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DIRECTOR:	
SUPERVISOR:	
6. PERSON IN CHARGE:	7. DATE FILED: 01/25/07
8. DOCKET NO: P-00072247	9. EFFECTIVE DATE: 00/00/00

PARTY/COMPLAINANT: DEFAULT SERVICE PLAN

RESPONDENT/APPLICANT: DUQUESNE LIGHT COMPANY

COMP/APP COUNTY: UTILITY CODE: 110150

ALLEGATION OR SUBJECT

PETITION OF DUQUESNE LIGHT COMPANY FOR APPROVAL OF DEFAULT SERVICE PLAN FOR THE PERIOD JANUARY 1, 2008 THROUGH DECEMBER 31, 2010.

DOCUMENT FOLDER

DOCKETED
JAN 31 2007

ORIGINAL

Duquesne Light
Our Energy... Your Power

411 Seventh Avenue
8th Floor
Pittsburgh, PA 15219

Tel 412-393-1541
Fax 412-393-1418
gjack@duqlight.com

Gary A. Jack
Assistant General Counsel

January 25, 2007

VIA HAND DELIVERY

RECEIVED
JAN 2 5 2007
PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

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

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

Dear Secretary McNulty:

Enclosed for filing, on behalf of Duquesne Light Company ("Duquesne"), please find an original and three copies of the Petition Of Duquesne Light Company For Approval Of Default Service Plan For The Period January 1, 2008 through December 31, 2010 ("Default Service Plan"). Due to the risk that Duquesne Power, LLC is incurring in holding proposed rates open under the Default Service Plan during the regulatory review period and the need to provide customers notice of the precise changes in their Price To Compare in order to facilitate retail shopping, Duquesne requests expedited approval of the Default Service Plan by July 1, 2007. To facilitate approval by this date, Duquesne has filed its direct testimony herewith and respectfully requests that the Pennsylvania Public Utility Commission ("Commission") assign this matter to the Office of Administrative Law Judge for evidentiary hearings and the issuance of a Recommended Decision as soon as possible.

Pursuant to Section 5.41(b) of the Commission' regulations, 52 Pa. Code § 5.41(b), and as indicated on the certificate of service, Duquesne is serving this Petition on the Office of Trial Staff, the Office of Consumer Advocate, and the Office of Small Business Advocate. Duquesne is also serving all parties in Duquesne's POLR III proceeding, *Petition of Duquesne Light Company for Approval of Plan for Post-Transition Period Provider of Last Resort Service*, Docket No. P-00032071, and in Duquesne's recent distribution rate proceeding at Docket No. R-00061346. Moreover, Duquesne is providing notice of the Petition to customers through a press release, newspaper publication and a bill insert.

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Please record me and the following attorneys as Attorneys of Record:

David B. MacGregor
Post & Schell, P.C.
Four Penn Center
1600 John F. Kennedy Blvd.
Philadelphia, PA 19103-2808

Michael W. Gang
Anthony Kanagy
Post & Schell, P.C.
17 North Second Street
12th Floor
Harrisburg, PA 17101-1601

In addition, please direct any questions regarding this matter to the undersigned.

Very truly yours,

Gary A. Jack, Esq.

Enclosure

c: Wendell F. Holland, Chairman
James H. Cawley, Vice Chairman
Terrance J. Fitzpatrick, Commissioner
Kim Pizzingrilli, Commissioner

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the Application has been served upon the following persons by first class mail on or about January 25, 2007:

VIA FIRST-CLASS MAIL AND/OR E-MAIL

Johnnie Simms
Charles Daniel Shields, Esquire
Robert V. Eckenrod, Esquire
Office of Trial Staff
P. O. Box 3265
Harrisburg, PA 17105-3265

William Lloyd
Steven C. Gray, Esquire
Office of Small Business Advocate
1102 Commerce Building
300 North Second Street
Harrisburg, PA 17101

Sonny Popowsky
Tanya J. McCloskey
David T. Evrard
Office of Consumer Advocate
555 Walnut Street
Forum Place, 5th Floor
Harrisburg, PA 17101-1923

David Kleppinger
Pamela C. Polacek, Esquire
Adam Benshoff, Esquire
McNees, Wallace & Nurick
P. O. Box 1166
100 Pine Street
Harrisburg, PA 17101-1166

Kevin J. Moody, Esquire
Daniel Clearfield, Esquire
Wolf Block Schorr & Solis-Cohen LLP
213 Market Street, 9th Floor
Harrisburg, PA 17108-0865

Thomas Brogan, Esquire
Brian J. Knipe, Esquire
Klett Rooney Lieber & Schorling
17 North Second Street, 15th Floor
Harrisburg, PA 17101-1503

Timothy W. Merrill
NRG Energy, Inc.
111 S. Commons
Pittsburgh, PA 15212

Scott J. Rubin
Public Utility Consulting
3 Lost Creek Drive
Selinsgrove, PA 17870-9357

Gregory Rhodes
One Oxford Centre, 40th Floor
Pittsburgh, PA 15219

George Jugovic, Jr., Senior Attorney
PennFuture
425 Sixth Avenue, Suite 2770
Pittsburgh, PA 15219

David I. Fein, Sr.
Martha A. Duggan
Gregory Urbin
Constellation NewEnergy, Inc.
111 Market Place, Suite 700
Baltimore, MD 21202

Geoffrey A. Sawyer III
Morris Nichols Arsht & Tunnell LLP
1201 North Market Street
P. O. Box 1347
Wilmington, DE 19899-1347

Joseph L. Vullo
Burke Vullo Reilly Roberts
1460 Wyoming Avenue
Forty Fort, PA 18704

John E. McCaffrey
Harvey L. Reiter
Jaime S. Dibble
Stinson Morrison Hecker LLP
1150 18th Street NW
Suite 800
Washington, DC 20036-3816

Scott H. DeBroff, Esq.
Stuart S. Sacks, Esq.
Smigel, Anderson & Sacks
River Chase Office Center
4431 North Front Street
Harrisburg, PA 17110

Theodore H. Jobes
Fox Rothschild LLP
2000 Market Street
Tenth Floor
Philadephia, PA 19103-3291

James Steffes
Vice President Government Affairs &
Chief Compliance Officer
Centrica North America
263 Tresser Boulevard
One Stamford Plaza, 8th Floor
Stamford, CT 06901

Todd S. Steward, Esquire
Hawke McKeon Sniscak & Kennard LLP
100 North Tenth Street
P. O. Box 1778
Harrisburg, PA 17105-1778

Gary A. Jeffries, Esquire
Dominion Resources Services, Inc.
1201 Pitt Street
Pittsburgh, PA 15221

Paul R. Bonney, Esquire
Ward L. Smith, Esquire
Exelon Business Services Company
2301 Market Street, S23-1
Philadelphia, PA 19101

David Hughes
Citizen Power, Inc.
2121 Murray Avenue
Pittsburgh, PA 15217

W. Edwin Ogden, Esquire
Alan Michael Seltzer, Esquire
John F. Povilaitis, Esquire
Matthew A. Totino, Esquire
Ryan, Russell, Ogden & Seltzer LLP
1105 Berkshire Blvd., Suite 330
Wyomissing, PA 19610-1222

John L. Munsch, Esquire
Allegheny Energy
800 Cabin Hill Drive
Greensburg, PA 15601-1689

Kenneth L. Wiseman, Esquire
Mark, F. Sundback, Esquire
Andrews Kurth LLP
1701 Pennsylvania Avenue, NW
Washington, DC 20006

Denise R. Foster, Esquire
Senior Counsel
PJM Interconnection, LLC
955 Jefferson Avenue
Valley Forge Corporate Center
Norristown, PA 19403-2497

Michael Reid
Director, Materials Management Services
AmeriNet Central
500 Commonwealth Drive
Warrendale, PA 15086-7513

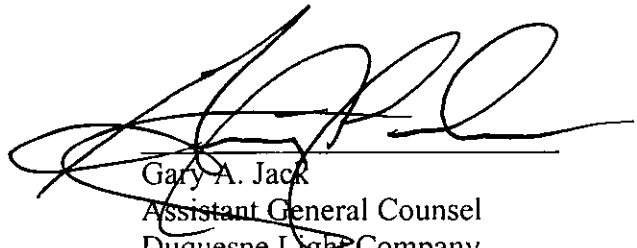
Thomas M. Mullooly, Esquire
Foley & Lardner
777 E. Wisconsin Avenue
Suite 3800
Milwaukee, WI 53202-5367

Craig A. Doll, Esquire
25 West Second Street
P. O. Box 403
Hummelstown, PA 17036

Peter E. Meier, Esquire
Pepco Energy Services, Inc.
1300 North 17th Street
Suite 1600
Arlington, VA 22209

John Hanger, Esquire
Penn Future
610 N. Third Street
Harrisburg, PA 17101

Lisa Yoho
Calpine Corporation
1350 I Street, NW
Suite 1270
Washington, DC 20005



Gary A. Jack
Assistant General Counsel
Duquesne Light Company
411 Seventh Avenue, 8th Floor
Pittsburgh, PA 15219
412-393-1541 (phone)/412-393-1418 (fax)
gjack@duqlight.com

Dated: January 25, 2007

ORIGINAL

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

PETITION OF DUQUESNE LIGHT COMPANY
FOR APPROVAL OF DEFAULT SERVICE PLAN

Pursuant to Chapter 28 of the Public Utility Code and 52 Pa. Code § 5.41, Duquesne Light Company ("Duquesne Light" or the "Company") petitions the Pennsylvania Public Utility Commission ("Commission") for approval of a default service plan for the period from January 1, 2008 through December 31, 2010 ("Default Service Plan" or "Plan"), and (ii) for the issuance of certain other related approvals, described in Section IV hereof, required for the implementation of the Plan. Duquesne Light's current default service plan, commonly referred to as the POLR III Plan, expires on December 31, 2007. *Petition of Duquesne Light Company for Approval of Plan For Post-Transition Period Provider of Last Resort Service,* Docket No. P-00032071, Order entered August 23, 2004 ("*POLR III Order*"). Duquesne Light is filing this Petition well in advance of December 31, 2007, so that the Commission has adequate time to consider the proposals made herein. Duquesne Light respectfully requests expedited approval of the Default Service Plan on or before July 1, 2007, in order that upon approval, Duquesne Light may take the necessary actions to implement the Plan on January 1, 2008.

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

I. EXECUTIVE SUMMARY

A. Background

Since restructuring, Duquesne Light has implemented three very successful default service programs which have helped create the most competitive shopping environment in the Commonwealth and also have provided customers with substantial rate reductions. By this

filing, Duquesne Light seeks to build on these prior successes and proposes a three-year default service plan to serve as a transition to January 1, 2011, when the generation rate caps for most electric customers in the Commonwealth will expire. Approval of this Plan will assure that Duquesne Light's Residential customers receive default service under terms and conditions similar to that received by other Pennsylvanians. A three-year term also is consistent with the term approved by the Commission in other default service proceedings, including Duquesne Light's POLR II and POLR III proceedings.

Duquesne Light made a commitment, as part of the Settlement of its recent distribution rate proceeding, to provide stakeholders an opportunity to participate in the development of the Default Service Plan. Pursuant to that commitment, Duquesne Light solicited input from a number of interested parties. The opinions and proposals of these parties were carefully considered in the development of the Default Service Plan. As a result, Duquesne Light believes that there will be substantial support for a number of elements of the Plan from a broad cross-section of parties.

The details of Duquesne Light's Default Service Plan are set forth below and in the extensive testimony and exhibits accompanying this Petition. Before turning to these issues, however, one important matter should be addressed. The rates proposed in this filing for Residential, Small C&I and Lighting customers reflect an average increase of 10.2%, on a total bill basis, and a 17.6% increase as compared to current POLR III supply rates. These rates reflect prevailing market prices for the Default Service Plan service period and therefore should further promote retail competition in Duquesne Light's service territory. However, these increases are relatively modest, particularly when compared to the increases seen in other POLR filings which have employed an RFP or auction process. And, even with these proposed

increases, the supply rates for Residential, Small C&I and Lighting customers, on average, will still be below the regulated rate levels which were in effect under the POLR I Plan. At the same time, Duquesne continues to have, by far, the highest level of customer shopping in the Commonwealth and among the highest in the nation. These are truly remarkable results, which reflect both the extraordinary efforts of Duquesne Light and the fundamental success of electric competition, to date, in Duquesne Light's service territory. Duquesne Light's track record as a default service provider speaks for itself and fully supports approval of its proposed Default Service Plan.

B. Proposed Default Service Rates

The Default Service Plan consists of three plans tailored to meet the specific needs of major customer groups. For large commercial and industrial ("Large C&I") customers, Duquesne Light will offer a real time hourly market price service as the default service option. Duquesne Light does not propose to offer fixed price service to Large C&I customers. Competition for Large C&I customers in Duquesne Light's service territory is robust, with 98% of Large C&I load currently shopping. Real time hourly default service is appropriate for this mature market segment.

For small commercial and industrial ("Small C&I") customers, Duquesne Light proposes to increase rates on January 1, 2008 to reflect prevailing market prices. The average rate increase for Small C&I Rate GS/GM customers will be 9.3%, on a total bill basis. These rates will be adjusted annually, for 2009 and 2010, based upon changes in an annual forward market price index. In addition, rates will be redesigned to eliminate supply related demand charges and declining energy blocks over a three-year period. As of January 1, 2010, all Small C&I customers will pay a single energy charge for default service. These measures will promote competition by resetting rates to reflect prevailing market prices, adjusting these rates annually to

reflect changes in market conditions and by phasing out legacy rate design features. A flat usage charge also will encourage conservation.

For Residential and Lighting customers, Duquesne Light proposes to increase rates on January 1, 2008, to reflect prevailing market prices for the three-year term of the Plan (2008-2010). The average increase for Residential Rate RS customers is 9.2%, on a total bill basis; the average increase for Lighting customers is 7.4%, on a total bill basis. In addition, Duquesne Light proposes to eliminate, over a three-year period, declining energy blocks for residential heating customers. As of January 1, 2010, all Residential customers will pay a single energy charge for default service. These actions will promote retail competition by resetting rates to reflect prevailing market prices and by adopting a simplified rate structure. The Plan will also provide Residential customers rate stability, significant protection against potentially disruptive rate increases and a rate design that encourages conservation.

C. Power Procurement

In order to procure power for Residential, Lighting and Small C&I customers, Duquesne Light will amend its fixed price, full requirements contract with its affiliate, Duquesne Power. Duquesne Power will rely on competitive wholesale market purchases in PJM to obtain power for Duquesne Light's customers. Duquesne Power also will assume regulatory approval, customer switching, load following and other regulatory and business related risks associated with default service supply.

Duquesne Light carefully considered obtaining default supply through a competitive procurement process, but has determined that such an approach is not appropriate at this time. There is considerable uncertainty in the outcome of a competitive procurement process, not only as to rates but as to the number of bidders. Many prior competitive procurement processes have had little or no success or have resulted in extremely high price increases. As a result, a

competitive procurement process would present considerable risks for Residential and Small C&I customers. Given that the majority of Pennsylvanians have stable generation rates through 2010, Duquesne Light believes that its Residential and Small C&I customers should not be subject to the risks associated with a competitive procurement process at this time.

D. Determination of Prevailing Market Prices

The rates under the Default Service Plan are based on prevailing market prices for a three-year, fixed price full requirements contract for 2008 through 2010. In order to determine prevailing market prices, Duquesne Light reviewed the results of wholesale solicitations in several states, including Pennsylvania, New Jersey, Maryland and Illinois. All of these solicitations involved full requirement default service supply to residential and/or small C&I customers, and were completed primarily within the last twelve months.

In order to compare these solicitations on an "apples to apples" basis, Duquesne Light made several adjustments to reflect the particular facts and circumstances presented in Duquesne Light's Plan. These adjustments included stating the prices on a comparable basis, adjusting for location and timing differences and adjusting for different risk factors assumed by the various suppliers. Based upon these adjusted solicitations, Duquesne Light believes that its rates proposed under the Default Service Plan appropriately reflect prevailing market prices for a three-year, fixed price full requirements contract for 2008 through 2010.

E. Market Enhancements

Duquesne Light currently has the highest level of customer shopping in the Commonwealth. As of December 2006, 18% of Residential load, 19% of Small C&I load and 98% of Large C&I load in Duquesne Light's service territory was being served by an alternative supplier. As reported by the Office of Consumer Advocate in January 2007, with regard to total shopping in the Commonwealth, the vast majority of shopping load – 95% of residential load,

81% of commercial load and 90% of industrial load – is located in Duquesne Light's service territory.

Duquesne Light's Default Service Plan contains several important features designed to further promote retail competition. As noted above, Duquesne Light proposes to reset rates for Residential and Small C&I customers to reflect prevailing market prices and to simplify its rate design to reflect market conditions to provide greater transparency to customers and suppliers.

In addition, Duquesne Light has agreed to a purchase of receivables ("POR") program whereby it will purchase the accounts receivable, without recourse, associated with EGS sales of retail electricity to Residential and Small C&I customers. The POR program provides substantial benefits to marketers by eliminating their risks associated with serving credit-troubled customers and by allowing marketers to serve these customers without incurring significant costs for upfront credit analysis, collection activities or uncollectible accounts.

Duquesne Light also will be implementing several process improvements that will promote retail competition. For example, Duquesne Light proposes to improve communications with employees concerning its Code of Conduct. In addition, as part of the settlement of its last rate case, Duquesne Light agreed to convene regular meetings with EGSs to discuss retail supplier issues and to conduct an analysis to determine whether its cost allocation procedures are appropriate. This cost analysis demonstrated that Duquesne Light is properly allocating its costs and led to the adoption of several minor changes to further improve its cost allocation procedures. Both the Commission and the Federal Energy Regulatory Commission ("FERC") have recently reviewed Duquesne Light's cost allocation procedures and have determined that they are appropriate.

F. Conservation and Economic Development

In the rate case Settlement, Duquesne Light agreed to contribute a total of $6 million to fund renewable energy projects and/or energy efficiency and energy education projects in its service territory. In addition, Duquesne Light promotes energy conservation through several different programs, including: (1) a Load Response Program that compensates customers for reducing demand when market prices increase; (2) a Direct Load Control Pilot Program for Residential and small commercial customers that reduces air conditioning usage during hot weather; (3) offering web based tools to assist customers in conserving energy; (4) issuing New Mover's Guide's to all consumers moving into Duquesne Light's service territory that include information on how to use energy wisely; (5) presenting conservation programs to school students; and (6) promoting conservation at the Pittsburgh Home and Garden Show.

In the rate case Settlement, Duquesne Light also agreed to evaluate the proposals of other parties regarding energy conservation and education, time of use metering and economic development and to submit proposals that it deemed to be appropriate in this default service filing. Duquesne Light has evaluated these proposals and has concluded that while they may have some merit, implementation of these proposals would be premature in this proceeding. In its discussions with parties, Duquesne Light determined that there was no consensus support for implementation of these proposals at this time. Certain parties expressed an interest in advanced metering options with time-of-use and/or seasonal rates, but only if they were optional and did not impose additional costs on customers. Others believed that such proposals should be provided by the market and not by the regulated default service provider. Duquesne Light supports coordinated statewide efforts as the most efficient and effective way to address these types of issues. For example, Duquesne Light supports and actively participates in the Commission's Demand Side Response ("DSR") working group.

With regard to economic development, in its current merger proceeding, Duquesne is proposing an economic development program under which eligible customers will receive a discount of $3 per MWh below market prices if they create new load or expand existing load and create new jobs. The offer is available for three years per project and will be in effect until March 1, 2013. This proposal will provide important incentives for economic development in Duquesne Light's service territory.

G. Schedule

Duquesne requests expedited approval of this Petition, with a Commission decision on or before July 1, 2007. Under the Default Service Plan, Duquesne Power is assuming all risk of market price changes during the course of this proceeding. The longer the approval process, the greater the risk. Expedited approval also is necessary to ensure that Duquesne Power has adequate time to obtain power to provide default service to Duquesne Light customers commencing on January 1, 2008, and because of the need to inform customers of the precise changes in their Price To Compare in order to facilitate retail shopping.

To support an accelerated schedule, Duquesne Light has included its direct testimony with this Petition, and Duquesne Light will endeavor to work with parties to amicably resolve any contested issues. Indeed, as explained above, Duquesne Light already has undertaken extraordinary efforts to meet with interested parties and to reflect their input in this filing. As a result, Duquesne Light believes that there will be substantial support on a number of elements of the Plan from a broad cross-section of parties, and should permit accelerated review of this case.

For these reasons, and as explained more fully below, Duquesne Light believes that its Default Service Plan is in the public interest and should be approved.

II. DESCRIPTION OF RELEVANT PRIOR REGULATORY PROCEEDINGS

1. Duquesne Light filed its restructuring plan under the Electricity Generation Customer Choice and Competition Act ("Competition Act") on August 1, 1997. Under its restructuring plan, Duquesne Light conducted an auction and sold its generating assets to Orion Power Midwest LP, ("Orion")[1]. As part of the auction process, Duquesne Light purchased its default service requirements for the transition period from Orion at a price equal to then-existing generation rate caps. This agreement protected Duquesne Light from volatile electric markets while Duquesne Light collected competitive transition charges ("CTCs") and provided customers fixed rates for default service (the "POLR I Agreement"). In addition, the auction was very successful in mitigating stranded costs. As a result, Duquesne Light's transition period was the shortest of any major utility in the Commonwealth, ending in 2002 for most customers.

2. In order to procure power to provide post-transition period default service to customers, Duquesne Light entered into a subsequent agreement (commonly referred to as the "POLR II Agreement") with Orion, under which Orion would supply power to meet Duquesne Light's default supply requirements through December 31, 2004. *Pa. PUC v. Duquesne Light Company, Petition for Approval of Plan for Post-Transition Period POLR Service,* Docket No. R-00974104 (Order entered November 30, 2000). The agreement allowed Duquesne Light to continue to provide fixed rates to all of its customers, and when combined with termination of the CTC resulted in Residential customers receiving a rate reduction on a total bill basis of 21% under POLR II. On a system-wide basis, the average rate reduction was 17%.

3. Prior to the expiration of the POLR II Plan, Duquesne Light filed a Petition with the Commission requesting approval of its POLR III Plan for the period of January 1, 2005

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[1] Orion was subsequently acquired by what is currently a subsidiary of Reliant Resources, Inc. ("Reliant").

through December 31, 2010. *POLR III Order*, *supra*. In its POLR III Petition, Duquesne Light proposed to offer customers default service at fixed rates for a six-year period. Duquesne Light also proposed to enter into a contract with its affiliate, Duquesne Power, under which Duquesne Power would procure power necessary to provide default service to Duquesne Light's small customers. Duquesne Light chose a six-year period for the POLR III Plan in order to align its customers with the large majority of all other default service customers in the Commonwealth who remained subject to generation rate caps until December 31, 2010.

4. On August 23, 2004, the Commission approved Duquesne Light's POLR III Plan with certain modifications. *POLR III Order*, *supra*. Of importance here, the Commission limited the term of the POLR III Plan to three years. While not adopting a six-year term, the Commission did find that Duquesne Light's proposed rates for the first three years were consistent with prevailing market rates. In this regard, the Commission found that testimony regarding recent supply auctions in a neighboring jurisdiction in PJM and several market price analyses established that Duquesne Light's proposed rates reasonably reflected prevailing market prices.

5. As was the case with the prior two default service plans, the POLR III Plan provided important benefits to customers. Under the POLR III Plan, customers continued to receive service at fixed rates which reflected prevailing market prices, and these market-based prices continued to provide savings compared to regulated rates in effect prior to the adoption of the Competition Act. The POLR III Plan also encouraged a competitive shopping environment, and since restructuring, Duquesne Light's service territory has been, by far, the most competitive in the Commonwealth.

6. In accordance with the requirements of the Competition Act, Duquesne Light has implemented electric restructuring and three default service programs. These actions have provided important benefits to customers, such as rate reductions and rate stability and have helped create the most competitive shopping environment in the Commonwealth. In aggregate, Duquesne Light's electric restructuring and default service programs will have saved customers over $950 million through 2010, and **at the same time**, produced the highest level of customer shopping in the Commonwealth and among the highest in the country. These are remarkable achievements.

III. DUQUESNE LIGHT'S DEFAULT SERVICE PLAN

A. Introduction

7. In developing its Default Service Plan, Duquesne Light carefully balanced many considerations, including in particular the effect of the Plan on retail competition and customers' rates. During the development of the Plan, Duquesne Light went to unprecedented lengths to solicit input from interested parties, including EGSs, customer advocates and others. These efforts are discussed in detail in the direct testimony of Frederick J. Eichenmiller. While Duquesne Light did not reach a consensus on all issues, it carefully considered the proposals of other parties and has developed a balanced plan that, among other things, promotes competition, provides stable rates for Residential, Lighting and Small C&I customers and provides a bridge to 2011 when generation rate caps for most other electric customers in the Commonwealth will expire.

8. Section III.B describes the elements of the Plan for the major customer classes and sets forth the proposed rates under the Plan. Section III.C explains Duquesne Light's proposal to acquire power to supply default service customers pursuant to a contract with Duquesne Power, and the reasons that a competitive solicitation process was not proposed. This

section also demonstrates that the rates proposed in this proceeding reflect prevailing market prices and therefore comply with the legal standard that Duquesne Light acquire default supply at prevailing market prices. Section III.D explains how the Plan will promote retail competition. Section III.E addresses energy conservation, time of use metering and economic development issues. Section III.F summarizes the many benefits of the Plan. Section IV explains the related approvals that Duquesne Light is requesting in conjunction with the Plan. Section V sets forth how Duquesne Light proposes to notify potential parties of this filing and inform customers as to the proposed rate changes. In Section VI, Duquesne Light requests expedited approval of this Petition.

B. Proposed Default Service Rates

9. The Default Service Plan is not a "one size fits all" approach to default service. In developing the Plan, Duquesne Light recognized that each customer class has different characteristics, including: (1) pre-existing rate structures; (2) different abilities to accept or react to changing prices; and (3) different competitive opportunities. The Plan takes these differences into account and proposes a different solution for each of the major customer groups. A description of the principal elements of the Plan for each major customer group is provided below.

1. Large C&I Customers[2]

10. Duquesne Light proposes to offer Large C&I customers a real-time hourly market price default service with no fixed price service option. Pursuant to the Commission's Reconsideration Order in the POLR III proceeding, Duquesne Light's fixed price option for Large C&I customers expires on May 31, 2007, and currently, very few customers have elected

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[2] Large C&I customers are those customers that have a demand greater than 300 kilowatts ("kW") and include rate classes GL, GLH, L and HVPS.

this option.[3] See Docket No. P-00032071, Reconsideration Order entered October 5, 2004, p. 24. The competitive market for Large C&I customers is quite robust, with approximately 98% of Large C&I load receiving service from EGSs. Therefore, Duquesne Light proposes to rely on EGSs to offer these customers fixed price service.

11. Duquesne Light's current default service tariff contains several riders applicable to Large C&I customers. Rider No. 9 contains the terms and conditions under which Duquesne Light provides hourly price default service to Large C&I customers. This Rider also contains provisions for recovery of administrative costs. Rider No. 9 currently contains separate charges for each of the four Large C&I rate classes, and the charge for each class has both a risk component and an administrative component. The Default Service Plan proposes to replace this structure with a single charge for all Large C&I customers. The new charge will not contain a risk component. In addition, Duquesne Light is updating these charges to reflect current costs and current default service sales. This proposal is explained further in the testimony of Duquesne Light's witness William V. Pfrommer.

12. Duquesne Light also proposes to eliminate Rider 23, the Generation Rate Adjustment switching rider. This Rider applies only to Large C&I customers that take fixed price service. Since Duquesne Light is eliminating the fixed price option, Rider 23 is no longer necessary.

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[3] As of December 31, 2006, only 6 out of 871 eligible customers were receiving fixed price default service from Duquesne Light.

2. Small C&I Customers[4]

13. The Default Service Plan proposes to establish Small C&I customer generation rates based on prevailing market prices and to phase out legacy rate design features, such as declining blocks and demand charges which do not reflect competitive market conditions.

14. Energy rates for Small C&I customers will be based on prevailing market prices, at the time of the filing, for a three-year fixed price, full requirements contract for 2008-2010. These rates will be adjusted for 2009 and 2010 to reflect changes based on an annual forward market price index. For example, Duquesne Light will determine the change in the index from when rates were initially established near the time of this filing to October 1, 2008, and then adjust Small C&I rates on January 1, 2009, based on this change in the index. The same procedure will be employed to set rates for 2010.

15. The rates for the Small C&I customers are shown on Exhibit WVP-1 of Mr. Pfrommer's testimony. Small C&I Rate GS/GM customers, on average, will experience a generation supply rate increase of 13.6% over POLR III supply rates. On a total bill basis, this constitutes an increase of 9.3%. The proposed generation supply rates for Small C&I Rate GS/GM customers, on average, are 3.4% lower than the generation rates which were in effect under the POLR I Plan.[5] Individual customers will experience different percentage increases

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[4] The Small C&I customers classes include Rate GS, Rate GM and Rate GMH. Rate GS has approximately 19,000 customers. Rate GS customers are not demand metered and their average usage is less than 1000 kilowatt-hours ("kWh") per month. Rate GM customers are demand metered and have diverse usage and load profiles. These customers are billed for demand for load in excess of 5 kW and for energy at declining block rates. There are approximately 33,000 Rate GM customers. Rate GMH customers are electric space heating customers. These customers are billed for demand for load in excess of 5 kW in the non-heating months and for energy at declining block rates. There are approximately 3,400 Rate GMH customers.

[5] In order to provide comparable figures, the rate comparisons include ancillary service and PJM administrative costs in the supply rates. In addition, the referenced POLR I rates include all generation-related charges including energy, capacity and CTC charges.

depending upon the individual rate under which they receive service and their individual usage patterns.

16. Duquesne Light currently has a declining block rate structure for Small C&I customers. This structure is a carryover from rates that existed prior to restructuring. Under this rate structure, customers are billed lower energy rates for usage over 1300 kWh per month.[6] For Rate GS customers, Duquesne Light proposes to eliminate the declining block rate structure as of January 1, 2008. This will simplify the rate structure and provide customers and EGSs with a clearer price to compare for purposes of retail shopping. Because very few Rate GS customers use more than 1300 kWh per month, there is only modest tail block usage, and eliminating the declining block structure will not cause disparate rate impacts.

17. By contrast, immediately eliminating declining block rates would result in substantial rate increases for certain Rate GM and Rate GMH customers. Therefore, second block rates for Rate GM and Rate GMH customers will be phased out over three years, so that as of January 1, 2010, these rates will consist of a single energy charge for default service. This will move rates to a more competitive platform over time but will avoid rate distortions that would occur by immediately eliminating this rate structure for these customers.

18. Duquesne Light's existing rate structure also includes supply related demand charges for certain Small C&I customers. Duquesne Light proposes to eliminate supply related demand charges for Small C&I customers over a three-year period. This will simplify the rate structure and promote competition while at the same time mitigating disparate rate increases. In addition, Duquesne Light's tariff includes a Rider which provides time of day discounts for

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[6] For rate GMH customers, this rate feature changes in the October to May heating months such that GMH customers are billed lower rates for usage over 1250 kWh per month plus 150 kWh for each kW of demand over 6 kW.

demand charges ("Rider No. 5"). Because Duquesne Light is proposing to phase out demand charges, Duquesne Light also proposes to phase out Rider No. 5.

19. In providing default service to customers, Duquesne Light incurs certain ancillary service and PJM Interconnection, LLC ("PJM") administrative costs. These costs are currently recovered as part of generation supply rates for Small C&I customers. Both PJM administrative costs and ancillary service costs are transmission-related costs imposed under the PJM Open Access Transmission Tariff ("OATT") and are properly recovered through retail transmission rates. Duquesne Light proposes to unbundled these costs from Small C&I customer supply rates and recover them through Duquesne Light's Transmission Service Charge ("TSC"). The TSC is a reconcilable charge designed to recover Duquesne Light's retail transmission costs and was approved in Duquesne Light's last distribution rate proceeding, at Docket No. R-00061346.

3. Residential Customers[7]

20. Duquesne Light proposes to establish Residential customer generation rates based on prevailing market energy prices and to phase out, over three years, declining block energy rates for residential heating customers. As of January 1, 2010, Duquesne Light's rate structure for all Residential customers will consist of a single energy rate.

21. Default service rates for Residential customers will be established based on prevailing market prices, at the time of the filing, for a three-year, fixed price full requirements contract. These rates will be fixed for a three-year period.

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[7] The Residential Customer group includes Rate RS – Residential Service ("Rate RS"), Rate RH – Residential Service Heating ("Rate RH") and Rate RA – Residential Service Add-on Heat Pump ("Rate RA"). Rate RS is the Company's standard residential service rate, and the rate structure consists of a single flat energy charge per kWh. Rate RH and Rate RA are the Company's residential space heating rates. Both have the same rate structure as Rate RS during the non-heating season. During the heating season, Rate RH and Rate RA have a declining block rate structure and a reduced rate for usage greater than 500 kWh.

22. The rates for residential customers are shown on Exhibit WVP-1 of Mr. Pfrommer's testimony. Residential Rate RS customers, on average, will experience a generation supply rate increase of 17.6% over POLR III supply rates. On a total bill basis, this constitutes an increase of 9.2%. The proposed generation supply rates for Residential Rate RS customers, on average, are 9.1% lower than the generation rates which were in effect under the POLR I Plan.[8] Individual Residential customers will experience different percentage increases in rates depending upon the individual rate under which they receive service and their individual usage patterns.

23. Duquesne Light currently has a declining block rate structure for Residential heating customers. This structure is a carryover from rates that existed prior to restructuring. Under this rate structure, Residential heating customers are billed lower energy rates during the November through April heating season for usage over 500 kWh per month. Under the Default Service Plan, declining second block energy rates for Residential heating customers are being phased out over three years, to avoid rate distortions that would occur by immediately eliminating this rate structure. As of January 1, 2010, all residential customers will receive default service at a single energy charge, which will facilitate shopping for both customers and EGSs.

24. As with Small C&I customers, ancillary service and PJM administrative costs currently are bundled in supply rates for Residential customers. As explained above, Duquesne Light proposes to unbundle these costs from supply rates and recover them through the TSC.

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[8] In order to provide comparable figures, the rate comparisons include ancillary service and PJM administrative costs in the supply rates. In addition, the referenced POLR I rates include all generation-related charges including energy, capacity and CTC charges.

4. Lighting Customers[9]

25. Duquesne Light is setting rates for Lighting customers based on an estimate of prevailing market prices, at the time of the filing, for a three-year fixed price, full requirements contract. These rates will be fixed for a three-year period.

26. The rates for Lighting customers are shown on Exhibit WVP-1 of Mr. Pfrommer's testimony. Lighting customers, on average, will experience a generation supply rate increase of 29.5% over POLR III supply rates. On a total bill basis, the average increase will be 7.4% over POLR III rates. The proposed supply rates for Lighting customers, on average, are 23.6% lower than generation rates which were in effect under the POLR I Plan.[10] Individual Lighting customers will experience different percentage increases in rates depending upon the rate under which they receive service.

27. As a result of the legacy effects of unbundling and the POLR III rate design, resetting rates for lighting customers will result in decreases for some customers and increases for others. Implementing these proposed changes to the lighting class rates will simplify the rates, eliminate inconsistencies between rate classes, and promote retail competition.

C. Power Procurement

1. Duquesne Light Proposes To Acquire Default Supply From Duquesne Power At Prevailing Market Prices

28. Consistent with its POLR III plan, Duquesne Light proposes to amend its existing fixed price full requirements contract with its affiliate, Duquesne Power, to procure supply for Small C&I, Residential and Lighting customers. Duquesne Power will acquire the power needed

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9 The classes defined as Lighting include Rate AL – Architectural Lighting Service, Rate SE – Street Lighting Energy, Rate SM – Street Lighting Municipal, Rate SH – Street Lighting Highway, Rate UMS – Unmetered Service and Rate PAL – Private Area Lighting.

10 In order to provide comparable figures, the rate comparisons include ancillary service and PJM administrative costs in the supply rates. In addition, the referenced POLR I rates include all generation-related charges including energy, capacity and CTC charges.

to serve this load through purchases in the wholesale market. Duquesne Power also will procure alternative energy credits in order to comply with the Alternative Energy Portfolio Standards Act, 73 P.S. § 1648.1 *et seq.*

29. In order to provide increased rate certainty to customers and to provide the Commission with a concrete proposal for review, Duquesne Power has agreed to hold the proposed rates open during the regulatory review period. Duquesne Power also is assuming the risks associated with: (1) changes in sales, (2) changes in load shape during peak and off-peak periods, (3) changes in regulatory requirements, (4) supplier default, (5) shopping risks, and (6) other risks associated with providing default service supply for Duquesne Light. This commitment by Duquesne Power provides substantial benefits to customers and the Commission.

30. Duquesne Light considered obtaining default supply through a competitive procurement process, but believes that such a process should not be implemented at this time. Under a wholesale competitive solicitation process, default service customers would bear the risks that electricity prices will increase. Duquesne Light does not believe that it is appropriate to place this substantial risk on default service customers.

31. Duquesne Light's position is not mere speculation, but is supported by real life examples. For example, Pike County Light & Power conducted a single auction to set default service rates for customers, and this auction resulted in a 129% increase in generation rates. *Pa. PUC v. Pike County Light & Power Company,* Docket No. P-00052168, Order entered December 21, 2005. Also, as mentioned by the Commission in its Investigation Order entered on May 24, 2006, in *Policies to Mitigate Potential Electricity Price Increases,* Docket No. M-00061957, in Delaware, Delmarva Power Company residential customers faced a 59% rate

increase on May 1, 2006, as a result a competitive procurement process to obtain default supply. Likewise, in Maryland, residential customers of Baltimore Gas & Electric Company faced a 72% increase in electric bills on July 1, 2006, subject to deferral through a rate stabilization plan, as a result of a competitive procurement process to obtain default supply. These examples illustrate that customers bear substantial risks if default supply is obtained through a competitive procurement process. By contrast, Duquesne Light proposed Residential Rate RS supply rate increase for the period 2008 – 2010 is 17.6%.

32. In addition to the problems identified above, a competitive solicitation process may not generate many bidders. Duquesne Light conducted several competitive RFP processes – in October 2004, March 2006, and May 2006, to procure power for Large C&I customers. The first RFP process received six bids, most of which offered to supply only a limited number of tranches. The second RFP conducted in March 2006 resulted in no bids from any suppliers at any price. The Commission then made several changes to the RFP process in order to make the product more attractive to potential bidders and encourage supplier participation. Docket No. P-00032071, Order entered May 4, 2006. Even after these changes, Duquesne Light only received one bid. As this demonstrates, a competitive solicitation process may not generate many bidders.

33. Competitive solicitations also have not proven to result in higher levels of shopping. In fact, Duquesne Light has significantly higher shopping levels than other jurisdictions that have relied on competitive solicitations to establish default service.

34. The rates under the Default Service Plan are based on prevailing market prices for a three-year, fixed price full requirements contract for 2008 through 2010. A detailed analysis of how the rates were determined is included in the testimony of Neil S. Fisher. In determining prevailing market prices, Duquesne Light reviewed recent competitive solicitations in

Pennsylvania, New Jersey, Maryland and Illinois. All of the solicitations that were reviewed involve full-requirements default service supply to Residential and/or Small C&I customers and were conducted primarily in the last twelve months.

35. After reviewing the competitive solicitations, Duquesne Light adjusted the results in order to evaluate them on a comparable basis. Major adjustments included: (1) major definitional differences in the product being provided; (2) locational and timing differences; and (3) differences in risk assumption by the supplier. This analysis demonstrates that Duquesne Light's proposed default service rates appropriately reflect prevailing market prices.

2. The Default Service Plan Satisfies The Statutory Standard Of "Acquiring Energy At Prevailing Market Prices"

36. Duquesne Light's basic statutory obligation to provide default service is set forth in Section 2807(e)(3) of the Code, which provides as follows:

> If a customer contracts for electric energy and it is not delivered or if a customer does not choose an alternative electric generation supplier, the electric distribution company or commission-approved alternative supplier *shall acquire electric energy at prevailing market prices* to serve that customer and shall recover fully all reasonable costs. (Emphasis added)

37. There has been some controversy regarding the meaning of this statutory provision, and in particular, the meaning of the phrase "prevailing market prices." The term is not defined by the legislature. However, in the Competition Act, the legislature has directed the Commission to "promulgate regulations to define the electric distribution company's obligation to connect and deliver and acquire electricity" under Section 2807(e)(3). At this time, the Commission has not issued final default service regulations.

38. Based upon the plain language of Section 2807(e)(3), Duquesne Light's proposed strategy for procuring power for default service customers fully complies with the statutory requirement that electric energy shall be purchased at prevailing market prices. As stated above,

under the Default Service Plan, Duquesne Light is purchasing electricity from Duquesne Power based on prevailing market prices, at the time of the filing, for a three-year, fixed price full requirements contract. The prices were developed by reviewing recent competitive auctions for full-requirements default service supply in New Jersey, Maryland, Illinois and Pennsylvania and adjusting the results of these auctions to reflect Duquesne Light's particular circumstances.

39. In other default service proceedings, some parties and commentators have argued that the term "prevailing market prices" requires the default service provider to acquire power only in the short-term, spot market. Duquesne Light does not believe that this is a correct interpretation.

40. As noted above, the term "prevailing market prices," was not defined by the legislature, and in fact, the legislature directed the Commission to issue regulations defining how EDCs acquire electricity for default customers. Under well-established case law, the Commission has very broad discretion in issuing regulations, and its exercise of discretion will be upheld unless the regulations bear no reasonable relationship to the underlying statutory provision on which they are based. *Rohrbaugh v. Pa. PUC*, 556 Pa. 199, 727 A.2d 1080 (1999). Therefore, there is no basis to argue that the legislature intended to restrict the term "prevailing market prices" to short-term, spot market prices.

41. This is also evident by the use of the term "prevailing market prices" in the plural, rather than the singular. There are many prevailing market prices for electricity over different terms, including short-term, medium-term and long-term prices. There also are a wide variety of electricity products, including capacity, load following energy, around-the-clock energy, full-requirements service, derivatives and hedges. These products are available for different lengths of time and, in fact, the prevailing market price for the product often directly depends on the

length of time. Clearly, the existence of these products demonstrates that the prevailing market is not simply a short-term market.

42. Further, these products, including the long-term products, are available to all market participants, including EDC default providers and marketers. As such, all market participants, including default service providers, should be able to take advantage of the full range of market products.

43. In prior proceedings, the Commission has found that "prevailing market prices" are not limited to short-term prices. In Duquesne Light's POLR III proceeding, the Commission approved a three-year term for the Plan and found that Duquesne Light's proposed rates for this three-year period reflected prevailing market prices over this term. *POLR III Order*, entered August 23, 2004. In addition, the Commission indicated that a second three-year term may be appropriate after the POLR III term expired. *POLR III Order*, p. 17. Likewise, the Commission approved a three-year term for Duquesne Light's POLR II Plan and also for UGI's recent default service plan. *Petition of UGI Utilities, Inc. – Electric Division For Approval To Implement 2007-2009 Default Service Tariff Provisions On One Day's Advance Notice,* Docket No. P-00062212 (Order entered June 23, 2006).

D. Market Enhancements

44. Duquesne Light already has implemented three very successful default service programs, and Duquesne Light's service territory is the most competitive in the Commonwealth. By this filing, Duquesne Light seeks to build on that success and further promote retail competition in its service territory.

45. The rate and rate structure changes under the Default Service Plan will promote competition. By raising generation rates to prevailing market prices, EGSs will have a better opportunity to serve Residential, Small C&I and Lighting customers. Phasing out declining

energy blocks and supply related demand charges also will promote competition by simplifying the rate structure and making it easier for customers and EGSs to compare offers.

46. In addition to these measures, Duquesne Light proposes to implement several additional measures that are designed to promote retail competition. Duquesne Light has agreed to implement a purchase of receivables program that all of the parties involved in Duquesne Light's prior distribution rate proceeding either support or do not oppose. In addition, Duquesne Light has conducted an analysis addressing whether any portion of Duquesne Light's operations is inappropriately subsidizing its affiliate, Duquesne Light Energy ('Duquesne Energy") to ensure that Duquesne Energy is operating on a level playing field with other EGSs. Duquesne Light also is taking or has already taken substantial additional measures to enhance competition in its service territory, including improving enforcement of its Code of Conduct, committing to utilize a marketer friendly consolidated billing program, and convening regular meetings with EGSs to discuss market development issues. These issues are discussed below.

1. Purchase of Receivables Program

47. In the Settlement of its last distribution rate proceeding at Docket No. R-00061346, Duquesne Light agreed to meet with parties to consider the development of a Purchase of Receivables Program ("POR") for suppliers serving Residential and Small C&I customers in Duquesne Light's service territory as an alternative to full unbundling of any default service costs in distribution rates. Shortly after the Settlement was signed, Duquesne Light developed a POR proposal and presented it to the parties for review. Over the next two months, the parties developed the POR agreement that is attached to the testimony of Nancy J. D. Krajovic.

48. Under the POR program, Duquesne Light has agreed to purchase the accounts receivable, without recourse, associated with EGS sales of retail electricity to Residential and

Small C&I customers in Duquesne Light's service territory. Duquesne Light will purchase the accounts receivable at a small discount and then seek to recover EGS receivables from customers consistent with Duquesne Light's existing collection procedures. In this Petition, Duquesne Light requests a waiver of Commission regulations and guidelines that prohibit collection procedures, including termination of service, for unpaid receivables purchased from EGSs.[11]

49. The POR program provides considerable benefits to both customers and EGSs. The POR program will benefit customers because EGSs that participate in the program cannot reject customers based on credit-related issues. This should create increased access to competitive options for customers that might otherwise be overlooked by EGSs due to poor credit scores or past financial troubles.

50. The POR program also provides considerable benefits to EGSs. The primary benefit is that the POR program eliminates EGSs' risks of serving payment troubled customers. This will allow EGSs to expand their markets without incurring costs associated with upfront credit analysis of customers, collection activities or uncollectible accounts in the event of non-payment.

51. Given the protections provided to EGSs under the POR program, the POR program should promote competition for Residential and Small C&I customers. Additional details regarding the POR program are provided in the testimony of Ms. Krajovic.

2. Enhancement of Duquesne Light/EGS Communications

52. Another market enhancement measure involves enhancing communications between Duquesne Light and EGSs. In Duquesne Light's last rate case, certain EGSs expressed concerns about the level and quality of communications between themselves and Duquesne

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[11] Duquesne Light will not terminate customers for failure to pay amounts in excess of what the customer would have paid under default service rates during the non-payment period.

Light. In response to these concerns, Duquesne Light agreed to conduct several meetings each year to enhance communication between Duquesne Light and EGSs. Duquesne Light will convene two meetings per year with interested EGSs to discuss current and emerging issues associated with market development and competition. Participants will include a representative from Duquesne Light's Supplier Service Center and the operational personnel of EGSs that serve in Duquesne Light's service territory. In addition, Duquesne Light will conduct an annual meeting with interested EGSs and interested C&I customers to discuss customer choice issues. This meeting is intended to enhance customer education regarding competitive issues.

53. These annual meetings will provide a specific venue for participants to present ideas or concerns about competitive market issues and should promote competition. The meetings will allow both Duquesne Light and EGSs to hear issues of concern and to present proposals to solve market problems or promote competition.

3. Cost Allocation Analysis

54. In its last distribution rate case, Duquesne Light agreed to submit an analysis in this proceeding addressing whether any portion of Duquesne Light's operations is subsidizing its affiliates, including Duquesne Energy. See Paragraph 17(b) of the Rate Case Settlement filed at Docket No. R-00061346 and approved by the Commission by Order entered on December 1, 2006. Pursuant to the Settlement, Duquesne Light has carefully reviewed its cost allocations and has presented the results of that analysis in this proceeding in the Direct Testimony of Susan S. Betta. In her analysis, Ms. Betta reviewed Duquesne Light's cost allocation procedures and determined that Duquesne Light properly allocates costs out of its regulated business and has protections in place to separate regulated and unregulated business activities. Based on the analysis, the Company implemented several minor changes to its cost allocation procedures to better reflect actual costs incurred.

55. In addition to the cost allocation analysis performed by Ms. Betta, both the Federal Energy Regulatory Commission ("FERC") and the Commission recently audited Duquesne Light's cost allocation procedures, and both found no cross-subsidization. FERC also reviewed these issues in the Duquesne Light merger proceeding and found that there was no cross-subsidization.

56. In addition to considering cost allocation issues, Ms. Betta also reviewed Duquesne Light's supply agreement with Duquesne Power under which Duquesne Power supplies energy to Duquesne Light for default service customers. Upon review of the supply agreement, Ms. Betta concluded that Duquesne Light is not subsidizing Duquesne Energy under the supply agreement. Moreover, in its recent audit, FERC also reviewed the supply agreement and did not find any cross-subsidization.

4. Code of Conduct Review

57. Duquesne Light is subject to a Code of Conduct set forth in the Commission's regulations. 52 Pa. Code § 54.122. The Code of Conduct is designed, in part, to ensure that EDCs do not give undue preference to EGSs, including affiliate EGSs. The Code of Conduct also contains provisions relating to EDC and EGS advertising, dispute resolution procedures, customer information requests and independent functioning of employees.

58. In order to assure continued compliance with the Code of Conduct requirements, Duquesne Light will require employees in the Supplier Service Center and its Major Account Representatives who have relationships with larger customers to review the Code of Conduct on a yearly basis and commit in writing to its terms. This will further ensure that key employees remember and follow the Code of Conduct's provisions, thereby ensuring that Duquesne Light does not give preferential treatment to EGSs, including its affiliate Duquesne Energy.

E. Energy Conservation And Economic Development

59. Duquesne Light promotes energy conservation through several different programs. In the Settlement of its last distribution rate proceeding, Duquesne Light agreed to contribute $6.0 million to fund renewable energy projects and/or energy efficiency and energy education projects in its service territory. Through this Settlement provision, Duquesne Light provides substantial funding for energy conservation programs in its service territory. Duquesne Light also has several other programs that are designed to promote energy conservation including a Load Response Program that compensates customers for reducing demand when market prices increase and a Direct Load Control Pilot Program for Residential and small commercial customers that reduces air conditioning usage during hot weather. In addition, on its website, Duquesne Light has tools that provide valuable information for customers regarding measures they can take to improve their energy efficiency. Duquesne Light also: (1) issues New Movers Guide's to customers moving in its service territory which include information on how to use energy wisely; (2) presents energy conservation programs to school students under the "Watt Do You Know?" program; and (3) provides energy conservation materials at the Pittsburgh Home and Garden Show. Through these programs, Duquesne Light actively educates consumers about important conservation measures they can implement to reduce energy usage.

60. In the Settlement of its last distribution rate proceeding, Duquesne Light also agreed to evaluate the proposals of other parties relating to energy conservation and education, time of use metering and economic development and to make proposals deemed by Duquesne Light to be appropriate as to such matters in this filing. Duquesne Light has considered these issues and does not believe that additional proposals on these matters are appropriate for this proceeding. In discussions with parties, Duquesne Light determined that there is a lack of consensus among the parties on these issues. There was some interest in advanced metering

options with time-of-use and/or seasonal rates, but certain parties indicated that they should only be implemented if they were optional and did not impose additional costs on customers. Others believed that these types of proposals should not be provided by the default service provider, but by other market participants. In addition, the Default Service Plan is a short term, three-year plan. Given the lack of consensus and the short term of the Plan, Duquesne Light believes that these types of issues may be more appropriately considered on a statewide basis after rate caps for all EDCs have expired. In this regard, the Commission has established a Demand Side Response ("DSR") working group to investigate reasonable, cost-effective programs that EDCs, EGSs and other stakeholders can implement to help customers conserve energy or use it more efficiently. *Investigation of Conservation, Energy Efficiency Activities, and Demand Side Response by Energy Utilities and Ratemaking Mechanisms to Promote Such Efforts*, Docket No. M-00061984, Order entered October 11, 2006. Duquesne Light is an active party in the DSR working group and supports the Commission's efforts in this regard.

F. Benefits of the Default Service Plan

61. The Default Service Plan is designed to provide many benefits for customers and marketers. These benefits include promoting competition, providing stable rates for Residential, Lighting and Small C&I customers, providing a bridge to 2011 when generation rate caps for most other remaining utility customers will expire, and promoting conservation.

62. A primary benefit of the Default Service Plan is that it promotes competition for all customer classes in Duquesne Light's service territory. The Plan promotes competition by:

- Providing POLR service to Large C&I customers at real time hourly prices.
- Completely eliminating switching restrictions other than the switching rules required by regulation.
- Setting Small C&I customers' rates to prevailing market levels with annual adjustments to reflect changes in market conditions.

- Setting Residential customers' rates to prevailing market levels.
- Eliminating supply related demand charges and declining energy blocks for Small C&I customers.
- Eliminating declining energy blocks for Residential customers.
- Adopting the Purchase of Receivables program.
- Scheduling annual meetings with EGSs to discuss market issues.
- Reviewing cost allocation and Code of Conduct procedures to assure that services are provided on a non-discriminatory basis.

63. In addition to promoting competition, the Default Service Plan provides other substantial benefits. These benefits include:

- Providing rate stability for Residential and Small C&I customers at rates which are only modestly above current rates and are below rates in effect under the POLR I Plan.
- Ensuring Residential and Small C&I customers do not experience rate shock after the POLR III plan expires.
- Holding proposed rates open during the regulatory review period.
- Providing a bridge to 2011 when generation rate caps for most other utility customers expire.
- Promoting conservation through changes in rate design.

64. For these reasons, and as further explained in this Petition, Duquesne Light believes that its Default Service Plan is in the public interest and should be approved.

IV. RELATED APPROVALS

65. In addition to approving the Default Service Plan, Duquesne also requests several additional approvals by the Commission.

66. First, Duquesne Light requests that the Commission issue an order in this proceeding stating that if the Commission's default service regulations become effective prior to January 1, 2011, Duquesne Light will be granted a waiver of those regulations to the extent that

they conflict with the provisions of the Default Service Plan. This waiver is necessary in order for Duquesne Power to procure supply for Duquesne Light's default service customers. As indicated above, Duquesne Power is assuming considerable risks under the Default Service Plan, and Duquesne Light respectfully requests that the Commission eliminate the risk that the final default service regulations could override the terms and conditions of this Plan.

67. Second, as set forth in this Petition, Duquesne Light has agreed to purchase the receivables associated with EGS sales of electricity to Residential and Small C&I customers in Duquesne Light's service territory. The Agreement to establish the POR program permits Duquesne Light to terminate delivery and EGS commodity service to customers whose accounts receivable were purchased and who fail to make payments of amounts due on their bill. Any termination shall be consistent with the provisions of Chapter 14 of the Public Utility Code and Chapter 56 (or a successor chapter) of the Commission's regulations. However, Duquesne Light will not terminate EGS' customers for failure to pay EGS supply rates that are higher than Duquesne Light's default service rates during the non-payment period. Duquesne Light requests that the Commission approve the POR program and grant any waivers that may be necessary for Duquesne Light to terminate customers under the program including waiver of: (1) the Commission's guidelines in *Final Order Re: Guideline for Maintaining Customer Services at the Same Level of Quality pursuant to 66 Pa.C.S. § 2807(D) and Assuring Conformance with 52 Pa. Code Chapter 56 pursuant to 66 Pa.C.S. § 2809 (E) and (F)*, Docket No. M-00960890F0011, Order entered July 11, 1997; (2) any provision of Chapter 56 that would prevent Duquesne Light from terminating customers for failure to pay receivables purchased from EGSs; and (3) any other regulation, policy or guideline, to the extent necessary, for Duquesne Light to implement all of the terms and conditions of its POR program.

68. Finally, in the POLR III proceeding, the Commission approved the Duquesne – Duquesne Power supply arrangements as an affiliated interest agreement pursuant to Section 2102(b) of the Code for a six-year term, or until December 31, 2010. Under the Default Service Plan, Duquesne Light is updating its power supply contract with Duquesne Power to purchase power to supply default service to Small C&I, Residential and Lighting customers. When this agreement is finalized, Duquesne Light will submit it to the Commission for review and approval in this proceeding. Because Duquesne Light is only making minor modifications to this agreement and to update the prices, Duquesne Light does not anticipate that the modifications will be controversial.

V. CUSTOMER NOTIFICATION

69. As indicated by the enclosed certificate of service, Duquesne Light has served a copy of this Petition upon all of the parties to Duquesne Light's most recent rate proceeding at Docket No. R-00061346 and to its POLR III proceeding, at Docket No. P-00032071. In addition, Duquesne Light is providing notice of the Default Service Plan to customers through a bill insert.

VI. REQUEST FOR EXPEDITED APPROVAL

70. Duquesne Light respectfully requests expedited approval of this Petition such that the Default Service Plan is approved by July 1, 2007. To facilitate approval by this date, Duquesne Light has filed its direct testimony along with this Petition, and respectfully requests the Commission to assign this matter to the Office of ALJ for evidentiary hearings and the issuance of a Recommended Decision as soon as possible.

71. Approval by July 1, 2007 is necessary so that Duquesne Power will be able to complete, in a timely manner, the wholesale purchase of baseload energy, capacity, peaking power and other services to provide default service to Duquesne Light's Residential, Small C&I

and Lighting customers and the need to provide customers notice of the precise changes in their Price To Compare in order to facilitate retail shopping.

72. In addition, as explained above, Duquesne Power has assumed considerable risk in holding proposed rates open through the regulatory review period. Expedited review by the Commission will help minimize this risk.

73. As indicated above, Duquesne Light went to unprecedented lengths to meet with parties prior to filing this Plan in order to receive their input. Duquesne Light anticipates that there will be substantial support for many elements of its Plan, which will support an expedited schedule in this proceeding.

74. WHEREFORE, for all of the foregoing reasons, Duquesne Light Company respectfully requests the that the Pennsylvania Public Utility Commission approve the Default Service Plan as proposed in this Petition by July 1, 2007, approve the tariff sheets that are provided as Exhibits to the testimony of Nancy J. D. Krajovic, issue all approvals required under the Public Utility Code, and grant any additional relief that is just and reasonable under the circumstances.

Respectfully submitted,

David B. MacGregor (ID # 28804)
Post & Schell, P.C.
Four Penn Center
1600 John F. Kennedy Boulevard
Philadelphia, PA 19103-2808
Phone: 215-587-1197
Fax: 215-320-4879
E-mail:dmacgregor@postschell.com

Michael W. Gang (ID # 25670)
Anthony D. Kanagy (ID # 85522)
Post & Schell, P.C.
17 North Second Street
12th Floor
Harrisburg, PA 17101-1601
Phone: 717-731-1970
Fax: 717-731-1985
E-mail:mgang@postschell.com
E-mail:akanagy@postschell.com

Gary A. Jack (ID # 95066)
Duquesne Light Company
411 Seventh Avenue Mail Drop 8-2
Pittsburgh, PA 15219
Phone: 412-393-1541
Fax: 412-393-1418
E-mail:gjack@duqlight.com

Attorneys for Duquesne Light Company

Of Counsel:

Post & Schell, P.C.

Date: January 25, 2007

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

AFFIDAVIT

I, Frederick J. Eichenmiller, being duly sworn according to law, depose and say that I am Director, Rates & Regulatory Affairs of Duquesne Light Company; that I am authorized to and do make this affidavit for it; and that the facts set forth in the foregoing Petition are true and correct to the best of my knowledge, information, and belief, and I expect the said Duquesne Light Company to be able to prove the same at any hearing hereof.

Frederick J. Eichenmiller
Director, Rates & Regulatory Affairs

Sworn and subscribed before me
this 23rd day of January, 2007.

Notary Public

COMMONWEALTH OF PENNSYLVANIA
Notarial Seal
Mary Jane Hammer, Notary Public
City of Pittsburgh, Allegheny County
My Commission Expires Oct. 6, 2007
Member, Pennsylvania Association of Notaries

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DUQUESNE STATEMENT NO. 1

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Petition Of Duquesne Light Company	:	
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DIRECT TESTIMONY OF MORGAN K. O'BRIEN

Dated: January 25, 2007

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

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

Q. WHAT IS YOUR CURRENT POSITION?

A. I am President and Chief Executive Officer of Duquesne Light Holdings, Inc. and of Duquesne Light Company ("Duquesne Light" or the "Company").

Q. PLEASE DESCRIBE YOUR EDUCATIONAL AND PROFESSIONAL EXPERIENCE.

A. I graduated in 1982 with a Bachelor of Arts degree in Business Administration and a Master of Science degree in 1985 from Robert Morris College. Thereafter, I was employed in public accounting with Coopers & Lybrand and also with Deloitte & Touche. In 1991, I began my employment with Duquesne Light Company. Since that time, I have held numerous positions with the Company, including Controller and Treasurer, Vice President of Corporate Development, and Chief Operating Officer. I assumed my present position of President and Chief Executive Officer of Duquesne Light Holdings (formerly DQE, Inc.) in September 2001 and President and Chief Executive Officer of Duquesne Light in August 2003. Additional information regarding my qualifications, work experience and background are attached as Exhibit MKO-1.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to provide an overview of Duquesne Light's plan for default service for the period from January 1, 2008 through December 31, 2010 ("Default Service Plan" or "Plan"). Part I of my testimony summarizes Duquesne Light's proposed Default Service Plan for 2008 through 2010. Part II provides a general background on Duquesne Light's prior restructuring and three prior default service plans. This experience helped form the design of the proposed Default Service Plan. Part III identifies the major policy considerations associated with Duquesne Light's development of its Default Service Plan. Part IV provides some further details of the Default Service Plan and explains how Duquesne Light balanced the major policy considerations in developing this Plan.

I. SUMMARY OF THE DEFAULT SERVICE PLAN

Q. PLEASE PROVIDE A SUMMARY OF THE DEFAULT SERVICE PLAN.

A. The Default Service Plan is a comprehensive program under which Duquesne Light will provide default service to its customers for 2008 through 2010. This three-year period was selected because it provides a critically important three-year bridge to 2011, when generation rate caps expire for most other major Pennsylvania electric distribution companies ("EDCs"). Approval of this Plan will assure that Duquesne Light's residential customers receive default service under terms and conditions similar to the service received by other Pennsylvanians. In addition, we have included in our Plan a number of measures that are designed to further promote retail competition in the Duquesne Light service territory. The primary elements of the Default Service Plan are as follows:

Large C&I Customers

- The default service rate for Large Commercial & Industrial ("Large C&I") customers will be hourly pricing. Per the Commission's POLR III Order, Duquesne Light will no longer provide a fixed price option to Large C&I customers beginning June 1, 2007.

Small C&I Customers

- Rates for Small Commercial & Industrial ("Small C&I") customers will be based on the prevailing market price, at the time of the filing, for a three-year (2008-2010) fixed price, full requirements contract. During the Plan period, rates will be adjusted annually for 2009 and 2010 based upon a market index adjustment factor that will reflect changes in market price levels from the time rates were developed.

- Supply related demand charges and declining energy blocks for Small C&I customers will be eliminated over a three-year period.

- For 2010 and thereafter, there will be a single energy rate for Small C&I customers.

Residential & Lighting Customers

- Rates for Residential and Lighting customers will be based on the prevailing market price, at the time of the filing, for a three-year (2008-2010) fixed price, full requirements contract.

- Declining energy blocks for Residential heating customers will be eliminated over a three-year period.

- For 2010 and thereafter, there will be a single energy rate for Residential customers.

Market Enhancement Measures

- Duquesne Light is proposing a purchase of receivables ("POR") program to purchase EGS billings to Residential and Small C&I customers. The POR program was developed in discussions arising out of Duquesne Light's recent distribution rate case and reflects a consensus proposal with broad support from many parties.

- As explained above, Duquesne Light proposes, over a three-year period, to simplify its rate structure to flat energy prices for Residential and Small C&I customers, which will allow customers and EGSs to more easily compare competitive offers.

- Pursuant to the settlement of its recent distribution rate proceeding, Duquesne Light will convene regular meetings with EGSs to discuss supplier issues.

- Pursuant to the settlement of its recent distribution rate proceeding, Duquesne Light has performed a cost allocation analysis and determined that it properly allocates costs out of its regulated business and has protections in place to separate regulated and unregulated businesses.

- Duquesne Light will strengthen enforcement of its Code of Conduct by having key employees annually commit in writing to follow its terms.

As an initial matter, I want to emphasize that this Plan was not developed in a vacuum. As explained in more detail by Mr. Eichenmiller, Duquesne Light has undertaken extensive efforts to meet with interested parties to develop a default service plan that balances the interests of customers, EGSs and Duquesne Light as competitive markets continue to develop. Duquesne Light also has built upon the success achieved in promoting competition through its prior default service plans and proposes significant steps to further promote retail competition in its service territory. Taken together, the Default Service Plan provides customers with just and reasonable rates for default service based on prevailing market prices, actively promotes the further development of retail competition and provides a balanced and pro-active bridge to 2011 when generation rate caps for the majority of electric customers in the Commonwealth expire. Duquesne Light strongly believes that the Plan reflects an appropriate balance of these competing interests and should be approved.

Q. PLEASE INTRODUCE THE TESTIMONY OF DUQUESNE LIGHT'S OTHER WITNESSES.

A. Duquesne Light is submitting the testimony of five other witnesses. Frederick Eichenmiller, Director of Rates and Regulatory Affairs, will describe the process used to prepare the filing, an overview of the key steps Duquesne Light is proposing to transition to competitive markets, and measures that Duquesne Light takes to promote conservation. Neil Fisher, an expert on retail markets from The Northbridge Group, provides support for Duquesne Light's proposal to offer three types of default service by customer type and provides market evidence that the fixed prices offered to Residential, Lighting and Small C&I customers reflect prevailing market prices. Mr. Fisher also describes the market index adjustment factor for Small C&I rates. William Pfrommer, Manager of Rates, will describe the proposed default service rates and associated tariff rules. Nancy Krajovic, Manager of Regulatory Affairs, describes the considerable effort made prior to this filing by Duquesne Light and the other parties to develop a new POR program. Susan Betta, Duquesne Light's Controller, provides an analysis addressing whether any portion of Duquesne Light's operations is subsidizing its affiliates, including its affiliate EGS, Duquesne Light Energy.

II. REGULATORY BACKGROUND

Q. WHAT TOPICS DO YOU ADDRESS IN THIS SECTION OF YOUR TESTIMONY?

A. I first provide a brief summary of certain aspects of Duquesne Light's prior restructuring and default service proceedings that may be relevant in assessing the proposed Default

Service Plan. I then provide a brief summary of the status of the Commission's default service regulations, and Duquesne Light's position regarding these regulations.

Q. PLEASE DESCRIBE DUQUESNE LIGHT'S ELECTRIC RESTRUCTURING PLAN TO THE EXTENT IT RELATES TO THIS PROCEEDING.

A. The important part of Duquesne Light's restructuring plan, as pertinent to this proceeding, is the sale of Duquesne Light's generating plants and the resulting mitigation of stranded costs. In 1998, the Commission approved a plan whereby Duquesne Light would (i) swap its partial interests in certain coal and nuclear plants with FirstEnergy for wholly-owned interests in other coal-fired generating plants, and (ii) subsequently sold the assets received from FirstEnergy, together with Duquesne Light's other wholly-owned fossil units, to third parties through a formal bidding process. The winning bidder in this auction was Orion Power Midwest, Inc. ("Orion"), an entity later purchased by Reliant Resources, Inc. ("Reliant"). This auction was very successful in mitigating stranded costs. As a result of the auction, Duquesne Light's transition period for collecting a competitive transition charge ("CTC") was shortened from 2007 to 2002 for most customers, and Duquesne Light became the first major utility in the Commonwealth to terminate stranded cost recovery, resulting in substantial rate reductions for customers.

Q. GIVEN THAT DUQUESNE LIGHT DIVESTED ITS GENERATION, HOW DID DUQUESNE LIGHT PROCURE POWER ON BEHALF OF ITS DEFAULT SERVICE CUSTOMERS?

A. Duquesne Light initially purchased its default service supply requirements at wholesale from Orion. The generation auction included a wholesale requirements contract under which Orion would supply power for Duquesne Light's default service load at prices consistent with the statutory rate cap then in effect. This contract terminated at the end of the transition period for each rate schedule. Specifically, after termination of the CTC for a given rate schedule, Orion no longer had an obligation to supply loads in that rate schedule. In addition, under the Competition Act, rate caps for those customers expired.

Q. HOW DID DUQUESNE LIGHT ADDRESS ITS DEFAULT SERVICE SUPPLY REQUIREMENTS FOLLOWING TERMINATION OF THE CTC?

A. Soon after closing of the auction, Duquesne Light commenced negotiations with Orion to procure the power necessary to provide post-transition period default service. The product of those negotiations was a full requirements agreement (commonly referred to as the "POLR II Agreement") under which Orion would supply power to meet Duquesne Light's default service supply requirements through December 31, 2004. The agreement was similar in most respects to the first agreement with Orion and allowed Duquesne Light to continue to provide default service at fixed rates to all of its customers. Although the wholesale rates charged by Orion increased under the second full requirements agreement, termination of the CTC meant that residential customers

received a net rate reduction of 21% under POLR II. On a system-wide basis, the average net rate reduction was 17%.

Q. DID THE COMMISSION APPROVE THE RATES AND TERMS OF DEFAULT SERVICE FOR THIS PERIOD?

A. Yes. Duquesne Light filed its proposal, commonly referred to as the "POLR II Plan," on June 30, 2000. The POLR II petition was assigned to a stakeholder negotiation conducted by then-Chairman Quain and Commissioner Fitzpatrick. Most of the active parties to the proceeding were thereafter able to reach a settlement ("POLR II Settlement"). The settlement was approved on November 30, 2000. *Pennsylvania Public Utility Commission v. Duquesne Light Company; Petition for Approval of Plan for Post-Transition Period POLR Service,* Docket No. R-00974104 (Order entered Nov. 30, 2000).

Q. HOW DID DUQUESNE LIGHT ADDRESS ITS DEFAULT SERVICE REQUIREMENTS AFTER POLR II?

A. On December 9, 2003, Duquesne Light filed a Petition requesting approval of its Plan for Provider of Last Resort ("POLR III") for the period of January 1, 2005 through December 31, 2010. In its POLR III Petition, Duquesne Light proposed to offer Residential and Small C&I customers default service at fixed rates for the period January 1, 2005 through December 31, 2010. The POLR III rates, as filed, reflected an increase of 11.5% in January 2005, followed by a 9.3% increase in January 2008. To obtain power for these small customers, Duquesne Light proposed to rely on its affiliate,

Duquesne Power, to procure power through a combination of generation assets owned by Duquesne Power and wholesale market purchases. Duquesne Light chose a six-year period to align Duquesne Light's customers with the large majority of other default service customers in the Commonwealth. Under the POLR III Plan as proposed, Duquesne Light's small customers would have had fixed rates through 2010, when rate caps for the majority of electric customers in the Commonwealth expire.

The second element of the POLR III plan provided for competitive solicitations to procure power to serve Large C&I customers taking default service. Duquesne Light proposed to offer an hourly market price service ("HPS") under which the customer would pay the real-time market clearing prices within PJM applicable to its location as well as a capacity payment to satisfy PJM's capacity obligation. Duquesne Light also proposed a Fixed-Price Default Service ("FPDS") under which default service rates would be fixed for a one-year period.

Q. DID THE COMMISSION APPROVE THE POLR III PLAN?

A. In part. The Commission approved Duquesne Light's POLR III Plan with certain modifications. *Petition of Duquesne Light Company for Approval of Plan For Post-Transition Period Provider of Last Resort Service,* Docket No. P-00032071, Order entered August 23, 2004 ("*POLR III Order*"). Of importance here, the Commission limited the term of the POLR III Plan to three years. While the Commission did not adopt a six-year term, the Commission did find that Duquesne Light's proposed rates for the first three years were consistent with prevailing market prices. In finding that

Duquesne Light's proposed rates were market based, the Commission relied on Duquesne Light's testimony regarding recent supply auctions in a neighboring jurisdiction in PJM and evidence presented by the Office of Consumer Advocate that several market price analyses in the record supported the proposed rates.

In addition, the Commission approved Duquesne Light's plan to offer both HPS and FPDS to Large C&I customers. The Commission modified the structure of the POLR III proposal to make HPS the default option and ordered that FPDS terminate as a default service option on May 31, 2007. (Reconsideration Order entered October 5, 2004.)

Q. WHAT IS THE STATUS OF THE COMMISSION'S DEFAULT SERVICE REGULATIONS?

A. In late 2004, the Commission commenced a rulemaking proceeding to adopt default service regulations. *Rulemaking Re Electric Distribution Companies' Obligation to Serve Retail Customers at the Conclusion of the Transition Period Pursuant to 66 Pa. C.S. § 2807(e)(2),* Docket No. L-00040169 (Order entered December 16, 2004). Proposed regulations were published in the Pennsylvania Bulletin on February 26, 2005 and the public comment period concluded on June 27, 2005. The Independent Regulatory Review Commission ("IRRC") issued its comments on the proposed regulations on July 27, 2005. On November 10, 2005, the Commission issued an Order reopening the public comment period for the proposed default service regulations to receive comments regarding the interaction of default service with the Alternative Energy

Portfolio Standards Act of 2004 ("AEPS") and the mandates of the Energy Policy Act of 2005, as well as specific issues raised by IRRC.

On March 8, 2006, Duquesne Light submitted Comments in accordance with the Commission's schedule. In its Comments, Duquesne Light expressed its concerns with the proposed default service regulations, and especially the provisions that would adopt a competitive wholesale solicitation process as the only model for procuring default supply service and determining default service prices. Duquesne Light noted the recent experience of Pike County Light & Power where default prices rose 129%, high prices resulting from auctions in New Jersey and Delaware, and Duquesne Light's success in two post-transition default service plans as support for its position. Duquesne Light proposed that the Commission incorporate greater flexibility in its regulations for both pricing of default service and the acquisition of default supply. Duquesne Light also commented that if default service regulations are adopted, they should not be made effective until 2011, when the transition periods of other major electric distribution companies expire. In addition, Duquesne Light commented on the questions specifically identified by the Commission.

On April 7, 2006, Duquesne Light filed Reply Comments. In its Reply Comments, Duquesne Light urged the Commission not to apply regulations prior to 2011 when all major EDCs had emerged from rate caps. Duquesne Light also requested that the Commission provide flexibility with respect to alternatives for how: a) default suppliers acquire supply, b) prevailing market prices are established, and c) costs are reconciled.

Duquesne Light commented that flexibility was especially important because wholesale and retail market development is an evolving process.

At this time, the Commission has not issued any further order with regard to its proposed default service regulations.

III. POLICY CONSIDERATIONS AND DEFAULT SERVICE SUPPLY OPTIONS

Q. AS AN INITIAL MATTER, IS DUQUESNE LIGHT'S DEFAULT SERVICE PLAN INTENDED TO ESTABLISH PRECEDENT FOR OTHER EDCS?

A. No. Duquesne Light's Default Service Plan is not intended to establish a precedent for the rest of Pennsylvania, but rather is an interim plan intended to bridge the gap between when POLR III expires on December 31, 2007, and January 1, 2011, when all Pennsylvania EDCs will no longer be subject to rate caps.

Q. WHAT WERE THE IMPORTANT POLICY CONSIDERATIONS ASSOCIATED WITH DEVELOPING THE DEFAULT SERVICE PLAN?

A. We considered several important policy issues in developing our proposed Default Service Plan. Two of the most important issues were: (i) the effect of the plan on competition, and (ii) the level of price certainty and rate stability provided by the plan for different customer groups. Other important considerations included the risks to be assumed by Duquesne Light, the transitional nature of the filing, the impact of legacy rate designs and conservation.

Q. CAN THERE BE TENSION AMONG THESE POLICY CONSIDERATIONS?

A. Yes. For example, customers may prefer a lower rate for default service, but such rates may provide less opportunity for EGSs to compete to serve retail customers and less opportunity for the default service provider to be compensated for the risks assumed in procuring default supply and providing default service. Similar concerns arise in considering the time period for setting default prices. A longer term, fixed rate plan provides more price certainty and less price volatility for customers but can increase risk to the default supplier and can, in certain circumstances, inhibit the development of retail competition.

Q. ARE THERE RISKS ASSOCIATED WITH PROVIDING LONG-TERM, FIXED RATE DEFAULT SERVICE OPTIONS?

A. Yes. Long-term arrangements to supply default service at fixed prices provide increased certainty and predictability of electric rates for customers; however, they also, by their nature, involve increased risks for the default service supplier. The wholesale electric markets can be quite volatile. Price volatility poses significant risks for any supplier that commits to sell electricity at a fixed price, as Duquesne Power is doing in this proceeding. Moreover, the risks associated with price volatility increase with a longer-term arrangement.

Q. WHAT OTHER CONSIDERATIONS WERE IMPORTANT TO DUQUESNE LIGHT IN DESIGNING ITS DEFAULT SERVICE PLAN?

A. Duquesne Light also was cognizant of the different characteristics of, and circumstances facing, our small and large customer groups. There is more competition by EGSs to serve Large C&I customers than Residential and Small C&I customers and, in addition, larger customers generally are better able to weigh the benefits and risks of various power supply options. For these reasons, we have proposed significantly different default service plans for these different customer groups.

Finally, in developing the Default Service Plan, we gave significant consideration to the fact that the majority of electric customers in the Commonwealth are still under rate caps until 2011 and that Duquesne Light's existing rates have certain legacy features that require some continued rate design measures to avoid individual customer rate dislocation.

Q. HOW DOES DUQUESNE LIGHT'S DEFAULT SERVICE PLAN ADDRESS THESE POLICY CONSIDERATIONS?

A. Duquesne Light's Default Service Plan is designed to fairly balance the policy considerations outlined above in light of the circumstances faced by Duquesne Light at this time. This does not mean that our Plan has generic applicability to other utilities in the Commonwealth or the state-wide rules for post-transition period default service that the Commission will ultimately adopt. Rather, Duquesne Light's Default Service Plan

addresses the particular circumstances it faces and the fact that most EDC rates in Pennsylvania will continue to be subject to rate caps until 2011.

IV. DEFAULT SERVICE PLAN

Q. PLEASE SUMMARIZE THE RATES PROPOSED BY DUQUESNE LIGHT IN THIS PROCEEDING?

A. The proposed average supply rates are presented in Mr. Pfrommer's testimony as Exhibit WVP-3. Under the Plan, the average supply rate for Residential Rate RS customers would increase by 17.6%, as compared to current POLR III levels. The average supply rate for Small C&I Rate GS/GM customers would increase by 13.6%. On the same basis, the average supply rates for Lighting customers would increase by 29.5%. As explained by Mr. Pfrommer, Duquesne Light's POLR III supply rates include ancillary service charges and PJM administrative charges. The Company is proposing to recover these costs in its retail transmission rates. However, in order to provide comparable figures, the rate comparisons set forth above include ancillary service and PJM administrative costs in the supply rates.

Q. HOW WERE THESE RATES DEVELOPED?

A. In order to establish the proposed fixed rate levels for Residential and Small C&I customers, Duquesne Light reviewed the market price results of recent solicitations to supply full requirements default service. Mr. Fisher describes the solicitations that were reviewed and the analysis of the results in his testimony. As part of this analysis, Duquesne Light considered relevant market information (including Duquesne-specific

customer load patterns and differences in Duquesne Zone market prices) as well as potential rate impacts for certain customer classes. The rate design and rate impact issues considered are described in Mr. Pfrommer's testimony.

Q. HOW DID DUQUESNE LIGHT BALANCE THE POLICY CONSIDERATIONS DESCRIBED IN SECTION III OF YOUR TESTIMONY?

A. As noted in Section III above, important policy issues that were considered in developing the Default Service Plan include promoting competition, providing price certainty and rate stability for Residential and Small C&I customers, providing an effective transition from the POLR III plan to 2011 when generation rate caps for the majority of customers in the Commonwealth expire and eliminating legacy rate designs that do not encourage conservation. The Default Service Plan effectively balances these important considerations.

The Default Service Plan promotes competition for Residential customers by setting default rates to reflect prevailing market prices and eliminating declining energy blocks over a three-year period. By setting rates to reflect prevailing market prices, marketers will have a better opportunity to serve these customers. Eliminating declining energy blocks should also promote competition. By 2010, Duquesne Light will have a single energy rate for all Residential customers. This simplified rate structure should promote competition by making it easy for marketers and customers to compare rate offers.

At the same time, the Default Service Plan balances the need for price certainty and rate stability for Residential customers by providing fixed rates for the three-year period 2008 through 2010. The Plan also serves as an effective transition for Residential customers to 2011 by raising rates to prevailing market levels to mitigate potential rate shock and eliminating declining energy blocks for residential heating customers over a three-year period. Eliminating declining energy blocks also encourages conservation.

For Small C&I customers, the Plan promotes competition by setting rates to reflect prevailing market prices, annually adjusting the rates based upon a market index, eliminating declining energy blocks and supply related demand charges and creating a single energy rate for all usage over a three-year period. By setting rates to reflect prevailing market prices, marketers should have a better opportunity to serve these customers because the proposed rates are higher than current rates under the POLR III plan. In addition, by making annual adjustments to rates, marketers have assurance that the rates will change with market conditions. Eliminating declining energy blocks and demand charges should also promote competition. By 2010, Duquesne Light will have a single energy rate for all Small C&I customers. This should promote competition because it will make it easier for marketers and customers to compare rate offers.

At the same time, the Plan balances the need to provide price certainty and rate stability to Small C&I customers by fixing rates over one-year terms. The Plan also serves as an effective transition to 2011 by raising rates to reflect prevailing market prices,

eliminating declining energy blocks and eliminating demand charges. Eliminating declining energy blocks also promotes conservation.

The weighting of policy considerations is somewhat different for Large C&I customers than for the other customer classes. Large C&I customers are generally better prepared to make informed supply decisions and do not require the same level of price stability as Residential and Small C&I customers. Moreover, competition for these customers is the most robust. As of December 2006, approximately 98% of the Large C&I customer load in Duquesne Light's service territory was shopping with a competitive supplier. Duquesne Light, therefore, proposes to offer hourly priced default service to these customers with no fixed price service. Pursuant to the Commission's Reconsideration Order entered on October 5, 2004 in the POLR III proceeding, Duquesne Light's fixed price service for Large C&I customers expires on May 31, 2007. After May 31, 2007, Duquesne Light proposes to rely on EGSs to offer these customers fixed price service.

Q. IS IT POSSIBLE, HOWEVER, THAT SOME LARGE CUSTOMERS WOULD PREFER FIXED RATES AS ARE BEING OFFERED TO SMALL CUSTOMERS?

A. Yes, that is certainly possible. However, it has proven difficult for Duquesne Light to offer a fixed price service in a manner that is attractive to Large C&I customers. Recent competitive solicitations conducted by Duquesne Light attracted few bidders and customers did not elect the resulting fixed price service. If a Large C&I customer desires fixed rates, it can negotiate such an arrangement with an EGS and structure that arrangement to meet its particular needs.

Q. PLEASE DESCRIBE OTHER WAYS THE DEFAULT SERVICE PLAN PROMOTES COMPETITION.

A. The Plan also implements other important market enhancement measures which are designed to promote competition and apply to more than one customer class. Under the Plan, Duquesne Light is implementing a POR program under which Duquesne Light has agreed to purchase the accounts receivable, without recourse, associated with EGS sales of retail electricity to Residential and Small C&I customers in Duquesne Light's service territory. Duquesne Light will purchase the accounts receivable at a small discount and then seek to recover EGS receivables from customers consistent with Duquesne Light's existing collection procedures.

The POR program should promote competition for these customers because it will eliminate EGSs' risks of serving payment troubled customers and allow EGSs to expand their markets without incurring costs associated with upfront credit analysis of customers, collection activities or uncollectible accounts in the event of non-payment. Under the POR program, EGSs cannot reject customers based on credit-related issues. This should promote access to competitive options for customers that might otherwise not be served by EGSs.

Duquesne Light has implemented other important market enhancement measures that are designed to promote competition. Duquesne Light will strengthen enforcement of its Code of Conduct by requiring key employees to annually commit in writing that they will follow its terms. This will benefit marketers by ensuring that Duquesne Light will not

provide preferential treatment to its affiliates. In addition, as agreed to in its last rate case, Duquesne Light will convene multiple meetings each calendar year with EGSs to facilitate market development. This should also promote competition by providing an avenue for EGSs to communicate their concerns about market development. Pursuant to the rate case Settlement, Duquesne Light has also reviewed its cost allocation procedures and has determined that its cost assignment and allocation practices properly allocate costs between its regulated business and its unregulated businesses and that it has protections in place to separate regulated and unregulated business activities. This promotes competition because it ensures that Duquesne Light is not subsidizing its affiliated EGS, Duquesne Light Energy.

Q. HOW WILL DUQUESNE LIGHT ACQUIRE THE POWER NECESSARY TO SUPPLY DEFAULT SERVICE TO RESIDENTIAL AND SMALL C&I CUSTOMERS?

A. Duquesne Light will procure supply for residential and Small C&I customers through a full requirements contract with its affiliate, Duquesne Power. The Commission has already approved this basic supply agreement for the 2008-2010 period between Duquesne and Duquesne Power in its *POLR III Order*:

> Duquesne has also requested approval of the Duquesne – Duquesne Power supply arrangements as an affiliated interest agreement pursuant to Section 2102(b) of the Code...We agree that the affiliated interest agreement for supply arrangements is in the public interest and we will approve that agreement as required by Section 2102(b) of the Code. In doing so, we acknowledge that the term of the power supply agreement extends beyond the term of the Small Customer Plan as approved herein. As we have discussed at length, nothing in this Opinion and Order prevents Duquesne from seeking to recover market based prices for energy acquired for POLR supply subsequent to the term mandated herein. (*POLR III Order*, p. 53.)

Furthermore, the Federal Energy Regulatory Commission has already granted Duquesne Power the authority to establish market-based rates and has already granted a waiver of the affiliate sales prohibitions and code of conduct requirement. (FERC Order Authorizing Disposition of Jurisdictional Facilities and Accepting Market-Based Rate Tariff, Docket EC04-36-000, August 6, 2004).

Under the Default Service Plan, Duquesne Light will amend its contract with Duquesne Power to update the prices that are paid for power and to make other minor modifications that are necessary to implement the Plan. After the amendments are finalized, Duquesne Light will submit the updated agreement to the Commission for review and approval in this proceeding. Because the Commission has previously approved the form of the agreement and the modifications are minor, Duquesne Light does not anticipate that this agreement will be controversial.

In addition, as a part of this Plan, Duquesne Power has agreed to rely on competitive wholesale market purchases in PJM to obtain 100% of its supply obligations for Duquesne Light's customers. In order to acquire electricity at prevailing market prices, Duquesne Power may enter into bilateral contracts with third party suppliers, conduct RFPs, and/or purchase spot electricity in the competitive wholesale market. Duquesne Power will assume market price, regulatory approval, customer switching, load following and other regulatory and business related risks associated with providing fixed price default service supply. Duquesne Power also will procure alternative energy credits in order to comply with AEPS.

Q. DUQUESNE LIGHT IS HOLDING ITS FIXED-RATE OFFER FOR RESIDENTIAL AND SMALL C&I CUSTOMERS OPEN DURING THE REGULATORY APPROVAL PERIOD. WHY IS THAT?

A. We believe that this approach gives the Commission the best information upon which to base its decision. Rather than have the Commission approve a solicitation process with an uncertain future outcome, Duquesne Light has developed rates that are known at the time of this filing. The Commission and the parties in this proceeding will have adequate time to evaluate these rate levels and consider the impact on customers and retail competition. Duquesne Power, and not retail customers, bears the risk of market price movements between now and the time this Plan is approved. This is a significant difference between Duquesne Light's Default Service Plan and solicitation processes recently conducted in Maryland and New Jersey. Duquesne Light, therefore, developed rates that would adequately compensate for all risks being undertaken, including the risk of changes in market prices during the regulatory approval period. However, because of this risk, Duquesne Light is requesting expedited approval of the Default Service Plan.

Q. ARE THOSE RISKS SIGNIFICANT?

A. Yes. As discussed by Mr. Fisher, Duquesne Power faces a wide range of risks, including changes in prices, quantity, length of regulatory review period, changes in load shape due to shopping, and other risks in agreeing to provide full requirements, default supply for Duquesne Light's customers. The risks are built into the prices proposed in the Default Service Plan. This is appropriate, in my view, because it provides fixed rates for

customers, and all else equal, results in somewhat higher prices which will further promote retail competition.

Q. WHAT PREMIUM IS DUQUESNE POWER PROPOSING TO CHARGE TO COVER THE COSTS AND RISKS ASSOCIATED WITH HOLDING ITS FIXED PRICE OPEN DURING THE REGULATORY REVIEW PERIOD?

A. In exchange for being the supplier in Duquesne's Default Service Plan, Duquesne Power is willing to provide this benefit for a charge of 0.3 cents per kWh for Residential customers and 0.15 cents per kWh for Small C&I customers. While the length of the regulatory review period is expected to be the same for both customer classes, the level of risk is greater for Residential customers than for Small C&I customers due to the longer term of the fixed price commitment.

Q. DID DUQUESNE LIGHT CONSIDER PURCHASING POWER FOR DEFAULT CUSTOMERS THROUGH A STRUCTURED SOLICITATION PROCESS LIKE THAT USED IN EITHER MARYLAND OR NEW JERSEY?

A. Yes. Duquesne Light considered obtaining default supply through a solicitation process but believes that its proposal is better than a solicitation process at this time. Many prior solicitation processes have had little or no success or have resulted in very significant rate increases for customers. As mentioned above, Pike County Light & Power Company conducted an auction to set default service rates which resulted in a 129% increase in generation rates. Also, as mentioned by the Commission in its Investigation Order entered May 24, 2006, in *Policies to Mitigate Potential Electricity Price Increases*,

Docket No. M-00061957, in Delaware, Delmarva Power Company residential customers faced a 59% rate increase on May 1, 2006, and in Maryland, residential customers of Baltimore Gas & Electric Company faced a 72% increase in electric bills on July 1, 2006, subject to deferral through a rate stabilization plan.

Likewise, as discussed by Mr. Fisher, Duquesne Light conducted a competitive RFP process three times for Large C&I customers – in October 2004, March 2006, and May 2006. The first RFP process received six bids, most of which offered to supply only a limited number of tranches. The second RFP conducted in March 2006 resulted in no bids from any suppliers at any price. The Commission in its May 4, 2006 Order then made several changes to the RFP process in order to make the product more attractive to potential bidders and encourage supplier participation. Even after these changes, Duquesne Light only received one bid, and that was from its affiliate, Duquesne Power. As this demonstrates, there is considerable uncertainty in the outcome of a solicitation process, not only as to rates but as to the number of bidders. In addition, if Duquesne Light were to implement a structured solicitation procurement process to obtain power, this would create additional implementation costs that would need to be recovered from customers. In this regard, a solicitation process to obtain default supply may make more sense in 2011 as procurement processes and documents become more standardized and markets continue to develop. Duquesne Light is currently participating in a Commission working group to address the potential for developing standardized procurement processes and documents for the entire Commonwealth.

Q. UNDER THE DEFAULT SERVICE PLAN, DOES DUQUESNE LIGHT PROPOSE TO RECONCILE THE COSTS ASSOCIATED WITH MEETING NEW REQUIREMENTS RELATED TO RENEWABLE SUPPLY OR PJM CAPACITY REQUIREMENTS?

A. No, Duquesne Light proposes to fix the supply rates without reconciliation for Residential and Small C&I customers. This will provide greater rate certainty to both customers and EGSs that wish to market to customers. The only market adjustment the Company proposes is the annual adjustment to Small C&I customer rates that is described by Mr. Fisher.

Q. IS DUQUESNE REQUESTING ANY ADDITIONAL APPROVALS FROM THE COMMISSION?

A. Yes. When Duquesne Light submitted its Comments and Reply Comments on the Commission's proposed default service regulations, Duquesne Light suggested that if the Commission adopts final default service regulations, they should not be made effective until 2011 when rate caps for all EDCs in the Commonwealth expire. As Duquesne Light commented, it is concerned that until the transition period has ended for all EDCs, the market for acquiring default service energy may not be fully functional. However, in the event that the Commission approves final default service regulations prior to the expiration of the Default Service Plan, Duquesne Light respectfully requests that the Commission order that the regulations will not apply to the Default Service Plan because it was filed prior to the effective date of the regulations.

Duquesne Light is also requesting that the Commission approve the POR program and any waivers that may be necessary for Duquesne Light to implement this program as filed. The waivers requested by Duquesne Light with respect to the POR program are described in further detail in the testimony of Ms. Krajovic.

In addition, as explained above, Duquesne Light is updating its power supply contract with Duquesne Power in order to procure supply to serve Small C&I, Residential and Lighting customers. Duquesne Light will submit that contract to the Commission when the amendments are finalized and requests that the Commission approve the power supply contract in this proceeding.

Q. DOES THIS CONCLUDE YOUR TESTIMONY AT THIS TIME?

A. Yes.

Exhibit MKO-1

Morgan K. O'Brien

Education

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

Employment History

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

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

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

Deloitte & Touche – Senior Manager, 1986-1990.

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

Outside Affiliations

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

DUQUESNE STATEMENT NO. 2

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

RECEIVED
JAN 25 2007
PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

DIRECT TESTIMONY OF FREDERICK J. EICHENMILLER

Dated: January 25, 2007

DIRECT TESTIMONY OF FREDERICK J. EICHENMILLER

Q. Please state your full name and business address.

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

Q. What is your position at Duquesne Light Company?

A. I am currently employed as the Director of Rates and Regulatory Affairs.

Q. How long have you worked at Duquesne Light?

A. I have been employed by Duquesne Light Company ("Duquesne" or "the Company") for over 33 years.

Q. What are your qualifications and educational background?

A. I have a Bachelor of Science Degree in Electrical Engineering from Grove City College, and I am a graduate of the Management Program for Executives from the Katz Graduate School of Business at the University of Pittsburgh. I am a licensed professional engineer in the Commonwealth of Pennsylvania.

Q. What has been your business experience?

A. I began my career as an electrical engineer with Duquesne in 1973, and I have over 33 years of varied experience in line, staff and administrative positions. I have held line positions related to almost all aspects of the distribution engineering, operations, and operations support functions.

In addition, from 1987 to 1989, I served as Executive Assistant to the President, CEO and Chairman of Duquesne. Subsequently, I held the position of Director of Operations Support, which provides supply chain (purchasing and materials management), transportation and fleet management, and facilities management services for the Company. Since then, I have held management and leadership responsibilities for key processes that have direct impacts on system reliability and customer satisfaction. Specifically, as Director of Work Management and as Director of Operations and Underground, I have been responsible for the company's work management processes, including operations and maintenance management, construction, engineering, and vegetation management. In these positions, I had oversight of the company's service centers located in communities throughout the Duquesne service territory. In 2004, I assumed my current position as Director of Rates and Regulatory Affairs.

Q. Please describe your current responsibilities as the Director of Rates and Regulatory Affairs?

A. I am responsible for the oversight and direction of activities related to Duquesne's rates and regulatory matters. My primary responsibilities are to assure continued compliance with regulatory requirements, and to ensure that regulatory issues and strategies are appropriately considered and deployed in Duquesne's business plans. More recently, I have been responsible for the development, oversight and direction of Duquesne's recent distribution rate case filed at the Pennsylvania Public Utility Commission ("Commission") and Duquesne's transmission rate

case filing at FERC. Finally, I am also responsible for certain aspects of the planning, oversight and direction of Duquesne's filing in this proceeding ("Default Service Plan" or "Plan").

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to describe the key features of Duquesne's Default Service Plan that will support the further development of the competitive market, and to summarize how the Plan reflects the input and concerns of various stakeholders, including customers and competitive electric generation suppliers ("EGS"). Additionally, I will discuss what measures and initiatives Duquesne has implemented in support of conservation and demand side response efforts.

Q. Please summarize your main conclusions?

A. For the 2008-2010 period, Duquesne is proposing significant steps to continue the successful development and further promotion of retail competition in its service area. In developing its Default Service Plan, Duquesne has undertaken an extensive effort to meet with the parties to develop a Plan that balances the interest of customers, EGSs and Duquesne. Additionally, Duquesne is making a commitment as part of this filing to enhance the communication and enforcement of its code of conduct with its employees.

Q. Do you recommend that the default service structure outlined in Duquesne's Plan should be used to set a precedent for default service in Pennsylvania?

A. No. This plan is not intended to set precedent. It is a plan specifically designed to transition Duquesne, its customers, and other market participants, to the time when generation rate caps expire for other major Pennsylvania electric utilities. The Plan also is specifically tailored for the level of market development experienced in Duquesne's service territory, and may not be appropriate for other electric distribution companies.

Q. Does the Plan represent your recommendation for the structure of default service in a fully developed competitive retail market?

A. Because the retail market in Pennsylvania is not yet fully developed, this plan is designed to be an "interim," or "transition" plan, and not necessarily a final plan for default service in a fully developed competitive retail market. Interim plans (e.g., POLR II and POLR III) have been adopted in Duquesne's service territory since Duquesne's generation rate caps expired in 2002 for most customers. Each interim plan involved resetting supply rates to market levels and implementing features that accommodated the needs of customers at that time while supporting the development of the competitive market. The Plan proposed in this proceeding recognizes that the market is still not yet fully developed for all customers. As a result, this Plan was developed in coordination with market participants to move us further along the continuum to a more fully developed retail market.

Furthermore, the Plan provides a default service structure that will be in effect until the end of 2010, when the majority of customers in Pennsylvania will

experience the expiration of their generation rate caps. This will allow more time for both wholesale and retail markets to develop further, and will provide regulators with more time to observe the relative benefits of this Plan and the default service plans adopted outside of Duquesne's service territory.

Unlike most of the state, Duquesne has implemented a variety of successful post-transition period default service plans. Duquesne has the highest level of customer shopping in the Commonwealth, with over 50% of its customer load receiving service from an EGS. As reported by the Office of Consumer Advocate on January 1, 2007, Duquesne's service territory accounts for 95% of the residential shopping load, 81% of the commercial shopping load, and 90% of the industrial shopping load in Pennsylvania. This success was achieved by implementing default service plans, each tailored to the market conditions and particular customer needs at the time. Duquesne's Plan builds on this success and will continue to make progress toward a more competitive retail market.

Q. What features of this Plan support the development of a competitive market?

A. The Plan incorporates several features, which together support the development of the competitive market for all customer classes.

With respect to large C&I customers, who have demonstrated the ability to participate in a retail market, the default rate will reflect hourly market prices. As a result, large C&I customers will be provided direct market signals and EGSs

will have substantial opportunities to offer fixed rate services, or other types of services, to these customers. Consistent with the Commission's POLR III Order, as of June 1, 2007, Duquesne will not provide a fixed rate offering for large C&I customers. As of December 2006, approximately 98% of large C&I customer load in Duquesne's service territory is already shopping with an EGS, and Duquesne's efforts to obtain a reasonable fixed price for these customers using a solicitation process has proven to be difficult.

With respect to small C&I customers, for whom the retail market is not yet fully developed, the Plan incorporates substantial steps to further competition. Small C&I customers' rates are reset to prevailing market levels for calendar year 2008, and will be further adjusted in 2009 and in 2010 by a market index that reflects subsequent changes in market prices. This will provide EGSs with an increased opportunity to compete for these customers, while not exposing small C&I customers to short-term market price fluctuations that they may not be equipped to handle. The Plan also modifies the small C&I rate structure by eliminating all supply related demand charges and below market declining energy blocks so that by 2010 there will be a single energy rate for all small C&I customers. This will simplify price comparisons with EGS offerings, thereby promoting competition.

With respect to residential customers, for whom the market is the least developed, the Plan provides the greatest amount of price stability, while still promoting competition. Under the Plan, residential customer rates are reset to market levels,

thereby providing EGSs further opportunities to compete for these customers. The Plan also modifies the residential rate structure by phasing out below market declining energy blocks for residential heating customers, so that by 2010 there will be a single energy rate for all residential customers. Again, this will simplify price comparisons with EGSs and promote customer shopping.

In another significant step to further develop the competitive market for residential and small C&I customers, Duquesne negotiated with EGSs, customer groups, and other parties a new purchase of receivables ("POR") program, whereby Duquesne will offer to purchase the receivables of EGSs serving residential and small C&I customers. This will allow EGSs to more easily market to low-income and poor-credit customers and eliminate the uncertainty surrounding their credit and collection activities. Likewise, this program should also provide customers with greater access to competitive markets. All parties in the distribution rate case (plus Dominion Retail) have agreed to support or not oppose this negotiated POR program, and the supporting parties consider it to be a significant and important positive step forward. Duquesne witness Ms. Krajovic describes the POR program in greater detail in her testimony.

Finally, as I will explain later, Duquesne has committed to strengthen its code of conduct related to interactions and communications between Duquesne and its unregulated affiliates, Duquesne Energy ("DLE") and Duquesne Power.

Q Please describe the actions that the Company took to ensure that various stakeholders had the opportunity to participate in the development of the Plan?

A. Duquesne made a formal commitment, as part of its settlement of its most recent distribution rate case, to provide certain stakeholders an opportunity to actively participate in the development of the Plan in advance of the filing. The Company has met this commitment and, in fact, Duquesne has gone far beyond the terms of the settlement.

To ensure that the input of customers was considered in the development of the Plan, Duquesne met with and had phone conversations with advocates and certain customers during various stages of its development.

In order to ensure that the input of the EGSs was considered, Duquesne, over a period of five months prior to this filing, worked closely and at length with several EGSs to develop the framework of the Plan. Duquesne committed to a series of meetings with several EGSs to discuss the framework and features of the Plan. The Company also held a collaborative session on October 19th, and invited all active and licensed EGSs in its service territory to attend and express their opinions about the appropriate default service for 2008-2010.

In summary, Duquesne and other stakeholders have collectively invested significant time and resources in the development of this Plan.

Q. What input and concerns were communicated to Duquesne by customer stakeholders?

A. There was no clear consensus among customers and customer advocates regarding the structure of the Plan. As a result, and because different types of customers have different needs, the Plan's default service structure differs across the different types of customers.

With that said, there was a recurring theme on several issues:

(1) Most parties agreed that the 2008-2010 period is an ideal time to implement practices that help customers who do not currently have the ability or sophistication to participate in the competitive market to transition toward such a market.

(2) Most parties expressed concern about exposing customers to short-term market prices or prices set based on a one time solicitation for supply while competitive markets are still developing, instead preferring varying levels of rate stability during the transition to a fully competitive market.

(3) For smaller customers, there was general agreement that declining energy block and demand charges should be eliminated, but that this step should be taken over time to mitigate rate shock for this customer segment.

(4) There was a preference to structure the plan so that residential and small C&I customers are offered separate default service plans tailored to meet their specific needs.

(5) While there was an interest in advanced metering options with time-of-use and/or seasonal rates, these measures should be implemented only if they were optional and did not impose additional costs on customers.

Q. What input and concerns were communicated to Duquesne by EGSs?

A. All of the participants agreed that the Plan must not step backward from the goal of developing a competitive market. The EGSs realized that the Duquesne territory enjoys the highest level of customer shopping in the Commonwealth, although it was also understood that the future of the retail market within the Duquesne service territory is still uncertain. EGSs expressed concern that a poorly-designed default service plan could quickly reverse the progress of the market; so, there was a strong interest to work together toward a plan that promoted retail competition. For example, EGSs asserted that the health of the competitive retail market would be jeopardized if Duquesne provided multiple default service options (e.g., optional time-of-use or seasonal rates) to customers, or if Duquesne promoted its default service. I think it is also fair to say that most of the EGSs we spoke with were primarily concerned with serving large C&I and small C&I customers during the interim period. There were only a few EGSs that expressed significant interest in serving the residential market at this time.

One area that was supported or unopposed by all of the EGSs and other market participants was the development of a POR program.

EGSs also voiced concerns about interaction and information exchange between Duquesne and its unregulated affiliate, DLE. As I will explain later in my testimony, Duquesne has responded to these concerns with strengthened communications of the Code of Conduct Policy.

Finally, EGSs also were very interested in participating in Duquesne-sponsored meetings and/or workshops in conjunction with other EGSs and customers. As I will explain later in my testimony, Duquesne has committed to these types of meetings commencing this year.

Q. Was there a clear consensus among the EGSs regarding specific features that should be included in the Plan in order to enhance competition without jeopardizing the market?

A. No. There are many differing points of view and opinions on certain aspects of the Plan. There was no clear consensus about specific aspects of the Plan. For example, some EGSs recommended that default service supply be acquired through an RFP or an auction. Other EGSs strongly opposed this type of procurement process, especially if it involved a laddering of supply contracts entered into at different points in time such that the retail rates, in their view, are not reflective of prevailing market prices at any point in time.

Q. Please identify the specific features of the Plan that were included in response to the input and concerns voiced by stakeholders.

A. While I have already mentioned several features of the Plan that support the development of a competitive market, I will summarize some of the features of Duquesne's Default Service Plan that were included (or not included) in response to the input and concerns voiced by stakeholders.

1. In response to customer-focused stakeholders, Duquesne developed a tailored Plan that reflects the different circumstances, preferences and market conditions faced by different customer groups, e.g., residential, small C&I and large C&I.

2. In response to EGS concerns, and our past experience, we did not propose to continue to offer large C&I customers a fixed rate option. This is appropriate given that 98% of the large C&I load is already shopping, Duquesne found it difficult to obtain fixed prices for these customers in past solicitations, and it is consistent with the Commission's POLR III Order.

3. In response to EGS input that it was important for Duquesne to make further progress toward exposing more customers to shorter-term market price signals, Duquesne decided to reset small C&I customer rates in 2009 and 2010 based on a market price index, so that retail rates for these customers (approximately 55,000 customers) would change from current levels for each year of the three year period.

4. In response to input we received from several parties, and earlier motions filed by Commissioners, Duquesne decided to eliminate declining energy blocks and demand charges over a three-year period and to simplify the Company's supply rate structure.

5. After considerable thought and discussion, Duquesne decided not to propose time-of-use or seasonal rates for residential and small C&I customers at this time due to a lack of consensus among the parties. Consumer groups generally supported such rate offerings only if they were adopted on a voluntary basis and questioned the ability of small customers to respond to such price signals. In general, they supported such measures only if they were economic and did not impose additional costs on customers. Meanwhile, EGSs generally did not want Duquesne to offer multiple default service options to customers, such as seasonal or time-of-use rates. Additionally, with the establishment of the current DSR working group charged with making specific recommendations, Duquesne did not want to start down one path at a time when the Commission may adopt other standards or initiatives. For these reasons, Duquesne chose not to undertake these potentially expensive initiatives at this time.

6. In response to certain EGSs, the Company agreed to implement a POR program whereby Duquesne will purchase EGS receivables for residential and small C&I customers. In response to small consumer advocates,

Duquesne agreed not to terminate or disconnect service under the POR program if a customer failed to pay EGS charges in excess of the default service rates.

7. In response to EGS concerns about the interactions and communications between Duquesne and its unregulated affiliate, DLE, Duquesne has taken several actions that will be discussed later in the Code of Conduct comments.

8. Duquesne, as agreed to in its distribution rate case settlement, has submitted in this case an analysis addressing whether any portion of its operations is subsidizing its unregulated affiliates. As part of this analysis, Duquesne has made several improvements in the method it uses to allocate costs among its affiliated companies. This analysis and improvements in cost allocation procedures are described in the testimony of Duquesne witness Susan S. Betta.

9. In response to EGS concerns about Duquesne service to EGSs and communication with C&I customers, Duquesne agreed, as a part of its distribution rate case settlement, to conduct a series of meetings to improve communications among market participants. Duquesne will convene one meeting per calendar year among Duquesne, all interested EGSs, and interested C&I customers to discuss customer choice issues.

Duquesne also will convene semi-annual service meetings with interested EGSs, and include participation from Duquesne's Supplier Service Center and the operational personnel of EGSs that are serving customers in Duquesne's service territory, to discuss retail supplier issues.

10. In response to certain EGSs, 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 purchases in the short-term market.

11. Also as agreed to in Duquesne's distribution rate case settlement, Duquesne will utilize a consolidated billing program, which accepts "rate ready" bill information from participating EGSs.

Q. **Has Duquesne reached any specific agreement with any parties regarding its Default Service Plan?**

A. Yes. After several meetings and extensive discussions with several parties, Reliant Energy and Dominion Retail have agreed to support the basic structure of Duquesne's Default Service Plan. I would also note that we are continuing

discussions with other interested parties and expect to enter into further agreements with other parties as this case proceeds.

Q. Please discuss Duquesne's commitment to its Code of Conduct?

A. During the early stages of discussions with EGSs, it became apparent that there were misperceptions and concerns about interaction and information exchange between Duquesne's employees and its unregulated affiliate DLE , and specifically, communication between major account representatives and DLE.

These discussions provided us with an opportunity to discuss and subsequently strengthen the level of communications and commitment to the Code of Conduct in key areas of the company. Duquesne has met with management of key areas that have regular communications with customers and with EGSs. These key areas include Duquesne's Supplier Service Center, Information Technology (IT) Application Unit and Major Account Representatives who have relationships with larger customers in Duquesne's service territory. This year, Duquesne management in each of these areas will review the revised Code of Conduct Policy and have each employee in those areas sign a letter committing to the terms of the policy. This process will be conducted on a regular basis each year and assures key employees will be reminded of and commit in writing to the principles of the Code of Conduct.

Q. What are the responsibilities of Duquesne's Major Customer Account Representatives?

A. Duquesne's account representatives assist commercial and industrial customers in determining how to best integrate their physical installations into Duquesne's physical transmission and distribution ("T&D") plant, including the application of the T&D tariff requirements. They also provide support for all account maintenance and billing issues. Account maintenance issues include mailing and billing address changes, facilitating account ownership changes, etc. Billing issues include estimated and corrected billing reconciliation. In addition, the account representatives provide around-the-clock support for these customers during unscheduled interruptions.

Q. Where are the offices of the Duquesne account representative located?

A. The Duquesne account representatives' offices are located at various Duquesne facilities throughout our service territory, but none are physically located at the Company's headquarters at 411 Seventh Avenue. Therefore, the Duquesne account representatives are not physically located in the same building as the employees of either DP or DLE

Q. Does Duquesne market or otherwise promote default or POLR service, or promote its affiliate EGS, DLE by providing any preference or advantage over any other EGS?

A. No, in accordance with the Commission's Order in Duquesne's POLR III proceeding, Duquesne employees are not permitted to, and they do not market or promote default or POLR service, or promote DLE by providing it with any preference or advantage over any other EGS.

Q. Has Duquesne considered any energy conservation programs proposed by outside parties in this proceeding?

A. Yes. In the Settlement of its last distribution rate proceeding, Duquesne agreed to evaluate the proposals of other parties relating to energy conservation and education, time of use metering and economic development and to make proposals deemed by Duquesne to be appropriate as to such matters in this default service filing. In that proceeding, Citizens For Pennsylvania's Future made certain proposals related to these topics.

Duquesne has considered the issues and does not believe that it is appropriate to make those additional proposals in this proceeding. With regard to energy conservation and education, Duquesne is contributing $6 million to fund renewable energy projects and/or energy efficiency education projects in its service territory from 2007 to 2010. As also explained in later testimony, Duquesne has several other programs in place to promote conservation. With regard to economic development, Duquesne is proposing an economic development program in its merger proceeding under which eligible customers

will receive a discount of $3 per MWh below market prices if they create new load or expand existing load and create new jobs.

Also, in its discussions with parties, Duquesne determined that there is a lack of consensus among the parties on these issues. Some parties generally supported such proposals, but only if they were voluntary and did not impose additional costs on customers. Others believed that these types of proposals should not be provided by the default service provider, but by other market participants. In addition, the Default Service Plan is a short term plan. Given the lack of consensus and the short term of the Plan, Duquesne believes that these types of issues may be more appropriately considered on a statewide basis after rate caps for all EDCs have expired. As noted later, the Commission has established a DSR working group to investigate reasonable, cost-effective programs that EDCs, EGSs and other stakeholders can implement to help customers conserve energy or use it more efficiently. Duquesne is an active party in the DSR working group and supports the Commission's efforts to address these issues through a statewide proceeding.

Q. Please describe aspects of the Default Service Plan that address or promote the efficient use of energy and conservation?

A. Duquesne offers large C&I customers (approximately 46% of its total system load) hourly price default service. This service clearly makes these customers

aware of the dramatic price variations that can exist in the market and sends strong market price signals to conserve energy during high priced hours.

In addition, Duquesne's Plan eliminates declining energy blocks and demand charges which are not reflective of market prices and may encourage uneconomic consumption. By eliminating these legacy rate structures, and moving to a single energy charge, customers on these rates will be encouraged to conserve and use electricity more efficiently than under current rates. Likewise, resetting rates to prevailing market prices for residential and small C&I customers, as well as using a market index to adjust small C&I rates on an annual basis also will improve price signals to smaller size customers.

Q. Has Duquesne made any recent commitments to energy conservation in its rate case settlement?

A. Yes. Duquesne also will contribute $1.5 million per year for each of the four years 2007 through 2010 the Pennsylvania Energy Development Authority (PEDA) to fund renewable energy projects that meet the requirements of Tier 1 technologies which include solar energy specified in the Alternative Energy Portfolio Act (Act 213) and/or to fund energy efficiency and energy education projects.

Q. Does Duquesne offer or participate in Load Response Programs with customers?

A. Yes. Duquesne has a real time economic Load Response Program. This voluntary program compensates customers for reducing electrical demand (kilowatts). The program applies to certain Duquesne commercial and industrial customers who have on-site generation or operational flexibility to reduce electrical usage for short periods of time, typically during normal business hours. The Load Response Program seeks to register those customers who wish to be considered for notification and given an opportunity to enter into a demand reduction agreement.

With advanced notice, Duquesne may declare a voluntary load curtailment, when the market price for generation is anticipated to reach a level that makes load reduction economically attractive for both the customer and the Company. Under this voluntary program, customers request to be notified of the opportunity for curtailing electrical load in exchange for financial reimbursement.

Q. Does Duquesne offer any DSR programs to small customers?

A. Yes. Duquesne has a Direct Load Control Pilot Program, offered to residential and small commercial customers who own their home or place of business, have central air conditioning and have no outstanding balance on their Duquesne account. The pilot program was first offered in 2002 and currently allows for enrollment of up to 200 participants.

Q. What are the terms of the program?

A. Under the terms of the program, a load control device is installed on the power supply to participants' air conditioning units. During the program period of June through September, the Company may initiate "events" or interruptions of the air conditioning load for up to four hours when the temperature reaches 85 degrees. These interruptions may last for up to four hours and are limited to no more than eight events over the program period.

Q. Are there benefits for the customers for participating in the program?

A. Yes. Participants receive a monthly bill credit based upon their chosen program option. Under Option A the participants' air conditioners may be interrupted for up to four continuous hours during each event. Option B cycles the air conditioners off for 45 minutes and on for 15 minutes over a period of up to four hours. Participants receive monthly bill credits of $10 or $5 during the program period.

Q. Are there other programs that Duquesne offers customers to educate or help them manage and conserve electricity?

A. Yes. Duquesne has several programs to assist and aid customers with energy conservation. For example, Duquesne just launched a new "Wise-Use Segment" on its website. Duquesne's customers now can receive fast and free advice on how to manage their home energy usage via Duquesne's online Home Energy Calculator. The calculator is one of many helpful tools available on the company's new Home Energy Center. Users answer general questions about their

home, such as the number of people living there, type of windows and temperature setting for the thermostat. Once that information has been inputted, the calculator estimates the monthly and annual energy usage and costs for the customer's home. The calculator automatically factors in local electricity and natural gas prices, providing customers with a direct ability to manage and conserve their energy usage.

The calculator's estimate provides customers with a starting point to compare potential energy-saving measures, such as adjusting thermostat settings, adding double-pane windows, etc. Along with the calculator, the new Home Energy Center offers online tools for estimating energy savings for appliances and lighting, an interactive home designed to help customers understand where and how energy is used and an extensive home energy library.

Other programs/communications Duquesne offers featuring wise-use information include:

1. Customer Newsletter – The Company's "ServiceLine" newsletter, inserted with monthly customer bills, regularly includes wise-use tips that correspond with the season.
2. New Movers Guide – Duquesne's New Movers Guide, which is sent to all consumers moving within the service territory, continues to include information on how to manage energy use wisely. Approximately 30,000 New Movers Guides are issued in a 12-month period.

3. Watt Do You Know? School Program – Beginning in 2002, Duquesne has presented its "Watt Do You Know?" wise energy use program to more than 50 schools, reaching 12,000 students. Targeted to grades 4-6, the program was developed with the following objectives:

   a. Encourage the wise use of energy among elementary and middle school students in order to build lifelong habits.

   b. Heighten awareness of the relationship between wise energy usage and the environment.

   c. Encourage students to share the information with their parents, teachers and, most importantly, one another.

4. Home and Garden Show – Duquesne has incorporated wise use educational materials and exhibits during the 10-day Pittsburgh Home and Garden show that attracts an estimated 350,000 attendees per year. The 2007 show will feature a new hands-on exhibit detailing the difference between compact florescent and incandescent light bulbs.

5. Speakers Team – Wise-use messages are being incorporated into these presentations to community-based organizations and civic groups. This grassroots approach is particularly helpful in reaching the senior audience.

Q. **What do you conclude about Duquesne's Default Service Plan?**

A. Duquesne is committed to the successful development of the competitive market, and is striving to ensure that stakeholders' needs, including EGSs, customers and the environment, continue to be addressed. While there are still considerable

differences of opinion among the parties with respect to whether and how utilities should provide default service in the post-transition period, I believe that Duquesne has proposed a fair and balanced Plan that will continue to support retail competition in a manner that benefits customers in Duquesne's service territory.

Q. Does this conclude your testimony?

A. Yes.

DUQUESNE STATEMENT NO. 3

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

RECEIVED
JAN 25 2007
PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

DIRECT TESTIMONY OF
NEIL S. FISHER

Dated: January 25, 2007

I. Introduction

Q. Please state your name and business address.

A. My name is Neil S. Fisher. My business address is 30 Monument Square, Suite 105, Concord, Massachusetts, 01742.

Q. What is your current position?

A. I am a Principal with The NorthBridge Group ("NorthBridge"), an economic and strategic consulting firm for the electric and natural gas industries. NorthBridge has advised Duquesne Light Company ("Duquesne" or the "Company") on restructuring matters for many years. I have advised Duquesne on supply rate design and rate matters, including issues relating to its provider-of-last-resort service ("POLR" or "default service") since the start of retail access, including Duquesne's pilot, POLR I, POLR II, and POLR III programs.

Q. Please describe your educational and professional experience.

A. I graduated from Swarthmore College with a Bachelor of Arts degree in Economics with Honors. I graduated from Yale University with a Masters in Business Administration. I joined NorthBridge in 1993. Before that, I worked as a consultant at Putnam, Hayes & Bartlett, where I concentrated on electric and natural gas restructuring. As a consultant, I have assisted regulated electric utility clients in several states design default service and prepare for retail access. I have also developed strategies for unregulated retail electric providers interested in participating in retail markets.

Q. Have you testified previously before this Commission?

A. Yes, I testified in Docket A-110150F0035 and A-311233F3002, Duquesne's pending merger application; Docket R-00061346, Duquesne's most recent distribution rate case; Docket P-00032071, Duquesne's Petition for Approval of Plan for Post-Transition Period POLR Service ("POLR III"); and in Docket P-00021969, Duquesne's Petition Requesting Modification to POLR II Plan to Permit Participation in PJM. I also participated in Duquesne's POLR II collaborative led by several Pennsylvania Commissioners.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to:

- Provide support for Duquesne's post-transition period interim default service plan ("Default Service Plan" or "Plan") to offer three types of default service tailored to each customer class:
  1. Hourly supply rates for large commercial and industrial ("Large C&I") customers,
  2. Fixed annual supply rates for small C&I ("Small C&I") customers subject to a market price index adjustment, and
  3. Three-year fixed supply rates for residential customers.
- I also describe how the fixed supply rates were established for residential and Small C&I customers, and.
- Describe the market price index used to adjust the fixed supply rates for Small C&I customers.

Q. Please summarize your conclusions.

A. My main conclusions are summarized below:

- Duquesne's Default Service Plan for the period 2008-2010 represents sound public policy.
- Market evidence demonstrates that the proposed supply rates are based on prevailing market prices and recover reasonable costs.
- Duquesne's methodology to adjust (up or down) its fixed supply rates for Small C&I customers relies on changes in visible market prices that can be measured in a verifiable and objective manner.

Each of these conclusions is described in more detail below.

Q. Are you sponsoring any exhibits?

A. Yes, I sponsor seventeen exhibits:

Exhibit NSF-1	Shopping Levels in the United States by Customer Type
Exhibit NSF-2	Utilities with Hourly Price Default Service for Large C&I Customers
Exhibit NSF-3	Fixed Supply Rate Expiration Dates for Major Pennsylvania Utilities
Exhibit NSF-4	Comparison of Residential Shopping Levels – Duquesne vs. Utilities that Rely on Solicitations
Exhibit NSF-5	Residential Customer Supply Rate Reductions Relative to Restructuring Generation Rate Cap (1996-2010)
Exhibit NSF-6	List of Reviewed Solicitations
Exhibit NSF-7	Comparison of Duquesne's Proposed Rates and the Results of Recent Solicitations
Exhibit NSF-8	Summary of Key Definitional Differences in Recent Solicitations

Exhibit NSF-9	Comparison of Duquesne's Proposed Rates and the Results of Recent Solicitations Adjusted for Definitional Differences
Exhibit NSF-10	Locational Spot Energy Basis Differentials Between Duquesne and Other Utility Zones
Exhibit NSF-11	Comparison of Duquesne's Proposed Rates and the Results of Recent Solicitations Adjusted for Definitional, Locational, and Timing Differences
Exhibit NSF-12	Illustration of Potential Market Price Movements During the Regulatory Review Period
Exhibit NSF-13	Derivation of Class Average Rates
Exhibit NSF-14	PJM Western Hub Electricity Market Prices (1998-2006)
Exhibit NSF-15	Henry Hub Natural Gas Prices (1998-2006)
Exhibit NSF-16	Description of the Market Price Multiplier
Exhibit NSF-17	Duquesne Zone versus PJM Northern Illinois Hub ("NiHub") Spot Prices

II. Duquesne's Default Service Plan Represents Sound Public Policy

Q. Please summarize why Duquesne's Default Service Plan for the period 2008-2010 represents sound public policy.

A. There are five main reasons:

1. Duquesne's Default Service Plan appropriately balances competing interests and objectives.
2. Duquesne's Default Service Plan is tailored to meet the needs of its customers taking into account the different market situations that exist for each customer class.
3. Duquesne's Default Service Plan will continue to promote and further advance retail competition in Duquesne's service area.

4. Duquesne's Default Service Plan provides a "bridge" or "interim plan" to 2011 when generation rate caps for most other Pennsylvania utility customers expire.
5. Duquesne's Default Service Plan will continue to provide residential and Small C&I customers with a safe and reliable source of supply at stable and reasonable rates while retail markets continue to develop.

a) Balances Competing Interests

Q. Explain what you mean by balancing competing interests and objectives.

A. The Pennsylvania Public Utility Commission ("Commission") should balance the interests of customers, Electric Generation Suppliers ("EGSs"), and Duquesne when considering a default service plan. Customers want Duquesne to provide a safe and reliable source of supply at stable and reasonable rates that do not expose them to wholesale market price volatility while competitive retail markets continue to develop. This is especially true for smaller customers (residential and Small C&I customers), for whom there are relatively few opportunities to shop for competitive supply. EGSs generally want market-based default service rates that frequently adjust with changes in market conditions and/or are established at high levels. Such default service rates may allow EGSs to offer price security or may provide significant headroom (i.e., the difference between the retail rate and the market cost to serve), but are less attractive to customers. Duquesne, like other suppliers offering a fixed-price service, seeks adequate compensation for the costs and risks that it assumes on behalf of customers.

The Commission should not be surprised that customers want the lowest possible stable rates or that EGSs want customers to be exposed to default service rates that adjust frequently or that include significant headroom to encourage customers to leave utility default service. The Commission must balance these competing goals.

The ultimate policy question facing the Commission is what form of default service makes the most sense given that a) wholesale electricity markets are and will likely continue to be volatile, b) the vast majority of residential and Small C&I customers remain on default service, c) small customers, especially residential customers, want rate stability and do not want to be exposed to short-term volatile wholesale electric prices, and d) retail markets, especially for smaller customers, have been slow to develop throughout much of the United States.

Q. How does Duquesne's Plan balance these competing interests?

A. Duquesne's Default Service Plan continues to provide rate stability to smaller customers, while expanding market opportunities to more customers in order to promote retail competition.

- For Customers: Duquesne's Default Service Plan continues to provide residential and Small C&I customers with a safe and reliable source of supply at stable and reasonable rates, while gradually exposing more of Duquesne's customers to market prices that change more frequently than they do today. The proposed purchase of receivables ("POR") program

should also expand competitive opportunities to shop, especially to low-income and poor credit customers.

- For EGSs: Duquesne's Default Service Plan continues to promote and further advance retail competition in Duquesne's service area by resetting supply rates to reflect prevailing market prices, eliminating demand charges, eliminating below market declining energy blocks, providing only an hourly price default service for Large C&I customers, beginning to adjust Small C&I rates more frequently, simplifying rate structures and EGS price comparisons, implementing a POR program for residential and Small C&I customers, committing to meet with EGSs and customers during each year, enhancing communication and enforcement of Duquesne's code of conduct, and improving cost allocations among its affiliates.
- For Duquesne and its supplier: Duquesne's Default Service Plan continues to compensate for the costs and risks, including the significant risks assumed by proposing fixed prices for one or three years and holding these rate offers open during the regulatory review period and thereafter.

b) Tailors Plan To Customer Type and Market Situation

Q. Do you support Duquesne's Plan to tailor its default service offering by customer type?

A. Yes. For Large C&I customers (representing over 46% of Duquesne's total system load), Duquesne's Default Service Plan would offer hourly price service (Rider No. 9) as market prices change hour to hour. Duquesne proposes to

eliminate its existing Fixed Price Option (Rider No. 8) and the Generation Rate Adjustment switching rule (Rider No. 23).

For approximately 55,000 Small C&I customers (or 24% of Duquesne's total system load), Duquesne's Plan offers fixed supply rates, but begins to expose these customers to annual market price adjustments. In addition, Duquesne proposes to redesign the rates of Small C&I customers to align the rates more closely with the competitive market by phasing out demand charges and declining energy blocks over the three-year period. These changes, along with the POR program, should expand opportunities for most Small C&I customers to shop for electricity.

For residential customers (representing 29% of Duquesne's total system load), Duquesne's plan offers fixed supply rates like that being offered by most other Pennsylvania utilities through 2010. The fixed supply rates provide rate stability as wholesale and retail markets continue to evolve. A fixed supply rate for residential customers is especially important given the limited competitive retail opportunities provided to these customers in Duquesne's service area. At the same time, Duquesne proposes several market enhancements that should increase opportunities for residential customers to shop for their electricity (including rate simplification, resetting the rates to reflect prevailing market prices, phasing out declining energy blocks and below market energy charges for residential heating customers over the three-year period, and implementing a POR program.)

Q. Do you support Duquesne's proposal to eliminate the fixed price option for Large C&I customers at this time?

A. Yes. This is consistent with the Commission's POLR III order and is appropriate given the current situation in Duquesne's service area. Large C&I customers have more opportunities to shop for competitive supply and are better prepared to make informed supply decisions than residential and Small C&I customers. Large C&I customers throughout the United States and within Duquesne's service area have relatively high levels of retail shopping as compared to smaller customers. See Exhibit NSF-1. In fact, Duquesne appears to have the highest retail shopping rate among Large C&I customers in the country with about 98% of the Large C&I customer load already switched to an EGS.[1]

Duquesne has found it very difficult to obtain fixed price bids at attractive price levels to provide default service supply to these customers using a competitive RFP process. Duquesne conducted a competitive RFP process three times on behalf of Large C&I customers – in October 2004, March 2006, and May 2006. Prior to the issuance of the RFPs, the Company spent considerable time and effort developing RFP guidelines, a supply contract, bid sheets, bidder qualification requirements, and so forth. The first RFP process resulted in six bids, most of which offered to supply only a limited number of tranches. In addition, the bids received included a wide variation in price, with the highest price bid almost twice that of the lowest bid. Few customers elected the resulting fixed rate option. The second RFP conducted in March 2006 resulted in no bids from any suppliers at any price. The Commission in its May 4, 2006 Order then

[1] As of December 15, 2006, there were nine EGSs serving Large C&I customers.

made several changes to the RFP process in order to make the product more attractive to potential bidders and encourage supplier participation. The Commission capped the amount of load eligible for the RFP price to provide greater certainty to potential bidders. If the load exceeded this amount, the winning supplier was allowed to offer another price subject to Commission approval. The Commission also allowed suppliers to adjust the winning bid price for upcoming regulatory changes related to capacity markets (i.e., the PJM Reliability Pricing Model or "RPM"). The Commission allowed Duquesne's affiliate, Duquesne Power, to bid in the RFP. Even after these changes, Duquesne only received one bid and that was from its affiliate, Duquesne Power. In sum, the Company devoted significant time and effort on these RFP solicitations to obtain supply at fixed prices. The RFPs attracted very little interest among bidders, and given the resulting price levels, there was very little interest among customers for Duquesne's fixed price option. As of December 15, 2006, there were only six customers on the fixed price product, which represent less than four MW of non-coincident peak load.

Q. Do other states treat Large C&I customers differently than residential and Small C&I customers?

A. Yes. Differentiating between Large C&I and other customer groups has become increasingly common. In Texas, Large C&I customers greater than one MW were not offered "Price-To-Beat" service. In New Jersey, Maryland, New York and Illinois, large customers are exposed to shorter-term market price signals than are smaller customers. While jurisdictions have different definitions of what

constitutes a "large" customer, "Large C&I customers are generally expected to be well-informed buyers with wide energy procurement experience. As such, some states determined that large C&I customers are more likely to be able to quickly obtain the benefits of retail competition without additional help from state regulators provided in the form of fixed price POLR prices."[2]

Q. Do other utilities offer Large C&I customers hourly price default service?

A. Yes. I am aware of 16 utilities in five states that offer hourly price default service. These are shown in Exhibit NSF-2. Of those, 10 of the 16 utilities offer real-time hourly prices, including those utilities in Maryland, New Jersey, Illinois and Pennsylvania (Duquesne).[3] Given Duquesne's current situation, I believe this type of default service plan will continue to promote retail competition in Duquesne's service area.

Q. Please explain why Duquesne's Default Service Plan treats Small C&I customers differently than residential customers.

A. As Exhibit NSF-1 shows, Small C&I customers in the United States generally have somewhat higher switching levels than residential customers, indicating that Small C&I customers are somewhat more sophisticated about their service options and have more opportunities to shop than do residential customers. As a result, it is appropriate at this stage of market development to provide Small C&I

[2] Draft Report to Congress on Competition in the Wholesale and Retail Markets for Electric Energy, Docket No. AD05-17-000, Electric Energy Market Competition Task Force and the FERC, June 2006, at 87.

[3] Duquesne's program currently appears to have the lowest kW threshold among those utilities offering hourly price default service.

customers with more exposure to market price adjustments, rather than fix their rates for three years. This will further promote retail competition, while not exposing these customers to the same market price movements that Duquesne proposes for Large C&I customers.

Duquesne's Plan attempts to tailor default service by customer type and market situation in a manner that balances the interests of customers and competitive suppliers while further developing retail competition.

c) Continues to Promote and Advance Retail Competition

Q. How does Duquesne's retail access program compare with that of other utilities in the United States?

A. Duquesne has one of the most successful retail access programs in the country. Duquesne has achieved relatively high customer switching rates, as shown in Exhibit NSF-1. Duquesne has the highest percentage of Large C&I customer load switched in the entire United States and the ninth highest percentage of residential load switched in the United States. Within Pennsylvania, the OCA reports that the vast majority of customer load – 95% of residential load, 81% of commercial load and 90% of industrial load – that is currently shopping in Pennsylvania is located in Duquesne's service area.[4]

Many industry observers point to Texas as having the most advanced retail market in the country. According to the most recent Texas commission report on the state of competition, "56% of electricity sold in the competitive market in

[4] Pennsylvania Electric Shopping Statistics, January 1, 2007.

Texas is supplied by providers other than the traditional affiliated REP."[5] By comparison, Duquesne has 54% of its total system load being supplied by competitive suppliers. Of course, the Texas market is certainly much bigger in terms of market size and its ability to attract competitive suppliers, but on a percentage basis, Duquesne is similar to Texas in terms of encouraging customers to shop for their electricity. This is a significant accomplishment.

While some parties may argue that having the utility remain in the commodity business or having the utility offer a fixed price will pose a barrier to retail competition, the fact is, relative to most retail access jurisdictions, Duquesne has developed one of the most successful retail access programs in the United States.

Q. Explain how, and by what standards, you determined that Duquesne has one of the most successful programs.

A. My statement is based on a number of factors, that when considered together, make Duquesne's restructuring program one of the most successful in the United States.

- Duquesne was one of the first utilities in the nation to recover its stranded costs and move to market-based pricing.
- Duquesne provided retail customers with one of the largest rate reductions in the country when it eliminated its competitive transition charge ("CTC").

[5] Report to the 80th Texas Legislature, Scope of Competition in Electric Markets, PUCT, January 2007, at 51.

- Duquesne has achieved relatively high shopping levels in the United States without exposing small customers to significant rate increases, without the use of opt-out customer assignment programs, and without exposing small customers to short-term market price volatility.
- Duquesne was one of the first utilities in the nation to offer hourly pricing to all customers greater than 300 kW.
- Unlike other utilities that have divested their generation and have attempted to offer customers fixed default service rates, Duquesne has effectively managed its supply costs and risks, thereby avoiding the problems experienced in California.
- Throughout much of the post-transition period process, Duquesne has been able to obtain support from various parties for its default service plans (e.g., POLR II Settlement and POLR III Stipulations).

Q. Why do you think Duquesne's retail access program has been relatively successful?

A. There are several reasons.

First, Duquesne has attempted to establish default service rates to reflect market price levels in order to promote retail competition. In contrast, jurisdictions that have established fixed default service rates at below market levels have virtually eliminated retail competition. In some instances, "blended" default service rates, which are based on the average prices from a mix of wholesale supply contracts resulting from solicitations, have virtually eliminated retail competition. While blended rates may provide customers rate stability, they

do not represent prevailing market prices for a particular time period. As a result, EGSs often cannot contract for their supply needs at prices that allow them to offer attractive rates to retail customers, especially during prolonged periods of rising market prices. I believe this has contributed to the lack of retail shopping among residential and small C&I customers in New Jersey.

The key question for policymakers is how often utility default service rates should adjust to changes in market prices. The optimal frequency depends upon a number of factors, including customer sophistication, market price volatility, the number of competitive service alternatives, what customers are accustomed to, and the costs and benefits associated with exposing customers to greater price volatility. Duquesne's Plan tailors its default service for each customer group taking into account these considerations.

Second, Duquesne's management has been committed to retail access from the start of customer choice in Pennsylvania. Throughout the restructuring process and post-transition period, Duquesne's management has taken significant actions to promote retail competition while balancing the interests of its customers and shareholders. For example, Duquesne's management proposed a market determination of stranded costs through the voluntary divestiture of its generation assets. Duquesne's management structured an innovative asset swap to maximize the value of its existing generation asset portfolio. These steps by Duquesne's management transformed assets that were valued administratively at approximately $110 million in Duquesne's restructuring case[6] and ultimately led

[6] Application of Duquesne Light Company for Approval of its Restructuring Plan Under Section 2806 of the Public Utility Code, Docket R-00974104, May 21, 1998, at 130.

to the asset divestiture at market for $1.7 billion. These voluntary actions taken by Duquesne's management provided enormous benefits to customers in the form of accelerated recovery of stranded costs and significant rate reductions.

Duquesne's management also initiated at the start of retail access a "jump start" supply program for EGSs serving retail customers in its service area.[7] This program provided wholesale supply to EGSs at prices below Duquesne's default service rates in order to encourage supplier entry. Duquesne's management also offered to extend this program to EGSs during POLR II.[8] Duquesne's management periodically proposed increases in supply rates over time (both in POLR II and in POLR III) to better track changes in market prices. In another effort to foster retail competition at the start of POLR II, Duquesne's management agreed to levelize supply rates at the request of EGSs.[9] During POLR II discussions, Duquesne's management also adopted several other suggestions requested by EGSs, which included modifying its procedure for determining responsibility for losses and calculating load responsibility, expanding EGS

[7] Duquesne initiated and developed its first "Jump Start" program in the fall of 1998. The price for Jump Start power was $26.00 per MWH. Supply in the program came from Duquesne's owned generation plants. The program began in January 1999 and lasted for six months through June 1999. At the end of the program, Duquesne allowed EGSs to retain the Jump Start customers with no action required by the supplier. During the program, Duquesne was responsible for procuring and scheduling power on an hourly basis on behalf of the supplier. Duquesne did not charge for this service. No forecasting, supply or scheduling actions by an EGS was necessary for "Jump Start" power. All ancillary services associated with "Jump Start" power was provided by Duquesne at no additional cost. Suppliers could enroll up to 600 MW of customer load in total. Approximately 17 suppliers signed up for the Jump Start program.

[8] Duquesne's management also proposed another Jump Start program during POLR II – called "Jump Start II". Duquesne's management negotiated supply arrangements with Orion and proposed Jump Start II to ensure EGSs could procure energy at below the POLR II shopping credits. EGSs could buy at the same prices Orion sold power to Duquesne. However, at the request of the Mid-Atlantic Power Supply Association ("MAPSA"), the Jump Start II program was deleted from the Duquesne POLR II Plan.

[9] In POLR II, Duquesne's management proposed to increase generation rates every year to better track changes in market prices. At the request of EGSs, Duquesne modified its original proposal and levelized POLR II generation rate increases over the three year period. Rates were levelized to further promote retail competition at the start of the POLR II period.

access to customer information,[10] and developing an hourly pricing program for Large C&I customers once a visible and liquid spot market price was available. Later in POLR III, Duquesne management voluntarily developed and proposed an hourly pricing program for all customers with peak demands greater than 300 kW.

Q. What do you conclude about the actions of Duquesne's management with respect to promoting retail competition?

A. In my view, Duquesne has succeeded in balancing the interests of customers, EGSs, and shareholders in a manner that is quite remarkable in the industry. During the post-transition period, Duquesne has explored a variety of alternative methods to establish prevailing market prices that included relying on a fully negotiated bilateral contract in POLR II to using an hourly market index formula rate and a wholesale market solicitation process in POLR III. Throughout this period, the majority of Duquesne's customers have experienced significant rate reductions and stable rates, while customer shopping levels are among the highest in the country.

Q. Even with all that Duquesne has done, is it possible that Duquesne's retail access program could be improved?

[10] In the POLR II Joint Petition For Settlement, Docket No. R-0974104, Duquesne agreed to provide all EGSs access to customer information in a similar fashion as provided in the Joint Petition for Settlement in Docket No. A-110550F0147, paragraphs 46a and 46b, approved by Commission Order adopted on June 22, 2000 involving the merger of PECO Energy Co. and Unicom Corporation. Specifically, Duquesne agreed to provide to EGSs, for all customers who have authorized the release of their information, the most recent available twelve individual months of historical monthly electric usage and billed demand, per customer account, and the customer's service anniversary date. This information, which was to be provided on Duquesne's web site, was to be updated quarterly and would continue to be available through December 31, 2004. However, Duquesne is still offering EGSs access to this customer information, and Duquesne currently updates the eligibility list monthly rather than quarterly. Duquesne does not impose a charge for furnishing this information to EGSs.

A. Yes, and Duquesne has proposed many improvements in this filing. Mr. Eichenmiller provides an overview of these changes. I would expect that implementation of these improvements will contribute to the continued success of Duquesne's retail access program.

d) Provides Interim Bridge to 2011 When Generation Rate Caps for Most Other Utility Customers Expire

Q. Are there other reasons why Duquesne's Default Service Plan represents sound public policy?

A. Yes. Given Duquesne's situation and that of other major Pennsylvania utilities, Duquesne's Default Service Plan represents a "bridge" or "interim default service plan" to 2011. Duquesne's fixed supply rates expire on December 31, 2007. Meanwhile, the majority of customers in Pennsylvania, including those served by PECO Energy, PPL Electric Utilities ("PPL"), West Penn Power Co., Pennsylvania Electric Co. and Metropolitan Edison Co., have fixed supply rates through December 31, 2010 (or December 31, 2009 in the case of PPL). (See Exhibit NSF-3.)

Duquesne's Default Service Plan offers residential customers a level of rate stability that is consistent with that enjoyed by most other Pennsylvania electric utility consumers. Meanwhile, Duquesne's Plan begins to expose approximately 55,000 Small C&I customers to annual adjustments in supply rates. For these customers, this represents a reasonable transition to market prices that adjust more often.

Duquesne's interim Default Service Plan will allow more time for a) wholesale and retail markets to develop further in Pennsylvania, b) the Commission to develop its regulations for post-transition period default service throughout the Commonwealth, and c) the Commission to learn from the default service experiences outside the Commonwealth. As of this month, Texas eliminated the Price-to-Beat service for residential and other small customers that are less than 1 MW. In New York, several utilities expose customers to variable rates. Elsewhere, statewide or utility specific solicitations (both with laddered contracts and non-laddered contracts) are being conducted. There is much that can be learned from these default service models in terms of impacts on rates and retail competition. Pennsylvania regulators should take this opportunity to evaluate the results of these alternative approaches before committing to any particular approach for the state of Pennsylvania.

As Commissioner Fitzpatrick has stated:

> The electric utilities serving a great majority of the customers in Pennsylvania remain in the transition period, and will generally continue in this transition period until 2010-2011. It is a challenge to craft regulations now that will remain appropriate in light of conditions that may exist five years from now, and this difficulty would have been even greater had the Commission promulgated the regulations sometime in the past. Anyone who doubts the truth of that statement should ponder the unforeseen events that have taken place in the energy sector during the past five years.[11]

Duquesne's interim Plan provides a bridge to when generation rate caps expire for most other Pennsylvania customers across the state.

[11] Concurring Statement from Commissioner Fitzpatrick, Petitions for Reconsideration of Duquesne Light Company and Constellation Power Source, Inc. and Constellation NewEnergy, Inc. Opinion and Order approving Post-Transition Period Provider of Last Resort Service, September 30, 2004.

Q. Did the Commission recognize that a three-year extension of Duquesne's default service plan may be appropriate?

A. Yes. In the Commission's POLR III Order, the Commission stated that it is possible that a second three-year term with a price adjustment will be adopted and suggested that the Commission would review the competitive market and regulatory landscape at that time.[12] The Commission also found [at 51] that Duquesne demonstrated that it met the requirements of Section 2807(e)(3) of the Competition Act and there was nothing in the POLR III Order that would prevent Duquesne from obtaining the same determination for a subsequent three-year period, depending on the evidence presented at that time.[13]

In fact, the Commission approved the six-year supply agreement between Duquesne and Duquesne Power:

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

[12] 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 17.
[13] Ibid., at 51.
[14] Ibid., at 53.

Q. Should the Commission's decision whether to approve the Default Service Plan be influenced by whether wholesale solicitations might be used in future default service regulations?

A. Even if the Commission determines that wholesale solicitations are appropriate in future default service regulations, a state-wide or multi-jurisdictional solicitation process may prove to be the most economic and efficient means to procure default service supplies. The Commission should not require Duquesne on a stand-alone basis to implement a wholesale solicitation process prior to 2011.[15] Wholesale solicitations do not provide the same level of price certainty to retail customers (i.e., a known price held open during an extended regulatory review period), nor have wholesale solicitations proven to result in higher levels of shopping than currently experienced in Duquesne's service area. In fact, as shown in Exhibit NSF-4, Duquesne currently has significantly higher residential shopping levels than other jurisdictions that have relied on solicitations to establish default service prices.

Duquesne is also concerned that repeated attempts to conduct RFPs limited to its service area have not produced a large number of bidders. Duquesne must compete with larger RFP processes being conducted in neighboring states. Given the relatively high levels of switching in Duquesne's service area, bidders

[15] The Commission also acknowledged the importance of ensuring that "regulations promulgated now be flexible enough to accommodate markets as they continue to evolve. . . . Consequently, the Commission seeks to avoid overly prescriptive language that may infringe on both its and all other interested parties' ability to manage the default service obligations." Default Rulemaking at 6. Further, the proposed rules provide that "each default service provider should have the option of proposing a default service implementation plan best suited to its service territory." Default Rulemaking at 10.

may also perceive greater switching risks associated with supplying default service than experienced in other solicitations.[16]

Though I agree that a solicitation process is *one* reasonable way to procure power, it is not necessarily the *most* reasonable method for all utilities under all market conditions. Indeed, in Duquesne's POLR III proceeding, the Commission explicitly recognized that "a competitive procurement process is not the exclusive method to arrive at a prevailing market price." Reconsideration Order at 26.

e) Provides Stable and Reasonable Rates to Small Customers

Q. Why is it important that Duquesne's Default Service Plan continue to provide residential and Small C&I customers with a safe and reliable source of supply at stable and reasonable rates?

A. Retail and wholesale markets are still evolving. Given the volatility of electric prices, the uncertain development of competitive retail markets for smaller customers, and the customers' preference for fixed prices, Duquesne's residential and Small C&I customers should continue to be offered fixed rate default service.[17]

Smaller customers, and especially residential customers, do not want to be exposed to short-term wholesale market price volatility while competitive retail

[16] For instance, Duquesne has approximately 90,000 residential customers who are currently shopping with one supplier. A potential bidder could be concerned that all of these customers could return suddenly to default service at a time when market prices have increased.

[17] Stable default service rates will not necessarily harm or promote retail competition. Stable rates can be set at below market levels, at market levels, or above market levels with differing impacts on retail competition. In some cases, a fixed price default service may provide a benchmark against which EGSs may compete and allow EGSs to market "known savings" off of that benchmark. If variable default service rates are unknown in the future, then it becomes difficult for an EGS to guarantee savings while providing the customer price security.

markets continue to develop. Retail competition has not developed as quickly as hoped at the time of restructuring. A recent draft report to Congress summarized retail competition as follows:

> Although it has been almost a decade since states started to implement retail competition, residential customers in most of these states still have very little choice among suppliers. Few residential customers have switched to alternative suppliers or marketers in these states. Commercial and industrial customers, however, have more choices and options than residential customers ...One of the main impediments to market-based competition has been the lack of entry by alternative suppliers and marketers to serve retail customers.[18]

Customer switching among residential customers, in particular, has been slow to materialize. As Exhibit NSF-1 shows, most utilities with retail access in the United States have more than 95 percent of their residential load remaining on utility default service.

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

A. No. Many obstacles still remain in the development of retail markets for smaller customers throughout the nation (e.g., customer inertia, high EGS retailing costs, credit and financial concerns, etc.).[19] These hurdles have created high barriers for EGS success throughout much of the United States. As indicated by the generally

[18] Draft Report to Congress on Competition in the Wholesale and Retail Markets for Electric Energy, Docket No. AD05-17-000, Electric Energy Market Competition Task Force and the FERC, June 2006, at 71.

[19] For example, the Pennsylvania Consumer Advocate identified several factors that depressed retail entry by suppliers to serve residential customers, including "the acquisition costs associated with marketing programs to reach residential customers, the costs of serving such customers once acquired, and the rising prices for generation supply service in the wholesale market." Ibid., at 85.

low migration levels shown in Exhibit NSF-1, in most jurisdictions in the country including Duquesne's, suppliers generally have not yet provided small customers the variety of price and service packages that were anticipated in a more mature market. Therefore, I do not believe at this stage of market development EGSs can be relied on to provide fixed price protection to all residential and Small C&I customers. The Commission should not assume that EGSs will suddenly appear, offer fixed price services at reasonable prices to all customers, and remain in business for years into the future.

Q. Will setting the rates based on current market prices result in significant rate increases?

A. No. The total average rate increase in 2008 for a residential (RS) and a Small C&I (GS/GM) customer is 9.2% and 9.3%, respectively. Mr. Pfrommer describes the rate impacts in more detail.

Q. Will fixing rates for three years for residential customers result in significant rate impacts in 2011?

A. Not necessarily. Duquesne has reset its supply rates to market levels every few years as it moved from POLR I to POLR II to POLR III and now in this Plan. This frequency of resetting rates has resulted in manageable rate impacts for customers at each reset. Unlike other utilities both within and outside Pennsylvania that have abruptly moved from long-term generation rate caps to solicitations, Duquesne has successfully avoided sharp rate increases and provided customers with stable rates over time.

> Recent events in Pennsylvania, Maryland, and Delaware have shown that consumers of electricity can be exposed to sudden, dramatic price increases when long-term generation price caps, mandated or agreed upon as part of various state restructuring proceedings, expire. Here in Pennsylvania, the 4,400 customers of Pike County Light and Power Co. ("Pike") experienced an increase of over 70% in their total electric bill at the beginning of 2006. In Delaware, Delmarva Power Co. ("Delmarva") increased rates for residential customers by 59% effective May 1, 2006. In Maryland, residential customers of Baltimore Gas & Electric Co. ("BG & E") will face a 72% increase in their electric bills on July 1, 2006. Sudden price increases of this magnitude produce what is referred to as "price shock," making it very difficult for customers to adjust their budgets and their usage.[20]

By comparison, Duquesne's POLR II and POLR III plans, both of which extended for about three years, resulted in modest rate impacts for residential customers. It is very possible that the 2010-2011 rate impact will also be very manageable. Furthermore, if the Default Service Plan is implemented, the 2010-2011 rate impact for Duquesne's smaller customers could very well be much less than that of other Pennsylvania utilities' customers, because most other Pennsylvania utilities' rates were established long ago during the restructuring process and therefore may be further from market levels.

Q. While most Pennsylvania customers continue to be served under generation rate caps, how do Duquesne's supply rates compare to the regulated generation rate cap approved in Duquesne's restructuring proceeding?

A. The Default Service Plan is a part of one of the largest and longest sustained supply rate reductions in the country. As compared to the generation rate caps approved in Duquesne's restructuring case in May of 1998, residential and Small

[20] Motion of Commissioner Terrance J. Fitzpatrick, Policies to Mitigate Potential Electricity Price Increases, Public Meeting May 19, 2006, at 1.

C&I customers in Duquesne's service area are expected to realize about $950 million in savings (nominal dollars) over the 1999-2010 period, if the Commission approves Duquesne's Default Service Plan. In addition, to the extent that customers have realized and will continue to realize even greater savings by shopping for electricity, the total savings resulting from Duquesne's restructuring are even larger.

For example, Duquesne's Default Service Plan provides fixed supply rates for a residential RS customer that are on average 9% (2008-2010) below the generation rate cap levels (including CTC) approved in Duquesne's restructuring case. Adjusting for inflation, a residential customer in Duquesne's service area is expected to experience a 37% real rate decrease in 2010 as compared to the 1996 rate levels in effect when the restructuring legislation was enacted. (See Exhibit NSF-5.) This is a remarkable result, especially given the large increases in fuel and electricity market prices during this period.[21]

Q. Do others share your view that stable supply rates are necessary for small customers as markets continue to evolve?

A. Yes. Throughout the restructuring process and the development of Duquesne's default service plans, Pennsylvania consumer groups have consistently stressed

[21] Commission Fitzpatrick summarized the change in fuel prices during this period as follows: "According to the EIA, monthly natural gas prices at Henry Hub have increased from $3.39/Mcf in January 1997 to $7.18/Mcf in April 2006 (112% increase); Delivered natural gas prices to Pennsylvania city gates has increased from $4.24/Mcf in December 1996 to $10.72/Mcf in February 2006 (152% increase); Distillate (#2) oil prices used in combustion turbines in the New York region have increased from 72.808 cents/gal in December 1996 to 210.800 cents/gal in December 1996 to 121.57 cents/gal in April 2006 (133% increase); Average delivered to utility plan coal prices in Pennsylvania, including long-term coal contracts, have increased from $1.38/mmbtu in 1996 to $1.58/mmbtu in 2005 (14.5%); Current Northern Appalachian coal spot prices, according to Coal News and Markets Report, have increased from $22.50 per ton in July 2000 to $42.00 per ton in May 2006 (87% increase)." Motion of Commissioner Terrance J. Fitzpatrick, Policies to Mitigate Potential Electricity Price Increases, Public Meeting May 19, 2006, at 2, Fn5.

the importance of having stable and predictable rates. The limited competitive options available, when coupled with significant market price volatility and structural change in wholesale power markets, have caused both national and Pennsylvania consumer organizations to advocate for rate stability and certainty in the provision of default service. The Consumer Energy Council of America ("CECA")[22] released a report in April 2003 concluding, in relevant part, that:

> Electric industry restructuring should not expose residential and small business consumers to volatile prices...Designing default service rates to be volatile or reflect short-term wholesale market conditions in order to spur customers to migrate to alternative providers creates the potential for hardship for customers who do not enter the competitive market or whose marketer fails to provide them with service. (p. VII.) One of the underlying attributes of an optimal electric power system is the provision of stable and predictable prices for electric service. Residential and small business consumers who have historically been provided electric service at stable rates should not have to suffer price volatility and extreme increases in monthly electric bills as the "price" of adopting a competitive market. Such a result would be particularly harmful to residential and small commercial customers, especially since they generally have no way to respond to or protect themselves against such price volatility. (p. VI.)[23]

Echoing these conclusions, a consumer report prepared for the National Center for Appropriate Technology stated "reliance on short-term wholesale market prices to provide vital electric service to most consumers is a dangerous and risky

[22] CECA is a public policy organization focusing on energy issues from the perspective of consumers, particularly residential and small business consumers. In January 2002, CECA convened a year-long Electric Industry Restructuring Forum to address the experiences to date of electric industry restructuring efforts at both the state and federal levels.

[23] CECA, "Positioning the Consumer for the Future: A Roadmap to an Optimal Electric Power System," April 2003.

business."[24] More recently, the National Association of State Utility Consumer Advocates provided the following comments.

> The most important attribute of retail competitive markets -- at least for residential customers -- is the establishment of just and reasonable default service rates for customers who do not or cannot shop for alternative generation service. The vast majority of residential customers in restructured states have continued to purchase generation from their traditional distribution utility or some state-established surrogate for that company. In NASUCA's view, the default service (also referred to as standard offer or provider of last resort service) must be as good as or better than the traditional regulated service that customers received before restructuring. *That means that the service should be stable and* affordable, not volatile and expensive.[25]

The Pennsylvania Office of Consumer Advocate ("OCA") issued a similar press release stressing the need to provide consumers with stable, reasonably priced electric service:

> 'The last thing American electricity consumers need is high, volatile electricity prices,' [Pennsylvania Consumer Advocate] Popowsky said. 'The purpose of electric restructuring is to make consumers better off, not to expose them to uncontrolled price spikes from immature markets.' The CECA report recommends that 'default service should be designed to assure stable, predictable and equitable prices' and that such service should be the 'benchmark' against which competitive offerings can be compared. 'This is a critical recommendation,' Popowsky stated. 'All customers should continue to be able to receive safe and adequate service at reasonable prices from a default service provider. In most states, that provider will be the incumbent utility. To the extent that competitors can provide service that is either cheaper in price or greater in value to consumers -- such as green or renewable power -- then consumers will benefit even more from restructuring. But in no case should consumers be made worse off.'[26]

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[24] "Managing Default Service To Provide Consumer Benefits in Restructured States: Avoiding Short-Term Price Volatility," Barbara Alexander, NCAT, June 2003, p. 2.

[25] Comments of the Pennsylvania Office of Consumer Advocate on Wholesale and Retail Electricity Competition, Electric Energy Market Competition Task Force, Docket No. AD05-17-000, November 18, 2005, at 36.

[26] PA OCA press release, April 24, 2003.

> The Pa. OCA does not support policies and programs that are designed to harm consumers by exposing them to short term, volatile default prices; making default service "ugly" and unaffordable; or transferring customers to competitive suppliers without their knowledge or consent. There is no basis in law or policy for the notion that residential customers must be exposed to more short term price volatility or higher prices in order to see "benefits" from retail restructuring. [27]

Duquesne's Default Service Plan provides residential customers the type of default service supported by consumer representatives -- a dependable, stable price option at reasonable rates.

Q. Could rate stability be achieved with a solicitation process?

A. While it may be possible to obtain a three year fixed price in a solicitation process, residential and Small C&I customers would be exposed to greater price uncertainty than under Duquesne's Default Service Plan. Duquesne is proposing fixed supply rates that reflect prevailing market prices and is willing to hold those fixed prices open during the regulatory review period. In contrast, if rates were instead set by a solicitation, Duquesne's retail customers would assume all market price risks between now and the time that the solicitation is complete. While Duquesne's affiliate, Duquesne Power LP ("Duquesne Power"), will acquire electricity at prevailing market prices to supply default service, the critical difference is that Duquesne Power (and not the retail customer) will assume the costs and risks associated with future market price movements from the time of this filing to the time of delivery. Unlike the solicitations conducted in Maryland,

[27] Comments of the National Association of State Utility Consumer Advocates on Wholesale and Retail Electricity Competition, *Electric Energy Market Competition Task Force*, Docket No. AD05-17-000, November 18, 2005, at 6.

New Jersey, and elsewhere, the Commission will have more time to review and approve the supply rates as opposed to approving a process with an uncertain price outcome. In these other jurisdictions, the state commission typically has only a few days in which to consider the rate levels and customer impacts established in the solicitation process.

Q. Wouldn't it be more economically efficient and promote competition to allow retail rates to float with short-term market price movements?

A. This is a complicated policy question. First, it is important to remember that Duquesne proposes to expose over 46% of its total system load (Large C&I customers) to hourly market prices. Second, to improve market price signals during the 2008-2010 period, the Company proposes to begin adjusting supply rates annually to reflect changes in market price levels for approximately 55,000 Small C&I customers (or approximately 24% of the Company's total system load). As a result, more than 70% of Duquesne's total system load will be subject to default service rates that adjust annually or hourly. Third, as described more fully in Mr. Pfrommer's testimony, Duquesne also proposes significant changes to its rate design for residential and Small C&I customers to better reflect market prices. These improved price signals will provide incentives for more efficient customer consumption decisions and investment in conservation and demand side management measures.

Finally, while some parties may argue that smaller customers should be exposed to even shorter-term (e.g., quarterly or monthly) market prices for economic efficiency and competition reasons, this is not appropriate. Smaller

customers should not be forced onto a regulated default service that exposes them to price volatility with limited opportunities to hedge those risks in the competitive market.

Providing customers dynamic and volatile price signals to encourage economically efficient load response is especially difficult for residential and Small C&I customers. In some jurisdictions, customers experience significant price volatility with little economic benefit. In the absence of cost-effective enabling technology (e.g., advanced metering, communications, and metering data management systems) for smaller customers, there is little benefit to sending customers volatile market price signals,[28] and in the absence of EGSs willing to serve that market, there is little customers can do to mitigate the impact of volatile market prices.

Q. What has been the experience in service areas that have attempted to expose smaller customers to shorter-term market price signals?

A. Customers have been exposed to more market price volatility, but retail shopping levels are not necessarily higher in those service areas than in Duquesne's service area. For example, as reported in the draft report to Congress on retail competition, "Massachusetts based the generation portion of the POLR service on

[28] Without such technology, utilities must take metered usage and allocate it to hours in the month using deemed load shapes regardless of the customer's actual usage. Therefore, there is little economic incentive for a customer to change consumption without the necessary enabling technology to support those actions. Utilities also typically have limited ability to communicate price signals in advance to allow customers to respond to short-term price signals. Monthly prices are billed long after consumption occurs and price information is not revealed until after-the-fact. Furthermore, while there have been numerous studies and pilot programs attempting to measure customer response to market prices, the specifics regarding the magnitude of price movements, the frequency and timing of price movements, how prices are communicated to customers, and specific customer characteristics may impact the ability of customers to respond to the market prices even with the appropriate enabling technology.

the price of supply procured in wholesale markets through fixed-priced, short-term (three or six months) supply contracts. Rates for the generation portion of POLR service in the Boston Edison (north) territory increased from 7.5 to 12.7 cents per KWh from 2005 to 2006."[29] Meanwhile, very few EGSs are providing residential customers with fixed price protection.

III. Market Evidence Demonstrates That The Proposed Supply Rates Are Based On Prevailing Market Prices And Recover Reasonable Costs

Q. Briefly summarize the Electricity Competition Act's requirements for the post-transition period as it relates to default service.

A. Section 2807 (e)(3) of the Competition Act simply states that the electric distribution company or commission-approved alternative supplier "shall acquire electric energy at prevailing market prices and shall recover fully all reasonable costs."

Q. Does the Competition Act define "prevailing" or "reasonable costs"?

A. No, the legislature could have, but did not, specify a single method or test for establishing "prevailing market prices." I am aware, however, that there has been extensive debate among EDCs, wholesale and retail electric suppliers, consumer groups, and Pennsylvania Commission staff regarding the proper interpretation of

[29] Draft Report to Congress on Competition in the Wholesale and Retail Markets for Electric Energy, Docket No. AD05-17-000, Electric Energy Market Competition Task Force and the FERC, June 2006, at 71.

this requirement.[30] In particular, parties disagree on the frequency in which retail rates should be reset to market levels, which impacts the extent to which customers are exposed to market price volatility, and on the methods that electric distribution companies ("EDCs") may employ to procure their electricity supply.

Q. Do you believe the Commission should require a single method for establishing prevailing market prices at this stage of market development?

A. No, I believe that the interpretation of "prevailing market prices" should remain flexible. The Commission should permit alternative supply procurement methods and allow for the use of short and/or long-term products to set prevailing market prices.

Prevailing market prices may be established by comparisons with other market prices in the region, through a market price index formula, or by a solicitation. In fact, Duquesne already has experience establishing default service rates deemed to be in compliance with the Competition Act using each of these different methods.[31] The Commission explicitly recognized in Duquesne's

[30] This debate has occurred in the litigation of post-transition period default service plans for Duquesne Light, UGI, Penn Power, and PPL, as well as in the Pennsylvania Commission's effort to develop default service regulations for the Commonwealth.

[31] The Company started serving default service customers from its owned generation. Duquesne subsequently divested its generating assets and served its default service customers by means of negotiated full-requirements supply contracts with a non-affiliate during the POLR I and POLR II periods. In POLR III, Duquesne treated Large C&I customers differently from residential and Small C&I customers. Large C&I customers were supplied with a PJM hourly market index formula rate. Alternatively, Large C&I customers could elect a fixed rate established by a solicitation. Meanwhile, POLR III residential and Small C&I customers on default service were supplied at a three-year fixed price based on an agreement with Duquesne's affiliate, where the rate levels were established based on comparisons with recent solicitations. Each of these methods to supply and establish default service rates was approved by the Commission, and presumably, considered consistent with establishing rates at "prevailing market" prices per the Pennsylvania Competition Act.

POLR III proceeding that "a competitive procurement process is not the exclusive method to arrive at a prevailing market price."[32]

Furthermore, at any point in time, there can be a variety of products in the marketplace, each with its own prevailing market price. For example, when someone purchases a mortgage for their home, he or she has a choice between variable, five-year fixed, ten-year fixed, and thirty-year fixed mortgage rates. At any point in time, the mortgage rates, associated risks, and product features (e.g., closing costs) may differ by product. If that person were to choose a five-year fixed rate mortgage, he or she would pay the prevailing market rate for that product given the specific terms and conditions. It would be incorrect to argue that mortgages of only one term length reflect prevailing market interest rates. The type of mortgage that is most appropriate varies by situation, just as different types of default service are appropriate for different types of electricity customers, especially since the level of retail competition varies across customer classes.[33]

During the development of its POLR II and POLR III plans, Duquesne found it necessary to apply different supply procurement methods and use different approaches to establish market prices given the specific circumstances that Duquesne and its customers faced at the time each default service plan was implemented. Based on this experience, I believe that the appropriate method for establishing prevailing market prices will depend on numerous factors (e.g., customer characteristics, EGS market participation, customer shopping activity,

[32] Reconsideration Order at 26.

[33] I am not suggesting that there should be numerous default service offerings that could potentially interfere with the development of retail markets. Rather, I am suggesting that the type of default service should be tailored to the market conditions and customer characteristics at the time the default service is established.

market price volatility, ability of customers to respond to market price signals, financial stability of market players, etc.). Given the current state of market development in Duquesne's service area, I believe it would be bad public policy to interpret the statutory provision in a manner that requires default service rates to be based solely on short-term market prices or market prices established only by solicitations, in all situations for all types of customers.

Q. In the POLR III Order, did the Commission find that Duquesne was able to demonstrate that the proposed fixed default service rates for a three-year period met the requirements of the Competition Act?

A. Yes. In the POLR III Order, the Commission found that "Duquesne has established, by a preponderance of the evidence, that its proposed rates for the Small Customer Plan satisfy the Act's requirements that such rates reflect prevailing market prices for the three-year term period beginning January 1, 2005, through December 31, 2007.[34]

Q. Did Duquesne rely on similar market price evidence to establish its proposed rates in this proceeding?

A. Yes. As described further below, I examined the results of recent solicitations and available market price and customer information to establish Duquesne's proposed retail rates. Except, unlike the POLR III proceeding, which primarily focused on an analysis of the New Jersey auction results, I now have had an opportunity to examine a broader range of solicitations and also have had the

[34] POLR III Order at 22.

benefit of more visible market price information within Duquesne's service area, since Duquesne is now a member of PJM.

Q. Briefly summarize the proposed supply rates under Duquesne's Default Service Plan and describe how they compare with those approved in POLR III.

A. The proposed average supply rates for residential (RS) and Small C&I (GS/GM) customers are 7.156 and 7.083 cents per kWh, respectively. As described by Mr. Pfrommer, however, there are a few changes in the supply rate cost components. Unlike POLR III supply rates, the proposed supply rates include the costs and risks associated with meeting new requirements for RPM capacity and the Alternative Energy Portfolio Standards Act of 2004 ("AEPS"). Unlike the POLR III supply rates, which included ancillary service charges and PJM administrative charges within the fixed bundled rate, the Company includes these costs in its transmission rate adjustment mechanism, and will adjust these charges as actual costs billed by PJM change.[35] Adding Duquesne's estimate of the ancillary service and PJM administrative costs to the proposed supply rates suggests that the average supply rates in 2008 for residential (RS) and Small C&I (GS/GM) customers exceeds the current POLR III supply rates by an average of about 17.6% and 13.6%, respectively.

[35] Supply, transmission, ancillary services, and PJM administrative charges will continue to be included in the Price-to-Compare.

Q. What is the basis for the increase in supply rates above current POLR III levels?

A. The proposed rates allow Duquesne to charge prevailing market prices and recover reasonable costs for the default service products Duquesne is offering to retail customers. Substantial market evidence demonstrates the need to increase supply rates above POLR III levels, including:

1) The results of recent solicitations indicate that Duquesne's supply rates need to be increased in order to reflect prevailing market prices and to recover reasonable costs.
2) In addition, historical wholesale spot electricity prices and natural gas prices have increased by 33% and 23% since calendar year 2003, the year that Duquesne's POLR III rates were developed.
3) Furthermore, as described by Mr. O'Brien, the proposed supply rates will be a pass-through of the price charged to Duquesne by Duquesne Power, which reflects the costs and risks incurred by Duquesne Power to acquire power at prevailing market prices in the competitive wholesale market.

Each of these points is described further below.

a) The Results of Recent Solicitations Indicate that Duquesne's Proposed Default Service Rates Are Consistent With Prevailing Market Prices

Q. Have you reviewed the market price results of recent solicitations to supply full requirements default service?

A. Yes, this was the most important factor in establishing Duquesne's proposed rate levels for residential and Small C&I customers.

Q. Please summarize how Duquesne's retail rates were developed.

A. I reviewed the market price results of recent solicitations to supply full requirements default service to residential and Small C&I customers. The results were adjusted for significant differences relating to the supply product definition, timing, location, and associated risks. Based on this analysis, I developed average rates for the three year period by customer class.

The class average rates were used by Mr. Pfrommer to develop retail rates by rate schedule. As described by Mr. Pfrommer, the Company also considered market-based changes in retail rate components (such as the elimination of supply-related demand charges and declining energy blocks) and potential rate impacts for certain customer classes, primarily affecting residential and Small C&I heating customers.[36]

Finally, as described by Mr. O'Brien, Duquesne Power has agreed to provide default service to Duquesne at these rate levels and hold open these prices during the regulatory review period.

Q. What do you conclude from this analysis?

[36] Based on the customer load patterns and how they impact energy, capacity and load following costs, there appears to be little market justification for the significant differences in Duquesne's current average rate levels between heating and non-heating customers. As described by Mr. Pfrommer, Duquesne proposes to eliminate these differences over a three-year period in order to simplify the rate structure and better align the average rates by rate schedule with market levels.

A. The market prices observed in these solicitations, appropriately adjusted to reflect the differences in product structure and market conditions, are consistent with those proposed in Duquesne's Default Service Plan. Therefore, I conclude that Duquesne's proposed default service rates reflect prevailing market prices and recover reasonable costs.

Q. Why should the Commission consider the results of recent full requirements solicitations?

A. Full requirements solicitations provide a good measure of prevailing market prices at the time of the solicitation for the default service supply product being offered to customers in a particular location. This supply product involves certain types of costs (e.g., energy, capacity, load following, etc.) and risks (e.g., customer switching, general load/weather uncertainty, future market price risks, regulatory risks, etc.), and Duquesne must incur many of the same types of costs and must assume similar risks when serving its residential and Small C&I customers. Several utilities in other service areas have outsourced the responsibility for these costs and risks to suppliers through solicitations to provide full requirements default supply at fixed prices to residential and Small C&I customers. These solicitations take the form of an auction or an RFP, and in response to these solicitations prospective default service suppliers indicate the prices at which they are willing to provide default service supply. The resulting price represents a fair indication of the prevailing market price for the supply of full requirements default service for the product in the solicitation.

Q. Briefly describe what you mean by "full requirements" default service?

A. "Full requirements" default service means that the default service supplier must satisfy a fixed percentage of all of the default service customers' supply requirements throughout the delivery period, regardless of the customers' instantaneous changes in energy consumption, and regardless of how frequently customers switch onto or off of default service.

Q. What are the contributors to the prevailing market price of full requirements default service?

A. There are many components that comprise the full requirements default service obligation. These components represent services or benefits provided to the customer and, correspondingly, costs and risks to the supplier. For example, full requirements default service supply includes the obligation to meet the energy and capacity requirements (and sometimes transmission service) necessary to serve the load of retail customers. Full requirements default service suppliers may be required to satisfy any renewable resource requirements and must also incur the administrative costs associated with their obligations.

In addition, full requirements default service suppliers face costs and risks associated with customer switching. If the default service is being provided at a fixed rate to customers, customers are likely to elect default service when market prices are higher than the default service rates, and not elect default service when market prices are lower than the default service rates. This customer switching option can be very valuable for customers, but very expensive for default service suppliers.

Full requirements default service suppliers also assume some degree of regulatory risk; that is, the risk that potential future changes in regulatory policy will affect the default service, the expected cost of the default service, or the utility's or customers' ability to compensate the default service supplier under the terms of the agreement.

Finally, full requirements default service suppliers assume costs and risks associated with the regulatory review period. Specifically, when a supplier offers to provide full requirements default service at a fixed price, it assumes the risk associated with market price movements between the time that the price is proposed and the time of regulatory approval. The applicable regulatory body has the duration of the review period to decide whether to approve the offered default service supply price. This standing offer to perform at the specified price levels protects the customers if market prices rise and the regulatory body approves the proposal, resulting in increased costs to the supplier to meet its obligations, costs from which customers are shielded. This is a benefit to the customers, at the expense of the supplier.

Q. Which solicitations for full requirements default service supply to residential and Small C&I customers did you analyze?

A. I reviewed the recent competitive auctions in the New Jersey service areas of Atlantic City Electric Company ("AECO"), Jersey Central Power & Light Company ("JCPL"), Public Service Gas & Electric Company ("PSEG"), and Rockland Electric Company ("RECO"). Also, I considered the recent competitive RFPs in the Maryland service areas of Baltimore Gas & Electric Company

("BGE"), Allegheny Power ("Allegheny"), Delmarva Power ("Delmarva"), and the Potomac Electric Power Company ("Pepco"). Finally, I examined the recent solicitations in the service areas of Commonwealth Edison ("ComEd"), Penn Power and Pike County. Exhibit NSF-6 provides a list of the solicitations I considered and summarizes the term, customers included, and the date of the solicitation.

Q. Why did you consider these solicitations?

A. These solicitations satisfy several key criteria. First, these solicitations involve full requirements default service supply to residential and/or Small C&I customers. Second, these solicitations were completed primarily within the last 12 months, so the winning bids are relatively "fresh."[37] Third, these solicitations (with a few exceptions) involve supply in service areas that are part of PJM. Even though Penn Power and Pike County are not in PJM, I reviewed these solicitations in my analysis because these service areas are geographically close to Duquesne and located in Pennsylvania. Fourth, I relied on solicitations where there was enough available market information to adequately analyze the solicitation.

Q. Please provide a comparison of the winning bid prices in these solicitations and Duquesne's proposed default service rates.

A. Exhibit NSF-7 shows the winning bid prices as compared to Duquesne's proposed retail rates. As can be seen in the exhibit, there appears to be significant differences across solicitations, and in most instances, the bid prices were

[37] The earliest bid date of all of these solicitations is December 2005.

significantly higher than Duquesne's proposed retail rates. This cursory look at the winning bids would suggest that Duquesne's proposed rates are too low.

Q. Is this a fair comparison?

A. No. Looking at the raw data can be confusing and misleading. In order to properly compare the results of these solicitations with Duquesne's proposed rates, several adjustments are necessary to express these results on an apples-to-apples basis with Duquesne's proposed rates.

Q. Summarize the approach you used to compare the results of these solicitations with Duquesne's proposed rates.

A. First, I removed the Pennsylvania gross receipts tax ("GRT") and line losses from Duquesne's proposed rates.[38] By removing 5.9% for GRT, and 6.9% and 6.1% for line losses, the resulting rates are $63.02/MWH for residential and $62.80/MWH for Small C&I customers, respectively.

Next, I adjusted the results of the solicitations so that they could be compared on an apples-to-apples basis with Duquesne's rates, net of line losses and GRT. These adjustments were organized into three categories:

1. **Major definitional differences** – removing components that may be included in the bid price (e.g., transmission, ancillary services, line losses, taxes) that are not included in Duquesne's proposed rates (net of GRT and line losses).

[38] For the purposes of this analysis, I used the average rates in 2010 for the residential and Small C&I customer classes. Duquesne's average supply rates for 2008 and 2009 are somewhat lower.

2. **Locational and timing differences** – adjusting for the market cost differences (e.g., differences in locational energy prices, load shapes, capacity prices, etc.) and adjusting for timing differences (e.g., differences between market conditions at the time of the solicitation versus Duquesne's filing, and the term of the supply delivery period).

3. **Asymmetric risk differences** – considering the differences in costs associated with asymmetric risks; that is, risks that have greater downside than upside, such as risks related to the regulatory review period and customer switching.

I describe each of these adjustments in greater detail later. Some of these adjustments are quite simple to explain and relatively easy to quantify. Others are just as real, and may be significant, but are more difficult to measure. Furthermore, it is important to note that while I have identified certain asymmetric risk differences between Duquesne's Plan and other solicitations, there certainly are other risks that are assumed by a default service supplier, whether it is Duquesne Power or a bidder in a solicitation.

Q. Briefly describe these other risks that Duquesne Power will assume as the default service supplier.

A. Duquesne Power must assume numerous risks when providing a fixed rate under the Company's Default Service Plan, including:

- **Price (unhedged positions).** The risk that wholesale market prices will rise once the fixed rates are established. This could occur for numerous reasons (higher fuel costs, increased demand, impact of the new RPM

capacity structure, higher than expected costs of renewables, impact of marginal transmission losses, etc.).

- **Quantity.** The risk that retail customers use more or less load than expected, due to weather or other factors, such as changes in the economy.[39]
- **Load shape.** The risk that retail customers use more during peak periods when market prices are high, and less during off-peak periods, than was expected.
- **Basis differential.** The risk that prices rise in the Duquesne Zone as transmission congestion is reduced and lower cost generation can move from the Duquesne Zone to higher priced areas in PJM (i.e., the historical basis differential between the Duquesne Zone and other PJM regions diminishes).
- **Unexpected changes in regulatory requirements, market rules, and laws.** The risk of unforeseen changes in market rules, regulations and laws that could increase supply costs.
- **Supplier default.** The risk that Duquesne Power could be forced to obtain replacement power at higher prices if its suppliers default on their contracts.
- **Collateral.** The risk that downward price movements or other circumstances would require Duquesne Power to post significant collateral under its contracts to purchase its supply.

[39] Customer switching risks are related to quantity risk, but are discussed later in the asymmetric risk category.

Like Duquesne Power, default service suppliers that bid in structured solicitations typically assume similar risks, and seek compensation in their bids. Therefore, even though Duquesne Power will assume these risks, I did not make any adjustments for these risks to the results of the solicitations.

Q. Please describe the first category of adjustments -- accounting for major definitional differences.

A. The winning bids in New Jersey and Penn Power solicitations include the cost of transmission service, while Duquesne's supply rates do not, so it was necessary to remove the cost associated with this service from the winning bids in these solicitations. Similarly, the winning bids in Maryland's and Pike County's[40] solicitations include the cost of line losses, so I netted the effect of these line losses from these bids. The Pike County rate also includes GRT, so this too was removed. Finally, the cost associated with ancillary services was removed from all of the bids because they include coverage of ancillary services costs, but Duquesne's proposed supply rates do not.[41] Exhibit NSF-8 summarizes the definitional adjustments that were made, and Exhibit NSF-9 shows the resulting price comparison after adjusting for these definitional differences.

Q. Is this a fair comparison?

[40] For Pike County I reviewed the retail rates that resulted from the most recent solicitation.

[41] For purposes of discussion, I combined ancillary services and PJM administration costs together and refer to the combined costs as "ancillary services."

A. No. While it is more accurate than looking at the raw bid results, this comparison still ignores several very important differences – namely locational and timing differences.

Q. Describe your second category of adjustments -- locational and timing differences.

A. Locational differences arise mainly because energy and capacity market prices differ by region. These differences can largely be attributed to differences in supply and demand in particular market areas, and transmission constraints between market areas. Exhibit NSF-10 shows the differences in the average spot energy prices between the utility zones where the solicitations were held and the Duquesne Zone for the most recent 12 month period. As can be seen in the exhibit, some of these basis differentials historically have been quite significant, ranging anywhere from $2 per MWH to $27 per MWH. Large differences in market prices at different locations can also be observed by studying the differences in forward market prices (i.e., market prices for future delivery). Besides the basis differential, locational differences in the market cost of energy and capacity are driven by differences in customer consumption patterns (i.e., load shapes).

In addition, there are two important timing differences. First, the solicitations occurred at different points in time. Therefore, I considered how market conditions have changed since each solicitation was conducted. Second, the solicitations have different delivery periods, ranging from 12 months to 36 months. Even if everything else is equal, the prevailing market price for supply

over a shorter delivery period will likely be different than the prevailing market price for supply over a longer delivery period due to different market costs and expectations over the different periods. In addition, if a delivery period covers exactly one, two or three full years, the cost to provide load following energy and capacity will be different than if the delivery period includes a disproportionate number of non-summer or summer months.

Q. Summarize briefly how you adjusted for the locational and timing differences.

A. In order to adjust a given solicitation's result for locational and timing differences, I used available market price information as of the time of that solicitation and associated load data to quantify cost components related to energy, capacity, load shaping, etc.[42] I then summed these market values for the given solicitation's default service. Next, I used a consistent methodology to determine and sum the current market values of each of the same cost components for Duquesne's default service supply. I then subtracted from that sum the aggregated value that I calculated for the given solicitation to calculate the quantifiable differences related to locational and timing differences. For a given solicitation, the net result reflects differences relative to the Duquesne Zone

[42] My analysis considered the differences between the customer load patterns for each utility solicitation and the applicable Duquesne customer class load pattern. Differences in Auction Revenue Rights credits were also accounted for in my analysis.

attributable to energy and capacity prices, load shapes,[43] delivery periods, and the point in time when the prices were established.[44]

Exhibit NSF-11 shows the price comparison with adjustments for the definitional differences as well as the locational and timing differences across solicitations. The average price of the solicitations that included residential load was $60.02/MWH and the average price of the solicitations that included Small C&I load was $61.30/MWH.[45] This exhibit demonstrates that the results across solicitations are more consistent than they first appeared before any adjustments, as shown in Exhibit NSF-7.

Q. Please explain the third category of adjustments -- differences in asymmetric risks.

A. Duquesne and Duquesne Power assume several asymmetric risks (i.e., risks that have greater downside than upside) when providing a fixed rate under the Company's Default Service Plan, including regulatory review period risk and customer switching risk. Winning bidders in solicitations may face similar types of asymmetric risks to some extent, but as I will explain later, the costs associated with these risks are significantly different under Duquesne's Default Service Plan than they are in the solicitations analyzed. As a result, Duquesne's rates should

[43] In some instances, the solicitations combined supply procurement for residential and Small C&I customers (e.g., New Jersey and ComEd). My analysis reflects the differences between the combined load shape used for the solicitation and the appropriate Duquesne load shape for a particular rate class (i.e., residential or Small C&I customers).

[44] I generally did not consider the processes utilities used to translate winning wholesale bid prices to retail rate schedules because my analysis already accounts for differences in line losses and customer load shapes. Other differences, such as averaging the results of the most recent solicitation with the results of solicitations in prior years as they do in New Jersey, are not applicable.

[45] These figures do not include transmission, ancillary services, line losses or GRT.

be considered in light of the product and risk differences when comparing the proposed rates with the results of structured solicitations.

Q. Please describe the first type of asymmetric risk that you identified, the regulatory review period risk faced by Duquesne Power.

A. To the extent that Duquesne Power chooses not to buy power in advance of regulatory approval (a "short" position), there is a risk that wholesale market prices will increase during the review period, the Commission will approve the Plan, and Duquesne Power will be forced to procure supply at the higher prices. To the extent that Duquesne Power chooses to procure power in advance of regulatory approval (a "long" position), there is a risk that wholesale market prices will fall during the review period, the Commission will not approve the Plan, and Duquesne Power will be forced to sell its contracted supply at the lower prices.

Clearly, the Commission has an option to accept or reject the proposed fixed rates. While the Commission will consider many factors in its decision, this option provides price protection for Duquesne's customers, and regardless of Duquesne Power's supply procurement strategy, this price protection is provided at the expense of the default service supplier.

Q. Please explain why the regulatory review period risk assumed by the default service supplier is significantly greater, and the associated price protection provided to retail customers is significantly greater, under Duquesne's Plan than in the solicitations.

A. Duquesne (and Duquesne's supplier, Duquesne Power) is offering to hold open its fixed price while this docketed proceeding takes place to consider the offer. In comparison, winning bidders in the solicitations typically only hold open their fixed bid prices for less than five business days before the state commission must decide whether or not to accept the bids. Therefore, bidders in competitive solicitations assume a much smaller portion of the risk associated with market price movements than Duquesne Power does under Duquesne's Plan.

Duquesne's offer to hold the fixed price open during a multi-month regulatory review period represents a fundamental difference between Duquesne's Plan and a solicitation. Under either approach, a multi-month regulatory proceeding is necessary, and somebody must assume the risk of market price movements during the duration of the proceeding. Duquesne's Plan provides a significant benefit to customers in the form of greater certainty and known rates. At the same time, Duquesne's Plan provides the Commission and parties in this proceeding with sufficient time to evaluate the Plan and the resulting rate impacts.

Q. Couldn't Duquesne request that the Commission approve its Plan within a short time period (e.g., 5 business days) to mitigate the regulatory review period risk?

A. This would significantly reduce the risks to Duquesne Power, but Duquesne does not believe that it is realistic to request Commission approval of its Plan within such a short time period.

Q. Why couldn't the Commission approve and conduct a solicitation process immediately, and approve the results of the solicitation within a few days in order to lock in rates at current prevailing market prices and mitigate this regulatory review period risk?

A. Even if all parties somehow immediately agreed to conduct a solicitation, many significant and potentially contentious issues would still need to be resolved before the solicitation could be conducted.[46] For example, some parties would likely advocate for a Maryland-style RFP process, while others would likely support a New Jersey or Illinois declining-clock auction approach. Some parties may favor the laddering of supply contracts, while others would not. Some would desire the use of long-term contracts, while others would support only the use of short-term products, and still others may advocate a certain blend of long and short-term products. Some may favor supply to be procured in the form of a fixed price full requirements product, while others may favor other forms of the supply product that shift more of the price and volume risk from suppliers to retail customers. In addition to these issues regarding the format of the solicitation and the definition of the supply product, many other questions would need to be answered. Who will be the solicitation manager? Will it be the utility or a third party? What will be the structure and rules regarding communications between the bidders and the solicitation manager? Who, if anyone, will monitor the solicitation process to ensure that protocols are properly followed? What are the qualification criteria and application process to be a bidder, and what credit and

[46] 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.

collateral requirements must be met? Will caps be placed on the amount of supply that can be awarded to any single bidder? What is the contingency plan if the solicitation fails, and what constitutes failure in the first place? All of these issues would need to be resolved, associated documents would need to be drafted, and this takes time. In fact, in response to some parties' desire to adopt solicitation processes for default service throughout the state, the Commission established a working group to reach some agreement on the issues related to such a process. The initial meeting of the working group was held on July 26, 2006. While the working group is working to reach some consensus on the issues, none of the issues has yet to be resolved.

During the time required to resolve these issues and obtain final Commission approval of any solicitation plan, market prices are likely to change. In a solicitation, retail customers would bear the risks of these changes in market prices. Conducting a solicitation does not eliminate the regulatory review period risk; it merely shifts this risk from the default service supplier to retail customers.

It is also important to remember that there is considerable uncertainty surrounding the success of a new solicitation. What events may impact market prices prior to the bid? What if the solicitation is not structured appropriately? Will potential bidders be comfortable with the level of customer switching risks and basis differentials in Duquesne's service area? What additional costs and risks would customers need to assume in order to attract bidders in a solicitation? How many suppliers will bid? What prices will they bid? Obviously, customer rate impacts would 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.[47] Duquesne's Plan avoids the uncertainty and costs associated with the solicitation process and its outcome.

Finally, it is not at all clear from market evidence that conducting a solicitation will actually promote retail competition. Duquesne already has relatively higher levels of residential customer shopping than most, if not all, service areas that rely on a structured solicitation process.

Q. What compensation is Duquesne Power proposing to charge to cover its costs and risks associated with holding its fixed price offer open during the regulatory review period?

A. Duquesne Power is willing to provide this benefit for a charge of 0.3 cents per kWh for residential customers and 0.15 cents per kWh for Small C&I customers. While the length of the regulatory review period is expected to be the same for both customer classes, the level of risk is greater for residential customers than for Small C&I customers due to the longer term of the fixed price commitment.

[47] Based on my analysis of the solicitations and Duquesne's customer load patterns, I expect residential (RH) and Small C&I (GMH) heating customers would experience large and immediate rate increases as a result of a solicitation process. As described by Mr. Pfrommer, Duquesne, as a part of its Plan, has proposed to phase-in the supply rate increases for these customers over a three year period.

Q. Couldn't Duquesne Power hedge its regulatory review period risk to reduce the expected cost?

A. Duquesne Power may develop a strategy to hedge this risk (e.g., take a "long" position, take a "short" position, or some combination), but this strategy will only be useful in reducing its losses under certain outcomes (with respect to future market prices and the regulatory approval decision). A supply strategy will not reduce the expected cost of this risk, and the strategy itself may be costly. For example, Duquesne Power may decide to procure its supply now, or it may wait for Commission approval of the Plan. Under either strategy, Duquesne Power will assume considerable risk during the regulatory review period. Even if Duquesne Power tried to purchase options to hedge its regulatory review period risk, the options would need to be purchased at a cost with no guarantee of future recovery.

Q. In order to assess whether Duquesne Power is offering a reasonable charge to provide customers price certainty during a multi-month regulatory review period, did you attempt to quantify the potential risk associated with the regulatory review period?

A. Yes, I have performed an analysis that illustrates the size of this risk and indicates that Duquesne Power's offer is reasonable. Before I explain my analysis, I believe that it is important to note that estimating the potential magnitude of future risks is a more subjective science than is predicting other types of items, such as a cost category in a distribution rate case. Still, the risk that I have discussed is very real and significant, and my quantification provides a reasonable

illustration of the potential magnitude of the regulatory review period risk that is shifted from retail customers to Duquesne Power under Duquesne's Plan.

In order to illustrate the size of this risk, I recognized that a key driver of the risk is the magnitude of the potential market price movements during the regulatory review period. Therefore, I studied actual historical market price movements. Specifically, for each trade date since March 30, 2005 (the first date in which adequate market price data was available), I tabulated the New York Mercantile Exchange's ("NYMEX") reported forward market price for around-the-clock ("ATC") energy[48] delivered at PJM Western Hub for calendar year 2007. Using this data, I calculated the percentage change in forward market prices from each given trade date to the date six months later. Each of these percentages represents an actual market scenario that occurred. As a result, the entire set of percentages is the distribution of market price movements witnessed in the market over the specified period of time. This distribution is shown in Exhibit NSF-12. Assuming that the regulatory review period is about six months long, this distribution can be used to illustrate the possibilities, with regard to market price movements, during the regulatory review period.

Next, I identified the 90th percentile scenario; that is, the percentage price increase such that 10 percent of the scenarios had a percentage price increase that was higher. The percentage price increase in this scenario is 23.0%. This implies that there is a 10% probability that market prices could increase by more than 23.0% during the regulatory review period. Such a scenario would be costly to

[48] ATC energy is by far the largest component and driver of full requirements market value, and other components of the full requirements market value are correlated with the ATC energy price.

Duquesne Power if it had not purchased supply in advance of regulatory approval and the Commission decided to approve the default service rate that is offered in the Plan, because Duquesne Power would need to obtain supply at the higher market prices. Applying this percentage market price increase to a market value of approximately $64/MWH (before GRT), translates into a cost to Duquesne Power and a benefit to customers of over $14/MWH.

Q. Could Duquesne Power avoid this cost by procuring its supply now?

A. If Duquesne Power procures its supply now, it no longer incurs significant costs when market prices increase, but it instead incurs significant costs when market prices decrease. Over the historical period that I studied, the 10^{th} percentile scenario for the percentage price change over six months is -17.2%. This implies that there is a 10% probability that market prices could decrease by more than 17.2% during the regulatory review period. Applying this percentage market price decrease to a market value of approximately $64/MWH (before GRT), translates into a cost of about $11/MWH.

Q. What do you conclude about the regulatory review period risk?

A. Under the Default Service Plan, small retail customers are provided a significant benefit due to Duquesne Power's willingness to assume the regulatory review period risk that I have described. Customers would not be provided this benefit under a solicitation approach. A solicitation process does not make this risk disappear; it merely transfers the risk from the default service supplier to retail customers. Actual market evidence indicates that the charge that Duquesne

Power is offering (0.3 and 0.15 c/kWh for residential and Small C&I customers, respectively) as compensation for assuming this risk, instead of requiring retail customers to shoulder it, is less than the potential costs associated with this risk.

Q. Please describe the second type of asymmetric risk that you identified, customer switching risk.

A. When a default service supplier such as Duquesne Power provides supply at a fixed rate that is passed through to customers, customers have the incentive to elect the rate when it is lower than EGSs' offers, and they have the incentive not to elect the rate when it is higher than EGSs' offers. As a result, customers are likely to elect default service when market prices are higher than the default service rates, and not elect default service when market prices are lower than the default service rates. This customer switching option can be very valuable for customers, but very expensive for default service suppliers. The customer switching risk results in possible losses for default service suppliers, and the size and likelihood of these losses are largely dependent upon market price volatility and the likelihood that customers will take advantage of this switching option.

Q. Why do you believe that customer switching risks are higher in Duquesne's service area than in other service areas where solicitations were held?

A. Like many other service areas, Duquesne no longer has any switching rules or restrictions on residential and Small C&I customers to prevent them from

switching back and forth between fixed price default service and EGS service.[49] However, unlike most of the service areas that rely on solicitations, Duquesne currently has significantly higher levels of residential shopping. The principal switching risk associated with the residential customers currently served by EGSs is that they will return to default service unexpectedly at a time when market prices are high, forcing Duquesne Power to obtain additional supplies at a cost exceeding the default service contract prices. Duquesne's switching risk is exacerbated by the large concentration of shopping load served by a single EGS who can suddenly decide to switch all of its customers back to Duquesne whenever it chooses. EGSs serving residential customers have in the past threatened to switch back large numbers of residential customers onto default service all at once.[50] Also, it is important to note that in Duquesne's POLR II settlement the parties agreed to a switching rule trigger if over 50,000 residential customers were returned to default service within a three-month time period, and that switching rule was triggered only several months after the POLR II settlement was approved.

In addition, other states have been able to adopt certain measures to mitigate customer switching and gaming risks. In Maryland, there is a volumetric rate adjustment mechanism in the event customer switching levels increase significantly. Unlike Duquesne's proposal, this provision transfers risks from the default supplier to retail customers. Some states have approved seasonal rates

[49] During the early years of retail access, significant numbers of customers returned to Duquesne's default service during the summer months and then elected to be served by EGSs during the non-summer months. This led to the development of switching rules for residential and Small C&I customers during POLR II. These switching restrictions were eliminated by the Commission in the POLR III Order.

[50] Allegheny Energy Supply threatened to return over 100,000 residential customers in early 2001 and has since sold its EGS business in Duquesne's service area.

(e.g., New Jersey), but for reasons described in Mr. Eichenmiller's testimony, Duquesne has found it difficult to reach consensus among consumer groups and EGSs on this issue.

For all of these reasons, customer switching risks in Duquesne's service area are likely to be higher than they are in many other regions.

Q. Is Duquesne or Duquesne Power requesting any compensation in this filing to cover the costs associated with these additional customer switching risks?

A. No, it is not. But it is important to note that, should a solicitation be held in Duquesne's service area at some time in the future, unless changes are made to the rules regarding customer switching and/or pricing, bidders would likely seek compensation for these additional customer switching risks.

Q. Are there other risks that the wires business is assuming as a part of the Company's Default Service Plan?

A. Yes. The Company will assume several additional potential risks, including a) the risk that Duquesne may experience greater fluctuation in revenues due to changes in consumption (due to weather, demand response, business activity, or other unrelated factors) with the elimination of supply demand charges and declining energy blocks, and b) the risk that higher supply rates and the new POR program could increase total credit and collection costs.

Q. Is Duquesne requesting any compensation in this filing to cover these other additional risks you mentioned?

A. No, as part of its Default Service Plan, Duquesne is willing to assume these risks at no additional cost to customers during the 2008-2010 period.

Q. Other than the regulatory review period risk adjustment described above, what other adjustments did you make to the average of the solicitation results shown in Exhibit NSF-11?

A. I added the cost of the applicable line losses for the Duquesne service area and Pennsylvania GRT. Exhibit NSF-13 shows the average supply rates for residential, Small C&I and lighting customers that I provided to Mr. Pfrommer so that he could develop the retail rates by rate schedule and rate component.

Q. Briefly describe how the average rate levels for lighting customers were developed.

A. Lighting customers generally consume a higher proportion of their electricity consumption during off-peak hours. Therefore, both the energy and capacity costs are lower than that of residential and Small C&I customers.[51] I calculated a lower average rate level for lighting customers based on these differences in load patterns and capacity obligations.

Q. Do the prices in the solicitations that you reviewed typically include retailing costs that an EGS must incur?

[51] The MTS rate schedule, which applies to street traffic lights, is an exception. Traffic lights operate during peak hours and are more similar to the Small C&I customer class.

A. The winning bids in these solicitations generally reflect all the costs of serving full requirements default service load at the wholesale level. Since the default service suppliers are providing supply to an aggregated load awarded to them in the solicitation process, the winning bids, however, do not reflect the costs of marketing and customer acquisition that an EGS typically would incur. On the other hand, the default service supplier incurs costs and risks that an EGS typically might not incur (or at least not of the same magnitude), such as regulatory review period risk and increased customer switching risks.

It is important to recognize that EGS offers and utility default service offers do not always reflect the same terms and conditions. An EGS has much more flexibility regarding the risks it is willing to assume, with whom, and when. EGSs are not required to sell to all customers. EGSs can negotiate the length of customer contracts. EGSs have more flexibility to update their pricing as market conditions change (e.g., the price of a one-year contract offered today may be very different than the price of a one-year contract offered next month). EGS contracts may include price re-openers if market prices increase. EGSs can potentially terminate existing offers or stop making new offers. Finally, unlike the default supplier, an EGS may completely exit the business. In short, an EGS has much more flexibility than the default supplier. This flexibility allows an EGS to manage its risks through marketing, contracting, or entering and exiting the market. The utility, as a default supplier, does not have this same flexibility and should be compensated for the risks that it assumes. Consequently, EGS price offers generally do not reflect all of the risks incurred by a default provider. On the other hand, utility default service providers do not face the customer

acquisition and aggregation costs that EGSs typically incur. Therefore, appropriately compensating the default supplier for customer switching and regulatory review period risks may provide EGSs an opportunity to recover the marketing and acquisition costs that a default supplier does not incur.

b) Electricity and Natural Gas Prices Have Increased

Q. Is there other market evidence to support the need for an increase in supply rates above current POLR III levels?

A. Yes. Spot electricity prices have increased significantly since POLR III rate levels were developed in 2003. Since then, PJM Western Hub electricity prices have increased 33%. (See Exhibit NSF-14.) Spot natural gas prices also have increased since the POLR III rate levels were developed. Since 2003, natural gas prices have increased about 23%. (See Exhibit NSF-15.) While I did not rely on historical spot price changes to develop rates in this proceeding, they provide an indication of the overall magnitude of the level of price increases since Duquesne's rates were last developed. I did, however, rely on market expectations about future market prices when evaluating solicitation bids and developing Duquesne's average rates.

c) Duquesne Power Will Obtain Its Supply from the Competitive Market

Q. Is there any other evidence to suggest that the rates being offered by Duquesne reflect prevailing market prices?

A. Yes. Unlike many utilities in Maryland, New Jersey, and Pennsylvania, Duquesne voluntarily divested its generation assets during its restructuring

process. Duquesne's affiliate, Duquesne Power, owns very little generation (approximately 100 MW). As part of its merger application, the Company has committed about half of those megawatts to expanding economic development programs in its service area. As part of this filing, Duquesne Power has agreed to purchase 100% of its default service supply in the competitive wholesale market. In order to meet its default service obligations, Duquesne Power can enter into negotiated bilateral contracts, conduct a more structured solicitation, and/or acquire power in the spot market. In any case, it has little incentive to offer rates below market prices when it will acquire electricity at prevailing market prices in the competitive wholesale market.

Q. What do you conclude about the level of Duquesne's proposed default service supply rates?

A. Duquesne's proposed supply rates represent prevailing market prices and recover reasonable costs. The results of recent solicitations when adjusted properly for definitional, locational, timing, and risk differences support this conclusion. Other market price evidence shows that there have been significant increases in electricity and natural gas prices since POLR III rates were developed. In addition, relative to POLR III, the proposed rates include new risks and costs associated with PJM-related RPM capacity and AEPS requirements. Finally, Duquesne's affiliate will acquire its supply from unaffiliated suppliers in the competitive market at prevailing market prices.

IV. Duquesne's Methodology To Adjust The Small C&I Fixed Supply Rates Each Year Relies On Changes In Visible Market Prices That Can Be Measured In A Verifiable And Objective Manner

Q. Briefly describe how Duquesne will adjust the default service rates for Small C&I customers based on changes in market prices.

A. Duquesne proposes to serve Small C&I customers at fixed annual rates for 2008-2010. Initial rates are based on prevailing market prices at the time of the filing for the 2008-2010 period, but the 2009 and 2010 rates will be adjusted to reflect subsequent changes in market prices. This adjustment will be accomplished through application of a "Market Price Multiplier" to the initial rates set forth in Exhibit WVP-1. The Market Price Multiplier will be calculated based on changes in wholesale electricity forward prices from the date when rates are initially established near the filing date, to the first day of October 2008 for 2009 deliveries, and to the first day of October 2009 for 2010 deliveries. For example, on October 1, 2008 Duquesne will calculate the Market Price Multiplier for calendar year 2009, which will be applied to the GS, GM, and GMH base rate components for 2009 shown in Exhibit WVP-1. Depending on market price movements over time, the Market Price Multiplier may be less than or greater than 1, resulting in either a decrease or increase in rates. A similar rate adjustment will be calculated on October 1, 2009 and become effective January 1, 2010. The steps involved in calculating the Market Price Multiplier are described in more detail in Exhibit NSF-16. This exhibit also shows the calculation of the 2009 and 2010 base index prices.

Q. Is the adjustment to Small C&I rates based on visible market prices that can be measured in a verifiable and objective manner?

A. Yes. The results can be replicated and are auditable. The Market Price Multiplier will be calculated from a formula that uses the PJM NiHub electricity market prices reported by NYMEX, a data source that reports electricity forward market prices on a daily basis. Specifically, as explained in Exhibit NSF-16, the formula used to calculate the Market Price Multiplier involves the averages of electricity market prices reported by NYMEX over twenty-day periods.

Q. Why do you rely on the PJM NiHub price as opposed to some other index?

A. 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.

Q. Why does the calculation use the average of electricity market prices reported by NYMEX spanning twenty trading days, rather than using the price reported on a single trading day?

A. A twenty-day period provides sufficient duration to smooth out anomalies that might occur in a single day or in a week. Yet, a twenty-day period is short enough that it is still representative of current market conditions.

Q. Have other jurisdictions relied on averaging prices over twenty trading days for the purpose of developing a market price index to set retail rates?

A. Yes. In Texas, natural gas prices were averaged over twenty trading days to adjust PTB rate levels.[52] In New York, NYSEG and RG&E rely on a market price index mechanism that incorporated electricity market prices over a twenty-trading-day period. Likewise, the Power Purchase Option offered by Illinois utilities was based on a market index mechanism that relied on a twenty-trading-day average of electricity market prices.

Q. Why are rates finalized October 1st prior to the start of the calendar year?

A. The primary purpose is to provide both customers and EGSs sufficient notice of the new rates prior to their effective date. This will allow EGSs time to market to customers, and provide customers an opportunity to shop before the new rates become effective.

Q. Does that conclude your testimony?

A. Yes, it does.

[52] Unlike the Texas PTB mechanism, Duquesne will not have discretion over when to file for an adjustment. Duquesne's rates could decrease, not just increase, depending on market price movements.

NSF Exhibits

Exhibit NSF-1	Shopping Levels in the United States by Customer Type
Exhibit NSF-2	Utilities with Hourly Price Default Service for Large C&I Customers
Exhibit NSF-3	Fixed Supply Rate Expiration Dates for Major Pennsylvania Utilities
Exhibit NSF-4	Comparison of Residential Shopping Levels – Duquesne vs. Utilities that Rely on Solicitations
Exhibit NSF-5	Residential Customer Supply Rate Reductions Relative to Restructuring Generation Rate Cap (1996-2010)
Exhibit NSF-6	List of Reviewed Solicitations
Exhibit NSF-7	Comparison of Duquesne's Proposed Rates and the Results of Recent Solicitations
Exhibit NSF-8	Summary of Key Definitional Differences in Recent Solicitations
Exhibit NSF-9	Comparison of Duquesne's Proposed Rates and the Results of Recent Solicitations Adjusted for Definitional Differences
Exhibit NSF-10	Locational Spot Energy Basis Differentials Between Duquesne and Other Utility Zones
Exhibit NSF-11	Comparison of Duquesne's Proposed Rates and the Results of Recent Solicitations Adjusted for Definitional, Locational, and Timing Differences
Exhibit NSF-12	Illustration of Potential Market Price Movements During the Regulatory Review Period
Exhibit NSF-13	Derivation of Class Average Rates
Exhibit NSF-14	PJM Western Hub Electricity Market Prices (1998-2006)
Exhibit NSF-15	Henry Hub Natural Gas Prices (1998-2006)
Exhibit NSF-16	Description of the Market Price Multiplier
Exhibit NSF-17	Duquesne Zone versus PJM Northern Illinois Hub ("NiHub") Spot Prices

U.S. Retail Access Shopping Statistics

Residential Customer Load

Rank	Utility	State	Migration Rate	Notes
1	AEP Texas North Company	TX	52%	_a/
2	AEP Texas Central Company	TX	40%	_a/
3	Texas-New Mexico Power	TX	38%	_a/
4	Centerpoint	TX	36%	_a/
5	Orange and Rockland Utilities	NY	35%	_b/
6	TXU	TX	33%	_a/
7	Rochester Gas & Electric	NY	23%	
8	Ohio Edison	OH	18%	_c/
9	**Duquesne Light Co.**	**PA**	**18%**	
10	NSTAR	MA	17%	_c/
11	Toledo Edison	OH	12%	_c/
12	Consolidated Edison	NY	10%	
13	Niagara Mohawk Power Corp.	NY	9%	
14	New York State Electric & Gas	NY	8%	
15	Cleveland Electric Illuminating	OH	8%	_c/
16	Potomac Electric Power Co.	MD	7%	
17	Western Massachusetts Electric Co.	MA	3%	
18	Massachusetts Electric Co.	MA	2%	
19	JCP&L	NJ	2%	
20	Maine Public Service Co.	ME	2%	
21	Cincinnati Gas & Electric	OH	2%	
22	Potomac Electric Power Co.	DC	2%	
23	Baltimore Gas & Electric	MD	1%	
24	PSEG	NJ	1%	
25	Central Hudson Gas & Electric	NY	1%	
26	Delmarva Power & Light	DE	1%	
27	Atlantic City Electric	NJ	1%	
28	Bangor Hydro Electric Co.	ME	1%	
28	Central Maine Power Co.	ME	1%	
30	**PECO Energy Co.**	**PA**	**0%**	
31	Delmarva Power & Light	MD	0%	
32	Narragansett Electric Co.	RI	0%	
33	Fitchburg Gas & Electric	MA	0%	
34	Detroit Edison	MI	0%	
35	AmerenCILCO	IL	0%	
35	AmerenCIPS	IL	0%	
35	Commonwealth Edison	IL	0%	
35	Illinois Power	IL	0%	
35	MidAmerican Energy Company	IL	0%	
35	Allegheny (Potomac Edison, Monongahela)	MD	0%	
35	Consumers Energy	MI	0%	
35	Rockland Electric	NJ	0%	
35	Columbus Southern Power Co.	OH	0%	
35	Dayton Power & Light	OH	0%	
35	Ohio Power Company	OH	0%	
35	**Allegheny Power (West Penn Power)**	**PA**	**0%**	
35	**Met Ed / Penelec**	**PA**	**0%**	
35	**Pennsylvania Power & Light**	**PA**	**0%**	
35	**Pennsylvania Power Co.**	**PA**	**0%**	

Notes:
Some differences exist in how jurisdictions define customer groups and in how they measure customer shopping.

_a/ Assigned to Texas PTB provider with natural gas price fuel factor index.
_b/ Customer referral program.
_c/ Opt-out customer assignment program.
Source: State websites; Duquesne figures based on Company billed kWh as of January 2007.

U.S. Retail Access Shopping Statistics

Small Customer Load

Rank	Utility	State	Migration Rate	Notes
1	AEP Texas Central Company	TX	85%	_a/
2	AEP Texas North Company	TX	80%	_a/
3	TXU	TX	69%	_a/
4	Texas-New Mexico Power	TX	69%	_a/
5	Centerpoint	TX	60%	_a/
6	Potomac Electric Power Co.	MD	56%	
7	Niagara Mohawk Power Corp.	NY	56%	
8	Rochester Gas & Electric	NY	53%	
9	Baltimore Gas & Electric	MD	50%	
10	Consolidated Edison	NY	47%	
11	Orange and Rockland Utilities	NY	47%	_b/
12	New York State Electric & Gas	NY	46%	
13	Western Massachusetts Electric Co.	MA	43%	
14	Bangor Hydro Electric Co.	ME	41%	
14	Central Maine Power Co.	ME	41%	
16	Delmarva Power & Light	MD	38%	
17	Toledo Edison	OH	37%	_c/
18	Massachusetts Electric Co.	MA	36%	
19	NSTAR	MA	36%	_c/
20	Allegheny (Potomac Edison, Monongahela)	MD	35%	
21	Maine Public Service Co.	ME	32%	
22	Commonwealth Edison	IL	31%	
23	Ohio Edison	OH	27%	
24	Detroit Edison	MI	26%	
25	Central Hudson Gas & Electric	NY	24%	
26	Fitchburg Gas & Electric	MA	22%	
27	**Duquesne Light Co.**	**PA**	**19%**	_d/
28	Cleveland Electric Illuminating	OH	17%	
29	Dayton Power & Light	OH	12%	
30	Consumers Energy	MI	11%	
31	**PECO Energy Co.**	**PA**	**10%**	
32	Narragansett Electric Co.	RI	10%	
33	Cincinnati Gas & Electric	OH	8%	
34	**Pennsylvania Power Co.**	**PA**	**3%**	
35	Illinois Power	IL	3%	
36	JCP&L	NJ	2%	
37	Columbus Southern Power Co.	OH	2%	
38	PSEG	NJ	1%	
39	Atlantic City Electric	NJ	1%	
40	AmerenCIPS	IL	1%	
41	AmerenCILCO	IL	0%	
42	**Pennsylvania Power & Light**	**PA**	**0%**	
42	MidAmerican Energy Company	IL	0%	
42	Rockland Electric	NJ	0%	
42	Ohio Power Company	OH	0%	
42	**Allegheny Power (West Penn Power)**	**PA**	**0%**	
42	**Met Ed / Penelec**	**PA**	**0%**	

Notes:
Some differences exist in how jurisdictions define customer groups in terms of size and type, and in how they measure customer shopping.

_a/ Assigned to Texas PTB provider with natural gas price fuel factor index.
_b/ Customer referral program.
_c/ Opt-out customer assignment program.
_d/ Duquesne figures for small C&I customers <300 kW (billed kWh as of January 2007). OCA reports 49% shopping for all commercial customers in Duquesne's service area as of January 2007. The OCA's figure is comparable to those reported for other Pennsylvania utilities.

Source: State websites.

U.S. Retail Access Shopping Statistics

Large Customer Load

Rank	Utility	State	Migration Rate	Notes
1	**Duquesne Light Co.**	**PA**	**98%**	**a/**
2	Baltimore Gas & Electric	MD	95%	
3	Atlantic City Electric	NJ	94%	
4	Fitchburg Gas & Electric	MA	94%	
5	Delmarva Power & Light	MD	94%	
6	*Potomac Electric Power Co.*	MD	93%	
7	Allegheny (Potomac Edison, Monongahela)	MD	92%	
8	Western Massachusetts Electric Co.	MA	92%	
9	Bangor Hydro Electric Co.	ME	91%	
9	Consolidated Edison	NY	91%	
11	Central Maine Power Co.	ME	90%	
12	Maine Public Service Co.	ME	88%	
13	JCP&L	NJ	86%	
14	Massachusetts Electric Co.	MA	86%	
15	PSEG	NJ	85%	
16	Central Hudson Gas & Electric	NY	82%	
17	NSTAR	MA	82%	
18	Rockland Electric	NJ	79%	
19	New York State Electric & Gas	NY	69%	
20	Niagara Mohawk Power Corp.	NY	66%	
21	Dayton Power & Light	OH	61%	
22	Rochester Gas & Electric	NY	61%	
23	Commonwealth Edison	IL	59%	
24	Narragansett Electric Co.	RI	42%	
25	Orange and Rockland Utilities	NY	39%	
26	AmerenCILCO	IL	33%	
27	Consumers Energy	MI	22%	
28	Ohio Edison	OH	18%	
29	Detroit Edison	MI	13%	
30	**Pennsylvania Power Co.**	**PA**	**12%**	
31	Cleveland Electric Illuminating	OH	11%	
32	Illinois Power	IL	11%	
33	**Met Ed / Penelec**	**PA**	**7%**	
34	AmerenCIPS	IL	2%	
35	Toledo Edison	OH	2%	
36	Cincinnati Gas & Electric	OH	0%	
37	**PECO Energy Co.**	**PA**	**0%**	
38	MidAmerican Energy Company	IL	0%	
38	Columbus Southern Power Co.	OH	0%	
38	Ohio Power Company	OH	0%	
38	**Allegheny Power (West Penn Power)**	**PA**	**0%**	
38	**Pennsylvania Power & Light**	**PA**	**0%**	

Notes:

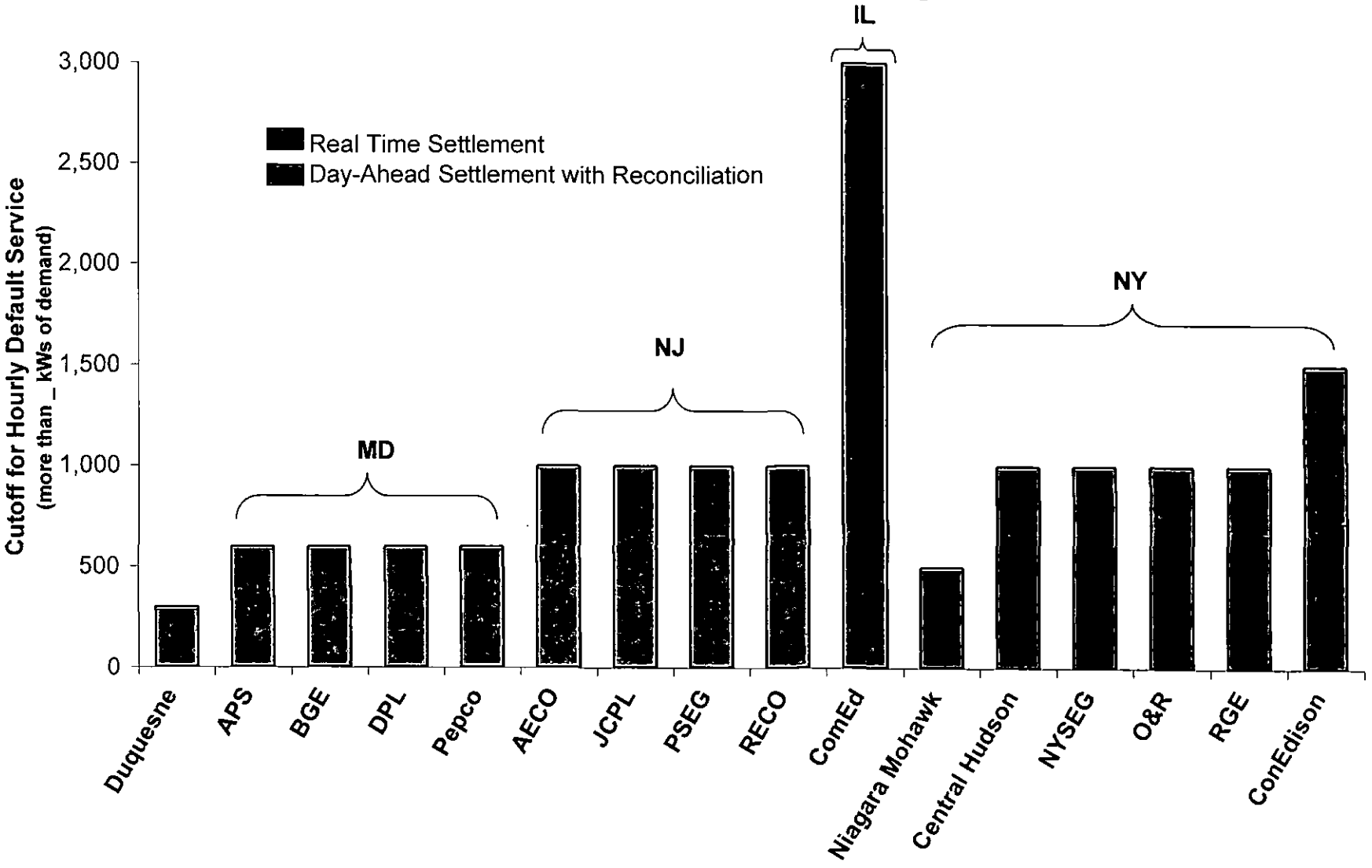
Some differences exist in how jurisdictions define customer groups in terms of size and type, and in how they measure customer shopping.

Texas reports do not show shopping by service area for large C&I customers, but reports that primary and transmission voltage level customers, which tend to be large customers with a demand greater than 1 MW, have 68% of the MWH sold to this class provided by non-affiliated retail electric providers.

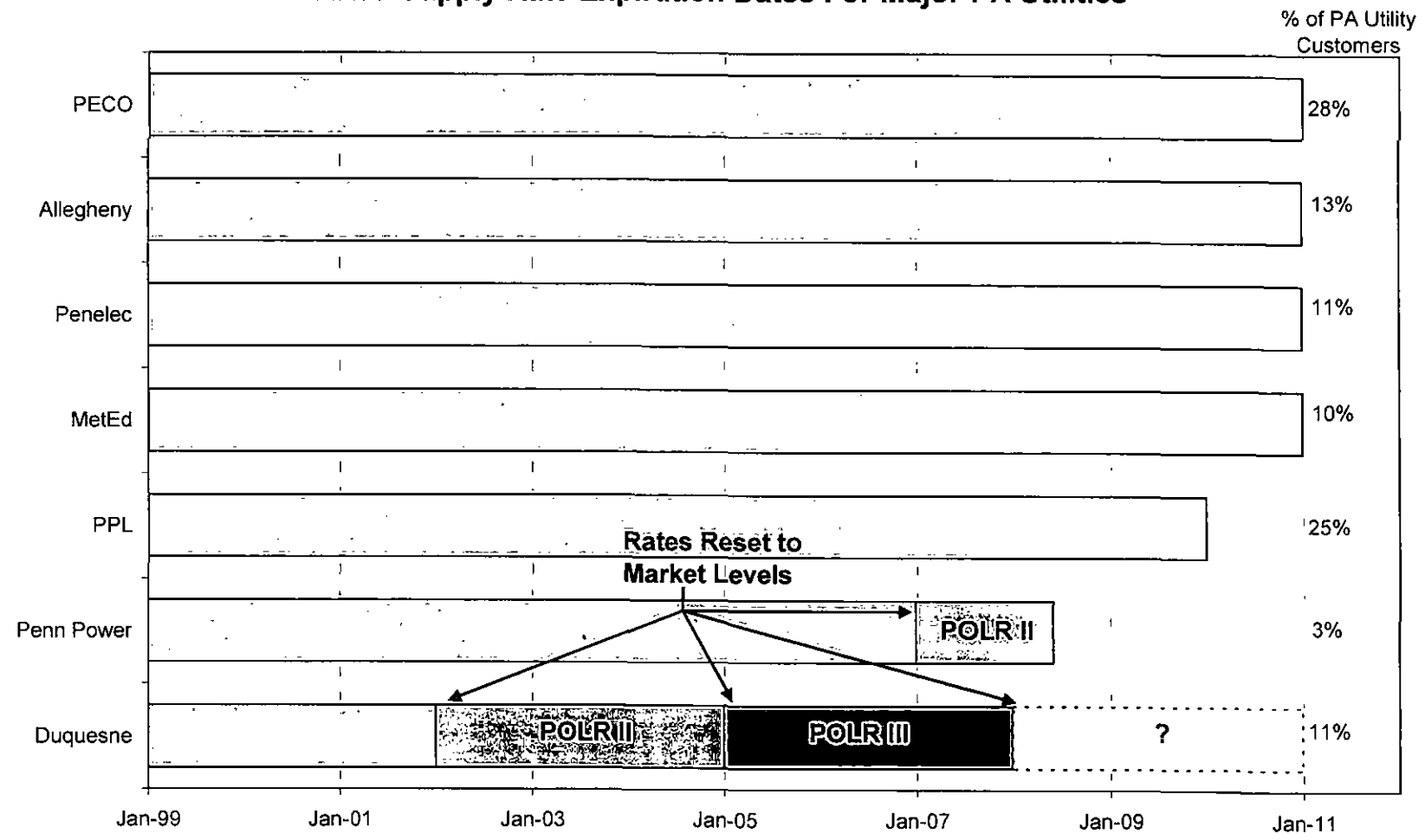
_a/ Duquesne figures for large C&I customers >300 kW (billed kWh as of January 2007). OCA reports 86% shopping for all industrial customers in Duquesne's service area as of January 2007. The OCA's figure is comparable to those reported for other Pennsylvania utilities.

Source: State websites.

Utilities with Hourly Price Default Service for Large C&I Customers



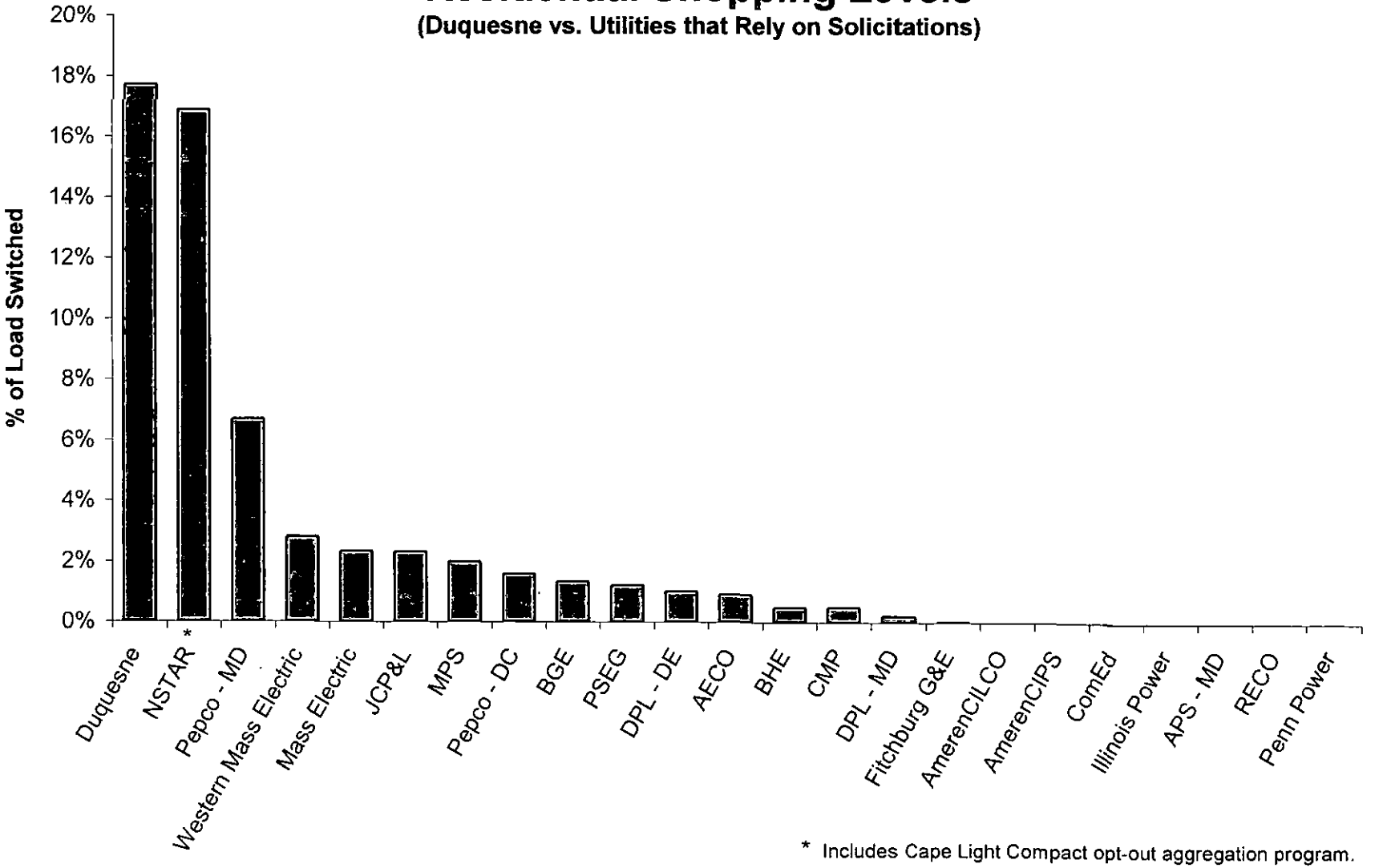
Fixed Supply Rate Expiration Dates For Major PA Utilities



Source: Numbers of customers served from 2005 FERC Form 1.

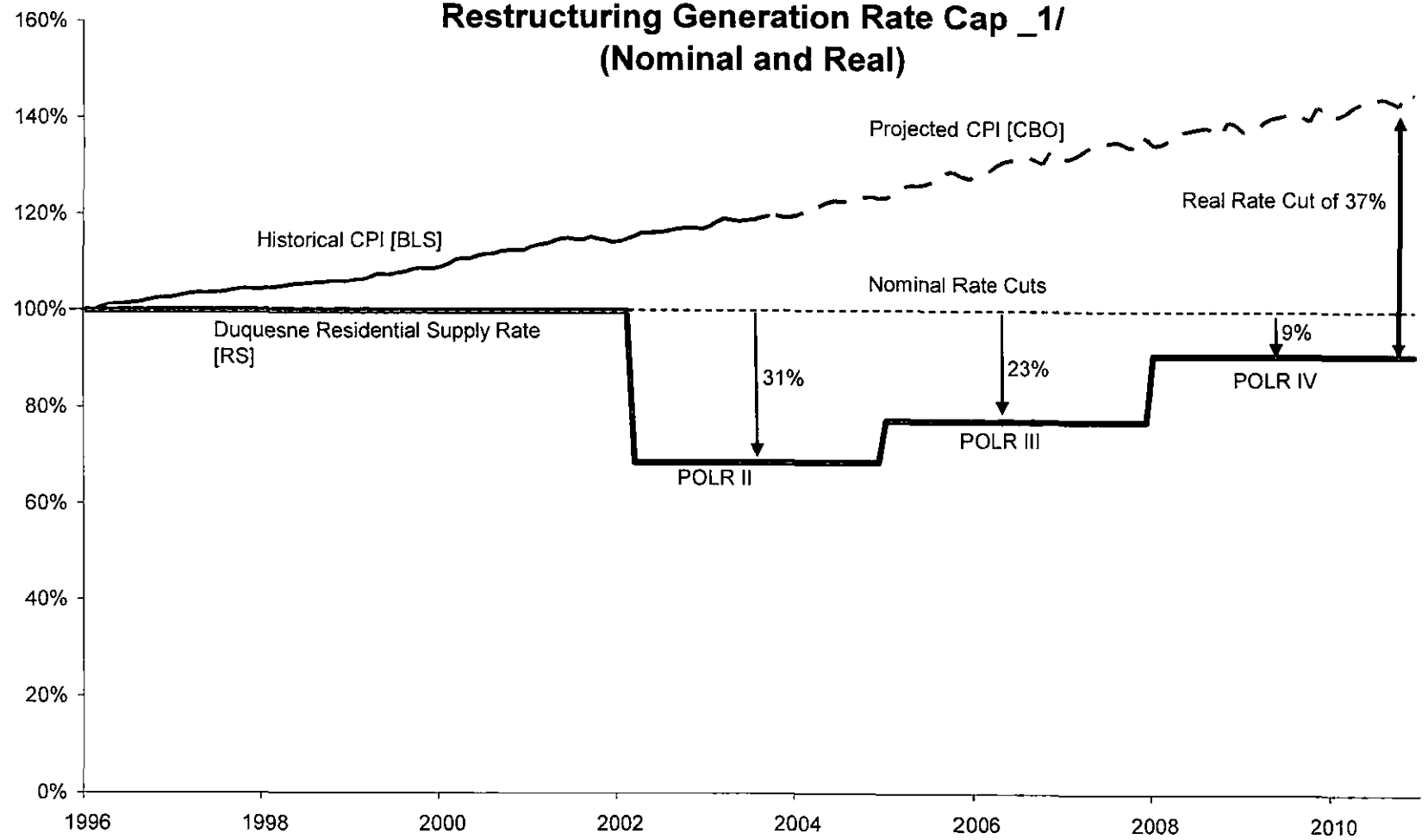
Residential Shopping Levels

(Duquesne vs. Utilities that Rely on Solicitations)



* Includes Cape Light Compact opt-out aggregation program.

Duquesne Residential Supply Rate [RS] Reductions Relative to Restructuring Generation Rate Cap _1/ (Nominal and Real)

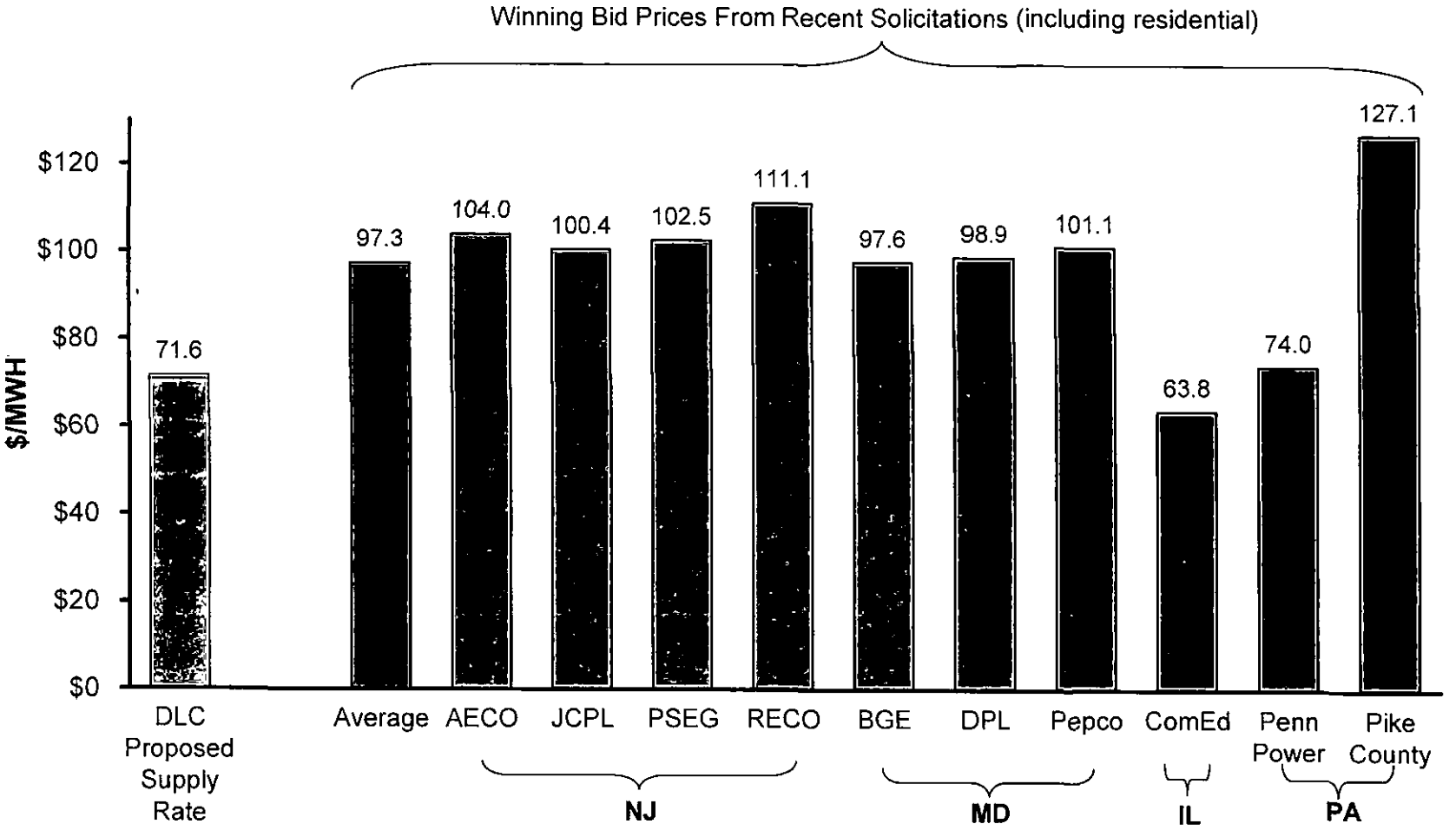


_1/ Duquesne's pre-restructuring rates were established in a 1987 rate case and are adjusted for GRT @ 5.9%. POLR IV supply rates have been adjusted to include ancillary services and the PJM surcharge. POLR IV rates also cover new costs associated with PJM-RPM and renewable portfolio standards.

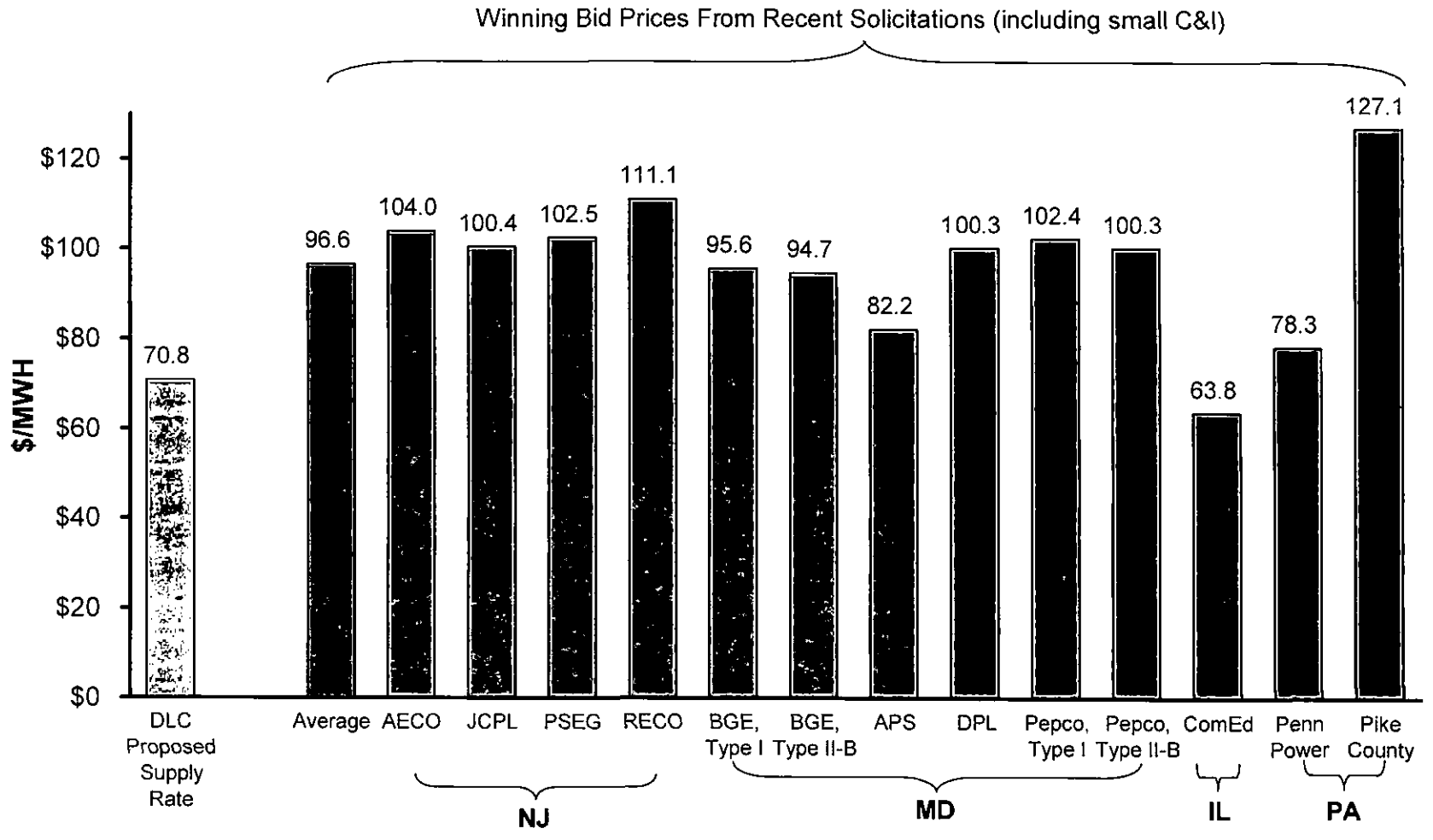
SOLICITATIONS REVIEWED

Utility Solicitation	Term	Customer Class	C&I Breakdown	Date
New Jersey				
AECO	36 Months	Residential and Small C&I	up to 1250 kW	2/7/2006
JCPL	36 Months	Residential and Small C&I	up to 1250 kW	2/7/2006
PSEG	36 Months	Residential and Small C&I	up to 1250 kW	2/7/2006
RECO	36 Months	Residential and Small C&I	up to 1250 kW	2/7/2006
Maryland				
BGE	11,23,35 Months	Residential		12/5/05, 1/23/06, 2/21/06
BGE	12,24 Months	Type I C&I	up to 60 kW	12/5/05, 1/23/06, 2/21/06
BGE	12 Months	Type II-B C&I	60-100 kW	12/5/05, 1/23/06, 2/21/06
APS	12,24 Months	Type I C&I	up to 50 kW	12/5/05, 1/23/06, 2/21/06
DPL	12,24 Months	Residential		12/5/05, 1/23/06, 2/21/06
DPL	12,24 Months	Type I C&I	up to 60 kW	12/5/05, 1/23/06, 2/21/06
Pepco	12,24 Months	Residential		12/5/05, 1/23/06, 2/21/06
Pepco	12,24 Months	Type I C&I	up to 25 kW	12/5/05, 1/23/06, 2/21/06
Pepco	12 Months	Type II-B C&I	25-100 kW	12/5/05, 1/23/06, 2/21/06
ComEd				
ComEd	17 Months	Residential and Small C&I	up to 400 kW	9/8/2006
ComEd	29 Months	Residential and Small C&I	up to 400 kW	9/8/2006
ComEd	41 Months	Residential and Small C&I	up to 400 kW	9/8/2006
Pennsylvania				
Penn Power	17 Months	Residential		5/31/06, 7/18/06
Penn Power	17 Months	Small C&I	All Secondary Voltages	5/31/06, 7/18/06
Pike County	19 Months	Residential and C&I	All Secondary Voltages	4/26/2006
Duquesne's Default Service Plan				
DUQUESNE	36 Months 12 Months	Residential Small C&I	up to 300 kW	Jan-07 Jan-07

Duquesne's Proposed Rate vs. Winning Bid Prices (Residential)



Duquesne's Proposed Rate vs. Winning Bid Prices (Small C&I)

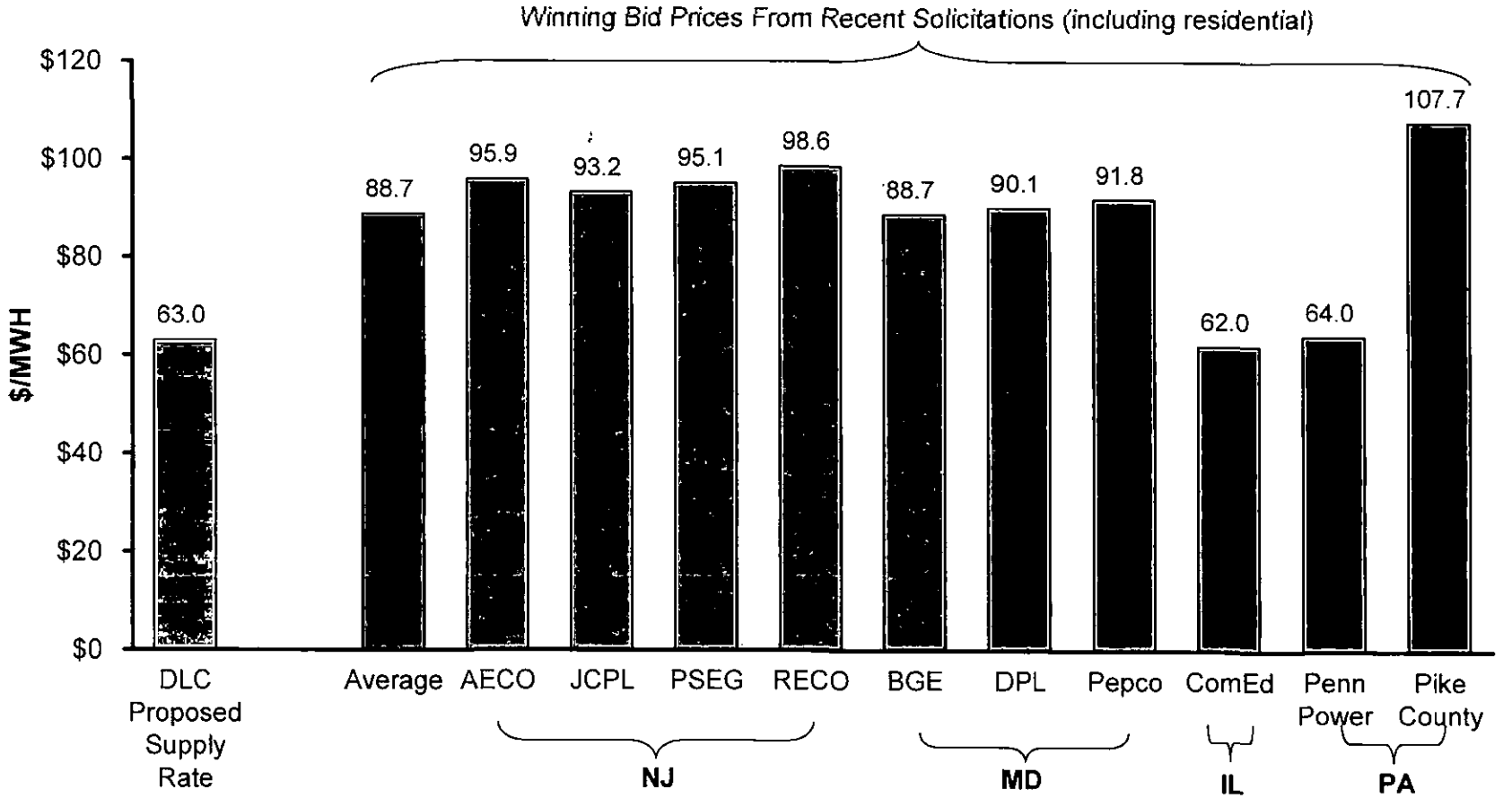


Key Definitional Differences: Solicitations vs. Duquesne's Supply Rates

	Components Included In Solicitation				Definitional Adjustments _a/
Utility Solicitation Bids	**Line Losses**	**Network Transmission**	**Ancillary Services _b/**	**Gross Receipts Taxes**	
New Jersey					
AECO	No	Yes	Yes	No	Transmission and ancillary services were subtracted from bid prices.
JCPL	No	Yes	Yes	No	
PSEG	No	Yes	Yes	No	
RECO	No	Yes	Yes	No	
Maryland					
BGE	Yes	No	Yes	No	Line losses and ancillary services were subtracted from bid prices.
DPL	Yes	No	Yes	No	
Pepco	Yes	No	Yes	No	
Illinois					
ComEd	No	No	Yes	No	Ancillary services were subtracted from bid prices.
Pennsylvania					
Penn Power	No	Yes	Yes	No	Transmission and ancillary services were subtracted from bid prices.
Pike County _c/	Yes	No	Yes	Yes	Line losses, ancillary services and GRT were subtracted from retail rates.
Duquesne's Supply Rates					
Duquesne	Yes	No	No	Yes	Line losses and GRT were subtracted from retail rates.

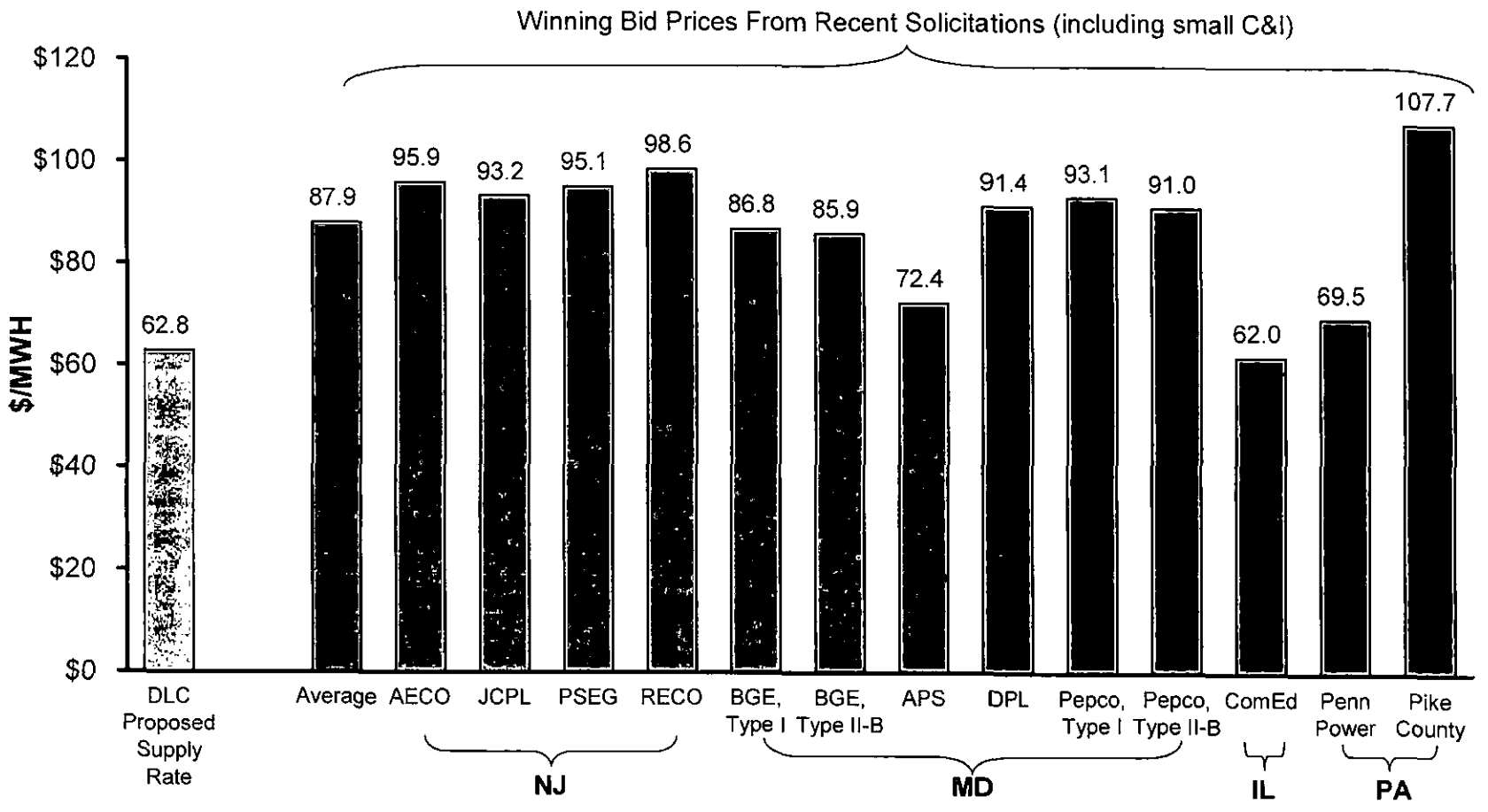
_a/ When available, values for each component were based on data specific to each utility.
_b/ Including RTO administrative costs.
_c/ For Pike County, the retail rates resulting from the solicitation in April 2006 were used.

Duquesne's Proposed Rate vs. Winning Bid Prices (Residential)
Adjusted for Definitional Differences

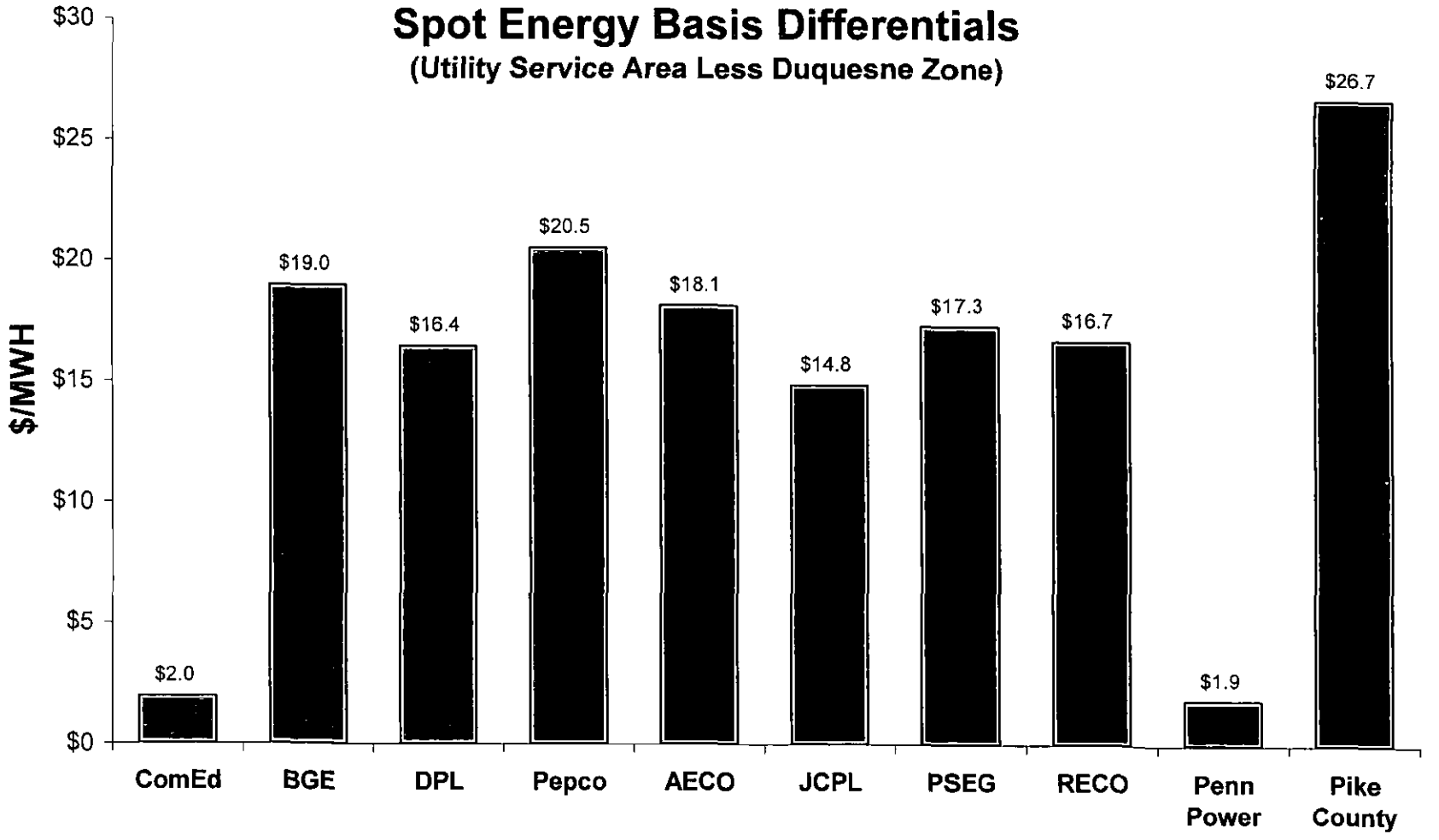


Note: Prices do not include transmission, ancillary services, line losses or GRT. Some solicitations also included small C&I customers.

Duquesne's Proposed Rate vs. Winning Bid Prices (Small C&I) Adjusted for Definitional Differences

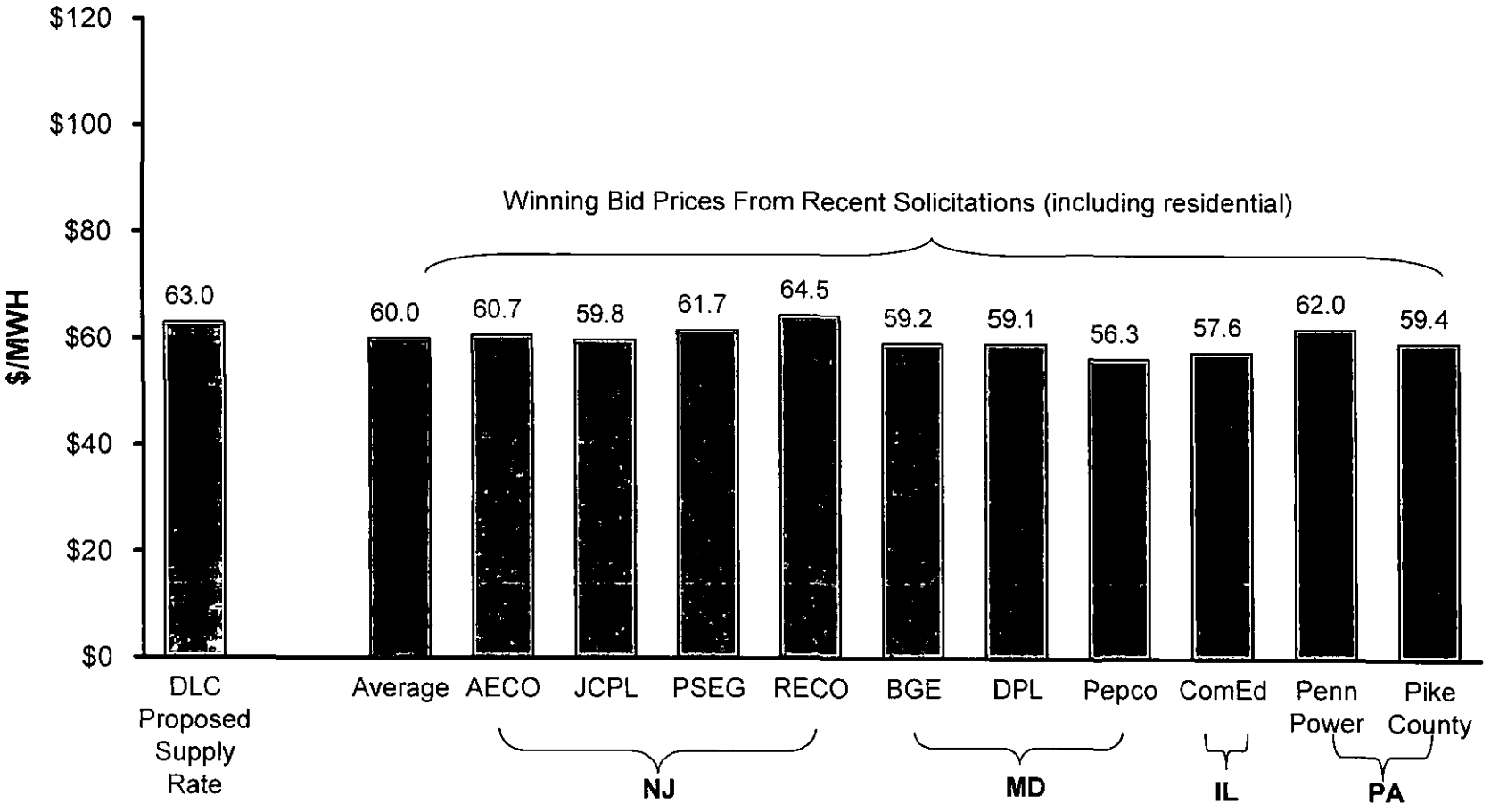


Note: Prices do not include transmission, ancillary services, line losses or GRT. Some solicitations also included residential customers.



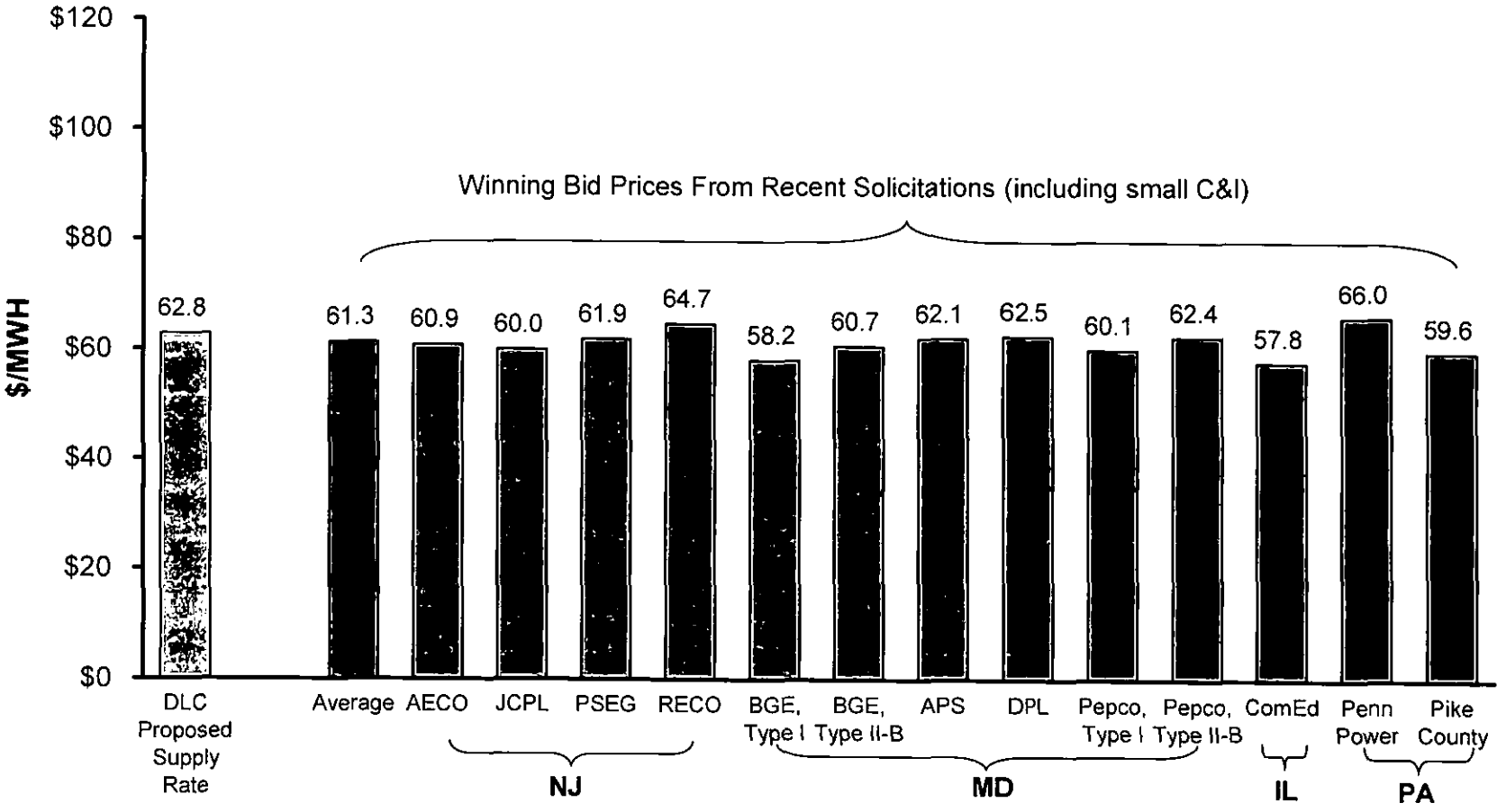
Note: Twelve months ending October 31, 2006.

Duquesne's Proposed Rate vs. Winning Bid Prices (Residential)
Adjusted for Definitional, Locational and Timing Differences



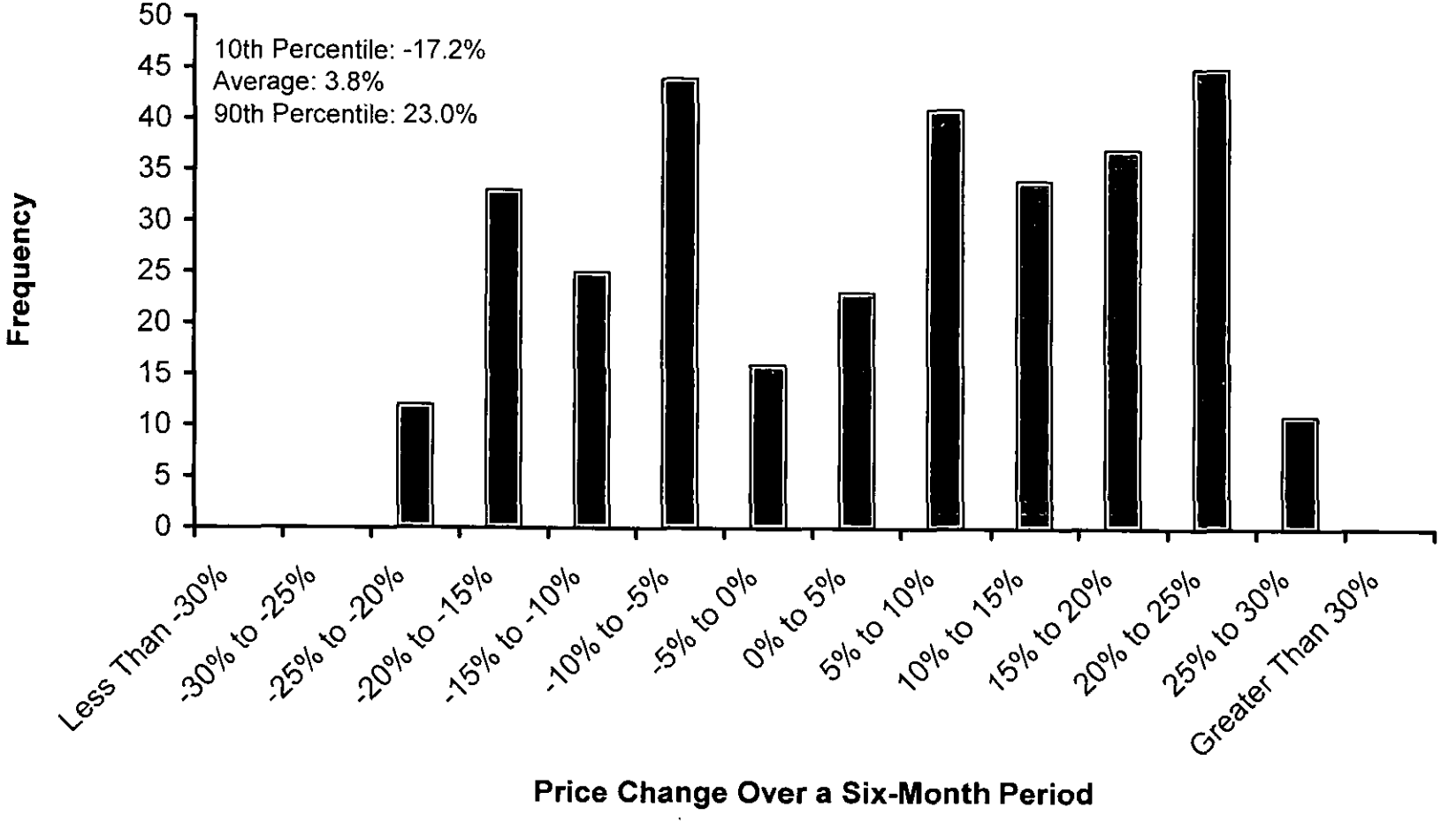
Note: Prices do not include transmission, ancillary services, line losses or GRT.

Duquesne's Proposed Rate vs. Winning Bid Prices (Small C&I) Adjusted for Definitional, Locational and Timing Differences



Note: Prices do not include transmission, ancillary services, line losses or GRT.

Historical Six-Month Percentage Changes
In The PJM Western Hub 2007 ATC Electricity Futures Price



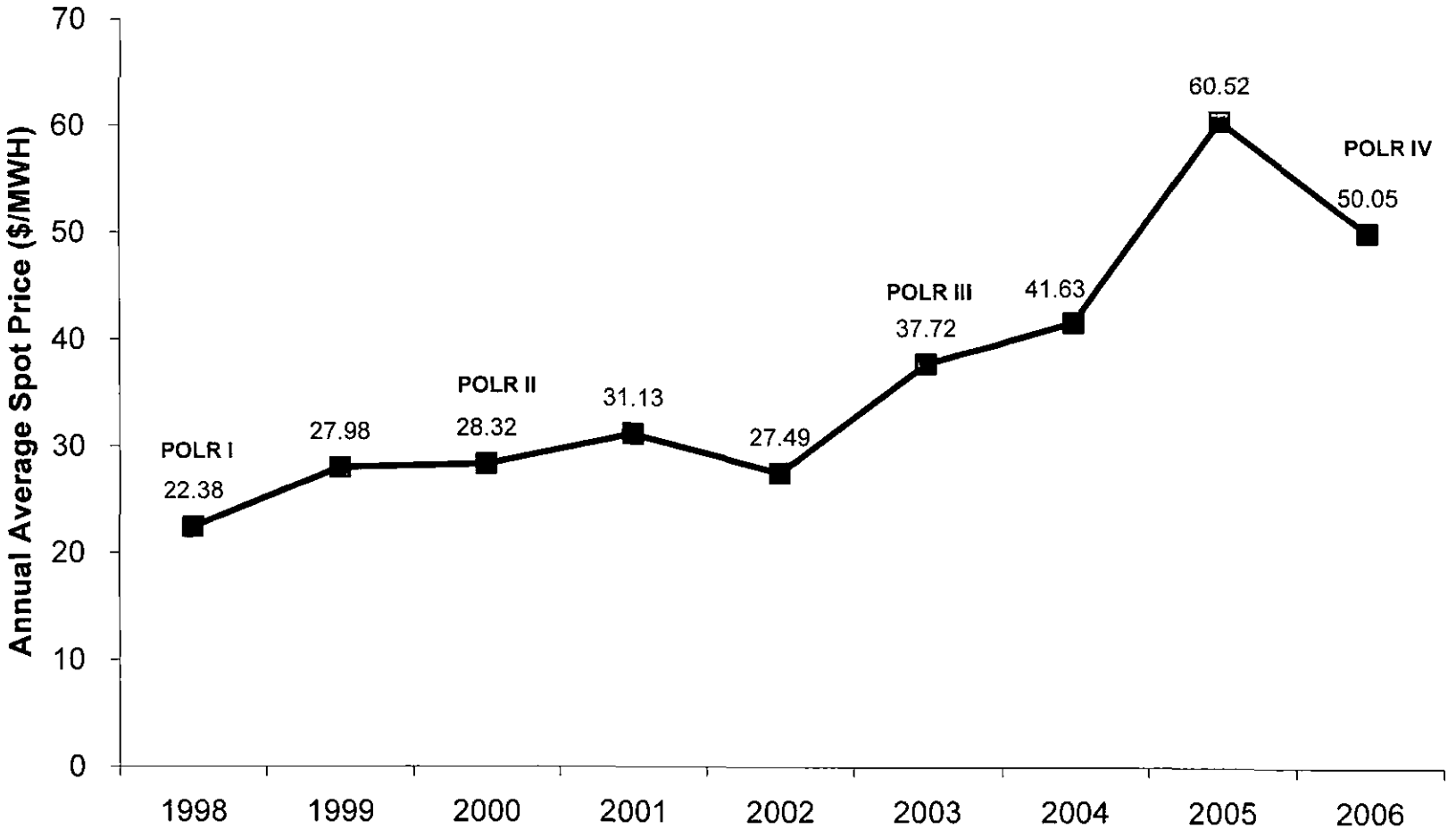
Total Average Supply Rates By Customer Class

($/MWH)

	Residential		Small C&I		Lighting		Unmetered Lighting	
Average of Recent Solicitations	60.02	_a/	61.30	_a/	49.16	_b/	56.17	_b/
Regulatory Review Period Risk	3.00		1.50		3.00		3.00	
Line Losses	4.32		3.85		3.57		4.05	
GRT	4.22		4.18		3.49		3.96	
Total Average Supply Rate _c/	**71.56**		**70.83**		**59.23**		**67.18**	

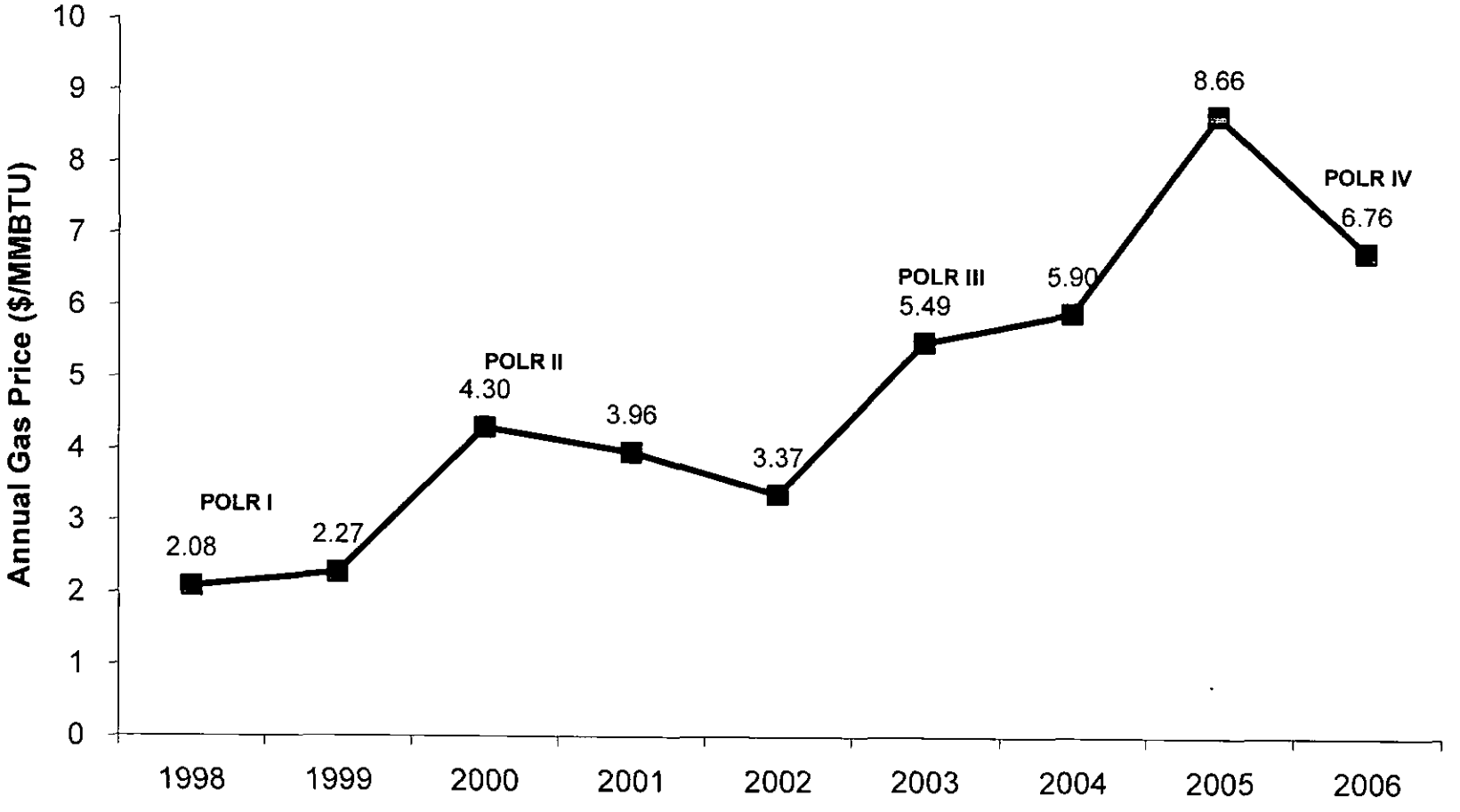
_a/ From Exhibit NSF-11.
_b/ The lighting and unmetered lighting averages are based on the results of the competitive solicitations (including small C&I customers) adjusted for the differences in the consumption patterns and capacity obligations of Duquesne's lighting customers.
_c/ Rates for heating customers will be phased in over a three year period.

PJM Western Hub Annual Average Spot Prices



Sources and Notes: Data from April 1, 1998 to December 31, 2006 taken directly from PJM Day-Ahead market results. For the 1998 data point, a time weighted average of peak and off-peak market results reported on Bloomberg L.P. is used to derive PJMW Hub data for the January 1, 1998 to March 31, 1998 period.

Natural Gas Henry Hub Prices



Source: Bloomberg, L.P and Enerfax. Daily close of natural gas spot price for Henry Hub, Louisiana.

Annual Market Price Adjustment Methodology for Small C&I Rates

In order to determine the final retail supply rates effective January 1, 2009 through December 31, 2010 for the GS, GM and GMH rate schedules, a "Market Price Multiplier" will be calculated and applied to the supply rates shown in Exhibit WVP-1. Separate Market Price Multipliers will be calculated for calendar year 2009 and calendar year 2010, and each will be based on changes in wholesale electricity futures prices after January 10, 2007. Duquesne has calculated the wholesale electricity futures prices for calendar years 2009 and 2010 as of January 10, 2007 ("Base Index Price"). Market price changes from those Base Index Prices will be measured as of the first day in October prior to the start of the applicable calendar year. For example, on October 1, 2008, Duquesne will calculate a Market Price Multiplier for calendar year 2009, based on 2009 futures prices visible in the marketplace. The Market Price Multiplier for a given calendar year will be calculated as follows:

Market Price Multiplier = (Index Price / Base Index Price)

The Index Price for calendar year 2009 will be calculated as follows:

1. Duquesne will calculate the simple average of the 12 monthly financially-settled on-peak PJM Northern Illinois Hub ("NIHUB") electricity futures contract prices reported by the New York Mercantile Exchange ("NYMEX") for January through December 2009 as of each of the 20 trading days immediately preceding October 1, 2008.
2. Duquesne will calculate the simple average of the 12 monthly financially-settled off-peak NIHUB electricity futures contract prices reported by NYMEX for January through December 2009 as of each of the 20 trading days immediately preceding October 1, 2008.
3. Duquesne will calculate the simple average of the 20 calendar year 2009 on-peak futures prices calculated in Step #1 above.
4. Duquesne will calculate the simple average of the 20 calendar year 2009 off-peak futures prices calculated in Step #2 above.
5. The resulting on-peak futures price calculated in Step #3 above, and the resulting off-peak futures price calculated in Step #4 above, will then each be adjusted by multiplying the price by the corresponding on-peak or off-peak basis differential factor as measured over the most recent 12 calendar months. For either the on-peak or off-peak period, the basis differential factor will be calculated as the simple average of the Duquesne Zone locational marginal energy prices divided by the simple average of the NIHUB locational marginal energy prices. For the calculation of the on-peak basis differential factor, all locational marginal energy prices during the on-peak period will be used. For the calculation of the off-peak basis differential factor, all locational marginal energy prices during the off-peak period will be used.
6. The resulting on-peak and off-peak futures prices will then be weighted by the number of on-peak and off-peak hours during calendar year 2009 to obtain a single Index Price for calendar year 2009.

The same methodology will be used to determine the 2010 Market Price Multiplier, using the applicable data for 2010. The Base Index Price for each of calendar years 2009 and 2010 was calculated using the same methodology, except that futures prices as of the 20 trading days immediately preceding and including January 10, 2007 were used, and locational marginal energy price data from the January 2006 – December 2006 period was used to calculate the basis differential factors. The Base Index Price for 2009 and 2010 and the methodology used to calculate these figures are shown in the attached pages to this exhibit.

The Market Price Multiplier for a given calendar year will be multiplied by the applicable supply rates by rate component within each rate schedule for the GS, GM and GMH supply rates shown in Exhibit WVP-1 to obtain the rates effective during that calendar year. Depending on market price movements, the retail supply rates could be higher or lower than those shown in Exhibit WVP-1.

2009 Base Index Price Calculation

$/MWH

Step 1: Calculation of Calendar Year 2009 NIHUB On-Peak Futures Prices
* For each trade date, calculated from averages of monthly NYMEX futures prices

Calendar Year 2009 Futures Prices

Trade Date	NIHUB Futures Price
1/10/2007	60.38
1/9/2007	60.25
1/8/2007	59.75
1/5/2007	58.81
1/4/2007	59.31
1/3/2007	59.50
1/2/2007	59.11
12/29/2006	59.11
12/28/2006	59.38
12/27/2006	58.25
12/26/2006	59.22
12/22/2006	59.75
12/21/2006	60.13
12/20/2006	59.44
12/19/2006	60.00
12/18/2006	59.75
12/15/2006	60.88
12/14/2006	61.13
12/13/2006	61.13
12/12/2006	61.00

Step 2: Calculation of Calendar Year 2009 NIHUB Off-Peak Futures Prices
* For each trade date, calculated from averages of monthly NYMEX futures prices

Calendar Year 2009 Futures Prices

Trade Date	NIHUB Futures Price
1/10/2007	34.13
1/9/2007	34.00
1/8/2007	34.13
1/5/2007	34.00
1/4/2007	33.88
1/3/2007	34.25
1/2/2007	33.03
12/29/2006	33.03
12/28/2006	33.00
12/27/2006	33.75
12/26/2006	33.71
12/22/2006	34.00
12/21/2006	34.75
12/20/2006	34.38
12/19/2006	34.75
12/18/2006	34.06
12/15/2006	34.50
12/14/2006	34.50
12/13/2006	34.50
12/12/2006	34.38

Step 3: Calculation of Average Calendar Year 2009 NIHUB On-Peak Futures Price

Average	**59.81**

Step 4: Calculation of Average Calendar Year 2009 NIHUB Off-Peak Futures Price

Average	**34.04**

2009 Base Index Price Calculation

Steps 5 & 6: Calculation and Application of Basis Differential Factors, and Final Index Price Calculations

Calculations of Basis Differential Factors

$/MWH

	On-Peak	Off-Peak
Average 12-Month Historical Day-Ahead LMPs		
Duquesne Zone	48.72	30.52
NIHUB	51.62	31.76
Basis Differential Factor	0.9438	0.9608

Calculation of Index Price

	On-Peak	Off-Peak	All Hours	
NIHUB Futures Price	59.81	34.04		from Step 3 and Step 4
Basis Differential Factor	0.9438	0.9608		
Resultant Futures Price	56.45	32.70		
Hours	4,096	4,664		
2009 Base Index Price			**43.81**	

Note: The same methodology using updated market price information will be used to calculate the 2009 Index Price as of October 1, 2008.

2010 Base Index Price Calculation

$/MWH

Step 1: Calculation of Calendar Year 2010 NIHUB On-Peak Futures Prices
* For each trade date, calculated from averages of monthly NYMEX futures prices

Calendar Year 2010 Futures Prices

Trade Date	NIHUB Futures Price
1/10/2007	59.50
1/9/2007	59.75
1/8/2007	59.06
1/5/2007	58.81
1/4/2007	58.94
1/3/2007	59.25
1/2/2007	57.97
12/29/2006	57.97
12/28/2006	58.06
12/27/2006	57.13
12/26/2006	58.47
12/22/2006	59.00
12/21/2006	59.25
12/20/2006	59.00
12/19/2006	58.75
12/18/2006	59.50
12/15/2006	60.13
12/14/2006	60.50
12/13/2006	60.50
12/12/2006	60.13

Step 3: Calculation of Average Calendar Year 2010 NIHUB On-Peak Futures Price

Average	**59.08**

Step 2: Calculation of Calendar Year 2010 NIHUB On-Peak Futures Prices
* For each trade date, calculated from averages of monthly NYMEX futures prices

Calendar Year 2010 Futures Prices

Trade Date	NIHUB Futures Price
1/10/2007	36.13
1/9/2007	36.30
1/8/2007	36.04
1/5/2007	36.13
1/4/2007	35.81
1/3/2007	35.63
1/2/2007	35.72
12/29/2006	35.72
12/28/2006	35.73
12/27/2006	36.01
12/26/2006	35.16
12/22/2006	35.50
12/21/2006	36.00
12/20/2006	36.00
12/19/2006	36.00
12/18/2006	36.25
12/15/2006	36.50
12/14/2006	36.50
12/13/2006	36.25
12/12/2006	36.50

Step 4: Calculation of Average Calendar Year 2010 NIHUB On-Peak Futures Price

Average	**35.99**

2010 Base Index Price Calculation

Steps 5 & 6: Calculation and Application of Basis Differential Factors, and Final Index Price Calculations

$/MWH

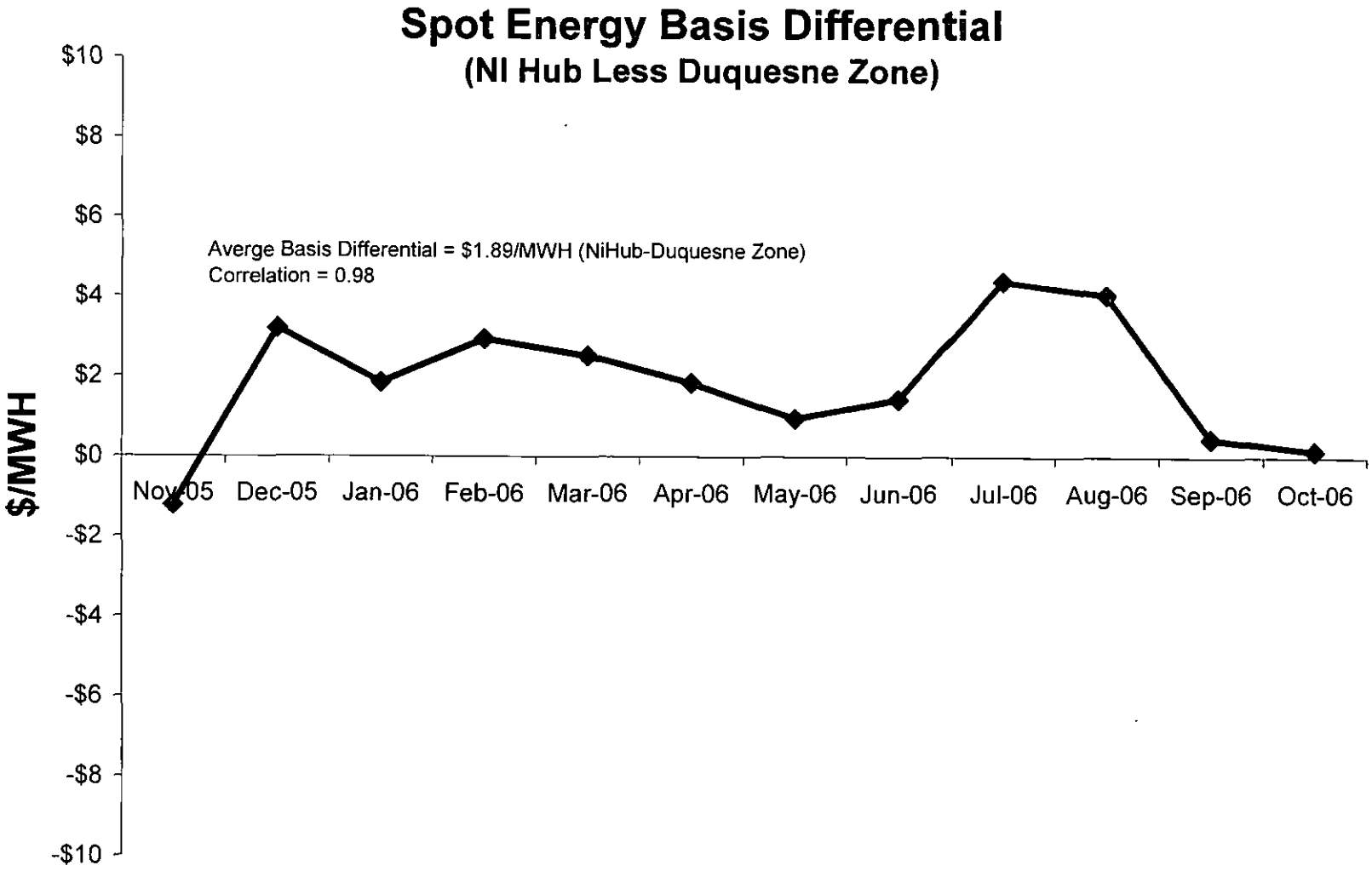
Calculations of Basis Differential Factors

	On-Peak	Off-Peak
Average 12-Month Historical Day-Ahead LMPs		
Duquesne Zone	48.72	30.52
NIHUB	51.62	31.76
Basis Differential Factor	0.9438	0.9608

Calculation of Index Price

	On-Peak	Off-Peak	All Hours	
NIHUB Futures Price	59.08	35.99		from Step 3 and Step 4
Basis Differential Factor	0.9438	0.9608		
Resultant Futures Price	55.76	34.58		
Hours	4,096	4,664		
2010 Base Index Price			**44.49**	

Note: The same methodology using updated market price information will be used to calculate the 2010 Index Price as of October 1, 2009.



Note: Twelve months ending October 31, 2006.

DUQUESNE STATEMENT NO. 4

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

RECEIVED
JAN 25 2007
PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

DIRECT TESTIMONY OF WILLIAM V. PFROMMER

Dated: January 25, 2007

DIRECT TESTIMONY OF WILLIAM V. PFROMMER

Q. Please state your full name and business address.

A. My name is William V. Pfrommer. My business address is Duquesne Light Company, 411 Seventh Avenue, Pittsburgh, PA 15219.

Q. What is your position at Duquesne Light Company?

A. I am employed by Duquesne Light Company ("Duquesne Light", "Duquesne" or "Company") as the Manager, Rates.

Q. How long have your worked at Duquesne Light?

A. I have been employed by Duquesne Light, Duquesne Holdings or its subsidiaries for 24 years.

Q. What are your current responsibilities?

A. I am responsible for overseeing the Company's retail rates and wholesale transmission rates, which includes supervising the preparation, development and implementation of the transmission and distribution rates proposed in this proceeding. In addition, it is my responsibility to ensure the rates are properly applied to customer bills.

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

A. I received a Bachelor of Science Degree in Mechanical Engineering from Grove City College in 1978 and a Masters in Business Administration from the University of Pittsburgh in 1989. I was employed by Westinghouse Air Brake Company in 1978 and performed various duties as a staff engineer. I began my career at the Company in 1982 as a Project Engineer in the Engineering and Construction Division at the Beaver Valley Power Station. Over the last 24 years, I have held staff, supervisory and managerial positions in engineering, nuclear construction, customer technical services, marketing and rates. In the Rate Department at Duquesne, I was responsible for the calculations to unbundle the

rates to support the implementation of electric utility restructuring and customer choice in Pennsylvania. I also worked at AquaSource, Inc., the previous water and wastewater subsidiary of DQE, Inc. While at AquaSource, I was General Manager of Rates, responsible for analyzing the adequacy of rates, providing direction to regional controllers on all regulatory matters, and maintaining the tariffs in the 12 states where AquaSource had utility operations. I testified before the Pennsylvania Public Utility Commission ("Commission") on rate design matters in the Company's Provider of Last Resort ("POLR") proceeding at Docket P-00032071. I also provided rate design testimony in the form of an affidavit before the Federal Energy Regulatory Commission ("FERC") at Docket No. ER05-85-000 for changes to the PJM Open Access Transmission Tariff ("PJM OATT") to integrate the Company into the PJM Interconnection, *L.L.C.* ("PJM") markets and tariff effective January 1, 2005. Most recently, I testified in the Company's distribution rate case proceeding at Docket R-00061346. I am a licensed professional engineer in the Commonwealth of Pennsylvania.

Q. What is the purpose of your direct testimony regarding the Company's request for default service supply rates?

A. The purpose of my testimony is to address the following items regarding the Company's proposed default service plan:

1. Describe the proposed changes to Duquesne's retail rate structure and the rationale for those changes. This will include a description of the necessary changes to Duquesne's retail tariff to implement the proposed default service plan.
2. Sponsor a schedule of the supply rates for residential, small commercial and industrial ("small C&I"), and lighting customers.
3. Describe the proposed changes to the Company's transmission rates to recover ancillary services and PJM administrative costs.
4. Sponsor a schedule of class average rates and comparison to current rates.
5. Describe the proposed rate for large commercial and industrial ("large C&I") customers.

Q. Are you sponsoring any exhibits as part of your direct testimony?

A. Yes. I am sponsoring the following exhibits attached to my testimony:

Exhibit	Description
WVP-1	Supply Rates by Rate Schedule 2008-2010
WVP-2	Rate Class Average Rates 2008-2010
WVP-3	Supply Rate Comparison to Current Rates
WVP-4	Total Bill Comparison to Current Rates
WVP-5	Supply Rate Comparison to Restructuring Rates

Q. Please explain how these exhibits were prepared?

A. All exhibits were prepared either by me or under my direct supervision. They were prepared, to the best of my knowledge, in accordance with Commission requirements and practice.

Q. How is your testimony organized?

A. My testimony may be summarized as follows. First, I will discuss the proposed rate design for the small customer classes, i.e., residential, small C&I and lighting classes. Second, I will discuss the proposed supply rates for the small customer classes including the Company's proposal to adjust retail transmission rates to recover the costs for ancillary services and PJM administrative costs. Third, I will discuss the proposed class average rate impact by rate schedule for the small customer classes. Finally, I will describe the Company's rate proposal for large C&I customers.

I. SMALL CUSTOMER RATE DESIGN

Q. What rate classes are affected by the small customer rate design?

A. The small customer classes include residential rates RS, RH and RA; small C&I rates include GS/GM and GMH and all of the lighting classes including AL, SE, SM, SH, UMS and PAL.

Q. What were your overall objectives in designing the proposed supply rates for these customer classes?

A. There were five objectives in designing the proposed supply rates. The first objective was to reset the rates to reflect prevailing market prices. This was necessary to eliminate below market rates that discourage conservation and do not provide customers with an opportunity to shop. This will promote competition and will ensure the Company is moving forward to develop retail rates that better reflect market prices.

The second objective was to move to a single, flat energy charge for each rate class by 2010. The current rate structure for supply includes demand charges and declining energy block rates. These supply charges are not indicative of competitive market prices and can make it more difficult for customers to compare offers from alternative electric suppliers. This objective will establish a simple price comparison with electric generation supplier ("EGS") offers.

Third, the Company wanted to address instances of inconsistent rates among rate classes that resulted from the restructuring of the Company in accordance with the Electricity Generation Customer Choice and Competition Act ("Competition Act"). Part of this objective is to achieve more inter-class and intra-class consistency among rate classes and customer classes though rational rates consistent with market prices and specific to the characteristics of each class.

The fourth objective was to evaluate the rate class and monthly bill impacts associated with the first three objectives and mitigate significant bill impacts. The Company recognizes that eliminating demand charges and declining block rates to move toward a single energy-based charge in one step could result in disparate impacts on certain individual customers. Therefore, the Company proposes to phase-in the proposed rate design for several rate classes over a three-year period (2008-2010). This is an important consideration for heating class customers who currently have rates that are below market prices and may experience above average increases in their rates as declining blocks are eliminated.

Fifth, the Company wanted to align Duquesne's retail transmission rates more closely with PJM's transmission charges to all load serving entities (including Duquesne and EGSs). To accomplish this objective, the Company

recently filed and obtained Commission approval for a transmission service charge ("TSC") that will adjust annually. As part of this initiative, the Company proposes to move the charges for PJM administrative costs and ancillary services from supply rates to the TSC so that these costs also will more closely follow PJM charges.

This approach to rate design, as a whole, enables the Company to balance its objectives of reflecting market prices, simplifying rates for customers and EGSs, and mitigating disparate rate impacts. Combined, they should promote retail competition and better enable retail customers to understand the charges and prices of the market.

Q. What was the starting point for developing supply rates for residential, small C&I and lighting customers?

A. I used the average energy supply rates by customer class (residential, small C&I and lighting) described by Mr. Fisher and summarized in Table No. 1 as the starting point for rate design. These average supply rates include adjustments for rate class specific line losses and load profiles. This enabled me to analyze the class and monthly impacts of implementing a single energy price and determine what, if any, rate changes should be phased-in over time.

Table No. 1 Average Supply Rates

Customer Class	Applicable Rate Classes	Average Rate Cents/kWh
Residential	RS, RH, RA	7.156
Small C&I	GS/GM, GMH	7.083
Unmetered Service	UMS	6.718
Lighting	AL, SE, SM, SH, PAL	5.923

Q. What changes are you proposing to the rate design of the residential rate classes?

A. Rate RS, with about 500,000 customers, is the Company's standard residential service rate. This rate is currently a single flat energy charge per kilowatt-hour

("kWh"). The rate will be reset to the supply rate in Table No. 1 with no changes in rate design.

Rate RH and rate RA (with approximately 25,000 and 3,300 customers, respectively) are the Company's residential space heating rates. Both have the same rate structure as rate RS during the May through October non-heating season, but have a declining block rate structure and a reduced rate for usage greater than 500 kWh during the November through April heating season. These rates for usage greater than 500 kWh (2.6133 ¢/kWh for RH and 2.702 ¢/kWh for RA) are currently below current market prices, and as expected, customer shopping for these classes is very low. For example, less than 1% of rate RH customers are shopping with an EGS.

For the proposed supply rates, the same rate RS energy charge will apply during the non-heating season for rate RH and RA customers since customers in these three rate classes, in general, have similar usage characteristics during these months. The two-step declining block rate design will be retained to mitigate rate impacts during the heating season, but will be phased-out over three years. The supply rate for usage up to 500 kWh per month during the heating season will be the same rate applicable during the May to October non-heating season. The current tail block rates for usage in excess of 500 kWh per month for RH and RA will be increased on January 1, 2008, 2009 and 2010 so that the declining block structure is eliminated by 2010 and all residential customers are charged the same supply rate.

The proposed rate structures for RH and RA are consistent with simplification of the rate design, inter-class consistency, improving economic price signals, and understandability by customers.

Q. Why do you propose to phase-in the supply rate increases for rate classes RH and RA?

A. The Company believes that it is important to phase-in significant changes in rate structure to mitigate rate impacts, especially for rates that have been in place for over 20 years. The average rate a customer will be charged on these rate classes

will depend on their individual monthly usage and should be considered on an annual basis. As proposed, all residential customers will pay the same rate during the non-heating season and for the first 500 kWh during the heating season. The Company is proposing a modest increase to the rate for usage in excess of 500 kWh in 2008. Therefore, the effect on the average rate on an annual basis will depend on the customer's actual usage during the heating season. While not moving all the way to a single energy price in 2008, this proposal provides a measured approach that achieves the Company's objective in 2010.

Q. Please describe the current rate structure applicable to small C&I rate classes.

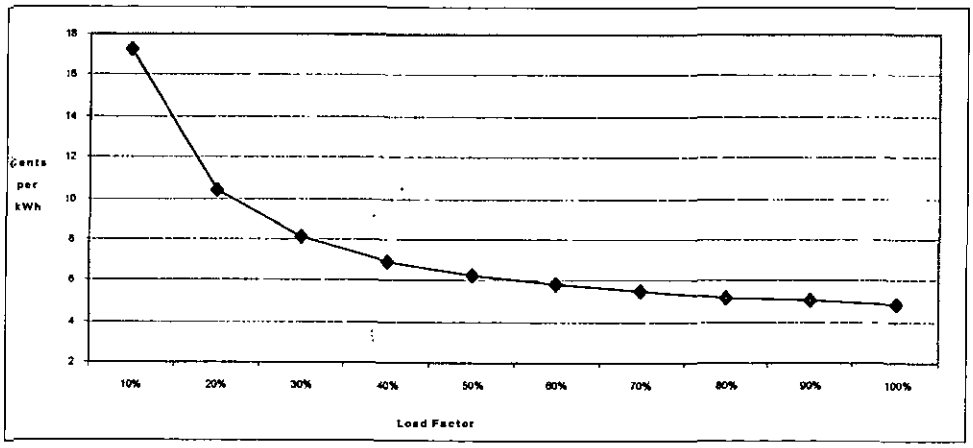
A. General service small and medium rates (GS/GM) and the general service medium heating rate (GMH) constitute the small C&I rate class. Rate GS/GM, with approximately 52,000 customers, has the second largest number of customers of all rate schedules. Within this rate class, there are approximately 19,000 rate GS customers. These customers are not demand metered and their average usage is less than 1,000 kWh per month. There are approximately 33,000 rate GM customers, all of whom are demand metered with diverse usage and load profiles. Rate GM customers are billed for metered demand in excess of 5 kilowatts ("kW") at $9.28/kW and for energy at a declining block energy rate of 3.4824 ¢/kWh, neither of which reflect current market prices.

Rate GMH is the complementary electric space-heating rate to general service rate GM. There are approximately 3,400 customers on rate GMH. During the non-heating season, these customers are billed according to the same rate structure as rate GM though at different rates. During the heating season, these customers are billed using a variable, two-step declining block energy rate structure, the legacy of pre-restructuring rates. The current energy rate for the second block (3.0442 ¢/kWh) is also below current market prices.

Q. What changes are you proposing to the rate design of the small C&I rate classes?

A. Duquesne proposes to simplify the existing rate structure for both rate classes by implementing a single energy rate for all small C&I customers. This will simplify price comparisons with competitive EGS offers. By 2010, Duquesne will eliminate existing demand charges that do not reflect current market prices and eliminate declining energy block rates that are below market levels and discourage conservation. Demand charges of the current magnitude are not reflective of market prices and produce significant diversity in a customer's average supply charge within rate GM depending on the customer's monthly load factor. Load factor is defined as the kWh consumed by the customer divided by their monthly-metered demand in kW divided by the number of hours in the month. Graph No. 1 shows the average supply charge in cents per kWh for a rate GM customer with a 20 kW billed meter demand at current supply rates at various load factors under the current rate structure.

Graph No. 1 Rate GM Average Supply Rate at Various Load Factors



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 the non-coincident peak demand to determine a 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.

Combined, this proposed rate design reduces class diversity of supply rates over time while mitigating rate impacts to the smallest customers, simplifying the rate structure, and implementing a rate structure consistent with market price structures.

Q. Please describe how you have redesigned the small C&I rates to eliminate demand charges and declining block rates.

A. Similar to the residential rate design, I used the energy charge for rates GS/GM and GMH in Table No. 1 as the basis for rate design.

Rate GS customers on average use 300 kWh/month and the majority use less than 1,000 kWh/month. They are billed according to the rate GS/GM rate structure which is a flat energy charge up to 1300 kWh per month. Therefore, rate GS customers will continue to be charged a single rate for all usage equal to the supply rate in Table No. 1.

For rate GM, however, a different approach was used because of the diversity of the customers, as noted above. Fully eliminating demand charges and declining block rates for rate GM will impact monthly bills differently depending on the individual customer's load factor (i.e. their consumption relative to their monthly metered demand). By fully eliminating demand charges, low load factor customers would see a decrease in their monthly bill and high load factor customers would see an increase. Whether a customer would see an increase or decrease in their supply charges would depend on their load factor and the proposed supply rate in Table No. 1. To allow customers to adjust to this change in the supply charge rate structure, the Company proposes to phase-out the demand charges and declining block rates to transition all customers to a flat energy supply rate. The demand charges will be reduced equally each year until they are completely phased-out in 2010. An offsetting increase will be made to the current tail block energy rates so that by 2010 only a flat energy rate per kWh will be in place. Therefore, customers will be affected based on their specific load and usage characteristics while the rate class average supply charge will be that shown in Table No. 1.

Q. Please describe the proposed changes to rate GMH.

A. The Company proposes to change the rate design using principles similar to those used for residential heating rates. Heating customers will be billed the same demand and energy charges as general service rate GM during the non-heating season months. For the heating season, the current variable two-block energy rate structure will be retained to mitigate customer rate impacts, but phased-out over three years. The energy-based rates for the first energy block during the heating season will be reset to equal the supply rate identified in Table No. 1. Similar to the proposed rate design for the residential space heating rates, the second block winter usage charge for rate GMH will be increased equally on January 1, 2008, 2009 and 2010 so that the declining block structure is eliminated by 2010 and the supply rate equals the rate GM supply charge rate in 2010.

Q. Will these proposed changes to the small C&I rate schedules effect any other charges applicable to these rate schedules?

A. Yes. The minimum charges associated with these rate schedules have been modified to be consistent with the proposed POLR supply rates and elimination of demand charges. In addition, Rider 5 is the Company's Time of Day discount to demand charges that is a legacy of pre-restructuring rate design when the Company owned generation. The rider provides a discount to demand charges associated with the monthly meter read. Since the Company is proposing to phase out the demand charges for rates GM and GMH, it does not make sense to keep this rider for discounts applicable only to distribution charges. The Company proposes to completely eliminate this rider effective January 1, 2010. Phasing-out this rider over time will allow customers to modify their operation to the extent possible and enable them to become accustomed to the new rate structure.

Q. What changes are you proposing to the rate design for the lighting classes?

A. Duquesne is not proposing any changes to the rate design for the lighting classes, but will reset the average rate levels for each rate class to the supply price defined

in Table No. 1. As a group, the lighting classes currently consist of a diverse mix of charges and rate design. However, the majority of lighting customers pay a flat rate per fixture per month based on the lamp wattage and nominal monthly kWh usage specific to each fixture. Duquesne is not proposing to change this rate structure for lighting customers. Duquesne will calculate a new flat monthly rate per fixture using the monthly kWh consumption per fixture and the supply price defined in Table No. 1. In some cases, as a result of the legacy effects of unbundling and POLR III rate design, this will result in both average rate increases and decreases. However, the proposed rate design will result in all lighting customers paying the same supply rate on a cents per kWh basis. Implementing these proposed changes to the lighting class rates achieves the objective of simplifying the rates and eliminating inconsistencies by better aligning inter and intra-class charges with market price levels.

II. SMALL CUSTOMER RATES

Q. What changes are you proposing to the rates of the small customer rate classes?

A. The Company is proposing three changes to the small customer rates. First, the supply rates will be reset to prevailing market prices defined in Table No. 1. Second, using the market index adjustment factor described by Mr. Fisher, Duquesne Light will adjust the 2009 and 2010 rates up or down based on changes in market prices prior to the start of each calendar year. Third, the Company proposes to recover ancillary services and PJM administrative expenses in transmission rates. The Company proposes to recover these costs through the recently approved TSC.

Q. Have you prepared an exhibit that summarizes the supply rates the Company proposes to include in its retail tariff?

A. Yes. Exhibit WVP-1 summarizes the proposed supply rates for each rate schedule for each year for 2008-2010. These rates are also shown for each year in the proposed tariff supplement sponsored by Ms. Krajovic as Exhibit NJDK-3.

Q. Please describe the second change, how you will revise the small C&I rates annually based on a market price index.

A. Mr. Fisher describes the proposed market price multiplier that will be applied to the supply rates for GS/GM and GMH shown in Exhibit WVP-1. As described by Mr. Fisher, this is a transparent market index adjustment mechanism to adjust the small C&I supply rates, upward or downward, depending on changes in market price indices. The proposed supply rates in Exhibit WVP-1 assume no changes over the 2008-2010 period (i.e., a multiplier of 1.00). The Company proposes to implement the 2008 supply rates in Exhibit WVP-1 effective January 1, 2008. No later than October 1, 2008, the Company will submit a filing to the Commission adjusting the 2009 rates in Exhibit WVP-1 by the index multiplier described by Mr. Fisher for 2009. Both the demand and energy charges will be multiplied by the index multiplier to calculate new rates that will become effective for usage on or after January 1, 2009. The same index multiplier will also be applied to the supply charges of rate GMH shown in Exhibit WVP-1 for 2009.

The same methodology will be used to adjust rates in 2010. The Company will apply the appropriate index multiplier for 2010 to each GS/GM and GMH supply rate component shown in Exhibit WVP-1 for 2010. No later than October 1, 2009, the Company will submit a filing to the Commission establishing the revised supply rates for GS/GM and GMH. Effective January 1, 2010, demand charges, declining block energy charges, and declining block seasonal rates will be eliminated and replaced with a single flat energy rate for all small C&I customers.

Q. Have you prepared an example calculation showing how this market index adjustment will work?

A. Yes. Table No. 2 provides a calculation based on a hypothetical market index adjustment for 2009 for rate GM. The 2009 proposed rates are the same rates identified in Exhibit WVP-1. These rates will simply be multiplied by the market price multiplier to calculate the adjusted rates the Company would file with the Commission on October 1, 2008.

Table No.2 Market Index Adjustment Example Calculation

		2009 Rates	2009 Index Adjusted Rates
Market Price Multiplier			0.975
Demand Charge	$/kW/Month	$3.09	$3.01
First 1,300 kWh	Cents/kWh	7.0830	6.9059
Additional kWh	Cent/kWh	6.1840	6.0294

Q. What changes are necessary to the tariff describing this annual adjustment?

A. The Company is proposing two changes to the tariff to implement this change. First, Rider No. 20 has been added to the tariff supplement attached as Exhibit NJDK-3 to Ms. Krajovic's testimony. The purpose of Rider No. 20 is to describe the process by which the Company will calculate the rate multiplier that will be applied to the supply charges in rate schedules GS/GM and GMH for 2009 and 2010.

Second, the "Electric Charges" language of rate schedules GS/GM and GMH will be revised as follows:

> No later than October 1 of 2008, the Company will submit a filing to the Commission adjusting the 2009 Supply Charges to reflect changes in the market price of electricity. The 2009 Supply Charges will be multiplied by the Annual Market Price Adjustment described in Rider 20 to establish rates that will become effective for usage on or after January 1, 2009. No later than October 1 of 2009, the Company will submit a filing to the Commission adjusting the 2010 Supply Charges to reflect changes in the market price of electricity. The revised rates will become effective for usage on or after January 1, 2010. The 2010 Supply Charges will be multiplied by the Annual Market Price Adjustment described in Rider 20 to establish rates that will become effective for usage on or after January 1, 2010.

Q. Please describe your third change, how you propose to recover the costs for ancillary services and PJM administrative expenses.

A. The Company is proposing to recover the costs of ancillary services and PJM administrative costs associated with default service for small customer classes through the retail transmission rates and TSC. (For large C&I customers, ancillary services and PJM administrative costs will continue to be recovered in Rider No. 9 and will adjust as PJM charges adjust.) The Commission approved the TSC by order entered December 1, 2006 at Docket R-00061346. This change will enable the Company to recover the expenses it incurs as a provider of transmission service to retail customers taking default service from the Company.

Q. Do the average supply rates in Table No. 1 and the supply rates in Exhibit WVP-1 include the costs associated with ancillary services and PJM administrative expenses?

A. No, they do not. However, the transmission rates in Exhibit WVP-1 have been adjusted to include recovery of the charges for ancillary services and PJM administrative costs.

Q. How are these costs currently recovered for residential, small C&I and lighting customers?

A. In POLR III, Duquesne fixed the PJM surcharge for residential, small C&I and lighting class customers and included the surcharge in the fixed supply rate. Similarly, ancillary service costs were fixed and bundled together in the fixed supply rate, although no separate charge was identified.

PJM administrative expenses that the Company is currently incurring are being recovered through retail tariff PJM Surcharge Rider No. 1. Rider No. 1 became effective January 1, 2005 when the Company joined PJM and as defined in its POLR III order, is effective until December 31, 2007. As described in the Company's distribution rate case at Docket R-00061346, the Company proposed

to retain Rider No. 1 through December 31, 2007, at which point the Company proposed to roll those PJM expenses into the proposed transmission service charge so the default service supply rates will not reflect any such PJM costs. (Pfrommer, Direct, p. 19, l. 10)

Q. Why is it appropriate to recover the costs associated with ancillary services and PJM administrative expenses through the transmission rates?

A. These are transmission related costs the Company incurs in accordance with the OATT, and as such they are appropriately recovered through retail transmission rates, in this case the TSC. This approach will have no effect on the price to compare ("PTC") and since it is updated annually through the TSC, will ensure there is no competitive distortion.

Q. How will the Company adjust the transmission rates to recover ancillary services and PJM administrative costs?

A. The Company proposes to modify the definition of projected total expenses in the TSC to include these expenses for all small customer classes. Both ancillary service and PJM administrative costs will be recovered on the basis they are incurred, primarily MWh, to ensure there is no cost shifting. The revenue collected will be trued-up with expenses incurred in the subsequent TSC filing.

Q. Have you estimated the average costs for ancillary services?

A. Yes. Based on the 12 months ending December 2006, the ancillary service expense the Company proposes to recover in the transmission expense will be set initially at $2.175/MWh. This rate will recover the estimated ancillary service expenses for spinning reserves, operating reserves, regulation, synchronous condensing charges, schedule 1A and black start service. This rate also includes an adjustment for transmission and distribution line losses and Pennsylvania gross receipts tax ("GRT").

Q. Have you estimated the average costs for PJM administrative expenses?

A. Yes. I used the stated rates in Schedules 9-1 to 9-5 and Schedule 9-FERC in the PJM OATT to calculate a rate of $0.408/MWh to recover PJM administrative expense. Similar to derivation of the ancillary service rate, the PJM administrative rate has been adjusted for transmission and distribution line losses and GRT.

Q. Will you update the estimated costs for ancillary services prior to January 1, 2008?

A. Yes. The Company proposes to update the estimated cost for ancillary services based on the average costs for the 12 months ending November 30, 2007. This will provide an updated rate beginning January 1, 2008 using the most recent data and will reduce the potential effects of adjusting these rates in April 2008, the date of the then subsequent TSC filing.

Q. What changes do you propose to the retail tariff to recover these costs through the TSC?

A. First, the "Electric Charges" section of each rate schedule will be revised to explain that these costs will be recovered through the TSC which is Appendix A of the tariff. Second, the Company will revise the TSC to incorporate language explaining that ancillary service expenses and PJM administrative expenses are part of the TSC for each rate schedule. Third, since the PJM administrative expenses will be recovered through the TSC, Rider No. 1 has been eliminated. Rider No. 9 has been revised to provide more discussion on the PJM surcharge. All of these changes are shown in Exhibit NJDK-3 attached to Ms. Krajovic's testimony.

III. SMALL CUSTOMER CLASS AVERAGE RATE IMPACTS

Q. Have you prepared an exhibit showing the average rates by rate class?

A. Yes. Exhibit WVP-2 shows the class average rates for distribution, transmission and supply. The transmission rates include the transmission rates in accordance with the TSC and include ancillary services and PJM administrative expenses. The demand charges and declining block rates are eliminated in 2010 and as such, the residential and small C&I rates are identical to those in Table No. 1. When divided by the monthly kWh per fixture, all of the lighting supply charges also equal the average rates shown in Table No. 1.

Q. How do the proposed supply rates compare to the current supply rates?

A. Exhibit WVP-3 provides a comparison of the proposed supply rates to current POLR III supply rates. The overall increase for the small customer classes compared to current supply rates is 17.6%. The supply rate for the average residential rate RS customer will increase 17.6% and the average supply rate for a small C&I customer on rate GS/GM will increase 13.6%. For the lighting classes, the supply rates will increase 29.5% on average. The rate impacts vary across the lighting classes due to adjusting the supply rates to market levels and eliminating uneconomic disparities in supply rates that were created during the unbundling process in the Company's restructuring proceeding.

Q. How do the proposed class average rates compare to the current class average rates on a total bill basis?

A. Exhibit WVP-4 provides a comparison of the proposed rates to current rates on a total bill basis. The increases are much lower on a total bill basis. The overall increase for the small customer classes on a total bill basis is 10.2%. The average residential rate RS customer bill will increase 9.2% and the average increase for small C&I rate GS/GM is 9.3%. On a total bills basis, the average increase for the lighting classes will be 7.4% over current rates.

Q. How do the proposed supply rates compare to the generation rate cap (including the competitive transition charge) approved in Duquesne's restructuring case?

A. Exhibit WVP-5 provides a comparison of class average POLR I generation rate caps to the proposed supply rates. For the vast majority of residential and small C&I customers, the proposed supply rates remain below Duquesne's restructuring generation rate caps. These modest changes in residential and small C&I customer rates are particularly remarkable given the significant increase in market prices in the past ten years and the relatively high levels of customer shopping in Duquesne's service area. Mr. O'Brien and Mr. Fisher provide more description regarding how the Company was able to mitigate stranded costs, reduce rates, and at the same time, promote retail competition.

V. LARGE CUSTOMER SUPPLY RATES

Q. What changes are you proposing to the supply rates of the large C&I rate classes?

A. Rate schedules GL, GLH, L and HVPS define the large C&I rate classes and are applicable to approximately 871 customers with monthly-metered demands greater than 300 kW. Currently these customers have the option to purchase default service supply from the Company under fixed price service ("FPS") retail tariff Rider No. 8 or hourly price service ("HPS") Rider No. 9. FPS Rider No. 8 is scheduled to expire May 31, 2007. As described by Mr. O'Brien, Duquesne will only offer HPS service to large C&I customers effective June 1, 2007. Duquesne will no longer offer large C&I customers a fixed price option (Rider No. 8), but rather will rely on EGS's to provide this service.

Q. Will this change affect many customers?

A. No. As of December 31, 2006, there were only six of an eligible 871 customers on FPS service, less than 1%. Since FPS Rider No. 8 will terminate May 31,

2007, no customers will be on this rate when the Company implements its default service plan January 1, 2008.

Q. How will eliminating the fixed price option affect the retail tariff?

A. Retail tariff Rider No. 8 will be eliminated. Rule 45.2 regarding switching rules will be revised to eliminate its applicability to large C&I rate schedules since Rider No. 8 is eliminated. The Generation Rate Adjustment switching rule ("GRA") described in retail tariff Rider No. 23 is applicable only to customers electing FPS Rider No. 8 and will also be eliminated. Upon elimination of Rider No. 23, Duquesne will have no switching restrictions in the retail tariff other than the protocols defined and required by the Commission.

Q. Are you proposing changes to HPS Rider No. 9?

A. Duquesne is not proposing any changes to the formula described in Rider No. 9 and will continue to offer hourly price default service to large C&I customers. Duquesne is proposing to recover the cost of ancillary services and PJM administrative costs in the same manner as it does today as defined in the Rider No. 9 formula rate. Duquesne is, however, proposing to revise the fixed retail adders defined in the rider.

Q. Please described the current fixed retail adders in Rider No. 9?

A. Table No. 3 summarizes the adders approved in the POLR III proceeding. The adder for each rate class consists of a risk component and an administrative charge component. The administrative charge component for each rate class is $1.35/MWh. The administrative charge adder was based on the incurred costs and annual costs for POLR III and a forecast level of sales for large C&I customers expected to remain on POLR III supply rates when they became effective January 1, 2005.

Table No. 3 Current Rider No. 9 Fixed Retail Adders

Rate	Adder $/MWh
GL	$4.89
GLH	$3.52
L	$3.41
HVPS	$1.70

Q. What is the revised adder you are proposing for hourly price service Rider No. 9?

A. The Company has eliminated the risk component of the adder and seeks only to recover its administrative costs of providing the hourly price default service. Therefore, I revised the adders to reflect current annual costs and to reflect actual POLR sales on the hourly price service. The annual cost to provide HPS service is approximately $800,000. The Company is proposing an administrative cost adder of $3.97 per MWh based on estimated annual POLR sales of 201,736 MWh. This adder will apply to POLR sales for any customer that receives hourly price service.

Q. Does this conclude your direct testimony?

A. Yes, it does.

DUQUESNE LIGHT COMPANY
SUPPLY RATES BY RATE SCHEDULE

Rate Class		Billing Unit	2007	2008	2009	2010
RS	All kWh	¢/kWh	6.3031	7.1560	7.1560	7.1560
RH	May thru October	¢/kWh	7.6604	7.1560	7.1560	7.1560
	First 500 kWh - November thru April	¢/kWh	7.6604	7.1560	7.1560	7.1560
	Additional kWh - November thru April	¢/kWh	2.6133	4.1275	5.6418	7.1560
RA	May thru October	¢/kWh	7.7806	7.1560	7.1560	7.1560
	First 500 kWh - November thru April	¢/kWh	7.7806	7.1560	7.1560	7.1560
	Additional kWh - November thru April	¢/kWh	2.7020	4.1867	5.6713	7.1560
GS	First 1300 kWh	¢/kWh	7.9914	7.0830	7.0830	7.0830
	Additional kWh	¢/kWh	3.4824	7.0830	7.0830	7.0830
GM	Demand first 5 kW	$/kW/mo.	$0.00	$0.00	$0.00	$0.00
	Demand additional kW	$/kW/mo.	$9.28	$6.19	$3.09	$0.00
	First 1300 kWh	¢/kWh	7.9914	7.0830	7.0830	7.0830
	Additional kWh	¢/kWh	3.4824	5.2849	6.1840	7.0830
GMH	Demand first 5 kW	$/kW/mo.	$0.00	$0.00	$0.00	$0.00
	Demand additional kW	$/kW/mo.	$9.66	$6.19	$3.09	$0.00
	First 1300 kWh - June thru September	¢/kWh	8.2699	7.0830	7.0830	7.0830
	Additonal kWh - June thru September	¢/kWh	3.0442	5.2849	6.1840	7.0830
	First block kWh - October thru May	¢/kWh	7.2685	7.0830	7.0830	7.0830
	Additional kWh - October thru May	¢/kWh	3.0442	4.3905	5.7367	7.0830
AL	Demand all kW	$/kW/mo.	$5.06	$0.00	$0.00	$0.00
	First 300 kWh	¢/kWh	7.1574	5.9230	5.9230	5.9230
	Additional kWh	¢/kWh	1.7392	5.9230	5.9230	5.9230
SE	All kWh	¢/kWh	3.8918	5.9230	5.9230	5.9230
SM	Mercury Vapor ($/fixture/month)	kWh/mo.				
	100 watts	44	$1.60	$2.61	$2.61	$2.61
	175 watts	74	$2.07	$4.38	$4.38	$4.38
	250 watts	102	$2.58	$6.04	$6.04	$6.04
	400 watts	161	$3.49	$9.54	$9.54	$9.54
	1000 watts	386	$7.56	$22.86	$22.86	$22.86
	Sodium Vapor ($/fixture/month)					
	70 watts	29	$1.62	$1.72	$1.72	$1.72
	100 watts	50	$2.07	$2.96	$2.96	$2.96
	150 watts	71	$2.46	$4.21	$4.21	$4.21
	250 watts	110	$3.59	$6.52	$6.52	$6.52
	400 watts	170	$4.68	$10.07	$10.07	$10.07
	1000 watts	387	$9.77	$22.92	$22.92	$22.92
SH	Sodium Vapor ($/fixture/month)	kWh/mo.				
	100 watts	50	$5.72	$2.96	$2.96	$2.96
	150 watts	71	$7.02	$4.21	$4.21	$4.21
	200 watts	95	$8.35	$5.63	$5.63	$5.63
	400 watts	170	$13.54	$10.07	$10.07	$10.07
UMS	First 1,300 kWh	¢/kWh	7.2530	6.7180	6.7180	6.7180
(Unmetered)	Additonal kWh	¢/kWh	1.6954	6.7180	6.7180	6.7180
PAL	High Pressure Sodium ($/fixture/month)	kWh/mo.				
	70 watts	29	$1.62	$1.72	$1.72	$1.72
	100 watts	50	$2.07	$2.96	$2.96	$2.96
	150 watts	71	$2.45	$4.21	$4.21	$4.21
	250 watts	110	$3.58	$6.52	$6.52	$6.52
	400 watts	170	$4.67	$10.07	$10.07	$10.07
	Flood Lighting ($/fixture/month)		$0.00			
	100 watts	46	$1.86	$2.72	$2.72	$2.72
	150 watts	67	$2.17	$3.97	$3.97	$3.97
	250 watts	100	$2.61	$5.92	$5.92	$5.92
	400 watts	155	$3.34	$9.18	$9.18	$9.18
	Unmetered ($/fixture/month)		$0.00			
	70 watts	29	$1.27	$1.72	$1.72	$1.72
	100 watts	46	$2.02	$2.72	$2.72	$2.72
	150 watts	67	$2.93	$3.97	$3.97	$3.97
	250 watts	100	$4.37	$5.92	$5.92	$5.92
	400 watts	155	$6.78	$9.18	$9.18	$9.18

EXHIBIT WVP-2

DUQUESNE LIGHT COMPANY
RATE CLASS AVERAGE RATES (CENTS/KWH)

Proposed Class Average Rates 2008 (1)

Rate Class	Distribution	Transmission	Supply	Total Average Charge
RS	5.40	0.60	7.16	13.16
RH	4.11	0.42	5.87	10.40
RA	3.14	0.59	6.32	10.04
GS/GM	2.67	0.52	7.08	10.28
GMH	2.40	0.45	6.17	9.02
AL	0.94	0.26	5.92	7.12
SE	5.50	0.26	5.92	11.68
SM	30.22	0.26	5.92	36.40
SH	13.42	0.26	5.92	19.60
UMS	5.09	0.41	6.72	12.22
PAL	12.33	0.26	5.92	18.51
Weighted Avg.	4.23	0.55	6.99	11.77
Residential	5.25	0.58	7.02	12.85
Small C&I	2.64	0.52	6.99	10.14
Lighting/UMS	14.74	0.30	6.13	21.17

Proposed Class Average Rates 2009 (1)

Rate Class	Distribution	Transmission	Supply	Total Average Charge
RS	5.40	0.60	7.16	13.16
RH	4.11	0.42	6.51	11.04
RA	3.14	0.59	6.74	10.46
GS/GM	2.67	0.52	7.08	10.28
GMH	2.40	0.45	6.62	9.48
AL	0.94	0.26	5.92	7.12
SE	5.50	0.26	5.92	11.68
SM	30.22	0.26	5.92	36.40
SH	13.42	0.26	5.92	19.60
UMS	5.09	0.41	6.72	12.22
PAL	12.33	0.26	5.92	18.51
Weighted Avg.	4.23	0.55	7.05	11.83
Residential	5.25	0.58	7.09	12.92
Small C&I	2.64	0.52	7.03	10.19
Lighting/UMS	14.74	0.30	6.13	21.17

Proposed Class Average Rates 2010 (1)

Rate Class	Distribution	Transmission	Supply	Total Average Charge
RS	5.40	0.60	7.16	13.16
RH	4.11	0.42	7.16	11.68
RA	3.14	0.59	7.16	10.88
GS/GM	2.67	0.52	7.08	10.28
GMH	2.40	0.45	7.08	9.93
AL	0.94	0.26	5.92	7.12
SE	5.50	0.26	5.92	11.68
SM	30.22	0.26	5.92	36.40
SH	13.42	0.26	5.92	19.60
UMS	5.09	0.41	6.72	12.22
PAL	12.33	0.26	5.92	18.51
Weighted Avg.	4.23	0.55	7.11	11.89
Residential	5.25	0.58	7.16	12.99
Small C&I	2.64	0.52	7.08	10.24
Lighting/UMS	14.74	0.30	6.13	21.17

1/ Assumes no increase to distribution rates 2008-2010. Transmission rates do not reflect changes resulting from annual FERC formula filings.

EXHIBIT WVP-3

DUQUESNE LIGHT COMPANY
CLASS AVERAGE SUPPLY RATES
CURRENT RATES VERSUS PROPOSED DEFAULT SERVICE RATES (CENTS/KWH)

	Current	Proposed Supply Rates					
Rate Class	POLR III Supply Rates (1)	2008 (2)	Change Over POLR III	2009 (2)	Change Over POLR III	2010 (2)	Change Over POLR III
RS	6.30	7.41	17.6%	7.41	17.6%	7.41	17.6%
RH	5.53	6.13	11.0%	6.77	22.6%	7.41	34.2%
RA	6.35	6.58	3.5%	6.99	10.1%	7.41	16.7%
GS/GM	6.46	7.34	13.6%	7.34	13.6%	7.34	13.6%
GMH	5.48	6.42	17.2%	6.88	25.5%	7.34	33.9%
AL	6.43	6.18	-3.9%	6.18	-3.9%	6.18	-3.9%
SE	3.89	6.18	58.8%	6.18	58.8%	6.18	58.8%
SM	4.38	6.18	41.1%	6.18	41.1%	6.18	41.1%
SH	8.72	6.18	-29.1%	6.18	-29.1%	6.18	-29.1%
UMS	7.03	6.98	-0.7%	6.98	-0.7%	6.98	-0.7%
PAL	2.87	6.18	115.5%	6.18	115.5%	6.18	115.5%
Weighted Avg.	6.27	7.25	15.7%	7.31	16.6%	7.37	17.6%
Residential	6.23	7.28	16.9%	7.35	18.0%	7.41	19.1%
Small C&I	6.36	7.24	13.9%	7.29	14.7%	7.34	15.4%
Lighting/UMS	4.93	6.39	29.5%	6.39	29.5%	6.39	29.5%

1/ Current supply rates include ancillary services and the PJM surcharge of .0708 cents per kWh per retail tariff Rider No. 1.

2/ For equivalent comparison, proposed supply rates include ancillary service costs (.2175 cents per kWh) and PJM administrative costs (.0408 cents per kWh). However, these costs will be recovered through the Company's transmission rates. Proposed supply rates also include the costs and risks with PJM RPM capacity requirements and new renewable energy supply requirements.

DUQUESNE LIGHT COMPANY
TOTAL BILL COMPARISON AT CLASS AVERAGE RATES
CURRENT RATES VERSUS PROPOSED DEFAULT SERVICE RATES (CENTS/KWH)

	Current Rates (POLR III)				Proposed Total Average Charges (1)					
Rate Class	D	T	S	Total	2008	Change Over POLR III	2009	Change Over POLR III	2010	Change Over POLR III
RS	5.40	0.34	6.30	12.05	13.16	9.2%	13.16	9.2%	13.16	9.2%
RH	4.11	0.16	5.53	9.79	10.40	6.2%	11.04	12.7%	11.68	19.3%
RA	3.14	0.33	6.35	9.82	10.04	2.3%	10.46	6.6%	10.88	10.8%
GS/GM	2.67	0.27	6.46	9.40	10.28	9.3%	10.28	9.3%	10.28	9.3%
GMH	2.40	0.19	5.48	8.07	9.02	11.7%	9.48	17.3%	9.93	23.0%
AL	0.94	0.00	6.43	7.37	7.12	-3.4%	7.12	-3.4%	7.12	-3.4%
SE	5.50	0.00	3.89	9.39	11.68	24.4%	11.68	24.4%	11.68	24.4%
SM	30.22	0.00	4.38	34.60	36.40	5.2%	36.40	5.2%	36.40	5.2%
SH	13.42	0.00	8.72	22.14	19.60	-11.5%	19.60	-11.5%	19.60	-11.5%
UMS	5.09	0.15	7.03	12.27	12.22	-0.4%	12.22	-0.4%	12.22	-0.4%
PAL	12.33	0.00	2.87	15.20	18.51	21.8%	18.51	21.8%	18.51	21.8%
Weighted Avg.	4.23	0.29	6.27	10.79	11.77	9.1%	11.83	9.7%	11.89	10.2%
Residential	5.25	0.32	6.23	11.80	12.85	8.9%	12.92	9.5%	12.99	10.1%
Small C&I	2.64	0.26	6.36	9.26	10.14	9.6%	10.19	10.1%	10.24	10.6%
Lighting/UMS	14.74	0.04	4.93	19.72	21.17	7.4%	21.17	7.4%	21.17	7.4%

1/ Assumes no increase to distribution rates 2008-2010. Proposed Total Class Average rates do not reflect changes in transmission rates resulting from annual FERC formula filings.

EXHIBIT WVP-5

DUQUESNE LIGHT COMPANY
CLASS AVERAGE SUPPLY RATES
POLR I RATES VERSUS PROPOSED DEFAULT SERVICE RATES (CENTS/KWH)

		Total Supply Cost					
Rate Class	POLR I Supply Rate (1)	2008 (2)	Change Over POLR I	2009 (2)	Change Over POLR I	2010 (2)	Change Over POLR I
RS	8.16	7.41	-9.1%	7.41	-9.1%	7.41	-9.1%
RH	7.11	6.13	-13.8%	6.77	-4.7%	7.41	4.3%
RA	7.88	6.58	-16.6%	6.99	-11.3%	7.41	-6.0%
GS/GM	7.60	7.34	-3.4%	7.34	-3.4%	7.34	-3.4%
GMH	6.52	6.42	-1.4%	6.88	5.6%	7.34	12.6%
AL	6.38	6.18	-3.1%	6.18	-3.1%	6.18	-3.1%
SE	5.44	6.18	13.6%	6.18	13.6%	6.18	13.6%
SM	10.59	6.18	-41.6%	6.18	-41.6%	6.18	-41.6%
SH	10.90	6.18	-43.3%	6.18	-43.3%	6.18	-43.3%
UMS	9.00	6.98	-22.5%	6.98	-22.5%	6.98	-22.5%
PAL	6.88	6.18	-10.2%	6.18	-10.2%	6.18	-10.2%
Weighted Avg.	7.81	7.25	-7.1%	7.31	-6.4%	7.37	-5.6%
Residential	8.05	7.28	-9.6%	7.35	-8.7%	7.41	-7.9%
Small C&I	7.49	7.24	-3.2%	7.29	-2.6%	7.34	-1.9%
Lighting/UMS	8.36	6.39	-23.6%	6.39	-23.6%	6.39	-23.6%

1/ Average supply rates include class average competitive transition charges.
2/ Includes ancillary services and PJM administrative costs.