BEFORE THE
PENNSYLVANNIA PUBLIC UTILITY COMMISSION

Petition of Duquesne Light Company	:	
for approval of a Default Service Plan	:	**Docket No. P-00072247**
for the period January 1, 2008	:	
through December 31, 2010	:	

DIRECT TESTIMONY OF

STEVEN W. RUBACK

ON BEHALF OF

CONSTELLATION NEWENERGY, INC.

Constellation NewEnergy Statement No. 1
Date Served: March 29, 2007
Date Admitted: APR 2 6 2007

DIRECT TESTIMONY OF

STEVEN W. RUBACK

ON BEHALF OF

CONSTELLATION NEWENERGY, INC.

Q. PLEASE STATE YOUR NAME AND ADDRESS.

A. My name is Steven W. Ruback, and my business address is 785 Washington Street, Canton, Massachusetts 02021.

Q. WHAT IS YOUR OCCUPATION?

A. I am the founder and a principal of The Columbia Group, Inc., which is a public interest consulting firm specializing in public utility issues on behalf of state agencies, local government agencies, municipal utilities, offices of attorneys general and staffs of public utility commissions.

My practice consists of providing expert testimony before state public utilities commissions, providing technical assistance to attorneys negotiating settlements or contracting for utility services, providing services to municipal utilities and other rate related services.

Q. PLEASE STATE YOUR QUALIFICATIONS.

A. I am a lawyer and engineer. For more than 25 years, I have worked as a rate consultant to state agencies, local governments, municipal utilities, offices of

attorneys general and staff's of public utility commissions. My principal areas of concentration have been the electric and natural gas utility industries.

I have provided expert testimony in numerous natural gas and electricity cases before regulatory commissions in Connecticut, Pennsylvania, Georgia, New Mexico, Virginia, and other jurisdictions. I have undertaken more than 400 utility assignments, and I have provided expert testimony in over 200 proceedings. I have specialized in gas and electric rate design, competitive issues, regulatory policy, gas transporation and gas supply.

Since 1979, I have provided rate design and other services to the Virginia Municipal League and the Virginia Association of Counties in connection with contract negotiations with Virginia Power. The value of the Virginia Power contract exceeds $250,000,000 annually. I have also provided these services to other associations of local governments in Virginia.

With respect to my municipal utility work, I have completed numerous allocated costs of service studies and rate design assignments for the City of Richmond (Virginia) Department of Public Utilities and the Danvers (Massachusetts) Municipal Electric Utility.

I graduated from Clarkson College of Technology in 1968 with a degree in Interdisciplinary Engineering & Management, and from the State University of

New York, School of Law, in 1973. I have not, however, practiced law since 1976, and my current practice consists solely of providing utility consulting services.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I was asked by Constellation NewEnergy to provide comments regarding the declining block rate design included in small commercial and industrial (small C&I) rate schedules General Service Small (GS), General Service Medium (GM) and General Service Medium Heating (GMH).

Duquesne Light Company (the "Company" or "Duquesne") has proposed to phase out the declining block rate design over three years.

Q. WHAT IS YOUR OPINION?

A. It is my opinion that the declining block rate design should be eliminated swiftly in order to promote retail competition for the small commercial and industrial (C&I) customers. The elimination of the declining block rate design will provide for greater price transparency and, therefore, promote competition between the incumbent utility and non-utility suppliers.

Complexity in rate design is not necessarily a virtue. A flat rate should be implemented when rates are reset in order to promote the attributes of a sound rate structure including simplicity and understandability.

Historically, the declining block rate design was thought to drive economic development. Economic development, however, is not driven solely by a declining block rate design. Reliance on economic development considerations as support for the declining block rate design has been overstated, as economic development is driven by numerous other considerations including -- but not limited to -- taxes, workmen compensation and unemployment rates, the skill of the local workforce, and quality of life.

Declining block rate designs have been justified based on cost of service considerations. However, the theoretical underpinnings of the declining block rate design are no longer appropriate pricing policy because power supply pricing has moved from a cost of service basis to market pricing.

Q. DOES A DECLINING BLOCK RATE DESIGN PROMOTE COMPETITION?

A. No, a declining block rate design retards competition. Attributes of a sound rate structure include simplicity, understandability, public acceptability and freedom from controversy as to proper interpretation. (See Bonbright, Principles of Public Utility Rates, Second Edition, March 1998 at page 384).

Only 19% of small C&I customers shop for service in Duquesne's service territory. This small percentage is largely the product of a declining block rate

design. For laymen, the easiest comparison is average cost. Flat rates offered by non-utility suppliers do not decline as usage increases. The unit cost stays the same irrespective of consumption. On the other hand, the unit cost declines as consumption increases with a declining block rate design. Because the tail blocks are priced at less than average cost, the declining block rate design fails to promote competition. In order to better levelize the competitive playing field, declining block rate designs for small commercial and industrial customers should be eliminated immediately rather than being phased out over three years.

Small commercial and industrial customers are not as able as large commercial and industrial customers to follow electric rate design issues. Confusion is to be avoided. For laymen, the declining block rate design is not a simple rate design which provides ease of price comparison. Customers must estimate usage and calculate an average rate based on the declining block rate design to compare against non-utility suppliers flat rates. The calculations are not necessarily free from controversy.

Let me briefly illustrate such a source of complication. While the GS and GM rate schedules in Duquesne have two blocks, the GMH rate is a load factor rate. For the first 1,250 kilowatt-hours plus 150 kilowatt hours for each kilowatt-hour of demand over 6 kilowatts, the energy charge is about 7 cents. For kilowatt-hours in excess of the first 1,250 kilowatt-hours plus 150 kilowatt hours for each kilowatt-hour of demand over 6 kilowatts, the energy charge is about 3 cents.

Based on my experience this rate design confuses customers and does not lend itself to a simple comparison of competitive offers. In my judgment, the Commission should err on the side of simplicity and eliminate customer confusion in order to promote retail competition.

Q. DOES A DECLINING BLOCK RATE DESIGN PROVIDE A PROPER PRICE SIGNAL TO CUSTOMERS?

A. No. A declining block rate design is inconsistent with conservation and is, therefore, not in the public interest. A declining block rate design promotes consumption of a scarce natural resource with lower than average prices in the tail blocks.

Encouraging consumption via declining block rates or otherwise may eventually lead to the construction of more expensive new generating facilities causing average costs to increase. A declining block rate design might lower unit costs for customers in the short run, but in the long run a declining block design will increase average costs. If marginal costs are more than existing costs, it does not make economic sense to encourage consumption.

Q. DOES A DECLINING BLOCK RATE DESIGN PROMOTE ECONOMIC DEVELOPMENT?

A. The declining block rate design may encourage economic development, but lower utility rates are not the sole driver of economic development. Business site

selection is complex and is not driven solely by a declining block rate design. Companies are often faced with conflicting factors when deciding upon a site for business and struggle with determining the relative importance of those factors. Factors in site selection, in addition to utility costs, include but are not limited to:

- Tax burdens;
- Incentives offered by state and local government;
- Availability of skilled workers;
- Transportation;
- Environmental considerations;
- General business climate;
- Rates for workmen's compensation insurance;
- Rates for unemployment insurance; and
- Quality of life.

In my judgment, reliance on economic development considerations as support for the declining block rate design has been overstated as economic development is driven by numerous other considerations.

Q. WHAT IS THE UNDERLYING THEORY FOR A DECLINING BLOCK RATE DESIGN?

A. The underlying theory of a declining block rate design is that the encouragement of consumption allows a utility to achieve economies of scale and economies of scale are obtained from large base load generating facilities. The importance of

economy of scale is, however, diluted when the cost of power supply is based on competitive considerations rather than cost of service. While high load factor loads command a relative better price in a competitive environment than low factor loads, the *absolute price* is not determined on a cost of service basis.

If there is insufficient base load capacity to meet customers' normal requirements, the price of such generation will be higher than the cost of service. If there is excess capacity of the right mix (base load for normal consumption and peaking capacity for high usage periods) in the marketplace, the price of such generation will be lower than the cost of service. In a competitive environment, price is determined by supply and demand irrespective of the cost of service. For that reason, the theoretical underpinnings of the declining block rate design are no longer applicable because a continuation of this rate design makes dubious economic sense in today's competitive environment.

Q. WHAT IS THE REASON FOR THE PROPOSED PHASE OUT?

A. The proposed three-year phase out will narrow the rate differentials between rate blocks. At the end of the proposed phase out, the rate differentials would be eliminated and a flat rate substituted for the declining block rate design. This approach would gradually reduce intra-class subsidies.

In my judgment, the need to gradually phase out the declining block rate design is outweighed by competitive considerations (only 19% of small and medium

general service customers shop) and the need to eliminate a price signal which is inconsistent with the public interest.

I also recommend additional rate schedules with more homogeneous customers included in each new rate schedule in order to better reflect cost of service.

Q. DOES THAT CONCLUDE YOUR TESTIMONY?

A. Yes. Thank you.

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REBUTTAL TESTIMONY OF

STEVEN W. RUBACK

ON BEHALF OF

CONSTELLATION NEWENERGY, INC.

Constellation NewEnergy Statement No. 1-R
Date Served: April 13, 2007
Date Admitted: APR 2 6 2007

Q. PLEASE STATE YOUR NAME.

A. My name is Steven W. Ruback.

Q. HAVE YOU FILED DIRECT TESTIMONY IN THIS PROCEEDING?

A. Yes. I filed direct testimony on March 29, 2007 on behalf of Constellation NewEnergy, Inc. ("Constellation NewEnergy"), recommending that the declining block rate design for Small Commercial and Industrial ("Small C&I") customers be eliminated when new rates are effective rather than phasing out the existing declining block rate design over three years, as proposed by the Duquesne Light Company ("Duquesne" or "Company").

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of my rebuttal testimony is to respond to the direct testimony of Brian Kalcic, filed on behalf of the Office of Small Business Advocate ("OSBA") on March 29, 2007, wherein OSBA acquiesced to the Company's proposed three-year phase-out of declining blocks and the implementation of flat rates by January 1, 2010. *See* OSBA St. No. 1, p. 16, lines 14 -19.

Q. WHAT IS THE PURPORTED BASIS FOR OSBA'S POSITION?

A. OSBA's position is that a three-year phase-out will mitigate customer bill impacts attributable to the elimination of the declining block rate deign and substitution of a flat rate design. *See* OSBA St. No. 1, p. 16, lines 14-19. OSBA's position

assumes that a three-year phase out is the only rate design approach to mitigate customer impacts. I disagree.

Q. IS THERE A RATE DESIGN METHOD THAT WOULD ALLOW FOR THE ELIMINATION OF THE DECLINING BLOCK RATE DESIGNS WITHOUT VIOLATING PRINCIPLES OF GRADUALISM?

A. Yes. More homogeneous Small C&I flat rate schedules, or sub-classes within a broader rate schedule, should be designed to recover the same revenue as the proposed declining block rates. This approach would eliminate the need for a three-year phase-out of the declining block rate design *and* promote competition in the Small C&I market. In contrast, a three-year phase-out would provide some rate mitigation via gradualism, but would do little to promote competition. It is my judgment that large intra-class revenue shifts can be avoided while promoting competition.

Q. PLEASE EXPLAIN HOW MORE HOMOGENEOUS SMALL C&I FLAT RATE SCHEDULES WOULD MITIGATE CUSTOMER RATE IMPACTS.

A. The declining block rate design is a cost-of-service rate designed to recover the generation revenue requirement in a bygone era of utility regulation when utilities owned generation. Today, in Pennsylvania, generation rates are based on market conditions. If the cost of service is not the retail pricing basis and there is insufficient evidence to conclude that the cost of service differences in the

existing declining block rate design are attributable to current market conditions, the basic ratemaking theory of the declining block rate design is no longer valid.

Declining block rate designs are based on class load factors. As the load factor improves, the average rate declines for customers with higher load factors than the average load factor. Conversely, low load factor customers, in the same rate schedule, will have a higher average rate.

The support for a three-year phase-out is to mitigate customer impacts from the change to flat rates. If higher load factor customers were billed on a flat rate, customer revenues would increase from these customers. If lower load factor customers were billed on a flat rate, customer revenues would decrease from these customers.

The difference in customer revenues from the declining block rate design to flat rates may run counter to principles of gradualism. There is, however, a rate design method that would promote competition and avoid gradualism problems caused by a shift to flat rates.

Instead of a single flat rate for all customers, more homogeneous customers should be grouped in new rate schedules, according to load factor, with a flat rate. That flat rate should recover the same revenues as the average rates billed on the existing declining block rate design. This would eliminate the need for

gradualism because average prices would remain nearly the same for customers and, at the same time, provide a boost to competition in the Small C&I market.

Q. PLEASE DISTINGUISH THE USE OF GRADUALISM WHEN RATES ARE BASED ON COST OF SERVICE PRINCIPLES AND WHEN RATES ARE BASED ON COMPETITIVE CONDITIONS.

A. When there are no competitive issues, rates are based on the cost to serve and are tempered by gradualism when rates based on solely on the cost of service would produce rate shock, disproportionate increases on customers within a particular rate schedule, or an inequitable allocation of revenue requirement among the classes of service.

When there are competitive issues, gradualism is of less importance than in circumstances when cost of service principles control. When there is competition, value of service principles are the primary consideration. Value of service sets rates at the cost of a competitive alternative, not at the cost of providing utility service.

Customers should be assumed to act in their own self interest. If the cost of a competitive alternative is less than utility rates, customers will choose the competitive alternative regardless of whether the higher utility price was set using principles of gradualism to reduce the rate from a higher pure cost of service price. The rate design theory is that some contribution to fixed costs is better than

no contribution at all. In such circumstances, gradualism is of less importance than with traditional cost of service ratemaking without competitive issues.

In this case, I have proposed more homogeneous rate schedules, based on load factor, with flat rates. My proposal eliminates the need to phase out the declining block rate design in three-years because the circumstances requiring the application of gradualism are not present. Each customer group will pay the same average rate under a flat rate design as under a declining block rate design with less customer load factor groupings. Since flat rates will improve competition without violating principles of gradualism, competition should be promoted.

Q. DOES THAT CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes. Thank you.