained by Mr. Fisher, that frequent*
16 *adjustments will be effective to increase customer options. It is clearly unnecessary in*
17 *these circumstances, particularly where Duquesne Light has developed other solutions*
18 *that will enhance competitive options for customers.*

19 It should be emphasized as well that Duquesne Light's default service plan is an interim
20 plan that is designed to transition customers to a more competitive market in 2011 when
21 rate caps for all Pennsylvania customers will expire.

22

1 **Q. Please respond to OCA's request for clarification of the circumstances under which**
2 **Duquesne Light would seek to increase fixed rates for residential customers.**

3 **A.** Duquesne Light has proposed to provide fixed rates for a three year period for residential
4 customers. However, Duquesne Light is reserving the right to change the rates during the
5 default service period in only very limited, unlikely circumstances. Duquesne Light will
6 agree not to seek a default service rate increase (other than the adjustments specifically
7 provided for in Duquesne Light's Petition and supporting testimony) unless (i) Duquesne
8 Power defaults on its power contract with Duquesne Light, and (ii) Duquesne Light
9 Holdings defaults on its parent guarantee, and (iii) these defaults threaten the financial
10 ability of Duquesne Light to continue providing reliable service to its customers. All
11 three of these events would have to occur.

12 The only other exception would be if necessary regulatory approvals to carry out the
13 default service plan as proposed by Duquesne Light are not obtained or maintained or if
14 substantial modifications are required as a result of regulatory requirements. It is not
15 possible to identify every potential future event that could cause Duquesne Light to
16 propose to change the fixed rates under the default service plan. Failure to obtain or
17 maintain regulatory approvals or changes in regulation could interfere with the ability to
18 carry out the plan. In these limited and unlikely circumstances, Duquesne Light reserves
19 the right to seek Commission approval to amend the default service plan and seeks here
20 only recognition that its proposal in this proceeding, if approved, does not bar or prevent
21 the Commission from granting an increase in rates, if appropriate.

22

1 **Q. Please respond to Mr. Kahal’s observations, on behalf of OCA, with regard to**
2 **demand side response and energy conservation programs.**

3 **A.** Mr. Kahal observes that “cost-effective demand side programs can have value in assisting
4 residential customers to manage their household energy costs.” (OCA St. No. 1, p. 22).
5 Duquesne Light does not disagree with Mr. Kahal’s proposition. However, the key is
6 developing “cost effective” programs that will in fact assist customers in reducing usage
7 and finding a means to fund such programs. The Commission’s Demand Side Response
8 Group, of which Duquesne is an active participant, is currently working on these issues.
9 Mr Kahal recognizes that it is not appropriate to mandate such programs in this case, and
10 Duquesne agrees with Mr. Kahal’s conclusion. Any program initiation should await
11 resolution of the issues I have identified.

12 **Q. Please respond to Mr. Lacey’s contention that utility call centers should be used to**
13 **educate customers about competitive market options.**

14 **A.** Mr. Lacey recommends that customers who contact the call center with a concern about
15 their bills should be educated about competitive market options. (Direct/RESA St. No. 1,
16 p. 17). Many customers contacting the call center are having difficulty paying their bills,
17 and are looking for relief on payment agreements. They are not calling for information
18 about competitive suppliers. We also believe that it would be confusing to customers to
19 attempt to interject education about customer choice into every call. Referral programs
20 should not be mandated by the Commission at this time without a careful review of the
21 costs and customer protections. I note that Neil Fisher expresses concerns about a
22 referral program in New York. The Commission should not require Duquesne Light to

1 implement such a program at this time without careful consideration of the costs and
2 customer protections.

3
4 In Duquesne Light's service area today, if a customer inquires about customer choice, the
5 customer is handled by the Customer Service Representative ("CSR") group, which is the
6 most highly skilled in addressing customer inquiries. The CSR will educate the customer
7 about choosing an electric supplier, provide the Duquesne Light "Price to Compare" and
8 then direct the customer to the Duquesne Light website which has links to the current list
9 of suppliers serving Duquesne Light customers. These referral links include links to the
10 Commission website on Electric Choice, the OCA's Residential Electric Shopping Guide,
11 as well as a toll free number for the OCA. If the customer does not have access to the
12 Internet, then the CSR will send the customer a list of suppliers and phone numbers so
13 the customers can contact the appropriate suppliers.

14 I do not believe that additional customer education with regard to competitive options is a
15 concern because EGSs serve 98% of the large C&I load in Duquesne Light's service
16 territory, and Duquesne Light has some of the highest shopping levels in the United
17 States for other customer classes.

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

19 **A.** I have nothing further at this point, but I note that Duquesne Light has not received all of
20 the answers to the discovery requests that it has sent to the other parties in this
21 proceeding, or has not received them in time to incorporate them into the testimony. I
22 reserve the right to file supplemental rebuttal testimony after Duquesne Light receives all
23 of the answers to its discovery requests.

Default Service Letter Agreement

This letter agreement ("Agreement") is entered into this 23rd day of January, 2007 by and among Duquesne Light Company ("Duquesne"), Reliant Energy, Inc. ("Reliant"), and Dominion Retail, Inc. ("Dominion") (collectively, the "Parties") regarding the structure of default service in the Duquesne Light Company ("Duquesne") service territory consistent with the terms set forth below:

Background

Duquesne's existing POLR III program for default generation service expires on December 31, 2007 for residential and small commercial and industrial customers, and on May 31, 2007 for large commercial and industrial customers. As part of the settlement of its 2006 base rate case, Duquesne agreed, inter alia, to meet with marketers on its system to discuss, among other things, its default service program and in particular the content of its 2007 default service filing (the "Filing"), which will establish terms and conditions for default service for the 2008-2010 time frame. Over the past several months, representatives of Duquesne have met with a number of potential parties to the default service proceeding to discuss these issues. As a result of these discussions, the Parties have reached agreement as to the basic structure of Duquesne's default service filing and desire, by this Agreement, to memorialize that agreement, to express their commitment to seek broader support for the structure outlined in this letter and to state their desire to continue discussions to address and attempt to resolve further details of this Filing before it is presented to the Commission.

Agreement

Specifically, the Parties have agreed that in early 2007, Duquesne will file with the Pennsylvania Public Utility Commission the Filing, which will consist of a Petition setting forth its proposed plan for providing default service to its customers for 2008 through 2010, containing the following terms and conditions:

1. Residential Customers

Duquesne will propose to serve residential customers at fixed rates for 2008-2010. These rates will reflect a proposed phase out of declining block charges and discounted rates for heating service.

2. Small Commercial and Industrial Customers (less than 300 kW maximum demand)

Duquesne will propose to serve small C&I customers at fixed annual rates for 2008-2010. These rates will be for the 2008-2010 period, but will be adjusted annually to reflect intervening changes in market prices. This adjustment will be accomplished through application of a "rate multiplier" to the initial rates set forth in Duquesne's Filing. The rate multiplier will be calculated based on changes in wholesale electricity futures prices from the date when rates are initially established at or near the filing date to the first day of October 2008. The first rate adjustment will become effective January 1, 2009 and a similar rate adjustment will become effective January 1, 2010. For example, on October 1, 2008 Duquesne will calculate the "rate multiplier" for calendar year 2009, which will be applied to the base rate for 2009 set forth in Duquesne's default service filing. The multiplier may result in decreases or increases in the initial rates set forth in Duquesne's Filing depending on changes in market prices. Details

regarding the calculation and application of these adjustments will be provided in Duquesne's Filing.

With regard to the rate design issues, as part of its filing, Duquesne also will propose a three-year phase out of demand charges, declining block rates and discounted heating rates for Small C&I customers.

3. Lighting Customers

Duquesne will propose that lighting customers receive default service at fixed rates for 2008-2010.

4. Large Commercial and Industrial Customers (over 300 kW maximum demand)

Duquesne's default service filing will propose hourly service as the only default service option for large C&I customers commencing June 1, 2007. Duquesne will propose to eliminate its existing Fixed Price Option (Rider 8) and the current GRA mechanism (Rider 23).

5. Source of Supply

Duquesne will acquire the power required to serve Residential, Small C&I and Lighting Customers from its affiliate Duquesne Power. In turn, Duquesne Power will obtain 100% of the power required to serve Residential, Small C&I and Lighting Customers from the competitive wholesale market from non-affiliated competitive wholesale suppliers. In order to satisfy its default service obligations, Duquesne Power can rely on a variety of market purchases, including but not limited to bilateral negotiated contracts, supply obtained from requests for proposals, and/or spot electricity.

Other Terms

The above terms and conditions reflect the agreement of the Parties as to the basic structure of Duquesne's default service Filing. Duquesne agrees that its Filing will be based on the structure outlined above, and the Parties agree to support, or at a minimum not to oppose this basic structure nor to propose alternative structures in any proceeding before the Commission to review Duquesne's Filing. The Parties recognize that additional details must be included in Duquesne's Filing and that, as a result, other issues, not addressed by this Agreement, may arise. The Parties recognize that other issues not addressed by this Agreement may include issues and concerns with additional details set forth in the Filing that supplement or describe in more detail one or more of the terms and conditions outlined above, including, but not limited to, the specific retail rates proposed by Duquesne and the details of the rate multiplier. The Parties reserve their respective rights with respect to any issues not specifically resolved by this Agreement and further agree that they will continue to discuss these open issues and seek to reach agreement on these issues to the extent possible. The Parties also agree that this Agreement relates exclusively to the terms and conditions of Duquesne's 2007 Filing and that each Party reserves the right to raise any issue, without regard to whether it is addressed in the 2007 Filing, in any other proceeding. The Parties also recognize that a unanimous settlement of all issues may not be achieved with all participants in the default service proceeding, and that non-settling parties may oppose certain aspects of the default service structure set forth in this Agreement. The Parties each reserve the right, to the extent they deem necessary, to respond to and oppose arguments and positions presented by such opposing parties. In responding to the opposing arguments and

proposals presented by non-settling parties, the Parties agree to continue their support or non opposition to the structure established in this Agreement. Finally, the Parties acknowledge that the Commission, by final order in this proceeding or by other regulations or orders, may mandate a result which is inconsistent with some or all of the positions set forth in this agreement, and that Duquesne must comply with any final Commission order even if such order is inconsistent with this Agreement. In the event that any regulation or order is inconsistent with any term of this Agreement, the Parties no longer shall be bound by that term of the Agreement. This Agreement supersedes all prior and contemporaneous understandings, oral or written, between or among the Parties with respect to the subject matter hereof.

The Parties agree this letter agreement can be executed in counterparts.

Respectfully submitted.

Fred Eschmiller

Fred Eschmiller
for Duquesne Light Company

Date: 1/23/07

[Signature]

Jerry Langdon
for Reliant Energy, Inc.

Date: 1/25/07

[Signature]

Tom Butler
for Dominion Retail, Inc.

Date: 1/23/07

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PENNSYLVANIA PUBLIC UTILITY COMMISSION

Petition Of Duquesne Light Company :
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REBUTTAL TESTIMONY OF
NEIL S. FISHER

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Dated: April 13, 2007

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1 **I. Introduction**

2 **Q. Please state your name.**

3 A. My name is Neil S. Fisher.

4
5 **Q. Are you the same Neil S. Fisher who submitted direct testimony in this case?**

6 A. Yes.

7
8 **Q. What is the purpose of your rebuttal testimony?**

9 A. The purpose of my rebuttal testimony is to respond intervenors' comments related to
10 eleven important policy questions:

- 11 1. Is the Duquesne Light Company ("Duquesne" or the "Company") interim default
12 service plan ("Default Service Plan" or "Plan") for the period 2008-2010 anti-
13 competitive?
- 14 2. Should the definition of "prevailing market prices" be limited to only short-term
15 market price products?
- 16 3. Is Duquesne's Plan consistent with the Electricity Generation Customer Choice and
17 Competition Act ("Competition Act")?
- 18 4. Why does Duquesne rely on a bilateral contract with its affiliate and not conduct a
19 wholesale competitive solicitation?
- 20 5. Would residential and small C&I customers be better off with default service rates that
21 adjust quarterly and/or monthly as recommended by Direct Energy Services, LLC
22 ("Direct"), the Retail Energy Supply Association ("RESA") and Strategic Energy, LLC
23 ("Strategic")?

- 1 6. Will Duquesne's Plan to purchase 100% of its supply requirements from Duquesne
2 *Power encounter problems similar to Pike County or other wholesale solicitations that*
3 *have purchased all of their supply at a given point in time?*
- 4 7. Is Duquesne's proposed market price index mechanism arbitrary and flawed as
5 claimed by the Office of Small Business Advocate ("OSBA")?
- 6 8. Should the Commission adopt the Office of Consumer Advocate's ("OCA's") proposal
7 to separate RH rates from other residential customer rates (RA and RS), and if so, what
8 impact would that have on the proposed rates?
- 9 9. Should Duquesne be required to adopt a customer referral program in this case?
- 10 10. Should Duquesne be required to amend its Plan to be consistent with the Pennsylvania
11 Public Utility Commission's ("Commission's") Advance Notice of Final Rulemaking
12 Order ("ANOFR") and proposed policy statement ("Policy Statement")?
- 13 11. Should the Commission postpone a decision on or limit the duration of Duquesne's
14 Plan until default service regulations are finalized?

15
16 **Q. Please summarize your conclusions.**

17 **A.** My main conclusions are summarized below:

- 18 1. Duquesne has presented a Default Service Plan based on a proven successful model
19 that will further promote retail competition in Duquesne's service territory in a manner
20 that is well-balanced and has received significant support from diverse interests.
- 21 2. The Commission should allow Duquesne to use discretion when establishing rates
22 based on prevailing market prices and should not restrict default service rates to short-
23 term market prices for all customers in all situations.

- 1 3. Duquesne's Plan fully complies with the Competition Act because Duquesne acquires
2 electricity at prevailing market prices, and retail rates recover reasonable costs.
- 3 4. Duquesne has valid reasons for relying on a bilateral contract with its affiliate at this
4 time and this agreement will provide customers with substantial benefits.
- 5 5. Direct/RESA's analysis of short-term market prices compared to POLR III rates is
6 seriously flawed and misleading – and their proposal to adjust rates quarterly or
7 monthly imposes additional risks and costs on customers, is not guaranteed to be below
8 Duquesne's proposed rates in this proceeding, is opposed by customer advocates, and
9 suffers from their own criticism in that it is not consistent with the Commission's
10 proposed ANOFR and Policy Statement.
- 11 6. Duquesne's Plan does not require Duquesne Power to purchase 100% of its supply
12 requirements at any given point in time and provides Duquesne Power the flexibility to
13 manage risks efficiently by obtaining a portfolio of supply at prevailing market prices
14 at different points in time without mandating a specific mix of supply resources and a
15 particular method of procurement.
- 16 7. The OSBA's concerns about the use of the market price multiplier to adjust small C&I
17 rates are not substantiated and should be rejected.
- 18 8. As Mr. Pfrommer describes, the Commission should not accept the OCA's proposal to
19 separate the RH rates from those of other residential customers; but if it does, the rate
20 for other residential customers should be increased.
- 21 9. The Commission should not mandate a customer referral program at this time.
- 22 10. The proposed regulations are not final and Duquesne should not be forced to amend its
23 Plan to be consistent with the draft regulations that most parties in this case have
24 serious concerns with and may change.

1 11. The Commission should not postpone its decision on or limit the duration of
2 Duquesne's three-year plan in order to re-visit these issues again for supply delivered
3 prior to January 1, 2011.

4 Each of these conclusions is described in more detail below.

5
6 **Q. Are you sponsoring any exhibits in your rebuttal testimony?**

7 **A.** Yes, I sponsor three exhibits:

8 **Exhibit NSF-18** Comments from Other Parties That Support Duquesne's Customer
9 Choice Program

10 **Exhibit NSF-19** Power Supply Agreement and Amendments

11 **Exhibit NSF-20** Discovery Responses (Includes certain discovery responses of
12 Duquesne and Other Parties)
13

14 **Q. Please provide an overview of the intervenors' testimony.**

15 **A.** I have four general observations. First, it is important to note that there are both customer
16 representatives (mainly the OCA) and retail suppliers (Dominion Retail, Inc. or
17 "Dominion" and Reliant Energy, Inc. or "Reliant") that support the basic structure of the
18 Plan as a transition plan to January 1, 2011. The OSBA raises concerns about the annual
19 market price index adjustment methodology, and then recommends that the Commission
20 order Duquesne to offer small C&I customers fixed rates for a three-year period like that
21 proposed for residential customers. Direct/RESA/Strategic support Duquesne's large C&I
22 customer plan, but oppose the residential and small C&I customer plan. Constellation
23 NewEnergy, Inc. ("Constellation") raises no issues with the fundamental structure of the

1 default service plan for residential, small C&I customers, or large C&I customers, except
2 that it requests that Duquesne eliminate declining energy blocks immediately.¹

3 Second, I observe that the consumer advocates generally support reasonably priced,
4 stable and reliable default service and tend to encourage the use of longer-term supply
5 contracts procured at different points in time in order to provide more stable default
6 service rates. Contrary to this position, certain electric generation suppliers (“EGSs”)
7 support short-term market rates (with quarterly or monthly rate adjustments) for residential
8 and small C&I customers and hourly pricing for large C&I customers. The alternative
9 proposals put forth by these EGSs generally do not include any laddering or blending of
10 contracts at different points in time (unlike what is supported by consumer advocates), do
11 not propose reconciliation (consistent with Duquesne’s Plan), and do not rely on long-term
12 contracts (unlike what is supported by consumer advocates). The positions of the OCA,
13 OSBA, and Duquesne Industrial Intervenors (“DII”) and certain suppliers (Direct,
14 Strategic, and certain unidentified members of RESA²) appear to be at complete odds with
15 each other in terms of the frequency with which default service rates should adjust and the
16 appropriate term of the underlying supply contracts.

17 Third, having worked on Duquesne’s retail access pilot, POLR I plan, POLR II
18 plan and POLR III plan, I am delighted by the relatively small number of contentious
19 issues remaining in this case relative to past default service plans. I think this is largely
20 due to the efforts of the parties prior to this filing to work together to develop the Plan.

21 Reliant comments that it appreciated “Duquesne’s willingness to work together to reach

¹ Duquesne notes that it had many discussions with Constellation NewEnergy, as it did with other EGSs and market participants, in an effort to develop its Default Service Plan.

² Mr. Lacey states in footnote 1 of his testimony that the opinions expressed in his testimony may not represent the view of all members of RESA. In fact, Reliant Energy, Inc. (“Reliant”), a member of RESA, files conflicting testimony that supports Duquesne’s Plan and concludes that Duquesne’s Plan should be approved by the Commission.

1 agreement” on a default service plan “that supports the interest of all parties and allows for
2 the continued development of electric competition.”³ Dominion lists that one of the
3 purposes of its testimony is to “support the preliminary rate structure plan to which DLC,
4 Dominion, and Reliant agreed to prior to the filing.”⁴ Direct’s witness, Mr. Lacey,
5 acknowledges the successful negotiation of the proposed purchase of receivables (“POR”)
6 program. He characterizes this process as a complex negotiation of divergent interests
7 resulting in a “win-win-win” that will especially benefit credit-challenged customers and
8 EGSs participating in the program.⁵ It is my understanding that most, if not all, parties in
9 the case agreed to support or not oppose the negotiated POR program. In addition,
10 virtually all the parties in the case generally support Duquesne’s proposal to eliminate
11 generation demand charges and declining energy blocks. Reliant also points out that
12 Duquesne has committed to hold two meetings per year with interested suppliers to discuss
13 *market issues relating to market development and competition.*⁶ While important issues
14 still need to be resolved, the Company and the parties have made considerable progress
15 prior to the filing of Duquesne’s Plan.

16 Fourth, many parties make reference to the ongoing efforts of the Commission to
17 develop final default service regulations in the Commonwealth. The Commission issued
18 draft regulations and a Policy Statement on February 9, 2007 shortly after Duquesne filed
19 its Default Service Plan on January 25, 2007. Several parties (including Duquesne, OCA,
20 Reliant and Dominion) believe that Duquesne’s Plan, as currently structured, is an
21 appropriate transition plan to January 1, 2011, when the vast majority of electric customers

³ Reliant at 7, lines 1-4.

⁴ Dominion at 2, lines 14-15.

⁵ Direct at 21, lines 17-27.

⁶ Reliant at 6, lines 8-10.

1 in the state transition from their generation rate caps to a post-transition period default
2 service offering. The OSBA also has filed comments in the default service proceeding that
3 it too believes the regulations should apply for the first time to default service programs
4 for the period beginning January 1, 2011.⁷ Several parties (including RESA, Direct, and
5 Strategic) ask the Commission to adopt in this case certain aspects of the proposed rules
6 that they support, while at the same time, they ignore other aspects of the proposed rules
7 that they do not support. While I can appreciate that parties have definitive positions that
8 they support, I find it very troubling that they criticize Duquesne's Plan for not being
9 consistent with certain aspects of the draft regulations that they themselves do not fully
10 support. The draft regulations were not issued until after Duquesne's Plan was filed and
11 may change given the numerous comments received by the Commission. Furthermore, I
12 do not believe that the alternative plans proposed by intervenors are consistent with the
13 Commission's draft regulations. In fact, most of the intervenors that argue in this case that
14 certain aspects of Duquesne's filing are inconsistent with the ANOFR and Policy
15 Statement, argue in the default service regulation docket that the proposed regulations are
16 seriously flawed and/or will not promote retail competition.

17 **II. Duquesne's Default Service Plan Is Based On A Proven Successful Model That Will**
18 **Further Promote Retail Competition In A Manner That Is Well-Balanced And Has**
19 **Received Significant Support From Diverse Interests**

20 **Q. Summarize the claims of Direct/RESA/Strategic regarding the negative impact of**
21 **Duquesne's Default Service Plan on retail competition.**

22 **A.** Direct and certain members of RESA claim that Duquesne has proposed a Plan "that is
23 anticompetitive and will continue to stifle electric competition at the residential and small

⁷ OSBA Initial Comments at 3, March 2, 2007.

1 commercial customer levels.”⁸ Direct witness, Mr. Lacey, argues that EGSs are not
2 inclined to invest substantial amounts of capital to enter Duquesne’s market if the
3 residential and small C&I customer plan is approved. Strategic witness, Mr. Hudson,
4 states that “Duquesne’s plans for residential and small C&I customers...will not promote
5 sustainable retail competition for these market segments.”⁹

6 *a) Duquesne’s Default Service Plans Have Proven Successful*

7 **Q. Is Duquesne’s post-transition period Default Service Plan anti-competitive?**

8 A. No. Duquesne currently has the fifth highest percentage of customer load shopping of any
9 electric utility in the United States. Duquesne has the single highest percentage of large
10 C&I load shopping in the United States, and the ninth highest level of residential load
11 shopping in the country.¹⁰ At the same time, Duquesne provides most residential and
12 small C&I customers stable rates that are still below the regulated rates in effect prior to its
13 restructuring. Many parties publicly cite features of Duquesne’s small and large customer
14 plans as an example of a proven, successful default service plan that is workable for both
15 retail customers and EGSs. (See Exhibit NSF-18 for a sample of such comments). While
16 any party could pick a particular aspect of Duquesne’s default service plan that does not
17 meet their liking, these comments support the fact that Duquesne has been able to develop
18 over a prolonged period of time¹¹ default service plans that when viewed in their entirety

⁸ Direct at 4, lines 10-11.

⁹ Strategic at 13, lines 7-11.

¹⁰ At times Duquesne has had even higher shopping levels among residential customers (e.g., 37 percent shopping in some months), but EGSs for whatever reason have made business decisions to completely exit the retail business or the state of Pennsylvania. For example, Green Mountain once served over 45,000 customers in the Duquesne service area and has since exited Pennsylvania altogether. Further, even in jurisdictions considered to be supportive of retail competition, the majority of residential customers remain on service provided by the default supplier.

¹¹ Duquesne has successfully implemented three default service plans.

1 represent a reasonable and balanced approach to default service. Duquesne's Plan in this
2 case is modeled after prior plans that have been tested and work.

3
4 **Q. What is your response to the assertion that EGSs are not inclined to invest**
5 **substantial amounts of capital to enter Duquesne's market if the residential and**
6 **small C&I customer plan is approved?**

7 A. Dominion, the EGS which serves the largest number of residential and small C&I
8 customers in Duquesne's service area, remarks that it "has been an active electricity
9 generation supplier...since 1997 and presently serves approximately 90,000 customers" in
10 Duquesne's service area.¹² It is significant that Dominion -- the largest small customer
11 supplier in Duquesne's service area -- supports the proposed structure of Duquesne's Plan.
12 Contrary to the positions taken by Direct, RESA and Strategic, it is also significant that
13 Dominion believes that it is important that the structure "not compromise the fixed price
14 aspects of the POLR service for small customers."¹³

15
16 **Q. Do other EGSs serve customers in Duquesne's service area.**

17 A. Yes. While Direct does not serve any customers in Duquesne's service area, Strategic, a
18 member of RESA, states that it "has actively served commercial and industrial customers
19 in the Duquesne service area since 1999."¹⁴ Strategic serves many small C&I customers
20 on Duquesne's system and has done so over a prolonged period of time. Currently, there
21 are two EGSs that serve residential customers, nine EGSs that serve small C&I customers,
22 and nine EGSs that serve large C&I customers. Given that Duquesne has relatively high

¹² Dominion at 1, lines 20-22.

¹³ Dominion at 9, lines 16-17 [emphasis added].

¹⁴ Strategic at 2, lines 23-24.

1 shopping levels and has EGSs that have been active in its service area for long periods of
2 time, I do not agree with Mr. Lacey's claim that EGSs are inclined not to enter Duquesne's
3 service area. Rather, the opposite is true. Duquesne has one of the more attractive service
4 areas in the United States for EGSs to invest time and capital.

5
6 **Q. What about Mr. Lacey's claim that "electricity prices could decrease by 50% over
7 the course of three years, yet suppliers are still not likely to enter the market despite
8 all of the potential savings, or 'headroom', because of the risk of being non-
9 competitive for long periods of time after the next POLR price is set"?¹⁵**

10 **A.** This statement seems to suggest that no matter what Duquesne's Default Service Plan
11 looks like for the 2008-2010 period, EGSs may not choose to enter Duquesne's service
12 area due to the risk of how rates will be set in 2011 when the new default service
13 regulations are in effect. In other words, if the default service regulations are not favorable
14 to competition from Direct/RESA's point of view, then these EGSs simply will not enter
15 Duquesne's service area no matter what. Given that RESA has already taken the position
16 in the default service regulations docket that, under the current draft rules, EGSs will not
17 have sufficient incentive to commit the considerable resources necessary to develop the
18 competitive retail electric market,¹⁶ I am even more convinced that small customers
19 require a default service now that provides these customers stable rates. RESA's
20 comments in the default service regulations suggest that their members cannot be relied on
21 to provide small customers with fixed price protection if the proposed rules are adopted as
22 currently structured.

¹⁵ Direct at 8, lines 11-15, [emphasis added].

¹⁶ See RESA's Initial Comments at 3 and 8 in the default service regulations docket.

1
2 **Q. While Direct and RESA support Duquesne’s Plan for large C&I customers,¹⁷ what is**
3 **your response to Mr. Lacey’s assertion that “the lack of a ‘bill ready’ consolidated**
4 **billing system creates a substantial disincentive for EGSs serving the large C&I**
5 **market”?**¹⁸

6 A. Given that Duquesne has the highest percentage of large C&I customer load shopping of
7 any electric utility in the entire United States, it is hard to support Mr. Lacey’s assertions
8 that retail competition is somehow harmed in Duquesne’s service area by the lack of a
9 “bill ready” option. In any event, if an EGS really wants to calculate the bill itself, it can
10 do so by billing customers directly. In fact, Strategic is a member of RESA and already
11 does so in Duquesne’s service area. A “bill ready” requirement should not be mandated
12 without consideration of the cost and a means for recovery of such cost. Mr. Lacey’s
13 claim is completely unsubstantiated by market evidence and should be rejected.

14 *b) Duquesne Proposes Significant Changes To Further Promote Retail Competition*

15 **Q. Is Duquesne making significant improvements to its customer choice program that**
16 **will further promote retail competition and encourage EGS entry?**

17 A. Yes. Duquesne’s Default Service Plan continues to promote and further advance retail
18 competition in Duquesne’s service area by resetting supply rates to reflect prevailing
19 market prices, eliminating demand charges, eliminating below market declining energy
20 blocks, providing only an hourly price default service for large C&I customers, beginning
21 to adjust small C&I rates more frequently, simplifying rate structures and EGS price

¹⁷ Direct at 5, lines 17-19.

¹⁸ Direct at 19, line 24 to 20, line 2 [emphasis added].

1 comparisons, implementing a POR program for residential and small C&I customers,
2 committing to meet with EGSs and customers during each year, enhancing communication
3 and enforcement of Duquesne's code of conduct, and improving cost allocations among its
4 affiliates. These are significant steps the Company is taking to improve its customer
5 choice program.

6 *c) Duquesne's Plan Balances Competing Interests And Has Received Significant Support*
7 *From Diverse Interests*

8 **Q. Briefly summarize how Duquesne's program balances competing interests and has**
9 **received support from diverse interests.**

10 A. As described earlier, virtually all of the EGSs support Duquesne's Plan for large C&I
11 customers. Meanwhile, the residential Plan received substantial support from the OCA as
12 well as Dominion, the largest EGS supplier to these customers, and Reliant.

13 With respect to the small C&I Plan, the OSBA argues for a three-year fixed rate
14 similar to the rate offered to residential customers.¹⁹ Meanwhile, certain EGSs (Direct,
15 Strategic, and some members of RESA) argue for quarterly or even monthly rate
16 adjustments. Duquesne, Dominion, and Reliant support an intermediate position -- with an
17 annual rate adjustment as a transition plan to January 1, 2011. Constellation takes no
18 position with respect to the overall structure of either the residential or small C&I plan.
19 Many parties also support or do not oppose the POR program and Duquesne's proposed
20 changes in rate design.

¹⁹ The rate proposed by the OSBA is somewhat higher than that proposed for residential customers due to the consumption pattern of these customers. OSBA at 2, lines 11-13.

1 **III. The Commission Should Recognize that Longer-Term Default Service Rates May Be**
2 **Appropriate In Certain Situations, And Should Not Restrict Default Service Rates To**
3 **Short-Term Market Prices For All Customers In All Situations**

4
5 **Q. Briefly summarize the differences of opinion among the parties regarding the**
6 **interpretation of “prevailing market prices.”**

7 A. There is a long and on-going debate in Pennsylvania regarding the appropriate
8 interpretation of the legislative language – “prevailing market prices.” The consumer
9 advocates (OCA, OSBA, DII) generally support reasonably priced, stable and reliable
10 default service and tend to encourage the use of longer-term supply contracts procured at
11 different points in time in order to provide more stable default service rates. Contrary to
12 this position, EGSs generally support short-term market rates (with quarterly or monthly
13 rate adjustments) for residential and small C&I customers and hourly pricing for large C&I
14 customers. The alternative proposals put forth by certain EGSs generally do not include
15 any laddering or blending of contracts at different points in time, do not propose
16 reconciliation, and do not rely on long-term contracts. The positions of the OCA, OSBA,
17 and DII appear to be at complete odds with those of certain suppliers (Direct, Strategic,
18 and certain members of RESA) in terms of the frequency with which default service rates
19 should adjust and the appropriate term of the underlying supply contracts.

20 The consumer advocates generally support fixed rates for longer periods of time.
21 The OCA comments that “prevailing market prices, however, are not simply spot prices
22 from an organized market; rather, they reflect the term over which the product is provided
23 and the point(s) in time when the power is acquired.”²⁰ The OCA states that the provision

²⁰ OCA at 9, lines 16-19.

1 of electricity is an essential service for residential customers, and POLR services should be
2 designed to ensure that the service remains stable and affordable.²¹ Rate Stability has long
3 been recognized as a desirable feature for all electric rates, and it is important for reasons
4 of affordability, budgeting, planning, and making rational decisions regarding appliance
5 and equipment purchases.²²

6 On the other side, Direct/RESA argue that the “root of the anti-competitiveness [in
7 Duquesne’s Plan] lies in the long-term POLR prices” that are not adjusted frequently
8 enough so as to correspond with prices at the time of delivery.²³ (Direct defines long-term
9 as one year or longer.) Certain RESA members support quarterly pricing for residential
10 and small C&I customers. While Mr. Lacey accepts “as a practical application” of
11 prevailing market prices the use of quarterly pricing for residential customers based on his
12 rationale that it “is close enough” to true prevailing market prices, he prefers monthly
13 pricing for all default service customers.²⁴ Strategic adds that “Duquesne’s POLR rates for
14 residential and small C&I customers must adjust at least quarterly to be market-reflective
15 and market-responsive.”²⁵

16 *a) Prevailing Market Prices Should Not Be Limited to Short-Term Prices*

17 **Q. How do you respond?**

18 A. I believe the appropriate answer as to how best to interpret the “prevailing market price”
19 standard requires discretion and depends on the situation. It depends on the competitive
20 options available to customers, it depends on the customers’ ability to choose, it depends

²¹ OCA at 9, lines 5-6.

²² OCA at 10, lines 10-12.

²³ Direct at 6, lines 15-18.

²⁴ Direct at 13, lines 6-13.

²⁵ Strategic at 6, lines 19-21.

1 on the level of market development, and other factors. Therefore, I believe it would be a
2 mistake to apply a “hard-and-fast rule” to all types of customers in all situations.

3 The logic of Direct and certain other suppliers, when taken to their extreme, would
4 suggest that the only “true” prevailing market price is the hourly price since it reflects
5 prices at the time of delivery. This simply is not true. There are many products in the
6 marketplace and each has a prevailing market price. There are long-term products and
7 short-term products. I believe the best default service product depends on the needs of the
8 type of customer and the market situation those customers face. This requires discretion
9 and suggests the need to tailor default service to different types of customers. This is
10 exactly what Duquesne has proposed in its Default Service Plan.

11 Even Direct and other suppliers seem to recognize that some discretion is necessary
12 when proposing alternative default service plans. They do not propose hourly pricing for
13 all customers. Rather, they are willing to accept quarterly or monthly pricing for
14 residential and small C&I customers as a “practical application” that is considered by them
15 as “close enough.”

16
17 **Q. Does Direct offer customers long-term fixed prices at prevailing market prices?**

18 **A.** Using Mr. Lacey’s logic in this case, this would be impossible since no long-term market
19 price can ever represent prevailing market prices at the time of delivery. Curiously,
20 however, when asked in discovery, Mr. Lacey states that Direct offers residential
21 customers a plethora of products, including long-term fixed price term products. He states
22 that “in order to maintain our competitiveness, we must offer customers a prevailing
23 market-priced product.” Mr. Lacey adds that these prices “reflect the fair market value of
24 the underlying commodity(ies) and the risk management tools needed to provide the

1 customer exactly what the customer desires.”²⁶ Like Direct, Duquesne is offering a fixed
2 price product that represents prevailing market prices at the time the offer is made.
3

4 **Q. Does Direct oppose offering residential and small C&I customers fixed prices as a**
5 **matter of public policy or principal?**

6 A. Apparently not. It appears that Direct opposes utilities offering small customers fixed
7 default service prices, but in other jurisdictions, I am generally aware that Direct has
8 advocated for establishing fixed default service prices for one or more years by means of
9 involuntarily assigning customers to Direct through an opt-out aggregation program, not
10 unlike what they proposed in Pike County.²⁷ In sum, it appears that Direct is okay with
11 assigning small customers to a fixed price default service if Direct is able to supply this
12 service, but opposes it if the default service is to be provided by the utility.

13 *b) The Competition Act Does Not Restrict the Term of Potential Default Service Products*
14 *Or Rates*

15 The Competition Act clearly does not specify the term of potential default service
16 products or rates, and it should not be interpreted by the Commission to force all default
17 service customers in the Commonwealth onto rates that expose these customers to short-
18 term market price volatility with little opportunity to mitigate this exposure in an immature
19 competitive retail market. Not many EGSs are actively serving small customers,
20 especially residential customers, and short-term pricing would expose these customers to

²⁶ Direct Response to Duquesne Interrogatory I-10.

²⁷ In its response to Duquesne interrogatory I-15, Direct admits that the price it quoted for the Pike County fixed price service was based on the then-current market conditions, not unlike Duquesne’s current proposal. Mr. Lacey further notes that this price does not represent today’s prevailing market price. If one were to accept Mr. Lacey’s definition of the prevailing market price requirement under the Competition Act, which I do not, one could argue that Direct’s service in Pike County violates the requirements of the Competition Act.

1 volatile rates with little opportunity to mitigate that exposure in the competitive market.

2 The Commission should acknowledge that prevailing market prices may include the prices
3 of long-term fixed price default service products, and should not be limited only to short-
4 term market prices. Discretion is necessary given the different needs of customers and the
5 situations they face.

6 *c) Other Parties Support the Use of Longer-Term Products*

7 **Q. Do other parties recognize that longer-term products may reflect prevailing market**
8 **prices?**

9 A. Yes. Several parties filed comments in the default service docket supporting this position,
10 including Constellation, OSBA, OCA, IECPA, EA, and PPL. For example, Constellation
11 argued that “if a wholesale supplier bids on a one-year or a three-year default service
12 product, for instance, it is including in its bid price its expectations of where the market is
13 and will be over the term of the product. In doing so, the bidder provides a fixed price that
14 achieves a reasonable amount of price stability, but also is reflective of the market.
15 Importantly, it shifts risk management to the parties that are best equipped to do so: the
16 wholesale suppliers.”²⁸ The Industrial Energy Consumers of Pennsylvania (“IECPA”)
17 states that “multiple products exist in the wholesale market with differing duration and
18 price stability. Each product has its own ‘prevailing market price’ at a given time.”²⁹
19 IECPA concludes that “a long-term contract satisfies Section 2807(e)(3) as long as it
20 reflects the prevailing market price for similar contracts of like character and duration at

²⁸ Constellation Initial Comments at 11, March 2, 2007.

²⁹ IECPA Initial Comments at 6, March 2, 2007.

1 the time of execution.”³⁰ Both the Energy Association (“EA”) and PPL suggest that the
2 prevailing market price definition should be interpreted to recognize that, at any point in
3 time, the wholesale market includes many electric generation supply products available
4 over many time periods. The price for each of these different products over the agreed-
5 upon term is a prevailing market price at the time the generation supply is purchased.³¹

6 *d) More Frequent Rate Adjustments Will Not Necessarily Track Market Prices Better*

7 **Q. Do you believe that frequent rate adjustments (e.g., quarterly) would be more**
8 **reflective of market prices than a longer-term product?**

9 A. No, not necessarily. It is not that black-and-white. Direct, RESA and Strategic imply that
10 quarterly rate adjustments are good and long-term fixed rates are bad, but it is not that
11 simple. Long-term default service rates are known at the time of the offering. The default
12 supplier bears the risk of market price increases during the term of the fixed rate. Short-
13 term default service rates, on the other hand, pass the risk of market price volatility onto
14 the customer.³² Thus, these are two fundamentally different products that allocate risks
15 differently between suppliers and customers. Sitting here today, it is difficult to know
16 which product in the future, after the fact, will provide a lower price over a three year
17 period.

³⁰ IECPA Initial Comments at 18, March 2, 2007.

³¹ Initial Comments of EA at 5 and PPL at 5, March 2, 2007.

³² The key policy question then becomes who is best able to manage market price risks in a given situation – customers, wholesale suppliers, or EGSs. Often customers are willing to pay for security and piece-of-mind. That is why some people enter into 30-year mortgages rather than rely on annual adjustable mortgages. Each product has a prevailing market price at a given point in time. Default service is also complicated by the fact that customers have the option to leave. If market prices turn out to be lower for extended periods of time than the long-term fixed rate, customers can switch to an alternative supplier. If, on the other hand, market prices increase, customers are relieved that they are protected by the fixed rate.

1 Furthermore, it is important to recognize that even the term “quarterly rate
2 adjustment” is not as straightforward as it may sound. One could design a system to
3 *procure 100% of the supply each quarter as the EGSs would prefer. One could also design*
4 *a system to procure a portion of the supply under a three-year contract each quarter and*
5 *blend that supply purchase into rates. Alternatively, one could also use a portfolio of*
6 *supply products with varying terms. Each of these alternative procurement strategies*
7 *could be implemented while rates are adjusted quarterly. However, the implications for*
8 *retail competition, rate stability, and whether the resulting rates reflect market prices at a*
9 *given point in time, would be dramatically different depending on the procurement method*
10 *selected. It is possible to establish quarterly rate adjustments that do not reflect market*
11 *prices at a given point in time, just as it is possible to design long-term fixed rates that do*
12 *not reflect market prices at a given point in time. One approach is not necessarily good or*
13 *bad. There should be no mistake, however, that the quarterly rate adjustments proposed by*
14 *Direct, Strategic and RESA are not the same as the quarterly rate adjustments in the*
15 *Commission’s draft ANOFR, which include the use of longer-term contracts laddered*
16 *together at different points in time subject to reconciliation. In fact, several of the*
17 *suppliers that have filed testimony in this case argue that the Commission’s proposed*
18 *regulations would distort market price signals and harm retail competition.*

19 **IV. Duquesne’s Plan Fully Complies With The Competition Act**

20 **Q. Do Direct and Strategic believe Duquesne’s Default Service Plan is consistent with**
21 **the Competition Act?**

22 **A.** Yes and no. Both EGSs support the large C&I plan arguing that it is consistent with the
23 *Competition Act, but claim that Duquesne’s Plan to serve residential and small C&I*

1 customers is not consistent with the Competition Act and will not lead to rates that reflect
2 “prevailing market prices at the times customers receive POLR service.”³³

3
4 **Q. How do you respond?**

5 A. Section 2807 (e)(3) of the Competition Act simply states that the electric distribution
6 company or commission-approved alternative supplier “shall acquire electric energy at
7 prevailing market prices and shall recover fully all reasonable costs” (emphasis added).
8 The Competition Act refers to the price at which the default service provider acquires its
9 electricity, and does not impose a requirement to consider only prices “at the times
10 customers receive POLR service.” As stated earlier, I fundamentally disagree with
11 Direct’s and Strategic’s interpretation of “prevailing market prices.” Their interpretation
12 applies a “hard-and-fast rule” to all customers in all situations with little or no discretion.

13 *a) Duquesne Acquires Electricity At Prevailing Market Prices*

14 **Q. Will Duquesne acquire electricity at prevailing market prices?**

15 A. Yes. Duquesne has a full requirements agreement with Duquesne Power to provide its
16 default service supply, and the OCA correctly points out that, “Duquesne Power must buy
17 all supply in wholesale markets from non-affiliated power suppliers or generation
18 owners.”³⁴ (I discuss why Duquesne chose this method of procurement later in my
19 testimony.) In order to acquire electricity at prevailing market prices, Duquesne Power
20 may enter into bilateral contracts with third party suppliers, conduct RFPs, and/or purchase
21 spot electricity in the competitive wholesale market. In any case, Duquesne Power has no

³³ Direct at 6, lines 7-9, emphasis added. Strategic at 13, lines 7-11 (emphasis added).

³⁴ OCA at 20-21.

1 incentive to offer rates below market prices. No party in this case attempts to put forth any
2 rationale whatsoever why Duquesne Power would want to provide default service and not
3 recover its expected costs. This should alleviate concerns that the rate is set “too low”.³⁵
4

5 *b) The Proposed Retail Rates Recover Reasonable Costs*

6 **Q. What costs is Duquesne proposing to recover from its retail customers?**

7 A. Duquesne will recover its supply contract costs dollar for dollar plus Pennsylvania gross
8 receipts taxes (“GRT”). In fact, the contract prices are tied directly to the proposed retail
9 rates less GRT.
10

11 **Q. How do we know that the rates charged to Duquesne and ultimately to retail
12 customers are not too high, as suggested by Direct and RESA?**

13 A. The retail rates are based on a thorough analysis of the prices that resulted from recent
14 competitive solicitations for full requirements default service supply.³⁶ This analysis
15 appropriately makes adjustments, based on market data, for differences in product
16 structure and market conditions. Furthermore, the rates are adjusted to reflect the costs
17 and risks to the default service supplier (and the corresponding benefits to customers)
18 associated with holding open the proposed rates at fixed price levels while this docketed
19 proceeding takes place to consider the offer.³⁷ As further described later in my testimony,
20 Dominion considers Duquesne’s offer to be on the low end of the reasonable range of

³⁵ See my Direct Testimony at 62-64.

³⁶ See my Direct Testimony at 37-64.

³⁷ See my Direct Testimony at 49-58.

1 prices given the significant market risks it assumes.³⁸ This offer to hold the fixed price
2 open during the multi-month review period represents a fundamental difference between
3 Duquesne's Plan and a solicitation. As a result, the market price associated with the costs
4 and risks involved with such an offer was determined by studying the risks associated with
5 actual observed electricity market price movements. Based on this study of actual market
6 price data, it was determined that the adjustment to the rate to compensate the default
7 service supplier for holding open its offer for such a long time is reasonable and less than
8 the costs that customers might otherwise bear if the offer was not held open.

9 Furthermore, it is logical that the proposed POLR IV rates are higher than the
10 POLR III rates. Market price evidence shows that there have been significant increases in
11 electricity and natural gas prices since POLR III rates were developed.³⁹

12
13 **Q. Do other parties in this case support your conclusion that the proposed rates are not**
14 **too high?**

15 A. Yes. The comments of the consumer advocates, in particular, are persuasive. These
16 parties presumably would have the most to gain by claiming that the rates are too high.
17 Instead, the OCA concludes that the proposed fixed rate "appears to be in line with market
18 conditions for the DLC service area and is supported by an analysis conducted by DLC of
19 other POLR power procurements in the PJM region."⁴⁰ The OCA witness states, "I
20 believe that Mr. Fisher's detailed analysis demonstrates that the Company's price proposal

³⁸ Dominion at 3, lines 4-8.

³⁹ See Exhibits NSF-14 and NSF-15. In addition, relative to POLR III, the proposed rates include new risks and costs associated with PJM-related capacity and renewable energy requirements.

⁴⁰ OCA at 6, lines 7-10.

1 is a reasonable estimate of what a competitive procurement would produce.”⁴¹ The OCA
2 further adds that the proposed rate increases “are less severe than the rate increases
3 experienced by many other POLR providers within the past year” and finds the rate
4 increase acceptable.⁴²

5 The OSBA’s comments are telling as well. The OSBA notes that my initial
6 adjustments for definitional differences in market prices “are both straightforward and
7 appropriate, but my methodology for measuring locational and timing differences are more
8 difficult to evaluate since I provided so much information and data.”⁴³ Mr. Kalcic agrees
9 that “one should adjust for the locational and timing differences” but due to time
10 constraints he was unable to offer an opinion as to whether I properly quantified these
11 important factors. On page 6 of his testimony he states that in his opinion Duquesne has
12 not adequately demonstrated that the small C&I one-year fixed rate of 7.083 cents per
13 kWh properly reflects prevailing market prices, but at page 14 of his testimony he
14 recommends that the Commission order Duquesne to offer small C&I customers a three-
15 year fixed rate of 7.252 cents per kWh. He believes that many small C&I customers
16 would choose this fixed price service. The OSBA’s somewhat higher price level is based
17 on my analysis of the solicitations and risk adjustments. Mr. Kalcic applies the same risk
18 premium for residential customers to small C&I customers when fixing the small C&I rate
19 for three years adjusted for line losses and taxes. Obviously, the OSBA must believe that
20 Duquesne’s proposed rate meets the prevailing market test if it recommends locking it in
21 for three years.

⁴¹ OCA at 12 (line 22) to 13 (line2).

⁴² OCA at 6, lines 19-22.

⁴³ OSBA at 5-6.

1 From a competitive supplier's viewpoint, Dominion claims that the proposed rate
2 (7.156 cents per kWh) for residential customers is "at the lower end of a range of
3 reasonable prices." Based upon their view of how they price their services, Dominion
4 projects a range of prices between 7.2 and 7.7 cents per kWh. Dominion concludes that
5 Duquesne appears to be absorbing significant market risks with minimal compensation,⁴⁴
6 but believes that Duquesne's "price is the minimum acceptable price" for the three year
7 fixed-price offer that Duquesne has proposed.⁴⁵ With respect to the market price index
8 proposed for small C&I customers, Dominion further adds that "from a supplier's
9 perspective, the annual adjustment formula presented by witness, Neil Fisher, is sound and
10 reasonable."⁴⁶

11 The fact that both consumer advocates, the OSBA and OCA, do not believe the
12 proposed rate levels are too high,⁴⁷ and Duquesne's largest retail supplier serving
13 residential and small C&I customers, believes that the proposed rate is not too low,
14 provides additional compelling evidence that it reflects prevailing market prices for the
15 period of proposed service.

16 Finally, while Direct/RESA has a fundamentally different interpretation of the term
17 "prevailing market prices" than does Duquesne, they admit that the "prices Duquesne
18 proposed represent a fair proxy for where market prices are today in the Duquesne service
19 territory."⁴⁸
20

⁴⁴ Dominion at 3, lines 4-8.

⁴⁵ Dominion at 7, lines 14-17.

⁴⁶ Dominion at 9, lines 7-8.

⁴⁷ The OSBA mostly raises issues related to the annual market price adjustment mechanism and its desire for Duquesne to offer a fixed rate for three years. It appears to accept the rate levels as evident by its recommendation.

⁴⁸ Direct at 9, lines 6-8.

1 Q. How do you respond to complaints made by some parties that you relied on large
2 volumes of data and that your analysis is very complex?

3 A. It is true that I relied on large volumes of data, and in the course of discovery, I provided
4 parties numerous electronic spreadsheets showing the calculations and formulas that I
5 relied upon. This is largely due to the large number of solicitations I reviewed and the
6 degree to which I relied on actual market price and customer load data at the time of each
7 solicitation for both residential and small C&I customers.

8
9 Q. Has any party raised any substantive issues regarding the calculations underlying
10 your analysis of the competitive solicitations?

11 A. No, not that I am aware of.
12

13 V. Duquesne Has Valid Reasons For Relying On A Bilateral Contract With Its Affiliate
14 At This Time And The Agreement Provides Substantial Benefits to Customers

15 Q. Briefly summarize Strategic/Direct/RESA's arguments related to the need to conduct
16 a structured wholesale solicitation to procure default service supply?

17 A. Strategic asserts that the Commission should require Duquesne to procure its supply
18 through a transparent competitive procurement process.⁴⁹ Mr. Hudson suggests that if
19 Duquesne wishes to rely on the results of competitive solicitations to meet the prevailing
20 market prices standard, then Duquesne should simply conduct competitive bid solicitations
21 to fulfill its supply obligations.⁵⁰ Similarly, Mr. Lacey recommends that Duquesne amend

⁴⁹ Strategic at 15, lines 10-15.

⁵⁰ Strategic at 17, lines 20-22.

1 its Plan to acquire supply through a competitive bid solicitation process.⁵¹ “RESA
2 believes Duquesne should implement a quarterly auction for its residential and small C&I
3 customers,”⁵² while Direct believes that small C&I customers should be exposed to
4 monthly-priced auctions.⁵³ Both parties argue that this is consistent with the draft
5 regulations.

6
7 **Q. Is it necessary for Duquesne to conduct a wholesale solicitation to determine**
8 **prevailing market prices?**

9 A. No. As approved in POLR III, I have relied on the results of competitive solicitations to
10 establish retail rate levels at prevailing market prices. I do not believe that Duquesne
11 should be required to conduct a competitive solicitation in all circumstances for all
12 customers. Other states allow default service suppliers discretion in how they obtain
13 electric supply.⁵⁴ In my opinion, the Commission should not seek to impose a “one-size
14 fits all” approach to supply procurement that may impose additional costs and/or risks on
15 retail customers and may potentially harm retail competition.

16
17 **Q. Why has Duquesne chosen to rely on a bilateral contract with its affiliate and not**
18 **conduct a structured wholesale competitive solicitation at this time?**

⁵¹ Direct at 11, line 23.

⁵² Direct at 12, lines 11-12.

⁵³ Direct at 13, lines 10-13. Ultimately, Direct supports monthly or more frequent adjustments for all default service customers.

⁵⁴ For example, default service suppliers in Texas and in New York are not required to adhere to a mandated type of procurement process and have allowed default service suppliers discretion in how they obtain supply to meet their default service obligations. In his response to Duquesne Interrogatories I-3 and I-10, Mr. Lacey admits that “New York utilities are permitted to procure on a ‘long-term’ basis” and “are permitted to hedge procurement costs with a portfolio of supply purchased at different points in time” and the “default supplier is allowed to enter bi-lateral contracts” and “purchase supply from an affiliate.” Despite these admissions, he considers New York to be one of the more vibrant competitive retail markets for residential customers in the United States.

1 A. I believe Duquesne has many valid reasons, including:

- 2 • Duquesne’s procurement plan is a relatively simple, low-cost method that relies on
3 an existing contract approved by the Commission.
- 4 • Duquesne/Duquesne Power’s willingness to hold its price offer open during an
5 extended regulatory review period provides customers with significant benefits not
6 typically offered in competitive solicitations.
- 7 • Competitive solicitations involve numerous decisions regarding process and
8 product design that take considerable time to develop.
- 9 • Competitive solicitations do not always work as anticipated.
- 10 • Competitive solicitations may be more effective if conducted on a state-wide,
11 multi-jurisdictional basis.
- 12 • Competitive solicitations may harm retail competition in Duquesne’s service area.
- 13 • Duquesne’s Plan does not require Duquesne Power to purchase 100% of its supply
14 requirements at any given point in time, nor does the Plan mandate a particular
15 procurement method or product mix.

16 Each of these is described below.

17 *a) Duquesne’s Procurement Plan Is A Relatively Simple, Low-Cost Method That Relies*
18 *on an Existing Contract Approved by the Commission*

19 **Q. Strategic argues that “Duquesne’s procurement method is unnecessarily**
20 **complicated.”⁵⁵ Do you agree?**

21 A. No. In fact, the opposite is true. As Mr. O’Brien described in his direct testimony at 21,
22 Duquesne is simply amending its existing contract with Duquesne Power to make minor

⁵⁵ Strategic at 17, lines 16-17.

1 modifications that are necessary to implement the Plan. These amendments are described
2 on two pages in Duquesne's response to OCA I-5 and are minor in nature. (Exhibit NSF-
3 19 includes the amendment as well as the entire agreement.) Furthermore, the
4 Commission previously approved in Duquesne's POLR III proceeding the form of the
5 agreement for a six year supply period ending December 31, 2010:

6 Duquesne has also requested approval of the Duquesne – Duquesne Power supply
7 arrangements as an affiliated interest agreement pursuant to Section 2102(b) of the
8 Code...We agree that the affiliated interest agreement for supply arrangements is
9 in the public interest and we will approve that agreement as required by Section
10 2102(b) of the Code. In doing so, we acknowledge that the term of the power
11 supply agreement extends beyond the term of the Small Customer Plan as approved
12 herein. As we have discussed at length, nothing in this Opinion and Order prevents
13 Duquesne from seeking to recover market-based prices for energy acquired for
14 POLR supply subsequent to the term mandated herein.⁵⁶

15 By comparison, if Duquesne were required to conduct formal solicitations every
16 quarter or every month as suggested by Direct/RESA/Strategic, this would require
17 additional time and funds to implement that would ultimately be borne by retail customers.

18 *b) Duquesne/Duquesne Power's Willingness To Hold Its Price Offer Open During An*
19 *Extended Regulatory Review Period Provides Customers With Significant Benefits Not*
20 *Typically Offered In Competitive Solicitations*

21 Duquesne is willing to offer small customers greater price security than could be
22 achieved with a solicitation. Duquesne and Duquesne Power's offer to hold the fixed price
23 open during a multi-month regulatory review period represents a fundamental difference
24 between Duquesne's Plan and a competitive solicitation. Under either approach, a multi-
25 month regulatory proceeding is necessary, and somebody must assume the risk of market
26 price movements during the duration of the proceeding. Duquesne's Plan provides a
27 significant benefit to customers in the form of greater certainty and known rates. At the

⁵⁶ Opinion and Order, Petition of Duquesne Light Company for Approval of Plan for Post-Transition Period Provider of Last Resort Service ("POLR III Order"), P00032071, August 23, 2004, at 53.

1 same time, Duquesne's Plan provides the Commission and parties in this proceeding with
2 sufficient time to evaluate the Plan and the resulting rate impacts. The fact that we can
3 know and debate the proposed rates well in advance of regulatory approval is unique to
4 Duquesne's proposal. Unlike the solicitations conducted in Maryland, New Jersey, and
5 elsewhere, the Commission will have more time to review and approve the supply rates as
6 opposed to approving a process with an uncertain price outcome. In these other
7 jurisdictions, the state commission typically has only a few days in which to consider the
8 rate levels and customer impacts established in the solicitation process. The OCA witness
9 recognizes this benefit stating that "the upfront rate offer, locked in for three years, avoids
10 the risk associated with conducting a competitive procurement this fall."⁵⁷ The bilateral
11 agreement between Duquesne and Duquesne Power allows retail customers to "know the
12 price" and customer rate impacts in advance of a lengthy regulatory review period rather
13 than require the Commission to approve a solicitation process with an uncertain future
14 price outcome.

15 *c) Competitive Solicitations Involve Numerous Decisions Regarding Process And*
16 *Product Design That Take Considerable Time To Develop*

17 Even if all parties somehow immediately agreed to conduct a solicitation, many
18 significant and potentially contentious issues would still need to be resolved before the
19 solicitation could be conducted.⁵⁸ For example, some parties would likely advocate for a
20 Maryland-style RFP process, while others would likely support a New Jersey or Illinois
21 declining-clock auction approach. Some parties may favor the laddering of supply

⁵⁷ OCA at 6, lines 11-13.

⁵⁸ We have already observed many differences of opinion with regard to solicitations and their logistics, in prior Pennsylvania default service proceedings as well as in default service proceedings in other states.

1 contracts, while others would not. Some would desire the use of long-term contracts,
2 while others would support only the use of short-term products, and still others may
3 advocate a certain blend of long and short-term products. Some may favor supply to be
4 procured in the form of a fixed price full requirements product, while others may favor
5 other forms of the supply product that shift more of the price and volume risk from
6 suppliers to retail customers. No party proposing competitive solicitations has proposed
7 specific procedures to conduct such solicitations in this case.

8 Structured solicitations, if not designed properly, can result in high bid premiums
9 and/or the lack of supplier participation. Many parties in the default service proceeding
10 have raised issues related to the structure of the competitive procurement process and
11 product specification that could impact both supplier participation and the resulting bid
12 prices. A solicitation process is generally a more structured approach than a bilateral
13 agreement, and the development of a solicitation typically involves settling upon well-
14 defined terms, conditions, and bid procedures before the contract is put out to bid. This
15 involves many decisions, and takes considerable time to develop.

16 All of these issues would need to be resolved, associated documents would need to
17 be drafted, and this takes time. In fact, in response to some parties' desire to adopt
18 solicitation processes for default service throughout the state, the Commission established
19 a working group to reach some agreement on the issues related to such a process. I
20 attended an initial meeting of the working group held on July 26, 2006. While the working
21 group was formed to address numerous issues, I am not aware of any issues that have yet
22 to be resolved after more than eight months of time.

23 Market prices are likely to change during the time required to resolve these issues,
24 obtain final Commission approval of any solicitation plan, and conduct the solicitation. In

1 a solicitation, retail customers would bear the risks of these changes in market prices.

2 Conducting a solicitation does not eliminate the regulatory review period risk; it merely
3 shifts this risk from the default service supplier to retail customers.

4 *d) Competitive Solicitations Do Not Always Work As Anticipated*

5 The Company is well aware that solicitations do not always work as anticipated.

6 There is no guarantee that a structured solicitation, even if tested in another jurisdiction,
7 will be successful in attracting reasonable bids in all situations for all types of customers.⁵⁹

8 The POLR III competitive solicitations in March and May of 2006 for large C&I
9 customers in Duquesne's service area were not successful at attracting bids from multiple
10 suppliers.⁶⁰ While it is possible to point to particular reasons why these solicitations did
11 not work as envisioned after they were completed, the fact is solicitations may not work in
12 all situations for all types of customers. In addition, as several parties noted in this case, a
13 solicitation on a particular day can take place at an unfortunate time – such as after a
14 hurricane when market prices are high.

15 Several parties in the default service proceeding also express concerns that
16 wholesale suppliers may be reluctant to participate or may include high premiums in
17 structured procurements if the bid process or products are not designed properly. Parties
18 cite numerous issues regarding the timing of and differentiation of bids across service
19 areas, bid rules (e.g., load caps and price targets), product specification (e.g., block

⁵⁹ Default service products typically differ between states, within states, and sometimes even within service areas. Often different jurisdictions and default suppliers choose to allocate risks differently among wholesale suppliers, default service providers, and retail customers (e.g., some contracts offer retail customers more or less price certainty than others. Some plans adjust prices more often and vary by customer type and size.) It is also true that not all service areas are starting from the same position (e.g., some service areas have more retail shopping than in other service areas.)

⁶⁰ The March solicitation had no bidders at any price and the May solicitation had only one bidder, Duquesne Power.

1 products vs. load following, spot energy requirements, contract term, etc.), risk allocation
2 (e.g., due to customer switching, regulatory uncertainty, congestion charges, etc.), and the
3 degree of flexibility in bid evaluation criteria (e.g., if a supplier goes bankrupt or there is
4 disclosure of accounting irregularities after qualifications have been met). In sum,
5 potential participants in these solicitations stress the importance of a well designed bid
6 process and product specifications. While solicitations may result in multiple bidders and
7 attractive prices in some instances, there are certainly many examples of situations where
8 regulatory commissions have rejected or been forced to reconsider the results of
9 solicitations for a variety of reasons.⁶¹ The Commission should recognize that there are
10 risks associated with defining a particular product and bid process, and it may not always
11 work as anticipated.

12 *e) Competitive Solicitations May Be More Effective If Conducted On a State-Wide, Multi-*
13 *Jurisdictional Basis*

14 As described later in my testimony, many parties in the default service proceeding
15 emphasize the importance of developing a state-wide or multi-jurisdictional solicitation
16 process. This further supports waiting to conduct a solicitation until all electric utilities
17 might participate in such a process.

18 *f) Competitive Solicitations May Harm Retail Competition In Duquesne's Service Area*

19 Finally, it is not at all clear from market evidence that conducting a solicitation will
20 actually promote retail competition. Duquesne already has relatively higher levels of

⁶¹ Obviously, customer rate impacts remain uncertain until the solicitation is finally completed. In Maryland and Illinois, several stakeholders have argued that the solicitations have resulted in "unacceptable" rates, and this has led to hard-fought battles to change the rates after the solicitations were completed. In several jurisdictions, utilities, regulators, and/or politicians have been forced to consider cost deferral programs and rate freezes, and this adds to the risk that utilities may not be able to recover their full procurement costs resulting from a solicitation. Duquesne's Plan avoids the uncertainty and costs associated with the solicitation process and its outcome.

1 residential customer shopping than most, if not all, service areas that rely on a structured
2 solicitation process. (See Exhibit NSF-4.)

3 *g) Duquesne's Plan Does Not Require Duquesne Power To Purchase 100% Of Its Supply*
4 *Requirements At Any Given Point In Time, Nor Does The Plan Mandate A Particular*
5 *Procurement Method or Product Mix*

6 **Q. Several parties mention the problems experienced in Pike County when it purchased**
7 **100% of its supply in October 2005. Is Duquesne's Plan similar?**

8 A. No. Duquesne's Plan does not require Duquesne Power to purchase its supply obligation
9 at a particular point in time nor does the Plan require Duquesne Power to rely on any
10 particular mix of supply products or procurement method. Duquesne's Plan provides
11 Duquesne Power the flexibility to obtain in the competitive market a portfolio of supply at
12 prevailing market prices at different points in time without prescribing when and how it
13 must do so. Duquesne Power, as the wholesale supplier, is responsible for managing the
14 risks associated with providing full requirements supply at specified rates. This flexibility
15 allows the wholesale supplier to manage its risks efficiently and to obtain supply whenever
16 it sees an opportunity to acquire the power in the market at favorable prices. Proposals
17 that mandate a particular supply mix or procurement method, such as those by Direct or
18 Strategic, limit the supply procurement strategy to a single approach and appear to involve
19 purchasing 100% of the supply at a single point in time.

20 **VI. Direct/RESA's Analysis Of Short-Term Market Prices Compared To Duquesne**
21 **POLR III Rates Is Seriously Flawed And Misleading**

22 **Q. According to Direct/RESA, what is the single biggest problem with Duquesne's**
23 **Default Service Plan?**

1 A. Direct/RESA witness Lacey claims that the single biggest problem is "...the long-term
2 nature of the default prices for residential and small C&I customers."⁶² In order to remedy
3 this alleged problem, Mr. Lacey proposes the use of short-term quarterly or monthly
4 auctions for default service supply to small C&I customers and quarterly auctions for
5 residential customers, presumably in which 100% of the supply is procured for the
6 upcoming period in each auction.⁶³ According to Mr. Lacey, "...the least-cost option –
7 over time – will always be the shorter term, market-reflective pricing."⁶⁴
8

9 **Q. Does Mr. Lacey provide any arguments to support his claim that the least-cost option
10 will always be shorter term pricing?**

11 A. Yes. Mr. Lacey makes two arguments to support this claim.
12

13 **Q. What is Mr. Lacey's first argument?**

14 A. Mr. Lacey notes that prices in longer contracts include premiums to cover risks such as
15 market risk, migration risk, and regulatory risk.⁶⁵ According to Mr. Lacey, these risks are
16 minimized or eliminated with quarterly or monthly procurement. Mr. Lacey explains that
17 Duquesne's testimony in this proceeding recognizes these risks.

18 *a) Mr. Lacey Compares "Apples and Oranges" and Ignores the Additional Risks and*
19 *Costs That Customers Would Assume Under His Proposal*

20 **Q. How do you respond to this argument?**

⁶² Direct at 6, lines 14-15.

⁶³ Direct at 12-13.

⁶⁴ Direct at 13, lines 23-24.

⁶⁵ Direct at 14.

1 A. Mr. Lacey and I fundamentally disagree on what type of default service is appropriate for
2 residential and small C&I customers at this stage of market development. I believe that
3 the default supplier should manage certain risks for residential and small C&I customers
4 while retail and wholesale markets continue to develop, and Mr. Lacey proposes that retail
5 customers should bear these risks with the hope that EGSs will appear and serve these
6 customers.

7

8 **Q. Would it be prudent to rely on EGSs, instead of the default service provider, to**
9 **provide rate stability at reasonable prices to all residential and Small C&I**
10 **customers?**

11 A. No. Many obstacles still remain in the development of retail markets for smaller
12 customers throughout the nation (e.g., customer inertia, high EGS retailing costs, credit
13 and financial concerns, etc.). These hurdles have created high barriers for EGS success
14 throughout much of the United States. As indicated by the generally low migration levels
15 shown in Exhibit NSF-1, in most jurisdictions in the country, suppliers generally have not
16 yet provided small customers the variety of price and service packages that were
17 anticipated in a more mature market. Therefore, I do not believe at this stage of market
18 development EGSs can be relied on to provide fixed price protection to all residential and
19 small C&I customers. The Commission should not assume that EGSs will suddenly
20 appear, offer fixed price services at reasonable prices to all customers, and remain in
21 business for years into the future.

22

23 **Q. Do you agree with Mr. Lacey's claim that market risks can be eliminated with short-**
24 **term procurements?**

1 A. No. Mr. Lacey's plan does not eliminate market price risks. They exist. The question is
2 who bears these risks. Mr. Lacey's proposal to offer short-term default service rates would
3 transfer these risks from the default supplier to retail customers. Mr. Lacey argues that
4 "point-in-time pricing...is in essence rolling the dice on what prices will be...Duquesne
5 may have made a good roll. Duquesne may have made a bad roll."⁶⁶ While he agrees that
6 the prices that Duquesne proposed represent a fair proxy for where market prices are
7 today, he is concerned about future market prices.⁶⁷ Customer advocates also share his
8 concern. That is why they prefer more stable, long-term default service rates. That is why
9 they are willing to pay an "insurance" premium for this service. Instead, Mr. Lacey asks
10 retail customers to "roll the dice" and manage these risks on their own at a time when there
11 are relatively few competitive opportunities to mitigate these risks.

12

13 **Q. Is it appropriate to include risk premiums in the default service rate for small**
14 **customers?**

15 A. Yes. When a default service supplier offers to provide full requirements supply at a fixed
16 price for a relatively long period of time, the default service supplier (whether it is
17 Duquesne Power or a bidder in a competitive solicitation) will incorporate a premium in its
18 offer to cover the costs associated with certain risks, but this is only because the supplier
19 assumes these costs and risks instead of the customer. In fact, Direct agrees in concept
20 that "Section 2807 (e) (3) plainly requires that post-transition POLR prices provide for
21 full recovery of all reasonable costs associated with providing POLR service, including: all
22 generation procurement expenses; all administrative costs; all operational costs; all

⁶⁶ Direct at 10, lines 1-4.

⁶⁷ Direct at 9, lines 6-8.

1 customer care costs; and all customer migration expenses.”⁶⁸ As I describe further below,
2 the study that Mr. Lacey relies on for his conclusion does not include these costs.
3

4 **Q. What is Mr. Lacey’s second argument to support shorter term pricing?**

5 A. Mr. Lacey presents a study that was commissioned by Direct. The study compares
6 Duquesne’s tariff rate during POLR III to wholesale spot market prices. The comparison
7 covered the period from January 1, 2005, through November 30, 2006. Based on this
8 study, Mr. Lacey argues that Duquesne’s customers would have paid less for their
9 electricity had Duquesne procured its default service supply on a monthly basis, and he
10 argues that this indicates that short-term default service pricing is the least-cost option for
11 customers.

12 *b) There Is No Guarantee That Short-Term Prices Will Be Lower Than Long-Term Prices*

13 **Q. Is it true that the least-cost option – over time – will always be the shorter term**
14 **pricing?**⁶⁹

15 A. No. There is no guarantee that short-term market prices will be lower than long-term fixed
16 rates. Mr. Lacey even admits that under Duquesne’s Plan default service rates could
17 remain below the market price for extended periods of time.⁷⁰ At any given time, there is
18 the possibility that market prices in the future will increase above current expectations, and
19 there is the possibility that they will decrease below current expectations. Mr. Lacey in
20 effect is recommending that customers not pay for insurance because he believes the costs
21 are too high based on a sample period in his study. This argument is analogous to saying

⁶⁸ Reply Comments of Direct Energy, POLR Roundtable, Docket M-00041792 at 3-4.

⁶⁹ Direct at 13, lines 23-24.

⁷⁰ Direct at 7, lines 7-8.

1 that it is good policy for a person not to buy health insurance in the future, because during
2 one period in which the person did purchase health insurance, the health insurance didn't
3 pay off because the person did not become sick. Further, if an EGS were to provide this
4 fixed price insurance, they too would have to cover the risks of providing this service.

5
6 **Q. If Mr. Lacey truly believes that Duquesne's proposed default service rates will exceed**
7 **market prices by \$100 million or more over the next 23 months or so, what would you**
8 **recommend?**

9 A. I would suggest that Direct enter Duquesne's service area and compete with Dominion
10 who has maintained a sustainable retail business in Duquesne's service area for many
11 years. Based on today's market prices, Direct could offer customers "guaranteed savings"
12 relative to Duquesne's proposed rate. Given Direct's estimate of the magnitude of this gap
13 in prices, there should be ample opportunity to offer customers fixed rates at considerable
14 savings and still make a profit to justify market entry.⁷¹ And given Direct's stated belief
15 that over time short-term market prices will always be the least cost option, it could supply
16 this product with spot market purchases as suggested by the study conducted by Direct's
17 consultant.

18 *c) The Study Relied on by Mr. Lacey Ignores the Costs and Risks of Providing Default*
19 *Service*

20 **Q. Does the study reflect the full costs and risks of procuring full requirements supply as**
21 **proposed by Mr. Lacey?**

⁷¹ Even though in response to Duquesne Interrogatory Direct I-13, Direct does not have any dollar estimate of what the magnitude of these entry costs.

1 A. No. Direct/RESA/Strategic are proposing quarterly pricing for residential customers, not
2 spot pricing as represented by the study. Even Mr. Lacey does not propose hourly pricing
3 for residential and small C&I customers, yet the market costs in the study are based on
4 hourly prices.

5 The study ignores a variety of risks and costs and is not consistent with Mr.
6 Lacey's own proposal in this case. The study is based on spot prices with after-the-fact
7 known load shapes, which do not reflect load following, weather, customer migration and
8 other risks inherent in the Direct/RESA/Strategic alternative proposals. The calculation of
9 the market prices in the study is flawed because it ignores costs and risks associated with
10 the obligation to provide "load following" service. For each given month, the energy
11 portion of the study's monthly market price is calculated by weighting day-ahead and real-
12 time hourly prices for the Duquesne Zone by hourly loads corresponding to some type of
13 standard hourly load profile for a different utility, Ohio Power Company. While the study
14 assumes that the default service supplier must satisfy a "standard profile" of customer load
15 corresponding to the Ohio Power Company, a full requirements default service supplier to
16 Duquesne must in reality meet all of the requirements of Duquesne's (not Ohio Power's)
17 actual customer load (not some standard profile) in every instant, regardless of how much
18 that load may deviate from a "standard profile" in each hour due to unexpected changes in
19 customer usage patterns, extreme weather conditions, etc. The results of his analysis are
20 therefore misleading and seriously flawed.

21
22 **Q. Does the study reflect customer migration risks associated with a fixed quarterly (or**
23 **monthly) rate, as proposed by Direct/RESA/Strategic?**

1 A. No. The calculation of the market prices in the study is flawed because these prices are
2 missing compensation for the customer migration risk assumed by default service
3 suppliers under fixed-price contracts.⁷² Customers are likely to elect default service when
4 market prices are higher than the default service rate, and not elect default service when
5 market prices are lower than the default service rate. In fact, I am aware that certain EGSs
6 have designed contracts in the past to provide this “benefit” to customers so that customers
7 could move back and forth between default service rates and EGS service. This customer
8 switching option can be very valuable for customers, but can be very expensive for
9 suppliers. The spot market prices relied on in the study do not include the costs associated
10 with this risk at all.

11
12 **Q. Do any other parties in this proceeding recognize the types of costs and risks that you**
13 **identified in your last two responses?**

14 A. Yes. Dominion’s witness, Mr. Butler, identifies these risks as part of the “unavoidable
15 market risks” that “any market participant offering a fixed price for full requirements
16 service will assume.”⁷³ Mr. Butler characterizes the risk associated with the load
17 following obligation as a risk that extends “beyond the more predictable *normal* load
18 following costs that are based on average load profiles” and that can occur over very short
19 periods of time (e.g., six hot days that cause prices to spike).⁷⁴ Dominion correctly points
20 out that the “unplanned costs and the costs of unhedged positions are commonplace

⁷² Mr. Lacey purports that the monthly market prices calculated in the study reflect the prices that Duquesne’s customers would have paid for electricity had Duquesne procured its supply on a monthly basis.

⁷³ Dominion at 4, lines 15-23.

⁷⁴ Dominion at 5, lines 9-22.

1 occurrence in this business and must be expected.”⁷⁵ The study that Mr. Lacey relies on
2 implicitly assumes that these costs are zero!

3 *d) Mr. Lacey’s Analysis Excludes the Costs of Designing and Implementing Multiple*
4 *Short-Term Solicitations*

5 **Q. Does the study include any costs associated with designing and implementing a**
6 **competitive solicitation every quarter or month?**

7 A. No. The study neglects to account for the costs associated with designing and
8 implementing a competitive solicitation every quarter or month. If the Commission were
9 to adopt Mr. Lacey’s proposal, Duquesne would need to conduct solicitations at least four
10 times per year for residential and small C&I customers. This will impose additional
11 administrative costs on Duquesne’s customers. Penn Power projected such costs to be
12 about \$1.2 million for its 2006 RFP,⁷⁶ and Mr. Lacey’s proposal requires multiple
13 solicitations.

14 *e) The Study Relies On Faulty Assumptions That Are Misleading*

15 **Q. Are there other reasons why the results shown in the study are misleading?**

16 A. Yes. The study’s residential and small C&I default service load estimates are overstated
17 because the study neglects customer switching and because the study relies on incorrect
18 estimates of customer consumption in Duquesne’s service area. These errors affect the
19 overall dollar estimates that Mr. Lacey claims customers could have saved if the POLR III
20 pricing structure were replaced by a monthly procurement.

⁷⁵ Dominion at 7, lines 5-6.

⁷⁶ Final Price Matrices from Penn Power’s RFP website.
http://www.pennpowerfp.com/Supplier_Documents.html

1 With regard to the study's failure to account for customer switching, the study
2 simply assumes that all of the RS and GS/GM delivery service customers accounted for in
3 Duquesne's 2005 FERC Form 1 had elected default service during the time period
4 observed in the study. The study ignores customer switching statistics that are readily
5 available on the OCA website. Based on the statistics reported by the OCA, the
6 percentage of residential customers that were being served by an EGS between January
7 2005 and November 2006 varies from 18% to 23%, and the percentage of commercial
8 customers that were being served by an EGS during that time varies between 16% and
9 21%.⁷⁷

10 While the study purports to be based on a typical residential and commercial
11 customer in the Duquesne region, it does not use reasonable estimates for usage per
12 customer for Duquesne's RS and GS/GM customers. Based on Duquesne's publicly
13 available 2005 FERC Form 1, the annual consumption level for an RS customer is 7,605
14 kWh and 55,512 kWh for a GS/GM customer. However the study uses what seems to be a
15 generic industry estimate of 11,000 kWh for the RS customers and 45,000 kWh for the
16 GS/GM customers. It is odd that the study ignores the 2005 FERC Form 1 data for the
17 Duquesne-specific consumption levels, but apparently uses the same FERC Form 1 to
18 calculate the number of customers in the RS and GS/GM rate classes.

19 These two errors result in a significant bias in the study's estimate of total energy
20 consumption of the RS default service customers. In fact, based on figures used in the
21 study total consumption for RS customers over the 23-month period is estimated to be

⁷⁷ OCA Switching Statistics can be found on <http://www.oca.state.pa.us/Industry/Electric/elecstats/instat.htm>

1 10,374,821 MWH⁷⁸ in Duquesne's service area, when the actual RS POLR load for that
2 period was 5,421,769 MWH. Thus, the study's estimate of RS load exceeded the actual
3 load by 91%. Mr. Pfrommer addresses these issues in more detail in his testimony.

4 In addition, it is interesting that the analysis completely ignores any mention of the
5 more than 28,000 heating customers whose default service rates are considerably lower.
6

7 **Q. What do you conclude about the study?**

8 A. The study ignores the additional risks and costs that customers would assume. The study
9 does not even represent the costs of providing quarterly or monthly default service
10 procurements as recommended by Direct/RESA/Strategic, but rather is based on spot
11 prices and known load patterns. Therefore, the study ignores a variety of costs and risks of
12 providing default service (e.g., load following, weather risks, customer migration,
13 administrative costs, etc.). Finally, the study relies on faulty assumptions that result in
14 misleading claims.
15

16 **VII. The OSBA's Concerns About The Use Of The Market Price Multiplier To Adjust**
17 **Small C&I Rates Are Not Substantiated And Should Be Rejected**

18 **Q. Briefly describe Duquesne's proposal regarding the mechanism to adjust 2009 and**
19 **2010 small C&I default service rates based on changes in market prices.**

20 A. As I explained in my direct testimony, the initial rates for small C&I customers will be
21 adjusted for 2009 and 2010 to reflect changes in market prices. This adjustment will be
22 accomplished through the application of a "Market Price Multiplier." The Market Price

⁷⁸ Loads do not include line losses. Study's estimate obtained by multiplying the load shapes on p.13 of Exhibit FPL-3 by the customer numbers on p.10 of the same exhibit.

1 Multiplier will be calculated based on changes in forward market prices from the date
2 when rates were initially established near the filing date, to the first day of October 2008
3 for 2009 deliveries, and to the first day of October 2009 for 2010 deliveries. The
4 calculation of the Market Price Multiplier can be replicated and is auditable, because the
5 Market Price Multiplier will be calculated from a formula that uses 20-day averages of
6 electricity forward market prices reported by NYMEX. The forward market prices that are
7 used in the calculation involve delivery at the PJM “NiHub,” because forward market
8 prices are not available for the Duquesne Zone.

9
10 **Q. Have any parties directly opposed this proposal to adjust the Small C&I rates?**

11 A. While Dominion and Reliant support this proposal, the OSBA has opposed it.

12
13 **Q. Please summarize the OSBA’s first objection to the Market Price Multiplier.**

14 A. The OSBA is concerned that the Market Price Multiplier will produce arbitrary results.⁷⁹
15 Specifically, the OSBA notes that Duquesne could have proposed to use forward market
16 prices applicable to another trading hub, instead of NiHub, in the calculation of the Market
17 Price Multiplier, and this would produce different values for the Market Price Multiplier,
18 so the OSBA states that this “...suggests that the MPM adjustment mechanism would
19 produce arbitrary results.”

20 *a) Changes in PJM NiHub Prices Track Those In the Duquesne Zone*

21 **Q. How do you respond?**

⁷⁹ OSBA at 8.

1 A. The OSBA's claim is without merit. Mr. Kalcic admits in response to Duquesne's
2 Interrogatory OSBA I-4 that "he has not performed an analysis in this area" and that he
3 merely relies on the fact that there are other market indices available. The OSBA's
4 assertion that the Market Price Multiplier may produce arbitrary results is based on its
5 statement that market prices at PJM NiHub do not necessarily follow market prices at
6 other PJM trading hubs. This fact is irrelevant to the decision to use PJM NiHub forward
7 prices in the calculation of the Market Price Multiplier. Other PJM trading hubs may
8 represent locations within PJM with very different transmission constraints, and supply
9 and demand dynamics. In order to assess whether it is reasonable to use PJM NiHub
10 forward prices in the calculation of the Market Price Multiplier, we need to know how
11 closely movements in market prices at PJM NiHub follow movements in market prices at
12 the Duquesne Zone, because the purpose of the Market Price Multiplier is to reflect market
13 price changes at the Duquesne Zone.⁸⁰ It does not matter at all whether market prices at
14 PJM NiHub are similar to market prices at other PJM trading hubs, market prices at
15 trading hubs outside of PJM, or market prices for a gallon of milk.

16
17 **Q. How can you assess whether changes in market prices at the PJM NiHub**
18 **approximate changes in market prices at the Duquesne Zone, if visible forward**
19 **market prices are not available at the Duquesne Zone?**

20 A. We can study spot prices, which have been available for both locations since January
21 2005.

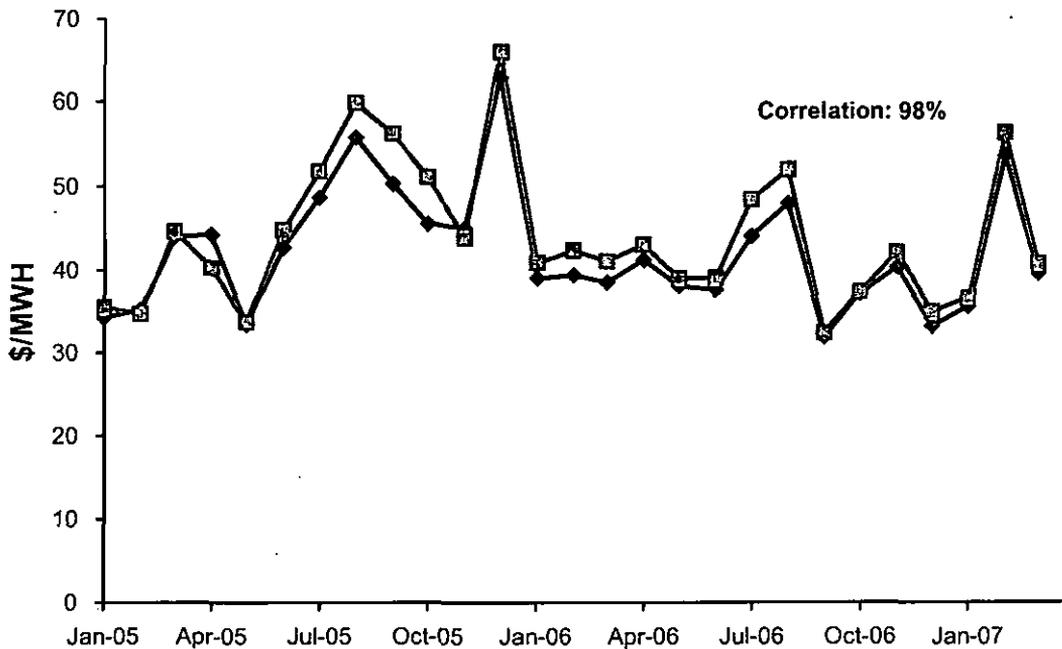
⁸⁰ NiHub is a liquid trading hub located within PJM. As shown in Exhibit NSF-17, price differences between NiHub and the Duquesne Zone historically have been low and relatively stable. The average basis differential between NiHub and the Duquesne Zone was \$1.89 per MWH, and the correlation between the two prices was 0.98 during the 12 months ending October 31, 2006. By comparison, the average basis differential between the PJM West Hub and the Duquesne Zone was \$13.15 per MWH, and the correlation between the two prices was 0.88 during the same period.

1

2 **Q. Are changes in spot prices at NiHub similar to changes at the Duquesne Zone?**

3 A. Yes. The graph below depicts the monthly average (day-ahead) spot prices at NiHub and
4 at the Duquesne Zone from January 1, 2005, when Duquesne joined PJM, through March
5 31, 2007. It is clear that market prices at the two locations track each other very closely.

Monthly Average Day-Ahead Energy Prices



6

7

8 **Q. Does the calculation of the Market Price Multiplier include a safeguard in case the**
9 **market prices at the two locations are not as similar in the future?**

10 A. Yes, even if the market prices were to diverge, the Market Price Multiplier includes a
11 safeguard that would help ensure that the adjustment to the default service rates reflects
12 market price changes at the Duquesne Zone. Specifically, as described in Exhibit NSF-16
13 attached to my direct testimony, the index prices used in the calculation of the Market
14 Price Multiplier are actually NiHub prices adjusted by the corresponding differential

1 factors (i.e., reflecting locational spot price basis differentials) as measured over the most
2 recent 12 calendar months between NiHub and the Duquesne Zone. This will help ensure
3 that the Market Price Multiplier reflects any changes in the differences between market
4 prices at NiHub and the Duquesne Zone.

5
6 **Q. Please summarize the OSBA's second objection to the Market Price Multiplier.**

7 A. The OSBA opposes the calculation methodology's use of forward prices spanning twenty
8 consecutive trading days in each of September 2008 and September 2009, in order to
9 calculate the Market Price Multiplier on October 1, 2008, and October 1, 2009,
10 respectively. Specifically, the OSBA states:

11 In essence, Duquesne uses the market activity over these 20 trading
12 days as a proxy for the price that a default supplier would pay for
13 generation if it were to acquire 100% of its default service
14 requirements in that particular market, within that same 20 day
15 window. To make matters worse, Duquesne proposes to use the 20
16 days ending on October 1, 2008 and October 1, 2009, i.e., during the
17 height of the hurricane season, to adjust Small C&I generation rates
18 in 2009 and 2010, respectively.⁸¹
19

20 *b) Averaging Twenty Trading Days Smooths Out Anomalies That Can Occur On A*
21 *Single Solicitation Date and This Methodology Has Been Used In Other Jurisdictions*

22 **Q. How do you respond to these allegations?**

23 A. First, it is important to realize that the purpose of the Market Price Multiplier is to reset
24 small C&I default service rates to market levels on an annual basis; the purpose is not to
25 determine or assume anything with regard to when Duquesne Power procures its supply.

26 Second, Duquesne has proposed using a twenty-day average of forward market
27 prices in the calculation of the Market Price Multiplier *because* it understands that

⁸¹ OSBA at 8.

1 anomalies such as hurricanes can have sudden short-term impacts on electricity forward
2 market prices, and Duquesne would like to limit the exposure to such anomalies. A
3 twenty-day average of forward market prices may smooth out anomalies that might occur
4 in a single day (e.g. with a competitive solicitation) or in a week. Yet, a twenty-day period
5 is short enough that it is still representative of current market conditions. As I noted in my
6 direct testimony, other jurisdictions in Texas, New York and Illinois have relied on
7 averaging prices over twenty days for the purpose of developing a market price index to
8 set retail rates.

9 *c) Duquesne Is Willing To Change the Index Date to December 1st*

10 Third, Duquesne is willing to index the small C&I default service rates on either
11 December 1 (using forward market prices spanning twenty days in November) or on
12 November 1 (using forward market prices spanning twenty days in October) to address the
13 OSBA's concern about the use of forward market prices spanning twenty days in
14 September. While Duquesne recognizes that it is possible that a significant hurricane can
15 have an impact on market prices for an extended period of time, the Company seeks to
16 balance providing customers some level of rate stability with the marketer's desire to have
17 rates that are more reflective of market prices at the time of delivery.

18 *d) Small C&I Rates Should Be Adjusted Annually During The Next Stage Of Market*
19 *Development*

20 **Q. How do you respond to the OSBA's desire to have three-year fixed rates similar to**
21 **residential customers?**

22 **A. As I stated in my direct testimony, Duquesne's Plan attempts to tailor default service by**
23 **customer type and market situation in a manner that balances the interests of customers**

1 and competitive suppliers while further developing retail competition. Currently, there are
2 only two EGSs that serve any residential customers in Duquesne's service area.
3 Meanwhile, there are nine EGSs that serve small C&I customers. In general, this activity
4 in Duquesne's service area is consistent with the experience elsewhere in the industry.
5 Throughout much of the United States, there are more EGSs serving small C&I markets
6 and more small C&I customers are shopping than is the case for residential markets.
7 (Exhibit NSF-1 shows small C&I customers in the United States generally have somewhat
8 higher switching levels than residential customers.) While I recognize that there is
9 considerable diversity among small C&I customers, I believe it is appropriate at this stage
10 of market development in Duquesne's service area to provide small C&I customers with
11 more exposure to market price adjustments, rather than fix their rates for three years. This
12 will further promote retail competition, especially for larger customers within the small
13 C&I group, while smaller C&I customers will likely benefit from the Company's rate
14 design proposal to eliminate demand charges.

15 **VIII. As Mr. Pfrommer Describes, The Commission Should Not Accept The OCA's**
16 **Proposal To Separate The RH Rates From Those Of Other Residential Customers;**
17 **But If It Does, The Rate For Other Residential Customers Should Be Increased**

18 **Q. Describe Duquesne's residential rate proposal as it relates to heating customers.**

19 A. Duquesne developed and proposed rates for all residential customers taking into account
20 the combined load pattern of all residential customers. This was done to simplify the rate
21 structure and because Duquesne did not find that significant differences in rate levels
22 between heating customers and non-heating customers could be justified on an economic,
23 market-cost-to-serve basis. However, due to concerns about significant rate impacts,
24 Duquesne voluntarily chose to phase-in the rate increases to RH and RA heating customers

1 over the three-year period. Importantly, Duquesne did not propose to recover the costs of
2 this phase-in of residential heating customer rates from other residential RS customers.

3
4 **Q. Did Duquesne propose to recover these costs from non-residential customers on**
5 **Duquesne's system?**

6 A. No.

7
8 **Q. Briefly summarize the OCA's suggestion to modify the residential rate for RH**
9 **customers in 2010.**

10 A. The OCA suggests only one minor modification to the Company's residential rate
11 proposal. While the OCA agrees with Duquesne's overall policy of narrowing the
12 differences in RH and RS rate levels, it does not believe the rates should be the same in
13 2010.⁸² The OCA believes "it would be appropriate to maintain at least a modest rate
14 differential" estimated by the OCA to be 0.5 cents per kWh between RS and RH in year 3
15 of Duquesne's Plan. In response to Duquesne's discovery question OCA I-4, the OCA
16 admits that it calculated a 0.36 cents differential but then "rounded up to 0.5 cents in order
17 to address the rate shock problem for RH customers." This difference was computed
18 based on data provided by the Company in response to OCA I-18.⁸³ The OCA's
19 justification for this change is that a larger percentage of RH customers' energy usage is in
20 lower cost non-summer months, and therefore these customers should face at least a
21 modestly lower market price for POLR supply.

22

⁸² OCA at 7, lines 3-11.

⁸³ OCA at 18, lines 19-22.

1 **Q. What is your response to this suggestion?**

2 A. As described by Mr. Pfrommer, Duquesne continues to support moving to a single
3 residential rate in 2010. However, if the Commission adopts the OCA's proposal to
4 separate the RH rate schedule from those of other residential customers, then the rate for
5 other residential customers should be increased. I will now explain why.

6 *a) Duquesne Used The Combined Load Profile For Non-Heating And Heating Customers*
7 *To Establish Residential Rates*

8 First, I used the aggregated load profile for all residential customers (non-heating
9 and heating) to establish the residential rate level. Therefore, both the load pattern and the
10 relative size of the heating rate schedules were taken into consideration in the development
11 of the proposed rates.

12 *b) Certain Heating Customers Are More Expensive To Serve Than Non-Heating*
13 *Customers*

14 Second, the RA heating customers, with an add-on heat pump, tend to consume
15 relatively more electricity during both winter and summer months (with air conditioning
16 load) than other residential (both RS and RH) customers. Since both the winter and
17 summer prices in Duquesne's service area tend to be higher than shoulder months, the RA
18 heating customer load profile has slightly higher costs to serve than other residential
19 customers. The OCA does not mention the RA rate and therefore I conclude is willing to
20 accept the combined rate for these customers.

1 c) *The OCA's Analysis Of The RH Load Pattern Relies On The Wrong Data And*
2 *Therefore Overstates The Differences Between RS And RH Customers*

3 OCA witness Kahal states at 18, line 19, that he used load data from Duquesne's
4 response to OCA I-18 to establish his 0.5 differential in 2010. This is not the right data to
5 use for his analysis. The data to which he refers includes monthly billed kWh and does not
6 reflect actual consumption for customers in a precise manner. This data records billed
7 customer consumption for the month of January for a customer whose bill is issued
8 January 1st and January 31st even though the actual consumption took place during
9 different time periods. This information is readily reported in Duquesne's billing system
10 but should not be used for the purpose of calculating the market cost to serve a particular
11 rate schedule. Rather, I used the actual hourly load obligations of aggregated RS, RA and
12 RH customers that suppliers (whether the POLR supplier or EGSs) would be obligated to
13 serve. This information was provided to the OCA in discovery, and more accurately
14 portrays the relative differences in customer consumption patterns. The OCA's calculation
15 (with the assumed rounding) therefore overestimates the relative difference in costs.

16 d) *In Any Event, There Is No Justification For Lowering The RH Rate Without Also*
17 *Increasing The RS/RA Rate*

18 If the Commission adopts the OCA proposal and orders Duquesne to separate the
19 RH load pattern from all other residential customers for market-cost-to-serve reasons, then
20 Duquesne should develop rates for the RH and other residential customers separately.
21 Applying the same market-cost-to-serve logic to the RS/RA combined load profile (i.e.,
22 removing the RH load pattern from the total residential load pattern) results in an increase
23 in the RS and RA rates during the 2008-2010 period. In other words, the RH consumption

1 pattern should either be combined with other residential rate schedules to establish rates
2 for the entire class, as the Company has proposed, or the RH consumption pattern should
3 be removed from that of other residential customers and rates should be developed
4 separately for the RS/RA customers and the RH customers. The OCA's recommendation
5 double counts the RH consumption pattern both in the development of the RS/RA rate
6 level and in the development of separate RH rate levels. Rates should be developed based
7 on market-cost-to serve principles using the appropriate consumption patterns of the
8 customers in that particular class. If the Commission accepts the OCA's suggestion to
9 develop separate rates for RH customers, then the consumption pattern for RH customers
10 must be separated from other residential customers.

11
12 **Q. Using the appropriate data, what impact would the OCA's proposal have on average
13 residential rates?**

14 **A.** Using the same methodology as before to establish rate levels but with two load profiles
15 (RS/RA and RH) instead of one aggregated load profile for all residential customers,
16 would result in the following average residential rates by rate schedule in 2010:

¢/kWh	2010
RS/RA	7.179
RH	6.895
Difference	0.284

17
18 Mr. Pfrommer describes in his rebuttal testimony how these average rates would be
19 translated into retail rates by year if the Commission decides to separate the RH load
20 pattern from all other residential customers.

1 **IX. The Commission Should Not Mandate A Customer Referral Program**

2 **Q. Do you agree with Direct/RESA's recommendation that Duquesne should adopt a**
3 **customer referral program in this proceeding?**⁸⁴

4 **A.** No. Referral programs should not be mandated by the Commission at this time without a
5 careful review of the costs, benefits and customer protections. Concerns about similar
6 referral programs have been raised in New York by Gerald Norlander, Executive Director
7 of the Public Utility Law Project of New York, Inc.⁸⁵ As recently as March 2007, Mr.
8 Norlander testified that:

9 The New York "ESCO Referral Program" offers a "teaser" introductory rate to
10 induce customers to switch...approximately \$2.80. Only after the switch does the
11 customer have the opportunity to learn what the rates and terms will be after the
12 introductory period – assuming that the disclosures are timely mailed and
13 scrutinized by the customer before the end of the period. This is a classic "bait and
14 switch" or "cramming" tactic: baiting the customer with a temporary price break...
15 and then switching to alternative, more expensive terms and conditions unless the
16 customer affirmatively rejects them...There is no oversight of the post introductory
17 rate levels or required disclosure of a comparison with regulated rates from the
18 distribution company. The "teaser" rate followed by significantly higher post-
19 introductory period rates, along with early termination charges, has led to
20 significant consumer dissatisfaction in New York.⁸⁶
21

22 I share similar concerns about the way these programs are structured and the ease
23 with which customers, in some instances, are deemed to "accept" a contract at unregulated
24 rates not subject to Commission review without their affirmative consent. For example, in
25 some programs, if a customer does not rescind an EGS contract within three days of
26 receipt, the customer is deemed to accept the contract. I know that at times I do not even

⁸⁴ Direct at 17.

⁸⁵ PULP is an independent nonprofit organization in Albany, New York, created by community and legal aid organizations to represent the interests of low income utility consumers.

⁸⁶ Testimony of Gerald A. Norlander, Executive Director, Public Utility Law Project of New York, Inc., Before the Committee on Energy and Technology of the Connecticut General Assembly, March 6, 2007, at 7-8.

1 open my mail within three days of receipt. The Commission should not require Duquesne
2 to implement such a program on a stand alone basis at this time without careful
3 consideration of the costs, benefits, and customer protections.

4 **X. The Proposed Regulations Are Not Final And Duquesne Should Not Be Required To**
5 **Amend Its Plan To Be Consistent With The Draft Regulations**

6 **Q. Summarize the claims of certain intervenors related to how Duquesne's residential**
7 **small C&I customer Plan is not consistent with the draft regulations issued on**
8 **February 6, 2007.**

9 A. While Mr. Lacey recognizes that Duquesne's Plan was filed in advance of the issuance of
10 the ANOFR and Policy Statement,⁸⁷ Direct/RESA criticize Duquesne's proposal claiming
11 that parts of the Plan are consistent with the ANOFR and the Policy Statement and other
12 parts are not.⁸⁸ Mr. Lacey concludes that Duquesne should amend its Plan to "incorporate
13 those competitive market design aspects" that it would like Duquesne to implement.⁸⁹
14 Strategic also recommends certain modifications since they are not "consistent with the
15 default service framework set forth in the ANOFR and Policy Statement Orders."⁹⁰ Both
16 parties provide a list of changes that they support suggesting that they are "consistent"
17 with the proposed draft regulations and Policy Statement.

18 *a) The Proposed ANOFR Is Not Final And May Change*

19 **Q. How do you respond?**

⁸⁷ Direct at 11, lines 17-18.

⁸⁸ Direct at 5, lines 5-9.

⁸⁹ Direct at 11, lines 18-19, emphasis added.

⁹⁰ Strategic at 15, lines 15-17.

1 A. Many parties (including RESA, Direct, Strategic, and OSBA) ask the Commission to
2 adopt in this proceeding certain aspects of the proposed rules that they support, while at
3 the same time, they ignore other aspects of the proposed rules that they strongly oppose.
4 While I can appreciate that parties have definitive positions that they support, I find it very
5 troubling that they criticize Duquesne's Plan for not being consistent with draft regulations
6 that were not issued until after the Plan was filed, and may well change given the
7 numerous comments that were received by the Commission.

8 *b) Certain Parties Argue That Duquesne Must Follow Certain Aspects Of The Draft*
9 *Rules When They Oppose Other Important Features Of The Draft Rules*

10 Ironically, most of the intervenors that argue in this case that certain aspects of
11 Duquesne's filing are inconsistent with the ANOFR and Policy Statement, argue in the
12 default service regulation docket that the proposed regulations are seriously flawed and
13 will not promote retail competition or not provide customers with the rate stability that
14 they desire.

15
16 **Q. Can you cite some specific examples?**

17 A. Yes. In this proceeding, Mr. Lacey hints that "not all aspects of the Commission's order
18 are favorable to the development of competitive markets."⁹¹ This is clearly an
19 understatement of Direct's position on the proposed regulations. It is clear from their
20 initial comments filed on March 2, 2007 in the default service proceeding that
21 Direct/RESA/Strategic do not believe the draft regulations, in their current form, will
22 create a viable competitive market.

⁹¹ Direct at 21, line 1-2.

1 RESA argues that the market structure created by the ANOFR and proposed Policy
2 Statement “essentially guarantees that Default Service will not reflect prevailing market
3 prices on a current and continuing basis” and will fall far short of compliance with the
4 Competition Act.⁹² Hess considers the Commission’s structure as an “adoption of a
5 synthetic and fatally flawed PTC mechanism” due to a “misalignment between the EGS
6 product prices and the PTC.”⁹³ RESA argues “that permitting reliance primarily upon
7 long-term, laddered supply contracts for Default Service will negate the positive changes
8 adopted or proposed by the Commission.”⁹⁴ RESA comments that “EGSs will not have
9 the incentive to commit, or to continue to commit, the considerable resources necessary to
10 develop the competitive retail electric market because they will not have the market
11 structure or regulatory certainty required for sustained, robust retail competition.”⁹⁵ RESA
12 further claims that the Commission’s proposed changes to facilitate retail choice will not
13 be sufficient to overcome the anti-competitive effects of the long-term laddered portfolio
14 procurement approach.⁹⁶ It should be clear from these comments that these parties have
15 serious concerns about the draft regulations as they are currently drafted. Therefore, even
16 if the ANOFR is adopted as proposed, these EGSs will likely choose not to compete in
17 Pennsylvania.

18
19 **Q. Is Duquesne’s Plan more supportive of customer choice than the Commission’s**
20 **proposed draft rules?**

21 **A.** Yes, I believe so, and I believe others share this view.

⁹² RESA Initial Comments at 8, 2-3, March 2, 2007.

⁹³ Hess Initial Comments at 10, March 2, 2007.

⁹⁴ Initial Comments of RESA at 2, Also see Initial Comments of Strategic at 3 and Direct at 4, March 2, 2007.

⁹⁵ RESA Initial Comments at 8, March 2, 2007.

⁹⁶ RESA Initial Comments at 5, March 2, 2007.

1 Regarding the small customer plan, Dominion submits as a final point in its initial
2 comments to the Commission “that it would be far more productive and wiser for the
3 Commission to base its rules on the success of the Duquesne POLR program that affects
4 over 500,000 customers, and not based upon over-reaction of one obvious failure – Pike
5 County – with comparably few customers.”⁹⁷

6 Strategic admits that Duquesne’s plan even goes beyond the requirements of the
7 ANOFR and Policy statement, correctly pointing out that Duquesne’s Plan proposes
8 hourly prices to all customers with peak demands of 300 kW or higher, while the ANOFR
9 would permit monthly pricing to customers with peak demands of 500 kW or higher. In
10 addition, the Policy Statement would permit Duquesne to propose a fixed-price option for
11 large C&I customers. In its comments on the default service regulations, Strategic urged
12 the Commission not to allow Duquesne to move back to longer term pricing. In this
13 proceeding, Strategic commends Duquesne stating that “Duquesne has correctly opted not
14 to propose a fixed-price option.”⁹⁸

15 *c) The Alternative Plans Put Forth By Direct/RESA/Strategic Are Not Consistent With*
16 *The Proposed Regulations*

17 **Q. Are the Direct/RESA/Strategic proposals consistent with the proposed default service**
18 **regulations?**

19 A. No, they do not allow for the use of longer-term contracts and laddering of supply
20 purchases at different points in time. Nor do they provide for the Commission’s preferred
21 approach of cost and revenue reconciliation. These fundamental differences between the
22 draft regulations and their recommendations in this case are completely ignored in their

⁹⁷ Dominion Initial Comments at 11-12, March 2, 2007.

⁹⁸ Strategic at 13 (line 19) to 14 (line 8). Also see Strategic’s response to Duquesne Interrogatory I-5.

1 testimony. I find it troubling that Direct/RESA/Strategic oppose key features of the
2 default service regulations, yet ask the Commission to selectively apply only certain
3 aspects of the draft regulations to this case, suggesting that Duquesne's interim Plan must
4 be consistent with draft regulations that are still changing and may not even become
5 effective until January 1, 2011.

6 **XI. The Commission Should Not Postpone A Decision On or Limit The Duration Of**
7 **Duquesne's Three Year Plan**

8 *a) Duquesne's Plan Provides A Valuable Bridge To January 1, 2011*

9 **Q. Do other parties, besides Duquesne, recognize the need for a transition plan to**
10 **January 1, 2011?**

11 **A.** Yes, several parties (including the OCA, Reliant and Dominion) believe that Duquesne's
12 Plan, as currently structured, is an appropriate transition plan to January 1, 2011 -- the time
13 when the vast majority of electric customers in the state transition from their generation
14 rate caps to a post-transition period default service offering. The OCA supports
15 Duquesne's Plan stating that "the three-year fixed rate will provide DLC customers taking
16 POLR service with rate certainty and stability during the remainder of the decade.
17 Importantly, the upfront rate offer, locked in for three years, avoids the risk associated
18 with conducting a competitive procurement this fall."⁹⁹ The OCA witness, Mr. Kahal,
19 comments that he views the proposed program as a transition to a longer-term arrangement
20 and methodology. The OCA points out that by the end of 2010, the Commission is
21 expected to have in place final POLR regulations and Pennsylvania's other major utilities
22 at that time will no longer be providing POLR service under the restructuring rate caps. In

⁹⁹ OCA at 6, lines 10-13.

1 this regard, the Plan “operates as a ‘bridge’ until those regulations are implemented and
2 DLC begins to operate under those regulations.”¹⁰⁰ Therefore, the OCA recommends that
3 the Commission approve the residential plan “as a transition program through 2010.”¹⁰¹
4 Similarly, Reliant argues that Duquesne’s Plan for the period January 1, 2008 through
5 December 31, 2010 is appropriate as a transition plan,¹⁰² as does Dominion.¹⁰³

6 The OSBA also has filed comments in the default service proceeding that it too
7 believes the regulations should apply for the first time to default service programs for the
8 period beginning January 1, 2011.¹⁰⁴ Under this approach, all customers in the state
9 would be affected by the rule changes at the same time and customer education and
10 communication efforts can be effectively coordinated on a statewide basis.

11
12 **Q. Isn’t it true that the Commission is expected to finalize default service regulations**
13 **later this year?**

14 **A.** Yes, that is my current understanding. The process to develop these regulations has been
15 both long and challenging for the Commission. As recently as March 2nd and March 23rd
16 of 2007, parties in that proceeding submitted numerous and important comments that
17 raised what I consider to be serious concerns about the proposed rules. These comments,
18 when considered in their entirety, convey several fundamental themes. In particular,
19 consumer advocates express concerns that the proposed rules will result in volatile retail
20 rates with frequent adjustments and over reliance on short-term market prices. EGSs cite
21 fundamental problems with the proposed structure and contend that the rules will result in

¹⁰⁰ OCA at 8, lines 8-16.

¹⁰¹ OCA at 23, 4-7.

¹⁰² Direct at 5, lines 7-8.

¹⁰³ Dominion at 2, lines 14-15.

¹⁰⁴ OSBA Initial Comments at 3, March 2, 2007.

1 little or no retail competition in Pennsylvania. Potential wholesale suppliers warn that
2 structured solicitations may suffer from lack of supplier participation and/or may result in
3 high bid prices if the Commission is not careful and a number of issues are not addressed
4 properly. EDCs express concerns that the proposed rules impose multiple and conflicting
5 procurement standards that they may lead to cost disallowances and harm their wires
6 business. The combination of volatile electric rates, little or no retail competition, and
7 unanticipated negative results from structured solicitations would be extremely detrimental
8 to customers in the Commonwealth.

9
10 **Q. Even if the regulations don't change and the regulations are finalized soon, does this**
11 **suggest that Duquesne's three year Plan should be shortened in order to have**
12 **Duquesne conform to the new rules as soon as possible?**

13 A. No, for several reasons. First, adequate time will be required to design and reach
14 agreement on appropriate supply products to be solicited, bidding rules, and procurement
15 procedures. Second, Duquesne should not be required to conduct a competitive
16 solicitation on a stand-alone basis. Third, I believe postponing or limiting the duration of
17 Duquesne's three year Plan could harm customers, retail competition, and/or Duquesne
18 Power. Fourth, given the success of Duquesne's customer choice program, there is no
19 pressing need to implement new regulations on a stand-alone-basis.

20 *b) Time Is Needed To Design Appropriate Supply Products To Be Solicited, Bidding*
21 *Rules, And Procurement Procedures*

22 Structured solicitations, if not designed properly, could result in high bid premiums
23 and/or lack of supplier participation. As the Commission is aware, there is an ongoing

1 effort in Pennsylvania to determine to what extent it is possible to develop standardized
2 bid documents and processes. Many parties in the default service proceeding have raised
3 issues related to the structure of the competitive procurement process and product
4 specification that could impact both supplier participation and the resulting bid prices.¹⁰⁵
5 This effort to develop appropriate bid documents and processes should not be rushed or
6 treated lightly. Default service regulations should not be implemented prematurely.

7 *c) Many Parties Emphasize The Importance Of Developing A State-Wide Or Multi-*
8 *Jurisdictional Solicitation Process*

9 Many parties in the default service proceeding emphasize the importance of
10 developing a state-wide or multi-jurisdictional solicitation process.¹⁰⁶ Even RESA
11 recommends that procurements “should be implemented in a simultaneous, coordinated
12 and uniform manner statewide for all DSPs which...will capture efficiencies and
13 economies of scale.”¹⁰⁷ FE comments that if DSPs individually conduct their own separate
14 solicitations at different points in time, disincentives are created for suppliers to bid their

¹⁰⁵ PPL comments that there are approximately 12 default service providers (“DSPs”) in Pennsylvania that could be seeking to obtain a variety of generation supply products on different, and perhaps conflicting procurement schedules. (PPL at 7-8.) PPL also argues that differences in products may result in less participation by wholesale generation supplier and less competitive prices for default service customers. (PPL at 11.) UGI suggests that DSPs may want to consider blocks of power instead of load following contracts, or include options or financial instruments in the portfolio. (UGI at 5-6.) Both Constellation and PPL recommend that the Commission eliminate the requirement to purchase spot energy suggesting that this will force DSPs to manage this risk either by establishing a trading operation or obtaining this service from the competitive market, and can create large energy rate adjustments. (PPL at 12 and Constellation at 12-13.) Allegheny Energy claims that artificially setting price targets or restricting the amount of load that a qualified bidder can serve may impede access to the wholesale market and drive prices up. (Allegheny Energy at 6.) PECO asserts that experience in other states has shown that the absence of reasonable switching rules will compel wholesale suppliers to build substantial risk premiums into their competitive bids, thereby increasing the price-to-compare (“PTC”) for all members of the class. (PECO at 16 and Energy Association or “EA” at 9.) Industrial Energy Consumers of Pennsylvania (“IECPA”) claims that if congestion charges are included in the PTC, this may result in a DSP accepting non-economic bids in its competitive procurement program. (IECPA at 16.) Finally, FE claims that there is need for additional flexibility in bid evaluation criteria to address unforeseen circumstances, such as a supplier that goes bankrupt or the disclosure of accounting irregularities after qualifications have been met. (FE at 4.)

¹⁰⁶ See Initial Comments of PPL at 8 and 10, PECO at 4, FE at 6, and Constellation at 7, March 2, 2007.

¹⁰⁷ RESA Reply Comments at 6, March 23, 2007.

1 best prices.¹⁰⁸ These arguments further support implementing the new regulations when
2 all electric utilities might participate in such a process after the major EDCs have
3 completed their transition periods.

4
5 **Q. Reliant comments that the Commission should not wait to approve Duquesne's Plan**
6 **until after a final order in the default service rulemaking and proposed Policy**
7 **Statement has been issued.¹⁰⁹ Do you agree?**

8 A. Yes.

9 *d) Postponing or Limiting The Duration Of Duquesne's Three Year Plan Could Harm*
10 *Customers, Retail Competition, and Duquesne Power*

11 Delaying implementation of or shortening Duquesne's Plan would expose small
12 customers to greater rate uncertainty and market price risk. The risks associated with new
13 capacity rules and renewable requirements obligations as well as the overall risk of market
14 price increases would be borne by retail customers. As a business matter, it would be
15 unreasonable for Duquesne Power to hold open the proposed fixed rates indefinitely. If
16 required to conduct a competitive solicitation at some point in the future, in addition to the
17 above risks, customers would also bear the risks associated with a poorly designed, hastily
18 prepared solicitation process that could result in high bid prices or lack of supplier
19 participation. The added regulatory uncertainty along with the new untested, yet to be
20 finalized, regulations could actually prove detrimental to retail competition in Duquesne's
21 service area. As described earlier, EGSs cite many reasons why retail competition could

¹⁰⁸ See Initial Comments of FE at 6, (Also see PPL at 8 and 10, PECO at 4, FE at 6, and Constellation at 7), March 2, 2007.

¹⁰⁹ Reliant at 7, lines 15-19.

1 be harmed under the proposed rules. Finally, it is my understanding from review of
2 Duquesne's response to Direct Interrogatory I-1, Duquesne Power has already acquired
3 some amount of supply with non-affiliated entities in the competitive wholesale market in
4 an effort to hedge its supply obligations. This would suggest that prior to Commission
5 approval of its Plan, Duquesne Power is assuming the risks associated with a "long"
6 supply position. If the Commission were to reject, postpone, or shorten the length of
7 Duquesne's Plan, this could expose Duquesne Power to considerable financial harm.

8 *e) Given The Success Of Duquesne's Customer Choice Program, There Is No Pressing*
9 *Need To Implement New Regulations On A Stand-Alone-Basis*

10 Finally, given the overall successes of Duquesne's retail choice program and the
11 significant improvements proposed in its new Program that I cited earlier, there is no
12 pressing reason why the Commission should require Duquesne, on a stand-alone basis, to
13 implement the proposed rules prior to when the vast majority of electric customers in the
14 state transition from their generation rate caps to a post-transition period default service
15 offering.

16
17 **Q. Does that conclude your rebuttal testimony?**

18 A. I have nothing further at this point, but I note that Duquesne has not received all of the
19 answers to the discovery requests that it has sent to the other parties in this proceeding, or
20 has not received them in time to incorporate them into the testimony. I reserve the right to
21 file supplemental rebuttal testimony after Duquesne receives all of the answers to its
22 discovery requests.

Success of Duquesne's Retail Access Program

(Excerpts From Publicly Available Statements)

General Comments

- Customer choice is largely nonexistent outside the territory of Duquesne, the only large EDC whose generation rate cap has expired. The experience of Duquesne shows that retail markets can work. Duquesne's territory has the highest rate of customer choice in Pennsylvania. Its overall retail electric rates remain 15% below what they were when the Competition Act was passed in 1996. (Commission, ANOFR at 21, Docket No. L-00040169, February 8, 2007).

Small Customer Plan

- Dominion Retail submits as a final point "that it would be far more productive and wiser for the Commission to base its rules on the success of the Duquesne POLR program that affects over 500,000 customers, and not based upon over-reaction of one obvious failure – Pike County – with comparably few customers." (Dominion Retail at 11-12, Docket No. L-00040169, March 2, 2007)
- Dominion Retail has been serving nearly 100,000 residential customers at rates below Duquesne Light Company's default service rates for a number of years; a clear signal that competition can work and does work when the rules allow it to work...Duquesne Light Company's program is the proof that markets can work. Even though Duquesne's program involved a three-year purchase agreement and a three-year stable rate, it does not involve long-term isolation of the retail rate from the wholesale price, or short-term price distortion of reconciliation. It is telling that now, ten (10) years after the implementation of the Competition Act, Duquesne Light's rates have still not returned to the pre-competition levels even though wholesale market prices have risen dramatically during that same period. (Dominion Retail at 3-6, Docket No. L-00040169, March 23, 2007.)
- The Office of Consumer Advocate ("OCA") comments that the greatest level of shopping in Pennsylvania has resulted in Duquesne's service territory while customers are offered multi-year fixed rates as part of its default service. With known rates over a period of time, customers are able to make an informed choice. Duquesne's program demonstrates the value of a stable fixed price for the customer in making an informed choice. In Duquesne's current default service proceeding, the OCA submits that Duquesne follows its successful prior POLR models where Duquesne, an electric distribution company ("EDC") that has divested its generation, contracts with its affiliate to procure supply at prevailing market prices, and allows Duquesne to provide reasonable, stable rates for residential customers. (Answer of the Consumer Advocate, Docket P-00072247, February 22, 2007, at 2-3.)

- The residential rate caps in Duquesne ended in 2002, and residential customers are still paying less - even in nominal dollars - than they were paying prior to restructuring. I think there are a couple reasons for that. First, Duquesne has not relied on volatile short-term auctions, but has instead applied a longer term portfolio approach to its default service acquisition policy. As a result, it has been able to provide a series of multi-year fixed price offers to residential customers that have avoided rate shock and maintained prices at a reasonable level. Second, Duquesne is located in a portion of PJM that has lower wholesale prices than its central and eastern Pennsylvania neighbors. Overall, I continue to point to Duquesne as the major success story in Pennsylvania restructuring, but a story that may not be repeated to the extent that other utilities acquire their post-rate cap service through auctions in higher priced PJM areas. (Interview with Sonny Popowsky, PennFuture Newsletter E³, March 28, 2007)
- Direct Energy is willing to work with the OCA and the Pennsylvania utilities to create an acceptable purchase of receivables agreement. The framework used in the recent Duquesne Light distribution case is a great example and starting point...It is truly a win-win-win proposition... (Direct Energy at 18-19, Docket No. L-00040169, March 23, 2007.)
- Alternatively, if a utility is willing to accept commodity risk, it should do so on its own accord. It should not burden ratepayers with its hedging issues. Duquesne Light has taken this approach in its past POLR cases, is asking for that risk again in its POLR IV case and advocating for being able to manage its commodity risk in this docket as well...Apparently, Duquesne is content without reconciliation. We have heard repeatedly about the successes of the Duquesne retail market. (Direct Energy at 15, Docket No. L-00040169, March 23, 2007.)

Large Customer Plan

- Hess comments that "the Duquesne retail market has demonstrated that a default service structure based on market-reflective price signals fosters a robust and sustainable competitive retail electric market structure...where competitive EGSs are serving 98% of the load for customers with peak demands of 300 kW and higher." (Hess at 4, Docket No. L-00040169, March 2, 2007.)
- In Duquesne Light's service territory, for example, almost half of the commercial customer load, and over 86% of the industrial load, is served by competitive retail suppliers. (Allegheny at 4, Docket No. L-00040169, March 2, 2007.)
- In the Duquesne Light Company service territory, where hourly priced service has been instituted for large customers, 96 percent of those customers have switched to competitive suppliers...The Commission should clarify that the ANOFR's mandate that large business customer rates adjust at minimum monthly, should not be viewed as a reason to turn back the clock on a pricing structure that has very successfully stimulated competition in the Duquesne

Light Company service territory. (Strategic Energy at 7-8, Docket No. L-00040169, March 2, 2007.)

- Duquesne Light's POLR III filing set the large business customer hourly priced service at 300 kW. As mentioned above, supplier responsiveness has been overwhelming with 86% market penetration. (Direct Energy at 10-11, Docket No. L-00040169, March 2, 2007.)

Office of Consumer Advocate
Interrogatories Set I
REVISED

5. At page 21, Mr. O'Brien indicates that Duquesne plans to amend its existing supply contract with Duquesne Power to incorporate the POLR IV program. Please provide a copy of those amendments. If this has not yet been completed, please indicate when the amendments are expected to be available.

Response:

Attached is a brief Amendment to the current Full Service Requirements Agreement to reflect only three changes necessary for the POLR IV supply period. First, the Agreement was modified to recognize that ancillary services, as defined in the PJM OATT, and transmission related PJM charges currently included in Duquesne Light's generation rates will be moved to Duquesne Light's Transmission Service Charge ("TSC"). In its POLR IV plan, Duquesne Light proposes to include in the TSC ancillary service charges pursuant to the PJM OATT associated with residential and small C&I customer POLR load using the methodology to calculate such charges for large C&I customers defined in Rider No. 9 of its Retail Tariff. Under the Agreement, Duquesne Light will pay Duquesne Power on a monthly basis using the same PJM OATT charges for ancillary services that Duquesne Light charges its residential and small C&I customers in the TSC. Second, the amendment also clarifies that all references to "POLR III Rate Schedule" in the agreement shall be amended to read "POLR Rate Schedule." Third, Schedule I of the Agreement, related to Company Use Energy Payments, shall be updated based on the new GS/GM rates approved by the Commission in POLR IV.

AMENDMENT TO FULL REQUIREMENTS SERVICE AGREEMENT

This AMENDMENT to Full Requirements Service Agreement by and between Duquesne Light Company, a Pennsylvania corporation, (hereinafter called "Duquesne Light" or "DLC") and Duquesne Power LLC, formerly Duquesne Power LP, (hereinafter called "Duquesne Power") on this ____ day of _____ 2007 (hereinafter jointly called "the Parties").

WHEREAS, Duquesne Light and Duquesne Power previously entered into that certain Full Requirements Service Agreement between each other dated January 1, 2005 for the providing of electric capacity and energy to Duquesne Light in order for it to fulfill its provider of last resort obligations in Pennsylvania. The Agreement (hereinafter referred to as "Full Requirements Service Agreement"); and

WHEREAS, said Full Requirements Service Agreement requires certain minimal modifications to incorporate changes in Duquesne Light's POLR IV plan from its POLR III plan; and

WHEREAS, The Parties hereby enter into this Amendment to agree, carry out, and effectuate those desired changes;

NOW THEREFORE WITNESS: Duquesne Light and Duquesne Power, in consideration of the mutual covenants and agreement herein, and intending to be legally bound, hereby agree and consent as follows:

1. The Agreement is hereby modified to recognize that ancillary services, as defined in the PJM OATT, and transmission related PJM charges currently included in Duquesne Light's generation rates will be moved to Duquesne Light's Transmission Service Charge ("TSC"). Accordingly, the parties agree that all pertinent sections of said Full Requirements Service Agreement are hereby amended to incorporate this change.

The following definitions are hereby modified or added to the Agreement:

"Ancillary Services Payment" means the Buyer shall pay the Seller on a monthly basis for Ancillary Services related to the POLR Supply Amount according to the same methodology used to calculate such charges to Rider No. 9, Hourly Price Service, customers of the Buyer's Retail Tariff. For clarity, this payment shall reflect line losses but not include Pennsylvania gross receipts taxes.

"Grid Management Charges" means the grid management charges defined in the PJM OATT as they may change from time to time, but excluding those charges recovered by Buyer from its retail customers through the PJM Surcharge Transmission Service Charges.

"Net Billed Generation Revenue" means the sum of the amounts resulting from the following calculation for each retail customer of Buyer that is receiving service from Buyer under a POLR-III Rate Schedule:

- (x) Billed Generation Revenue attributable to such customer, less
- (y) ~~the PJM Surcharge attributable to such customer,~~ multiplied by
- (z) a factor of nine hundred forty-one one thousandths (.941).

"Transmission Service Charges" means the charges as described in Appendix A of the Buyer's Retail Tariff.

A new Section 6.2(c) is hereby inserted in the Agreement:

Beginning on or about February 15, 2008 and continuing on or about the fifteenth day of each calendar month thereafter until the end of the term of this Agreement (or the earlier termination of this Agreement), Buyer shall provide to the Seller a calculation of the Ancillary Services Payment associated with the POLR Supply Amount for the prior month using the methodology prescribed in Rider No. 9 of the Buyer's Retail Tariff (including any adjustments for prior period reconciliations). After review of and agreement on these calculations, the Seller shall provide an invoice to the Buyer for the Ancillary Services Payment. The Buyer shall pay the Seller the Ancillary Services Payment within 7 business days of receiving the invoice from the Seller.

2. All references to "POLR III Rate Schedule" shall be amended to read "POLR Rate Schedule".

3. The table in Schedule 1 of the Agreement related to wholesale Company Use Energy Payments shall be replaced by a new table based on the PaPUC approved POLR IV GS/GM rates less the Pennsylvania Gross Receipts Taxes (5.9%).

In all other respects, the Full Requirements Service Agreement remains the same and is hereby confirmed and ratified by the parties. This Amendment to the Full Requirements Service Agreement is hereby agreed to, and executed by the parties' duly authorized representatives, on the date hereinabove stated.

DUQUESNE LIGHT COMPANY

By: _____

William F. Fields

Its: Vice President

DUQUESNE POWER LLC

By: _____

James E. Wilson

Its: President

FULL REQUIREMENTS SERVICE AGREEMENT

by and between

DUQUESNE LIGHT COMPANY

and

DUQUESNE POWER, L.P.

Dated as of January 1, 2005

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FULL REQUIREMENTS SERVICE AGREEMENT

THIS FULL REQUIREMENTS SERVICE AGREEMENT ("Agreement" or "FSA"), is made and entered into as of January 1, 2005 by and between Duquesne Power, L.P., a Delaware limited partnership, hereinafter referred to as "Seller" and Duquesne Light Company, a Pennsylvania corporation, hereinafter referred to as "Buyer" (each hereinafter referred to individually as "Party" and collectively as "Parties").

WITNESSETH:

WHEREAS, Buyer has an obligation as the provider of last resort (the "POLR") of Energy (as defined below), Capacity (as defined below) and Ancillary Services (as defined below) for its retail customers;

WHEREAS, Seller desires to sell Full Requirements Service (as defined below) and Buyer desires to purchase such Full Requirements Service to supply certain of Buyer's retail customers for a certain period of time, as provided herein, on a firm and continuous basis; and

WHEREAS, Seller intends to procure a portfolio of resources to satisfy Seller's Full Requirements Service obligations hereunder.

NOW, THEREFORE, and in consideration of the foregoing, and of the mutual promises, covenants, and conditions set forth herein, and other good and valuable consideration, the Parties hereto, intending to be legally bound by the terms and conditions set forth in this Agreement, hereby agree as follows:

ARTICLE I DEFINITIONS

In addition to terms defined elsewhere in this Agreement, the following definitions shall apply hereunder:

"Adjusted Consolidated Net Income" means, for purposes of calculating the Consolidated Cash Coverage Ratio only, in respect of any period, the sum of (a) Consolidated Net Income of the Certifying Company for such period less any non-cash income of the Certifying Company during such period, and (b) the amount of interest on all outstanding indebtedness of the Certifying Company paid or payable during such period, and (c) the amount of all depreciation and amortization allowances and other non-cash expenses of the Certifying Company, and (d) the amount of income taxes payable by the Certifying Company during such period.

"Affiliate" means, with respect to any entity, any other entity that, directly or indirectly, through one or more intermediaries, controls, or is controlled by, or is under common control with, such entity. For this purpose, "control" means the direct or indirect ownership of fifty percent (50%) or more of the outstanding capital stock or other equity interests having ordinary voting power.

“Ancillary Services” shall have the meaning ascribed thereto in the PJM OATT.

“Applicable Number of Days” means:

- (a) except to the extent clause (b) or (c) below applies, thirty-five (35) days;
or
- (b) in the event Seller elects to comply with Section 13.2(b), the number of days, as reasonably determined by Buyer, that is equal to (i) thirty-five (35) days plus (ii) the quotient of the face amount of the letter of credit determined in accordance with Section 13.2(a) and the Estimated Daily Amount Payable, rounded up to the nearest whole day; or
- (c) in the event Section 13.4 applies and Seller elects to comply with Section 13.4(b), the number of days, as reasonably determined by Buyer, that is equal to (A) thirty-five (35) days or, if Seller has also elected to comply with Section 13.2(b), the number of days, as reasonably determined by Buyer, that is equal to (i) thirty-five (35) days plus (ii) the quotient of the face amount of the letter of credit determined in accordance with Section 13.2(a) and the Estimated Daily Amount Payable, rounded up to the nearest whole day, plus (B) the quotient of the face amount of the letter of credit determined in accordance with Section 13.4(a) and the Estimated Daily Amount Payable, rounded up to the nearest whole day.

“Bankrupt” means, with respect to any entity, such entity: (i) voluntarily files a petition or otherwise commences, authorizes or acquiesces in the commencement of a proceeding or cause of action under any bankruptcy, insolvency, reorganization or similar law, or has any such petition filed or commenced against it by its creditors and such petition is not dismissed within sixty (60) calendar days of the filing or commencement; (ii) makes an assignment or any general arrangement for the benefit of creditors; (iii) otherwise becomes insolvent, however evidenced; (iv) has a liquidator, administrator, receiver, trustee, conservator or similar official appointed with respect to it or any substantial portion of its property or assets; or (v) is generally unable to pay its debts as they fall due.

“Billed Generation Revenue” means with respect to each retail customer of Buyer receiving service from Buyer under a POLR III Rate Schedule, the amount that Buyer bills, pursuant to the Retail Tariff (except for Rider 10 and Rider 21 thereof), to such customer.

“Business Day” means any day except a Saturday, Sunday or a day that PJM declares to be a holiday, as posted on the PJM website. A Business Day shall open at 8:00 a.m. and close at 5:00 p.m. EPT.

“Capacity” shall mean “Unforced Capacity” as set forth in the PJM RAA or the PJM West RAA, or any successor measurement of the capacity obligation of a Load Serving Entity as may be employed in PJM (whether set forth in the PJM RAA, the PJM West RAA or elsewhere).

"Capacity Responsibility" means the aggregation of peak load contributions for Buyer's retail customers, as determined by Buyer in accordance with the PJM Agreements and reported by Buyer to PJM pursuant to Buyer's retail load settlement process, and used by PJM in determining the Seller's capacity obligation under this Agreement.

"Certifying Company" means either Seller or the Corporate Guarantor, whichever entity has provided the latest dated certification to Buyer pursuant to Article 13 of this Agreement.

"Commercial Bank" means a commercial bank reasonably acceptable to Buyer with a minimum credit rating of at least two of the following ratings: (i) BBB+ as determined by S&P, or (ii) Baa1 as determined by Moody's, or (iii) a comparable rating by another nationally recognized rating service reasonably acceptable to Buyer.

"Company Use Energy" means all the metered electricity used, in the ordinary course of business, at or by Buyer's facilities and operations including, but not limited to, substations, operating headquarters, construction and maintenance facilities, office buildings, customer service operations, communications facilities and towers and ash handling, ash treatment and ash disposal facilities (but excluding on site station service electricity at generating stations, which station service electricity shall be the responsibility of the generating station owner). The Parties recognize and agree that, although the Company Use Energy comprises a portion of the POLR Supply Amount, the Company Use Energy to be supplied under this Agreement shall not be sold directly to Buyer, but instead Seller shall sell such Company Use Energy to Buyer's designated marketing affiliate which will, in turn, sell such Company Use Energy to Buyer.

"Company Use Energy Payment" means the sum of the amounts that Buyer must cause its marketing affiliate to pay to Seller, on a monthly basis, for the Company Use Energy that was included in the POLR Supply Amount (and that Seller sold to Buyer's designated marketing affiliate for sale to Buyer as contemplated in the definition of Company Use Energy) during the calendar month ending on or about forty-five (45) days prior to such date, pursuant to the terms of this Agreement, at a price equal to, for each hour, the product of (i) the amount of Company Use Energy measured on a monthly basis in kilowatt hours with respect to Energy and kilowatts with respect to non-coincident peak Capacity and (ii) the applicable rates for such amounts of Energy and Capacity set forth on Schedule 1 to this Agreement.

"Congestion Revenue Rights" or "CRR" means the current or any successor congestion management mechanism or mechanisms as may be employed by PJM (whether set forth in the PJM Tariff or elsewhere) for the purpose of allocating financial congestion hedges, or the revenues associated with the auction of financial congestion hedges.

"Consolidated Cash Coverage Ratio" means for any period of twelve (12) consecutive months from the date of determination, the ratio of (x) the sum of the Adjusted Consolidated Net Income of the Certifying Company for such period and the amount of principal on all outstanding indebtedness of the Certifying Company payable during the following twelve (12) month period to (y) the sum of the amount of interest on all

outstanding indebtedness of the Certifying Company paid or payable during such period, and the amount of principal on all outstanding indebtedness of the Certifying Company payable during the following twelve (12) month period.

“Consolidated Net Income” means, for purposes of calculating the Adjusted Consolidated Net Income only, in respect of any period, the net income (or loss) of the Certifying Company for such period (taken as a cumulative whole), as determined in accordance with GAAP.

“Corporate Guarantor” means an Affiliate of Seller that (x) has either an investment rating equal to or higher than the Minimum Investment Rating or a Consolidated Cash Coverage Ratio equal to or greater than the Minimum Consolidated Cash Coverage Ratio and (y) has delivered to Buyer a certificate from a duly authorized corporate officer of such Affiliate certifying that such Affiliate meets the foregoing requirements and consents to unconditionally guarantee Seller's obligations under this Agreement.

“Costs” means, with respect to the Non-Defaulting Party, brokerage fees, commissions, PJM charges, and other similar third party transaction costs and expenses reasonably incurred by such Party either in terminating any arrangement pursuant to which it has hedged its Full Requirements Service obligations or entering into new arrangements which replace such terminated arrangement; and all reasonable attorneys' fees and expenses incurred by the Non-Defaulting Party in connection with the termination of such hedging arrangement or the entrance into any such new arrangements.

“Default Damages” means, for the period of time specified in Section 11.2(b) (Remedies) any direct damages and Costs, calculated in a commercially reasonable manner, that the Non-Defaulting Party incurs as a result of an Event of Default. Direct damages may include, but are not limited to: (i) the positive difference (if any) between the price of Full Requirements Service hereunder and the price at which the Buyer or Seller is able to purchase or sell (as applicable) Full Requirements Service (or any components of Full Requirements Service it is able to purchase or sell) from or to third parties, including PJM; (ii) emergency energy charges (as defined in the PJM OATT); and (iii) additional transmission or congestion costs incurred to purchase or sell Full Requirements Service.

“Delivery Period” means the period beginning at one minute after 11:59 p.m. (EPT) on the day prior to the Effective Date and continuing through the term of this Agreement.

“Delivery Point” means the Duquesne Zone, and is the location at which Seller will deliver and Buyer will accept the POLR Supply Amount during the Delivery Period.

“Determination Date” means, initially, the Initial Determination Date and, thereafter, the first Business Day of each month following the month during which the Initial Determination Date occurs.

“Duquesne Zone” means the PJM defined load zone for Buyer.

“ECAR” means the Eastern Central Area Reliability Council or any successor organization thereto.

"Eastern Prevailing Time" or "EPT" means Eastern Standard Time or Eastern Daylight Savings Time, whichever is in effect on any particular date.

"Effective Date" means January 1, 2005.

"EGS" means an Electric Generation Supplier as defined in Buyer's then-current Supplier Tariff.

"Energy" means three-phase, 60-cycle alternating current electric energy, expressed in units of kilowatt-hours or megawatt-hours.

"Equitable Defenses" means any bankruptcy, insolvency, reorganization and other laws affecting creditors' rights generally, and with regard to equitable remedies, the discretion of the court before which proceedings to obtain same may be pending.

"Estimated Daily Amount Payable" means the Expected Annual Payments divided by either (i) 365, in the event that the remaining term of the Delivery Period is 12 months or greater, or (ii) the number of days remaining in the Delivery Period in the event that the remaining term of the Delivery Period is less than 12 months.

"Expected Annual Payments" means the expected payments from Buyer to Seller under this Agreement for the 12 months immediately following the current month or lesser period in the event that the remaining term of the Delivery Period is less than 12 months, calculated pursuant to Section 13.2 (Security). The method for calculating the Expected Annual Payments is described in Exhibit D.

"FERC" means the Federal Energy Regulatory Commission or its successor.

"Force Majeure" means an event or circumstance which prevents one Party from performing its obligations under this Agreement, which event or circumstance was not foreseen as of the date first written above, which is not within the reasonable control of, or the result of the negligence of the affected party and which, by the exercise of due diligence, the Party is unable to mitigate or avoid or cause to be avoided. Notwithstanding the foregoing, under no circumstance shall an event of Force Majeure be based on: (i) the loss or failure of Seller's supply; (ii) Seller's ability to sell the Full Requirements Service at a price greater than that received under this Agreement; or (iii) curtailment by a Transmitting Utility.

"Full Requirements Service" means all necessary Energy (including Energy that Buyer is obligated by a Governmental Authority to procure from renewable energy resources), Capacity, transmission service (other than Network Integration Transmission Service), Ancillary Services, transmission losses (as provided in the PJM OATT), congestion management costs, Grid Management Charges and such other services or products that are required to supply the POLR Supply Amount except for Network Integration Transmission Service and distribution service.

"GAAP" means United States generally accepted accounting principles including, but not limited to, the official interpretations thereof as defined by the Financial Accounting Standards Board, its predecessors and its successors.

"Gains" means, with respect to any Party, an amount equal to the present value of the economic benefit to it, if any (exclusive of Costs), resulting from the termination of this Agreement, determined in a commercially reasonable manner.

"Generation Billing Determinants" shall mean, with respect to each POLR III Rate Schedule in each month, the billed quantities of energy and demand, summed across all retail customers in such Rate Schedule.

"Generation Rates" means the retail generation rates to be used from the Effective Date through the term of this Agreement as set forth in the Retail Tariff.

"Governmental Authority" means any federal, state, local, municipal or other governmental entity, authority or agency, department, board, court, tribunal, regulatory commission, or other body, whether legislative, judicial or executive, together or individually, exercising or entitled to exercise any administrative, executive, judicial, legislative, policy, regulatory or taxing authority or power over a Party or this Agreement.

"Grid Management Charges" means the grid management charges defined in the PJM OATT as they may change from time to time, but excluding those charges recovered by Buyer from its retail customers through the PJM Surcharge.

"Initial Determination Date" means the first date on which the Certifying Company's Consolidated Cash Coverage Ratio is below the Minimum Consolidated Cash Coverage Ratio and the Certifying Company's investment rating is below the Minimum Investment Rating.

"Interest Rate" means, for any date, the lesser of: (i) the per annum rate of interest equal to the prime lending rate as may from time to time be published in *The Wall Street Journal* under "Money Rates" on such day (or if not published on such day on the most recent preceding day on which published), plus two percent (2%); and (ii) the maximum rate permitted by applicable law.

"kWh" means one kilowatt of electric power over a period of one hour.

"Load Serving Entity" or "LSE" has the meaning ascribed to it in the PJM Agreements.

"Long-Term Escalation Rate" shall mean a value of three percent (3%) per annum.

"Losses" means, with respect to any Party, an amount equal to the present value of the economic loss to it, if any (exclusive of Costs), resulting from the termination of this Agreement, determined in a commercially reasonable manner.

“Mark-to-Market Exposure” means the sum of the Monthly Mark-to-Market Exposures for the twelve months (12) immediately following the Initial Determination Date and, thereafter, following each Determination Date or the remaining months in the Delivery Period in the event that the remaining term of the Delivery Period is less than twelve (12) months. The method and an example for calculating the Mark-to-Market Exposure are included in Exhibit B.

“Minimum Consolidated Cash Coverage Ratio” means 2.0:1.0.

“Minimum Investment Rating” of a Person means that such Person has a minimum investment rating on its senior unsecured debt securities of each of the following ratings: (i) BBB- as determined by S&P and (ii) Baa3 as determined by Moody's.

“Monthly Mark-to-Market Exposure” means, with respect to each month remaining in the Delivery Period, the sum of: (i) the relevant month On-Peak Forward Price minus the relevant month On-Peak Initial Mark Price, multiplied by the product of the relevant month On-Peak Expected Load and (ii) the relevant month Off-Peak Forward Price minus the relevant month Off-Peak Initial Mark Price, multiplied by the product of the relevant month Off-Peak Expected Load. The method and an example for calculating the Monthly Mark-to-Market Exposure are included in Exhibit B.

“Moody’s” means Moody’s Investor Services, Inc. or its successor.

“MWh” means one megawatt of electric power used over a period of one hour which shall be rounded in a manner consistent with standards in the PJM Agreements. The current rounding standards are to the nearest one-thousandth of a megawatt hour.

“NERC” means the North American Electric Reliability Council or any successor organization thereto.

“Net Billed Generation Revenue” means the sum of the amounts resulting from the following calculation for each retail customer of Buyer that is receiving service from Buyer under a POLR III Rate Schedule:

- (x) Billed Generation Revenue attributable to such customer, less
- (y) the PJM Surcharge attributable to such customer, multiplied by
- (z) a factor of nine hundred forty-one one thousandths (.941).

“Network Integration Transmission Service” has the meaning ascribed to it in the PJM OATT.

“Off-Peak Expected Load” means the projected load for the Off-Peak Hours, stated in terms of MWh, for each month in the Delivery Period as described by Exhibit B.

“Off-Peak Forward Price” means the price, as provided by Buyer, for Off-Peak Hours, stated in terms of \$/MWh, associated with each of the next twelve (12) months

immediately following the current month, and shall be the product of: (i) the relevant month On-Peak Forward Price calculated pursuant to Exhibit B; and (ii) the relevant month Off-Peak/On-Peak Price Ratio.

“Off-Peak Hours” means those hours which are not On-Peak Hours.

“Off-Peak Initial Mark Price” means the price, as provided by Buyer on the Transaction Date, for Off-Peak Hours, stated in terms of \$/MWh, associated with each month in the Delivery Period, and shall be the product of: (i) the relevant month On-Peak Initial Mark Price calculated pursuant to Exhibit B; and (ii) the relevant month Off-Peak/On-Peak Ratio.

“Off-Peak/On-Peak Price Ratio” means the relevant monthly ratio of off-peak pricing to on-peak pricing of the PJM Western Hub (as defined in the PJM Agreements) day-ahead energy prices as set forth by Buyer based on the 36-month period immediately preceding the Transaction Date. The historical on-peak prices used by the ratio shall be the PJM Western Hub day-ahead energy price for the On-Peak Hours. The historical off-peak prices used by the ratio shall be the PJM Western Hub day-ahead energy price for the Off-Peak Hours. For each month of the 36-month period, the monthly on-peak and off-peak prices shall be summed and respectively divided by the amount of on-peak and off-peak hours in that month. The then calculated off-peak average price shall be divided by the on-peak average price to determine the individual monthly ratios. Such monthly ratios for the same months within the 36-month period shall then be summed and divided by three (3) to come up with the rolling three year month ratio average.

“On-Peak Expected Load” means the projected load for the On-Peak Hours, stated in terms of MWh, for each month in the Delivery Period as described by Exhibit B.

“On-Peak Forward Price” means the price, as determined by Buyer using the methodology described in Exhibit B, for On-Peak Hours, stated in terms of \$/MWh, associated with each of the next twelve (12) months immediately following the current month, and based on the most recent publicly available information and/or quotes from Reference Market-Makers on forward Energy transactions occurring at the PJM Western Hub.

“On-Peak Hours” means Hour Ending (“HE”) 0800 through HE 2300 EPT, Monday through Friday, excluding Saturday, Sunday and NERC holidays.

“On-Peak Initial Mark Price” means the price, as provided by Buyer on the Transaction Date, for On-Peak Hours, stated in terms of \$/MWh, associated with each month in the Delivery Period, determined by Buyer using the methodology described in Exhibit B.

“Person” means any individual, partnership, limited liability company, joint venture, corporation, trust, unincorporated organization or governmental entity or any department or agency thereof.

“PJM” means the PJM Interconnection, LLC or any successor organization thereto.

"PJM Agreements" means the PJM OATT, PJM Operating Agreement, PJM RAA, PJM West RAA, and any other applicable PJM manuals or documents, or any successor, superceding or amended versions that may take effect from time to time.

"PJM Control Area" has the meaning ascribed to it in the PJM Agreements.

"PJM OATT" or "PJM Tariff" means the Open Access Transmission Tariff of PJM or the successor, superceding or amended versions of the Open Access Transmission Tariff that may take effect from time to time.

"PJM Operating Agreement" means the Operating Agreement of PJM or the successor, superceding or amended versions of the Operating Agreement that may take effect from time to time.

"PJM Planning Period" has the meaning ascribed to it in the PJM Agreements. Currently, the PJM Planning Period is the twelve months beginning June 1 and extending through May 31 of the following year.

"PJM RAA" means the PJM Reliability Assurance Agreement or any successor, superceding or amended versions of the PJM Reliability Assurance Agreement that may take effect from time to time.

"PJM Surcharge" means those charges recovered by Buyer pursuant to Rider 1 of the Retail Tariff.

"PJM West RAA" means the PJM West Reliability Assurance Agreement or the successor, superceding or amended versions of the PJM West Reliability Assurance Agreement that may take effect from time to time.

"POLR" has the meaning ascribed to it in the Recitals.

"POLR Supply Amount" means the sum of (x) the actual hourly Energy requirements (including associated distribution losses, as provided in Table 1 of the Supplier Tariff) necessary to supply (i) Energy to serve each retail customer of Buyer receiving service from Buyer under a POLR III Rate Schedule, and (ii) Company Use Energy, and (y) Unaccounted For Energy. The POLR Supply Amount shall include only the requirements of retail customers located within the Pennsylvania franchised service territory of Buyer, as such territory exists on the Effective Date or may increase or decrease due to de minimis geographic border changes to such territory following the Effective Date. The POLR Supply Amount shall not include the requirements of retail customers that result from changes in such territory which occur as a result of a merger, consolidation, or acquisition of another entity which has a franchised service territory in Pennsylvania or as a result of a significant franchised service territory swap with another entity which has a franchised service territory in Pennsylvania.

"POLR Supply Estimate" means, for each hour during the term of this Agreement, Buyer's estimate of the Full Requirements Service associated with the POLR Supply Amount, as provided to PJM in accordance with Section 3.2 hereof.

"POLR III Rate Schedule" means any one of the following rate schedules under the Retail Tariff: RS, RH, RA, GS/GM, GMH, AL, SE, SM, SH, MTS and PAL.

"Preliminary Seller Charges" means an estimate of Seller Charges as determined by Buyer.

"PUC" means the Pennsylvania Public Utility Commission and any successor agency thereto.

"Reference Market-Maker" means any broker in energy products who is not an affiliate of Buyer or Seller.

"Retail Tariff" means the schedules of rates pursuant to which Buyer intends to bill its retail customers for generation from the Effective Date through the term of this Agreement, as such may be amended or modified from time to time.

"Retained Load Ratio" shall mean, in each month, Buyer's calculation, based on the most recent month's data, of the ratio of total Energy requirements required to serve retail customers receiving service from Buyer under a POLR III Rate Schedule to the total Energy requirements required to serve all customers eligible to receive service from Buyer under such POLR III Rate Schedule.

"S&P" means Standard & Poor's Ratings Group, a division of McGraw Hill, Inc. and any successor thereto.

"Seller Charges" means any amount billed by PJM to Buyer that represents all or a portion of any charges for which Seller is obligated hereunder or under any PJM Agreement but for which PJM has billed Buyer, in its capacity as a member of PJM, as a result of Seller failing to pay such charges or otherwise.

"Significant Subsidiary" means any subsidiary of Corporate Guarantor (other than Seller) that, on a consolidated basis with any of its subsidiaries as of any date of determination, accounts for more than ten percent (10%) of the consolidated assets of Corporate Guarantor and all consolidated subsidiaries.

"Supplier Tariff" means Buyer's Electric Generation Supplier Coordination Tariff, or its successor, filed with and approved by the PUC.

"Termination Payment" means, with respect to the Non-Defaulting Party, the Losses or Gains, and Costs, expressed in U.S. Dollars, which such Party incurs as a result of the termination of this Agreement pursuant to Article 11 (Events of Default – Remedies). The Termination Payment shall be considered an amount due to the Non-Defaulting Party under this Agreement if the total of the Losses and Costs exceeds the Gains and shall be considered an amount due to the Defaulting Party under this Agreement if the Gains exceed the total of the Losses and Costs.

"Transaction Date" means the date on which this Agreement is executed by Buyer and Seller.

“Transmitting Utility” means the utility or utilities, and their respective control area operators and their successors, transmitting all or any portion of the Full Requirements Service.

“Unaccounted For Energy” means the difference between the Buyer’s hourly system load and the sum of: (i) the estimated hourly customer loads (interval metered and profiled); and (ii) electrical losses, as such *Unaccounted For Energy* is determined in the Buyer’s retail load settlement process and prorated based on the amount of retail Energy consumed during each hour (including distribution and transmission losses) attributable to Energy supplied by Seller pursuant to this Agreement, as reported to PJM.

ARTICLE II TERMS AND CONDITIONS OF FULL REQUIREMENTS SERVICE

2.1 Seller’s Obligation to Provide Service.

- (a) Seller shall provide Full Requirements Service on a firm and continuous basis such that Full Requirements Service associated with the POLR Supply Amount is supplied at the Delivery Point beginning at one minute after 11:59 p.m. (EPT) on the day prior to the Effective Date and continuing through the term of this Agreement. Seller recognizes and agrees that it is responsible for delivering Full Requirements Service associated with the POLR Supply Amount as it may change over time for any reason, including seasonal factors, load fluctuation, increased or decreased usage, extremes in weather, and, subject to the limitations set forth in the Retail Tariff (as applied by the PUC), customer switching decisions regarding whether to receive POLR service or purchase Energy from an EGS.
- (b) Subject to the terms and conditions of this Agreement, beginning at one minute after 11:59 p.m. (EPT) on the day prior to the Effective Date and continuing through the term of this Agreement, Seller shall deliver to Buyer’s designated marketing affiliate each hour, on a continuous basis, the Company Use Energy to the Delivery Point.

2.2 Buyer’s Obligation to Take Service. Buyer shall accept Full Requirements Service as provided by Seller pursuant to Section 2.1 (Seller’s Obligation to Provide Service), and shall pay Seller for such Full Requirements Service in accordance with Article 6.

2.3 Network Integration Transmission Service and Distribution Service; Grid Management Charges. Buyer shall be responsible, at its sole cost and expense, for the provision of Network Integration Transmission Service and distribution service necessary to serve the POLR Supply Amount. Buyer is responsible, at its sole cost and expense, for future PJM charges assessed to network transmission customers for PJM-required transmission system enhancements pursuant to the PJM Regional Transmission Expansion Plan (as defined in the PJM Agreements)

and for future PJM charges assessed to network transmission customers for transition costs related to the elimination of through-and-out transmission rates. Seller shall be responsible, at its sole cost and expense, for Grid Management Charges.

- 2.4 Other Changes in PJM Charges. Except as provided in Section 2.3 (Network Integration Transmission Service and Distribution Service), Seller bears the risk of any other changes in PJM products and pricing during the term of this Agreement.
- 2.5 Status of Seller. Seller, for purposes of this Agreement, is not a Load Serving Entity and nothing contained herein shall be deemed to cause Seller to be a Load Serving Entity.
- 2.6 Sales for Resale. Subject to Section 2.1(b), all Full Requirements Service provided by Seller to Buyer shall be sales for resale, with Buyer reselling such Full Requirements Service to those of its customers that are receiving service from Buyer under a POLR III Rate Schedule. At Seller's request, Buyer shall provide Seller with mutually agreeable resale certificates related to the Full Requirements Service provided pursuant to this Agreement.
- 2.7 Governing Terms. This Agreement, including all schedules and exhibits hereto, any designated collateral, credit support, margin agreement or similar arrangements shall form a single integrated agreement between Buyer and Seller.

**ARTICLE III
SCHEDULING, FORECASTING, AND
INFORMATION SHARING**

- 3.1 Scheduling. Seller shall schedule Full Requirements Service in accordance with the terms and conditions of Article 7—Supply Scheduling—of the Supplier Tariff (including any future modifications to such tariff). Buyer will provide to PJM all information required by PJM, for the purpose of calculating Seller's Full Requirements Service obligations.
- 3.2 Load Estimates. On a daily basis, for each hour during the term of this Agreement on and following the Effective Date, Buyer shall deliver to Seller the POLR Supply Estimates for the following calendar day in accordance with the terms of the Supplier Tariff. Buyer may provide updates to any POLR Supply Estimates delivered to Seller by delivering to Seller a subsequent real-time POLR Supply Estimate. In addition, Buyer shall deliver to Seller, as often as is practicable but in no event later than the end of each month, a report listing known changes in the POLR Supply Amount, as well as any known changes to the Schedules attached hereto, which changes shall be incorporated into and become a part of the Schedules to which they relate, subject, however, to the prior consent of Seller to such changes to such Schedules if such consent is required under this Agreement. Buyer does not make any representation or warranty, and expressly disclaims any representation or warranty, regarding the accuracy or completeness of the POLR Supply Estimates, or any information contained in such POLR Supply Estimates. On a daily basis, for each hour during the term of this Agreement on and following the Effective Date, Buyer shall deliver to PJM Buyer's estimate of the Energy associate with the POLR Supply Amount for the preceding calendar day in accordance with the terms of the PJM Agreements. Buyer shall provide any necessary updates to PJM in accordance with the PJM Agreements.
- 3.3 Information Sharing. On each Business Day, Buyer shall provide to Seller on a reasonable efforts basis, Buyer's estimation of the Capacity Responsibility for the seventh following day associated with the POLR Supply Amount. Buyer does not warrant the accuracy of such information.

ARTICLE IV
SPECIAL TERMS AND CONDITIONS

- 4.1 Congestion and Congestion Management. Seller is responsible for any congestion costs incurred to supply Full Requirements Service associated with the POLR Supply Amount. Notwithstanding Section 2.5 (Status of Seller), Buyer shall transfer or assign to Seller, Buyer's rights to CRRs to which Buyer is entitled as an LSE pursuant to the PJM Agreements, provided that such rights are related to the service being provided to supply Full Requirements Service associated with the POLR Supply Amount. All rights and obligations associated with such CRRs will accrue to Seller through the transfer or assignment from Buyer to Seller including the ability of Seller to request or nominate such CRRs when applicable. Seller shall have the right to request and nominate CRRs if the Delivery Period is inclusive of the PJM Planning Period for which the CRRs are being requested or nominated. Should the conditions above not be met, the entity recognized by PJM as having the right to make the nominations at that time will nominate such CRRs for the upcoming PJM Planning Period and such CRRs will be allocated to Seller based upon Full Requirements Service associated with the POLR Supply Amount and in accordance with the PJM Agreements.
- 4.2 Load Response Programs. Buyer will permit its retail customers that are receiving service from Buyer under a POLR III Rate Schedule to participate in load response programs administered by PJM and to retain all of the benefits associated with such load response programs, pursuant to and in accordance with the PJM Agreements. Seller shall be responsible for all PJM charges, if any, associated with any such PJM load response programs.
- 4.3 PJM E-Accounts. Buyer and Seller shall work with PJM to establish any PJM E-Accounts (as defined in the PJM Agreements) necessary for Seller to provide Full Requirements Service. Seller shall work with PJM and Buyer to ensure that Buyer has full access to all necessary E-Account information of Seller, including any outstanding balances Seller accrues to PJM in providing Full Requirement Service.
- 4.4 [Reserved].
- 4.5 Pennsylvania Disclosure Requirements. Subject to any applicable confidentiality requirements, Seller shall provide to Buyer, to the best of its knowledge, the generation resources used to supply Full Requirements Service. All information provided pursuant to this Section 4.5 (Pennsylvania Disclosure Requirements) shall be provided in a timely manner and in an appropriate form to enable Buyer to comply with the requirements of the PUC or any other Governmental Authority that relate to reporting such information.
- 4.6 Title Transfer. Seller shall cease to have title to, possession of, and risk of loss with respect to liability pursuant to Sections 8.1 (Seller's Indemnification for Third-Party Claim) and 8.2 (Buyers Indemnification for Third-Party Claim) of

Full Requirements Service scheduled and received or delivered hereunder at the Delivery Point(s). Seller warrants that it has good title to the Full Requirements Service sold and delivered hereunder and that it has the right to sell such Full Requirements Service. The word "loss" in this Section 4.6 (Title Transfer) does not encompass electrical transmission losses (as provided in the PJM OATT) and distribution losses (as provided in Table 1 of the Supplier Tariff). As between Buyer and Seller only, and subject to Section 2.1(b), Buyer shall take title to, possession of, and risk of loss with respect to liability pursuant to Sections 8.1 (Seller's Indemnification for Third-Party Claim) and 8.2 (Buyer's Indemnification for Third-Party Claim) of Full Requirements Service scheduled and received or delivered hereunder at the Delivery Point(s). Notwithstanding the foregoing, nothing contained in this Agreement is intended to create or increase liability of Buyer to any third party beyond such liability, if any, that would otherwise exist under the PJM Agreements or under applicable law if Buyer had not taken title.

- 4.7 Reliability Guidelines. Each Party agrees to adhere to the applicable operating policies, criteria and/or guidelines of the NERC, PJM, ECAR, their successors, and any regional or sub regional requirements.
- 4.8 PJM Membership. Beginning on the Effective Date and continuing through the term of this Agreement, Seller shall be: (i) a member in good standing of PJM; and (ii) qualified as a PJM "Market Buyer" and "Market Seller" pursuant to the PJM Agreements. Beginning on the Effective Date and continuing through the term of this Agreement, Buyer shall be: (i) a member in good standing of PJM; and (ii) qualified as a PJM "Load Serving Entity" pursuant to the PJM Agreements.
- 4.9 FERC Authorization. Beginning on the Effective Date and continuing through the term of this Agreement, Seller shall have FERC authorization to make sales of energy, capacity and ancillary services at market based rates.

**ARTICLE V
TERM AND SURVIVAL**

- 5.1 Term. Unless otherwise agreed upon by Buyer and Seller, this Agreement shall continue in full force and effect from the date first written above until December 31, 2010, unless extended by mutual agreement of the Parties or unless the Agreement is terminated prematurely pursuant to Article 11 of this Agreement.
- 5.2 Survival. Except in the event this Agreement is terminated pursuant to the provisions of the last sentence of Section 5.1 (in which case, the Parties shall owe no further obligation or have any further liability to each other under this Agreement), the representations and warranties contained and/or made in this Agreement shall survive the termination of this Agreement, including but not limited to any and all payment obligations hereunder.

**ARTICLE VI
PAYMENT FOR FULL REQUIREMENTS SERVICE;
INVOICING, ESCROW AND OFFSET**

- 6.1 Payment. The payment for Full Requirements Service shall be the Net Billed Generation Revenue, and the Company Use Energy Payment.
- 6.2 Daily Payment of Net Billed Generation Revenues; and Monthly Payment of the Company Use Energy Payment.
- (a) Except as may otherwise be provided in this Article 6, beginning on the date that is the Applicable Number of Days following the Effective Date and continuing until the end of the term of this Agreement (or the earlier termination of this Agreement), Buyer shall pay to Seller the dollar amount equal to the aggregate amount of the sum of the Net Billed Generation Revenue attributable to each of Buyer's retail customers that was billed by Buyer, and whose Energy requirements were included in the POLR Supply Amount, on the date that was the Applicable Number of Days prior to such day, whether or not such billed amounts have been paid by such retail customers or EGSs. The Parties recognize and agree that in calculating such Net Billed Generation Revenue, Buyer shall, as necessary, pro rate by kilowatt-hour usage the total amount of Net Billed Generation Revenue attributable to such customers during such billing period in order to account for that portion of such billing period during which Seller supplied the POLR Supply Amount. Buyer shall bill all Buyer retail customers on a current basis.
- (b) Beginning on or about March 15, 2005 and continuing on or about the fifteenth day of each calendar month thereafter until the end of the term of this Agreement (or the earlier termination of this Agreement), Buyer shall cause its designated marketing affiliate pay to Seller the Company Use Energy Payment calculated for the Company Use Energy that was

included in the POLR Supply Amount during the calendar month ending on or about forty-five (45) days prior to such date.

6.3 PJM Billing.

- (a) Buyer and Seller shall direct PJM to invoice Seller and Buyer for charges and credits relating to Seller's and Buyer's rights and obligations under this Agreement, including for the avoidance of doubt Ancillary Services. Exhibit A sets forth the Parties' agreement as to the appropriate allocation of such charges and credits. If Seller fails to pay for any charges allocable to Seller in accordance with Exhibit A, Buyer shall treat any such amounts that PJM may bill to Buyer as Seller Charges and shall invoice such amounts in the invoice sent pursuant to Section 6.4(a) (Monthly Invoicing for Preliminary Seller Charges). If Buyer fails to pay for any charges allocable to Buyer in accordance with Exhibit A, Seller may invoice Buyer any such amounts that PJM may bill to Seller and Buyer shall pay the undisputed amount of such invoice within ten (10) days of receipt of such invoice.
- (b) The Parties agree that the PJM bill may change from time to time. Allocation of any charges that are reflected in a PJM bill that are not provided for in Exhibit A will be determined pursuant to Sections 2.3 (Network Integration Transmission Service and Distribution Service), 2.4 (Other Changes in PJM Charges), and 15.11 (PJM Agreement Modifications) of this Agreement. In the event that one or more EGSs serving load within the Duquesne Zone elects under the PJM Agreements to serve their load using nodal pricing, the definition of "Delivery Point" under this Agreement shall be amended to mean the end use load busses for the load associated with Buyer's retail customers that are located within the Duquesne Zone and are receiving service, the Energy for which is supplied to Buyer from Seller under this Agreement.

6.4 Billing for Seller Charges; Escrow; Offset.

- (a) Monthly Invoicing for Preliminary Seller Charges. Buyer shall, within ten (10) days following the end of each calendar month, invoice Seller for all Preliminary Seller Charges attributable to such month. Invoices rendered pursuant to this Section 6.4(a) shall be immediately due from Seller and payable to Buyer by offset pursuant to Section 6.4(d) hereof. Credits owing to Seller reflected on any invoices rendered pursuant to this Section 6.4(a) shall be immediately due from Buyer and netted against any payments owing to Buyer on such invoice with any excess amount payable to Seller by increasing by the amount of any such excess the amount of Net Billed Generation Revenue to be paid to Seller under Section 6.1 hereof on the day that the invoice reflecting such excess is rendered.

- (b) Monthly Statement of Account for Seller Charges (True-up and Adjustments). Buyer shall, after all customer accounts have been fully metered for a calendar month (which shall occur approximately sixty (60) days following the end of such calendar month); provide a statement of account to Seller adjusting one or more prior months' invoices rendered pursuant to Section 6.4(a) hereof for the difference between Preliminary Seller Charges and Seller Charges for such prior months. Payments owing to Buyer reflected on such statements of account rendered pursuant to this Section 6.4(b) shall be immediately due from Seller and payable to Buyer by offset pursuant to Section 6.4(d) hereof. Credits owing to Seller reflected on any statement of account rendered pursuant to this Section 6.4(b) shall be immediately due from Buyer and netted against any payments owing to Buyer on such statement of account with any excess amount payable to Seller by increasing by the amount of any such excess the amount of Net Billed Generation Revenue to be paid to Seller under Section 6.1 hereof on the day that the statement of account reflecting such excess is rendered.
- (c) Buyer Right to Escrow. In addition to any other right to escrow funds under this Agreement, Buyer shall have the right to withhold payment of Net Billed Generation Revenues otherwise owing to Seller pursuant to Section 6.1 hereof and to place such funds into an escrow account (the "Escrow Account") subject to the terms and conditions of an escrow agreement in form and substance reasonably satisfactory to the Parties (the "Escrow Agreement"), in the amounts and under the circumstances provided below:
- (i) Each Monday, Buyer shall estimate the total Net Billed Generation Revenue that was billed by Buyer to Buyer's retail customers within the preceding seven (7) days. The amount so estimated is defined as the "Weekly NBGR Estimate."
 - (ii) Each Monday, Buyer shall estimate that portion of the Preliminary Seller Charges that would be invoiced to Seller under Section 6.4(a) hereof and is attributable to the preceding (7) days. The amount so estimated is defined as the "Weekly Seller Charge Estimate."
 - (iii) Each Monday, Buyer shall sum all Weekly NBGR Estimates made during the current calendar month (including the Weekly NBGR Estimate made that day). The sum so calculated is defined as the "Cumulative Weekly NBGR Estimate."
 - (iv) Each Monday, Buyer shall sum all Weekly Seller Charge Estimates made during the current calendar month (including the Weekly Seller Charge Estimate made that day together with any known adjustments included in any statement of account

prepared by Buyer pursuant to Section 6.4(b) hereof). The sum so calculated is defined as the "Cumulative Weekly Seller Charge Estimate."

- (v) On any Monday of a calendar month, if the Cumulative Weekly Seller Charge Estimate calculated pursuant to Section 6.4(c)(iv) is greater than the Cumulative Weekly NBGR Estimate calculated pursuant to Section 6.4(c)(iii), then, except as may otherwise be provided in Section 6.4 hereof, Buyer may direct payment to the Escrow Account of the Net Billed Generation Revenue that would otherwise be payable to Seller pursuant to Section 6.1 hereof, until the earlier of the end of that calendar month or the next Monday in that calendar month.
 - (vi) If Buyer is unable to escrow any amount of funds pursuant to Section 6.4(c)(v) because the funds are also subject to offset pursuant to Section 6.4(d) hereof (the "Escrow Shortfall"), then Buyer may extend the period for escrow under Section 6.4(c)(v) until the dollar amount of the Escrow Shortfall has been withheld from payment of Net Billed Generation Revenues otherwise owing to Seller pursuant to Section 6.1 hereof and placed into the Escrow Account.
- (d) Buyer Right to Offset. In addition to any other right to offset against payments to Seller under this Agreement, Buyer shall have the right to offset any amounts Seller owes to Buyer pursuant to Sections 6.2(c), 6.4(a) and 6.4(b) hereof (except for such amounts reasonably disputed by Seller), against the amounts owed by Buyer pursuant to Section 6.1 hereof. Buyer may exercise the right to offset granted by this Section 6.4(d) in the amounts and under the circumstances provided below:
- (i) If the amount owing to Buyer on the invoice to be rendered by Buyer pursuant to Section 6.2(c) or Section 6.4(a) hereof, or the statement of account to be rendered by Buyer pursuant to Section 6.4(b) hereof, is less than or equal to the balance of the Escrow Account on the last day of the month (the "Month-End Escrow Balance"), then any amounts in the Escrow Account up to the amount owing to Buyer on such invoice or statement of account shall be released to Buyer as an offset in satisfaction thereof, and the difference between the Month-End Escrow Balance and the amount owing to Buyer on such invoice or statement of account shall be released to Seller.
 - (ii) If the amount owing to Buyer on the invoice to be rendered by Buyer pursuant to Section 6.2(c) or Section 6.4(a) hereof, or the statement of account to be rendered by Buyer pursuant to

Section 6.4(b) hereof, is greater than the Month-End Escrow Balance, then any amounts in the Escrow Account up to the Month-End Escrow Balance shall be released and retained by Buyer as an offset, and Buyer may withhold further payments of Net Billed Generation Revenue otherwise owing to Seller under Section 6.1 hereof as an offset until the difference between the Month-End Escrow Balance and the amount owing to Buyer on such invoice or statement of account has been fully recovered by Buyer.

- (iii) Buyer's right to offset Net Billed Generation Revenue under Section 6.4(d)(ii) shall take precedence over Buyer's right to escrow Net Billed Generation Revenue under Section 6.4(c)(v) hereof.

- 6.5 Payments of the Invoice. Except as may otherwise be provided in this Agreement, beginning on the Effective Date and continuing on each Business Day thereafter until the end of the term of this Agreement (or the earlier termination of this Agreement), all payments then due hereunder shall be made to the Party owed such payments by "Electronic Funds Transfer" (EFT) via "Automated Clearing House" (ACH), to a bank designated in writing by such Party, by 8:00 p.m. EPT. Payment of Invoices shall not relieve the paying Party from any other responsibilities or obligations it has under this Agreement (other than the obligation to make such payment), nor shall such payment constitute a waiver of any claims arising hereunder.
- 6.6 Payment Disputes. The Parties shall use their good faith best efforts to resolve all disputes relating to payments hereunder pursuant to Section 6.7 (Billing Disputes and Adjustment of Invoices).
- 6.7 Billing Disputes and Adjustments of Invoices.
- (a) Within twenty-four (24) months of the date on which an Invoice is issued, Buyer may, in good faith, adjust the Invoice to correct any errors. The adjustment shall include interest calculated at the Interest Rate from the original due date to the date of payment. Buyer shall provide Seller a written explanation of the basis for the adjustment.
 - (b) Within twenty-four (24) months of the date on which an Invoice is issued or an Invoice is adjusted pursuant to Section 6.7(a) (Billing Disputes and Adjustment of Invoices), Seller may, in good faith, dispute the correctness of such Invoice or adjustment, pursuant to the provisions of Article 12 (Dispute Resolution), and provided that Seller has paid any portion of an Invoice that is not disputed.
 - (c) Within twelve (12) months of the date on which a PJM bill is issued, Buyer or Seller may, in good faith, dispute the correctness of any such

PJM bill, pursuant to the provisions of Article 12 (Dispute Resolution), and provided that the disputing Party has paid any portion of an Invoice that is not disputed.

- 6.8 Interest on Unpaid Balances. Interest on delinquent amounts, other than amounts in dispute as described in Section 6.7 (Billing Disputes and Adjustment of Invoices), shall be calculated at the Interest Rate from the original due date to the date of payment.
- 6.9 Survival. Notwithstanding any other provision of this Agreement to the contrary, (i) the provisions of Section 6.7 and obligations of the Parties thereunder, shall survive the expiration of the term of this Agreement (or earlier termination of this Agreement) for a period not to exceed twelve (12) months from the date of the expiration or termination of this Agreement and (ii) the provisions of this Article 6 (other than Section 6.7) and Article 11, and the rights and obligations of the Parties thereunder, shall survive the expiration of the term of this Agreement (or earlier termination of this Agreement) for a period not to exceed one hundred twenty (120) days from the date of the expiration or termination of this Agreement for the purpose of satisfying the rights and obligations of the Parties under this Article 6 relating to the Full Requirements Service provided through the date of expiration or termination of this Agreement.

**ARTICLE VII
TAXES**

- 7.1 Cooperation. Each Party shall use reasonable efforts to implement the provisions of and administer this Agreement in accordance with the intent of the Parties to minimize taxes, so long as neither Party is materially adversely affected by such efforts.
- 7.2 Taxes.
- (a) The payment of any local, state and federal taxes, fees, and levies ("Governmental Charges") imposed on or with respect to Seller's delivery of Full Requirements Service to the Delivery Point shall be the responsibility of Seller. The payment of any Governmental Charges on or with respect to such Full Requirements Service following its delivery by Seller to the Delivery Point shall be the responsibility of Buyer. The payment of any Pennsylvania gross receipts taxes attributable to Buyer's sale of Energy to its retail customers shall be the responsibility of Buyer.
 - (b) Any Party paying Governmental Charges that should have been paid by the other Party pursuant to Section 7.2(a) (Taxes), shall charge such Governmental Charges against such other Party in the next invoice issued under this Agreement.

**ARTICLE VIII
INDEMNIFICATION**

- 8.1 Seller's Indemnification for Third-Party Claims. Seller shall indemnify, hold harmless, and defend Buyer and its Affiliates, and their respective officers, directors, employees, agents, contractors, subcontractors, invitees, successors, representatives and permitted assigns (collectively, "Buyer's Indemnitees") from and against any and all claims, liabilities, costs, losses, damages, and expenses including reasonable attorney and expert fees, disbursements actually incurred, and any penalties or fines imposed by Governmental Authorities in any action or proceeding between Buyer and a third party or Seller for damage to property of unaffiliated third parties, injury to or death of any person, including Buyer's employees or any third parties, to the extent directly caused by the gross negligence or willful misconduct of Seller and/or its officers, directors, employees, agents, contractors, subcontractors or invitees arising out of or connected with Seller's performance under this Agreement, Seller's exercise of rights under this Agreement, or Seller's breach of this Agreement.
- 8.2 Buyer's Indemnification for Third-Party Claims. Buyer shall indemnify, hold harmless, and defend Seller and its Affiliates, and their respective officers, directors, employees, agents, contractors, subcontractors, invitees, successors, representatives and permitted assigns (collectively, "Seller's Indemnitees") from and against any and all claims, liabilities, costs, losses, damages, and expenses

including reasonable attorney and expert fees, disbursements actually incurred, and any penalties or fines imposed by Governmental Authorities in any action or proceeding between Seller and a third party or Buyer for damage to property of unaffiliated third parties, injury to or death of any person, including Seller's employees or any third parties, to the extent directly caused by the gross negligence or willful misconduct of Buyer and/or its officers, directors, employees, agents, contractors, subcontractors or invitees arising out of or connected with Buyer's performance under this Agreement, Buyer's exercise of rights under this Agreement, or Buyer's breach of this Agreement.

8.3 Indemnification Procedures. If either Party intends to seek indemnification under Sections 8.1 (Seller's Indemnification for Third-Party Claims) or 8.2 (Buyer's Indemnification for Third-Party Claims), as applicable, from the other Party, the Party seeking indemnification shall give the other Party notice of such claim within ninety (90) days of the later of the commencement of, or the Party's actual knowledge of, such claim or action. Such notice shall describe the claim in reasonable detail, and shall indicate the amount, estimated if necessary, of the claim that has been, or may be, sustained by said Party. To the extent that the other Party will have been actually and materially prejudiced as a result of the failure to provide such notice, such notice will be a condition precedent to any liability of the other Party under the provisions for indemnification contained in this Agreement. Neither Party may settle or compromise any claim without the prior consent of the other Party; provided, however, said consent shall not be unreasonably withheld, conditioned or delayed.

8.4 Survival of Indemnification Provisions. The indemnification obligations of each Party under this Article 8 (Indemnification) shall continue in full force and effect during each applicable Delivery Period and for twelve (12) months thereafter.

ARTICLE IX LIMITATIONS ON LIABILITY

EXCEPT AS SET FORTH IN THIS AGREEMENT, THERE IS NO WARRANTY OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE, AND ANY AND ALL IMPLIED WARRANTIES ARE DISCLAIMED. THE PARTIES CONFIRM THAT THE EXPRESS REMEDIES AND MEASURES OF DAMAGES PROVIDED IN THIS AGREEMENT SATISFY THE ESSENTIAL PURPOSES HEREOF. FOR BREACH OF ANY PROVISION FOR WHICH AN EXPRESS REMEDY OR MEASURE OF DAMAGES IS PROVIDED, SUCH EXPRESS REMEDY OR MEASURE OF DAMAGES SHALL BE THE SOLE AND EXCLUSIVE REMEDY, THE OBLIGOR'S LIABILITY SHALL BE LIMITED AS SET FORTH IN SUCH PROVISION AND ALL OTHER REMEDIES OR DAMAGES AT LAW OR IN EQUITY ARE WAIVED. IF NO REMEDY OR MEASURE OF DAMAGES IS EXPRESSLY PROVIDED HEREIN, THE OBLIGOR'S LIABILITY SHALL BE LIMITED TO DIRECT ACTUAL DAMAGES ONLY, SUCH DIRECT ACTUAL DAMAGES SHALL BE THE SOLE AND EXCLUSIVE REMEDY AND ALL OTHER REMEDIES OR DAMAGES AT LAW OR IN EQUITY ARE WAIVED. UNLESS

EXPRESSLY HEREIN PROVIDED, NEITHER PARTY SHALL BE LIABLE FOR CONSEQUENTIAL, INCIDENTAL, PUNITIVE, EXEMPLARY OR INDIRECT DAMAGES, LOST PROFITS OR OTHER BUSINESS INTERRUPTION DAMAGES, BY STATUTE, IN TORT OR CONTRACT, UNDER ANY INDEMNITY PROVISION OR OTHERWISE. IT IS THE INTENT OF THE PARTIES THAT THE LIMITATIONS HEREIN IMPOSED ON REMEDIES AND THE MEASURE OF DAMAGES BE WITHOUT REGARD TO THE CAUSE OR CAUSES RELATED THERETO, INCLUDING THE NEGLIGENCE OF ANY PARTY, WHETHER SUCH NEGLIGENCE BE SOLE, JOINT OR CONCURRENT, OR ACTIVE OR PASSIVE. TO THE EXTENT ANY DAMAGES REQUIRED TO BE PAID HEREUNDER ARE LIQUIDATED, THE PARTIES ACKNOWLEDGE THAT THE DAMAGES ARE DIFFICULT OR IMPOSSIBLE TO DETERMINE, OR OTHERWISE OBTAINING AN ADEQUATE REMEDY IS INCONVENIENT AND THE DAMAGES CALCULATED HEREUNDER CONSTITUTE A REASONABLE APPROXIMATION OF THE HARM OR LOSS.

ARTICLE X FORCE MAJEURE

- 10.1 Force Majeure. Notwithstanding anything in this Agreement to the contrary, the Parties shall be excused from performing their respective obligations under this Agreement (other than the obligation to make payments with respect to performance prior to the event of Force Majeure) and shall not be liable for damages or otherwise due to their failure to perform, during any period that one Party is unable to perform due to an event of Force Majeure, provided that the Party declaring an event of Force Majeure shall: (i) act expeditiously to resume performance; (ii) exercise all commercially reasonable efforts to mitigate or limit damages to the other Party; and (iii) fulfill the requirements set forth in Section 10.2 (Notification).
- 10.2 Notification. A Party unable to perform under this Agreement due to an event of Force Majeure shall: (i) provide prompt written notice of such event of Force Majeure to the other Party, which shall include an estimate of the expected duration of the Party's inability to perform due to the event of Force Majeure; and (ii) provide prompt notice to the other Party when performance resumes.

ARTICLE XI EVENTS OF DEFAULT; REMEDIES

- 11.1 Events of Default. An "Event of Default" shall mean, with respect to a Party ("Defaulting Party") or a Significant Subsidiary, the occurrence of any of the following:
- (a) the failure to make, when due, any payment required pursuant to this Agreement if such failure is not remedied within two (2) Business Days after written notice;

- (b) any representation or warranty made by such Party herein is false or misleading in any material respect when made or when deemed made or repeated;
- (c) the failure of a Party to comply with the requirements of Section 4.8 (PJM Membership) and 4.9 (FERC Authorization) if such failure is not remedied within three (3) Business Days after written notice;
- (d) PJM has declared a Party to be in default of any provision of any PJM Agreement, which default prevents a Party's performance hereunder if such failure is not remedied within three (3) Business Days after written notice;
- (e) the failure to perform any material covenant or obligation set forth in this Agreement (except to the extent constituting a separate Event of Default) if such failure is not remedied within three (3) Business Days after written notice;
- (f) such Party becomes Bankrupt;
- (g) such Party consolidates with, or merges with or into, or transfers all or substantially all of its assets to, another entity, or assigns the Agreement or any rights, interests, or obligations hereunder without the prior written consent of the other Party when such consent is required, and, at the time of such consolidation, merger, transfer or assignment, the resulting, surviving, transferee, or assignee entity fails to assume all the obligations of such Party under this Agreement to which it or its predecessor was a party by operation of law or pursuant to an agreement reasonably satisfactory to the other Party;
- (h) the occurrence and continuation of: (i) a default, event of default or other similar condition or event in respect of such Party under one or more agreements or instruments, individually or collectively, relating to indebtedness for borrowed money in an aggregate amount of not less than \$50,000,000, if the effect of default or event is to accelerate, or to permit the acceleration of, the maturity of such indebtedness, or any such indebtedness shall be declared to be due and payable, or required to be prepaid (other than by a regularly scheduled required prepayment) prior to the stated maturity date thereof as a result of a default or similar adverse event; or (ii) a default by such Party in making on the due date therefor one or more payments, individually or collectively, in an aggregate amount of not less than \$50,000,000;
- (i) the failure of a Party to comply with its obligations pursuant to Article 13 (Security) if such failure is not remedied within three (3) Business Days after written notice;
- (j) with respect to Seller only:

- (i) if any representation or warranty made by the Corporate Guarantor in connection with this Agreement is false or misleading in any material respect when made or when deemed made or repeated;
- (ii) the failure of the Corporate Guarantor to make any payment required or to perform any other material covenant or obligation in any guaranty made in connection with this Agreement and such failure shall not be remedied within three (3) Business Days after written notice;
- (iii) the failure of the Corporate Guarantor's guaranty to be in full force and effect for purposes of this Agreement (other than in accordance with its terms) prior to the satisfaction of all obligations of such Party under this Agreement without the written consent of the other Party;
- (iv) the Corporate Guarantor repudiates, disaffirms, disclaims, or rejects, in whole or in part, or challenges the validity of any guaranty; or
- (v) conditions described with respect to Seller in subparagraphs (d), (e), (f), (h) and (i) of this Section 11.1 (Events of Default) occurs with respect to the Corporate Guarantor.

11.2 Remedies. If an Event of Default with respect to a Defaulting Party shall have occurred and be continuing, the other Party (the "Non-Defaulting Party"), shall provide written notice to the Defaulting Party and shall have the right to implement any or all of the following remedies:

- (a) designate a day, in such notice, no earlier than the day such notice is effective, as an early termination date ("Early Termination Date"), on which date this Agreement shall terminate and for the purposes of determining the Termination Payment,
- (b) calculate and receive from the Defaulting Party, payment for any Default Damages the Non-Defaulting Party incurs as of the date of the event giving rise to the Event of Default, until the earlier of: (i) the Early Termination Date (if applicable); or (ii) the Event of Default has been cured by the Defaulting Party; or (iii) the Non-Defaulting Party waives such Event of Default;
- (c) withhold any payments due to the Defaulting Party under this Agreement as an offset to any Default Damages or Termination Payment, as defined in Section 11.3 (Calculation and Net Out of Termination Payment); and
- (d) permanently suspend performance.

If an Event of Default has occurred and the Non-Defaulting Party is the Buyer, then unless the Event of Default was a failure by Seller to meet any or all of its Full Requirements Service obligations, Buyer may elect, at its sole discretion, in lieu of receipt of the Termination Payment, to retain any accrued and unpaid amounts otherwise payable to Seller, including without limitation any accrued and unpaid Net Billed Generation Revenues.

- 11.3 Calculation and Net Out of Termination Payment. The Non-Defaulting Party shall, at its sole discretion calculate, in a commercially reasonable manner, a Termination Payment as of the Early Termination Date or, to the extent that in the reasonable opinion of the Non-Defaulting Party this Agreement is commercially impracticable to liquidate and terminate or may not be liquidated and terminated under applicable law on the Early Termination Date, as soon thereafter as is reasonably practicable. The Non-Defaulting Party shall adjust the Termination Payment by netting out, at the option of the Non-Defaulting Party, any cash or other form of security, if any, then available to the Non-Defaulting Party pursuant to Article 13 (Security) and/or any or all other amounts due to the Defaulting Party under this Agreement and by adding any or all other amounts due to the Non-Defaulting Party under this Agreement. The Termination Payment shall be due to or from the Non-Defaulting Party, as appropriate.
- 11.4 Notice of Termination Payment. As soon as practicable after an Early Termination Date is declared, the Non-Defaulting Party shall provide written notice to the Defaulting Party of the amount of the Termination Payment and whether the Termination Payment is due to or due from the Non-Defaulting Party. The notice shall include a written statement explaining in reasonable detail the calculation of such amount. The owing Party shall make the Termination Payment within five (5) Business Days after such notice is effective.
- 11.5 Disputes With Respect to Termination Payment. If the Defaulting Party disputes the Non-Defaulting Party's calculation of the Termination Payment, in whole or in part, the Defaulting Party shall, within five (5) Business Days of receipt of Non-Defaulting Party's calculation of the Termination Payment, provide to the Non-Defaulting Party a notice that it intends to dispute the calculation of the Termination Payment ("Termination Payment Dispute Notice"), pursuant to the provisions of Article 12 (Dispute Resolution), and provided, however, that, if the Termination Payment is due from the Defaulting Party, the Defaulting Party shall first transfer collateral to the Non-Defaulting Party in an amount equal to the Termination Payment, such collateral to be in a form acceptable to the Non-Defaulting Party with the Termination Payment Dispute Notice.
- 11.6 Closing Setoffs. After calculation of a Termination Payment in accordance with Section 11.3, (Calculation and Net Out of Termination Payment) if the Defaulting Party would be owed the Termination Payment, the Non-Defaulting Party shall be entitled, at its option and in its discretion, to: (i) set off against such Termination Payment any amounts payable by the Defaulting Party to the Non-Defaulting Party under any other agreements, instruments or undertakings between the

Defaulting Party and the Non-Defaulting Party; and/or (ii) to the extent the Transactions are not yet liquidated in accordance with Section 11.2(a), withhold payment of the Termination Payment to the Defaulting Party. The remedy provided for in this Article shall be without prejudice and in addition to any right of setoff, combination of accounts, lien or other right to which any Party is at any time otherwise entitled (whether by operation of law, contract or otherwise). If any obligation is unascertained, the Non-Defaulting Party may in good faith estimate that obligation and set-off in respect of the estimate, subject to the Non-Defaulting Party accounting to the Defaulting Party when the obligation is ascertained.

- 11.7 Duty to Mitigate. Each Party agrees that it has a duty to mitigate damages and covenants that it will use commercially reasonable efforts to minimize any damages it may incur as a result of the other Party's failure to perform pursuant to this Agreement.

ARTICLE XII DISPUTE RESOLUTION

- 12.1 Informal Dispute Resolution. Before pursuing resolution of any dispute arising out of this Agreement, the disputing Party shall provide written notice to the other Party setting forth the nature of the dispute, the amount involved, if any, and the remedies sought. The Parties shall use good faith and reasonable commercial efforts to informally resolve such dispute. Such efforts shall last for a period of at least thirty (30) calendar days from the date that the notice of the dispute is first delivered from one Party to the other Party. Any amounts that are owed by one Party to the other Party as a result of resolution of a dispute pursuant to this Section 12.1 (Informal Dispute Resolution), shall be paid within two (2) Business Days of such resolution and the payment shall include interest calculated at the Interest Rate from the original due date through the date of payment.
- 12.2 Formal Dispute Resolution. After the requirements of Section 12.1 (Informal Dispute Resolution) have been satisfied, all unresolved disputes, except as noted below, between the Parties shall be submitted to the Parties' senior management. Notwithstanding anything set forth in this Article 12 (Dispute Resolution) to the contrary, and any dispute concerning new PJM charges will be resolved in accordance with the procedures set forth in Section 2.4 (Other Changes in PJM Charges).

ARTICLE XIII SECURITY

- 13.1 Officer's Certificate. On or before the Effective Date, Seller shall comply with one of the following provisions:

- (a) Seller shall provide a certificate from a duly authorized corporate officer of Seller (or the Corporate Guarantor) certifying that, as of such date, Seller (or the Corporate Guarantor) has an investment rating equal to or higher than the Minimum Investment Rating; or
- (b) Seller shall provide a certificate from a duly authorized corporate officer of Seller (or the Corporate Guarantor) certifying that, as of such date, Seller (or the Corporate Guarantor) has a Consolidated Cash Coverage Ratio equal to or greater than the Minimum Consolidated Cash Coverage Ratio.

13.2 Security. On or before the Effective Date, Seller shall either:

- (a) post, or cause the Certifying Company to post, an irrevocable letter of credit issued by a Commercial Bank in form and substance reasonably acceptable to Buyer with a drawable amount at all times equal to five percent (5%) of the Expected Annual Payments (as determined by Buyer pursuant to Exhibit D) for the following twelve months, rounded up to the nearest million dollars, as such letter of credit may be supplemented or replaced pursuant to the terms of this Agreement, which letter(s) of credit shall remain in place for such amount (or such other amount as may be determined pursuant to Section 13.4(a) hereof) for the entire term of this Agreement. In the event that Seller is required to increase the amount of such letter(s) of credit pursuant to the terms of this Agreement, then such letter(s) of credit for such increased amount shall remain in place for such time as may be required under the terms of this Agreement; or
- (b) provide written notice to Buyer that the Applicable Number of Days shall be the number of days determined pursuant to clause (b) of the definition of such term;

provided, that Seller may change its election pursuant to this Section 13.2 by providing written notice to Buyer, which change in election shall be effective upon (i) the receipt by Buyer of a letter of credit meeting the conditions of Section 13.2(a), if Seller is changing its election to Section 13.2(a) and (ii) the receipt of written acknowledgment from Seller accepting the determination of the Applicable Number of Days, as reasonably determined by Buyer, pursuant to clause (b) of the definition of such term.

13.3 Compliance.

- (a) If at any time during the term of this Agreement, (i) S&P or Moody's downgrades the investment rating of the Certifying Company or (ii) the Certifying Company's Consolidated Cash Coverage Ratio at the end of an accounting period is less than the Minimum Consolidated Cash Coverage Ratio, then Seller shall provide Buyer with written notice of such event within two (2) Business Days of the occurrence of any such event.

- (b) Within fifteen days of the end of each calendar quarter during the term of this Agreement, Seller shall deliver to Buyer a certificate from a duly authorized corporate officer of the Certifying Company certifying that, as of the date of such certification, the Certifying Company has either an investment rating equal to or higher than the Minimum Investment Rating or a Consolidated Cash Coverage Ratio equal to or greater than the Minimum Consolidated Cash Coverage Ratio (which certification shall include such calculations and evidence as Buyer shall reasonably request). The Parties recognize and agree that in addition to, and without limiting in any way, Seller's obligation to deliver a certificate from a duly authorized corporate officer of the Certifying Company contained in the immediately preceding sentence, Seller may deliver to Buyer such a certificate at any time during the term of this Agreement in order to change the Certifying Company or modify any information relating thereto.
- (c) (i) Within one hundred and twenty (120) days after the end of each fiscal year of the Certifying Company, Seller shall deliver to Buyer the financial statements of the Certifying Company, which financial statements shall have been prepared in conformity with GAAP and certified by a firm of certified public accountants of national standing and (ii) within sixty (60) days after the end of each fiscal quarter of the Certifying Company, Seller shall deliver to Buyer the financial statements of the Certifying Company for such most recently ended quarter, which financial statements shall have been prepared in conformity with GAAP.

13.4 Additional Security. If at any time during the term of this Agreement following the Effective Date the Certifying Company's Consolidated Cash Coverage Ratio is below the Minimum Consolidated Cash Coverage Ratio and the Certifying Company's investment rating is below the Minimum Investment Rating, then Seller shall immediately notify Buyer and upon five (5) Business Days' written notice from Buyer to Seller, Seller shall, so long as the Certifying Company's Consolidated Cash Coverage Ratio is below the Minimum Consolidated Cash Coverage Ratio and the Certifying Company's investment rating is below the Minimum Investment Rating, either:

- (a) post, or cause the Certifying Company to post, an incremental irrevocable letter of credit issued by a Commercial Bank in form and substance reasonably acceptable to Buyer with a drawable amount that equals the greater of (i) five percent (5%) of the Expected Annual Payments (as determined by Buyer pursuant to Exhibit D) for the following twelve months or lesser period in the event that the remaining term of the Delivery Period is less than twelve months, and (ii) the Mark-to-Market Exposure calculated on the most recent Determination Date, in each case rounded up to the nearest million dollars, which letter(s) of credit shall remain in place for such aggregate amount until such time as the Certifying Company's Consolidated Cash Coverage Ratio is equal to or greater than the Minimum Consolidated Cash Coverage Ratio or the

Certifying Company's investment rating is equal to or greater than the Minimum Investment Rating (at which time, although the letter of credit requirements of this Section 13.4(a) shall not apply, Seller shall continue to comply with any other applicable letter of credit requirements set forth in this Article 13); or

- (b) provide written notice to Buyer that the Applicable Number of Days shall be the number of days determined pursuant to clause (c) of the definition of such term;

provided, that Seller may change its election pursuant to this Section 13.4 by providing written notice to Buyer, which change in election shall be effective upon (i) the receipt by Buyer of a letter of credit meeting the conditions of Section 13.4(a), if Seller is changing its election to Section 13.4(a) and (ii) the receipt of written acknowledgment from Seller accepting the determination of the Applicable Number of Days, as reasonably determined by Buyer, pursuant to clause (c) of the definition of such term.

In the event Seller elects to provide the incremental irrevocable letter of credit pursuant to Section 13.4(a) above, Buyer shall notify Seller in accordance with Section 13.5(a) of any changes in the required drawable amount pursuant to Section 13.4(a)(i) or (ii) as determined by Buyer. In such event, Seller shall provide to Buyer written evidence executed by the letter of credit issuer evidencing the change in the drawable amount of the letter of credit within five (5) Business Day(s) of such notice from Buyer.

13.5 Mark to Market Exposure. Buyer shall calculate the Mark-to-Market Exposure on each Determination Date pursuant to the process and methodology described in Exhibit B. To the extent that the calculations of the Mark-to-Market Exposure for a given Determination Date result in a negative number, the Mark-to-Market Exposure for such date shall be deemed equal to zero.

- (a) Buyer shall use reasonable efforts to provide Seller with the Mark-to-Market Exposure within one (1) Business Day of its calculation, subject to the Confidentiality provisions of this Agreement.
- (b) Buyer shall use reasonable efforts to provide Seller with the On-Peak Initial Mark Price, Off-Peak Initial Mark Price, On-Peak Forward Price and Off-Peak Forward Price as they are determined on each Determination Date, subject to the confidentiality provisions of this Agreement.
- (c) Seller may dispute Buyer's determinations of the On-Peak Initial Mark Price, Off-Peak Initial Mark Price, On-Peak Forward Price and Off-Peak Forward Price if Seller can demonstrate that Buyer has been grossly negligent in such determinations, or that Buyer is making determinations in a manner that is arbitrary, capricious or erroneous on its face. Such dispute of Buyer's determinations by Seller shall not be cause for any

delay by Seller in posting any additional security requested by Buyer pursuant to Section 13.4.

ARTICLE XIV REPRESENTATIONS AND WARRANTIES

- 14.1 Representations and Warranties. On the date first written above and throughout the term of this Agreement, each Party represents and warrants to the other Party that:
- (a) it is duly organized, validly existing and in good standing under the laws of the jurisdiction of its formation;
 - (b) it has all regulatory authorizations necessary for it to legally perform its obligations under this Agreement;
 - (c) the execution, delivery and performance of this Agreement are within its powers, have been duly authorized by all necessary action and do not violate any of the terms and conditions in its governing documents, any contracts to which it is a party or any law, rule, regulation, order or the like applicable to it;
 - (d) this Agreement constitutes a legally valid and binding obligation of such Party enforceable against it in accordance with its terms; subject to any Equitable Defenses;
 - (e) it is not Bankrupt and there are no proceedings pending or being contemplated by it or, to its knowledge, threatened against it which would result in it being or becoming Bankrupt;
 - (f) there are no pending, or to its knowledge threatened, actions, suits or proceedings against it or any of its Affiliates any legal proceedings before any court, Governmental Authority, that could materially adversely affect its financial condition, business or operations or its ability to perform its obligations under this Agreement;
 - (g) no Event of Default with respect to it has occurred and is continuing and no such event or circumstance would occur as a result of its entering into or performing its obligations under this Agreement;
 - (h) it is not relying upon the advice or recommendations of the other Party in entering into this Agreement, it is capable of understanding, understands and accepts the terms, conditions and risks of this Agreement, and the other Party is not acting as a fiduciary for or advisor to it in respect of this Agreement;
 - (i) it is a "forward contract merchant" within the meaning of the United States Bankruptcy Code;

- (j) it has entered into this Agreement in connection with the conduct of its business and it has the capacity or ability to provide or take delivery of the Full Requirements Service as required by this Agreement; and it is an “eligible contract participant” as defined in Section 1a(12) of the Commodity Exchange Act.

**ARTICLE XV
MISCELLANEOUS**

- 15.1 Notices. Unless otherwise specified herein, all notices shall be in writing and delivered by hand, overnight or facsimile. Notice shall be effective on the next Business Day after it is sent. A Party may change its address by providing notice of the same in accordance with this Section 15.1. Notice information for Buyer and Seller is shown on Exhibit C.
- 15.2 General. This Agreement shall be considered for all purposes as prepared through the joint efforts of the Parties and shall not be construed against one Party or the other as a result of the preparation, substitution, submission or other event of negotiation, drafting or execution hereof. Each Party further agrees that it will not assert, or defend itself, on the basis that any applicable tariff is inconsistent with this Agreement. This Agreement shall not impart any rights enforceable by any third party other than a permitted successor or assignee bound to this Agreement. Any provision declared or rendered unlawful will not otherwise affect the remaining lawful obligations that arise under this Agreement; provided that in such event the Parties shall use commercially reasonable efforts to amend this Agreement in order to give effect to the original intention of the Parties.
- 15.3 Rules of Interpretation. The following principles shall be observed in the interpretation and construction of this Agreement:
- (a) unless otherwise stated, the terms “include” and “including” when used in this Agreement shall be interpreted to mean by way of example only and shall not be considered limiting in any way;
 - (b) all titles and headings used herein are for convenience and reference purposes only, do not constitute a part of this Agreement and shall be ignored in construing or interpreting the obligations of the parties under this Agreement;
 - (c) references to the singular include the plural and vice versa;
 - (d) references to Articles, Sections, Clauses and the Preamble are, unless the context indicates otherwise; references to Articles, Sections, Clauses and the Preamble of this Agreement;
 - (e) in carrying out its rights, obligations and duties under this Agreement, each Party shall have an obligation of good faith and fair dealing; and
 - (f) if any payment due under this Agreement would be, by operation of the terms and conditions of any provision hereof, due and payable on a day other than a Business Day, such payment shall be made on the next following Business Day.

15.4 Audit. Each Party has the right, at its sole expense and during normal working hours, to examine the records of the other Party to the extent reasonably necessary to verify the accuracy of any statement, charge or computation made pursuant to this Agreement. If any such examination reveals any inaccuracy in any statement, the necessary adjustments in such statement and the payments thereof will be made in accordance with Sections 6.7 and 6.8.

15.5 Confidentiality.

- (a) Each Party shall hold in confidence and not release or disclose any document or information furnished by the other Party in connection with this Agreement, unless: (i) compelled to disclose such document or information by judicial, regulatory or administrative process or other provisions of law; (ii) such document or information is generally available to the public; (iii) such document or information was available to the receiving Party on a non-confidential basis; (iv) such document or information was available to the receiving Party on a non-confidential basis from a third-party, provided that the receiving Party does not know, and, by reasonable effort, could not know that such third-party is prohibited from transmitting the document or information to the receiving Party by a contractual, legal or fiduciary obligation or (v) such disclosure is made to PJM and is necessary in order for the transactions contemplated by this Agreement to be consummated or to otherwise comply with the provisions of this Agreement.
- (b) Notwithstanding any other provision of this Section 15.5, a Party may disclose to its employees, representatives and agents all documents and information furnished by the other Party in connection with this Agreement, provided that such employees, representatives and agents have been advised of the confidentiality provisions of the Section 15.5, and further provided that in no event shall a document or information be disclosed in violation of the standard of conduct requirements established by FERC.
- (c) A Party receiving notice or otherwise concluding that any confidential document or information furnished by the other Party in connection with this Agreement is being sought under any provision of law, to the extent it is permitted to do so under any judicial, regulatory or administrative process or other provisions of applicable law, shall: (i) promptly notify the other Party; and (ii) use reasonable efforts in cooperation with the other Party to seek confidential treatment of such confidential information.
- (d) Any independent auditor performing an audit on behalf of a Party pursuant to Section 15.4 shall be required to execute a confidentiality agreement with the Party being audited. Such audit information shall be treated as confidential pursuant to this Section 15.5.

- (e) The Parties agree that monetary damages may be inadequate to compensate a Party for the other Party's breach of its obligations under this Section 15.5. Each Party accordingly agrees that the other Party shall be entitled to equitable relief, by way of injunction or otherwise, if the receiving Party breaches or threatens to breach its obligations under this Section 15.5, which equitable relief shall be granted without bond or proof of damages, and the receiving Party shall not plead in defense that there would be an adequate remedy at law.
- 15.6 Successors. This Agreement and all of the provisions hereof are binding upon, and inure to the benefit of, the Parties and their respective successors and permitted assigns.
- 15.7 Assignment/Change in Corporate Identity. Neither Party shall assign this Agreement, its rights or obligations hereunder without the prior written consent of the other Party, which consent may not be unreasonably withheld; provided, however, either Party may, without the consent of the other Party (and without relieving itself from liability hereunder),
- (a) transfer, sell, pledge, encumber or assign this Agreement or the accounts, revenues or proceeds hereof in connection with any financing or other financial arrangements,
 - (b) transfer or assign this Agreement to an Affiliate of such Party if such Affiliate either has a Consolidated Cash Coverage Ratio that equals or exceeds the Minimum Consolidated Cash Coverage Ratio or has an investment rating that is equal to or greater than the Minimum Investment Rating,
 - (c) transfer or assign this Agreement to any Person succeeding to all or substantially all of the assets if such Person either has a Consolidated Cash Coverage Ratio that equals or exceeds the Minimum Consolidated Cash Coverage Ratio or has an investment rating that is equal to or greater than the Minimum Investment Rating;
 - (d) provided, however, that in each such case, any such assignee shall agree in writing to be bound by the terms and conditions hereof and so long as the transferring Party delivers such tax and enforceability assurance as the non-transferring Party may reasonably request.
- 15.8 Governing Law. THIS AGREEMENT AND THE RIGHTS AND OBLIGATIONS OF THE PARTIES HEREUNDER SHALL BE GOVERNED BY AND CONSTITUTED IN ACCORDANCE WITH THE LAWS OF THE COMMONWEALTH OF PENNSYLVANIA, WITHOUT REGARD TO PRINCIPLES OF CONFLICTS OF LAW.
- 15.9 Jurisdiction and Venue. Except for matters jurisdictional to FERC, the PUC or the appellate courts having jurisdiction over the PUC or FERC matters, all disputes

hereunder shall be resolved in the Federal or State courts of Pennsylvania and each Party hereby irrevocably submits to the in personam jurisdiction of such courts. Each Party hereby waives its respective rights to any jury trial with respect to any litigation arising under or in connection with this Agreement.

15.10 Amendments. Except as provided in Section 15.11 (PJM Agreement Modifications), this Agreement shall not be amended, modified, terminated, discharged or supplemented, nor any provision hereof waived, unless mutually agreed, in writing, by the Parties. Except as provided in Section 15.11 (PJM Agreement Modifications), the rates, terms and conditions contained in this Agreement are not subject to change under Sections 205 or 206 of the Federal Power Act absent the mutual written agreement of the Parties. Absent the agreement of all parties to the proposed change, the standard of review for changes to this Agreement proposed by a Party, a non-Party or the FERC acting *sua sponte* shall be the "public interest" standard of review set forth in *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956), and *Federal Power Commission v. Sierra Pacific Power Co.*, 350 U. S. 348 (1956) (the "Mobile-Sierra" doctrine).

15.11 PJM Agreement Modifications.

- (a) If the PJM Agreements are amended or modified so that any schedule or section references herein to such agreements is changed, such schedule or section references herein shall be deemed to automatically (and without any further action by the Parties) refer to the new or successive schedule or section in the PJM Agreements which replaces that originally referred to in this Agreement.
- (b) If the applicable provisions of the PJM Agreements referenced herein, or any other PJM rules relating to the implementation of this Agreement, are changed materially from those in effect on the date first written above, both Parties shall cooperate to make conforming changes to this Agreement to fulfill the purposes of this Agreement.

15.12 Delay and Waiver. Except as otherwise provided in this Agreement, no delay or omission to exercise any right, power or remedy accruing to the respective Parties hereto upon any breach or default of any other Party under this Agreement shall impair any such right, power or remedy, nor shall it be construed to be a waiver of any such similar breach or default thereafter occurring; nor shall any waiver of any single breach or default be deemed a waiver of any other breach or default theretofore or thereafter occurring. Any waiver, permit, consent or approval of any kind or character of any breach or default under this Agreement, or any waiver of any provision or condition of this Agreement, must be in writing and shall be effective only to the extent specifically set forth in such writing.

- 15.13 No Third Party Beneficiaries. Nothing in this Agreement, express or implied, is intended to confer on any other Person except the Parties hereto any rights, interests, obligations or remedies hereunder.
- 15.14 Independent Contractors. The Parties acknowledge and agree that: (i) they are independent contractors, (ii) neither Party shall have any right, power or authority to enter into any agreement or commitment, act on behalf of, or otherwise bind the other Party in any way, and (iii) nothing contained in this Agreement shall create any relationship between Buyer and Seller other than that of independent contractors.
- 15.15 Counterparts. This Agreement may be executed in more than one (1) counterpart, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.
- 15.16 Entire Agreement. This Agreement, including the Schedules and Exhibits hereto, embodies the entire agreement and understanding of the Parties in respect of the obligations and requirements set forth in this Agreement. There are no restrictions, promises, representations, warranties, covenants or undertakings, other than those expressly set forth or referred to herein. This Agreement supersedes all prior agreements and understandings between the Parties with respect to the subject matter contained herein.

IN WITNESS WHEREOF, the Parties have caused this Agreement to be executed and delivered, as of the date first written above, by their respective duly authorized officers.

DUQUESNE LIGHT COMPANY

By: _____
Name:
Title:

DUQUESNE POWER, L.P.

By: **DUQUESNE POWER, INC.**
Its General Partner

By: _____
Name:
Title:

EXHIBIT A

ALLOCATION OF CHARGES

OPERATING AGREEMENT OF PJM INTERCONNECTION, L.L.C.:	Day- ahead	Balancing	Total
Charges:			
Spot Market Energy	Seller	Seller	Seller
Transmission Congestion	Seller	Seller	Seller
Transmission Losses (Point-to-Point)	Seller	Seller	Seller
Regulation			Seller
Spinning Reserve			Seller
Operating Reserves	Seller	Seller	Seller
Synchronous Condensing			Seller
Capacity Credit Market			Seller
Reconciliation for Spot Market			Seller
Reconciliation for Regulation			Seller
Reconciliation for Operating Reserves			Seller
Emergency Energy			Seller
FTR Auction			Seller
Meter Error Correction			Seller
PJM Load Response Program			Seller
Credits:			
Spot Market Energy	Seller	Seller	Seller
Transmission Congestion			
Hourly			Seller
Annual			Seller
Transmission Losses (Point-to-Point)			Seller
Regulation			Seller
Spinning Reserve			Seller
Operating Reserves	Seller	Seller	Seller
Synchronous Condensing			Seller
Capacity Credit Market			Seller
Reconciliation for Transmission Losses			Seller
Emergency Energy			Seller
FTR Auction			Seller

PJM OPEN ACCESS TRANSMISSION TARIFF:

	Total
Charges:	
PJM Scheduling, System Control and Dispatch Service	Buyer
Transmission Owner Scheduling, System Control and Dispatch Service (PJM Schedule 1A)	Seller
Reactive Supply and Voltage Control from Generation Sources Service (PJM Schedule 2)	Seller
Black Start Service (PJM Schedule 6A)	Seller
Network Integration Transmission Service (Attachment H)	Buyer
Network Transmission Service Offset Charges	Buyer
Firm Point-to-Point Transmission Service (PJM Schedule 7)	Seller
Non-Firm Point-to-Point Transmission Service (PJM Schedule 8)	Seller
Reliability Council Charges (PJM Schedule 10)	Buyer
Reconciliation for PJM Scheduling, System Control and Dispatch Service	Buyer
Reconciliation for Transmission Owner Scheduling, System Control and Dispatch Service	Seller
Credits:	
Non-Firm Point-to-Point Transmission Service	Buyer
Other Supporting Facilities	Buyer

Reliability Assurance Agreement Among Load Serving Entities in the PJM Control Area:

	Total
Charges:	
Capacity Deficiency	Seller
Credits:	
Capacity Excess	Seller

EXHIBIT B

METHODOLOGY FOR CALCULATION OF MARK TO MARKET EXPOSURE

Parameters

In calculating the Mark-to-Market Exposure, the following parameters are set on the Transaction Date:

1. Long-Term Escalation Rate
2. On-Peak Initial Mark Price
3. Off-Peak/On-Peak Price Ratio
4. Off-Peak Initial Mark Price
5. On-Peak Expected Load
6. Off-Peak Expected Load

The following parameters are set on each date on which the Mark-to-Market Exposure is calculated:

- 1) On-Peak Forward Price for each of the next twelve months immediately following
- 2) Off-Peak Forward Price for each of the next twelve months immediately following

On-Peak Initial Mark Prices

On the Transaction Date, Buyer shall obtain on-peak forward prices for the initial 12 months of the term of the Delivery Period. The preferred data source for forward prices shall be the New York Mercantile Exchange ("NYMEX") monthly PJM Physically Settled Electricity Futures Contract traded on the NYMEX Clearportsm over-the-counter trading platform and reported on NYMEX's website, www.nymex.com (the "Preferred Data Source"). For each month, Buyer shall first attempt to obtain a price from the Preferred Data Source. In the event that prices from the Preferred Data Source are not available for one or more months in the initial 12 months of the delivery period, Buyer shall contact four Reference Market-Makers to obtain bid and ask Energy price quotes for PJM Western Hub On-Peak Hours for those months for which prices from the Preferred Data Source are not available. For Buyer to include a monthly On-Peak Forward Price quote from a Reference Market-Maker, both bid and ask prices must be available. If a minimum of two quotes in a particular month is not available, then it shall be deemed that no quotes were available for that month. For any month for which there are no single month quotes, but for which there are two month, quarterly, or 12 month quotes available ("Aggregate Quotes"), Buyer shall disaggregate the Aggregate Quote into monthly components in the following manner. The most recently available single month quotes for the same calendar months contained in the Aggregate Quote shall be averaged. The percentage by which each single month price differs from the average of the single month prices for the same time period of the Aggregate Quote shall be applied to the Aggregate

Quote to establish monthly prices for the like month of the Aggregate Quote, such that the average shall be the Aggregate Quote. In the event that quotes for one or more months of a multi-month block and for the entire multi-month block in aggregate are both available, but are inconsistent with each other, Buyer shall use the one that is most consistent with other available quotes.

For each month beyond the initial 12 months of the Delivery Period Buyer shall multiply the On-Peak Initial Mark Price for the corresponding calendar month in the initial 12 months of the Delivery Period by one plus the Long-Term Escalation rate raised to the power of the number of years between the relevant month and the corresponding calendar month in the initial 12 months of the Delivery Period.

On-Peak and Off-Peak Expected Load

The On-peak and Off-peak Expected Loads shall be set for each month for the term of this Agreement at the values shown in the following schedule:

Month	On-Peak Expected Load	Off-Peak Expected Load
Jan-05	380,467	308,470
Feb-05	318,345	278,295
Mar-05	331,094	302,861
Apr-05	314,399	254,709
May-05	331,734	246,654
Jun-05	393,658	328,720
Jul-05	471,511	358,996
Aug-05	471,679	378,134
Sep-05	340,333	302,887
Oct-05	338,110	257,833
Nov-05	319,232	271,810
Dec-05	354,872	333,848
Jan-06	386,243	313,153
Feb-06	323,177	282,520
Mar-06	336,121	307,458
Apr-06	319,172	258,576
May-06	336,770	250,398
Jun-06	399,634	333,710
Jul-06	478,668	364,446
Aug-06	478,839	383,875
Sep-06	345,499	307,485
Oct-06	343,242	261,747
Nov-06	324,079	275,937
Dec-06	360,259	338,916
Jan-07	391,922	317,758
Feb-07	327,929	286,674
Mar-07	341,063	311,979
Apr-07	323,865	262,378
May-07	341,721	254,080
Jun-07	405,509	338,616
Jul-07	485,706	369,805
Aug-07	485,879	389,519
Sep-07	350,579	312,006
Oct-07	348,289	265,595
Nov-07	328,843	279,994
Dec-07	365,556	343,899
Jan-08	397,837	322,554
Feb-08	332,879	291,001
Mar-08	346,211	316,688
Apr-08	328,753	266,338
May-08	346,879	257,915
Jun-08	411,630	343,728
Jul-08	493,038	375,387
Aug-08	493,213	395,398
Sep-08	355,871	316,715
Oct-08	353,546	269,604
Nov-08	333,807	284,220
Dec-08	371,073	349,090
Jan-09	403,993	327,545
Feb-09	338,030	295,504
Mar-09	351,568	321,588
Apr-09	333,841	270,459
May-09	352,247	261,906
Jun-09	418,000	349,046
Jul-09	500,667	381,195
Aug-09	500,845	401,517
Sep-09	361,378	321,616
Oct-09	359,017	273,776
Nov-09	338,972	288,618
Dec-09	376,815	354,492
Jan-10	410,531	332,845
Feb-10	343,500	300,286
Mar-10	357,257	326,792
Apr-10	339,243	274,836
May-10	357,947	266,144
Jun-10	424,764	354,695
Jul-10	508,769	387,364
Aug-10	508,950	408,014
Sep-10	367,226	326,821
Oct-10	364,827	278,206
Nov-10	344,458	293,289
Dec-10	382,913	360,228

On-Peak Forward Prices

On each date on which the Mark-to-Market Exposure is calculated (i.e., on each Determination Date), Buyer shall collect on-peak forward prices for the 12 full calendar months immediately following the current month. If the remaining term of the Delivery Period is less than 12 months, Buyer shall obtain forward prices for each full calendar month in the remaining term of the Delivery Period. For each month, Buyer shall first attempt to collect a price from the Preferred Data Source. In the event that prices from the Preferred Data Source are not available for one or more months in the initial 12 months of the delivery period, Buyer shall contact four Reference Market-Makers to obtain bid and ask Energy price quotes for PJM Western Hub On-Peak Hours for those months for which prices from the Preferred Data Source are not available. For Buyer to include a monthly On-Peak Forward Price quote from a Reference Market-Maker, both bid and ask prices must be available. If a minimum of two quotes in a particular month is not available, then it shall be deemed that no quotes were available for that month. For any month for which there are no single month quotes, but for which there are Aggregate Quotes, Buyer shall disaggregate the Aggregate Quote into monthly components in the following manner. The most recently available single month quotes for the same calendar months contained in the Aggregate Quote shall be averaged. The percentage by which each single month price differs from the average of the single month prices for the same time period of the Aggregate Quote shall be applied to the Aggregate Quote to establish monthly prices for the like month of the Aggregate Quote, such that the average shall be the Aggregate Quote. In the event that quotes for one or more months of a multi-month block and for the entire multi-month block in aggregate are both available, but are inconsistent with each other, Buyer shall use the one that is most consistent with other available quotes.

Calculation of Monthly Mark-to-Market Exposures

The Buyer shall use the following process in calculating the Mark-to-Market Exposure:

1. For each of the 12 months immediately following the current month, Buyer shall subtract the On-Peak Initial Mark Price from the On-Peak Forward Price.
2. Buyer shall multiply the monthly values calculated in step 1 by the On-Peak Expected Load for each month.
3. For each of the 12 months immediately following the current month, Buyer shall subtract the Off-Peak Initial Mark Price from the Off-Peak Forward Price.
4. Buyer shall multiply the monthly values calculated in step 3 by the Off-Peak Expected Load for each month.
5. Buyer shall calculate the sum of the values generated in steps 2 and 4 for each month to calculate the Monthly Mark-to-Market Exposure for each month.

Calculation of Mark-to-Market Exposure

The Buyer shall calculate the sum of the Monthly Mark-to-Market Exposures for each of the twelve (12) months immediately following the current month to generate the Mark-to-Market Exposure. In the event that the remaining term of the Delivery Period is less than twelve (12) months the Mark-to-Market Exposure shall be calculated as the sum of the Monthly Mark-to-Market Exposures over the remaining term of the Delivery Period.

EXHIBIT C

FORM OF NOTICE

Any notices required under this Agreement shall be made as follows:

Buyer:

Seller:

All Notices:

Street: 411 Seventh Avenue
City/State/Zip: Pittsburgh, PA 15219
Attn: Contract Administration
Facsimile: 412-393-5620
Duns:
Federal Tax ID Number:

All Notices:

Street: 411 Seventh Avenue
City/State/Zip: Pittsburgh, PA 15219
Attn: Dennis Urban
Facsimile: 412-393-1234
Duns:
Federal Tax ID Number:

Invoices:

Attn: Mark R. Warren
Phone: 412-393-6171
Facsimile: 412-393-6157

Invoices:

Attn: Jacquelyn McGrew
Phone: 412-393-6353
Facsimile: 412-393-6157

Scheduling:

Attn: Dale M. Flaherty
Phone: 412-393-6237
Facsimile: 412-393-8642

Scheduling:

Attn: Anthony Pekny
Phone: 412-393-6293
Facsimile: 412-393-1070

Payments:

Attn: Mark R. Warren
Phone: 412-393-6171
Facsimile: 412-393-6157

Payments:

Attn: Jacquelyn McGrew
Phone: 412-393-6353
Facsimile: 412-393-6157

Wire Transfer:

BNK: Mellon Bank, N.A.
ABA:
ACCT:

Wire Transfer

BNK: Mellon Bank, N.A.
ABA:
ACCT:

Credit and Collections:

Attn: Mark R. Warren
Phone: 412-393-6171
Facsimile: 412-393-6157

With additional Notices of an

Event of Default to:

Attn: Legal Department
Phone: 412-393-1503
Facsimile: 412-393-5620

Credit and Collections:

Attn: Jacquelyn McGrew
Phone: 412-393-6353
Facsimile: 412-3936157

With Additional Notices of an

Event of Default to:

Attn: Legal Department
Phone: 412-393-1503
Facsimile: 412-393-5620

EXHIBIT D

METHODOLOGY FOR CALCULATION OF EXPECTED ANNUAL PAYMENTS

Buyer shall calculate Expected Annual Payments once on the Effective Date for the purpose of calculating Security pursuant to Article 13.2 of this Agreement. In the event that Seller is required to post Additional Security pursuant to Article 13.4, Buyer shall calculate Expected Annual Payments on the Initial Determination Date and each Determination Date thereafter.

Parameters

Buyer shall obtain the following information on the date on which the Expected Annual Payments calculation is performed:

1. Generation Billing Determinants for the most recent available 12 complete months
2. Retained Load Ratio for the most recent complete month

Calculation of Expected Annual Payments

1. In the event that the remaining term of the Delivery Period is 12 months or more, Buyer shall multiply each of Generation Billing Determinants for the most recent 12 months by the Retained Load Ratio. In the event that the remaining term of the Delivery Period is less than 12 months, Buyer shall multiply each of the Generation Billing Determinants for the applicable months remaining in the Delivery Period by the Retained Load Ratio.
2. Buyer shall multiply the values calculated in step 1 by the applicable Generation Rates for each POLR III Rate Schedule.
3. Buyer shall multiply the values calculated in step 2 by a factor of nine hundred forty-one thousandths (.941).
4. The Expected Annual Payments shall be generated by calculating the sum of the values calculated in step 3.

SCHEDULE 1

COMPANY USE ENERGY RATES

Company Use Charges (for each account)

			2005	2006	2007
Energy	first 550 kWh	¢/kWh	7.4533	7.4533	7.4533
	next 750 kWh	¢/kWh	7.4533	7.4533	7.4533
	additional kWh	¢/kWh	3.2103	3.2103	3.2103
Demand	Demand first 5 kW	\$/kW/mo.	0.00	0.00	0.00
	Demand additional kW	\$/kW/mo.	8.73	8.73	8.73

Notes: Company use wholesale charges are based on the PaPUC approved GS/GM rates less the PJM Surcharge (recovered in Duquesne Light Company's Rider 1) and the Pennsylvania Gross Receipts Taxes (5.9%). These charges also do not include network integration transmission service.

DIRECT ENERGY SERVICES, LLC AND RETAIL ENERGY SUPPLY ASSOCIATION'S RESPONSE TO DUQUESNE LIGHT COMPANY'S INTERROGATORIES AND REQUESTS FOR PRODUCTION OF DOCUMENTS, SET I, NO. 10, DATED APRIL 2, 2007, DOCKET NO. P-00072247.

Request:

10. Does Direct Energy offer residential customers fixed prices for terms of 1 year, 2 year or 3 years, and if so, do the prices for these long-term products reflect prevailing market prices?
 - a. If so, do the prices for those products offered to customers reflect the prevailing market price at that moment in time (e.g., spot energy and/or capacity costs similar to those presented in Exhibit FPL-3) or do they reflect the prevailing market prices at the time of the offer based on expectations of future market prices over the term of that contract?
 - b. If they don't reflect prevailing market prices, explain what the prices for these long-term products do reflect?

Response provided by: Frank Lacey, Director of Government and Regulatory Affairs

Response: Direct Energy offers residential customers in the markets in which we serve a plethora of products, including fixed price term products of the customers' choice. In order to maintain our competitiveness, we must offer customers a prevailing market-priced product. However, much like if someone purchases a share of Microsoft (or any other) stock today, it would likely convey at today's prevailing market price. This price today has no bearing on where the prevailing market price will be tomorrow, much less three years from now. Direct Energy's products enable a customer to hedge, according to their choices, against uncertainties from which they choose to protect themselves.

- a) Neither explicitly. They reflect the fair market value of the underlying commodity(ies) and the risk management tools needed to provide the customer exactly what the customer desires.
- b) They reflect the fair market value of the underlying commodity(ies) and the risk management tools needed to provide the customer exactly what the customer desires.

DIRECT ENERGY SERVICES, LLC AND RETAIL ENERGY SUPPLY ASSOCIATION'S RESPONSE TO DUQUESNE LIGHT COMPANY'S INTERROGATORIES AND REQUESTS FOR PRODUCTION OF DOCUMENTS, SET I, NO. 3, DATED APRIL 2, 2007, DOCKET NO. P-00072247.

Request:

3. Based on the witness' experience as described on p. 4, provide a list of utility service areas in the United States that the witness feels represent a "competitive retail market" (as referred to on p. 3) for electric residential customers and are consistent with the witnesses' views on prevailing market prices as described in his testimony. For each service area identified:
- a. Describe how often default service rates must be adjusted?
 - b. Indicate whether the default supplier is permitted by state regulators to enter into bilateral contracts.
 - c. Indicate whether the default supplier is permitted by state regulators to purchase supply from an affiliate.
 - d. Indicate whether there is any prohibition on the use of long-term supply contracts (i.e., one year or longer). If so, explain.

Response provided by: Frank Lacey, Director of Government and Regulatory Affairs

Response:

Residential customers see somewhat competitive markets in parts of New York, specifically, the Orange & Rockland and Consolidated Edison service territories, and in the ERCOT portions of the Texas market.

- a) In the competitive New York markets, default service rates for residential customers are adjusted on a monthly basis. The POLR rates in Texas are adjusted on an hourly basis.
- b) In New York, the default supplier is allowed to enter bi-lateral contracts.
- c) In New York, the default supplier is permitted by state regulators to purchase supply from an affiliate.
- d) In New York, there is no prohibition on the use of long-term supply contracts.

DUQUESNE LIGHT COMPANY

Docket No. P-00072247

**OSBA Response to the DLC
Set I Interrogatories**

DLC-OSBA-I-4

Referring to p. 8, line 4, clarify what "this" is referring to.

- a. Is it Mr. Kalcic's opinion that because different indices may produce different outcomes, this "suggests that the MPM adjustment mechanism would produce arbitrary results"?
- b. Does Mr. Kalcic believe that some indices may be more appropriate to use than others? If so, provide a liquid trading hub in PJM that the witness believes would represent a more accurate price index for Duquesne's service area. Provide the criteria used and support for Mr. Kalcic's conclusion. If Mr. Kalcic has not done such an analysis, how does he know that the results "would produce arbitrary results"?

Response:

Page 8, line 4 of Mr. Kalcic's testimony is referring to the case where Duquesne's MPM adjustment mechanism produces different results, depending on the PJM trading hub used in the analysis.

- a. Yes.
- b. Yes, Mr. Kalcic believes that some indices may be more appropriate than others. However, he has not performed an analysis in this area. As discussed on pages 7-8 of OSBA Statement No. 1, as long as the result obtained by Duquesne's MPM adjustment mechanism is hub-specific, the Company's proposed MPM adjustment may be deemed arbitrary. See also the response to DLC-OSBA-I-3 (b).

Witness: Brian Kalcic

DUQUESNE LIGHT COMPANY
Docket No. P-00072247

Office of Consumer Advocate Responses
to Duquesne Light Company
Interrogatories Set I

4. Referring to p. 7, lines 10-11 and p. 18, lines 19-22, provide an Excel spreadsheet, with all calculations and formulas intact that support maintaining a difference in year three of 0.5 cents per kWh for the RH rate schedule.

Response

There is no such analysis separate from Mr. Kahal's review of the cost data provided in response to OCA I-20 and II-7. For example, the Excel spreadsheet in response OCA II-7 provides a "wholesale shaped energy and capacity" cost to serve of \$47.38 per MWh for RH customers and \$49.88 for RS customers. This is a 5 percent cost premium for RS. ($\$49.88/\$47.38 = 1.0538$) At retail, this translates into: $5\% \times 7.16 \text{ cents} = 0.36 \text{ cents}$. This shaped energy differential of 0.36 cents is rounded up to 0.5 cents in order to address the rate shock problem for RH customers discussed in response to question (1).

Duquesne Light Company
Default Service Plan
Docket No. P-00072247

OCA I-18

Name: William V. Pfrommer

Office of Consumer Advocate
Interrogatories Set I

18. Please provide monthly Mwh sales, number of customers and sales per customer for each month of 2005 and 2006 for residential rate schedules RS, RH and RA.

Response:

Attachment OCA-I-18 provides Duquesne's Mwh sales for each month for 2005 and 2006 for rate schedules RS, RH and RA as well as the number of customers and the sales per customer.

Attachment OCA-I-18
Duquesne Light Company
Residential Rate Classes - Mwh, Customers and Mwh/Customer by Month

	2005			2006		
	Mwh Sales	Customers	Mwh/Customer	Mwh Sales	Customers	Mwh/Customer
BS						
January	329,601	499,375	0.660	334,723	497,181	0.673
February	290,287	499,425	0.581	283,889	497,402	0.571
March	280,405	499,435	0.561	277,418	497,505	0.558
April	249,134	498,089	0.500	247,786	496,619	0.499
May	223,103	497,050	0.449	223,543	495,717	0.451
June	296,715	496,514	0.598	288,662	495,467	0.583
July	429,257	496,118	0.865	369,366	495,114	0.746
August	477,789	495,956	0.963	472,746	495,205	0.955
September	355,870	495,961	0.718	328,109	495,363	0.662
October	280,363	495,842	0.565	243,206	495,672	0.491
November	253,800	496,326	0.511	260,514	495,897	0.525
December	312,822	497,016	0.629	293,904	497,016	0.591
RH						
January	43,602	24,400	1.787	43,922	24,995	1.757
February	45,440	24,513	1.854	39,626	25,079	1.580
March	42,147	24,572	1.715	40,139	25,161	1.595
April	27,645	24,527	1.127	27,456	25,086	1.094
May	18,657	24,497	0.762	16,780	25,023	0.671
June	17,649	24,483	0.721	17,868	25,011	0.714
July	19,647	24,432	0.804	18,047	25,010	0.722
August	22,634	24,522	0.923	22,784	25,133	0.907
September	17,444	24,576	0.710	16,460	25,162	0.654
October	15,541	24,647	0.631	17,083	25,267	0.676
November	22,331	24,708	0.904	25,946	25,367	1.023
December	41,078	24,815	1.655	32,049	25,521	1.256
RA						
January	4,026	3,048	1.321	4,214	3,137	1.343
February	3,498	3,050	1.147	3,608	3,148	1.146
March	3,397	3,050	1.114	3,451	3,152	1.095
April	2,907	3,053	0.952	3,032	3,156	0.961
May	2,578	3,061	0.842	2,578	3,156	0.817
June	3,289	3,057	1.076	3,322	3,167	1.049
July	4,535	3,056	1.484	4,077	3,175	1.284
August	5,034	3,065	1.643	5,086	3,189	1.595
September	3,797	3,071	1.237	3,525	3,200	1.102
October	3,020	3,081	0.980	2,848	3,241	0.879
November	3,048	3,116	0.978	3,378	3,262	1.036
December	3,852	3,130	1.231	3,825	3,278	1.167

Office of Consumer Advocate
Interrogatories Set I

20. Mr. Pfrommer states that it is appropriate to move from declining block to flat rates so that POLR rates are reflective of market prices. However, in the residential class, the declining block rates are winter only and only for heating customers. Does Duquesne agree that heating customers may have a more attractive (i.e., lower cost to serve) "load profile" than non-heating customers since a smaller portion of their load is in the expensive summer months? If that is true, would Duquesne further agree that having rates being reflective of market prices require that some "discount" for heating customers (compared to non-heating) be maintained? Please state Duquesne's position on this issue.

Response:

It is not necessarily true that heating customers may have a more attractive load profile than non-heating customers. Duquesne currently has three residential rate schedules: RS, RA and RH.

Residential Rate Schedules	Number of Customers (as of 12/31/06) (in 000s)
RS	496
RA (add-on heat pump)	3
RH (space heating)	26
Total	525

First of all, Duquesne wants to clarify that Duquesne did not use the non-heating customer load profile to establish rate levels. Rather, Mr. Fisher used the aggregated load profile for all residential customers (non-heating and heating) to establish the residential rate. Therefore, both the load pattern and the size of the heating rate schedules were taken into consideration in the development of the proposed rates.

Second, the RA heating customers, with an add-on heat pump, tend to consume relatively more electricity during both winter and summer months (with air conditioning load) than other residential customers. Since both the winter and summer prices in Duquesne's service area tend to be higher than shoulder months, the RA heating customer load profile has somewhat higher costs to serve than does the RS class or the composite residential customer load profile.

Third, Duquesne agrees that the load profile for customers in rate class RH has a slightly lower cost to serve than other residential customers. However, since these customers on

average consume relatively more electricity in winter months, which also tend to be high cost months on Duquesne's system, this difference was not considered to be significant enough to warrant establishing separate rates.

Duquesne considered establishing different rates for each rate schedule as the question implies. But upon review of both the differences in load weighted energy prices and the PJM capacity contributions for rate schedules RS, RA and RH, the Company concluded that the relatively small price differentials across rate schedules (all within 0.261 cents of the proposed rate) and the relatively small number of heating customers on Duquesne's system justified the use of one composite rate for the entire residential class, since a single rate would simplify customer education and the price-to-compare for customers and EGSs.

If, on the other hand, residential rates were disaggregated by rate schedule, this would imply that the RS and RA rates would need to be raised and the RH rate would need to be lowered somewhat. However, Duquesne does not believe the measured cost differences warrant the added complexity of developing separate supply rates for each rate schedule.

Direct Energy
Interrogatories Set I

1. (a) Does Duquesne Light, Duquesne Power, any other affiliate of Duquesne Light, or any agent of Duquesne Light or its affiliate(s) have an express, implied or tacit agreement or understanding of any kind – written or otherwise – with any non-affiliated entity for the acquisition of electric energy and/or capacity and/or related services to serve Residential and/or Small C&I customers during the entirety or any portion of the POLR IV period?
- (b) If so, please describe the agreement(s) and understanding(s), and the products(s) and service(s) involved, including the term length(s) and amounts (MWs, MWHs, etc.), but not the prices.
- (c) If not, please explain why not.

Response:

Duquesne Light notes that it has objected to this question and is providing an answer that is consistent with its objection.

(a) Yes.

(b) Duquesne Light does not have a supply agreement with a non-affiliated entity for the POLR IV period. It has a load following, full requirements agreement with its unregulated affiliate, Duquesne Power, for energy, capacity and related services necessary to supply the POLR load for the 2008-2010 time period. Duquesne Power is responsible for market price, quantity, load following, regulatory changes, customer switching, administrative costs, regulatory approval, and other risks associated with serving the POLR load.

Duquesne Power has informed Duquesne Light that, like many wholesale suppliers, Duquesne Power plans to rely on a portfolio of products, including, but not limited to, block energy products (e.g., 7x24, 5x16 on-peak, peaking, etc.), spot purchases and PJM capacity products to satisfy its load obligations throughout the term of the POLR agreement, some of which are already in place and some of which is yet to be purchased. It is Duquesne Light's understanding that Duquesne Power will be substantially hedged prior to or at the time of receiving a PUC approval order.

(c) N/A

DIRECT ENERGY SERVICES, LLC AND RETAIL ENERGY SUPPLY ASSOCIATION'S RESPONSE TO DUQUESNE LIGHT COMPANY'S INTERROGATORIES AND REQUESTS FOR PRODUCTION OF DOCUMENTS, SET I, NO. 1, DATED APRIL 2, 2007, DOCKET NO. P-00072247.

Request:

1. Referring to p. 1, provide a list of the electric utility service areas where Direct Energy currently serves residential electric customers in the United States. For each service area, provide the month and year in which Direct Energy began such service.
 - a. Provide the same information for each member of RESA identified in footnote 1 on page 2.

Response: Direct Energy provides residential electricity service in the states of New York, Texas and Pennsylvania. Direct Energy began serving customers in New York in February 2006; in Texas in December 2003 and in Pennsylvania in June 2006.

Response provided by: Frank Lacey, Director of Government and Regulatory Affairs

a) RESA has objected to this request, but nonetheless will provide such responsive information as is available, consistent with its objections.

Response: Strategic Energy's target market is commercial, industrial and institutional customers. While Strategic Energy does not currently actively market to residential customers, Strategic Energy's licenses may permit it to serve residential customers in one or more states.

Response provided by: Richard J. Hudson Jr., Market Manager-Regulatory Affairs

DIRECT ENERGY SERVICES, LLC AND RETAIL ENERGY SUPPLY ASSOCIATION'S RESPONSE TO DUQUESNE LIGHT COMPANY'S INTERROGATORIES AND REQUESTS FOR PRODUCTION OF DOCUMENTS, SET I, NO. 9, DATED APRIL 2, 2007, DOCKET NO. P-00072247.

Request:

9. Referring to p. 3, lines 4-7, and p. 6, lines 19-23, in New York where retail rates for some utilities may adjust on a monthly basis and reconcile revenues and costs, is the witness aware:
- a. Whether or not some utilities are permitted to procure electricity on a "long-term" basis. Describe the witness' understanding.
 - b. Whether or not some utilities are permitted to hedge procurement costs with a portfolio of supply purchased at different points in time? Describe the witness' understanding.
 - c. Whether or not some utilities have non-bypassable charges with longer-term legacy contracts that serve to hedge market price movements? Describe the witness' understanding.

Response provided by: Frank Lacey, Director of Government and Regulatory Affairs

Response:

- a) The New York utilities are permitted to procure on a "long-term" basis.
- b) Some utilities are permitted to hedge procurement costs with a portfolio of supply purchased at different points in time.
- c) Some utilities have non-bypassable charges with longer-term legacy contracts. It is not my understanding that they serve as a hedge to market price movements. It is my understanding, rather, that these are out-of-the-money legacy contracts that are being paid for by all customers so that utilities are not forced to take economic losses on long-term contracts they signed. These non-bypassable charges are effectively stranded costs.

**DIRECT ENERGY SERVICES, LLC AND RETAIL ENERGY SUPPLY
ASSOCIATION'S RESPONSE TO DUQUESNE LIGHT COMPANY'S
INTERROGATORIES AND REQUESTS FOR PRODUCTION OF DOCUMENTS, SET
I, NO. 13, DATED APRIL 2, 2007, DOCKET NO. P-00072247.**

Request:

13. Referring to p. 8, lines 1-3, what is the approximate dollar magnitude of the incremental amounts of capital required for Direct Energy to enter Duquesne's service area?
- a. How many full-time staff devoted to Duquesne's service area would this likely involve?
 - b. If unknown for Duquesne's service area, provide an approximate dollar magnitude of the incremental amounts of capital required for Direct Energy to enter service areas in New York that Direct energy recently entered.
 - c. When deciding whether to make such an investment to enter a service area, does Direct Energy consider economies of scale and its likely ability to enter neighboring service areas within a state? Please explain.

Response provided by: Frank Lacey, Director of Government and Regulatory Affairs

Response: Direct Energy has not made any projections of the cost of market entry into the residential customer segment of the Duquesne service territory.

- a) Direct Energy has not made any projections of the cost of market entry into the residential customer segment of the Duquesne service territory. However, at a minimum, Direct Energy would need to hire additional compliance personnel, sales personnel, and operations personnel. Duquesne has testified in prior proceedings that it has 5 people in its DLE operation (which should be noted here is only serving C&I customers). If I assume that the necessary head count is only 5 people, that is still 5 people who Direct Energy has made a commitment to hire and to pay on an on-going basis. If the market is not sustainable, those people will need to be fired, re-located, or otherwise re-directed. None of those alternatives is palatable.
- b) See response to No. 13.a. above.
- c) The primary driver of market entry is sustainability.

**DIRECT ENERGY SERVICES, LLC AND RETAIL ENERGY SUPPLY
ASSOCIATION'S RESPONSE TO DUQUESNE LIGHT COMPANY'S
INTERROGATORIES AND REQUESTS FOR PRODUCTION OF DOCUMENTS, SET
I, NO. 15, DATED APRIL 2, 2007, DOCKET NO. P-00072247.**

Request:

15. Referring to p. 8, line 15-18, do the prices Direct Energy offered to serve customers in the Pike County aggregation program represent prevailing market prices consistent with Mr. Lacey's interpretation of prevailing market prices? If yes, please explain.

Response provided by: Frank Lacey, Director of Government and Regulatory Affairs

Response: Direct Energy made an offer to the Commission in a competitively bid process to provide retail service to the customers of Pike County. We based that bid on the then-current market conditions. That bid did not represent, nor was it ever intended to represent, today's prevailing market price, as we are approximately one-year removed from that bid.

Additionally, the bid was made on an "opt-out" basis thereby avoiding the substantial cost of obtaining and maintaining customers.

**DIRECT ENERGY SERVICES, LLC AND RETAIL ENERGY SUPPLY
ASSOCIATION'S RESPONSE TO DUQUESNE LIGHT COMPANY'S
INTERROGATORIES AND REQUESTS FOR PRODUCTION OF DOCUMENTS, SET
I, NO. 16, DATED APRIL 2, 2007, DOCKET NO. P-00072247.**

Request:

16. Referring to p. 11, lines 2-4, is it Mr. Lacey's opinion that forward prices for electricity that are traded today for power to be delivered in the future do not represent prevailing market prices. Explain your answer.

Response provided by: Frank Lacey, Director of Government and Regulatory Affairs

Response: Forward prices for electricity contracts that are traded today for power to be delivered at some time in the future reflect today's prevailing market prices and conditions for that future period. However, the forward prices for electricity contracts that are traded today are not in any way dependent on, or representative of, the prevailing market prices for electricity tomorrow, the next day, the next month, the next year or any time in the next three years, and therefore do not reflect the actual prevailing market price of power consumed by customers during a specified period.

STRATEGIC ENERGY, LLC'S RESPONSE TO DUQUESNE LIGHT COMPANY'S INTERROGATORIES AND REQUESTS FOR PRODUCTION OF DOCUMENTS, SET I, NO. 5, DATED APRIL 2, 2007, DOCKET NO. P-00072247.

5. Referring to p. 13-14, would Strategic Energy agree that Duquesne's proposed default service plan for large C&I Customers will likely promote a more competitive market than what is permitted or required in the ANOFR and Policy Statement? If not, please explain.

Response:

Strategic Energy agrees that Duquesne's POLR plan for large C&I customers is more conducive to sustainable retail competition than what is required in the ANOFR and Policy Statement. Strategic Energy believes that hourly priced default service for large C&I customers (kW peak demand equal to or greater than 300 kW) is a market structure that will promote sustainable retail competition. As stated in the witness's testimony in the instant proceeding, Strategic Energy believes that Duquesne's proposal is fully consistent with the vision for default service set forth in the Commission's ANOFR and Policy Statement.

Response provided by: Richard J. Hudson Jr., Market Manager-Regulatory Affairs

DUQUESNE STATEMENT NO. 4-R

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**Petition of Duquesne Light Company :
For Approval of Default Service Plan :
For the Period January 1, 2008 : Docket No. P-00072247
Through December 31, 2010 :**

**REBUTTAL TESTIMONY OF
WILLIAM V. PFROMMER**

**DOCUMENT
FOLDER**

DOCKETED
MAY 08 2007

Date: April 13, 2007

RATE RH 2010 DEFAULT SERVICE RATE

1
2
3 **Q. Please briefly summarize OCA witness Kahal's proposal for residential rate**
4 **design.**

5 A. Mr. Kahal finds the overall POLR rates for most residential customers to be
6 acceptable (p. 6, lines 23-24), agrees with the rate design objective of moving
7 gradually to a "flatter" generation rate design (on a phased-in basis) and reducing
8 the average generation rate disparity between RS and the heating customers (p.
9 17, lines 1-4). He also agrees that the tail-block rate for rate RH customers is far
10 out of line with market prices for generation (p. 18, lines 3-5). His only proposed
11 modification to the rate design is to maintain a 0.5 cents per kWh differential
12 between residential heating rate RH customers and all other residential customers
13 beginning in 2010. His reasoning is to recognize what he believes to be the lower
14 cost to provide generation to RH customers and to address "rate shock" concerns
15 (p 18, lines 23-27 and p. 19 lines 1-2).

16
17 **Q. What is your response to Mr. Kahal's rate design proposal?**

18 A. Except for the adjustment to rate RH in 2010, Mr. Kahal's rate design approach is
19 consistent with the rate design proposed by the Company. Mr. Kahal supports the
20 rate design objectives applicable to residential customers identified on page 4 of
21 my direct testimony, Statement No. 4, namely, to eliminate below market rates,
22 move to a single flat energy charge and mitigate monthly bill impacts. His
23 position is also consistent with the Company's response to OCA-I-20, which is
24 provided as Exhibit WVP-1R, that a single rate would simplify customer
25 education and the price-to-compare for customers and EGSs.

26
27 **Q. Do you agree with his adjustment to rate RH in 2010?**

28 A. No, for several reasons. First, his adjustment is inconsistent with simplifying the
29 residential rates. In 2010, rate RH would be lower than basic service rate RS and
30 add-on heat pump rate RA. Duquesne Light proposes to eliminate declining
31 energy blocks and demand charges for all customer classes in order to simplify

1 rate schedules. I do not believe that it is appropriate to provide a different rate for
2 Rate RH customers in 2010. Moreover, maintaining such differentials may create
3 confusion with competitive offers from EGSs.
4

5 Second, the Company voluntarily proposed a rate design that mitigates the
6 monthly bill impact to residential heating customers on rates RH and RA by
7 phasing in the increase to bring the RH and RA rates to market prices and avoid
8 potential rate shock. The Company's proposed rate design results in a revenue
9 reduction of \$6.1 million for Rate RH for 2008 and 2009 combined as compared
10 to market prices. This is because the declining block rate during the heating
11 months is not fully eliminated until January 1, 2010. Mr. Kahal now proposes a
12 further reduction in the rate RH supply rate in 2010 that would create an
13 additional \$1.6 million revenue loss. When Duquesne developed its rates in this
14 proceeding, Duquesne recognized that the declining blocks were below market
15 but chose not to immediately move these rates to market in order to mitigate rate
16 impacts on customers. However, Duquesne did not seek to recover this shortfall
17 from customers. Now, Mr. Kahal seeks to require Duquesne to forego additional
18 revenue under his proposal, without any mechanism to recover these costs.
19

20 Third, in response to Duquesne interrogatory OCA-I-6, Mr. Kahal claims the
21 revenue loss from his proposal is about \$1.3M over three years, or about \$0.4M
22 per year. See Exhibit WVP-2R. This is not accurate and is misleading. The
23 revenue loss under his proposal is about \$1.6 million based on 2006 POLR sales
24 of 316,464 MWh for rate RH. This revenue reduction is *in 2010*, not spread over
25 three years. The Company has already proposed a total revenue reduction of \$6.1
26 million for 2008 and 2009.
27

28 Fourth, as explained in more detail in the rebuttal testimony of Company witness
29 Fisher, the Company does not agree with the 0.5 cent per kWh differential Mr.
30 Kahal calculated as the supply price differential between RS/RA customers and
31 RH customers.

1 **Q. Do you recommend the Commission accept Mr. Kahal's proposal to adjust**
2 **the residential rate RH rate design in 2010?**

3 A. No, I do not. However, should the Commission accept OCA's proposal for a rate
4 differential between rate RH and the other residential rates based on the OCA's
5 argument that RH customers have a lower cost consumption pattern, then the rates
6 for other residential customers (RS and RA) must reflect their consumption
7 pattern excluding the RH consumption pattern. In other words, the rates should
8 reflect the consumption pattern of the particular classes served – whether it is all
9 residential customers as the Company proposed or whether it is RH and remaining
10 residential customers (RS and RA) as the OCA suggests. If the RH and RS/RA
11 consumption patterns are calculated separately, market prices for the RS/RA
12 classes increase. Therefore, if Mr. Kahal's recommendation is adopted by the
13 Commission, the tariff rates in Table No. 1 should be approved to ensure that the
14 rates correspond to the appropriate consumption pattern in each of the three years.

15
16 **Q. Please further explain your alternative proposal?**

17 A. As described by Mr. Fisher in Statement 3R, if the Commission accepts an
18 adjustment to rate RH in 2010 for differences in rate class load profiles, then it is
19 appropriate to adjust the market prices and tariff rates for *all* residential rate
20 classes in 2008 and 2009 as well as 2010 using the same methodology. The
21 resulting adjustment, described in detail by Mr. Fisher, would result in modest
22 increases to the rate RS and RA supply rates in each of the three years. The
23 average supply price for RS and RA would increase to 7.179 cents per kWh from
24 7.156 cents per kWh. The average supply price for rate RH would decrease to
25 6.895 cents per kWh from 7.156 cents per kWh originally proposed by the
26 Company.

27
28 In developing default service rates, two of the Company's primary goals were to
29 have rates reflect prevailing market prices and to phase out declining blocks to
30 avoid rate shock for customers. Under the Company's alternative to Mr. Kahal's
31 proposal, rates for RS and RA customers would be increased from the filed rates

1 in all three years to reflect prevailing market prices for those two customer
 2 classes, and the rates for RH customers would be decreased in all three years to
 3 reflect prevailing market prices for the rate RH class on its own. The Company
 4 recognizes that, under its alternative proposal, the revenue reduction for rate RH
 5 would be \$5.7 million as opposed to \$6.1 million for 2008 and 2009. However,
 6 Duquesne believes that, if Mr. Kahal's proposal is adopted, it should be adopted
 7 in a manner that reflects prevailing market prices. There is no basis to set RS
 8 rates below market prices in 2008 and 2009. Moreover, given the minor increase
 9 in the RS and RA rates over the Company's original proposal, it is not necessary
 10 to phase in these rates.

11
 12 **Q. Have you calculated the tariff rates that would result from these revised**
 13 **prices?**

14 **A.** Yes I have. Table No. 1 summarizes the revised tariff rates for each of the three
 15 years assuming the adjusted supply prices for the residential classes based upon
 16 the Company's alternative proposal. As with the original rate design, the
 17 Company would still offer to phase-out the declining block rates to mitigate
 18 customer bill impacts but would maintain a differential (about 0.28 cents per
 19 kWh) between rates RS and RH.

20
 21 Table No. 1 Revised Residential Tariff Rates (Cents/kWh)

Rate	Energy Block	2008	2009	2010
RS	All kWh	7.179	7.179	7.179
RH	May-Oct All kWh	6.895	6.895	6.895
	Nov-Apr First 500 kWh	6.895	6.895	6.895
	Nov-Apr Additional kWh	4.040	5.468	6.895
RA	May-Oct All kWh	7.179	7.179	7.179
	Nov-Apr First 500 kWh	7.179	7.179	7.179
	Nov-Apr Additional kWh	4.194	5.687	7.179

1 "BILL READY" BILLING SYSTEM

2

3 **Q. Please summarize your understanding of "rate ready" and "bill ready"**
4 **billing systems.**

5 A. The Company has been operating using a rate ready billing system for
6 consolidated billing purposes as an Electric Distribution Company ("EDC") since
7 the inception of customer choice. Using a rate ready system, the EDC collects the
8 monthly consumption and demand information, then calculates the Electric
9 Generation Supplier ("EGS") charges based on the pricing information provided
10 by the EGS to compute the customer's EGS charges. These charges are
11 incorporated into a single consolidated bill along with the charges for distribution
12 and transmission.

13

14 Using a bill ready system, the EDC would provide the monthly consumption and
15 demand information to the EGS. The EGS would then compute the customer's
16 EGS supply charges for the period and send the total EGS supply charges back to
17 the EDC. The EDC would then incorporate a single EGS dollar amount on the
18 consolidated bill.

19

20 **Q. Please summarize Mr. Lacey's arguments why Duquesne should be required**
21 **to implement a bill ready billing system.**

22 A. Mr. Lacey claims a bill ready system is more practical for billing complex energy
23 products tailored to customers that tend to be highly sophisticated energy users
24 and who desire more complex pricing products such as variable price and hybrid
25 products (p. 19, lines 16-19). Mr. Lacey also claims a bill ready system enables
26 the EGS to calculate its customer's complete bill and through an electronic
27 transaction submit the "bottom line" to the utility at or very close to the time of
28 the customer's next meter read, thus ensuring the EGS calculation accurately
29 reflects the variable price portion of the customer's charges (p. 19, line 20-24).
30 Mr. Lacey further claims the lack of a bill ready consolidated billing system
31 creates a substantial disincentive for EGSs serving the large C&I market from

1 participating in Duquesne's consolidated billing program. This, he claims, closes
2 off a billing option for these customers who choose to take competitive EGS
3 service (p.19, lines 24-25, p. 20, lines 1-3). Finally, RESA believes that by
4 utilities offering both rate ready and bill ready consolidated billing systems, more
5 EGSs will enter the market and participate in consolidated billing (p. 20, lines 5-
6 8).

7
8 **Q. Are EGSs permitted to provide their own separate billing to the customer?**

9 A. Yes. In fact, Duquesne can and does support EGSs who wish to provide their
10 highly sophisticated energy users complex pricing products. Duquesne provides
11 the EGS the interval data via Electronic Data Interchange ("EDI") transactions
12 and the EGS does the complex bill calculation.

13
14 **Q. Does it make sense to you that a highly sophisticated energy user would want
15 a consolidated bill from the EDC showing only the "bottom line" of a
16 complex pricing product from the EGS?**

17 A. No. Intuitively, it is logical to me that sophisticated users would want to have
18 more detail than just a "bottom line" figure to understand if their complex pricing
19 product is worth the effort.

20
21 **Q. How many large commercial and industrial customers, the largest customers
22 in Duquesne's service area and often considered the more sophisticated users
23 of electricity, are billed using consolidated billing and how many receive
24 separate billing?**

25 A. There are 872 large commercial and industrial customers on rate schedules GL,
26 GLH, L and HVPS combined. 793 (91%) of these customers, representing 98%
27 of the sales and load of the rate classes combined, purchase their electric supply
28 requirements from nine different EGSs. Of these 793 customers, 60% are
29 receiving a single consolidated bill from Duquesne and the remaining 40%
30 receive separate billing from their EGS. Based on this information, there is little

1 if anything to be gained by implementing a bill ready consolidated billing system
2 to effect the competitive market.
3

4 **Q. Have any EGSs requested bill ready billing other than RESA?**

5 A. It is my understanding in Duquesne's merger proceeding at Docket No. A-
6 110150F0031 and A-311233F0002, only Hess, a member of RESA, argued that
7 Duquesne should provide bill ready billing. As part of that proceeding, Duquesne
8 provided an estimate of \$1M to RESA and Hess to implement a bill ready billing
9 system in addition to the Company's existing rate ready billing system.
10

11 **Q. Has Mr. Lacey identified who would pay Duquesne to implement bill ready
12 billing?**

13 A. No.
14

15 **Q. What do you conclude with respect to Mr. Lacey's proposal that Duquesne
16 should be required to offer bill ready billing?**

17 A. I recommend his proposal be rejected. I believe most customers will approach
18 and engage those suppliers who have the energy product(s) they desire. Over
19 98% of the load and sales of large C&I customers is supplied by nine EGSs in
20 Duquesne's service area. Clearly these customers consider more than the type of
21 billing system offered. If EGSs prefer to offer complex pricing products, they
22 may do so on their own through separate billing as some EGSs do today.
23
24

25 **PROPOSALS FOR RATE DESIGN**
26

27 **Q. What are Constellation witness Rubak's proposals for rate design?**

28 A. Mr. Rubak proposes two changes to the rate design for small C&I customers. Mr.
29 Rubak proposes the declining block rate design should be eliminated swiftly in
30 order to promote retail competition (p. 3, line 15-19). Mr. Rubak also
31 recommends the Company add additional rate schedules with more homogeneous

1 customers included in each new rate schedule in order to better reflect cost of
2 service (p. 9, line 4-5).
3

4 **Q. Do you agree with Mr. Rubak's proposal to "swiftly" eliminate the declining
5 block rate design.**

6 A. No. The Company proposes to eliminate the declining block rate design as well as
7 demand charges for small C&I customers in three steps over a two year period, on
8 January 1, 2008, 2009 and 2010. This gradual approach to changes in rate design
9 is consistent with the Company's rate design methodology approved by the
10 Commission in Docket No. R-00061346 for changes to the Company's
11 distribution rates. In that proceeding, the Company proposed to gradually
12 simplify the rate structure over time to reflect distribution rates that more closely
13 reflect the nature of a delivery business, i.e., an emphasis on demand charges to
14 recover costs. In this proceeding, it is unreasonable to immediately eliminate
15 declining block rates given the long-standing history of declining block rates in
16 Duquesne's service area. Under Constellation's proposal, certain customers
17 would experience different price signals that are less consistent with what
18 Duquesne has proposed. Duquesne's proposal will give customers a chance to
19 adjust to the new rate structure changes.
20

21 **Q. Can you explain how customers may be impacted by Constellation's
22 proposal?**

23 A. Yes. Constellation proposes to eliminate declining blocks but not demand
24 charges. Eliminating declining blocks without eliminating demand charges will
25 create rate distortions within this non-homogenous rate class. Moreover,
26 immediately eliminating both declining blocks and demand charges would result
27 in dramatic rate increases to certain customers.
28
29
30

1 **Q. Do other parties in this proceeding support the pace at which Duquesne**
2 **proposed to phase-out declining block rates?**

3 A. Yes. The Office of Small Business Advocate ("OSBA") supports the Company's
4 proposal to establish flat default service rates by January 1, 2010 (p16, lines 14-
5 19).

6

7 **Q. Has Mr. Rubak provided any basis or support for his second proposal for**
8 **adding additional rate schedules with more homogeneous groups?**

9 A. No, he has not.

10

11 **Q. Should the Company add additional rate classes in this proceeding?**

12 A. No, for several reasons. First, Duquesne's rate classifications are reasonable and
13 were approved by the Commission distribution rate case proceeding at Docket
14 No. R-00061346, order December 2006. Second, the appropriateness of the rate
15 schedules should be addressed in a base rate proceeding, not a default service
16 proceeding. Finally, a total of only four supply rates will become effective
17 January 1, 2010 under the Company's proposal in this proceeding. This simple
18 approach to supply charges is precisely what Mr. Rubak proposes (p. 6, lines 2-4).

19

20

21

INDEPENDENT THIRD PARTY STUDY

22

23 **Q. Please summarize the purpose Mr. Lacey's Exhibit FPL-3, "Power Price**
24 **Report - Direct Energy," prepared by Intelometry, Inc.**

25 A. This document presents the findings of an analysis comparing the difference in
26 historical Duquesne Light tariff default service (generation) rates for residential
27 and small commercial customers to wholesale spot market prices. The document
28 provides total calculations of generation revenue under tariff rates and wholesale
29 prices for the period from January 1, 2005 through November 30, 2006 for
30 residential rate schedule RS and small commercial rate schedule GS/GM (Exhibit
31 FPL-3, page 3).

1 Q. **Have you reviewed Mr. Lacey's Exhibit FPL-3, "Power Price Report - Direct**
2 **Energy," prepared by Intelometry, Inc.?**

3 A. I have reviewed the report with respect to the calculations and assumptions
4 regarding the application of Duquesne rate schedules RS and GS/GM in the
5 regulated tariff. Company witness Fisher has also reviewed this document and
6 provides separate comments in his rebuttal testimony.
7

8 Q. **Do you believe the report provides an accurate and reasonable portrayal of**
9 **the total generation revenues for these two rate schedules for the time period**
10 **stated?**

11 A. No. It is clear from my review that the assumptions and application of the tariff
12 rates contained in this document are in error and lead to entirely misleading
13 results. I base this statement on the following errors within the document:

14 1. An analysis is provided that calculates a delta between tariff rates and
15 estimated generation market cost from January 1, 2005 to November 30, 2006
16 (p. 10). Mr. Lacey uses these results to proclaim this delta as the savings
17 residential and small commercial customers in Duquesne's service area could
18 have received since January 1, 2005 had they purchased power from the
19 wholesale market instead of Duquesne default service (Lacey, direct, p. 15,
20 lines 18 and 24). This delta is computed assuming all residential customers
21 (496,026) and small commercial customers (54,626) purchased default service
22 for the entire time period. This is a fundamental flaw that in itself provides a
23 meaningless delta to be claimed as customer savings. By contrast, only 80%
24 of all residential customers on average received default service during this
25 period and about 83% of GS/GM customers on average received default
26 service in 2006 (responses to OSBA-I-3 and OCA-I-2). See Exhibits WVP-
27 3R and WVP-4R. Using total sales instead of default service sales greatly
28 exaggerates the delta.

29 2. The analysis estimates a tariff cost (revenue) for the referenced time frame of
30 \$653,979,066 for residential rate RS customers. Duquesne default service
31 tariff rate RS is a flat 6.3031 cents per kWh. Default service billed POLR

1 sales for rate class RS for this time period were 5,421,768,707 kWh.

2 Multiplying the rate by the quantity results in \$341,739,500, *nearly half* the
3 projected tariff cost calculated in the study.

- 4 3. It appears this study was not specific to Duquesne Light but rather to a group
5 of utilities and tariffs. Consider the phrases "...employed in the analyses of
6 remaining utilities included as part of this study" (p. 12, first para.) and "The
7 tariffs utilized in the analysis for each utility..." (p. 13, first para.). An
8 accurate analysis must focus solely on the aspects of the Duquesne regulated
9 tariff rates.
- 10 4. The analysis assumes 11,000 kWh for residential customers and 45,000 kWh
11 for small commercial customers on an annual basis (p. 12, first para.). As
12 stated in Duquesne's 2005 FERC Form 1 report which the document
13 references (starred note, p. 10), the average annual consumption was 7,605
14 kWh per customer and 55,512 kWh per customer for rate RS and rate GS/GM
15 classes respectively. Further, annual and monthly average residential
16 consumption figures are provided in response to OCA-I-18. See Exhibit
17 WVP-5R. The information in that response is not used and is significantly
18 lower than usage information in the Residential table on page 13. The authors
19 give no basis for annual consumption figures nor why they ignored the rate
20 class consumption data they already had in the FERC Form 1 report and the
21 response to an interrogatory.
- 22 5. The study misapplies tariff rates and rate structures. First, Duquesne's tariff
23 rates are applied to billing month consumption and non-coincident peak
24 metered demand. Duquesne tariff rate GS/GM is applicable to small
25 commercial and industrial customers with peak monthly non-coincident
26 demands ranging for 0 kW to 300 kW. The tariff structure has block demand
27 and energy charges that must be considered when calculating revenue. The
28 study uses a proxy load profile to create a monthly billing demand and
29 average usage per customer in this rate class (p. 13). Applying the tariff rate
30 structure to an average profile without considering the size and diversity of the

1 customer demand and energy as well as applying a blended rate as posed on
2 page 8 of the document ignores correct application of the tariff rates.
3

4 **Q. What do you conclude about this analysis and exhibit?**

5 A. For this proceeding, it is inappropriate to proclaim results from an analysis
6 presented as factual when the analysis itself is based on non-factual data,
7 unsubstantiated assumptions, and misapplication of tariff pricing.
8

9 **Q. Does this conclude your rebuttal testimony?**

10 A. I have nothing further at this point, but I note that Duquesne Light has not
11 received all of the answers to the discovery requests that it has sent to the other
12 parties in this proceeding, or has not received them in time to incorporate them
13 into the testimony. I reserve the right to file supplemental rebuttal testimony after
14 Duquesne Light receives all of the answers to its discovery requests.

Office of Consumer Advocate
Interrogatories Set I

20. Mr. Pfrommer states that it is appropriate to move from declining block to flat rates so that POLR rates are reflective of market prices. However, in the residential class, the declining block rates are winter only and only for heating customers. Does Duquesne agree that heating customers may have a more attractive (i.e., lower cost to serve) "load profile" than non-heating customers since a smaller portion of their load is in the expensive summer months? If that is true, would Duquesne further agree that having rates being reflective of market prices require that some "discount" for heating customers (compared to non-heating) be maintained? Please state Duquesne's position on this issue.

Response:

It is not necessarily true that heating customers may have a more attractive load profile than non-heating customers. Duquesne currently has three residential rate schedules: RS, RA and RH.

Residential Rate Schedules	Number of Customers (as of 12/31/06) (in 000s)
RS	496
RA (add-on heat pump)	3
RH (space heating)	26
Total	525

First of all, Duquesne wants to clarify that Duquesne did not use the non-heating customer load profile to establish rate levels. Rather, Mr. Fisher used the aggregated load profile for all residential customers (non-heating and heating) to establish the residential rate. Therefore, both the load pattern and the size of the heating rate schedules were taken into consideration in the development of the proposed rates.

Second, the RA heating customers, with an add-on heat pump, tend to consume relatively more electricity during both winter and summer months (with air conditioning load) than other residential customers. Since both the winter and summer prices in Duquesne's service area tend to be higher than shoulder months, the RA heating customer load profile has somewhat higher costs to serve than does the RS class or the composite residential customer load profile.

Third, Duquesne agrees that the load profile for customers in rate class RH has a slightly lower cost to serve than other residential customers. However, since these customers on

average consume relatively more electricity in winter months, which also tend to be high cost months on Duquesne's system, this difference was not considered to be significant enough to warrant establishing separate rates.

Duquesne considered establishing different rates for each rate schedule as the question implies. But upon review of both the differences in load weighted energy prices and the PJM capacity contributions for rate schedules RS, RA and RH, the Company concluded that the relatively small price differentials across rate schedules (all within 0.261 cents of the proposed rate) and the relatively small number of heating customers on Duquesne's system justified the use of one composite rate for the entire residential class, since a single rate would simplify customer education and the price-to-compare for customers and EGSs.

If, on the other hand, residential rates were disaggregated by rate schedule, this would imply that the RS and RA rates would need to be raised and the RH rate would need to be lowered somewhat. However, Duquesne does not believe the measured cost differences warrant the added complexity of developing separate supply rates for each rate schedule.

DUQUESNE LIGHT COMPANY
Docket No. P-00072247

Office of Consumer Advocate Responses
to Duquesne Light Company
Interrogatories Set I

6. Would the OCA support lowering the RH rate with a corresponding increase in the RS and RA rate in order to generate the same revenues? If no, explain your answer.

Response

No. As explained in response to question (1), the revenue loss from lowering the RH is about \$1.3 million over three years, or about \$0.4 million per year. This compares to about \$700 million over three years in POLR revenue (assuming 4 million MWh per year x 7.16 cents x 83 percent POLR x 3 years) -- less than 0.2 percent. The 7.16 cent residential rate compares to a wholesale commodity cost of about 5.0 cents according to the Company's response to OCA II-7, and moreover, includes an additional risk adder of 3 mills per kWh. A revenue loss of \$0.4 million per year would reduce the 3 mill risk adder to 2.9 mills.*

The OCA understands that the proposed 3 mills risk adder is in addition to the risk adders already demanded by wholesale bidders in procurements conducted by other utilities, as analyzed by Mr. Fisher. Moreover, the additional 3 mills appear to be a subjective value sought by Duquesne and is not subject to precise calculation. While the OCA is not specifically contesting the 3 mills, an overall outcome of a 2.9 mill risk adder certainly would be reasonable given the subjective and proximate value of that adder.

* \$0.4 million revenue loss spread over residential annual sales of 4 million MWh is 0.1 mills per kWh. This is equivalent to reducing the 3 mill risk adder to 2.9 mills.

Duquesne Light Company
Default Service Plan
Docket No. P-00072247

OSBA I-3

Name: William V. Pfrommer

Office of Small Business Advocate
Interrogatories Set I

3. Please provide a bill frequency analysis for Rate GM customers taking *POLR service* in 2006, showing a) the numbers of customers, and b) the number of kWhs consumed, for each of the following billing demand ranges: 0.1 to 5.0 kW; 5.1 to 25.0 kW; 25.1 to 100.0 kW; 100.1 to 200 kW; 200.1 to 300.0 kW; and over 300 kW.

Response:

Please see Attachment OSBA I-3.

An electronic version of this attachment is provided in spreadsheet 'DLC OSBA Set I 1-5 Attachments.xls'.

**Attachment OSBA-I-3
Duquesne Light Company
Rate GM Bill Frequency Analysis**

Monthly Metered Demand Range (1)	<u>POLR Customers</u>	<u>POLR kWh</u>	<u>Shopping Customers</u>	<u>Shopping kWh</u>	<u>Total Customers</u>	<u>Total kWh</u>
0 kW Customers (2)	17,014	83,260,735	1,890	12,527,727	18,904	95,788,462
0.1 to 5.0 kW	1,741	8,580,874	430	1,720,549	2,171	10,301,423
5.1 kW to 25.0 kW	17,400	418,489,929	3,598	78,605,990	20,998	497,095,919
25.1 to 100.0 kW	5,720	724,639,002	2,032	210,276,574	7,752	934,915,576
100.1 to 200 kW	971	481,477,121	478	161,980,169	1,449	643,457,290
200.1 to 300 kW	302	289,606,132	150	97,401,186	453	387,007,318
300 kW and Greater	196	308,511,478	100	104,180,615	297	412,692,093
Total	43,345	2,314,565,271	8,678	666,692,810	52,023	2,981,258,081

1/ Customers assigned to each segment based on their peak monthly metered demand in 2006.

2/ Customers assigned to rate GS, Rate Plan 200.

Duquesne Light Company
Default Service Plan
Docket No. P-00072247

OCA I-2

Name: William V. Pfrommer

Office of Consumer Advocate
Interrogatories Set I

2. Please provide a listing each year since the inception of restructuring of the total number of residential customers and the number of residential customers taking competitive generation service. Average annual figures would be preferred, but if not readily available, calendar year-end figures would be satisfactory. For 2007, provide the data for February 2007.

Response:

Attachment OCA-I-2 provides the total number of residential customers and number of residential customers taking competitive generation service for years 1999 to February 2007. Except for the February 1, 2007, the data was taken from the Company's quarterly switching reports filed with the OCA.

**Attachment OCA-I-2
Duquesne Light Company
Total Residential Customers and
Residential Customers Taking EGS Service**

	<u>Total Residential Customers</u>	<u>Residential Customers on EGS Service</u>
1/1/1999	524,343	56,629
4/1/1999	525,137	68,793
7/1/1999	523,701	70,176
10/1/199	523,638	98,444
1/1/2000	525,922	115,177
4/1/2000	523,980	132,567
7/1/2000	525,307	153,915
10/1/2000	525,112	173,287
1/1/2001	525,783	169,828
4/1/2001	524,431	175,160
7/1/2001	524,762	171,230
10/1/2001	525,329	164,218
1/1/2002	525,917	158,301
4/1/2002	526,801	155,143
7/1/2002	525,567	150,680
10/1/2002	514,566	143,564
1/1/2003	526,982	141,284
4/1/2003	527,565	138,644
7/1/2003	526,110	135,789
10/1/2003	525,882	133,311
1/1/2004	527,212	131,065
4/1/2004	527,870	129,592
7/1/2004	525,427	127,311
10/1/2004	525,038	124,854
1/1/2005	526,428	123,132
4/1/2005	527,318	121,916
7/1/2005	524,243	119,737
10/1/2005	523,878	117,401
1/1/2006	525,000	103,530
4/1/2006	526,059	97,321
7/1/2006	523,864	94,086
10/1/2006	523,668	92,218
1/1/2007	525,817	91,019
2/1/2007	526,244	90,381

Duquesne Light Company
Default Service Plan
Docket No. P-00072247

OCA I-18

Name: William V. Pfrommer

Office of Consumer Advocate
Interrogatories Set I

18. Please provide monthly Mwh sales, number of customers and sales per customer for each month of 2005 and 2006 for residential rate schedules RS, RH and RA.

Response:

Attachment OCA-I-18 provides Duquesne's Mwh sales for each month for 2005 and 2006 for rate schedules RS, RH and RA as well as the number of customers and the sales per customer.

Attachment OCA-I-18
Duquesne Light Company
Residential Rate Classes - Mwh, Customers and Mwh/Customer by Month

	2005			2006		
	Mwh Sales	Customers	Mwh/Customer	Mwh Sales	Customers	Mwh/Customer
<u>RS</u>						
January	329,601	499,375	0.660	334,723	497,181	0.673
February	290,287	499,425	0.581	283,889	497,402	0.571
March	280,405	499,435	0.561	277,418	497,505	0.558
April	249,134	498,089	0.500	247,786	496,619	0.499
May	223,103	497,050	0.449	223,543	495,717	0.451
June	296,715	496,514	0.598	288,662	495,467	0.583
July	429,257	496,118	0.865	369,366	495,114	0.746
August	477,789	495,956	0.963	472,746	495,205	0.955
September	355,870	495,961	0.718	328,109	495,363	0.662
October	280,363	495,842	0.565	243,206	495,672	0.491
November	253,800	498,326	0.511	260,514	495,897	0.525
December	312,822	497,016	0.629	293,904	497,016	0.591
<u>RH</u>						
January	43,602	24,400	1.787	43,922	24,995	1.757
February	45,440	24,513	1.854	39,626	25,079	1.580
March	42,147	24,572	1.715	40,139	25,161	1.595
April	27,645	24,527	1.127	27,456	25,086	1.094
May	18,657	24,497	0.762	16,780	25,023	0.671
June	17,649	24,483	0.721	17,868	25,011	0.714
July	19,647	24,432	0.804	18,047	25,010	0.722
August	22,634	24,522	0.923	22,784	25,133	0.907
September	17,444	24,576	0.710	16,460	25,162	0.654
October	15,541	24,647	0.631	17,083	25,267	0.676
November	22,331	24,708	0.904	25,946	25,367	1.023
December	41,078	24,815	1.655	32,049	25,521	1.256
<u>RA</u>						
January	4,026	3,048	1.321	4,214	3,137	1.343
February	3,498	3,050	1.147	3,608	3,148	1.146
March	3,397	3,050	1.114	3,451	3,152	1.095
April	2,907	3,053	0.952	3,032	3,156	0.961
May	2,578	3,061	0.842	2,578	3,156	0.817
June	3,289	3,057	1.076	3,322	3,167	1.049
July	4,535	3,056	1.484	4,077	3,175	1.284
August	5,034	3,065	1.643	5,086	3,189	1.595
September	3,797	3,071	1.237	3,525	3,200	1.102
October	3,020	3,081	0.980	2,848	3,241	0.879
November	3,048	3,116	0.978	3,378	3,262	1.036
December	3,852	3,130	1.231	3,825	3,278	1.167

DUQUESNE STATEMENT NO. 6-R

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Petition of Duquesne Light Company :
For Approval of Default Service Plan :
For the Period January 1, 2008 : **Docket No. P-00072247**
Through December 31, 2010 :

**REBUTTAL TESTIMONY OF
SUSAN S. BETTA**

**DOCUMENT
FOLDER**

DOCKETED
MAY 08 2007

Date: April 13, 2007

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

2 **A.** My name is Susan S. Betta. My business address is 411 Seventh Avenue, Pittsburgh, PA
3 15219.

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

5 **A.** I am Controller of Duquesne Light Company (“Duquesne Light” or the “Company”).

6 **Q. Have you provided testimony previously in this proceeding?**

7 **A.** Yes, I have. I have provided written testimony that was designated as Duquesne
8 Statement No. 6.

9 **Q. Please describe the purpose of your rebuttal testimony.**

10 **A.** The purpose of my rebuttal testimony is to respond to the comments of Richard J.
11 Hudson, Jr. on behalf of Strategic Energy, LLC (“Strategic”) and the Retail Energy
12 Supply Association (“RESA”) regarding Duquesne Light’s and its affiliates’ cost
13 allocations and comments alleging that Duquesne Light and its affiliates are cross-
14 subsidizing Duquesne Light Energy (“DLE”).

15 **Q. Do the parties have a separate agreement regarding these issues?**

16 **A.** Yes. In the Company’s current merger proceeding at Docket Nos. A-110150F0035 and
17 A-311233F0002, the parties, including Duquesne Light, RESA, Strategic, and Direct
18 Energy Services, LLC agreed that the settlement reached in that proceeding resolves all
19 issues regarding inter company cost allocations in the merger proceeding and in this
20 default service proceeding. Upon Pennsylvania Public Utility Commission
21 (“Commission”) approval of the merger, the cost allocation/cross-subsidy issues raised
22 by Strategic and RESA will become moot. Mr. Hudson recognizes this on page 4, lines

1 3-6 of his direct testimony. I note that Administrative Law Judge Robert P. Meehan
2 approved the merger settlement by order issued on March 30, 2007, and it is now pending
3 Commission review.

4 **Q. Please summarize your testimony.**

5 **A.** My testimony is summarized as follows:

- 6 • Duquesne Light's and its affiliates' cost allocations and cost allocation procedures are
7 appropriate.
- 8 • Duquesne Light is not cross-subsidizing DLE, and therefore Duquesne Light's
9 ratepayers are not subsidizing DLE.
- 10 • The Commission and FERC audit reports confirm that Duquesne Light's cost
11 allocation procedures are appropriate and that Duquesne Light and its affiliates do not
12 cross-subsidize DLE.
- 13 • DLE appropriately pays for all services that it receives from affiliates.
- 14 • The cost allocation changes that Duquesne Light implemented in response to my
15 review demonstrate Duquesne Light's commitment to properly allocating costs
16 among affiliates.
- 17 • Mr. Hudson's proposed remedies are unnecessary.

18 **Q. Are Duquesne Light's cost allocations and cost allocation procedures proper?**

19 **A.** Yes. In response to issues raised by parties in Duquesne Light's recent base rate
20 proceeding at Docket No. R-00061346 and in the merger proceeding, I have thoroughly
21 reviewed Duquesne Light's and its affiliates' cost allocations and cost allocation
22 procedures and have determined that Duquesne Light properly allocates costs among

1 affiliates. As explained in my direct testimony, where appropriate, costs are directly
2 assigned to affiliates. Duquesne St. No. 6, pp. 3-4. Costs that cannot be directly assigned
3 are allocated based on allocation factors. Based upon my thorough review of Duquesne
4 Light's and its affiliates' cost allocations, I conclude that the Company's cost allocations
5 and cost allocation procedures are proper.

6 **Q. Is Duquesne Light or any affiliate cross-subsidizing DLE?**

7 **A.** No. In reviewing the cost allocation issues raised by the parties, I have specifically
8 reviewed this issue and have concluded that no Duquesne company is cross-subsidizing
9 DLE. DLE is allocated all appropriate costs for services provided by its affiliates.
10 Moreover, Duquesne Light's ratepayers are not subsidizing DLE's operations.

11 I note that Mr. Hudson's testimony contains many unsupported, speculative assumptions
12 regarding possible ways that Duquesne Light affiliates might be subsidizing DLE. When
13 weighed against my thorough review of this issue, the Commission's recent audit and the
14 Federal Energy Regulatory Commission's ("FERC") recent audit, all of which found that
15 Duquesne Light's cost allocation procedures are proper and accurate, it is clear that Mr.
16 Hudson's speculative assumptions have no merit.

17 **Q. On page 6 of his testimony, Mr. Hudson states that the Commission and FERC**
18 **audit reports cannot be relied upon as evidence that Duquesne Light does not**
19 **subsidize the operations of DLE. Do you agree with his conclusion?**

20 **A.** Certainly not. Mr. Hudson states that the Commission's audit report cannot be relied
21 upon because it is out of date. SE/RESA St. No. 1, p. 6. Mr. Hudson claims that the
22 Commission audit report focused primarily on the period 1999 – 2003, and DLE did not

1 begin actively marketing until 2004. Mr. Hudson's statement that the Commission's
2 audit report focused primarily on the time period from 1999 – 2003 misinterprets the
3 audit process. While the Commission's review initially focuses on data from this period,
4 the Commission's actual fieldwork began on August 23, 2004 and continued through
5 March 16, 2005. The Commission's fieldwork consisted of interviewing Company
6 personnel and other persons associated with or knowledgeable about Duquesne Light,
7 analyzing records and documents, including documents from 2004 and 2005, and visiting
8 facilities to observe work practices. The fieldwork was an important part of the audit,
9 and it was conducted when DLE was actively marketing. Contrary to Mr. Hudson's
10 assertions, the Commission's audit is not out of date.

11 Moreover, through its fieldwork, the Commission performed an in-depth analysis of
12 Duquesne Light's affiliate relationships and found that the Company's cost allocation
13 procedures were appropriate and accurate. The Commission's audit report reflects an
14 effective evaluation of Duquesne Light's current affiliate relationships, and certainly
15 should be given more weight than Mr. Hudson's speculative assumptions.

16 Mr. Hudson also claims that the FERC audit report cannot be relied upon as evidence
17 because it has not been finalized by FERC. By this statement, Mr. Hudson ignores all the
18 work that FERC performed to develop the draft report. Although in draft form, the report
19 is based on a thorough review of Duquesne Light and its affiliates' operations over more
20 than a two-year period, or from January 1, 2004 through February 28, 2006. If FERC had
21 identified errors with Duquesne Light's cost allocation procedures, FERC would have
22 mentioned these errors in the draft report. The FERC audit provides further evidence that

1 Duquesne Light's and its affiliates' cost allocations are proper and accurate and that
2 Duquesne Light and its affiliates are not subsidizing DLE.

3 **Q. In his testimony, Mr. Hudson questions how DLE has been able to double its large**
4 **C&I load from 2005 to 2006 with only five employees unless DLE is receiving**
5 **support from other Duquesne Light companies and not paying full compensation**
6 **for such support. Do you agree with Mr. Hudson's analysis?**

7 **A.** No, I do not. The POLR III rates were implemented January 1, 2005, and during 2005
8 customers were making decisions over time as to which supplier to choose. Thus DLE
9 was adding customers throughout 2005, and in many instances served these customers for
10 only a portion of 2005. In addition, there were still some large industrial customers being
11 served under Duquesne Light's POLR I arrangement until September 2005, and it was
12 only at that time that they selected an alternative supplier, thereby increasing the load
13 served by DLE late in 2005, but that load has existed for all of 2006.

14 In addition, the overall number of direct employees is irrelevant. Other DLH companies
15 provide legal and administrative support to DLE, and DLE compensates these companies
16 for the services that they provide. In addition, DLE outsources a significant portion of its
17 supply portfolio management activities (including planning, procuring, scheduling and
18 hedging). During 2005 and 2006, DLE had a full-requirements supply contract with
19 Duquesne Power. Duquesne Power (and/or the parties that Duquesne Power may
20 contract with to help it manage its supply portfolio) managed these load obligations and
21 the associated price and quantity risks. Beginning January 1, 2007 DLE no longer has
22 this full-requirements contract with Duquesne Power, however it still purchases some of
23 its energy needs from Duquesne Power and pays a third party to help manage its supply

1 portfolio management activities. Without these arrangements, DLE would be responsible
2 for actively managing these obligations and risks, and would likely require more in-house
3 employees to do so. Because DLE outsources many of its business functions, and
4 receives administrative related services from Duquesne Light or other affiliates, DLE can
5 operate without a large number of employees. Moreover, DLE fully compensates
6 Duquesne Power and other affiliates for services that are provided.

7 **Q. Mr. Hudson also claims that DLE shares office space and employees and receives**
8 **“substantial administrative, operational, and other business support from other**
9 **Duquesne companies” and that this creates a cost allocation problem. (p.5) Do you**
10 **agree?**

11 **A.** Again, I do not agree with Mr. Hudson’s conclusion. Mr. Hudson is correct that DLE
12 shares office space and employees and receives support from other Duquesne companies.
13 However, this does not create a cost allocation problem. Rent and employee costs are
14 directly assigned to DLE. In addition, other costs are either directly assigned or allocated
15 as appropriate.

16 Cost allocation among affiliates is not unique to the Duquesne companies. Many utilities
17 who have affiliates allocate costs among the affiliates. This is standard practice, and
18 Duquesne Light, and other utilities, have developed reasonable and accepted methods for
19 allocating costs. Mr. Hudson’s notion that Duquesne Light has a “complicated cost
20 allocation problem” is simply incorrect.

1 Q. In his testimony, Mr. Hudson argues that because Duquesne Power procures power
2 and provides portfolio management services for both DLE and Duquesne Light, this
3 presents cross-subsidization concerns. Do you agree?

4 A. No. As I indicate in my direct testimony, Duquesne Power has separate contracts with
5 Duquesne Light and DLE to provide supply.

6 On page 18 of his testimony, Mr. Hudson states that because Duquesne Power's
7 agreement with Duquesne Light to provide POLR supply "was established *prior* to
8 DLE's agreement with Duquesne Power, it is likely that all of the costs associated with
9 the provision of these portfolio management services are recovered through DLC's
10 [Duquesne Light's] POLR rates." By this statement, Mr. Hudson completely ignores
11 how the contract rates were determined. Duquesne Power is paid based on the rates
12 Duquesne Light charges POLR customers. In the POLR III proceeding, the Commission
13 found that Duquesne Light's POLR III rates reflected prevailing market prices over the
14 POLR III period. Duquesne Light pays these prices for power, and the contract does not
15 include any costs for services or power that Duquesne Power provides to DLE.

16 Likewise, in this proceeding, Duquesne Light proposes to pay Duquesne Power
17 prevailing market prices for power supplied to serve Duquesne Light's default service
18 customers. The prices were determined by Mr. Fisher based upon the results of recent
19 auctions. The default service rates that Duquesne Light proposes in this proceeding do
20 not include any subsidy for DLE.

21 I note that in his testimony, Mr. Hudson recommends that, in the event the merger is not
22 approved, the Commission should prohibit DLE from contracting with its affiliates,

1 including Duquesne Power, for power procurement functions. SE/RESA St. No. 1, pp.
2 10-11, 18.¹ Mr. Hudson has not provided any factual basis to support this request, and
3 the Commission should not accept it. As indicated above, Duquesne Power has separate
4 contracts with Duquesne Light and DLE for the services that Duquesne Power provides.
5 Moreover, Duquesne Light has adequate protections in place to prevent cross-
6 subsidization, and Duquesne Light continually monitors cost allocation and affiliate
7 issues.

8 **Q. Mr. Hudson claims that DLE receives credit support from Duquesne Light Holdings**
9 **("DLH") which gives DLE a competitive advantage over other suppliers. Please**
10 **respond to this statement.**

11 **A.** While Mr. Hudson is correct that DLE receives credit support from DLH, credit support
12 costs are properly allocated to DLE. Exhibit SSB-1R shows DLH's allocation of credit
13 line costs for the year ended 2006 to affiliates, including DLE. Credit line costs are
14 allocated based on a percentage of assets, and contrary to Mr. Hudson's assertions, DLE
15 does not have a competitive advantage over other suppliers in this area.

16 **Q. Mr. Hudson argues that Duquesne Light's own analysis revealed inaccurate cost**
17 **allocations which supports his position. What is your response?**

18 **A.** As I note in my direct testimony, after reviewing the Company's cost allocation
19 procedures, we implemented a few changes. These changes are described on pages 7-9
20 of my direct testimony. These changes were minor, and the prior allocations created no

¹ In the alternative, Mr. Hudson proposes that the Commission require Duquesne Light to procure power through a competitive solicitation process. Mr. Fisher describes in detail in his direct and rebuttal testimony the flaws associated with a competitive procurement process.

1 competitive advantage for DLE. If anything, the changes demonstrate Duquesne Light's
2 commitment to properly allocating costs among affiliates.

3 Mr. Hudson states that I have not provided any details on how Duquesne Light will make
4 changes to implement a general corporate overhead allocation. SE/RESA St. No. 1, p. 8.
5 Information regarding these changes was provided in response to an informal discovery
6 request, and I will explain these changes below. The corporate overhead cost allocation
7 in question involves costs for rent and office supplies for Duquesne Light employees that
8 spend a portion of their time providing services to affiliates. Duquesne Light uses a ratio
9 of allocated labor to total labor for each cost center to allocate the total rent for each cost
10 center for those employees who perform work for an affiliate. Office supplies are a small
11 component of total miscellaneous expenses. The allocations are shown on Exhibit SSB-
12 2R. It is important to note that the overall amount of these cost allocations is very minor.
13 In addition to direct charges for both rent and office supplies, affiliates were also
14 allocated \$243,082 of rent cost in 2006 and \$1,889 of office supplies relating to
15 Duquesne Light employees who provide services to affiliates.

16 On pages 8-9 of my direct testimony, I also explain that Duquesne Light is now
17 allocating certain costs to affiliates that were historically allocated to DLH. In these
18 instances, there was an allocation of the employee's time out of Duquesne Light, but this
19 allocation was made to the parent company, DLH, instead of to one or more affiliates,
20 such as Duquesne Power or DLE. This has now been corrected. In addition, we now
21 allocate certain costs incurred at DLH to its affiliates, including Duquesne Power and
22 DLE. These costs include the salary and benefits of the Chief Executive Officer of DLH,
23 and costs associated with the Board of Directors fees and expenses. These allocations are

1 shown on Exhibit SSB-1R, and shows DLH's allocation of these costs for the year ended
2 2006 to affiliates, including DLE. Contrary to Mr. Hudson's assertions, it is not
3 difficult to accurately identify and determine the value of services that Duquesne
4 companies provide DLE.

5 **Q. In the merger settlement, DLH agreed to hire an independent consultant to conduct**
6 **a cost allocation assessment. Why did DLH agree to this condition?**

7 **A.** DLH agreed to this independent audit solely in the context of the merger proceeding. In
8 that proceeding, Strategic and RESA expressed heightened concerns regarding cost
9 allocation issues due to the merger. SE/RESA Ex. RH-2. DLH agreed to conduct an
10 independent assessment to address these concerns and to encourage settlement. I note
11 that if the merger is not approved, these heightened concerns no longer exist. Moreover,
12 I have thoroughly reviewed Duquesne Light's costs allocation procedures, and they are
13 appropriate.

14 **Q. In his testimony, Mr. Hudson proposes that the Commission initiate a review of**
15 **Duquesne Light's affiliate relationships and cost allocation procedures in the event**
16 **that the merger is not approved. Do you have a response to his statement?**

17 **A.** Yes. As stated above, upon Commission approval of the merger settlement, the cost
18 allocation/cross subsidy issues raised by Strategic and RESA will become moot due to
19 the merger settlement. In the event the merger is not approved, Mr. Hudson has not
20 provided any factual basis to support his request for a Commission investigation of these
21 issues. Mr. Hudson presents many speculative assumptions, but few facts. I have
22 thoroughly reviewed Duquesne Light's cost allocation procedures and affiliate

1 relationships and have determined that they are proper. I also note that Duquesne Light
2 continually monitors these issues.

3 I also note that on page 11 of his testimony, Mr. Hudson proposes several remedies that
4 the Commission should consider to address any inappropriate affiliate relationships or
5 cost allocation issues. Mr. Hudson's proposed "remedies" are vague, and more
6 importantly, unnecessary because Duquesne Light has appropriate cost allocation
7 procedures in place, and Duquesne Light and its affiliates are not subsidizing DLE. This
8 is supported by my through review, the Commission's recent audit and FERC's audit.
9 The Commission should give no weight to Mr. Hudson's unsupported, speculative
10 assumptions.

11 **Q. Does this conclude your testimony at this time?**

12 **A.** I have nothing further at this point, but I note that Duquesne Light has not received all of
13 the answers to the discovery requests that it has sent to the other parties in this
14 proceeding, or has not received them in time to incorporate them into the testimony. I
15 reserve the right to file supplemental rebuttal testimony after Duquesne Light receives all
16 of the answers to its discovery requests.

Duquesne Light Holdings
 Allocations to Affiliates
 Year ended 2006

Description	DLC	Financial	Dug. Enterprises	Energy Solutions	DGE Communications	Dug. Power	Dug. Light Energy	Keystone	Conemaugh
Salary and Benefits (a)	2,189,074	40,891	3,448	26,126	34,979	15,026	19,459	1,478	1,478
Directors Fees and Compensation (a)	697,317	13,520	1,140	8,307	11,565	4,988	6,434	489	489
Credit Line - Upfront and availability fees (b)	-	63,689	5,290	39,284	54,458	23,487	30,287	2,245	2,245
Total	2,886,391	118,100	9,878	72,717	101,002	43,481	56,181	4,211	4,211

Notes:

(a) Allocation amounts based on percentage of assets

(b) Allocation amounts based on percentage of assets. However DLC is not included since it has its own credit line.

Duquesne Light Company
2006 Administrative Rent Allocation

Subsidiary	Rent Allocation
Holdings	105,639
Keystone	1,873
Conemaugh	1,895
Duq. Power	29,658
Duq. Light Energy	10,468
DCE Energy Services	26,007
Data Com.	2,340
Financial	41,024
DCE Communications	13,251
DCE CAP CORP	4,515
ML&P	122
DCE Enterprises	2,554
DCE Systems	1,453
Agua Source	1,951
Cherrington	282
Total	243,082

Note: Rent expense was allocated based on a ratio of total labor to total rent for each cost center then assigned based on each employee's salary that performs work for an affiliate. The rent expense at the employee level is allocated to affiliates at the same percentage as that employee's time.

Duquesne Light Company
2006 Administrative Misc. Allocation

Subsidiary	Misc. Allocation
Holdings	975.61
Keystone	14.13
Conemaugh	14.17
DGE Power	98.48
Duc. Light Energy	82.84
DGE Energy Services	296.15
Data Com	15.16
Financial	239.73
DGE Communications	148.11
DGE CAP CORP	18.35
ME&P	0.19
DGE Enterprises	4.15
DGE Systems	2.38
Aqua Source	3.48
Cherryton	0.44
Total	<u>1,889.32</u>

Note:

Allocation calculation was based on the assumption that each employee represents 1% of the miscellaneous costs

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Petition of Duquesne Light Company :
For Approval of Default Service Plan :
For the Period January 1, 2008 : Docket No. P-00072247
Through December 31, 2010 :

SURREBUTTAL TESTIMONY OF
WILLIAM V. PFROMMER

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

Date: April 20, 2007

1 **SURREBUTTAL TESTIMONY OF WILLIAM V. PFROMMER**

2
3 **Q. Please state your full name and business address.**

4 A. My name is William V. Pfrommer. My business address is Duquesne Light
5 Company, 411 Seventh Avenue, Pittsburgh, PA 15219.

6
7 **Q. What is your position at Duquesne Light Company?**

8 A. I am employed by Duquesne Light Company (“Duquesne Light”, “Duquesne” or
9 “Company”) as the Manager, Rates.

10
11 **Q. Did you previously submit direct and rebuttal testimony in this proceeding**
12 **on behalf of the Company?**

13 A. Yes. I submitted my direct testimony, Statement No. 4, on January 25, 2007 and
14 my rebuttal testimony, Statement No. 4R, on April 13, 2007.

15
16 **Q. What is the purpose of your surrebuttal testimony?**

17 A. My surrebuttal testimony will respond to the rate design issues raised in the
18 rebuttal testimony of Constellation NewEnergy (“Constellation”) witness Ruback
19 and Direct Energy Services /Retail Electric Suppliers Association
20 (“Direct/RESA”) witness Lacey.

21
22 **Q. What is your reaction to Constellation witness Ruback’s proposal to develop**
23 **new rate schedules, according to load factor, such that the “flat rate should**
24 **recover the same revenues as the average rates billed on the existing**
25 **declining block rate design” (Constellation Rebuttal at 3, lines 20-23)?**

26 A. Mr. Ruback’s proposal appears to perpetuate the problems of the old rate design
27 by designing flat average rates that that would reflect “the declining block rate
28 design” that he admits were developed “to recover the generation revenue
29 requirement in a bygone era of utility regulation when utilities owned generation.”
30 (Constellation Rebuttal at 2, lines 18-20.) As I understand it, Mr. Ruback’s
31 proposal would continue to send customers within the GM and GMH rate

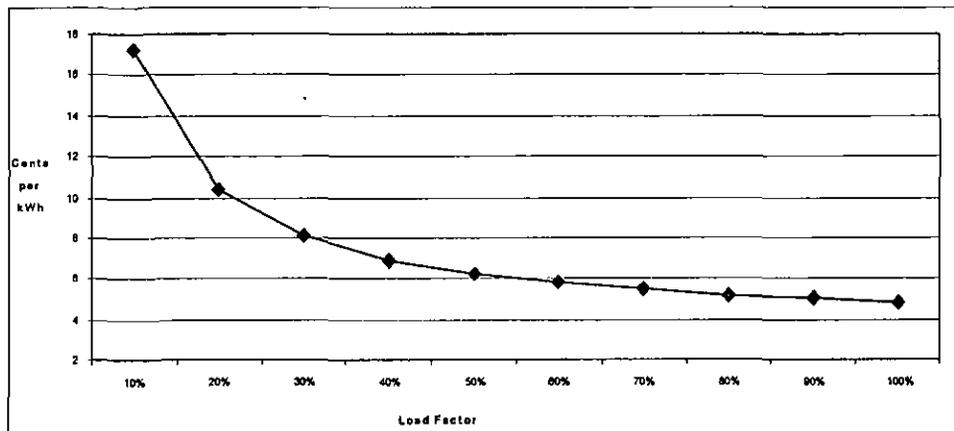
1 schedules inaccurate price signals, while Duquesne's plan would send customers
2 better market price signals. As I described in my direct testimony at pages 7-8,
3 Duquesne proposed to simplify the existing rate structure by implementing a
4 single energy rate for all small C&I customers. This will simplify price
5 comparisons with competitive EGS offers, and by 2010, Duquesne will eliminate
6 existing demand charges that do not reflect market prices and eliminate declining
7 energy block rates that are below market levels and discourage conservation.

8
9 Demand charges of the current magnitude are not reflective of market prices and
10 produce significant diversity in a customer's average supply charge within rate
11 GM depending on the customer's monthly load factor. Graph No. 1 in my direct
12 testimony showed the average supply charge in cents per kWh for a rate GM
13 customer with a 20 kW billed meter demand at current supply rates at various
14 load factors under the current rate structure.

15

1

Graph No. 1 Rate GM Average Supply Rate at Various Load Factors



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As shown, the average supply charge varies from just below 5 cents per kWh to over 17 cents per kWh depending on load factor. This is the result of using a customer's non-coincident peak demand to determine the customer's supply-related demand charge and the high level of current demand charges in today's retail rates. Market capacity costs represent a relatively small component of total supply costs, and there is little economic justification for this variation.

10

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Mr. Ruback's proposal is vague. He does not provide specific details regarding how many new customer classes he would create, what load factors he would use for each class and how he would determine prices for each class. However, as I understand Mr. Ruback's proposal, he recommends that Duquesne develop new customer classes according to load factor, each with a flat energy rate. For example, customers with load factors of 10% or less could be assigned a flat rate of 17 cents per kWh or more, customers with load factors between 10-20% would be assigned a flat rate of 12 cents per kWh, and so on.

18

19

20

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22

Even if more detail was provided, I believe this proposal should be rejected for several reasons. First, Mr. Ruback presents no cost or market justification for his proposal. In fact, I believe his proposal would eliminate many of the benefits of Duquesne's proposed rate redesign. Duquesne's plan is intended to provide

1 customers within the rate class better market price signals by eliminating above
2 market demand charges and below market declining energy blocks. Mr. Ruback's
3 proposal maintains these uneconomic price signals by simply converting the tariff
4 charges to flat energy rates based on load factor. As a result, low load factor
5 customers would continue to receive average supply rates at above market rate
6 levels and high load factor customers would receive average supply rates below
7 market rate levels. Duquesne's plan proposes to improve market price signals to
8 customers by phasing out both demand and declining block energy rate
9 components within the current rate design, while Mr. Ruback's plan maintains the
10 status quo average supply rates.

11
12 Second, all else equal, Mr. Ruback's proposal would tend to make high load
13 factor customers, with low existing average supply rates, less attractive to serve
14 from an EGS's perspective. In contrast, Duquesne's proposal will tend to provide
15 greater incentive for EGSs to serve high load factor customers and will promote
16 retail competition. Meanwhile, low load factor customers are currently paying
17 relatively high average supply rates, and under Duquesne's plan, this anomaly
18 will be eliminated over time. Duquesne's proposed rate design changes, when
19 considered together, will likely promote retail competition within the small C&I
20 customer class and will send customers better price signals that are more
21 consistent with market levels.

22
23 Third, the market price for a customer is not developed on load factor as currently
24 characterized for small C&I customers. Rather, it is the customers' load pattern
25 and their coincident peak that more appropriately determines the market price to
26 serve, not their load factor which is driven by non-coincident peak. For example,
27 two customers could have identical load factors by today's definition but very
28 different load profiles, thus creating different market prices for each. I believe it
29 is more appropriate to phase-out the current rate structure rather than create a new
30 temporary rate plan that is no more accurate and that may create unforeseen
31 problems from the customers' perspective that have not yet been identified.

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Fourth, as a practical matter, Duquesne currently does not have the interval load data needed to separate small C&I customers into separate rate schedules according to load factor and more appropriately, the customers' load profile. Absent such data, the Company uses load shapes deemed appropriate for small C&I customers within a particular rate class. Therefore, the same consumption pattern is applied to metered consumption whether the customer has a 20% load factor or a 90% load factor. Therefore, the Company is not able to distinguish differences in hourly consumption patterns without incurring additional metering and load profiling costs.

Fifth, according to Mr. Ruback's response to Duquesne Light's interrogatories, Mr. Ruback has not prepared any analysis of any kind as to the individual customer rate impacts of implementing his proposal. See Exhibit WVP-1S. Mr. Ruback's proposal is unsupported by actual evidence of how it would impact customers.

For all the above reasons, Mr. Ruback's proposal should be rejected.

Q. What is your reaction to Direct/RESA witness Lacey's comment that many customers are paying "below market" rates or rates that do not reflect prevailing market prices and that in POLR III, like the rates proposed in POLR IV, rates were engineered in a cost of service manner (Direct/RESA at 7, lines 20-22, page 8, line 1)?

A. Mr. Lacey has correctly cited my direct testimony. However, he has taken it out of context to support his position in this proceeding. Duquesne Light's default service rates are not engineered but based on market prices. Some of the existing tariff rates and rate structures contain charges and rate designs not reflective of rates a customer may incur if they purchased their electric supply requirements directly from the market. However, one must not look at these charges in isolation, but rather consider the evolution of the rates and rate

1 structure to the current and proposed rates, the constraints of changing rate design,
2 and the Company's steady progression to more competitive market rate structures.

3
4 Since restructuring, rate design has been an issue raised by intervening parties
5 primarily for those rate classes that include demand charges and multiple block
6 consumption charges, many of which have been in place for over 40 years.
7 During Duquesne's restructuring process, rate caps were imposed by rate
8 schedule, thus preserving the rate structures that were in place.

9
10 During POLR II, tariff rates were negotiated with Orion and as part of that
11 negotiation, it was agreed to maintain the existing retail rate structure in order to
12 mitigate rate impacts within each customer class. In POLR III, Duquesne
13 developed class average supply rates that, for 2005-2007, were approved by the
14 Commission as prevailing market prices. While global rate redesign was not
15 implemented, the Company did make two significant steps to progress toward
16 better market price signals. For all customers greater than 300 kW, who represent
17 about 50% of the Company's sales, hourly price rates and fixed rates designed
18 consistent with market pricing were proposed and approved. The Company
19 significantly reduced demand charges for these large C&I customers. In addition,
20 the Company agreed to implement the OSBA's recommendation to reduce the
21 demand charges for rate GS/GM and rate GMH with an offsetting increase to the
22 consumption charge to move the rate design closer to a market price structure.

23
24 Now in POLR IV, the Company has proposed further progress to provide
25 customers with supply rates that better reflect market price rate structures. Most
26 if not all parties in this proceeding appear to support the elimination of demand
27 charges and declining energy blocks. The only issue, however, is how fast these
28 changes should be accomplished. Some EGSs believe two years is not fast
29 enough. However, the Company does not believe it is appropriate to implement a
30 30-35% increase on day one. Rather, the Company proposes to continue its
31 steady progression to a competitive market price structure in two years for the

1 same reasons as before, to mitigate customer bill impacts and enable customers to
2 adapt to changes in the pricing structure that they are accustomed.

3

4 In summary, the Company continues its transition and progress to a competitive
5 market rate design structure in its POLR IV plan just as it has in past POLR
6 filings. The Company has not engineered rates in a cost of service manner.
7 Rather, as stated in my direct testimony, the Company believes mitigating
8 customer bill impacts is an important consideration in designing the POLR rates.

9

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

11 **A. Yes it does.**

Duquesne Light Company
Default Service Plan
Docket No. P-00072247

DQE/CNE I-4

RESPONSE TO DUQUESNE LIGHT COMPANY'S INTERROGATORIES AND REQUESTS
FOR PRODUCTION OF DOCUMENTS TO CONSTELLATION NEWENERGY, INC. - SET I

Respondent: Steven W. Ruback
785 Washington Street
Canton, MA 02021
(781) 821-5570

4. Has Mr. Ruback prepared any analysis of any kind as to the individual customer rate impacts of implementing his proposal? If so, provide copies of all analyses, including all related documents and workpapers.

Response: Mr. Ruback has prepared no analyses of this nature as of this time.