

APR 26 2007 Hbg-JX

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission,
et al

v.

Duquesne Light Company

Docket No. P-00072247

PREPARED DIRECT TESTIMONY
OF
THOMAS J. BUTLER
ON BEHALF OF DOMINION RETAIL, INC.

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PA PUBLIC UTILITY COMMISSION
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Issues Addressed:

- Three-year POLR Pricing
- TSC Inclusions and Annual Reconciliations
- POLR Structure Agreement
- Small Commercial Annual Adjustment
- Purchase of Receivable Program/Tariff

Served: March 29, 2007

1 **Q. Please state your name and employer for the record.**

2 A My name is Thomas J. Butler, and I am employed by Dominion Retail, Inc., as
3 the Director of Business Development.

4
5 **Q. When did you join Dominion Retail and can you briefly describe your job
6 responsibilities as Director of Business Development?**

7 A. I joined Dominion Retail in 1996 when electricity Choice was just beginning in
8 Pennsylvania. I was a principal participant in my company's start-up of its retail
9 energy business unit. My role is business development for Dominion Retail,
10 which entails identification and evaluation of new retail energy markets,
11 managing regulatory policy matters in states where Dominion Retail operates or
12 plans to operate, overseeing the implementation of short term business plans,
13 pursuing potential business acquisitions and/or partnerships and overseeing our
14 commercial/industrial gas sales business. I have testified in a number of
15 Commission proceedings involving default service programs, including
16 Duquesne's POLR III proceeding, as well as Pennsylvania Power Company and
17 PPL Electric Utilities, Inc.'s more recent POLR proceedings, to name a few.

18

19 **Q. What is your interest in this proceeding?**

20 A. Dominion Retail has been an active electricity generation supplier on Duquesne
21 Light Company's ("Duquesne Light" or "DLC") system since 1997 and presently
22 serves approximately 90,000 customers. Our interest is to ensure that DLC's

1 default service plan is market based, fair to customers, balanced for all market
2 participants, and complies with the currently applicable POLR rules.

3
4 **Q. What is the purpose of your testimony?**

5 A. The purpose of my testimony is to:

- 6
- 7 ■ Provide evidence on the level of the rates for small customers and discuss whether
8 the proposed rates are equivalent to current prevailing market prices on the
9 Duquesne Light system.
 - 10
 - 11 ■ Provide my response to DLC's proposal regarding the transmission service charge
12 and items included in the transmission service charge (TSC).
 - 13
 - 14 ■ Support the preliminary rate structure plan to which DLC, Dominion, and Reliant
15 agreed to prior to the filing.
 - 16
 - 17 ■ Provide feedback on DLC's proposed annual adjustment mechanism for small
18 commercial customers.
 - 19
 - 20 ■ Support the Purchase of Receivables plan proposed by Duquesne Light in its
21 filing.
 - 22

1 **POLR Rate Levels**

2 **Q. Does Dominion have a concern with DLC's proposed POLR rates for small**
3 **customers (residential /small commercial (GS/GM))?**

4 A. Yes. My estimates show that the rate level proposed by Duquesne Light, \$71.56
5 per megawatt hour ("MWH"), is at the lower end of a range of reasonable prices.
6 Based upon our view of the market, and how we price our services, I project that
7 range as being approximately \$72 per MWH to \$77 per MWH. Duquesne
8 appears to be absorbing significant market risks with minimal compensation.

9
10 **Q. What simple market price evidence supports your price calculations?**

11 A. The on-peak price of energy at the Cinergy Hub is 67% higher for the POLR IV
12 period as compared to what it was for the POLR III period. DLC's proposed rates
13 for the POLR IV period have only increased by 17.6%.

14
15 **Q. What standard cost elements do you include in your generation price?**

16 A. The following:

- 17 ▪ Pre-purchased energy - on peak and off-peak purchased prior to delivery
- 18 ▪ Hourly load following costs - energy costs for balancing hourly loads
- 19 ▪ Weather risk
- 20 ▪ Capacity costs – costs that are now going to be set by auction
- 21 ▪ Energy losses
- 22 ▪ Renewable Energy credits
- 23 ▪ Offertory risk

- 1 ▪ Customer migration risk
- 2 ▪ Gross margin
- 3 ▪ Gross receipts tax

4

5 **Q. How do DLC's prices match-up to your estimates?**

6 A. While it appears that DLC did not individually calculate the risks and include all
7 of the costs that I include, its rates appear to be at the low end of what I would
8 calculate as a range of reasonable rates. However, DLC is taking a huge offertory
9 risk for a very minor reward, in my opinion, which probably explains why the
10 rates are on the low end of the range.

11

12 **Q. What are all of the standard market risk factors that should be added to the**
13 **price?**

14 A. By offering a fixed rate for three (3) years for residential customers and a fixed
15 rate for one (1) year for small commercial customers, Duquesne Light assumes
16 unavoidable market risks. Any market participant offering a fixed price for full
17 requirements service will assume these standard risks. This is to say that these
18 risks are common to POLR providers and/or EGSs that sell fixed-price electricity
19 to small customers. The five main risks are: 1) full requirements risk (change in
20 load and price risk during the delivery period); 2) offertory risk (change in load
21 prior to delivery period); 3) load shape risk (change in load shape during the
22 delivery period); 4) customer migration risk (unexpected or unpredictable change
23 in load during delivery period); and, 5) the risk of change in market rules or the

1 addition of new charges (exposure due to changes outside the POLR provider's
2 control such as new capacity rules and renewable compliance costs). According
3 to DLC, it did not independently calculate these risks, but nonetheless proposes to
4 capture these risks in a price adder that is added to the pure energy prices along
5 with taxes, load balancing costs, etc. So it is therefore difficult to perform an
6 itemized comparison and see if there are differences in costs.

7
8 **Q. Can you further describe these market risks?**

9 A. Yes. Standard market risks include full requirement service risks because you can
10 never exactly estimate what the full requirement costs will be during the term, and
11 because suppliers also assume costs for weather, load and price variations. A
12 supplier almost always loses with weather variations because wholesale prices are
13 demand driven; so when customer load is down so are prices, and when load is up
14 so are prices. This market risk is beyond the more predictable *normal* load
15 following costs that are based on average load profiles. This is the risk that you
16 cannot adequately hedge with power purchases, e.g., 6 consecutive hot days in the
17 beginning of August that cause power prices to rise to over \$250/MWH. Since
18 you cannot predict when a weather event may occur, this risk must be borne by
19 the supplier and incorporated into the pricing. In a simple example, 400,000
20 residential customers using an additional 1/4 MWH at \$150/MWH (price
21 premium of \$100/MWH) could cost the supplier \$10 million. A similar hot spell
22 event occurred last August.

1 Offertory risks relate to changes in load prior to the delivery period and
2 can be estimated by the market costs of acquiring options for the percentage of the
3 load that may shift. In the case of POLR service, the customer load switching
4 quantity is not predictable and may or may not be relatively low during the one-
5 year period prior to the start, depending on market price conditions. Given the
6 fact that DLC has purchased 3 year's worth of power for a specific load
7 requirement, the risk exposure could be extremely high. If the wholesale market
8 moves down by \$10/MWH (very possible in 1 year), for example, and 10% of the
9 customers (40,000) switch to a less expensive option. DLC could lose \$240 per
10 customer, times 40,000 customers or \$9.6 million. The wholesale market is
11 volatile and could change significantly by the end of the year. Accordingly, the
12 offertory risk is significant.

13 Load shape risk is more relevant for commercial customers served by the
14 POLR supplier. With blocked rate structures, EGSs tended to target high cost,
15 poor load factor customers, since the high load factor customers could not be
16 acquired due to low rates. Now that high load factor commercial customers may
17 be price eligible for customer choice, the load profile for the POLR provider may
18 change over time to one that is less favorable and that adds more costs. Load
19 shape risk is hard to quantify but the cost is not zero.

20 Customer switching is the risk of unexpected or non-normal load change
21 during the delivery term. One can assume that if market prices are higher than
22 DLC's POLR rate for prolonged periods of time (e.g. six months or more), then
23 customers will start switching back to DLC and DLC will lose money by being

1 short on hedged energy. Alternatively, if DLC's default rate is higher than
2 market, customers will switch away from DLC and DLC will lose money on
3 selling its excess energy. This risk could be significant, since 18% of DLC
4 residential and commercial load is shopping and is able to switch back to DLC.

5 Unplanned costs and the costs of unhedged positions are commonplace
6 occurrence in this business and must be expected. For example, who would have
7 predicted SECA costs or Brunot Island RMR costs? While the costs associated
8 with both of these matters are being recovered separately in rates, unforeseen
9 generation costs in this evolving market cannot be disregarded, especially with the
10 new PJM capacity auction yet to be conducted. DLC could be exposed to
11 additional capacity charges of a significant amount. A reserve for unplanned
12 costs typically is incorporated in our EGS economics.

13
14 **Q. What do you recommend with regard to generation prices filed by DLC?**

15 A. While my estimate supports higher prices than what DLC has proposed, its price
16 is the minimum acceptable price for the sort of 3 year fixed-price offer that DLC
17 has proposed here.

18
19 **Transmission Service Charge Inclusions and Reconciliation**

20 **Q. What change is DLC proposing to its transmission service charge?**

21 A. Duquesne is proposing to collect ancillary services costs and PJM administrative
22 costs through its Transmission Service Charge. These costs currently are
23 collected through the generation charge on a non-reconcilable basis. These costs

1 are driven by PJM rules and regulatory requirements and will certainly change
2 during the POLR IV period.

3
4 **Q. Do you agree with this change?**

5 A. While we generally oppose reconciliation of any charges, we will agree not to
6 oppose this change assuming DLC agrees to add projected ancillary costs and
7 PJM administrative costs to its transmission rate starting January 1, 2008, which
8 should not be significantly different than historical costs incurred in 2007. If
9 DLC was proposing not to include any estimate of these costs going forward and
10 simply reconcile and true up after-the-fact, it would present a problem. But my
11 understanding is that Duquesne will include an estimate of these charges (one
12 made just prior to 2008) in the transmission rate and then reconcile versus actual
13 charges going forward. This process should keep the rates in line with the costs.

14
15 **Preliminary Agreement regarding POLR Structure**

16 **Q. Did you enter into an agreement presented by DLC regarding POLR**
17 **structure?**

18 A. Yes.

19 **Q. Do you still support all aspects of that agreement presented by DLC in its**
20 **filing?**

21 A. Yes.

1 **Small Commercial Annual Adjustment Mechanism**

2 **Q. Have you reviewed DLC's proposed small commercial annual price**
3 **adjustment formula?**

4 A. Yes.

5

6 **Q. Do you have any concerns with the methodology?**

7 A. From a supplier's perspective, the annual adjustment formula presented by
8 witness, Neil Fisher, is sound and reasonable. DLC has to select a timeframe to
9 purchase its power for the forthcoming annual period since DLC is offering a
10 fixed price. The price adjustment mechanism has to match up with the power
11 purchases, which are planned to occur over 20 days. If there is concern about
12 which months and how the corresponding power purchases are made, I'm sure
13 DLC should be able to adjust its procedure accordingly.

14

15 **Q. Would Dominion agree to further modifications?**

16 A. Dominion would accept a structure that does not compromise the fixed price
17 aspects of the POLR service for small customers.

18

19 **Purchase Of Receivables Plan (POR)**

20 **Q. Did you enter into an agreement presented by DLC in this case regarding a**
21 **POR plan for small customers?**

22 A. Yes.

23

1 **Q. Do you still support all aspects of that agreement and proposed tariff**
2 **presented by DLC in its filing?**

3 A. Yes

4

5 **Q. Do you think that a POR program is a benefit to customers?**

6 A. Absolutely. A POR program will permit EGSs to make offers to all customers
7 rather than having to screen customers on the basis of credit. This allows greater
8 access for all customers to the benefits of competition.

9

10 **Q. Do you have anything further that you wish to add ?**

11 A. Not at this time.