

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC
UTILITY COMMISSION

v.

DUQUESNE LIGHT COMPANY

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DOCKET NO. R-00061346

DIRECT TESTIMONY OF
LAFAYETTE K. MORGAN, JR.

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

ON BEHALF OF THE
OFFICE OF CONSUMER ADVOCATE

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EXETER

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Introduction and Summary

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Q. WOULD YOU PLEASE STATE YOUR NAME AND BUSINESS ADDRESS?

A. My name is Lafayette K. Morgan, Jr. I am a Senior Regulatory Analyst with Exeter Associates, Inc. Our offices are located at 5565 Sterrett Place, Columbia, Maryland 21044. Exeter is a firm of consulting economists specializing in issues pertaining to public utilities.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND QUALIFICATIONS.

A. I received a Master of Business Administration degree from The George Washington University. The area of concentration for this degree was Finance. I received a Bachelor of Business Administration degree with concentration in Accounting from North Carolina Central University. I am also a Certified Public Accountant licensed in the State of North Carolina.

Q. WOULD YOU PLEASE DESCRIBE YOUR PROFESSIONAL EXPERIENCE?

A. From May 1984 until June 1990, I was employed by the North Carolina Utilities Commission - Public Staff in Raleigh, North Carolina. I was responsible for analyzing testimony, exhibits and other data presented by parties before the North Carolina Utilities Commission. I had the additional responsibility of performing the examinations of books and records of utilities involved in rate proceedings and summarizing the results into testimony and exhibits for presentation before that commission. I was also involved in numerous special projects, including participating in compliance and prudence audits of a major utility and conducting research on several issues affecting natural gas and electric utilities.

From June 1990 until July 1993, I was employed by Potomac Electric Power Company (Pepco) in Washington, D.C. At Pepco, I was involved in the preparation of

1 the cost of service, rate base and ratemaking adjustments supporting the company's
2 requests for revenue increases in the State of Maryland and the District of Columbia. I
3 also conducted research and gave presentations to management on several issues
4 affecting the electric utility industry.

5 In July 1993, I accepted my current position with Exeter Associates, Inc. Since
6 then, I have been involved in the analysis of the operations of public utilities, with
7 particular emphasis on utility rate regulation. I have also been involved in the review and
8 analysis of utility rate filings, focusing primarily on revenue requirements determination.
9 This work has involved natural gas, water, electric and telephone companies.

10 Q. HAVE YOU PREVIOUSLY TESTIFIED IN REGULATORY PROCEEDINGS
11 ON UTILITY RATES?

12 A. Yes. I have previously presented testimony and affidavits on numerous occasions before
13 the North Carolina Utilities Commission, the Pennsylvania Public Utility Commission,
14 the Virginia Corporation Commission, the Louisiana Public Service Commission, the
15 Georgia Public Service Commission, the Maine Public Utilities Commission, the
16 Kentucky Public Service Commission, the Public Utilities Commission of Rhode Island,
17 the Vermont Public Service Board, the Illinois Commerce Commission and the Federal
18 Energy Regulatory Commission (FERC).

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

20 A. Exeter Associates has been retained by the Office of Consumer Advocate (OCA) to
21 review the reasonableness of the level of revenues which Duquesne Light Company
22 (Duquesne or the Company) is proposing to charge its customers. In this testimony, I
23 present my findings on behalf of the OCA regarding certain adjustments to Duquesne's
24 future test year rate base and net operating income at present rates. In addition, I also
25 present a summary of the OCA's findings regarding the current levels of Duquesne's

1 earnings and determine the necessary change in its revenues that is required to produce an
2 overall rate of return on rate base of 7.85 percent. This return is based on the
3 recommendation of OCA witness Stephen Hill.

4 Q. IN CONNECTION WITH THIS CASE, HAVE YOU PERFORMED AN
5 EXAMINATION AND REVIEW OF THE COMPANY'S TESTIMONY AND
6 EXHIBITS?

7 A. Yes. I have reviewed Duquesne's testimony and exhibits, its rate filing, as well as its
8 responses to the OCA's, the Office of Trial Staff's and other parties' data requests.

9 Q. WOULD YOU PLEASE SUMMARIZE WHAT IS PRESENTED ON THE
10 ATTACHED SCHEDULES?

11 A. Yes. I have prepared a set of schedules, which I have labeled Schedules LKM-1 through
12 26, that present my findings and recommendations regarding the Company's rate base
13 and net operating income. Schedule LKM-1 summarizes my overall findings regarding
14 net operating income. Schedule LKM-2 presents a summary of rate base and my
15 adjustments thereto. Schedule LKM-3 summarizes each of my adjustments to
16 Duquesne's net income. Schedule LKM-26 presents a reconciliation of the current
17 income taxes. The remaining schedules show the derivation of each of my adjustments to
18 rate base and net operating income.

19 Q. PLEASE SUMMARIZE YOUR FINDINGS.

20 A. As shown on Schedule LKM-1, I have determined the appropriate change in Duquesne's
21 distribution revenues to be a \$67.9 million increase as compared to the Company's
22 request of \$143.7 million. This represents a reduction of \$75.8 million in the Company's
23 requested distribution revenue increase.

24 According to the Company's rate increase application, Duquesne is planning to
25 also pass through a Federal Energy Regulatory Commission (FERC)-approved

1 transmission rate increase of \$19.0 million to its customers beginning January 1, 2007.
2 The combined transmission and distribution rate increases would produce an overall
3 increase in total revenue (transmission, distribution and supply) of 13.3 percent. In
4 comparison, the OCA recommended distribution revenue increase, when combined with
5 the FERC-approved transmission revenue increase, would result in a 7.1 percent increase
6 in total revenue (transmission, distribution and supply).

7 In addition to the customary revenue requirements issues, I will also address the
8 OCA's position on Duquesne's proposals relating to the Distribution System
9 Improvement Charge (DSIC) and authority to accrue Allowance for Funds Used during
10 Construction (AFUDC) on Plant Held for Future Use (Account 105).

11 Q. WHAT TIME PERIOD DID YOU USE IN YOUR ANALYSIS OF THE
12 COMPANY'S OPERATING RESULTS?

13 A. The Company's filing includes revenue requirement analyses based upon both a
14 historical test period ended December 31, 2005 and a future test period ending December
15 31, 2006. I have based my analysis of the Company's operating results on the future test
16 year ending December 31, 2006. This is the same period used by the Company to
17 determine its requested rate increase in its rate filing, direct testimony and exhibits.

18 Q. HOW IS THE REMAINDER OF YOUR TESTIMONY ORGANIZED?

19 A. First, I will address each of the adjustments I am recommending. The discussion of those
20 issues is presented in the order identified in the table of contents to this testimony. For
21 each issue, I will document and explain why it was necessary to make the adjustment. In
22 the remainder of this testimony I will then discuss the policy issues regarding the DSIC
23 and the accrual of AFUDC on Plant Held for Future Use.

1 **RATE BASE ISSUES**

2
3 **Plant in Service**

4 Q. WHAT ADJUSTMENT ARE YOU RECOMMENDING FOR PLANT IN
5 SERVICE?

6 A. The Company's plant in service balance included in rate base is the 2006 budgeted plant.
7 In addition, Duquesne adjusted the budgeted plant to include the capitalized portion of its
8 proposed pension cost and matching of 401-K benefits. I am recommending three
9 adjustments to plant in service. The first adjustment that I have made is to reflect actual
10 plant expenditures for the first four months of 2006. Given the actual expenditures are
11 now known, I am essentially removing the budget amounts and replacing them with the
12 actual expenditures. I believe this approach is reasonable because as I reviewed the
13 previous year's budget and actual data, I recognized that the budgeted amounts usually
14 exceeded the actual expenditures. Thus, this adjustment is necessary to avoid overstating
15 plant in service.

16 The second adjustment removes the capitalized pension costs that were added to
17 plant in service by the Company. As I will explain later in this testimony, I disagree with
18 the Company's proposal to use the pension contribution for ratemaking purposes.

19 Third, I am recommending an adjustment to remove from plant in service
20 Duquesne's inclusion of additional 401-K costs related to the achievement of non-
21 financial goals. The Company has not properly supported these costs, so I have removed
22 them from rate base. Moreover, the Company has not demonstrated that plant
23 expenditures will exceed the budgeted levels.

24 A summary of my adjustment to plant in service is presented on Schedule LKM-
25 4. This adjustment reduces rate base by \$13.9 million.

1 **Materials and Supplies**

2 Q. WHY HAVE YOU MADE AN ADJUSTMENT TO REDUCE MATERIALS
3 AND SUPPLIES?

4 A. The future test year presented by the Company reflects a 12 percent increase in materials
5 and supplies. The Company's explanation of the increase in the average monthly balance
6 is that it is currently going through a period of capital expansion. According to the
7 Company's filing, its capital investment program is a 3-year program that began in 2005.
8 However, when the 2005 materials and supplies balance is compared to the 2004 balance,
9 there is no significant increase. I have adjusted the future test year materials and supplies
10 balance to the level of the historical test year (2005). The reason for the adjustment is
11 twofold. First, the increased materials and supplies balance is not representative of the
12 ongoing level of these costs. Given that the capital investment period began in 2005, the
13 end of 2007 (the first year in which the new rates will be in effect) would mark the third
14 year of the program, and any increase in the materials and supplies balance would be
15 discontinued. Second, one of the findings of the recently released Commission
16 management audit of the Company was that the Company had an excessive amount of
17 inventory and recommended that the inactive inventory be reviewed to determine
18 obsolete inventory to be written-off¹. In the response to OCA-VI-9, the Company
19 indicated that it had agreed to all of the audit's recommendations. Therefore, it is
20 reasonable to assume the materials and supplies balance will not increase by 12 percent
21 as the Company predicts. My adjustment reducing Materials and Supplies by \$1.2
22 million is presented on Schedule LKM-5.

¹ Focused Management and Operations Audit of Duquesne Light Company Report, page 61.

1 **Customer Deposits**

2 Q. WHY HAVE YOU ADJUSTED CUSTOMER DEPOSITS?

3 A. Duquesne's future test year filing reflects a decrease in Customer Deposits from the
4 historical test year. The Company's explanation for the decrease is that the 2005 balance
5 reflected a decrease from the previous year, which was a trend it expected to continue in
6 the future test year. According to the Company, with the existence of Chapter 14, it
7 expects Customer Deposits to decrease by an additional \$300,000 because Chapter 14
8 allows Customer Deposits to be applied to delinquent accounts. It is my understanding
9 that Chapter 14 may not have such an effect on Customer Deposits because it also allows
10 the Company to collect deposits from delinquent customers under certain circumstances.
11 However, in the response to OTS-RE-44, Duquesne stated that there is no anticipated
12 effect of Chapter 14 on uncollectibles. One would assume that uncollectibles would
13 decrease if deposits were being applied to delinquent accounts as the Company claims. It
14 is my opinion that it may too early to make a conclusion about the effect of Chapter 14 on
15 Customer Deposits. While the foregoing information from the Company has not
16 provided any conclusive evidence that Customer Deposits will decrease, the actual
17 customer deposits for the first 4 months of 2006 do not show a \$300,000 decrease. With
18 such evidence I believe it would be improper to reduce the Customer Deposits balance.
19 My adjustment to increase customer deposits by \$300,000 is presented on Schedule
20 LKM-6.

21 **Allowance for Cash Working Capital**

22 Q. HOW DO YOU DEFINE CASH WORKING CAPITAL?

23 A. For ratemaking purposes, cash working capital is the investment that a utility needs to
24 have on hand to fund its day-to-day operations. Positive cash working capital represents
25 funds provided by investors which should be included in rate base so that the Company

1 earns a return on it. Negative cash working capital represents ratepayer-supplied funds
2 which should be recognized as a rate base offset.

3 Q. HOW DID THE COMPANY REFLECT CASH WORKING CAPITAL IN ITS
4 FILING?

5 A. The Company's cash working capital allowance is calculated based upon the results of a
6 lead-lag study. A lead-lag study is an in-depth analysis that measures the difference
7 between the lapse of time when the Company receives revenue for the provision of
8 service and the lapse of time when the Company pays for the costs of providing service.
9 This difference, expressed as a number of days is used to calculate the level of investor
10 funds advanced for operations if the difference is positive. If the difference is negative, it
11 is used to calculate the funds advanced by customers.

12 The revenue lag represents the average number of days from the date on which
13 service is provided to the customers until the date on which payment is received from the
14 customers. It is measured from the midpoint of the service period covered by the bill to
15 the date payment for that service is received by the Company. The Company's expense
16 lag represents the average number of days from the date the expense is incurred in
17 rendering service until the date the expense is paid.

18 After both the Company's revenue lag and expense payment lag have been
19 determined, one can make a reasonable approximation of the Company's cash working
20 capital requirement. This calculation is made by dividing the expenses by 365 days to
21 determine the average daily amount. The average daily amount is multiplied by the net
22 lead-lag days (the difference from subtracting the expense lag from the revenue lag) to
23 derive the Company's working capital requirements. If the total working capital
24 requirement is positive, it represents a level of funds that the investors must advance for

1 operations. If the amount is negative, then it is the customers who have advanced the
2 funds.

3 Q. PLEASE DEFINE THE TERMS "LEAD" AND "LAG" AS YOU USE THEM
4 IN YOUR TESTIMONY.

5 A. The term "lead" is used to indicate either the receipt of revenue prior to the date that
6 service is provided or the payment of an expense prior to the date that the expense is
7 incurred. The term "lag" is used to indicate either the receipt of revenue after the date
8 that service is provided or the payment of an expense after the date that the expense is
9 incurred.

10 Q. WHAT ADJUSTMENTS HAVE YOU MADE TO THE ALLOWANCE FOR
11 CASH WORKING CAPITAL?

12 A. I have made two adjustments to the cash working capital allowance. The first adjustment
13 involves the lag days assigned to Other Expenses. The Company calculated the lag on
14 Other Expenses based on the time between the invoice date to the check-clearing date. In
15 addition, the sample of invoices chosen by the Company included charitable donations,
16 stores costs, and surety bonds among the expenses. I disagree with the lag days
17 calculated by the Company because it does not appropriately reflect the service period
18 over which the service or product occurred. For example, there are many charges for
19 temporary staffing and vegetation control. Those services are performed in advance of
20 the invoice date, but the Company treated them as if they were performed on the invoice
21 date. As a result the lag days are understated. I recalculated the Other Expense lag by
22 making the calculation based upon the midpoint of the service period to the check
23 clearing date. The Company was unable to provide the service period, as requested by
24 OCA. Hence, I calculated the service period by assuming the service period was the
25 month prior to the invoice date. The result of that calculation changed the Other Expense

1 Lag from 34.86 days to 63.14 days. In addition to changing the service period, I removed
2 the costs associated with charitable donations, stores costs and surety bonds. Charitable
3 donations were removed because they are not included in the cost of service. Therefore,
4 those costs should not influence the lag day calculation. With regard to the Stores costs
5 and the Surety Bonds, those costs were included separately in rate base as prepayments.
6 As a result, those costs should be removed from the calculation of the Other Expense lag.

7 The second adjustment to the cash working capital study is necessary to reflect
8 the level of expense deemed necessary for utility operations. As a result of the various
9 O&M expense adjustments that I have made to the cost of service, it is necessary to flow
10 those adjustments through the expenses contained in the cash working capital study to
11 avoid a misstatement of the cash working capital. On Schedule LKM-7, page 1, I show
12 the removal of the various O&M expense adjustments that I have made from the
13 expenses used in the cash working capital study.

14 The combination of these two adjustments results in an \$11.4 million decrease to
15 rate base. The adjustment to cash working capital is summarized on Schedule LKM-7,
16 page 1.

17 **Non-Operational Settlement Claims Reserve**

18 Q. WHAT ADJUSTMENT ARE YOU PROPOSING TO THE NON-
19 OPERATIONAL SETTLEMENT CLAIMS RESERVE?

20 A. The Company has proposed an adjustment to include the cost of non-operational
21 settlement claims in operating expenses. These claims relate to damages and other claims
22 incurred by third parties involving the Company's property. Duquesne indicates that
23 these costs are accrued to a reserve (liability account) from which claims are paid. In
24 other words, the expense that is recorded and charged to the reserve is not a cash
25 transaction. It is only when a claim is settled and paid that a cash transaction occurs.

1 Therefore, when the expense is included in rates, the cost recognized is the amount
2 recorded in the reserve account, and represents funds that are advanced by ratepayers to
3 the Company for payment in the future. Since I have accepted the Company's inclusion
4 of these costs in operating expenses, I have also included the related reserve in rate base
5 as cost-free capital since the Company does not pay a return to ratepayers on the held
6 funds. This adjustment is presented on Schedule LKM-8, and it reduces rate base by \$2.4
7 million

8 **OPERATING INCOME ISSUES**
9

10 **Payroll Expense**

11 Q. PLEASE EXPLAIN YOUR ADJUSTMENT TO PAYROLL EXPENSE.

12 A. Duquesne has included payroll expense in the cost of service by escalating the budgeted
13 payroll by 4 percent and including costs for additional employees. During the discovery
14 phase, the OCA sought supporting documentation for the budgeted payroll. The data
15 provided was not sufficient to adequately determine whether the payroll amount was
16 reasonable. Therefore, I am proposing an adjustment on Schedule LKM-9 to reflect
17 payroll expense at the historical test year level.

18 Q. HAVE YOU ATTEMPTED TO OBTAIN THE NECESSARY
19 DOCUMENTATION TO PROPERLY EVALUATE PAYROLL EXPENSE?

20 A. Yes. Even though the request for the supporting payroll data was submitted during the
21 early phase of discovery, the response was not received until a week and a half before
22 testimony due date. This presented insufficient time to adequately submit follow-up
23 discovery and receive responses before filing this testimony. However, the Company
24 remains cooperative in its efforts to provide the necessary data to evaluate the payroll
25 costs. Upon receiving the data, the OCA will revise the payroll adjustment as necessary.

1 Pension Expense

2 Q. PLEASE EXPLAIN YOUR ADJUSTMENT TO PENSION EXPENSE.

3 A. In its filing, Duquesne's claim for pension expense is based upon its contribution to the
4 pension plan rather than the actuarially determined amount pursuant to SFAS 87. SFAS
5 87 is the accounting standard established by the Financial Accounting Standards Board
6 (FASB) for companies to follow in order to record pension expense in accordance with
7 Generally Accepted Accounting Principles (GAAP). Under SFAS 87, pension expense is
8 recognized in the period in which it is earned by the employee. This standard is
9 consistent with the fundamental principle of GAAP referred to as the matching principle
10 that serves as the backbone of accrual accounting. I disagree with the Company's use of
11 the pension contribution for pension expense, and have made an adjustment to reflect the
12 SFAS 87 accrual for pension expense.

13 Q. WHAT IS THE PENSION CONTRIBUTION BASED UPON?

14 A. The contribution amount is determined based upon the minimum contribution amount
15 and the maximum tax-deductible contribution allowed under ERISA guidelines and the
16 Internal Revenue Code. It is important to note that these entities do not govern any
17 GAAP-related cost recognition. According to Duquesne, it contributed \$20 million to
18 pension plans in 2006 and plans to continue funding at that level.

19 Q. WILL THE COMPANY HAVE TO CONTINUE TO FUND AT THAT LEVEL?

20 A. No. I do not believe that is likely to be the case. In OCA IV-28, the Company was asked
21 to provide support for the \$20 million future pension contribution. The data supplied by
22 the Company showed that the \$20 million amount was not required under either ERISA
23 or the Internal Revenue Code. Instead, it appeared to be a predetermined amount selected
24 by the Company.

1 Q. IF THE SFAS 87 AMOUNT IS USED TO DETERMINE PENSION EXPENSE,
2 WILL THE COMPANY FALL SHORT OF COLLECTING ITS PENSION
3 PLAN CONTRIBUTIONS?

4 A. No. As Company witness Susan Betta states in her direct testimony, over extended
5 periods of time the total contributions and the SFAS 87 accruals will be the same.²

6 Q. IF THE CONTRIBUTIONS AND ACCRUALS END UP BEING THE SAME,
7 WHY NOT LET THE CONTRIBUTION AMOUNT BE USED?

8 A. I believe the SFAS 87 is a more objective approach because SFAS 87 results in one
9 amount as the pension costs. Under the contributions approach, the amount to contribute
10 to the pension plan is left to the Company's discretion.

11 Q. WHY IS THE CONTRIBUTION AMOUNT AT THE COMPANY'S
12 DISCRETION?

13 A. As I indicated earlier, the contribution amount is determined by ERISA and the Internal
14 Revenue Code. The ERISA guidelines determine the minimum amount to be funded in
15 order to comply with the law. The Internal Revenue Code determines the maximum
16 amount that can be deducted on the Company's tax return. These two amounts are
17 usually not the same. Therefore, the Company makes its own determination regarding
18 the amount it will fund by choosing an amount that will not violate either of these rules.

19 Q. HOW WAS PENSION EXPENSE DETERMINED IN THE COMPANY'S
20 LAST RATE CASE?

21 A. The Company's last rate case was during the period when SFAS 87 was released. The
22 amount allowed in rates was the SFAS 87 amount, even though the Commission did not
23 explicitly state it was adopting the SFAS 87 amount. However, it does not appear that it

² Witness Betta's Direct Testimony, Page 15, Lines 2 and 3.

1 was necessary for the Commission to clarify that it was adopting SFAS 87 since it was
2 the amount presented by the Company.

3 Q. DO YOU BELIEVE THE BASIS ON WHICH PENSION EXPENSE WAS
4 ESTABLISHED IN THE LAST CASE IS RELEVANT IN THIS CASE?

5 A. Yes. In cases involving other companies, this Commission has stressed the importance of
6 consistency with regard to the recognition of pension expense. Thus, I believe adopting
7 my recommendation is in keeping within past Commission directives.

8 Q. IS THE USE OF THE ACCRUAL BASIS (SFAS 87) CONSISTENT WITH
9 THE MANNER IN WHICH POSTRETIREMENT BENEFITS OTHER THAN
10 PENSIONS (SFAS 106) IS RECOVERED?

11 A. Yes. It is consistent.

12 Q. PLEASE SUMMARIZE YOUR PENSION EXPENSE ADJUSTMENT.

13 A. On Schedule LKM-10, I am proposing an adjustment that reduces pension expense by
14 \$8.3 million. This amount removes the pension contribution from the cost of service.

15 **Employee Benefits**

16 Q. WHAT ADJUSTMENT ARE YOU PROPOSING TO EMPLOYEE BENEFITS?

17 A. The level of employee benefits is calculated based upon the level of payroll costs
18 included in the cost of service. Given that I have removed the future test year payroll
19 increase, it is necessary to also remove the increase in employee benefits since they are
20 based upon the higher level of payroll. Therefore, on Schedule LKM-11, I am proposing
21 an adjustment to reduce employee benefits by \$307,000.

1 **401-K Matching**

2 Q. WHAT ADJUSTMENT ARE YOU PROPOSING TO 401-K MATCHING
3 COSTS?

4 A. The Company has proposed an adjustment to include additional 401-K matching.
5 According to Duquesne these costs were not budgeted, so they were not already reflected
6 in the budgeted operating expense. According to the Company the additional 401-K
7 matching is awarded for achievement of certain safety and non-financial goals. It stands
8 to reason that these costs are not budgeted because they are not certain. Therefore, I do
9 not believe it is appropriate to include them as annual recurring costs, so I am proposing
10 an adjustment to remove the total \$334,000 from O&M expenses on Schedule LKM-12.

11 **SFAS 123R Costs**

12 Q. PLEASE EXPLAIN YOUR ADJUSTMENT TO SFAS 123R ADOPTION
13 COSTS.

14 A. Duquesne has included \$638,000 in operating expenses related to the adoption of SFAS
15 123R, Accounting for Share-Based Payments. This accounting pronouncement requires
16 companies to recognize the cost of employee services received in exchange for equity
17 instruments based on the fair value on the date granted. I am removing the adoption costs
18 because they are one-time costs and should not be included in the cost of service as
19 annual costs. On Schedule LKM-13, I present this adjustment which decreases operating
20 expenses by \$596,000

21 **Advertising Expense**

22 Q. PLEASE EXPLAIN YOUR ADJUSTMENT TO ADVERTISING EXPENSE.

23 A. The Company included approximately \$2.0 million in the cost of service for advertising
24 expense. The sample advertisements that were submitted to support these costs appear to

1 include corporate image advertising. Therefore, I am proposing an adjustment on
2 Schedule LKM-14 to remove these costs from the cost of service.

3 Q. WHAT KIND OF ADVERTISING DO YOU BELIEVE IS APPROPRIATE TO
4 INCLUDE IN THE COST OF SERVICE?

5 A. I believe advertising included in the cost of service should address conservation, safety,
6 rate information and employment. However, advertisements that, as the primary
7 message, tell how good the Company is are of little benefit to ratepayers and do little
8 more than promote the Company's image. Therefore, those costs should not be
9 recovered from ratepayers. This adjustment is summarized on Schedule LKM-14, and
10 results in a decrease of \$1.9 million in Pennsylvania jurisdictional revenues.

11 **Company-Use Energy**

12 Q. WHAT ADJUSTMENT ARE YOU RECOMMENDING FOR COMPANY-USE
13 ENERGY?

14 A. Duquesne included an increase of \$700,000 in the cost of service to include additional
15 costs for weather-related energy consumption by the Company, and additional energy
16 consumption related to an additional building. The supporting data for these costs were
17 inadequate to determine whether the costs included by the Company are reasonable.
18 Additional information has been sought and, when received, the adjustment will be
19 revised if necessary. This adjustment, which reduces expenses by \$654,000, is presented
20 on Schedule LKM-15.

21 **Rate Case Expenses**

22 Q. WHAT ADJUSTMENT ARE YOU RECOMMENDING FOR RATE CASE
23 EXPENSE?

24 A. Duquesne has included an adjustment of \$1,704,000 to reflect a 3-year normalization of
25 rate case expenses. The cost presented by the Company includes fees for outside

1 consultants, lawyers, data processing technology, Company personnel, travel, etc. In
2 addition, the Company indicated that it avoided \$207,000 of costs that were to be
3 incurred during 2005, thereby reducing its total costs. As a result of serving
4 interrogatories on this issue, I have found it necessary to recalculate rate case costs which
5 results in a reduction of \$453,000 to the Company's claim.

6 Q. HOW IS YOUR ADJUSTMENT TO RATE CASE EXPENSE DERIVED?

7 A. I have calculated the rate case expenses by using the revised rate case costs of \$4.9
8 million presented in the response to OTS-RE-7-D. From that amount, I removed
9 expenses that appear to be normal Company costs that are already accounted for
10 elsewhere in the cost of service, or are costs that will not be incurred at all. The result of
11 removing these expenses is a total rate case expense of \$3.8 million. When amortized
12 over a three-year period, it results in an adjustment reducing rate case expense by
13 \$453,000. This adjustment is presented on Schedule LKM-16.

14
15 **Incentive Compensation**

16 Q. WHY HAVE YOU REMOVED A PORTION OF INCENTIVE
17 COMPENSATION FROM OPERATING EXPENSES?

18 A. Included in Duquesne's operating expenses are \$5.1 million of costs related to its
19 incentive compensation plans. The Company offers an incentive plan that has established
20 goals or targets that must be achieved in order for payments under the plan to be
21 triggered. These thresholds are based on financial and non-financial measures.
22 Accordingly, financial performance thresholds are established annually and must be
23 attained before any incentive compensation payouts are made, regardless of individual or
24 other company performance measures.

1 I believe the costs related to financial performance should not be included in
2 expenses because by achieving the financial goals, the additional earnings would provide
3 the funds from which to pay the incentives. In other words, if management is successful
4 in achieving the plan goals, meeting those goals would result in additional income from
5 which the incentive compensation can be paid. Including the cost of the incentive plan in
6 rates would have the effect of requiring ratepayers to pay the costs of increasing
7 Duquesne's earnings.

8 I have also used the average incentive compensation amount for the non-financial
9 incentive because incentive compensation is "at risk" pay. Unlike regular salary and
10 wages, incentive compensation is not guaranteed as a level of pay or payouts under the
11 plan. As a result, the incentive compensation can fluctuate from year to year. Therefore,
12 the 3-year average incentive compensation was used to prevent an over-collection of
13 these costs.

14 The adjustment to incentive compensation is presented on Schedule LKM-17. As
15 shown there, excluding incentive compensation related to financial goals and using the 3-
16 year average for the remaining incentive payment reduces operating expenses by \$2.8
17 million.

18 Storm Normalization

19 Q. WHY HAVE YOU REVERSED DUQUESNE'S STORM NORMALIZATION
20 ADJUSTMENT?

21 A. Duquesne included \$691,000 in the cost of service to normalize storm expenses. The
22 adjustment is based on a 3-year average of insurance premiums. This average includes 2
23 years of actual premiums and a 2006 budget premium that was derived by the Company
24 using a 10 percent escalation rate. Duquesne indicates that it will become self-insured for

1 storm damages, so its adjustment is derived by comparing the 3-year average to the
2 amount of premiums it expected to pay during the period before it becomes self-insured.

3 I have removed these costs from O&M expenses because they are not
4 representative of the costs that the Company will incur. If the Company is self insured,
5 then the premiums are no longer a valid measure of costs. Therefore, I have removed
6 these costs totaling \$691,000 on Schedule LKM-18.

7 Q. COULDN'T YOU HAVE USED THE ACTUAL HISTORICAL STORM
8 DAMAGE COSTS TO DEVELOP A REPRESENTATIVE LEVEL OF STORM
9 DAMAGE COSTS?

10 A. Yes, that is a possible alternative. However, even though the storm normalization data
11 was requested early during the discovery phase, the Company provided a response too
12 late in the process to allow the OCA to follow up and receive additional data. Moreover,
13 in the response to OTS-RE-29, Duquesne indicated that for 2003, 2004 and 2005 it did
14 not submit any insurance claims relating to storm damages. This implies that there were
15 no catastrophic events since its deductible was only \$2.5 million, less 1 percent of total
16 O&M expenses. Nevertheless, unless there were some catastrophic event or major storm,
17 I believe that storm damage costs have been captured in the budgeted amounts, making a
18 separate adjustment unnecessary. Under normal circumstances, the costs of storm
19 damage are captured in O&M expenses or are capitalized. Every year, there are weather-
20 related events that cause damage to the Company's facilities. If the cost of repairing
21 those facilities were capitalized, then they are now in rate base where a return is earned
22 and cost recovery is provided through depreciation. Given that there are storm damages
23 every year, they should already be included in the budgeted O&M expenses because
24 those costs are captured from year to year as normal operating costs. Hence, I believe the
25 Company filed costs include an allowance for the recovery of storm damage costs.

1 Q. THE COMPANY PROPOSED THAT IT BE GIVEN THE AUTHORITY TO
2 DEFER STORM DAMAGE COSTS EXCEEDING THE \$897,000 CLAIM IN
3 THIS CASE. DO YOU AGREE?

4 A. No. The Company has not satisfactorily established what normal storm damage costs
5 are, so there is no way to judge the reasonableness of the \$897,000 amount. More
6 importantly, however, there is no need to grant such an authority at this time.

7 **Depreciation Expense**

8 Q. WHAT ADJUSTMENT ARE YOU PROPOSING TO DEPRECIATION
9 EXPENSE?

10 A. As I previously indicated, I have adjusted plant in-service to remove certain costs. As a
11 result, I have recalculated depreciation expense to incorporate the revised plant in-service
12 balances. My calculation of depreciation expense, however, is based upon the
13 Company's depreciation rates. Therefore, the change in depreciation expense is based
14 solely on the change in the plant in-service amounts. This adjustment is presented on
15 Schedule LKM-19, and it reduces the cost of service by \$1.7 million.

16 **Utilities Expense**

17 Q. PLEASE EXPLAIN YOUR ADJUSTMENT TO UTILITIES EXPENSES.

18 A. The Company included an increase of \$965,000 in its budgeted expenses to reflect
19 increases in expenses for electricity, natural gas and water. The OCA did seek additional
20 information to substantiate the Company's claim. The response was received too late to
21 allow for follow up interrogatories, and the response was inadequate to allow an
22 evaluation of the reasonableness of these costs. Therefore, I am recommending an
23 adjustment of Schedule LKM-20 to remove these costs because they are not properly
24 supported.

1 **Industry Association Dues**

2 Q. WHY ARE YOU REMOVING A PORTION OF INDUSTRY ASSOCIATION
3 DUES?

4 A. As a result of an interrogatory, the Company has identified the portion of dues to various
5 trade associations that are related to lobbying. In past cases before this Commission, it
6 has been recognized that the portion of association dues associated with lobbying should
7 not be recovered from ratepayers. I have made an adjustment that removes these
8 lobbying related costs from the cost of service. Therefore, on Schedule LKM-21, I
9 present this adjustment, which reduces O&M expenses by \$87,000.

10 **Expiring Leases**

11 Q. WHAT ADJUSTMENT ARE YOU RECOMMENDING WITH REGARD TO
12 EXPIRING LEASES?

13 A. Included in the cost of service are leases that are expiring during the test year. Given that
14 these leases are expiring, the associated costs are non-recurring. I have removed these
15 costs from operating expenses. This adjustment is presented in Schedule LKM-22, and it
16 reduces expenses by \$120,000.

17 **PURTA**

18 Q. WHAT ADJUSTMENT ARE YOU RECOMMENDING TO THE PUBLIC
19 UTILITY REALTY TAX?

20 A. According to the Company, it has included an annualized level of Public Utility Realty
21 Tax (PURTA) based upon its projected taxable value that includes its capital
22 improvement projects. Since I have made adjustments to remove certain costs from plant
23 in service, I am recommending an adjustment to PURTA to remove the tax value
24 associated with the plant value that I have removed. This adjustment is presented on
25 Schedule LKM-23, and it results in a decrease in Taxes Other Than Income of \$338,000.

1 Miscellaneous Revenues

2 Q. PLEASE EXPLAIN YOUR ADJUSTMENT TO MISCELLANEOUS
3 REVENUES.

4 A. The 2006 budgeted revenues reflect a decrease in the level of revenues recorded in Rent
5 from Electric Property and Other Electric Revenues. The company has been asked to
6 furnish an explanation for these decreases, but the OCA has not yet received the
7 responses. On Schedule LKM-24 I have restated these revenues totaling \$2.3 million to
8 the historic test year levels. Upon receiving the necessary data from the Company, I will
9 revise my adjustment if necessary.

10 Interest Synchronization

11 Q. PLEASE EXPLAIN YOUR INTEREST SYNCHRONIZATION
12 ADJUSTMENT.

13 A. To determine the tax-deductible interest for ratemaking, I have multiplied the adjusted
14 rate base by the weighted cost of debt included in the capital structure. This procedure
15 synchronizes the interest deduction for tax purposes with the interest component of the
16 return on rate base to be recovered from ratepayers. As shown in Schedule LKM-25, this
17 adjustment increases the interest deduction by \$4.1 million compared to the interest
18 deduction recognized by Duquesne in its filing. This decreases state and federal income
19 taxes by \$412,000 and \$1,301,000 respectively.

20 Distribution System Improvement Charge

21 Q. PLEASE SUMMARIZE DUQUESNE ELECTRIC'S PROPOSED
22 DISTRIBUTION SYSTEM IMPROVEMENT CHARGE.

23 A. Duquesne is proposing to implement a Distribution System Improvement Charge (DSIC)
24 to provide for the recovery of the fixed costs of certain improvements to its distribution
25 system between rate cases. Under Duquesne's proposal, eligible projects would include:

1 replacements of existing facilities that have worn out, are in deteriorated condition or are
2 required as the result of new regulations; un-reimbursed costs of capital projects to
3 relocate facilities due to highway relocations; and security improvements. The fixed
4 costs recovered through the DSIC would include depreciation, a return on investment and
5 income taxes associated with new projects placed in service each year. Duquesne
6 recognizes that a DSIC is precluded by Pennsylvania law, but makes its proposal in the
7 event of future legislative change.

8 Q. DO YOU AGREE THAT THE PROPOSED DISTRIBUTION SYSTEM
9 IMPROVEMENT CHARGE IS SOUND RATEMAKING POLICY?

10 A. No. I have identified a number of issues and problems with the proposed DSIC, beyond
11 the legal reasons, which require its rejection by the Commission. These include:

- 12
- 13 • The DSIC would constitute improper single-issue ratemaking and would provide a
14 means of guaranteeing increases in rates to recognize certain cost increases without
15 recognizing offsetting cost savings.
- 16 • Verification of the eligibility of projects for inclusion in the DSIC would be
17 problematic.
- 18 • The DSIC would reduce or eliminate certain essential aspects of the review and
19 oversight of Duquesne's rates.

20 In addition to these technical issues and problems, Counsel advises me that the
21 DSIC is not permitted under the Pennsylvania Public Utility Code. The legal issues
22 associated with Duquesne's proposed DSIC will be addressed further by Counsel in the
23 OCA's Brief in this proceeding.

24 Q. WOULD YOU PLEASE EXPLAIN WHY THE DSIC WOULD CONSTITUTE
25 IMPROPER SINGLE ISSUE RATEMAKING?

26 A. Yes. Under the DSIC, the only changes in costs eligible for consideration would be the
27 depreciation, return and income taxes on certain improvements to the distribution system

1 between rate cases. As a result, the DSIC would serve as a form of an attrition
2 adjustment that would guarantee that rates would increase each year. The DSIC assumes
3 that net distribution plant will increase each year and ignores offsetting cost reductions.

4 Q. WHAT ARE THE OTHER COST SAVINGS WHICH DUQUESNE HAS
5 FAILED TO RECOGNIZE?

6 A. Duquesne's proposed DSIC ignores several offsets that would cause the charge under the
7 DSIC to be overstated. The offsets include:

- 8 • The rate base deduction for accumulated deferred income taxes (ADIT).
- 9 • The elimination of depreciation expense on existing plant replaced by DSIC eligible
10 projects.
- 11 • The reduction in maintenance costs resulting from the replacement of existing
12 facilities that are worn out or deteriorated.
- 13 • The contribution that new customers make to system costs.
- 14

15 Q. PLEASE EXPLAIN EACH OF THESE OFFSETTING FACTORS.

16 A. In calculating the distribution plant eligible to earn a return under the DSIC, Duquesne
17 has only proposed to recognize plant additions net of the accumulated depreciation on
18 those plant additions. In addition to the problem discussed previously with regard to the
19 overstatement of net distribution plant growth, the proposed DSIC would overstate the
20 plant eligible to earn a return by ignoring the ADIT associated with the plant included in
21 the DSIC.

22 Second, in calculating the depreciation expense associated with DSIC eligible
23 plant, Duquesne has only recognized the depreciation expense on the new plant. This
24 proposal ignores the fact that the rates established in this case include depreciation
25 accruals on all existing plant. When existing plant is removed from plant in service as a

1 result of being replaced by DSIC eligible projects, depreciation accruals on that plant
2 cease. Duquesne has failed to account for this reduction in depreciation expense.

3 Third, as older facilities deteriorate and wear out and are replaced by newer
4 facilities, maintenance costs typically decrease. However, the proposed DSIC gives no
5 consideration to maintenance cost savings.

6 Finally, while only non-revenue producing distribution plant additions are eligible
7 for inclusion in the proposed DSIC, Duquesne has ignored the fact that new customers
8 make a contribution toward the recovery of all system costs. By selectively seeking to
9 recover a portion of plant additions, the DSIC ignores the overall relationship between
10 rates and costs.

11 Q. THE SECOND PROBLEM WHICH YOU IDENTIFIED WITH REGARD TO
12 THE DSIC RELATES TO THE DETERMINATION OF THE ELIGIBILITY OF
13 PROJECTS FOR INCLUSION. WOULD YOU PLEASE EXPLAIN THIS
14 CONCERN?

15 A. Yes. If implemented, the Company would make the decision as to which distribution
16 construction projects meet the criteria it is proposing for DSIC eligibility. It would be
17 difficult and time consuming for the Commission Staff, the OCA or any other party to
18 evaluate the purpose of the project and to audit whether or not the criteria for eligibility
19 for inclusion are met. Moreover, some construction projects may meet the eligibility
20 requirements (e.g., replacing a deteriorated facility), but also result in improved or
21 increased system capabilities. Since the costs of projects that increase system capabilities
22 are not eligible for inclusion in the DSIC, it would effectively become a matter of
23 Duquesne's discretion as to whether or not the project is included in the DSIC.

24 It would not be appropriate for the Commission to simply accept the Company's
25 decision as to what projects should be included in the DSIC. Therefore, implementation

1 of the DSIC would require Duquesne to have in place accounting and information
2 systems to separately track and verify not only the costs of its construction projects and
3 whether they are completed and being used to provide service, but also details as to the
4 purpose of the projects and the basis for eligibility for DSIC inclusion. Without such
5 systems, an auditor would be unable to test the Company's decisions. However,
6 Duquesne has not established any such systems for examination in this case.

7 Q. PLEASE EXPLAIN YOUR CONCERN THAT THE PROPOSED DSIC
8 REDUCES THE PROPER OVERSIGHT OF DUQUESNE'S RATES.

9 A. In addition to the problems and concerns cited above, the DSIC would reduce or
10 eliminate the proper oversight of Duquesne's rates in several other ways as well. First,
11 Duquesne has proposed that the return on investment would automatically be revised to
12 reflect changes in the Company's capital structure. This would result in no opportunity
13 to review and challenge the appropriateness of changes in the Company's capital
14 structure.

15 Second, the DSIC would be a fully reconcilable surcharge. This would provide
16 guaranteed and automatic cost recovery for capital costs under circumstances where it
17 will be difficult at best for other parties and the Commission to evaluate the prudence and
18 reasonableness of the claimed costs.

19 Q: DO YOU HAVE ANY OTHER COMMENTS ABOUT THE PROPOSED
20 DSIC?

21 A. Yes. As indicated by the above, the costs which the DSIC would recover are part of the
22 normal costs which Duquesne must incur to provide service to its customers. As such,
23 the costs do not warrant special recovery separate and apart from the other costs included
24 in base rates.

AFUDC on Plant Held for Future Use

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Q. PLEASE SUMMARIZE DUQUESNE'S PROPOSAL ON AFUDC ON PLANT HELD FOR FUTURE USE.

A. Duquesne is requesting authority from the Commission to accrue AFUDC on its Plant Held for Future Use balances. The Company takes the position that the plant held for future use will be dedicated to utility operations. Hence at some point in the future, the plant will be transferred to plant in service. Given that Duquesne views the plant as potential utility plant, it seeks to accumulate AFUDC on the investment it has made thus far.

Q. PLEASE EXPLAIN HOW DUQUESNE WILL EARN A RETURN ON THE PLANT HELD FOR FUTURE USE INVESTMENT.

A. The AFUDC rate is a calculation that mimics the Company's cost of capital. Generally, it is accrued on the Construction Work in Progress (CWIP), and represents a return on the funds that the utility has dedicated to CWIP projects. A utility is allowed to accrue AFUDC on CWIP because CWIP is not eligible for inclusion in rate base where the utility can recover the return on the invested funds in the rates it currently charges ratepayers. Hence, a major difference in the manner in which AFUDC is earned, as compared to inclusion of the investment in rate base, is that the Company does not begin to collect the AFUDC return from ratepayers until the project is completed and placed in service. Duquesne is requesting to accumulate AFUDC on Plant Held for Future Use just as it does for CWIP.

1 Q. GIVEN THAT THE COMPANY IS ESSENTIALLY SEEKING THAT
2 FUTURE USE PLANT BE TREATED SIMILAR TO CWIP, DO YOU
3 BELIEVE THAT THE COMPANY SHOULD BE ALLOWED TO ACCRUE
4 AFUDC PLANT HELD FOR FUTURE USE?

5 Conceptually, the OCA will not oppose the accrual of AFUDC. However, the
6 OCA has not been provided the data that show what property and investments the
7 Company currently holds in Plant Held for Future Use. Therefore, it is difficult to
8 recommend that the Company's proposal be accepted. Thus, upon reviewing the data,
9 the OCA will make a formal recommendation.

10 Q. DOES THIS END YOUR TESTIMONY?

11 A. Yes, it does.

12

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14

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC
UTILITY COMMISSION

v.

DUQUESNE LIGHT COMPANY

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DOCKET NO: R-00061346

**SCHEDULES ACCOMPANYING THE
DIRECT TESTIMONY OF
LAFAYETTE K. MORGAN, JR.**

**ON BEHALF OF THE
OFFICE OF CONSUMER ADVOCATE**

JULY 7, 2006

EXETER

ASSOCIATES, INC.

5565 Sterrett Place

Suite 310

Columbia, Maryland 21044

DUQUESNE LIGHT COMPANY

Summary of Operating Income
For the Test Year Ended December 31, 2006
(\$000)

	PAPUC Jurisdictional Amount per Co.	OCA Cost of Service Adjustments	Amount After Adjustments	OCA Recommended Change In Revenue	After Proposed Rate Increase
Operating Revenues					
Sales Revenues	\$ 279,955	\$ -	\$ 279,955	\$ 67,957	\$ 347,912
Sales for Resale	-	-	-	\$ -	-
Other Operating Revenue	14,282	2,287	16,569	-	16,569
Total Operating Revenues	\$ 294,237	\$ 2,287	\$ 296,524	\$ 67,957	\$ 364,481
Operating Expenses					
O&M Expenses	\$ 166,288	\$ (19,342)	\$ 146,946	\$ 727	\$ 147,673
Depreciation Expense	62,917	(1,743)	61,174	-	61,174
Amortization Expense	3,484	-	3,484	-	3,484
Taxes Other Than Income	24,694	(547)	24,147	4,009	28,156
Total Operating Expenses	\$ 257,383	\$ (21,633)	\$ 235,750	\$ 4,736	\$ 240,486
Income Taxes					
State Income Tax	(1,222)	1,978	756	6,316	7,072
Current Federal Income Tax	(3,855)	6,235	2,380	19,917	22,297
Deferred Federal Income Tax	10,087	-	10,087	-	10,087
ITC Amortization	(1,142)	-	(1,142)	-	(1,142)
Consolidated Tax Adjustment	(753)	-	(753)	-	(753)
Total Federal Income Tax	4,337	6,235	10,572	19,917	30,489
Total Operating Expenses	\$ 260,498	\$ (13,421)	\$ 238,885	\$ 30,969	\$ 269,854
Net Operating Income	\$ 33,739	\$ 15,708	\$ 57,639	\$ 36,988	\$ 94,627
Rate Base	\$ 1,232,857		\$ 1,205,439		\$ 1,205,439
Return On Rate Base	2.74%		4.78%		7.85%

DUQUESNE LIGHT COMPANY

Summary of Revenue Increase at OCA Rate of Return
 For the Test Year Ended December 31, 2006
 (\$000)

		<u>Amount</u>	
Adjusted Rate Base		\$ 1,205,439	Schedule LKM-2, Page 2
Required Rate of Return		<u>7.850%</u>	
Net Operating Income Required		\$ 94,627	
Net Operating Income at Present Rates		<u>57,639</u>	Schedule LKM-1, Page 1
Income Deficiency/(Surplus)		\$ 36,988	
Revenue Multiplier		<u>1.83727</u>	
Required Change in Company Revenue		<u>\$ 67,957</u>	
Proposed Revenue Change		\$ 67,957	
Uncollectibles	1.0700%	727	
Gross Revenues Tax	5.900%	<u>4,009</u>	
Subtotal		\$ 63,221	
State Income Tax	9.990%	<u>6,316</u>	
Subtotal		\$ 56,905	
Federal Income Tax	35.00%	<u>19,917</u>	
Net Income Increase Required		<u>\$ 36,988</u>	

DUQUESNE LIGHT COMPANY

Summary of Rate Base
For the Test Year Ended December 31, 2006
(\$000)

	PAPUC Jurisdictional Amount per Co.	OCA Rate Base Adjustments	Amount After Adjustments
Total Plant in Service	\$ 1,930,872	\$ (13,853)	\$ 1,917,019
Depreciation Reserve	(613,163)	1,743	(611,419)
Net Plant in Service	\$ 1,317,709	\$ (12,109)	\$ 1,305,600
Working Capital Requirements			
Cash Working Capital	\$ 50,086	\$ (11,429)	\$ 38,657
Materials & Supplies	11,296	(1,199)	10,097
Total Working Capital Requirements	61,382	(12,628)	48,754
Deductions			
Customer Deposits	(1,413)	(300)	(1,713)
Settlement Reserve	-	(2,381)	(2,381)
Accumulated Deferred Income Taxes	(144,821)	-	(144,821)
Total Deductions	(146,234)	(2,681)	(148,915)
Total Rate Base	\$ 1,232,857	\$ (27,419)	\$ 1,205,439

DUQUESNE LIGHT COMPANY

Summary of Rate Base Adjustments
For the Test Year Ended December 31, 2006
(\$000)

	<u>Source</u>	<u>PAPUC Jurisdictional Amount per Co.</u>
Rate Base per Company Filing	Schedule LKM-2, Page 1	<u>\$ 1,232,857</u>
<u>OCA Adjustments:</u>		
Plant in Service	Schedule LKM-4	\$ (12,109)
Materials & Supplies	Schedule LKM-5	(1,199)
Customer Deposits	Schedule LKM-6	(300)
Cash Working Capital	Schedule LKM-7	(11,429)
Non-Operational Settlement Damage Reserve	Schedule LKM-8	<u>(2,381)</u>
Total Ratemaking Adjustments		<u>\$ (27,419)</u>
Adjusted Rate Base per OCA		<u><u>\$ 1,205,439</u></u>

DUQUESNE LIGHT COMPANY

Summary of Adjustments to Net Income
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>
Net Income per Company	<u>\$ 33,739</u>
<u>OCA Adjustments:</u>	
Remove Pension Contribution Expense	\$ 4,882
Remove 2006 Payroll Increase	1,334
Remove 2006 Employee Benefits Increase	180
Remove Additional 401-K Expense	195
Remove One-Time SFAS 123R Costs	349
Remove Image Advertising	1,134
Remove Increase in Company Use Energy	383
Normalize Rate Case Expense	265
Normalize Incentive Compensation	1,664
Remove Storm Normalization Increase	404
Normalize Depreciation Expense	1,020
Remove Utilities Expense Increase	529
Remove Lobbying from Association Dues	51
Remove Expiring Leases	70
Normalize PURTA	198
Normalize Miscellaneous Revenues	1,338
Interest Synchronization	<u>1,713</u>
 <i>Total Ratemaking Adjustments</i>	 <u>\$ 15,708</u>
 Total Adjusted Net Income per OCA	 <u>\$ 49,447</u>

DUQUESNE LIGHT COMPANY

Summary of Adjustments to Net Income
For the Test Year Ended December 31, 2006
(\$000)

	Operating Revenues	O&M Expenses	Depreciation Expense	Amortization Expense	Taxes Other Than Income	State Income Taxes	Federal Income Tax	Net Operating Income
Amount per Company	\$ 294,237	\$ 166,288	\$ 62,917	\$ 3,484	\$ 24,694	\$ (1,222)	\$ 4,337	\$ 33,739
OCA Adjustments:								
Remove Pension Contribution Expense	\$ -	\$ (8,344)	\$ -	\$ -	\$ -	\$ 834	\$ 2,629	\$ 4,882
Remove 2006 Payroll Increase	-	(2,071)	-	-	(209)	228	718	1,334
Remove 2006 Employee Benefits Increase	-	(307)	-	-	-	31	97	180
Remove Additional 401-K Expense	-	(334)	-	-	-	33	105	195
Remove One-Time SFAS 123R Costs	-	(596)	-	-	-	60	188	349
Remove Image Advertising	-	(1,938)	-	-	-	194	611	1,134
Remove Increase in Company Use Energy	-	(654)	-	-	-	65	206	383
Normalize Rate Case Expense	-	(453)	-	-	-	45	143	265
Normalize Incentive Compensation	-	(2,844)	-	-	-	284	896	1,664
Remove Storm Normalization Increase	-	(691)	-	-	-	69	218	404
Normalize Depreciation Expense	-	-	(1,743)	-	-	174	549	1,020
Remove Utilities Expense Increase	-	(904)	-	-	-	90	285	529
Remove Lobbying from Association Dues	-	(87)	-	-	-	9	27	51
Remove Expiring Leases	-	(120)	-	-	-	12	38	70
Normalize PURTA	-	-	-	-	(338)	34	107	198
Normalize Miscellaneous Revenues	2,287	-	-	-	-	228	720	1,338
Interest Synchronization	-	-	-	-	-	(412)	(1,301)	1,713
Total Ratemaking Adjustments	\$ 2,287	\$ (19,342)	\$ (1,743)	\$ -	\$ (547)	\$ 1,978	\$ 6,235	\$ 15,708
Total Adjusted Income	\$ 296,524	\$ 146,946	\$ 61,174	\$ 3,484	\$ 24,147	\$ 756	\$ 10,572	\$ 49,447

DUQUESNE LIGHT COMPANY

Adjustment to Plant In Service
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>	
Adjusted Plant in Service	\$ 2,356,423	1/
PA Jurisdictional Allocation Factor	<u>81.35%</u>	2/
PA Jurisdictional Plant in Service per OCA	\$ 1,917,019	
PA Jurisdictional Plant in Service per Company	<u>1,930,872</u>	2/
Adjustment to Plant in Service	<u><u>\$ (13,853)</u></u>	

Notes:

1/ Schedule LKM-4, Page 2.

2/ DLC Exhibit 2, Schedule C-1.

DUQUESNE LIGHT COMPANY

Calculation of Adjusted Plant in Service
For the Test Year Ended December 31, 2006
(\$000)

	Account No.	2006 Amount Per Company	1/ Remove Budget Variances	2/ Remove Payroll Adjustment	1/ Remove Additional 401-K	1/ Adjusted 2006 Amount
Intangible Plant						
Organization	301	\$ 100	\$ -	\$ -	\$ -	\$ 100
Franchise & Consents	302	7	-	-	-	7
Software	303	29,716	-	162	7	29,547
Total Intangible Plant		<u>29,823</u>	<u>-</u>	<u>162</u>	<u>7</u>	<u>29,654</u>
Transmission Plant						
Land & Land Rights	350	11,035	37	-	-	10,998
Structures & Improvements	352	7,637	25	6	-	7,606
Station Equipment	353	184,824	616	1,425	65	182,718
Towers & Fixtures	354	69,209	231	229	10	68,739
Poles & Fixtures	355	10,066	34	30	1	10,001
Overhead Conductors & Devices	356	43,871	146	50	2	43,673
Underground Conduit	357	55,965	186	649	30	55,100
Underground Conduit & Devices	358	38,767	129	650	30	37,958
Roads & Trails	359	4	0	-	-	4
Total Transmission Plant		<u>421,378</u>	<u>1,404</u>	<u>3,039</u>	<u>138</u>	<u>416,797</u>
Distribution Plant						
Land & Land Rights	360	9,962	33	-	-	9,929
Structures & Improvements	361	47,272	158	-	-	47,114
Station Equipment	362	299,299	997	1,481	68	296,753
Poles, Towers & Fixtures	364	291,340	971	383	17	289,969
Overhead Conductors & Devices	365	301,038	1,003	874	40	299,121
Underground Conduit	366	99,255	331	296	14	98,614
Underground Conduit & Devices	367	190,267	634	135	6	189,492
Line Transformers	368	231,667	772	910	41	229,944
OH & UND Services	369	74,258	247	10	-	74,001
Meters & Appurtenances	370	76,192	254	139	6	75,793
Meter Communication Equipment	370.1	33,237	111	-	-	33,126
Street Lighting	373	32,723	109	17	2	32,595
Total Distribution Plant		<u>1,686,510</u>	<u>5,619</u>	<u>4,245</u>	<u>194</u>	<u>1,676,452</u>
General Plant						
Land & Land Rights	389	5,859	20	-	-	5,839
Structures & Improvements	390	90,728	302	774	35	89,617
Office Equipment	391	14,148	47	-	-	14,101
Transportation Equipment	392	44,982	150	180	8	44,644
Stores Equipment	393	1,883	6	-	-	1,877
Tools, Shop & Garage Equipment	394	10,022	33	26	2	9,961
Laboratory Equipment	395	4,841	16	-	-	4,825
Power Operated Equipment	396	1,016	3	-	-	1,013
Communication Equipment	397	61,777	206	393	18	61,160
Miscellaneous Equipment	398	486	2	-	-	484
Total General Plant		<u>235,742</u>	<u>785</u>	<u>1,373</u>	<u>63</u>	<u>233,521</u>
Total Electric Plant in Service		<u>\$ 2,373,453</u>	<u>\$ 7,809</u>	<u>\$ 8,819</u>	<u>\$ 402</u>	<u>\$ 2,356,423</u>

Notes:

1/ DLC Exhibit 2, Schedule C-2.

2/ Total amount per response to OCA IV-9 and pro rated based budgeted amount excluding intangible plant.

DUQUESNE LIGHT COMPANY

Adjustment to Normalize Materials and Supplies
For the Test Year Ended December 31, 2006
(\$000)

	<u>PAPUC Jurisdictional Amount</u>
HTY Average Materials & Supplies Balance	\$ 15,558 1/
Allocation Factor	<u>64.9% 2/</u>
PA Jurisdictional Amount	\$ 10,097
FTY Average Materials & Supplies Balance	<u>11,296 3/</u>
Adjustment to Rate Base	<u>\$ (1,199)</u>

Notes:

- 1/ DLC Exhibit 3, Schedule C-5.
- 2/ DLC Exhibit 2, Schedule C-5.
- 3/ DLC Exhibit 2, Schedule C-1.

DUQUESNE LIGHT COMPANY

Adjustment to Normalize Customer Deposits
For the Test Year Ended December 31, 2006
(\$000)

	<u>PAPUC Jurisdictional Amount</u>
HTY Average Customer Deposits Balance	\$ 1,713 1/
FTY Average Materials & Supplies Balance	<u>1,413 2/</u>
Adjustment to Rate Base	<u>\$ 300</u>

Notes:

- 1/ DLC Exhibit 3, Schedule B-1, Page 2.
- 2/ DLC Exhibit 2, Schedule B-1, Page 2.

DUQUESNE LIGHT COMPANY

Adjustment to Allowance for Cash Working Capital
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount Per Company</u>	<u>OCA Adjustment</u> 1/	<u>Adjusted Amount</u>	<u>Lag Days</u>	<u>Dollar Days</u>	<u>Weighted Lags</u>
Revenue Lag Days						53.97
<u>Expenses</u>						
Payroll	\$ 59,771	\$ (7,252)	\$ 52,519	10.72	\$ 563,004	
Pension Expense	10,052	(8,911)	1,141	(151.00)	(172,291)	
Purchased Power	358,515	-	358,515	35.00	12,548,025	
Other Expenses	78,764	(6,592)	<u>72,172</u>	63.14	<u>4,556,919</u>	
			\$ 484,347		\$ 17,495,657	36.12
Net (Lead)/Lag Days						17.85
Daily Operating Expenses						\$ 1,327
O&M Working Capital						\$ 23,684
Average Prepayments						4,200
Accrued Taxes						16,467
Interest Payments						(4,635)
Preferred Dividends Payments						<u>169</u>
Total Working Capital Requirement						\$ 39,885
PA Jurisdictional Allocation Factor						<u>96.92%</u>
Cash Working Capital Allowance per OCA						\$ 38,657
Cash Working Capital Allowance per Company						<u>50,086</u>
Adjustment to Cash Working Capital Allowance						<u>\$ (11,429)</u>

DUQUESNE LIGHT COMPANY

Calculation of Other Expense Lag
For the Test Year Ended December 31, 2006
(\$000)

	<u>Payment Amount</u> 1/	<u>Lag Days</u>	<u>Dollar Days</u> 1/
June 2004	\$ 4,005,457		\$ 248,862,992
October 2004	3,626,807		222,177,258
February 2005	4,228,438		294,717,678
April 2005	<u>3,819,035</u>		<u>224,251,642</u>
Total	\$ 15,679,738		\$ 990,009,570
Weighted Lag Days		<u>63.14</u>	

Notes:

1/ Calculated based on data provided by Company.

DUQUESNE LIGHT COMPANY

Adjustment to Include Non-Operational Settlement Claims Reserve in Rate Base
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u> ^{2/}
Non-Operational Settlement Claims Reserve	\$ 2,543 1/
PA Jurisdictional Allocation Factor	<u>93.64% 2/</u>
Total Adjustment to O&M Expense	<u>\$ 2,381</u>

Notes:

1/ Response to OCA VIII-6.

2/ Calculated based on data presented on DLC Exhibit 2, Schedule D-4, Page 2, Line 80.

DUQUESNE LIGHT COMPANY

Adjustment to Annualize Payroll Expense
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>
Adjusted 2005 Payroll Expense	\$ 57,646 1/
Company Adjusted 2006 Payroll Expense	<u>59,769</u>
Adjustment to Payroll Expense	\$ (2,123)
PA Jurisdictional Allocation Factor	<u>97.57% 2/</u>
Total Adjustment to O&M Expense	<u>\$ (2,071)</u>
FICA Taxes	\$ (171)
FUTA	\$ (2)
SUTA	\$ (21)
City of Pittsburgh Payroll Tax	\$ (16)

Notes:

1/ DLC Exhibit 2, Schedule D-9, Page1.

2/ Calculated based on data presented on DLC Exhibit 2, Schedule D-4, Page 2, Line 85.

DUQUESNE LIGHT COMPANY

Adjustment to Remove Projected Contributions to Pension Expense
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>
Company Adjustment to Pension Expense	\$ 8,911 1/
PA Jurisdictional Allocation Factor	<u>93.64% 2/</u>
Total Adjustment to O&M Expense	<u>\$ (8,344)</u>

Notes:

1/ DLC Exhibit 2, Schedule D-9, Page1.

2/ Calculated based on data presented on DLC Exhibit 2, Schedule D-4, Page 2, Line 77.

DUQUESNE LIGHT COMPANY

Adjustment to Remove Employee Benefits Expense Related to Increased Employees
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>
Company Adjustment to Employee Benefits Expense	\$ 328 1/
PA Jurisdictional Allocation Factor	<u>93.64% 2/</u>
Total Adjustment to O&M Expense	<u>\$ (307)</u>

Notes:

1/ DLC Exhibit 2, Schedule D-9, Page 1.

2/ Calculated based on data presented on DLC Exhibit 2, Schedule D-4, Page 2, Line 77.

DUQUESNE LIGHT COMPANY

Adjustment to Remove Additional 401-K Matching
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>
Company Adjustment to Employee Benefits Expense	\$ 357 1/
PA Jurisdictional Allocation Factor	<u>93.45% 2/</u>
Total Adjustment to O&M Expense	<u>\$ (334)</u>

Notes:

1/ DLC Exhibit 2, Schedule D-12, Page 1.

2/ Calculated based on data presented on DLC Exhibit 2, Schedule D-4, Page 2, Line 84.

DUQUESNE LIGHT COMPANY

Adjustment to Remove One-Time Costs Associated With SFAS 123R
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>
Company Adjustment to Employee Benefits Expense	\$ 638 1/
PA Jurisdictional Allocation Factor	<u>93.45% 2/</u>
Total Adjustment to O&M Expense	<u>\$ (596)</u>

Notes:

1/ Company Response to OCA V-8.

2/ Calculated based on data presented on DLC Exhibit 2, Schedule D-4, Page 2, Line 84.

DUQUESNE LIGHT COMPANY

Adjustment to Remove Advertising Expenses
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>
Total Advertising Expenses Included in Cost of Service	\$ 2,069 1/
PA Jurisdictional Allocation Factor	<u>93.67% 2/</u>
Total Adjustment to O&M Expense	<u>\$ (1,938)</u>

Notes:

1/ DLC Exhibit 1, Attachment II-D-7d.

2/ Calculated based on data presented on DLC Exhibit 2, Schedule D-4, Page 2, Line 79.

DUQUESNE LIGHT COMPANY

Adjustment to Normalize Company Use Energy Expense
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u> ^{2/}
Remove Weather-Related Energy Consumption	\$ 400 1/
Remove Energy Related to Additional Building	<u>300 1/</u>
Adjustment to Company Use Energy Expense	\$ 700
PA Jurisdictional Allocation Factor	<u>93.45% 2/</u>
Total Adjustment to O&M Expense	<u>\$ (654)</u>

Notes:

1/ Response to OCA-V-6, Page 1.

2/ Calculated based on data presented on DLC Exhibit 2, Schedule D-4, Page 2, Line 84.

DUQUESNE LIGHT COMPANY

Adjustment to Normalize Rate Case Expenses
 For the Test Year Ended December 31, 2006
 (\$000)

		<u>Amount</u>
Actual Total Costs Incurred Through 5/31/2006		\$ 2,348 1/
Company Revised Estimated Cost of Rate Case	\$ 4,904 2/	
Actual Total Costs Incurred Through 5/31/2006	<u>2,348 1/</u>	
Total Remaining Cost to Complete	2,556	
Less: Preparation of Filing	(325) 3/	
Post Filing Preparation	(425) 3/	
Project Management	(200) 3/	
Strategy & Planning	<u>(200) 3/</u>	
	(1,150)	
Remaining Cost to Complete		<u>1,406</u>
Total Rate Case Expenses Subject to Recovery		\$ 3,754
Normalization Period (Years)		<u>3</u>
Normalized Rate Case Expenses per OCA		\$ 1,251
Normalized Rate Case Expenses per Company		<u>1,704 4/</u>
Adjustment to O&M Expenses		<u>\$ (453)</u>

Notes:

- 1/ Response to OCA-V-9.
- 2/ Response to OTS-RE-7-D.
- 3/ Response to OCA-XII-1.
- 4/ DLC Exhibit 2, Schedule D-8.

DUQUESNE LIGHT COMPANY

Adjustment to Remove Incentive Compensation Expense
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>
Three Year Average Incentive Compensation Portion Associated with Earnings	\$ 4,427 1/ <u>50%</u>
Incentive Compensation Eligible for Recovery 2006 Budgeted Incentive Compensation per Company	\$ 2,214 <u>5,129 2/</u>
Adjustment to Incentive Compensation PA Jurisdictional Allocation Factor	\$ (2,915) <u>97.57% 3/</u>
Total Adjustment to O&M Expense	<u>\$ (2,844)</u>

Notes:

1/ Response to OCA-IV-80.

2/ Response to OCA-IV-1, Page 2.

3/ Calculated based on data presented on DLC Exhibit 2, Schedule D-4, Page 2, Line 85.

DUQUESNE LIGHT COMPANY

Adjustment to Remove Storm Restoration Normalization Costs
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>
Company Adjustment to Include Storm Normalization Costs	\$ 691 1/
PA Jurisdictional Allocation Factor	<u>99.98% 2/</u>
Total Adjustment to O&M Expense	<u>\$ (691)</u>

Notes:

1/ DLC Exhibit 2, Schedule D-13.

2/ Calculated based on data presented on DLC Exhibit 2, Schedule D-4, Page 2, Line 54.

DUQUESNE LIGHT COMPANY

Adjustment to Depreciation Expense
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>	
Annual Depreciation Expense per OCA	\$ 72,689	1/
PA Jurisdictional Allocation Factor	<u>84.16%</u>	2/
PA Jurisdictional Annual Depreciation Expense per OCA	\$ 61,174	
PA Jurisdictional Annual Depreciation Expense per Company	<u>62,917</u>	2/
Adjustment to Depreciation Expense	<u>\$ (1,743)</u>	
Adjustment to Accumulated Depreciation	<u>\$ 1,743</u>	

Notes:

1/ Schedule LKM-20, Page 2.

2/ DLC Exhibit 2, Schedule D-1, Page 2

DUQUESNE LIGHT COMPANY

Calculation of Annual Depreciation Expense
For the Test Year Ended December 31, 2006
(\$000)

	Account No.	OCA Plant in Service	1/ Depreciation Rate	2/ Depreciation Expense
Intangible Plant				
Organization	301	\$ 100		\$ -
Franchise & Consents	302	7		-
Software	303	29,547	7.96%	2,352
Total Intangible Plant		<u>29,654</u>		<u>2,352</u>
Transmission Plant				
Land & Land Rights	350	10,998		-
Structures & Improvements	352	7,606	3.36%	256
Station Equipment	353	182,718	2.80%	5,116
Towers & Fixtures	354	68,739	2.24%	1,540
Poles & Fixtures	355	10,001	1.97%	197
Overhead Conductors & Devices	356	43,673	1.81%	790
Underground Conduit	357	55,100	1.97%	1,085
Underground Conduit & Devices	358	37,958	1.40%	531
Roads & Trails	359	4	3.24%	0
Total Transmission Plant		<u>416,797</u>		<u>9,516</u>
Distribution Plant				
Land & Land Rights	360	9,929		-
Structures & Improvements	361	47,114	2.54%	1,197
Station Equipment	362	296,753	2.32%	6,885
Poles, Towers & Fixtures	364	289,969	2.15%	6,234
Overhead Conductors & Devices	365	299,121	2.29%	6,850
Underground Conduit	366	98,614	2.03%	2,002
Underground Conduit & Devices	367	189,492	2.21%	4,188
Line Transformers	368	229,944	2.98%	6,852
OH & UND Services	369	74,001	1.60%	1,184
Meters & Appurtenances	370	75,793	2.80%	2,122
Meter Communication Equipment	370.1	33,126	12.68%	4,200
Street Lighting	373	32,595	2.19%	714
Total Distribution Plant		<u>1,676,452</u>		<u>42,428</u>
General Plant				
Land & Land Rights	389	5,839		-
Structures & Improvements	390	81,190	3.57%	2,898
Office Furniture	391	4,738	21.49%	1,018
Office Equipment	391.2	2,661	5.76%	153
Office Equipment Post 1-1-05	391.2	6,702	20.00%	1,340
Transportation Equipment	392	44,644	6.77%	3,022
Stores Equipment	393	1,877	7.10%	133
Tools, Shop & Garage Equipment	394	8,806	10.06%	886
Tools, Shop & Garage Equipment Post 1-1-05	394	1,155	4.00%	46
Laboratory Equipment	395	4,685	14.19%	665
Laboratory Equipment Post 1-1-05	395	140	5.00%	7
Power Operated Equipment	396	1,013	1.80%	18
Communication Equipment	397	38,420	17.28%	6,639
Communication Equipment 1-1-05	397	22,740	6.67%	1,517
Miscellaneous Equipment	398	484	10.23%	50
Total General Plant		<u>225,094</u>		<u>18,393</u>
Total Electric Plant in Service		<u>\$ 2,347,996</u>		<u>\$ 72,689</u>

Notes:

1/ Schedule LKM-4, Page 2.

2/ DLC Exhibit 2, Schedule D-17.

DUQUESNE LIGHT COMPANY

Adjustment to Remove Projected Increase Utilities Expense
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>
Company Adjustment to Increase Utilities Expense	\$ 965 1/
PA Jurisdictional Allocation Factor	<u>93.64% 2/</u>
Total Adjustment to O&M Expense	<u>\$ (904)</u>

Notes:

1/ DLC Exhibit 1, Attachment II-D-7a.

2/ Calculated based on data presented on DLC Exhibit 2, Schedule D-4, Page 2, Line 80.

DUQUESNE LIGHT COMPANY

Adjustment to Remove Lobbying Portion of Association Dues
 For the Test Year Ended December 31, 2006
 (\$000)

	<u>Amount</u>	<u>1/</u>	<u>Disallowed Lobbying Percentage</u>	<u>1/</u>	<u>Disallowed Amount</u>
2006 EEI Dues	\$ 263		25.0%		\$ 66
Energy Association of Pennsylvania	92		10.0%		9
Pennsylvania Chamber of Business & Industry	13		40.0%		5
Pennsylvania Business Roundtable	10		20.0%		2
National Association of Manufacturers	9		100.0%		9
Pittsburg Technology	9		15.0%		1
					<hr/>
Total Disallowed Dues					\$ 93
PA Jurisdictional Allocation Factor					<hr/> 93.64% 2/
Total Adjustment to O&M Expense					<hr/> <u>\$ (87)</u>

Notes:

1/ Response OCA-IV-59.

2/ Calculated based on data presented on DLC Exhibit 2, Schedule D-4, Page 2, Line 80.

DUQUESNE LIGHT COMPANY

Adjustment to Remove Expiring Leases
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>
Total Expiring Leases	\$ 128 1/
PA Jurisdictional Allocation Factor	<u>93.45% 2/</u>
Total Adjustment to O&M Expense	<u>\$ (120)</u>

Notes:

1/ Response to OCA-VIII-2.

2/ Calculated based on data presented on DLC Exhibit 2, Schedule D-4, Page 2, Line 84.

DUQUESNE LIGHT COMPANY

Adjustment to Annualize Public Utility Realty Tax
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>
OCA Adjustment to Plant in Service Tax Rate	\$ (13,853) 1/ <u>3.00% 2/</u>
Adjustment to PURTA	\$ (416)
PA Jurisdictional Allocation Factor	<u>81.35% 3/</u>
Total Adjustment to Taxes Other Than Income	<u>\$ (338)</u>

Notes:

1/ Schedule LKM-2.

2/ Response to OTS-RE-39.

3/ DLC Exhibit 2, Schedule C-1.

DUQUESNE LIGHT COMPANY

Adjustment to Annualize Miscellaneous Revenues
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>
HTY Rent from Electric Property	\$ 9,752 1/
FTY Rent from Electric Property	<u>8,747</u>
Adjustment to Rent from Electric Property	<u>\$ 1,005</u>
HTY Other Electric Revenue	\$ 20,401 2/
FTY Other Electric Revenue	<u>19,119</u>
Adjustment to Other Electric Revenue	<u>\$ 1,282</u>
Total Adjustment to Miscellaneous Revenues	<u><u>\$ 2,287</u></u>

Notes:

1/ DLC Exhibit 1, Attachment II-D-9.

2/ Calculated based on data presented on DLC Exhibit 2, Schedule D-4, Page 2, Line 80.

DUQUESNE LIGHT COMPANY

Interest Synchronization Adjustment
For the Test Year Ended December 31, 2006

	<u>Amount</u>
Staff Rate Base	\$ 1,205,439
Weighted Cost of Debt	<u>3.38%</u>
Adjusted Interest Deduction	\$ 40,744
Interest Deduction Per Company	<u>36,615</u>
Adjustment to Synchronize Interest Expense	\$ 4,129
Effective State Income Tax Rate	<u>9.99%</u>
Adjustment to State Income Taxes	<u>\$ (412)</u>
Federal Income Tax Base	\$3,717
Federal Income Tax Rate	<u>35.00%</u>
Adjustment to Federal Income Taxes	<u>\$ (1,301)</u>

DUQUESNE LIGHT COMPANY

Reconciliation of State and Federal Income Taxes
 For the Test Year Ended December 31, 2006

	Test Year Per Company	Rate-making Adjustments	Test Year at Present Rates	Increase at OCA Rate of Return	After Proposed Increase
CALCULATION OF COMBINED CURRENT INCOME TAX					
Net Operating Income Before Income Taxes	\$ 36,854	\$ 23,920	\$ 60,774	\$ 63,221	\$ 123,995
Adjustments for Income Taxes (Including Interest)	<u>(36,615)</u>	<u>(4,129)</u>	<u>(40,744)</u>	<u>-</u>	<u>(40,744)</u>
Subtotal	\$ 239	\$ 19,791	\$ 20,030	\$ 63,221	\$ 83,251
Special Tax Deductions	<u>(12,473)</u>	<u>-</u>	<u>(12,473)</u>	<u>-</u>	<u>(12,473)</u>
State Taxable Income	\$ (12,234)	\$ 19,791	\$ 7,557	\$ 63,221	\$ 70,778
State Income Tax	9.99% <u>\$ (1,222)</u>	<u>\$ 1,977</u>	<u>\$ 755</u>	<u>\$ 6,316</u>	<u>\$ 7,071</u>
Federal Taxable Income Before State Income Tax	\$ (12,234)	\$ 19,791	\$ 7,557	\$ 63,221	\$ 70,778
State Income Tax	<u>\$ (1,222)</u>	<u>\$ 1,977</u>	<u>\$ 755</u>	<u>\$ 6,316</u>	<u>\$ 7,071</u>
Federal Taxable Income	\$ (11,012)	\$ 17,814	\$ 6,802	\$ 56,905	\$ 63,707
Federal Income Tax	35.00% <u>\$ (3,854)</u>	<u>\$ 6,235</u>	<u>\$ 2,381</u>	<u>\$ 19,917</u>	<u>\$ 22,298</u>
Net Combined Current Income Tax	\$ (5,076)	\$ 8,212	\$ 3,136	\$ 26,233	\$ 29,368
Total Combined Current Income Taxes (Schedule LKM-1, Page 1)	<u>(5,077)</u>	<u>8,212</u>	<u>3,135</u>	<u>26,233</u>	<u>29,368</u>
Difference/Rounding	<u>\$ 1</u>	<u>\$ (0)</u>	<u>\$ 0</u>	<u>\$ (0)</u>	<u>\$ 0</u>

OCA STATEMENT NO. 1 (CORRECTED)

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC
UTILITY COMMISSION

v.

DUQUESNE LIGHT COMPANY

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:
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:

DOCKET NO. R-00061346

DIRECT TESTIMONY OF
LAFAYETTE K. MORGAN, JR.

RECEIVED

SEP 28 2006

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

ON BEHALF OF THE
OFFICE OF CONSUMER ADVOCATE

JULY 7, 2006

RECEIVED

SEP 20 2006

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

EXETER

ASSOCIATES, INC.
5565 Sterrett Place
Suite 310
Columbia, Maryland 21044

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1 **Introduction and Summary**

2 Q. WOULD YOU PLEASE STATE YOUR NAME AND BUSINESS ADDRESS?

3 A. My name is Lafayette K. Morgan, Jr. I am a Senior Regulatory Analyst with Exeter
4 Associates, Inc. Our offices are located at 5565 Sterrett Place, Columbia, Maryland
5 21044. Exeter is a firm of consulting economists specializing in issues pertaining to
6 public utilities.

7 Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND
8 QUALIFICATIONS.

9 A. I received a Master of Business Administration degree from The George Washington
10 University. The area of concentration for this degree was Finance. I received a Bachelor
11 of Business Administration degree with concentration in Accounting from North Carolina
12 Central University. I am also a Certified Public Accountant licensed in the State of North
13 Carolina.

14 Q. WOULD YOU PLEASE DESCRIBE YOUR PROFESSIONAL EXPERIENCE?

15 A. From May 1984 until June 1990, I was employed by the North Carolina Utilities
16 Commission - Public Staff in Raleigh, North Carolina. I was responsible for analyzing
17 testimony, exhibits and other data presented by parties before the North Carolina Utilities
18 Commission. I had the additional responsibility of performing the examinations of books
19 and records of utilities involved in rate proceedings and summarizing the results into
20 testimony and exhibits for presentation before that commission. I was also involved in
21 numerous special projects, including participating in compliance and prudence audits of a
22 major utility and conducting research on several issues affecting natural gas and electric
23 utilities.

24 From June 1990 until July 1993, I was employed by Potomac Electric Power
25 Company (Pepco) in Washington, D.C. At Pepco, I was involved in the preparation of

1 the cost of service, rate base and ratemaking adjustments supporting the company's
2 requests for revenue increases in the State of Maryland and the District of Columbia. I
3 also conducted research and gave presentations to management on several issues
4 affecting the electric utility industry.

5 In July 1993, I accepted my current position with Exeter Associates, Inc. Since
6 then, I have been involved in the analysis of the operations of public utilities, with
7 particular emphasis on utility rate regulation. I have also been involved in the review and
8 analysis of utility rate filings, focusing primarily on revenue requirements, determination.
9 This work has involved natural gas, water, electric and telephone companies.

10 Q. HAVE YOU PREVIOUSLY TESTIFIED IN REGULATORY PROCEEDINGS
11 ON UTILITY RATES?

12 A. Yes. I have previously presented testimony and affidavits on numerous occasions before
13 the North Carolina Utilities Commission, the Pennsylvania Public Utility Commission,
14 the Virginia Corporation Commission, the Louisiana Public Service Commission, the
15 Georgia Public Service Commission, the Maine Public Utilities Commission, the
16 Kentucky Public Service Commission, the Public Utilities Commission of Rhode Island,
17 the Vermont Public Service Board, the Illinois Commerce Commission and the Federal
18 Energy Regulatory Commission (FERC).

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

20 A. Exeter Associates has been retained by the Office of Consumer Advocate (OCA) to
21 review the reasonableness of the level of revenues which Duquesne Light Company
22 (Duquesne or the Company) is proposing to charge its customers. In this testimony, I
23 present my findings on behalf of the OCA regarding certain adjustments to Duquesne's
24 future test year rate base and net operating income at present rates. In addition, I also
25 present a summary of the OCA's findings regarding the current levels of Duquesne's

1 earnings and determine the necessary change in its revenues that is required to produce an
2 overall rate of return on rate base of 7.85 percent. This return is based on the
3 recommendation of OCA witness Stephen Hill.

4 Q. IN CONNECTION WITH THIS CASE, HAVE YOU PERFORMED AN
5 EXAMINATION AND REVIEW OF THE COMPANY'S TESTIMONY AND
6 EXHIBITS?

7 A. Yes. I have reviewed Duquesne's testimony and exhibits, its rate filing, as well as its
8 responses to the OCA's, the Office of Trial Staff's and other parties' data requests.

9 Q. WOULD YOU PLEASE SUMMARIZE WHAT IS PRESENTED ON THE
10 ATTACHED SCHEDULES?

11 A. Yes. I have prepared a set of schedules, which I have labeled Schedules LKM-1 through
12 26, that present my findings and recommendations regarding the Company's rate base
13 and net operating income. Schedule LKM-1 summarizes my overall findings regarding
14 net operating income. Schedule LKM-2 presents a summary of rate base and my
15 adjustments thereto. Schedule LKM-3 summarizes each of my adjustments to
16 Duquesne's net income. Schedule LKM-26 presents a reconciliation of the current
17 income taxes. The remaining schedules show the derivation of each of my adjustments to
18 rate base and net operating income.

19 Q. PLEASE SUMMARIZE YOUR FINDINGS.

20 A. As shown on Schedule LKM-1, I have determined the appropriate change in Duquesne's
21 distribution revenues to be an \$83 million increase as compared to the Company's
22 request of \$143.7 million. This represents a reduction of \$60.7 million in the Company's
23 requested distribution revenue increase.

24 According to the Company's rate increase application, Duquesne is planning to
25 also pass through a Federal Energy Regulatory Commission (FERC)-approved

1 transmission rate increase of \$19.0 million to its customers beginning January 1, 2007.
2 The combined transmission and distribution rate increases would produce an overall
3 increase in total revenue (transmission, distribution and supply) of 13.3 percent. In
4 comparison, the OCA recommended distribution revenue increase, when combined with
5 the FERC-approved transmission revenue increase, would result in an 8.4 percent
6 increase in total revenue (transmission, distribution and supply).

7 In addition to the customary revenue requirements issues, I will also address the
8 OCA's position on Duquesne's proposals relating to the Distribution System
9 Improvement Charge (DSIC) and authority to accrue Allowance for Funds Used during
10 Construction (AFUDC) on Plant Held for Future Use (Account 105).

11 Q. WHAT TIME PERIOD DID YOU USE IN YOUR ANALYSIS OF THE
12 COMPANY'S OPERATING RESULTS?

13 A. The Company's filing includes revenue requirement analyses based upon both a
14 historical test period ended December 31, 2005 and a future test period ending December
15 31, 2006. I have based my analysis of the Company's operating results on the future test
16 year ending December 31, 2006. This is the same period used by the Company to
17 determine its requested rate increase in its rate filing, direct testimony and exhibits.

18 Q. HOW IS THE REMAINDER OF YOUR TESTIMONY ORGANIZED?

19 A. First, I will address each of the adjustments I am recommending. The discussion of those
20 issues is presented in the order identified in the table of contents to this testimony. For
21 each issue, I will document and explain why it was necessary to make the adjustment. In
22 the remainder of this testimony I will then discuss the policy issues regarding the DSIC
23 and the accrual of AFUDC on Plant Held for Future Use.

1 **RATE BASE ISSUES**

2
3 **Plant in Service**

4 Q. WHAT ADJUSTMENT ARE YOU RECOMMENDING FOR PLANT IN
5 SERVICE?

6 A. The Company's plant in service balance included in rate base is the 2006 budgeted plant.
7 In addition, Duquesne adjusted the budgeted plant to include the capitalized portion of its
8 proposed pension cost and matching of 401-K benefits. I am recommending three
9 adjustments to plant in service. The first adjustment that I have made is to reflect actual
10 plant expenditures for the first four months of 2006. Given the actual expenditures are
11 now known, I am essentially removing the budget amounts and replacing them with the
12 actual expenditures. I believe this approach is reasonable because as I reviewed the
13 previous year's budget and actual data, I recognized that the budgeted amounts usually
14 exceeded the actual expenditures. Thus, this adjustment is necessary to avoid overstating
15 plant in service.

16 The second adjustment removes the capitalized pension costs that were added to
17 plant in service by the Company. As I will explain later in this testimony, I disagree with
18 the Company's proposal to use the pension contribution for ratemaking purposes.

19 Third, I am recommending an adjustment to remove from plant in service
20 Duquesne's inclusion of additional 401-K costs related to the achievement of non-
21 financial goals. The Company has not properly supported these costs, so I have removed
22 them from rate base. Moreover, the Company has not demonstrated that plant
23 expenditures will exceed the budgeted levels.

24 A summary of my adjustment to plant in service is presented on Schedule LKM-
25 4. This adjustment reduces rate base by \$13.9 million.

1 Materials and Supplies

2 Q. WHY HAVE YOU MADE AN ADJUSTMENT TO REDUCE MATERIALS
3 AND SUPPLIES?

4 A. The future test year presented by the Company reflects a 12 percent increase in materials
5 and supplies. The Company's explanation of the increase in the average monthly balance
6 is that it is currently going through a period of capital expansion. According to the
7 Company's filing, its capital investment program is a 3-year program that began in 2005.
8 However, when the 2005 materials and supplies balance is compared to the 2004 balance,
9 there is no significant increase. I have adjusted the future test year materials and supplies
10 balance to the level of the historical test year (2005). The reason for the adjustment is
11 twofold. First, the increased materials and supplies balance is not representative of the
12 ongoing level of these costs. Given that the capital investment period began in 2005, the
13 end of 2007 (the first year in which the new rates will be in effect) would mark the third
14 year of the program, and any increase in the materials and supplies balance would be
15 discontinued. Second, one of the findings of the recently released Commission
16 management audit of the Company was that the Company had an excessive amount of
17 inventory and recommended that the inactive inventory be reviewed to determine
18 obsolete inventory to be written-off¹. In the response to OCA-VI-9, the Company
19 indicated that it had agreed to all of the audit's recommendations. Therefore, it is
20 reasonable to assume the materials and supplies balance will not increase by 12 percent
21 as the Company predicts. My adjustment reducing Materials and Supplies by \$1.2
22 million is presented on Schedule LKM-5.

¹ Focused Management and Operations Audit of Duquesne Light Company Report, page 61.

1 **Customer Deposits**

2 Q. WHY HAVE YOU ADJUSTED CUSTOMER DEPOSITS?

3 A. Duquesne's future test year filing reflects a decrease in Customer Deposits from the
4 historical test year. The Company's explanation for the decrease is that the 2005 balance
5 reflected a decrease from the previous year, which was a trend it expected to continue in
6 the future test year. According to the Company, with the existence of Chapter 14, it
7 expects Customer Deposits to decrease by an additional \$300,000 because Chapter 14
8 allows Customer Deposits to be applied to delinquent accounts. It is my understanding
9 that Chapter 14 may not have such an effect on Customer Deposits because it also allows
10 the Company to collect deposits from delinquent customers under certain circumstances.
11 However, in the response to OTS-RE-44, Duquesne stated that there is no anticipated
12 effect of Chapter 14 on uncollectibles. One would assume that uncollectibles would
13 decrease if deposits were being applied to delinquent accounts as the Company claims. It
14 is my opinion that it may too early to make a conclusion about the effect of Chapter 14 on
15 Customer Deposits. While the foregoing information from the Company has not
16 provided any conclusive evidence that Customer Deposits will decrease, the actual
17 customer deposits for the first 4 months of 2006 do not show a \$300,000 decrease. With
18 such evidence I believe it would be improper to reduce the Customer Deposits balance.
19 My adjustment to increase customer deposits by \$300,000 is presented on Schedule
20 LKM-6.

21 **Allowance for Cash Working Capital**

22 Q. HOW DO YOU DEFINE CASH WORKING CAPITAL?

23 A. For ratemaking purposes, cash working capital is the investment that a utility needs to
24 have on hand to fund its day-to-day operations. Positive cash working capital represents
25 funds provided by investors which should be included in rate base so that the Company

1 earns a return on it. Negative cash working capital represents ratepayer-supplied funds
2 which should be recognized as a rate base offset.

3 Q. HOW DID THE COMPANY REFLECT CASH WORKING CAPITAL IN ITS
4 FILING?

5 A. The Company's cash working capital allowance is calculated based upon the results of a
6 lead-lag study. A lead-lag study is an in-depth analysis that measures the difference
7 between the lapse of time when the Company receives revenue for the provision of
8 service and the lapse of time when the Company pays for the costs of providing service.
9 This difference, expressed as a number of days is used to calculate the level of investor
10 funds advanced for operations if the difference is positive. If the difference is negative, it
11 is used to calculate the funds advanced by customers.

12 The revenue lag represents the average number of days from the date on which
13 service is provided to the customers until the date on which payment is received from the
14 customers. It is measured from the midpoint of the service period covered by the bill to
15 the date payment for that service is received by the Company. The Company's expense
16 lag represents the average number of days from the date the expense is incurred in
17 rendering service until the date the expense is paid.

18 After both the Company's revenue lag and expense payment lag have been
19 determined, one can make a reasonable approximation of the Company's cash working
20 capital requirement. This calculation is made by dividing the expenses by 365 days to
21 determine the average daily amount. The average daily amount is multiplied by the net
22 lead-lag days (the difference from subtracting the expense lag from the revenue lag) to
23 derive the Company's working capital requirements. If the total working capital
24 requirement is positive, it represents a level of funds that the investors must advance for

1 operations. If the amount is negative, then it is the customers who have advanced the
2 funds.

3 Q. PLEASE DEFINE THE TERMS "LEAD" AND "LAG" AS YOU USE THEM
4 IN YOUR TESTIMONY.

5 A. The term "lead" is used to indicate either the receipt of revenue prior to the date that
6 service is provided or the payment of an expense prior to the date that the expense is
7 incurred. The term "lag" is used to indicate either the receipt of revenue after the date
8 that service is provided or the payment of an expense after the date that the expense is
9 incurred.

10 Q. WHAT ADJUSTMENTS HAVE YOU MADE TO THE ALLOWANCE FOR
11 CASH WORKING CAPITAL?

12 A. I have made two adjustments to the cash working capital allowance. The first adjustment
13 involves the lag days assigned to Other Expenses. The Company calculated the lag on
14 Other Expenses based on the time between the invoice date to the check-clearing date. In
15 addition, the sample of invoices chosen by the Company included charitable donations,
16 stores costs, and surety bonds among the expenses. I disagree with the lag days
17 calculated by the Company because it does not appropriately reflect the service period
18 over which the service or product occurred. For example, there are many charges for
19 temporary staffing and vegetation control. Those services are performed in advance of
20 the invoice date, but the Company treated them as if they were performed on the invoice
21 date. As a result the lag days are understated. I recalculated the Other Expense lag by
22 making the calculation based upon the midpoint of the service period to the check
23 clearing date. The Company was unable to provide the service period, as requested by
24 OCA. Hence, I calculated the service period by assuming the service period was the
25 month prior to the invoice date. The result of that calculation changed the Other Expense

1 Lag from 34.86 days to 63.14 days. In addition to changing the service period, I removed
2 the costs associated with charitable donations, stores costs and surety bonds. Charitable
3 donations were removed because they are not included in the cost of service. Therefore,
4 those costs should not influence the lag day calculation. With regard to the Stores costs
5 and the Surety Bonds, those costs were included separately in rate base as prepayments.
6 As a result, those costs should be removed from the calculation of the Other Expense lag.

7 The second adjustment to the cash working capital study is necessary to reflect
8 the level of expense deemed necessary for utility operations. As a result of the various
9 O&M expense adjustments that I have made to the cost of service, it is necessary to flow
10 those adjustments through the expenses contained in the cash working capital study to
11 avoid a misstatement of the cash working capital. On Schedule LKM-7, page 1, I show
12 the removal of the various O&M expense adjustments that I have made from the
13 expenses used in the cash working capital study.

14 The combination of these two adjustments results in an \$11.4 million decrease to
15 rate base. The adjustment to cash working capital is summarized on Schedule LKM-7,
16 page 1.

17 **Non-Operational Settlement Claims Reserve**

18 Q. WHAT ADJUSTMENT ARE YOU PROPOSING TO THE NON-
19 OPERATIONAL SETTLEMENT CLAIMS RESERVE?

20 A. The Company has proposed an adjustment to include the cost of non-operational
21 settlement claims in operating expenses. These claims relate to damages and other claims
22 incurred by third parties involving the Company's property. Duquesne indicates that
23 these costs are accrued to a reserve (liability account) from which claims are paid. In
24 other words, the expense that is recorded and charged to the reserve is not a cash
25 transaction. It is only when a claim is settled and paid that a cash transaction occurs.

1 Therefore, when the expense is included in rates, the cost recognized is the amount
2 recorded in the reserve account, and represents funds that are advanced by ratepayers to
3 the Company for payment in the future. Since I have accepted the Company's inclusion
4 of these costs in operating expenses, I have also included the related reserve in rate base
5 as cost-free capital since the Company does not pay a return to ratepayers on the held
6 funds. This adjustment is presented on Schedule LKM-8, and it reduces rate base by \$2.4
7 million

8 **OPERATING INCOME ISSUES**
9

10 **Payroll Expense**

11 Q. PLEASE EXPLAIN YOUR ADJUSTMENT TO PAYROLL EXPENSE.

12 A. Duquesne has included payroll expense in the cost of service by escalating the budgeted
13 payroll by 4 percent and including costs for additional employees. During the discovery
14 phase, the OCA sought supporting documentation for the budgeted payroll. The data
15 provided was not sufficient to adequately determine whether the payroll amount was
16 reasonable. Therefore, I am proposing an adjustment on Schedule LKM-9 to reflect
17 payroll expense at the historical test year level.

18 Q. HAVE YOU ATTEMPTED TO OBTAIN THE NECESSARY
19 DOCUMENTATION TO PROPERLY EVALUATE PAYROLL EXPENSE?

20 A. Yes. Even though the request for the supporting payroll data was submitted during the
21 early phase of discovery, the response was not received until a week and a half before
22 testimony due date. This presented insufficient time to adequately submit follow-up
23 discovery and receive responses before filing this testimony. However, the Company
24 remains cooperative in its efforts to provide the necessary data to evaluate the payroll
25 costs. Upon receiving the data, the OCA will revise the payroll adjustment as necessary.

1 **Pension Expense**

2 Q. PLEASE EXPLAIN YOUR ADJUSTMENT TO PENSION EXPENSE.

3 A. In its filing, Duquesne's claim for pension expense is based upon its contribution to the
4 pension plan rather than the actuarially determined amount pursuant to SFAS 87. SFAS
5 87 is the accounting standard established by the Financial Accounting Standards Board
6 (FASB) for companies to follow in order to record pension expense in accordance with
7 Generally Accepted Accounting Principles (GAAP). Under SFAS 87, pension expense is
8 recognized in the period in which it is earned by the employee. This standard is
9 consistent with the fundamental principle of GAAP referred to as the matching principle
10 that serves as the backbone of accrual accounting. I disagree with the Company's use of
11 the pension contribution for pension expense, and have made an adjustment to reflect the
12 SFAS 87 accrual for pension expense.

13 Q. WHAT IS THE PENSION CONTRIBUTION BASED UPON?

14 A. The contribution amount is determined based upon the minimum contribution amount
15 and the maximum tax-deductible contribution allowed under ERISA guidelines and the
16 Internal Revenue Code. It is important to note that these entities do not govern any
17 GAAP-related cost recognition. According to Duquesne, it contributed \$20 million to
18 pension plans in 2006 and plans to continue funding at that level.

19 Q. WILL THE COMPANY HAVE TO CONTINUE TO FUND AT THAT LEVEL?

20 A. No. I do not believe that is likely to be the case. In OCA IV-28, the Company was asked
21 to provide support for the \$20 million future pension contribution. The data supplied by
22 the Company showed that the \$20 million amount was not required under either ERISA
23 or the Internal Revenue Code. Instead, it appeared to be a predetermined amount selected
24 by the Company.

1 Q. IF THE SFAS 87 AMOUNT IS USED TO DETERMINE PENSION EXPENSE,
2 WILL THE COMPANY FALL SHORT OF COLLECTING ITS PENSION
3 PLAN CONTRIBUTIONS?

4 A. No. As Company witness Susan Betta states in her direct testimony, over extended
5 periods of time the total contributions and the SFAS 87 accruals will be the same.²

6 Q. IF THE CONTRIBUTIONS AND ACCRUALS END UP BEING THE SAME,
7 WHY NOT LET THE CONTRIBUTION AMOUNT BE USED?

8 A. I believe the SFAS 87 is a more objective approach because SFAS 87 results in one
9 amount as the pension costs. Under the contributions approach, the amount to contribute
10 to the pension plan is left to the Company's discretion.

11 Q. WHY IS THE CONTRIBUTION AMOUNT AT THE COMPANY'S
12 DISCRETION?

13 A. As I indicated earlier, the contribution amount is determined by ERISA and the Internal
14 Revenue Code. The ERISA guidelines determine the minimum amount to be funded in
15 order to comply with the law. The Internal Revenue Code determines the maximum
16 amount that can be deducted on the Company's tax return. These two amounts are
17 usually not the same. Therefore, the Company makes its own determination regarding
18 the amount it will fund by choosing an amount that will not violate either of these rules.

19 Q. HOW WAS PENSION EXPENSE DETERMINED IN THE COMPANY'S
20 LAST RATE CASE?

21 A. The Company's last rate case was during the period when SFAS 87 was released. The
22 amount allowed in rates was the SFAS 87 amount, even though the Commission did not
23 explicitly state it was adopting the SFAS 87 amount. However, it does not appear that it

² Witness Betta's Direct Testimony, Page 15, Lines 2 and 3.

1 was necessary for the Commission to clarify that it was adopting SFAS 87 since it was
2 the amount presented by the Company.

3 Q. DO YOU BELIEVE THE BASIS ON WHICH PENSION EXPENSE WAS
4 ESTABLISHED IN THE LAST CASE IS RELEVANT IN THIS CASE?

5 A. Yes. In cases involving other companies, this Commission has stressed the importance of
6 consistency with regard to the recognition of pension expense. Thus, I believe adopting
7 my recommendation is in keeping within past Commission directives.

8 Q. IS THE USE OF THE ACCRUAL BASIS (SFAS 87) CONSISTENT WITH
9 THE MANNER IN WHICH POSTRETIREMENT BENEFITS OTHER THAN
10 PENSIONS (SFAS 106) IS RECOVERED?

11 A. Yes. It is consistent.

12 Q. PLEASE SUMMARIZE YOUR PENSION EXPENSE ADJUSTMENT.

13 A. On Schedule LKM-10, I am proposing an adjustment that reduces pension expense by
14 \$8.3 million. This amount removes the pension contribution from the cost of service.

15 **Employee Benefits**

16 Q. WHAT ADJUSTMENT ARE YOU PROPOSING TO EMPLOYEE BENEFITS?

17 A. The level of employee benefits is calculated based upon the level of payroll costs
18 included in the cost of service. Given that I have removed the future test year payroll
19 increase, it is necessary to also remove the increase in employee benefits since they are
20 based upon the higher level of payroll. Therefore, on Schedule LKM-11, I am proposing
21 an adjustment to reduce employee benefits by \$307,000.

1 **401-K Matching**

2 Q. WHAT ADJUSTMENT ARE YOU PROPOSING TO 401-K MATCHING
3 COSTS?

4 A. The Company has proposed an adjustment to include additional 401-K matching.
5 According to Duquesne these costs were not budgeted, so they were not already reflected
6 in the budgeted operating expense. According to the Company the additional 401-K
7 matching is awarded for achievement of certain safety and non-financial goals. It stands
8 to reason that these costs are not budgeted because they are not certain. Therefore, I do
9 not believe it is appropriate to include them as annual recurring costs, so I am proposing
10 an adjustment to remove the total \$334,000 from O&M expenses on Schedule LKM-12.

11 **SFAS 123R Costs**

12 Q. PLEASE EXPLAIN YOUR ADJUSTMENT TO SFAS 123R ADOPTION
13 COSTS.

14 A. Duquesne has included \$638,000 in operating expenses related to the adoption of SFAS
15 123R, Accounting for Share-Based Payments. This accounting pronouncement requires
16 companies to recognize the cost of employee services received in exchange for equity
17 instruments based on the fair value on the date granted. I am removing the adoption costs
18 because they are one-time costs and should not be included in the cost of service as
19 annual costs. On Schedule LKM-13, I present this adjustment which decreases operating
20 expenses by \$596,000

21 **Advertising Expense**

22 Q. PLEASE EXPLAIN YOUR ADJUSTMENT TO ADVERTISING EXPENSE.

23 A. The Company included approximately \$2.0 million in the cost of service for advertising
24 expense. The sample advertisements that were submitted to support these costs appear to

1 include corporate image advertising. Therefore, I am proposing an adjustment on
2 Schedule LKM-14 to remove these costs from the cost of service.

3 Q. WHAT KIND OF ADVERTISING DO YOU BELIEVE IS APPROPRIATE TO
4 INCLUDE IN THE COST OF SERVICE?

5 A. I believe advertising included in the cost of service should address conservation, safety,
6 rate information and employment. However, advertisements that, as the primary
7 message, tell how good the Company is are of little benefit to ratepayers and do little
8 more than promote the Company's image. Therefore, those costs should not be
9 recovered from ratepayers. This adjustment is summarized on Schedule LKM-14, and
10 results in a decrease of \$1.9 million in Pennsylvania jurisdictional revenues.

11 **Company-Use Energy**

12 Q. WHAT ADJUSTMENT ARE YOU RECOMMENDING FOR COMPANY-USE
13 ENERGY?

14 A. Duquesne included an increase of \$700,000 in the cost of service to include additional
15 costs for weather-related energy consumption by the Company, and additional energy
16 consumption related to an additional building. The supporting data for these costs were
17 inadequate to determine whether the costs included by the Company are reasonable.
18 *Additional information has been sought and, when received, the adjustment will be*
19 *revised if necessary.* This adjustment, which reduces expenses by \$654,000, is presented
20 on Schedule LKM-15.

21 **Rate Case Expenses**

22 Q. WHAT ADJUSTMENT ARE YOU RECOMMENDING FOR RATE CASE
23 EXPENSE?

24 A. Duquesne has included an adjustment of \$1,704,000 to reflect a 3-year normalization of
25 rate case expenses. The cost presented by the Company includes fees for outside

1 consultants, lawyers, data processing technology, Company personnel, travel, etc. In
2 addition, the Company indicated that it avoided \$207,000 of costs that were to be
3 incurred during 2005, thereby reducing its total costs. As a result of serving
4 interrogatories on this issue, I have found it necessary to recalculate rate case costs which
5 results in a reduction of \$453,000 to the Company's claim.

6 Q. HOW IS YOUR ADJUSTMENT TO RATE CASE EXPENSE DERIVED?

7 A. I have calculated the rate case expenses by using the revised rate case costs of \$4.9
8 million presented in the response to OTS-RE-7-D. From that amount, I removed
9 expenses that appear to be normal Company costs that are already accounted for
10 elsewhere in the cost of service, or are costs that will not be incurred at all. The result of
11 removing these expenses is a total rate case expense of \$3.8 million. When amortized
12 over a three-year period, it results in an adjustment reducing rate case expense by
13 \$453,000. This adjustment is presented on Schedule LKM-16.

14
15 **Incentive Compensation**

16 Q. WHY HAVE YOU REMOVED A PORTION OF INCENTIVE
17 COMPENSATION FROM OPERATING EXPENSES?

18 A. Included in Duquesne's operating expenses are \$5.1 million of costs related to its
19 incentive compensation plans. The Company offers an incentive plan that has established
20 goals or targets that must be achieved in order for payments under the plan to be
21 triggered. These thresholds are based on financial and non-financial measures.
22 Accordingly, financial performance thresholds are established annually and must be
23 attained before any incentive compensation payouts are made, regardless of individual or
24 other company performance measures.

1 I believe the costs related to financial performance should not be included in
2 expenses because by achieving the financial goals, the additional earnings would provide
3 the funds from which to pay the incentives. In other words, if management is successful
4 in achieving the plan goals, meeting those goals would result in additional income from
5 which the incentive compensation can be paid. Including the cost of the incentive plan in
6 rates would have the effect of requiring ratepayers to pay the costs of increasing
7 Duquesne's earnings.

8 I have also used the average incentive compensation amount for the non-financial
9 incentive because incentive compensation is "at risk" pay. Unlike regular salary and
10 wages, incentive compensation is not guaranteed as a level of pay or payouts under the
11 plan. As a result, the incentive compensation can fluctuate from year to year. Therefore,
12 the 3-year average incentive compensation was used to prevent an over-collection of
13 these costs.

14 The adjustment to incentive compensation is presented on Schedule LKM-17. As
15 shown there, excluding incentive compensation related to financial goals and using the 3-
16 year average for the remaining incentive payment reduces operating expenses by \$2.8
17 million.

18 **Storm Normalization**

19 Q. WHY HAVE YOU REVERSED DUQUESNE'S STORM NORMALIZATION
20 ADJUSTMENT?

21 A. Duquesne included \$691,000 in the cost of service to normalize storm expenses. The
22 adjustment is based on a 3-year average of insurance premiums. This average includes 2
23 years of actual premiums and a 2006 budget premium that was derived by the Company
24 using a 10 percent escalation rate. Duquesne indicates that it will become self-insured for

1 storm damages, so its adjustment is derived by comparing the 3-year average to the
2 amount of premiums it expected to pay during the period before it becomes self-insured.

3 I have removed these costs from O&M expenses because they are not
4 representative of the costs that the Company will incur. If the Company is self insured,
5 then the premiums are no longer a valid measure of costs. Therefore, I have removed
6 these costs totaling \$691,000 on Schedule LKM-18.

7 Q. COULDN'T YOU HAVE USED THE ACTUAL HISTORICAL STORM
8 DAMAGE COSTS TO DEVELOP A REPRESENTATIVE LEVEL OF STORM
9 DAMAGE COSTS?

10 A. Yes, that is a possible alternative. However, even though the storm normalization data
11 was requested early during the discovery phase, the Company provided a response too
12 late in the process to allow the OCA to follow up and receive additional data. Moreover,
13 in the response to OTS-RE-29, Duquesne indicated that for 2003, 2004 and 2005 it did
14 not submit any insurance claims relating to storm damages. This implies that there were
15 no catastrophic events since its deductible was only \$2.5 million, less 1 percent of total
16 O&M expenses. Nevertheless, unless there were some catastrophic event or major storm,
17 I believe that storm damage costs have been captured in the budgeted amounts, making a
18 separate adjustment unnecessary. Under normal circumstances, the costs of storm
19 damage are captured in O&M expenses or are capitalized. Every year, there are weather-
20 related events that cause damage to the Company's facilities. If the cost of repairing
21 those facilities were capitalized, then they are now in rate base where a return is earned
22 and cost recovery is provided through depreciation. Given that there are storm damages
23 every year, they should already be included in the budgeted O&M expenses because
24 those costs are captured from year to year as normal operating costs. Hence, I believe the
25 Company filed costs include an allowance for the recovery of storm damage costs.

1 Q. THE COMPANY PROPOSED THAT IT BE GIVEN THE AUTHORITY TO
2 DEFER STORM DAMAGE COSTS EXCEEDING THE \$897,000 CLAIM IN
3 THIS CASE. DO YOU AGREE?

4 A. No. The Company has not satisfactorily established what normal storm damage costs
5 are, so there is no way to judge the reasonableness of the \$897,000 amount. More
6 importantly, however, there is no need to grant such an authority at this time.

7 **Depreciation Expense**

8 Q. WHAT ADJUSTMENT ARE YOU PROPOSING TO DEPRECIATION
9 EXPENSE?

10 A. As I previously indicated, I have adjusted plant in-service to remove certain costs. As a
11 result, I have recalculated depreciation expense to incorporate the revised plant in-service
12 balances. My calculation of depreciation expense, however, is based upon the
13 Company's depreciation rates. Therefore, the change in depreciation expense is based
14 solely on the change in the plant in-service amounts. This adjustment is presented on
15 Schedule LKM-19, and it reduces the cost of service by \$1.7 million.

16 **Utilities Expense**

17 Q. PLEASE EXPLAIN YOUR ADJUSTMENT TO UTILITIES EXPENSES.

18 A. The Company included an increase of \$965,000 in its budgeted expenses to reflect
19 increases in expenses for electricity, natural gas and water. The OCA did seek additional
20 information to substantiate the Company's claim. The response was received too late to
21 allow for follow up interrogatories, and the response was inadequate to allow an
22 evaluation of the reasonableness of these costs. Therefore, I am recommending an
23 adjustment of Schedule LKM-20 to remove these costs because they are not properly
24 supported.

1 **Industry Association Dues**

2 Q. WHY ARE YOU REMOVING A PORTION OF INDUSTRY ASSOCIATION
3 DUES?

4 A. As a result of an interrogatory, the Company has identified the portion of dues to various
5 trade associations that are related to lobbying. In past cases before this Commission, it
6 has been recognized that the portion of association dues associated with lobbying should
7 not be recovered from ratepayers. I have made an adjustment that removes these
8 lobbying related costs from the cost of service. Therefore, on Schedule LKM-21, I
9 present this adjustment, which reduces O&M expenses by \$87,000.

10 **Expiring Leases**

11 Q. WHAT ADJUSTMENT ARE YOU RECOMMENDING WITH REGARD TO
12 EXPIRING LEASES?

13 A. Included in the cost of service are leases that are expiring during the test year. Given that
14 these leases are expiring, the associated costs are non-recurring. I have removed these
15 costs from operating expenses. This adjustment is presented in Schedule LKM-22, and it
16 reduces expenses by \$120,000.

17 **PURTA**

18 Q. WHAT ADJUSTMENT ARE YOU RECOMMENDING TO THE PUBLIC
19 UTILITY REALTY TAX?

20 A. According to the Company, it has included an annualized level of Public Utility Realty
21 Tax (PURTA) based upon its projected taxable value that includes its capital
22 improvement projects. Since I have made adjustments to remove certain costs from plant
23 in service, I am recommending an adjustment to PURTA to remove the tax value
24 associated with the plant value that I have removed. This adjustment is presented on
25 Schedule LKM-23, and it results in a decrease in Taxes Other Than Income of \$338,000.

1 **Miscellaneous Revenues**

2 Q. PLEASE EXPLAIN YOUR ADJUSTMENT TO MISCELLANEOUS
3 REVENUES.

4 A. The 2006 budgeted revenues reflect a decrease in the level of revenues recorded in Rent
5 from Electric Property and Other Electric Revenues. The company has been asked to
6 furnish an explanation for these decreases, but the OCA has not yet received the
7 responses. On Schedule LKM-24 I have restated these revenues totaling \$2.3 million to
8 the historic test year levels. Upon receiving the necessary data from the Company, I will
9 revise my adjustment if necessary.

10 **Interest Synchronization**

11 Q. PLEASE EXPLAIN YOUR INTEREST SYNCHRONIZATION
12 ADJUSTMENT.

13 A. To determine the tax-deductible interest for ratemaking, I have multiplied the adjusted
14 rate base by the weighted cost of debt included in the capital structure. This procedure
15 synchronizes the interest deduction for tax purposes with the interest component of the
16 return on rate base to be recovered from ratepayers. As shown in Schedule LKM-25, this
17 adjustment increases the interest deduction by \$4.1 million compared to the interest
18 deduction recognized by Duquesne in its filing. This decreases state and federal income
19 taxes by \$412,000 and \$1,301,000 respectively.

20 **Distribution System Improvement Charge**

21 Q. PLEASE SUMMARIZE DUQUESNE ELECTRIC'S PROPOSED
22 DISTRIBUTION SYSTEM IMPROVEMENT CHARGE.

23 A. Duquesne is proposing to implement a Distribution System Improvement Charge (DSIC)
24 to provide for the recovery of the fixed costs of certain improvements to its distribution
25 system between rate cases. Under Duquesne's proposal, eligible projects would include:

1 replacements of existing facilities that have worn out, are in deteriorated condition or are
2 required as the result of new regulations; un-reimbursed costs of capital projects to
3 relocate facilities due to highway relocations; and security improvements. The fixed
4 costs recovered through the DSIC would include depreciation, a return on investment and
5 income taxes associated with new projects placed in service each year. Duquesne
6 recognizes that a DSIC is precluded by Pennsylvania law, but makes its proposal in the
7 event of future legislative change.

8 Q. DO YOU AGREE THAT THE PROPOSED DISTRIBUTION SYSTEM
9 IMPROVEMENT CHARGE IS SOUND RATEMAKING POLICY?

10 A. No. I have identified a number of issues and problems with the proposed DSIC, beyond
11 the legal reasons, which require its rejection by the Commission. These include:

- 12 • The DSIC would constitute improper single-issue ratemaking and would provide a
13 means of guaranteeing increases in rates to recognize certain cost increases without
14 recognizing offsetting cost savings.
- 15 • Verification of the eligibility of projects for inclusion in the DSIC would be
16 problematic.
- 17 • The DSIC would reduce or eliminate certain essential aspects of the review and
18 oversight of Duquesne's rates.
- 19

20 In addition to these technical issues and problems, Counsel advises me that the
21 DSIC is not permitted under the Pennsylvania Public Utility Code. The legal issues
22 associated with Duquesne's proposed DSIC will be addressed further by Counsel in the
23 OCA's Brief in this proceeding.

24 Q. WOULD YOU PLEASE EXPLAIN WHY THE DSIC WOULD CONSTITUTE
25 IMPROPER SINGLE ISSUE RATEMAKING?

26 A. Yes. Under the DSIC, the only changes in costs eligible for consideration would be the
27 depreciation, return and income taxes on certain improvements to the distribution system

1 between rate cases. As a result, the DSIC would serve as a form of an attrition
2 adjustment that would guarantee that rates would increase each year. The DSIC assumes
3 that net distribution plant will increase each year and ignores offsetting cost reductions.

4 Q. WHAT ARE THE OTHER COST SAVINGS WHICH DUQUESNE HAS
5 FAILED TO RECOGNIZE?

6 A. Duquesne's proposed DSIC ignores several offsets that would cause the charge under the
7 DSIC to be overstated. The offsets include:

- 8 • The rate base deduction for accumulated deferred income taxes (ADIT).
- 9 • The elimination of depreciation expense on existing plant replaced by DSIC eligible
10 projects.
- 11 • The reduction in maintenance costs resulting from the replacement of existing
12 facilities that are worn out or deteriorated.
- 13 • The contribution that new customers make to system costs.
- 14

15 Q. PLEASE EXPLAIN EACH OF THESE OFFSETTING FACTORS.

16 A. In calculating the distribution plant eligible to earn a return under the DSIC, Duquesne
17 has only proposed to recognize plant additions net of the accumulated depreciation on
18 those plant additions. In addition to the problem discussed previously with regard to the
19 overstatement of net distribution plant growth, the proposed DSIC would overstate the
20 plant eligible to earn a return by ignoring the ADIT associated with the plant included in
21 the DSIC.

22 Second, in calculating the depreciation expense associated with DSIC eligible
23 plant, Duquesne has only recognized the depreciation expense on the new plant. This
24 proposal ignores the fact that the rates established in this case include depreciation
25 accruals on all existing plant. When existing plant is removed from plant in service as a

1 result of being replaced by DSIC eligible projects, depreciation accruals on that plant
2 cease. Duquesne has failed to account for this reduction in depreciation expense.

3 Third, as older facilities deteriorate and wear out and are replaced by newer
4 facilities, maintenance costs typically decrease. However, the proposed DSIC gives no
5 consideration to maintenance cost savings.

6 Finally, while only non-revenue producing distribution plant additions are eligible
7 for inclusion in the proposed DSIC, Duquesne has ignored the fact that new customers
8 make a contribution toward the recovery of all system costs. By selectively seeking to
9 recover a portion of plant additions, the DSIC ignores the overall relationship between
10 rates and costs.

11 Q. THE SECOND PROBLEM WHICH YOU IDENTIFIED WITH REGARD TO
12 THE DSIC RELATES TO THE DETERMINATION OF THE ELIGIBILITY OF
13 PROJECTS FOR INCLUSION. WOULD YOU PLEASE EXPLAIN THIS
14 CONCERN?

15 A. Yes. If implemented, the Company would make the decision as to which distribution
16 construction projects meet the criteria it is proposing for DSIC eligibility. It would be
17 difficult and time consuming for the Commission Staff, the OCA or any other party to
18 evaluate the purpose of the project and to audit whether or not the criteria for eligibility
19 for inclusion are met. Moreover, some construction projects may meet the eligibility
20 requirements (e.g., replacing a deteriorated facility), but also result in improved or
21 increased system capabilities. Since the costs of projects that increase system capabilities
22 are not eligible for inclusion in the DSIC, it would effectively become a matter of
23 Duquesne's discretion as to whether or not the project is included in the DSIC.

24 It would not be appropriate for the Commission to simply accept the Company's
25 decision as to what projects should be included in the DSIC. Therefore, implementation

1 of the DSIC would require Duquesne to have in place accounting and information
2 systems to separately track and verify not only the costs of its construction projects and
3 whether they are completed and being used to provide service, but also details as to the
4 *purpose of the projects and the basis for eligibility for DSIC inclusion.* Without such
5 systems, an auditor would be unable to test the Company's decisions. However,
6 Duquesne has not established any such systems for examination in this case.

7 Q. PLEASE EXPLAIN YOUR CONCERN THAT THE PROPOSED DSIC
8 REDUCES THE PROPER OVERSIGHT OF DUQUESNE'S RATES.

9 A. In addition to the problems and concerns cited above, the DSIC would reduce or
10 eliminate the proper oversight of Duquesne's rates in several other ways as well. First,
11 Duquesne has proposed that the return on investment would automatically be revised to
12 reflect changes in the Company's capital structure. This would result in no opportunity
13 to review and challenge the appropriateness of changes in the Company's capital
14 structure.

15 Second, the DSIC would be a fully reconcilable surcharge. This would provide
16 guaranteed and automatic cost recovery for capital costs under circumstances where it
17 will be difficult at best for other parties and the Commission to evaluate the prudence and
18 reasonableness of the claimed costs.

19 Q. DO YOU HAVE ANY OTHER COMMENTS ABOUT THE PROPOSED
20 DSIC?

21 A. Yes. As indicated by the above, the costs which the DSIC would recover are part of the
22 normal costs which Duquesne must incur to provide service to its customers. As such,
23 the costs do not warrant special recovery separate and apart from the other costs included
24 in base rates.

1 Q. GIVEN THAT THE COMPANY IS ESSENTIALLY SEEKING THAT
2 FUTURE USE PLANT BE TREATED SIMILAR TO CWIP, DO YOU
3 BELIEVE THAT THE COMPANY SHOULD BE ALLOWED TO ACCRUE
4 AFUDC PLANT HELD FOR FUTURE USE?

5 Conceptually, the OCA will not oppose the accrual of AFUDC. However, the
6 OCA has not been provided the data that show what property and investments the
7 Company currently holds in Plant Held for Future Use. Therefore, it is difficult to
8 recommend that the Company's proposal be accepted. Thus, upon reviewing the data,
9 the OCA will make a formal recommendation.

10 Q. DOES THIS END YOUR TESTIMONY?

11 A. Yes, it does.

12
13 89645.doc
14

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC
UTILITY COMMISSION

v.

DUQUESNE LIGHT COMPANY

:
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:
:

DOCKET NO: R-00061346

(CORRECTED)
SCHEDULES ACCOMPANYING THE

DIRECT TESTIMONY OF
LAFAYETTE K. MORGAN, JR.

ON BEHALF OF THE
OFFICE OF CONSUMER ADVOCATE

JULY 7, 2006

EXETER

ASSOCIATES, INC.
5565 Sterrett Place
Suite 310
Columbia, Maryland 21044

DUQUESNE LIGHT COMPANY

Summary of Operating Income
 For the Test Year Ended December 31, 2006
 (\$000)

	PAPUC Jurisdictional Amount per Co.	OCA Cost of Service Adjustments	Amount After Adjustments	OCA Recommended Change In Revenue	After Proposed Rate Increase
Operating Revenues					
Sales Revenues	\$ 279,955	\$ -	\$ 279,955	\$ 83,008	\$ 362,963
Sales for Resale	-	-	-	\$ -	-
Other Operating Revenue	14,282	2,287	16,569	-	16,569
Total Operating Revenues	\$ 294,237	\$ 2,287	\$ 296,524	\$ 83,008	\$ 379,532
Operating Expenses					
O&M Expenses	\$ 166,288	\$ (19,342)	\$ 146,946	\$ 888	\$ 147,834
Depreciation Expense	62,917	(1,743)	61,174	-	61,174
Amortization Expense	3,484	-	3,484	-	3,484
Taxes Other Than Income	24,694	(547)	24,147	4,897	29,044
	\$ 257,383	\$ (21,633)	\$ 235,750	\$ 5,785	\$ 241,535
Income Taxes					
State Income Tax	(1,222)	1,978	756	7,715	8,471
Current Federal Income Tax	(3,855)	6,235	2,380	24,328	26,708
Deferred Federal Income Tax	10,087	-	10,087	-	10,087
ITC Amortization	(1,142)	-	(1,142)	-	(1,142)
Consolidated Tax Adjustment	(753)	-	(753)	-	(753)
Total Federal Income Tax	4,337	6,235	10,572	24,328	34,900
Total Operating Expenses	\$ 260,498	\$ (13,421)	\$ 247,077	\$ 37,828	\$ 284,905
Net Operating Income	\$ 33,739	\$ 15,708	\$ 49,447	\$ 45,180	\$ 94,627
Rate Base	\$ 1,232,857		\$ 1,205,439		\$ 1,205,439
Return On Rate Base	2.74%		4.10%		7.85%

DUQUESNE LIGHT COMPANY

Summary of Revenue Increase at OCA Rate of Return
 For the Test Year Ended December 31, 2006
 (\$000)

	<u>Amount</u>	
Adjusted Rate Base	\$ 1,205,439	Schedule LKM-2, Page 2
Required Rate of Return	<u>7.850%</u>	
Net Operating Income Required	\$ 94,627	
Net Operating Income at Present Rates	<u>49,447</u>	Schedule LKM-1, Page 1
Income Deficiency/(Surplus)	\$ 45,180	
Revenue Multiplier	<u>1.83727</u>	
Required Change in Company Revenue	<u>\$ 83,008</u>	
Proposed Revenue Change	\$ 83,008	
Uncollectibles	1.0700% 888	
Gross Revenues Tax	5.900% <u>4,897</u>	
Subtotal	\$ 77,223	
State Income Tax	9.990% <u>7,715</u>	
Subtotal	\$ 69,508	
Federal Income Tax	35.00% <u>24,328</u>	
Net Income Increase Required	<u>\$ 45,180</u>	

DUQUESNE LIGHT COMPANY

Summary of Rate Base
For the Test Year Ended December 31, 2006
(\$000)

	PAPUC Jurisdictional Amount per Co.	OCA Rate Base Adjustments	Amount After Adjustments
Total Plant in Service	\$ 1,930,872	\$ (13,853)	\$ 1,917,019
Depreciation Reserve	(613,163)	1,743	(611,419)
Net Plant in Service	\$ 1,317,709	\$ (12,109)	\$ 1,305,600
Working Capital Requirements			
Cash Working Capital	\$ 50,086	\$ (11,429)	\$ 38,657
Materials & Supplies	11,296	(1,199)	10,097
Total Working Capital Requirements	61,382	(12,628)	48,754
Deductions			
Customer Deposits	(1,413)	(300)	(1,713)
Settlement Reserve	-	(2,381)	(2,381)
Accumulated Deferred Income Taxes	(144,821)	-	(144,821)
Total Deductions	(146,234)	(2,681)	(148,915)
Total Rate Base	\$ 1,232,857	\$ (27,419)	\$ 1,205,439

DUQUESNE LIGHT COMPANY

Summary of Rate Base Adjustments
For the Test Year Ended December 31, 2006
(\$000)

	<u>Source</u>	<u>PAPUC Jurisdictional Amount per Co.</u>
Rate Base per Company Filing	Schedule LKM-2, Page 1	<u>\$ 1,232,857</u>
<u>OCA Adjustments:</u>		
Plant in Service	Schedule LKM-4	\$ (12,109)
Materials & Supplies	Schedule LKM-5	(1,199)
Customer Deposits	Schedule LKM-6	(300)
Cash Working Capital	Schedule LKM-7	(11,429)
Non-Operational Settlement Damage Reserve	Schedule LKM-8	<u>(2,381)</u>
Total Ratemaking Adjustments		<u>\$ (27,419)</u>
Adjusted Rate Base per OCA		<u><u>\$ 1,205,439</u></u>

DUQUESNE LIGHT COMPANY

Summary of Adjustments to Net Income
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>
Net Income per Company	\$ 33,739
<u>OCA Adjustments:</u>	
Remove Pension Contribution Expense	\$ 4,882
Remove 2006 Payroll Increase	1,334
Remove 2006 Employee Benefits Increase	180
Remove Additional 401-K Expense	195
Remove One-Time SFAS 123R Costs	349
Remove Image Advertising	1,134
Remove Increase in Company Use Energy	383
Normalize Rate Case Expense	265
Normalize Incentive Compensation	1,664
Remove Storm Normalization Increase	404
Normalize Depreciation Expense	1,020
Remove Utilities Expense Increase	529
Remove Lobbying from Association Dues	51
Remove Expiring Leases	70
Normalize PURTA	198
Normalize Miscellaneous Revenues	1,338
Interest Synchronization	1,713
	<hr/>
Total Ratemaking Adjustments	\$ 15,708
	<hr/>
Total Adjusted Net Income per OCA	\$ 49,447

DUQUESNE LIGHT COMPANY

Summary of Adjustments to Net Income
 For the Test Year Ended December 31, 2006
 (\$000)

	Operating Revenues	O&M Expenses	Depreciation Expense	Amortization Expense	Taxes Other Than Income	State Income Taxes	Federal Income Tax	Net Operating Income
Amount per Company	\$ 294,237	\$ 166,288	\$ 62,917	\$ 3,484	\$ 24,694	\$ (1,222)	\$ 4,337	\$ 33,739
OCA Adjustments:								
Remove Pension Contribution Expense	\$ -	\$ (8,344)	\$ -	\$ -	\$ -	\$ 834	\$ 2,629	\$ 4,882
Remove 2006 Payroll Increase	-	(2,071)	-	-	(209)	228	718	1,334
Remove 2006 Employee Benefits Increase	-	(307)	-	-	-	31	97	180
Remove Additional 401-K Expense	-	(334)	-	-	-	33	105	195
Remove One-Time SFAS 123R Costs	-	(596)	-	-	-	60	188	349
Remove Image Advertising	-	(1,938)	-	-	-	194	611	1,134
Remove Increase in Company Use Energy	-	(654)	-	-	-	65	206	383
Normalize Rate Case Expense	-	(453)	-	-	-	45	143	265
Normalize Incentive Compensation	-	(2,844)	-	-	-	284	896	1,664
Remove Storm Normalization Increase	-	(691)	-	-	-	69	218	404
Normalize Depreciation Expense	-	-	(1,743)	-	-	174	549	1,020
Remove Utilities Expense Increase	-	(904)	-	-	-	90	285	529
Remove Lobbying from Association Dues	-	(87)	-	-	-	9	27	51
Remove Expiring Leases	-	(120)	-	-	-	12	38	70
Normalize PURTA	-	-	-	-	(338)	34	107	198
Normalize Miscellaneous Revenues	2,287	-	-	-	-	228	720	1,338
Interest Synchronization	-	-	-	-	-	(412)	(1,301)	1,713
Total Ratemaking Adjustments	\$ 2,287	\$ (19,342)	\$ (1,743)	\$ -	\$ (547)	\$ 1,978	\$ 6,235	\$ 15,708
Total Adjusted Income	\$ 296,524	\$ 146,946	\$ 61,174	\$ 3,484	\$ 24,147	\$ 756	\$ 10,572	\$ 49,447

DUQUESNE LIGHT COMPANY

Adjustment to Plant In Service
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>	
Adjusted Plant in Service	\$ 2,356,423	1/
PA Jurisdictional Allocation Factor	<u>81.35%</u>	2/
PA Jurisdictional Plant in Service per OCA	\$ 1,917,019	
PA Jurisdictional Plant in Service per Company	<u>1,930,872</u>	2/
Adjustment to Plant in Service	<u><u>\$ (13,853)</u></u>	

Notes:

1/ Schedule LKM-4, Page 2.

2/ DLC Exhibit 2, Schedule C-1.

DUQUESNE LIGHT COMPANY

Calculation of Adjusted Plant In Service
 For the Test Year Ended December 31, 2006
 (\$000)

	Account No.	2006 Amount Per Company	1/ Remove Budget Variances	2/ Remove Payroll Adjustment	1/ Remove Additional 401-K	1/ Adjusted 2006 Amount
Intangible Plant						
Organization	301	\$ 100	\$ -	\$ -	\$ -	\$ 100
Franchise & Consents	302	7	-	-	-	7
Software	303	29,716	-	162	7	29,547
Total Intangible Plant		<u>29,823</u>	<u>-</u>	<u>162</u>	<u>7</u>	<u>29,654</u>
Transmission Plant						
Land & Land Rights	350	11,035	37	-	-	10,998
Structures & Improvements	352	7,637	25	6	-	7,606
Station Equipment	353	184,824	616	1,425	65	182,718
Towers & Fixtures	354	69,209	231	229	10	68,739
Poles & Fixtures	355	10,066	34	30	1	10,001
Overhead Conductors & Devices	356	43,871	146	50	2	43,673
Underground Conduit	357	55,965	186	649	30	55,100
Underground Conduit & Devices	358	38,767	129	650	30	37,958
Roads & Trails	359	4	0	-	-	4
Total Transmission Plant		<u>421,378</u>	<u>1,404</u>	<u>3,039</u>	<u>138</u>	<u>416,797</u>
Distribution Plant						
Land & Land Rights	360	9,962	33	-	-	9,929
Structures & Improvements	361	47,272	158	-	-	47,114
Station Equipment	362	299,299	997	1,481	68	296,753
Poles, Towers & Fixtures	364	291,340	971	383	17	289,969
Overhead Conductors & Devices	365	301,038	1,003	874	40	299,121
Underground Conduit	366	99,255	331	296	14	98,614
Underground Conduit & Devices	367	190,267	634	135	6	189,492
Line Transformers	368	231,667	772	910	41	229,944
OH & UND Services	369	74,258	247	10	-	74,001
Meters & Appurtenances	370	76,192	254	139	6	75,793
Meter Communication Equipment	370.1	33,237	111	-	-	33,126
Street Lighting	373	32,723	109	17	2	32,595
Total Distribution Plant		<u>1,686,510</u>	<u>5,619</u>	<u>4,245</u>	<u>194</u>	<u>1,676,452</u>
General Plant						
Land & Land Rights	389	5,859	20	-	-	5,839
Structures & Improvements	390	90,728	302	774	35	89,617
Office Equipment	391	14,148	47	-	-	14,101
Transportation Equipment	392	44,982	150	180	8	44,644
Stores Equipment	393	1,883	6	-	-	1,877
Tools, Shop & Garage Equipment	394	10,022	33	26	2	9,961
Laboratory Equipment	395	4,841	16	-	-	4,825
Power Operated Equipment	396	1,016	3	-	-	1,013
Communication Equipment	397	61,777	206	393	18	61,160
Miscellaneous Equipment	398	486	2	-	-	484
Total General Plant		<u>235,742</u>	<u>785</u>	<u>1,373</u>	<u>63</u>	<u>233,521</u>
Total Electric Plant in Service		<u>\$ 2,373,453</u>	<u>\$ 7,809</u>	<u>\$ 8,819</u>	<u>\$ 402</u>	<u>\$ 2,356,423</u>

Notes:

1/ DLC Exhibit 2, Schedule C-2.

2/ Total amount per response to OCA IV-9 and pro rated based budgeted amount excluding intangible plant.

DUQUESNE LIGHT COMPANY

Adjustment to Normalize Materials and Supplies
For the Test Year Ended December 31, 2006
(\$000)

	<u>PAPUC Jurisdictional Amount</u>
HTY Average Materials & Supplies Balance	\$ 15,558 1/
Allocation Factor	<u>64.9% 2/</u>
PA Jurisdictional Amount	\$ 10,097
FTY Average Materials & Supplies Balance	<u>11,296 3/</u>
Adjustment to Rate Base	<u><u>\$ (1,199)</u></u>

Notes:

1/ DLC Exhibit 3, Schedule C-5.

2/ DLC Exhibit 2, Schedule C-5.

3/ DLC Exhibit 2, Schedule C-1.

DUQUESNE LIGHT COMPANY

Adjustment to Normalize Customer Deposits
For the Test Year Ended December 31, 2006
(\$000)

	<u>PAPUC Jurisdictional Amount</u>
HTY Average Customer Deposits Balance	\$ 1,713 1/
FTY Average Materials & Supplies Balance	<u>1,413 2/</u>
Adjustment to Rate Base	<u>\$ 300</u>

Notes:

1/ DLC Exhibit 3, Schedule B-1, Page 2.

2/ DLC Exhibit 2, Schedule B-1, Page 2.

DUQUESNE LIGHT COMPANY

Adjustment to Allowance for Cash Working Capital
 For the Test Year Ended December 31, 2006
 (\$000)

	<u>Amount Per Company</u>	<u>OCA Adjustment</u> 1/	<u>Adjusted Amount</u>	<u>Lag Days</u>	<u>Dollar Days</u>	<u>Weighted Lags</u>
Revenue Lag Days						53.97
<u>Expenses</u>						
Payroll	\$ 59,771	\$ (7,252)	\$ 52,519	10.72	\$ 563,004	
Pension Expense	10,052	(8,911)	1,141	(151.00)	(172,291)	
Purchased Power	358,515	-	358,515	35.00	12,548,025	
Other Expenses	78,764	(6,592)	<u>72,172</u>	63.14	<u>4,556,919</u>	
			\$ 484,347		\$ 17,495,657	36.12
Net (Lead)/Lag Days						17.85
Daily Operating Expenses						<u>\$ 1,327</u>
O&M Working Capital						\$ 23,684
Average Prepayments						4,200
Accrued Taxes						16,467
Interest Payments						(4,635)
Preferred Dividends Payments						<u>169</u>
Total Working Capital Requirement						\$ 39,885
PA Jurisdictional Allocation Factor						<u>96.92%</u>
Cash Working Capital Allowance per OCA						\$ 38,657
Cash Working Capital Allowance per Company						<u>50,086</u>
Adjustment to Cash Working Capital Allowance						<u>\$ (11,429)</u>

DUQUESNE LIGHT COMPANY

Calculation of Other Expense Lag
For the Test Year Ended December 31, 2006
(\$000)

	<u>Payment Amount</u> 1/	<u>Lag Days</u>	<u>Dollar Days</u> 1/
June 2004	\$ 4,005,457		\$ 248,862,992
October 2004	3,626,807		222,177,258
February 2005	4,228,438		294,717,678
April 2005	<u>3,819,035</u>		<u>224,251,642</u>
Total	\$ 15,679,738		\$ 990,009,570
Weighted Lag Days		<u>63.14</u>	

Notes:

1/ Calculated based on data provided by Company.

DUQUESNE LIGHT COMPANY

Adjustment to Include Non-Operational Settlement Claims Reserve in Rate Base
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount^{2/}</u>
Non-Operational Settlement Claims Reserve	\$ 2,543 1/
PA Jurisdictional Allocation Factor	<u>93.64% 2/</u>
Total Adjustment to O&M Expense	<u>\$ 2,381</u>

Notes:

1/ Response to OCA VIII-6.

2/ Calculated based on data presented on DLC Exhibit 2, Schedule D-4, Page 2, Line 80.

DUQUESNE LIGHT COMPANY

Adjustment to Annualize Payroll Expense
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>
Adjusted 2005 Payroll Expense	\$ 57,646 1/
Company Adjusted 2006 Payroll Expense	<u>59,769</u>
Adjustment to Payroll Expense	\$ (2,123)
PA Jurisdictional Allocation Factor	<u>97.57% 2/</u>
Total Adjustment to O&M Expense	<u>\$ (2,071)</u>
FICA Taxes	\$ (171)
FUTA	\$ (2)
SUTA	\$ (21)
City of Pittsburgh Payroll Tax	\$ (16)

Notes:

1/ DLC Exhibit 2, Schedule D-9, Page1.

2/ Calculated based on data presented on DLC Exhibit 2, Schedule D-4, Page.2, Line 85.

DUQUESNE LIGHT COMPANY

Adjustment to Remove Projected Contributions to Pension Expense
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>
Company Adjustment to Pension Expense	\$ 8,911 1/
PA Jurisdictional Allocation Factor	<u>93.64% 2/</u>
Total Adjustment to O&M Expense	<u>\$ (8,344)</u>

Notes:

1/ DLC Exhibit 2, Schedule D-9, Page1.

2/ Calculated based on data presented on DLC Exhibit 2, Schedule D-4, Page 2, Line 77.

DUQUESNE LIGHT COMPANY

Adjustment to Remove Employee Benefits Expense Related to Increased Employees
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>
Company Adjustment to Employee Benefits Expense	\$ 328 1/
PA Jurisdictional Allocation Factor	<u>93.64% 2/</u>
Total Adjustment to O&M Expense	<u>\$ (307)</u>

Notes:

1/ DLC Exhibit 2, Schedule D-9, Page1.

2/ Calculated based on data presented on DLC Exhibit 2, Schedule D-4, Page 2, Line 77.

DUQUESNE LIGHT COMPANY

Adjustment to Remove Additional 401-K Matching
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>
Company Adjustment to Employee Benefits Expense	\$ 357 1/
PA Jurisdictional Allocation Factor	<u>93.45% 2/</u>
Total Adjustment to O&M Expense	<u>\$ (334)</u>

Notes:

1/ DLC Exhibit 2, Schedule D-12, Page1.

2/ Calculated based on data presented on DLC Exhibit 2, Schedule D-4, Page 2, Line 84.

DUQUESNE LIGHT COMPANY

Adjustment to Remove One-Time Costs Associated With SFAS 123R
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>
Company Adjustment to Employee Benefits Expense	\$ 638 1/
PA Jurisdictional Allocation Factor	<u>93.45% 2/</u>
Total Adjustment to O&M Expense	<u>\$ (596)</u>

Notes:

1/ Company Response to OCA V-8.

2/ Calculated based on data presented on DLC Exhibit 2, Schedule D-4, Page 2, Line 84.

DUQUESNE LIGHT COMPANY

Adjustment to Remove Advertising Expenses
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>
Total Advertising Expenses Included in Cost of Service	\$ 2,069 1/
PA Jurisdictional Allocation Factor	<u>93.67% 2/</u>
Total Adjustment to O&M Expense	<u>\$ (1,938)</u>

Notes:

1/ DLC Exhibit 1, Attachment II-D-7d.

2/ Calculated based on data presented on DLC Exhibit 2, Schedule D-4, Page 2, Line 79.

DUQUESNE LIGHT COMPANY

Adjustment to Normalize Company Use Energy Expense
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u> ^{2/}
Remove Weather-Related Energy Consumption	\$ 400 1/
Remove Energy Related to Additional Building	<u>300 1/</u>
Adjustment to Company Use Energy Expense PA Jurisdictional Allocation Factor	\$ 700 <u>93.45% 2/</u>
Total Adjustment to O&M Expense	<u>\$ (654)</u>

Notes:

1/ Response to OCA-V-6, Page 1.

2/ Calculated based on data presented on DLC Exhibit 2, Schedule D-4, Page 2, Line 84.

DUQUESNE LIGHT COMPANY

Adjustment to Normalize Rate Case Expenses
 For the Test Year Ended December 31, 2006
 (\$000)

		<u>Amount</u>
Actual Total Costs Incurred Through 5/31/2006		\$ 2,348 1/
Company Revised Estimated Cost of Rate Case	\$ 4,904 2/	
Actual Total Costs Incurred Through 5/31/2006	<u>2,348 1/</u>	
Total Remaining Cost to Complete	2,556	
Less: Preparation of Filing	(325) 3/	
Post Filing Preparation	(425) 3/	
Project Management	(200) 3/	
Strategy & Planning	<u>(200) 3/</u>	
	(1,150)	
Remaining Cost to Complete		<u>1,406</u>
Total Rate Case Expenses Subject to Recovery		\$ 3,754
Normalization Period (Years)		<u>3</u>
Normalized Rate Case Expenses per OCA		\$ 1,251
Normalized Rate Case Expenses per Company		<u>1,704 4/</u>
Adjustment to O&M Expenses		<u>\$ (453)</u>

Notes:

- 1/ Response to OCA-V-9.
- 2/ Response to OTS-RE-7-D.
- 3/ Response to OCA-XII-1.
- 4/ DLC Exhibit 2, Schedule D-8.

DUQUESNE LIGHT COMPANY

Adjustment to Remove Incentive Compensation Expense
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>
Three Year Average Incentive Compensation Portion Associated with Earnings	\$ 4,427 1/ <u>50%</u>
Incentive Compensation Eligible for Recovery 2006 Budgeted Incentive Compensation per Company	\$ 2,214 <u>5,129 2/</u>
Adjustment to Incentive Compensation PA Jurisdictional Allocation Factor	\$ (2,915) <u>97.57% 3/</u>
Total Adjustment to O&M Expense	<u>\$ (2,844)</u>

Notes:

1/ Response to OCA-IV-80.

2/ Response to OCA-IV-1, Page 2.

3/ Calculated based on data presented on DLC Exhibit 2, Schedule D-4, Page 2, Line 85.

DUQUESNE LIGHT COMPANY

Adjustment to Remove Storm Restoration Normalization Costs
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>
Company Adjustment to Include Storm Normalization Costs	\$ 691 1/
PA Jurisdictional Allocation Factor	<u>99.98% 2/</u>
Total Adjustment to O&M Expense	<u>\$ (691)</u>

Notes:

1/ DLC Exhibit 2, Schedule D-13.

2/ Calculated based on data presented on DLC Exhibit 2, Schedule D-4, Page 2, Line 54.

DUQUESNE LIGHT COMPANY

Adjustment to Depreciation Expense
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>	
Annual Depreciation Expense per OCA	\$ 72,689	1/
PA Jurisdictional Allocation Factor	<u>84.16%</u>	2/
PA Jurisdictional Annual Depreciation Expense per OCA	\$ 61,174	
PA Jurisdictional Annual Depreciation Expense per Company	<u>62,917</u>	2/
Adjustment to Depreciation Expense	<u><u>\$ (1,743)</u></u>	
Adjustment to Accumulated Depreciation	<u><u>\$ 1,743</u></u>	

Notes:

1/ Schedule LKM-20, Page 2.

2/ DLC Exhibit 2, Schedule D-1, Page 2

DUQUESNE LIGHT COMPANY

Calculation of Annual Depreciation Expense
For the Test Year Ended December 31, 2006
(\$000)

	Account No.	OCA Plant in Service	1/ Depreciation Rate	2/ Depreciation Expense
Intangible Plant				
Organization	301	\$ 100		\$ -
Franchise & Consents	302	7		-
Software	303	29,547	7.96%	2,352
Total Intangible Plant		<u>29,654</u>		<u>2,352</u>
Transmission Plant				
Land & Land Rights	350	10,998		-
Structures & Improvements	352	7,606	3.36%	256
Station Equipment	353	182,718	2.80%	5,116
Towers & Fixtures	354	68,739	2.24%	1,540
Poles & Fixtures	355	10,001	1.97%	197
Overhead Conductors & Devices	356	43,673	1.81%	790
Underground Conduit	357	55,100	1.97%	1,085
Underground Conduit & Devices	358	37,958	1.40%	531
Roads & Trails	359	4	3.24%	0
Total Transmission Plant		<u>416,797</u>		<u>9,516</u>
Distribution Plant				
Land & Land Rights	360	9,929		-
Structures & Improvements	361	47,114	2.54%	1,197
Station Equipment	362	296,753	2.32%	6,885
Poles, Towers & Fixtures	364	289,969	2.15%	6,234
Overhead Conductors & Devices	365	299,121	2.29%	6,850
Underground Conduit	366	98,614	2.03%	2,002
Underground Conduit & Devices	367	189,492	2.21%	4,188
Line Transformers	368	229,944	2.98%	6,852
OH & UND Services	369	74,001	1.60%	1,184
Meters & Appurtenances	370	75,793	2.80%	2,122
Meter Communication Equipment	370.1	33,126	12.68%	4,200
Street Lighting	373	32,595	2.19%	714
Total Distribution Plant		<u>1,676,452</u>		<u>42,428</u>
General Plant				
Land & Land Rights	389	5,839		-
Structures & Improvements	390	81,190	3.57%	2,898
Office Furniture	391	4,738	21.49%	1,018
Office Equipment	391.2	2,661	5.76%	153
Office Equipment Post 1-1-05	391.2	6,702	20.00%	1,340
Transportation Equipment	392	44,644	6.77%	3,022
Stores Equipment	393	1,877	7.10%	133
Tools, Shop & Garage Equipment	394	8,806	10.06%	886
Tools, Shop & Garage Equipment Post 1-1-05	394	1,155	4.00%	46
Laboratory Equipment	395	4,685	14.19%	665
Laboratory Equipment Post 1-1-05	395	140	5.00%	7
Power Operated Equipment	396	1,013	1.80%	18
Communication Equipment	397	38,420	17.28%	6,639
Communication Equipment 1-1-05	397	22,740	6.67%	1,517
Miscellaneous Equipment	398	484	10.23%	50
Total General Plant		<u>225,094</u>		<u>18,393</u>
Total Electric Plant in Service		<u>\$ 2,347,996</u>		<u>\$ 72,689</u>

Notes:

1/ Schedule LKM-4, Page 2.

2/ DLC Exhibit 2, Schedule D-17.

DUQUESNE LIGHT COMPANY

Adjustment to Remove Projected Increase Utilities Expense
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>
Company Adjustment to Increase Utilities Expense	\$ 965 1/
PA Jurisdictional Allocation Factor	<u>93.64% 2/</u>
Total Adjustment to O&M Expense	<u>\$ (904)</u>

Notes:

1/ DLC Exhibit 1, Attachment II-D-7a.

2/ Calculated based on data presented on DLC Exhibit 2, Schedule D-4, Page 2, Line 80.

DUQUESNE LIGHT COMPANY

Adjustment to Remove Lobbying Portion of Association Dues
 For the Test Year Ended December 31, 2006
 (\$000)

	<u>Amount</u>	1/	Disallowed Lobbying Percentage	1/	<u>Disallowed Amount</u>
2006 EEI Dues	\$ 263		25.0%		\$ 66
Energy Association of Pennsylvania	92		10.0%		9
Pennsylvania Chamber of Business & Industry	13		40.0%		5
Pennsylvania Business Roundtable	10		20.0%		2
National Association of Manufacturers	9		100.0%		9
Pittsburg Technology	9		15.0%		<u>1</u>
Total Disallowed Dues					\$ 93
PA Jurisdictional Allocation Factor					<u>93.64% 2/</u>
Total Adjustment to O&M Expense					<u>\$ (87)</u>

Notes:

1/ Response OCA-IV-59.

2/ Calculated based on data presented on DLC Exhibit 2, Schedule D-4, Page 2, Line 80.

DUQUESNE LIGHT COMPANY

Adjustment to Remove Expiring Leases
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>
Total Expiring Leases	\$ 128 1/
PA Jurisdictional Allocation Factor	<u>93.45% 2/</u>
Total Adjustment to O&M Expense	<u>\$ (120)</u>

Notes:

1/ Response to OCA-VIII-2.

2/ Calculated based on data presented on DLC Exhibit 2, Schedule D-4, Page 2, Line 84.

DUQUESNE LIGHT COMPANY

Adjustment to Annualize Public Utility Realty Tax
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>
OCA Adjustment to Plant in Service	\$ (13,853) 1/
Tax Rate	<u>3.00% 2/</u>
Adjustment to PURTA	\$ (416)
PA Jurisdictional Allocation Factor	<u>81.35% 3/</u>
Total Adjustment to Taxes Other Than Income	<u>\$ (338)</u>

Notes:

1/ Schedule LKM-2.

2/ Response to OTS-RE-39.

3/ DLC Exhibit 2, Schedule C-1.

DUQUESNE LIGHT COMPANY

Adjustment to Annualize Miscellaneous Revenues
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>
HTY Rent from Electric Property	\$ 9,752 1/
FTY Rent from Electric Property	<u>8,747</u>
Adjustment to Rent from Electric Property	<u>\$ 1,005</u>
HTY Other Electric Revenue	\$ 20,401 2/
FTY Other Electric Revenue	<u>19,119</u>
Adjustment to Other Electric Revenue	<u>\$ 1,282</u>
Total Adjustment to Miscellaneous Revenues	<u><u>\$ 2,287</u></u>

Notes:

1/ DLC Exhibit 1, Attachment II-D-9.

2/ Calculated based on data presented on DLC Exhibit 2, Schedule D-4, Page 2, Line 80.

DUQUESNE LIGHT COMPANY

Interest Synchronization Adjustment
For the Test Year Ended December 31, 2006

	<u>Amount</u>
Staff Rate Base	\$ 1,205,439
Weighted Cost of Debt	<u>3.38%</u>
Adjusted Interest Deduction	\$ 40,744
Interest Deduction Per Company	<u>36,615</u>
Adjustment to Synchronize Interest Expense	\$ 4,129
Effective State Income Tax Rate	<u>9.99%</u>
Adjustment to State Income Taxes	<u><u>\$ (412)</u></u>
Federal Income Tax Base	\$3,717
Federal Income Tax Rate	<u>35.00%</u>
Adjustment to Federal Income Taxes	<u><u>\$ (1,301)</u></u>

DUQUESNE LIGHT COMPANY

Reconciliation of State and Federal Income Taxes
 For the Test Year Ended December 31, 2006

	<u>Test Year Per. Company</u>	<u>Ratemaking Adjustments</u>	<u>Test Year at Present Rates</u>	<u>Increase at OCA Rate of Return</u>	<u>After Proposed Increase</u>
CALCULATION OF COMBINED CURRENT INCOME TAX					
Net Operating Income Before Income Taxes	\$ 36,854	\$ 23,920	\$ 60,774	\$ 77,223	\$ 137,997
Adjustments for Income Taxes (Including Interest)	<u>(36,615)</u>	<u>(4,129)</u>	<u>(40,744)</u>	<u>-</u>	<u>(40,744)</u>
Subtotal	\$ 239	\$ 19,791	\$ 20,030	\$ 77,223	\$ 97,253
Special Tax Deductions	<u>(12,473)</u>	<u>-</u>	<u>(12,473)</u>	<u>-</u>	<u>(12,473)</u>
State Taxable Income	\$ (12,234)	\$ 19,791	\$ 7,557	\$ 77,223	\$ 84,780
State Income Tax	9.99% <u>\$ (1,222)</u>	<u>\$ 1,977</u>	<u>\$ 755</u>	<u>\$ 7,715</u>	<u>\$ 8,470</u>
Federal Taxable Income Before State Income Tax	\$ (12,234)	\$ 19,791	\$ 7,557	\$ 77,223	\$ 84,780
State Income Tax	<u>\$ (1,222)</u>	<u>\$ 1,977</u>	<u>\$ 755</u>	<u>\$ 7,715</u>	<u>\$ 8,470</u>
Federal Taxable Income	\$ (11,012)	\$ 17,814	\$ 6,802	\$ 69,508	\$ 76,311
Federal Income Tax	35.00% <u>\$ (3,854)</u>	<u>\$ 6,235</u>	<u>\$ 2,381</u>	<u>\$ 24,328</u>	<u>\$ 26,709</u>
Net Combined Current Income Tax	\$ (5,076)	\$ 8,212	\$ 3,136	\$ 32,043	\$ 35,178
Total Combined Current Income Taxes (Schedule LKM-1, Page 1)	<u>(5,077)</u>	<u>8,212</u>	<u>3,135</u>	<u>32,043</u>	<u>35,178</u>
Difference/Rounding	<u>\$ 1</u>	<u>\$ (0)</u>	<u>\$ 0</u>	<u>\$ (0)</u>	<u>\$ (0)</u>

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission :
v. :
Duquesne Light Company :

Docket No. R-00061346

SURREBUTTAL TESTIMONY OF
LAFAYETTE K. MORGAN, JR.

ON BEHALF OF THE
OFFICE OF CONSUMER ADVOCATE

AUGUST 2006

RECEIVED

SEP 28 2006

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

EXETER

ASSOCIATES, INC.
5565 Sterrett Place
Suite 310
Columbia, Maryland 21044

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

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1 **Introduction and Summary**

2 Q. WOULD YOU PLEASE STATE YOUR NAME AND BUSINESS ADDRESS?

3 A. My name is Lafayette K. Morgan, Jr. I am a Senior Regulatory Analyst with Exeter
4 Associates, Inc. Our offices are located at 5565 Sterrett Place, Columbia, Maryland
5 21044.

6 Q. ARE YOU THE SAME LAFAYETTE MORGAN WHO SUBMITTED DIRECT
7 TESTIMONY IN THIS PROCEEDING ON BEHALF OF THE OFFICE OF
8 CONSUMER ADVOCATE?

9 A. Yes, I am.

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

11 A. The purpose of this surrebuttal testimony is to respond to the rebuttal testimony of
12 Company witnesses Susan S. Betta, Robert L. O'Brien, William V. Pfrommer, Michele
13 Sandoe and Jeffrey L. Coward. Each of these witnesses has addressed issues that I raised
14 in my direct testimony in this proceeding.

15 Q. WOULD YOU PLEASE SUMMARIZE YOUR SURREBUTTAL
16 TESTIMONY?

17 A. Yes. As a result of the issues that I raised in my direct testimony, the Company has
18 responded by accepting some adjustments, and either revising or rejecting others.
19 However, through this process, I believe there are a number of issues on which the OCA
20 and the Company are now in agreement. In this testimony, I will outline those issues that
21 I believe should no longer be contested by either party. I will also identify and discuss
22 those issues on which both parties still disagree. I will also explain why the Commission
23 should not accept the Company's position on those issues. The lack of discussion of an
24 issue that has not been explicitly identified as an issue on which both parties agree should
25 not be construed as not being contested by the OCA.

1 Q. IN LIGHT OF CHANGES YOU AND THE COMPANY HAVE MADE,
2 PLEASE SUMMARIZE THE OCA'S CURRENT RECOMMENDED
3 REVENUE INCREASE.

4 A. On Schedule LKM-1S, I have determined the OCA's recommended revenue increase to
5 be \$90.1 million. Consistent with my direct testimony, the revenue increase is necessary
6 to produce an overall rate of return on rate base of 7.85 percent as recommended by OCA
7 witness Stephen Hill.

8 Q. HAVE YOU INCLUDED A COMPLETE SET OF SCHEDULES WITH YOUR
9 SURREBUTTAL TESTIMONY?

10 A. Yes. I have included Schedule LKM-1S through LKM-26S. Not all schedules were
11 changed, but were included for ease of use.

12 Q. WHAT ARE THE ISSUES ON WHICH YOU BELIEVE THE COMPANY
13 AND THE OCA ARE IN AGREEMENT?

14 A. Since the filing of my direct testimony, I have reviewed additional data relating to the
15 Company's request, including its rebuttal testimony, which indicates the Company has
16 accepted the OCA's amount in certain cases, or that the Company has revised its initial
17 claim. As a result of these changes I believe the OCA and the Company are in agreement
18 on the following issues:

- 19
- 20 • Materials and Supplies
 - 21 • Customer Deposits
 - 22 • Other O&M Expense Lag
 - 23 • Miscellaneous Revenues
 - 24 • Payroll Expense (Excluding Incentive Compensation)
 - 25 • SFAS 123R Expense
 - 26 • Utilities Expense
 - 27 • Company-Use Energy
 - 28 • Industry Association Dues
 - 29 • Expiring Leases
 - 30 • Rent Expense

1 **Materials & Supplies**

2 Q. YOU HAVE INDICATED THAT THE OCA AND THE COMPANY ARE IN
3 AGREEMENT WITH REGARD TO MATERIALS AND SUPPLIES. WOULD
4 YOU PLEASE COMMENT ON THIS ISSUE?

5 A. Yes. In my direct testimony, I proposed an adjustment to reduce materials and supplies
6 to the historical test year level. That adjustment was based upon comparing the data
7 available to me at the time with the Company's projected levels of 2006 materials and
8 supplies, and statements made with regard to the recently-released findings of the
9 Commission's management audit. In light of the most recent data for the twelve months
10 ended June 30, 2006, as presented by Ms. Betta, it appears the Company's future test year
11 claim for Materials & Supplies is reasonable. Therefore, I am withdrawing my
12 adjustment to reduce Materials and Supplies.

13 **Non-Operational Settlement Claims Reserve**

14 Q. MS. BETTA HAS RECOMMENDED THAT THE COMMISSION REJECT
15 YOUR ADJUSTMENT TO INCLUDE THE NON-OPERATIONAL
16 SETTLEMENT CLAIMS RESERVE IN RATE BASE. PLEASE ADDRESS
17 HER POSITION ON THIS ISSUE.

18 A. Ms. Betta's disagreement with the adjustment to include the Non-Operational Settlement
19 Claims Reserve is based on her belief that by inclusion of the three-year average claim in
20 rates, the amount collected would equal the amount paid out. Based on this assumption,
21 she states that no rate base inclusion of the reserve is needed.

22 Ms. Betta's view of this adjustment ignores certain facts that relate to these costs.
23 From an accounting perspective, these costs are recorded under contingent liability rules.
24 Under those rules, any liability that is probable and reasonably estimated should be
25 disclosed to alert the reader that there is a potential claim against the Company. As a

1 result of the ongoing nature of business, the balance in the settlement claims reserve
2 account is never drawn down to \$0, as implied by Ms. Betta's assertion that the amount
3 collected is equal to the amount paid out. In fact, there is a tendency for there to be a
4 time lag from when the incident occurred to when the claim from that incident is paid.
5 Therefore, an accrual is made to recognize the costs before the payment of these costs are
6 made. Because of this accrual, there will always be costs recorded in the liability
7 account, and those costs represent funds collected from ratepayers before payments are
8 made to the respective parties.

9 Q. PLEASE EXPLAIN THE RATIONALE FOR THE INCLUSION OF THE
10 RESERVE IN RATE BASE.

11 A. The costs recorded in reserve represent funds provided by ratepayers to the Company at
12 no cost. Since the Company has free use of the funds before they are used for the
13 intended purpose, ratepayers should be compensated for the funds they have advanced to
14 the Company. As a result, rate base is reduced by the amount of cost-free capital
15 provided by ratepayers.

16 Q. PLEASE SUMMARIZE YOUR POSITION ON THE INCLUSION OF THE
17 NON-OPERATIONAL SETTLEMENT CLAIMS RESERVE IN RATE BASE.

18 A. The proper treatment of the non-operational settlement claim reserve is to include the
19 reserve balance in rate base. This method is the proper treatment to recognize cost free
20 capital supplied by ratepayers. Ms. Betta's position that the amount collected in rates
21 would equal the cash outlay should be rejected by the Commission because it ignores
22 funds that are held in the reserve to account for the contingent liability.

1 **Cash Working Capital**

2 Q. COMPANY WITNESS ROBERT O'BRIEN INDICATES IN HIS REBUTTAL
3 TESTIMONY THAT HE HAS REVISED LAG DAYS FOR OTHER
4 EXPENSES. DO YOU ACCEPT THE REVISED LAG DAY CALCULATION?

5 A. Yes. Mr. O'Brien has revised the lag days from 34.86 to 45.26 days. I have reviewed the
6 calculation and accept the use of the 45.26 lag days in the cash working capital study.

7 Q. WHY IS THERE STILL A DIFFERENCE IN THE CASH WORKING
8 CAPITAL INCLUDED IN RATE BASE BETWEEN THE OCA AND THE
9 COMPANY?

10 A. The difference that currently exists is driven by the effect on the cash working capital
11 study of the O&M adjustments that I have made to the cost of service. In other words,
12 the difference is the corollary effect of the O&M expense adjustments.

13 **AFUDC on Plant Held for Future Use**

14 Q. IN YOUR DIRECT TESTIMONY, YOU INDICATED THAT THOUGH YOU
15 WERE NOT OPPOSED TO THE ACCRUAL OF AFUDC ON PLANT HELD
16 FOR FUTURE USE, YOU COULD NOT ACCEPT THE COMPANY'S
17 PROPOSAL BECAUSE OF OUTSTANDING DATA. WHAT IS YOUR
18 CURRENT POSITION ON THE ACCRUAL OF AFUDC ON PLANT HELD
19 FOR FUTURE USE (PHFU)?

20 A. Subsequent to filing my direct testimony, the Company provided the necessary data to
21 allow me to make a formal recommendation. As explained by the Company in the
22 response to OCA Data Request No. XII-4, it is not seeking to accrue AFUDC on
23 currently held PHFU. Instead, it was seeking the opportunity to accrue AFUDC on land
24 and land rights it acquires going forward. The OCA will not oppose the authority of the
25 Company to accrue AFUDC on PHFU. However, the OCA reserves the right to

1 challenge the reasonableness of the AFUDC accrued on PHFU or the calculation of the
2 AFUDC rate if warranted in a future proceeding.

3 **Miscellaneous Revenues**

4 Q. ACCORDING TO MS. BETTA'S REBUTTAL, YOU HAVE INDICATED
5 THAT YOU WILL WITHDRAW YOUR ADJUSTMENT TO MISCEL-
6 LANEOUS REVENUES. IS THAT AN ACCURATE REPRESENTATION OF
7 YOUR POSITION?

8 A. Yes. The Company provided additional data that suggests that an adjustment will not be
9 necessary. Therefore, I have withdrawn the adjustment to miscellaneous revenues.

10 **Payroll Expenses**

11 Q. PLEASE EXPLAIN THE DIFFERENCE THAT REMAINS BETWEEN THE
12 OCA AND THE COMPANY WITH REGARD TO PAYROLL EXPENSE.

13 A. As indicated in the rebuttal testimony of Ms. Betta, the OCA and the Company have
14 reached agreement on the ongoing level of salary and wages. However, as shown on
15 Schedule LKM-7S, there remains a difference in the total payroll expense. This
16 difference of \$2.9 million is due solely to my adjustment to remove 50 percent of the
17 incentive compensation expense from the cost of service.

18 Q. PLEASE COMMENT ON MS. BETTA'S OPPOSITION TO YOUR
19 ADJUSTMENT TO REMOVE 50 PERCENT OF INCENTIVE
20 COMPENSATION.

21 A. Ms. Betta, on pages 16 and 17 of her rebuttal testimony, outlines the Company's
22 incentive plan. Interestingly, Ms. Betta's own words lend credence to the position I have
23 taken on this issue. On page 16, line 17, Ms. Betta states, "...[i]f an employee does not
24 achieve at least 50 percent of their individual job related performance goals, the
25 employee is not eligible for incentive compensation". This point clearly illustrates why I

1 have stated that incentive compensation is uncertain. Because of this uncertainty, one
2 cannot assume that incentive compensation will grow linearly with salary levels or that
3 incentive compensation will be paid annually. Hence, it is proper to normalize incentive
4 compensation with the three-year average to avoid over or under-collecting incentive
5 compensation.

6 On lines 24 through 28 of page 16, she states, "...the incentive compensation
7 program is not fairly characterized as based on financial performance simply because 50
8 percent of the Company objective in 2006 is based on financial performance. Indeed, any
9 Company-wide financial objective is to ensure that there are sufficient funds to pay the
10 incentive compensation". This is precisely the point I made in my direct testimony when
11 I stated that financial goals would provide the funds from which to pay incentive
12 compensation. As Ms. Betta has stated, a properly structured incentive plan will provide
13 the additional funds to pay the incentive compensation, so including those costs would be
14 tantamount to an over-recovery of those costs.

15 Q: ARE EARNINGS ACHIEVED BY THE COMPANY THE THRESHOLD
16 THAT MUST BE CROSSED IN ORDER TO PAY INCENTIVE
17 COMPENSATION?

18 A. Yes. I have attached, as Appendix A, an excerpt from the Company's compensation
19 standard manual. The underlined section states, "Incentive compensation will factor in
20 both individual and organizational performance and will include a minimum threshold
21 level of financial performance for DLH that must be attained for any incentive
22 compensation payouts, regardless of individual or Company performance."

1 Q. MS. BETTA STATES THAT DUQUESNE LIGHT COMPANY HAS BEEN
2 GRANTED RECOVERY OF INCENTIVE COMPENSATION IN A
3 PREVIOUS PROCEEDING. IS YOUR ADJUSTMENT TO REMOVE 50
4 PERCENT OF INCENTIVE COMPENSATION A COST DISALLOWANCE?

5 A. No. My adjustment is not a cost disallowance per se. Instead, it is an adjustment that is
6 necessary to avoid over-recovery of the costs that Ms. Betta admits will be provided by
7 establishing financial goals. Moreover, since shareholders are the ones that stand to gain
8 by better financial performance, my adjustment creates a sharing of the incentive
9 compensation costs between ratepayers and shareholders. Therefore, the Commission
10 should reject the Company's position on this issue.

11 **Employee Benefits**

12 Q. WHY IS THERE A DIFFERENCE IN THE LEVEL OF EMPLOYEE
13 BENEFITS BETWEEN THE OCA AND THE COMPANY?

14 A. There is a difference in the level of employee benefit because of the difference in payroll
15 levels due to incentive compensation. In my adjustment, I used the same employee
16 benefit rate as Ms. Betta and applied it to the incentive compensation adjustment. If the
17 OCA's incentive compensation adjustment is not accepted, this adjustment must also be
18 removed.

19 **Pension Expense**

20 Q. MS. BETTA DISAGREES WITH YOUR PROPOSAL TO USE THE SFAS 87
21 AMOUNT FOR PENSION EXPENSE. WILL YOU PLEASE COMMENT ON
22 HER REBUTTAL TO YOUR POSITION?

23 A. On pages 11 through 16, Ms. Betta discusses the adjustment I made to pension expense
24 and explains why, in her view, the Company's proposal to use the contribution amount is
25 proper. Essentially, she portrays the SFAS 87 amount as being volatile, less predictable

1 and subject to change. However, as I will explain, Ms. Betta's conclusions should be
2 rejected because the depiction of the contribution amount relative to the SFAS 87 amount
3 is not accurate and the Company has not met its burden of proof on this issue.

4 Q. MS. BETTA STATES THE SFAS 87 AMOUNT IS VOLATILE DUE TO
5 FLUCTUATIONS IN INTEREST RATES AND MARKET RETURN. IS
6 CONTRIBUTION AMOUNT ALSO AFFECTED BY INTEREST RATES AND
7 MARKET RETURNS?

8 A. Yes. Interest rates and market returns also affect the contribution amount. For example,
9 market returns on pension plan assets have the effect of changing the percentage of the
10 current pension liability that is funded, which would cause a change in the contribution
11 amount. Therefore, the contribution amount is by no means a fixed and certain amount.

12 Q. MS. BETTA INDICATES THAT THE FINANCIAL ACCOUNTING
13 STANDARDS BOARD (FASB) IS IN THE PROCESS OF REPLACING SFAS
14 87. DOES THAT MEAN THAT SFAS 87 IS NO LONGER VALID?

15 A. No. Until there is a new pronouncement that supersedes SFAS 87, it will remain the
16 standard by which pension expense is recorded. Additionally, there are two points worth
17 highlighting with regard to Ms. Betta's statement. First, she states that the proposal to
18 change SFAS 87 is in "the first phase of a comprehensive project to reconsider guidance
19 in SFAS 87."¹ Hence, it could be several years before a new pronouncement goes into
20 effect. Second, as SFAS 87 is being reconsidered, the contribution to pension plans is not
21 likely to be ignored. As a result, no one knows what rules will govern contribution in the
22 future. It would be bad policy for the Commission to base its decision on this matter on
23 such uncertainty.

¹ Susan Betta, Rebuttal Testimony at page 12, lines 20-22.

1 Q. ASSUME FOR THE MOMENT THAT SFAS 87 IS MORE VOLATILE THAN
2 THE CONTRIBUTION AMOUNT. HAS THE COMPANY BEEN HURT IF
3 THE SFAS 87 AMOUNT IS COMPARED TO THE CONTRIBUTION
4 AMOUNT?

5 A. No. As Ms. Betta points out on page 14, lines 21 through 27 of her rebuttal testimony,
6 for the period 1987 through 2005 the cumulative SFAS 87 costs have been \$110,841,995
7 while cumulative contributions have been \$110,504,402. The difference in these
8 amounts is not significant.

9 Q. IS THE \$20 MILLION CONTRIBUTION AMOUNT THE COMPANY IS
10 REQUESTING THE ACTUAL AMOUNT REQUIRED TO ADEQUATELY
11 FUND THE PENSION PLAN?

12 A. No. In response to OCA IV-28, the Company was asked to provide support that \$20
13 million was required as the ongoing funding amount. The study provided by the
14 Company (an excerpt of which was included as Exhibit SSB-11 attached to Ms. Betta's
15 rebuttal testimony) showed the \$20 million as the annual contribution. However, it
16 appears that the Company requested its actuaries to run the study with "contributions
17 equal to the greater of the amount required to avoid funding deficiency or \$20 million".
18 In other words, the \$20 million was set as the "floor" or the minimum amount. I have
19 attached the full study as Appendix B.

20 Q. MS. BETTA STATES THAT PERCENTAGE FUNDING IS USED TO
21 MEASURE THE SEVERITY OF UNDER-FUNDING. USING THE STUDY
22 PROVIDED BY THE COMPANY, WHAT IS THE PERCENTAGE FUNDED?

23 A. The study contains two methods of measuring the percentage funded -- the smooth asset
24 valuation method and the fair market value method. Under the smooth asset valuation
25 method, if the funded current liability percentage (FCLP) drops below 80 percent, it

1 would trigger additional funding. The Company's study shows the FCLP is in the range
2 of 81 percent to 94.5 percent by 2011 using the \$20 million contribution. Under the fair
3 value asset valuation, the FCLP is in the range of 102.6 percent to 115.1 percent in 2011.
4 These high FCLP percentages suggest that the \$20 million contribution is more than
5 adequate.

6 Q. MS. BETTA SUGGESTS THAT, BASED ON PROPOSED CHANGES IN
7 PENSION RULES, THE MINIMUM FUNDING COULD BE AS HIGH AS \$30
8 MILLION. PLEASE COMMENT.

9 A. As I indicated earlier, no firm rules have been decided upon. Therefore Ms. Betta's
10 assertions are speculative and not embedded in certainty.

11 Q. IF THE COMMISSION DECIDES TO USE THE CONTRIBUTION
12 APPROACH, IS \$20 MILLION THE RIGHT AMOUNT?

13 A. No. As I explained, the \$20 million is not an amount required to avoid under-funding the
14 pension plan. Therefore, the Company must provide a more realistic amount. Ratepayers
15 should not have to pay more than is needed to meet the day-to-day obligations of the
16 Company.

17 **SFAS 123R Costs**

18 Q. YOU HAVE INDICATED THAT THE COMPANY AND THE OCA ARE IN
19 AGREEMENT ON THE SFAS 123R COSTS. PLEASE EXPLAIN.

20 A. In my direct testimony, I recommended an adjustment to remove these costs, and the
21 Company adopted the adjustment in its rebuttal testimony. As a result, this issue is not
22 being contested by either party.

23

1 **Storm Normalization**

2 Q. THE COMPANY HAS REVISED ITS STORM NORMALIZATION TO
3 REFLECT A SIX-YEAR AVERAGE OF ACTUAL STORM DAMAGE
4 EXPENSE. DO YOU AGREE WITH THE COMPANY'S REVISED
5 ADJUSTMENT?

6 A. Yes, but only partially. I agree with the use of the average actual storm damage expense,
7 but disagree with the use of a six-year period to derive the average.

8 Q. WHAT PERIOD DO YOU RECOMMEND BE USED TO DERIVE THE
9 ADJUSTMENT?

10 A. I recommend that the adjustment be calculated based on the most recent three-year
11 average. Therefore on Schedule LKM-18S, I present an adjustment to reduce the storm
12 damage normalization expenses by \$207,000.

13 Q. WHY SHOULD THE SIX-YEAR AVERAGE NOT BE USED IN THIS
14 ADJUSTMENT?

15 A. I am recommending that the Commission reject the six-year average because of lack of
16 consistency and lack of support. In the Company's initial adjustment, the normalized
17 costs were based upon a three-year average. Without explanation, the Company has
18 chosen to use a six-year average in the revised adjustment. The burden is on the
19 Company to explain why the six-year average is now better than the three-year average.
20 From the point of view of consistency, Duquesne Light has used the three-year period
21 throughout its filing for cost normalization.² Absent a compelling reason, I believe the
22 three-year period should be used in this adjustment as well. In fact, Company witness
23 Robert O'Brien makes a similar argument against the OTS's recommendation that rate
24 case expense be normalized over a five-year period.

² See the adjustments for uncollectibles, rate case expense, non-operation settlement claims.

1 **Advertising Expense**

2 Q. MS. BETTA HAS PROPOSED TO REMOVE \$516,000 OF COSTS FROM
3 ADVERTISING. YOU ARE RECOMMENDING AN ADDITIONAL
4 ADJUSTMENT OF \$431,000. WHAT IS THE CURRENT DIFFERENCE
5 BETWEEN YOU AND THE COMPANY?

6 A. In my direct testimony, I recommended an adjustment to remove all advertising expenses
7 from the cost of service. Ms. Betta responded in her rebuttal testimony by removing the
8 cost of advertising at sporting venues as being image-related. In the data supporting her
9 rebuttal testimony, Ms. Betta included further breakdown of the advertising costs
10 included in the cost of service. From that data, I am adjusting advertising expenses to
11 remove 50 percent of the informational advertising costs as additional image advertising
12 expense. The adjustment is presented on Schedule LKM-14S and the advertisements are
13 presented in Appendix C to this testimony.

14 **Utilities Expense**

15 Q. YOU INDICATED THAT THE OCA AND THE COMPANY ARE IN
16 AGREEMENT WITH REGARD TO UTILITIES EXPENSE. PLEASE
17 COMMENT.

18 A. The Company has revised its calculation of utilities expense. I have reviewed the basis of
19 the revised expenses amount and accepted the amount. Therefore, I am no longer
20 proposing an adjustment to utilities expense. In addition, the adjustment I proposed to
21 Company-Use Energy has been withdrawn because those costs were included in utilities
22 expense.

23

1 **Rate Case Expense**

2 Q. COMPANY WITNESS ROBERT O'BRIEN DISAGREES WITH YOUR
3 ADJUSTMENT TO RATE EXPENSE. CAN YOU EXPLAIN THE BASIS OF
4 HIS DISAGREEMENT?

5 A. Yes. Mr. O'Brien's disagreement with my adjustment is two-fold. First, he disagrees
6 with the adjustment I made because I did not apply a jurisdictional allocation factor to
7 derive the adjustment to the cost of service in proceeding. Second, I made adjustments to
8 remove costs that I considered normal costs, or costs that will not be incurred. He
9 disagrees with my characterization of these costs, and believes they should not be
10 removed from the cost of service.

11 Q. WOULD YOU PLEASE RESPOND TO HIS POSITION ON THE
12 JURISDICTIONAL ALLOCATION FACTOR?

13 A. In my experience involving various multi-jurisdictional utilities, I have noticed the
14 treatment rate case expense has either been directly assigned based upon the jurisdiction
15 for which the costs were incurred, or recorded in one account and allocated among
16 jurisdictions. Both of these methods are acceptable. It appears that Duquesne is one of
17 those utilities that allocates these costs instead of directly assigning them. Therefore, I
18 have revised my adjustment to reflect the 93.639 percent allocation factor recommended
19 by Mr. O'Brien.

20 Q. DO YOU BELIEVE THE COSTS THAT YOU REMOVED IN YOUR DIRECT
21 TESTIMONY SHOULD BE ADDED BACK?

22 A. No. The costs that I removed in my direct testimony were: Preparation of Filing Costs;
23 Post-Filing Preparation Costs, Project Management Costs; and Strategy and Planning
24 Costs. As presented in the response to OCA XII-1, Preparation of Filing and Post-Filing
25 Preparation were budgeted at \$325,000 and \$425,000, respectively, but it was indicated

1 in the in the response that no expenditures had occurred for those costs. As I understand
2 Mr. O'Brien's testimony, expenditures did occur. However, costs that fall within these
3 two categories were included and presented under other categories that are shown in the
4 interrogatory response, rather than being classified as in either of these two categories
5 instead. The data on OCA XII-1, show the remaining amount of costs to be incurred in
6 each of those categories after recognizing the costs already incurred. Therefore, given
7 that these costs are already captured in the other categories, there is no need to add them
8 back to rate case expense as additional budgeted costs to be incurred. Simply stated,
9 these costs have been incurred and recognized and are no longer potential costs.

10 With regard to the strategy and planning costs and project management costs, Mr.
11 O'Brien argues that these are rate case costs that would not be incurred on a regular basis
12 if there were not a rate case. While Mr. O'Brien is correct only to the extent that these
13 costs are categorized as rate case costs. However, these are not incremental costs that
14 are incurred because of the rate case. These are costs that would have been incurred
15 regardless of the rate case, but categorized somewhere else based on the Company's
16 priorities at the time. For example, Ms. Betta, as Comptroller of the Company will not
17 receive additional salary for working on the rate case. Instead, her workload has been
18 prioritized in such a manner that creates time for her and her resources to dedicate to the
19 rate case. If there were not a rate case, Ms. Betta's time would be devoted elsewhere
20 within the Company. She would not receive a reduction in her compensation. Therefore,
21 Mr. O'Brien's position should be rejected.

22 Q. DOES THIS END YOUR TESTIMONY?

23 A. Yes, it does.
24

Docket No. R-00061346
Surrebuttal Testimony of Lafayette K. Morgan, Jr.
Appendix A

Base Pay Increases

Base pay increases will be reviewed periodically by examining market trends and data, and balancing this with DLHs ability to fund the increase. The objective of base pay increases is to maintain market competitive base pay.

Incentive Compensation

Incentive compensation will:

- Align employees with organizational strategies and financial goals;
- Facilitate communication and focus attention on organizational priorities and performance;
- Reward both individual and organizational performance;
- Represent significant “pay-at-risk” and be based on stretch goals; and
- Ensure competitive total compensation for staff.



Incentive compensation will factor in both individual and organizational performance and will include a minimum threshold level of financial performance for DLH that must be attained for any incentive compensation payouts, regardless of individual or Company performance.

DLH may grant long-term incentive awards (equity) as it deems appropriate.

NOTE: Each subsidiary will utilize this model, but implementation of incentive compensation as well as other pay delivery methods will be determined by the business needs of the subsidiary.

Docket No. R-00061346
Surrebuttal Testimony of Lafayette K. Morgan, Jr.
Appendix B

Office of Consumer Advocate
Interrogatories Set IV

(REVISED)

28. Please provide all evidence to support the Company's statement that annual pension contributions will be \$20 million going into the future.

Response:

Our Pension Funding Policy considers the minimum contribution amount required and the maximum tax-deductible contribution allowed, which are determined annually, in accordance with Section 412 and 404, respectively, of the Internal Revenue Code, as well the amount required to avoid deterioration in the funded current liability percentage. During 2006, we have made contributions totaling \$20 million to the pension plans and plan to continue to fund the pension plans at this level into the future.

Our actuarial firm prepared cash funding projection estimates, considering the amount required to avoid a funding deficiency. See copies of this analysis

Memorandum

To: Darrin Duda

From: Joe Strazemski, Scott Berger, Shyam Raghavan

Subject: Retirement Plan cash funding and pension expense projection estimates

Date: February 10, 2006

As requested, we have prepared cash funding and pension expense projection estimates for the Retirement Plan the following scenario:

- Contributions equal to the greater of the amount required to avoid a funding deficiency or \$20 million

The projections are based on the current pension funding rules. In addition, we assumed that the rule that permits the current liability to be based on corporate bonds rather than 30-year treasuries is extended at least to the end of the projection period. Otherwise, because 30-year treasuries are typically lower than corporate bonds, higher minimum required contributions would result.

Our projections show that the 2006 funded current liability percentage (FCLP), based on the smoothed valuation asset, is in the 83% range. If this rate drops below 80%, this would create an additional funding requirement of IRC §412(l) (AFR) for 2006 of over \$70 million, which would use up the credit balance sooner than our projections show. We will not know the exact FCLP until we complete the 2006 valuation and the current liability rate for 2006 is known. However, if the plan does drop below 80%, additional contributions can be made up to September 15, 2006 to maintain the FCLP 80%. The main reason why the FCLP decreased from our prior projections is due to the assumption change for terminated-vesteds (assuming age 60 commencement). Note that if the method to determine the actuarial value of assets were fair market value instead of the current five-year average method, our projections show that the FCLP for 2006 is over 90% and therefore, under the fair-market value method, the plan would be exempt from the AFR.

Charts included:

For the above scenario, there are two charts: one for the funding valuation projection estimates and one for the accounting valuation projection estimates.

On the funding estimates chart, the actual contributions for the year are shown on line 15,

Mr. Darrin Duda

Page 2

“Actual Calendar Year Contributions.” As you requested, we have assumed that the \$20 million contributions are made on the first day of the calendar year. Also, we followed our usual practice to treat contributions made on the first day of the year as contributions for the prior plan/tax year and include them as a receivable for the current plan year. Lines 11, 12 and 13 show the minimum required contribution before and after reflecting the credit balance as well as the credit balance.

The funding estimates charts also show that the maximum tax-deductible contributions, line 14, are significant amounts. This does not reflect the IRC §404(a)(7) combined limitations for defined benefit and defined contribution plans.

Also on the funding estimates charts, comparing lines 6 and 9, we see that the actuarial value of assets lags behind the market value of assets. This happens because of the way that the actuarial value of assets smoothing method treats realized and unrealized capital gains. For example, lines 8 and 10 show the Plan’s current liability funded percentage based on the actuarial value of assets and the market value of assets, respectively. Under the scenario, the current liability funded percentage is in the 83% range when based on the actuarial value of assets and in the 95% range when based on the market value of assets.

Contributions equal to the greater of the amount required to avoid a funding deficiency or \$20 million:

We also see that the contributions made during the projection period are \$20 million (line 15) for all years in the projection period.

Looking at line 4, we see that the Plan is fully funded on an actuarial accrued liability basis. However, as noted earlier, after 2005 the Plan’s current liability funded percentage is in the 83% range when based on the actuarial value of assets and in the fully funded range when based on the market value of assets.

It’s also interesting to note that the minimum required contribution before reflecting the credit balance, line 11, increases by about \$81 million from 2006 to 2007. This is the result of the Plan being subject to the AFR. However, the credit balance is large enough so that the minimum required contribution is \$0. As noted earlier, if the current liability funded percentage drops below 80% for 2006, then the plan will also incur the additional funding charge in 2006. The AFR is shown on line 18.

Please let us know if you have any questions or if we can be of further assistance in this matter.

Duquesne Light Holdings, Inc.
Projected FAS 132 Disclosure Items and Fiscal Year Expense
Assumes Contribution Equal to the greater of the amount required to avoid a funding deficiency or \$20 million

Retirement Pension Plan

	<u>Estimated 2005</u>	<u>Estimated 2006</u>	<u>Estimated 2007</u>	<u>Estimated 2008</u>	<u>Estimated 2009</u>	<u>Estimated 2010</u>	<u>Estimated 2011</u>
Weighted-average assumptions as of December 31							
Discount rate	5.70%	5.70%	5.70%	5.70%	5.70%	5.70%	5.70%
Expected return on plan assets	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%
Rate of compensation increase	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%
Assumed Actual return on assets	6.85%	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%
Components of net benefit cost							
Service cost	\$ 7,620,000	\$ 10,930,000	\$ 10,090,000	\$ 9,860,000	\$ 10,230,000	\$ 10,030,000	\$ 10,430,000
Interest cost	38,550,000	42,550,000	43,510,000	44,390,000	45,190,000	45,950,000	46,570,000
Expected return on plan assets	(46,540,000)	(51,010,000)	(54,160,000)	(56,920,000)	(59,860,000)	(62,880,000)	(65,890,000)
Amortization of unrecognized net transition obligation	10,000	0	0	0	0	0	0
Amortization of prior service cost	4,440,000	5,840,000	5,410,000	5,010,000	4,970,000	4,730,000	4,110,000
Recognized net actuarial loss (gain)	0	0	0	0	0	0	0
Net periodic benefit cost	<u>4,080,000</u>	<u>8,310,000</u>	<u>4,850,000</u>	<u>2,340,000</u>	<u>530,000</u>	<u>(2,170,000)</u>	<u>(4,780,000)</u>
Curtailment cost	0	0	0	0	0	0	0
Settlement cost	0	0	0	0	0	0	0
Purchase Accounting Charge	0	0	0	0	0	0	0
Net benefit cost	<u>4,080,000</u>	<u>8,310,000</u>	<u>4,850,000</u>	<u>2,340,000</u>	<u>530,000</u>	<u>(2,170,000)</u>	<u>(4,780,000)</u>
Other year-end financial information							
Market related value of assets	634,970,000	674,980,000	710,260,000	747,890,000	786,510,000	825,500,000	864,570,000
Accumulated benefit obligation	747,770,000	762,650,000	777,170,000	791,060,000	804,240,000	815,860,000	825,560,000

Duquesne Light Holdings, Inc.
Projected FAS 132 Disclosure Items and Fiscal Year Expense
Assumes Contribution Equal to the greater of the amount required to avoid a funding deficiency or \$20 million

Retirement Pension Plan

	<u>Estimated 2005</u>	<u>Estimated 2006</u>	<u>Estimated 2007</u>	<u>Estimated 2008</u>	<u>Estimated 2009</u>	<u>Estimated 2010</u>	<u>Estimated 2011</u>
Change in benefit obligation							
Benefit obligation at beginning of year	\$ 679,905,074	\$ 763,850,000	\$ 781,370,000	\$ 797,480,000	\$ 812,440,000	\$ 826,730,000	\$ 838,920,000
Service cost	7,620,000	10,930,000	10,090,000	9,860,000	10,230,000	10,030,000	10,430,000
Interest cost	38,550,000	42,550,000	43,510,000	44,390,000	45,190,000	45,950,000	46,570,000
Plan participants' contributions	0	0	0	0	0	0	0
Actuarial loss (gain)	55,364,926	0	0	0	10,000	0	0
Benefits paid	(34,500,000)	(35,960,000)	(37,490,000)	(39,290,000)	(41,140,000)	(43,790,000)	(46,710,000)
Amendments	16,910,000	0	0	0	0	0	0
Curtailments	0	0	0	0	0	0	0
Purchase Accounting Charge	0	0	0	0	0	0	0
Benefit obligation at end of year	<u>763,850,000</u>	<u>781,370,000</u>	<u>797,480,000</u>	<u>812,440,000</u>	<u>826,730,000</u>	<u>838,920,000</u>	<u>849,210,000</u>
Change in plan assets							
Fair value of plan assets at beginning of year	598,815,545	638,450,000	673,720,000	710,230,000	747,790,000	786,430,000	825,400,000
Actual return on plan assets	42,064,455	51,230,000	54,000,000	56,850,000	59,780,000	62,760,000	65,760,000
Employer contribution*	32,070,000	20,000,000	20,000,000	20,000,000	20,000,000	20,000,000	20,000,000
Plan participants' contributions	0	0	0	0	0	0	0
Benefits paid	(34,500,000)	(35,960,000)	(37,490,000)	(39,290,000)	(41,140,000)	(43,790,000)	(46,710,000)
Fair value of plan assets at end of year	<u>638,450,000</u>	<u>673,720,000</u>	<u>710,230,000</u>	<u>747,790,000</u>	<u>786,430,000</u>	<u>825,400,000</u>	<u>864,450,000</u>
Funded status (unfunded PBO)	(125,400,000)	(107,650,000)	(87,250,000)	(64,650,000)	(40,300,000)	(13,520,000)	15,240,000
Unrecognized net transition obligation	0	0	0	0	0	0	0
Unrecognized prior service cost	42,670,000	36,820,000	31,410,000	26,400,000	21,430,000	16,700,000	12,590,000
Unrecognized net actuarial loss (gain)	<u>55,510,000</u>	<u>55,300,000</u>	<u>55,450,000</u>	<u>55,520,000</u>	<u>55,610,000</u>	<u>55,720,000</u>	<u>55,850,000</u>
Net amount recognized (accrued)	<u>(27,220,000)</u>	<u>(15,530,000)</u>	<u>(390,000)</u>	<u>17,270,000</u>	<u>36,740,000</u>	<u>58,900,000</u>	<u>83,680,000</u>
Amounts recognized in the statement of financial position consist of:							
Prepaid benefit cost	0	0	0	0	0	58,900,000	83,680,000
Accrued benefit liability	(109,320,000)	(88,930,000)	(66,940,000)	(43,270,000)	(17,810,000)	0	0
Intangible asset	42,670,000	36,820,000	31,410,000	26,400,000	21,430,000	0	0
Accumulated other comprehensive income	<u>39,430,000</u>	<u>36,580,000</u>	<u>35,140,000</u>	<u>34,140,000</u>	<u>33,120,000</u>	0	0
Net amount recognized	<u>(27,220,000)</u>	<u>(15,530,000)</u>	<u>(390,000)</u>	<u>17,270,000</u>	<u>36,740,000</u>	<u>58,900,000</u>	<u>83,680,000</u>

* Contributions are assumed to be made on first day of plan year.

Duquesne Light Retirement Pension Plan
Funding Valuation Estimates - Contributions to equal to the greater of the amount required to avoid a funding deficiency or \$20 million

	<u>1/1/2005</u>	<u>1/1/2006</u>	<u>1/1/2007</u>	<u>1/1/2008</u>	<u>1/1/2009</u>	<u>1/1/2010</u>	<u>1/1/2011</u>
(1) Actuarial Accrued Liability	\$ 539,493,700	\$ 562,186,809	\$ 580,566,629	\$ 598,304,997	\$ 615,536,973	\$ 632,647,992	\$ 647,409,619
(2) Valuation Assets	<u>561,075,800</u>	<u>576,615,000</u>	<u>597,781,500</u>	<u>630,380,600</u>	<u>675,586,800</u>	<u>711,623,400</u>	<u>744,951,200</u>
(3) Unfunded (Overfunded)	(21,582,100)	(14,448,192)	(17,214,871)	(32,075,603)	(60,049,827)	(78,975,408)	(97,541,581)
(4) % Funded	104.0%	102.6%	103.0%	105.4%	109.8%	112.5%	115.1%
(5) Gateway Current Liability	658,144,300	694,740,586	737,608,445	751,990,353	765,324,393	777,969,663	788,628,261
(6) Valuation Assets	<u>561,075,800</u>	<u>576,615,000</u>	<u>597,781,500</u>	<u>630,380,600</u>	<u>675,586,800</u>	<u>711,623,400</u>	<u>744,951,200</u>
(7) Unfunded (Overfunded)	97,068,500	118,125,586	139,826,945	121,609,753	89,737,593	66,346,263	43,677,061
(8) % Funded	85.3%	83.0%	81.0%	83.8%	88.3%	91.5%	94.5%
(9) Market Value of Assets	630,887,300	658,446,700	693,724,948	730,228,730	767,786,206	806,427,347	845,401,940
(10) Gateway Current Liability % Funded - MVA basis	95.9%	94.8%	94.1%	97.1%	100.3%	103.7%	107.2%
Minimum required contribution (end of year):							
(11) Total before reflecting credit balance	39,148,536	43,786,686	125,311,676	84,394,749	19,901,462	5,912,243	7,284,079
(12) Credit Balance	218,782,400	218,230,368	212,993,263	125,786,014	72,083,076	78,308,675	99,052,669
(13) Total after reflecting credit balance	0	0	0	0	0	0	0
Other Items:							
(14) Maximum Contribution	240,719,623	236,459,337	228,606,826	208,058,382	173,271,449	146,456,019	120,919,557
(15) Actual Calendar Year Contribution	32,071,720	20,000,000	20,000,000	20,000,000	20,000,000	20,000,000	20,000,000
(16) Normal cost (end of year)	5,355,560	7,453,604	6,773,479	6,570,515	6,845,388	6,635,648	6,901,074
(17) Expected benefit payments	34,739,200	35,959,152	37,494,418	39,289,224	41,136,259	43,788,107	46,712,077
(18) Additional Funding Requirement	0	0	78,121,595	42,368,871	16,055,980	0	0
(19) Funding / AAL interest rate	8.50%	8.50%	8.50%	8.50%	8.50%	8.50%	8.50%
(20) Current Liability interest rate for minimum contribution purposes	6.10%	5.82%	5.50%	5.50%	5.50%	5.50%	5.50%
(21) Current Liability interest rate for maximum contribution purposes	4.59%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%
Assumptions:							
(22) Assets earn 8.00% after 2005.							
(23) Other experience in accordance with assumptions for actuarial valuation.							
(24) Contributions are assumed to be made on the first day of the calendar year.							

Office of Consumer Advocate
Interrogatories Set IV

28. Please provide all evidence to support the Company's statement that annual pension contributions will be \$20 million going into the future.

Response:

Our Pension Funding Policy considers the minimum contribution amount required and the maximum tax-deductible contribution allowed, which are determined annually, in accordance with Section 412 and 404, respectively, of the Internal Revenue Code, as well the amount required to avoid deterioration in the funded current liability percentage. During 2006, we have made contributions totaling \$20 million to the pension plans and plan to continue to fund the pension plans at this level into the future.

Our actuarial firm prepared cash funding projection estimates, considering the amount required to avoid a funding deficiency. See copies of this analysis

Superseded


Memorandum

To: Darrin Duda

From: Joe Strazemski, Scott Berger, Shyam Raghavan

Subject: Retirement Plan cash funding and pension expense projection estimates

Date: February 10, 2006

As requested, we have prepared cash funding and pension expense projection estimates for the Retirement Plan the following scenario:

- Contributions equal to the greater of the amount required to avoid a funding deficiency or \$20 million

The projections are based on the current pension funding rules. In addition, we assumed that the rule that permits the current liability to be based on corporate bonds rather than 30-year treasuries is extended at least to the end of the projection period. Otherwise, because 30-year treasuries are typically lower than corporate bonds, higher minimum required contributions would result.

Our projections show that the 2006 funded current liability percentage (FCLP), based on the smoothed valuation asset, is in the 83% range. If this rate drops below 80%, this would create an additional funding requirement of IRC §412(1) (AFR) for 2006 of over \$70 million, which would use up the credit balance sooner than our projections show. We will not know the exact FCLP until we complete the 2006 valuation and the current liability rate for 2006 is known. However, if the plan does drop below 80%, additional contributions can be made up to September 15, 2006 to maintain the FCLP 80%. The main reason why the FCLP decreased from our prior projections is due to the assumption change for terminated-vesteds (assuming age 60 commencement). Note that if the method to determine the actuarial value of assets were fair market value instead of the current five-year average method, our projections show that the FCLP for 2006 is over 90% and therefore, under the fair-market value method, the plan would be exempt from the AFR.

Charts included:

For the above scenario, there are two charts: one for the funding valuation projection estimates and one for the accounting valuation projection estimates.

On the funding estimates chart, the actual contributions for the year are shown on line 15,

Mr. Darrin Duda

Page 2

"Actual Calendar Year Contributions." As you requested, we have assumed that the \$20 million contributions are made on the first day of the calendar year. Also, we followed our usual practice to treat contributions made on the first day of the year as contributions for the prior plan/tax year and include them as a receivable for the current plan year. Lines 11, 12 and 13 show the minimum required contribution before and after reflecting the credit balance as well as the credit balance.

The funding estimates charts also show that the maximum tax-deductible contributions, line 14, are significant amounts. This does not reflect the IRC §404(a)(7) combined limitations for defined benefit and defined contribution plans.

Also on the funding estimates charts, comparing lines 6 and 9, we see that the actuarial value of assets lags behind the market value of assets. This happens because of the way that the actuarial value of assets smoothing method treats realized and unrealized capital gains. For example, lines 8 and 10 show the Plan's current liability funded percentage based on the actuarial value of assets and the market value of assets, respectively. Under the scenario, the current liability funded percentage is in the 83% range when based on the actuarial value of assets and in the 95% range when based on the market value of assets.

Contributions equal to the greater of the amount required to avoid a funding deficiency or \$20 million:

We also see that the contributions made during the projection period are \$20 million (line 15) for all years in the projection period.

Looking at line 4, we see that the Plan is fully funded on an actuarial accrued liability basis. However, as noted earlier, after 2005 the Plan's current liability funded percentage is in the 83% range when based on the actuarial value of assets and in the fully funded range when based on the market value of assets.

It's also interesting to note that the minimum required contribution before reflecting the credit balance, line 11, increases by about \$81 million from 2006 to 2007. This is the result of the Plan being subject to the AFR. However, the credit balance is large enough so that the minimum required contribution is \$0. As noted earlier, if the current liability funded percentage drops below 80% for 2006, then the plan will also incur the additional funding charge in 2006. The AFR is shown on line 18.

Please let us know if you have any questions or if we can be of further assistance in this matter.

Duquesne Light Holdings, Inc.
Projected FAS 132 Disclosure Items and Fiscal Year Expense

	<u>Supplemental Pension Plan</u>						
	<u>Estimated</u> <u>2005</u>	<u>Estimated</u> <u>2006</u>	<u>Estimated</u> <u>2007</u>	<u>Estimated</u> <u>2008</u>	<u>Estimated</u> <u>2009</u>	<u>Estimated</u> <u>2010</u>	<u>Estimated</u> <u>2011</u>
Change in benefit obligation							
Benefit obligation at beginning of year	\$ 67,290,079	\$ 67,590,000	\$ 68,550,000	\$ 69,530,000	\$ 70,520,000	\$ 71,560,000	\$ 72,470,000
Service cost	950,000	760,000	790,000	830,000	860,000	890,000	930,000
Interest cost	3,790,000	3,750,000	3,810,000	3,860,000	3,910,000	3,970,000	4,020,000
Plan participants' contributions	0	0	0	0	0	0	0
Actuarial loss (gain)	5,299,921	10,000	0	(10,000)	10,000	0	0
Benefits paid	(3,490,000)	(3,560,000)	(3,620,000)	(3,690,000)	(3,740,000)	(3,950,000)	(4,170,000)
Amendments	(6,250,000)	0	0	0	0	0	0
Curtailments	0	0	0	0	0	0	0
Purchase Accounting Charge	0	0	0	0	0	0	0
Benefit obligation at end of year	<u>67,590,000</u>	<u>68,550,000</u>	<u>69,530,000</u>	<u>70,520,000</u>	<u>71,560,000</u>	<u>72,470,000</u>	<u>73,250,000</u>
Change in plan assets							
Fair value of plan assets at beginning of year	116,953,389	121,410,000	127,420,000	133,850,000	140,720,000	148,080,000	155,820,000
Actual return on plan assets	7,946,611	9,570,000	10,050,000	10,560,000	11,100,000	11,690,000	12,300,000
Employer contribution	0	0	0	0	0	0	0
Plan participants' contributions	0	0	0	0	0	0	0
Benefits paid	(3,490,000)	(3,560,000)	(3,620,000)	(3,690,000)	(3,740,000)	(3,950,000)	(4,170,000)
Fair value of plan assets at end of year	<u>121,410,000</u>	<u>127,420,000</u>	<u>133,850,000</u>	<u>140,720,000</u>	<u>148,080,000</u>	<u>155,820,000</u>	<u>163,950,000</u>
Funded status (unfunded PBO)	53,820,000	58,870,000	64,320,000	70,200,000	76,520,000	83,350,000	90,700,000
Unrecognized net transition obligation	0	0	0	0	0	0	0
Unrecognized prior service cost	(10,020,000)	(8,560,000)	(7,160,000)	(5,900,000)	(4,810,000)	(3,960,000)	(3,280,000)
Unrecognized net actuarial loss (gain)	<u>(12,600,000)</u>	<u>(12,650,000)</u>	<u>(12,620,000)</u>	<u>(12,610,000)</u>	<u>(12,610,000)</u>	<u>(12,610,000)</u>	<u>(12,600,000)</u>
Net amount recognized (accrued)	<u>31,200,000</u>	<u>37,660,000</u>	<u>44,540,000</u>	<u>51,690,000</u>	<u>59,100,000</u>	<u>66,780,000</u>	<u>74,820,000</u>
Amounts recognized in the statement of financial position consist of:							
Prepaid benefit cost	31,200,000	37,660,000	44,540,000	51,690,000	59,100,000	66,780,000	74,820,000
Accrued benefit liability	0	0	0	0	0	0	0
Intangible asset	0	0	0	0	0	0	0
Accumulated other comprehensive income	0	0	0	0	0	0	0
Net amount recognized	<u>31,200,000</u>	<u>37,660,000</u>	<u>44,540,000</u>	<u>51,690,000</u>	<u>59,100,000</u>	<u>66,780,000</u>	<u>74,820,000</u>

1/24/2006

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Duquesne Light Holdings, Inc.
Projected FAS 132 Disclosure Items and Fiscal Year Expense

	<u>Supplemental Pension Plan</u>						
	<u>Estimated 2005</u>	<u>Estimated 2006</u>	<u>Estimated 2007</u>	<u>Estimated 2008</u>	<u>Estimated 2009</u>	<u>Estimated 2010</u>	<u>Estimated 2011</u>
Weighted-average assumptions as of December 31							
Discount rate	5.70%	5.70%	5.70%	5.70%	5.70%	5.70%	5.70%
Expected return on plan assets	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%
Rate of compensation increase	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%
Assumed Actual return on assets	6.90%	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%
Components of net benefit cost							
Service cost	\$ 950,000	\$ 760,000	\$ 790,000	\$ 830,000	\$ 860,000	\$ 890,000	\$ 930,000
Interest cost	3,790,000	3,750,000	3,810,000	3,860,000	3,910,000	3,970,000	4,020,000
Expected return on plan assets	(8,720,000)	(9,510,000)	(10,070,000)	(10,560,000)	(11,110,000)	(11,700,000)	(12,310,000)
Amortization of unrecognized net transition obligation	0	0	0	0	0	0	0
Amortization of prior service cost	(1,000,000)	(1,460,000)	(1,400,000)	(1,260,000)	(1,080,000)	(850,000)	(670,000)
Recognized net actuarial loss (gain)	(100,000)	0	(10,000)	0	0	0	0
Net periodic benefit cost	<u>(5,080,000)</u>	<u>(6,460,000)</u>	<u>(6,880,000)</u>	<u>(7,130,000)</u>	<u>(7,420,000)</u>	<u>(7,690,000)</u>	<u>(8,030,000)</u>
Curtailment cost	0	0	0	0	0	0	0
Settlement cost	0	0	0	0	0	0	0
Purchase Accounting Charge	0	0	0	0	0	0	0
Net benefit cost	<u>(5,080,000)</u>	<u>(6,460,000)</u>	<u>(6,880,000)</u>	<u>(7,130,000)</u>	<u>(7,420,000)</u>	<u>(7,690,000)</u>	<u>(8,030,000)</u>
Other year-end financial information							
Market related value of assets	120,670,000	127,630,000	133,840,000	140,730,000	148,090,000	155,830,000	163,960,000
Accumulated benefit obligation	58,830,000	60,830,000	62,980,000	65,270,000	67,740,000	70,240,000	71,780,000

1/24/2006

Duquesne Light Retirement Pension Plan
Funding Valuation Estimates - Contributions to equal to the greater of the amount required to avoid a funding deficiency or \$20 million

	<u>1/1/2005</u>	<u>1/1/2006</u>	<u>1/1/2007</u>	<u>1/1/2008</u>	<u>1/1/2009</u>	<u>1/1/2010</u>	<u>1/1/2011</u>
(1) Actuarial Accrued Liability	\$ 539,493,700	\$ 562,166,809	\$ 580,566,629	\$ 598,304,997	\$ 615,536,973	\$ 632,647,992	\$ 647,409,619
(2) Valuation Assets	<u>561,075,800</u>	<u>576,615,000</u>	<u>597,781,500</u>	<u>630,380,600</u>	<u>675,586,800</u>	<u>711,623,400</u>	<u>744,951,200</u>
(3) Unfunded (Overfunded)	(21,582,100)	(14,448,192)	(17,214,871)	(32,075,603)	(60,049,827)	(78,975,408)	(97,541,581)
(4) % Funded	104.0%	102.6%	103.0%	105.4%	109.8%	112.5%	115.1%
(5) Gateway Current Liability	658,144,300	694,740,586	737,608,445	751,990,353	765,324,393	777,969,663	788,628,261
(6) Valuation Assets	<u>561,075,800</u>	<u>576,615,000</u>	<u>597,781,500</u>	<u>630,380,600</u>	<u>675,586,800</u>	<u>711,623,400</u>	<u>744,951,200</u>
(7) Unfunded (Overfunded)	97,068,500	118,125,586	139,826,945	121,609,753	89,737,593	66,346,263	43,677,061
(8) % Funded	85.3%	83.0%	81.0%	83.8%	88.3%	91.5%	94.5%
(9) Market Value of Assets	630,887,300	658,446,700	693,724,948	730,228,730	767,786,206	806,427,347	845,401,940
(10) Gateway Current Liability % Funded - MVA basis	95.9%	94.8%	94.1%	97.1%	100.3%	103.7%	107.2%
Minimum required contribution (end of year):							
(11) Total before reflecting credit balance	39,148,536	43,786,686	125,311,676	84,394,749	19,901,462	5,912,243	7,284,079
(12) Credit Balance	218,782,400	218,230,368	212,993,263	125,786,014	72,083,076	78,308,675	99,052,669
(13) Total after reflecting credit balance	0	0	0	0	0	0	0
Other Items:							
(14) Maximum Contribution	240,719,623	236,459,337	228,606,826	208,058,382	173,271,449	146,456,019	120,919,557
(15) Actual Calendar Year Contribution	32,071,720	20,000,000	20,000,000	20,000,000	20,000,000	20,000,000	20,000,000
(16) Normal cost (end of year)	5,355,560	7,453,804	6,773,479	6,570,515	6,845,388	6,835,648	6,901,074
(17) Expected benefit payments	34,739,200	35,959,152	37,494,418	39,289,224	41,136,259	43,788,107	46,712,077
(18) Additional Funding Requirement	0	0	78,121,595	42,368,871	16,055,980	0	0
(19) Funding / AAL interest rate	8.50%	8.50%	8.50%	8.50%	8.50%	8.50%	8.50%
(20) Current Liability interest rate for minimum contribution purposes	6.10%	5.82%	5.50%	5.50%	5.50%	5.50%	5.50%
(21) Current Liability interest rate for maximum contribution purposes	4.59%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%
Assumptions:							
(22) Assets earn 8.00% after 2005.							
(23) Other experience in accordance with assumptions for actuarial valuation.							
(24) Contributions are assumed to be made on the first day of the calendar year.							

Docket No. R-00061346
Surrebuttal Testimony of Lafayette K. Morgan, Jr.
Appendix C

Duquesne Light Company
Docket No. R-00061346

OCA-IV-49
Rich Sieber
Page 1 of 1

Office of Consumer Advocate
Interrogatories Set IV

49. Please provide copies of the advertisements whose costs appear on Attachment II-D-7(d).

Response: Attached are:

- a. Ads placed in local newspapers;
- b. Ads used primarily in magazines;
- c. Bus transit shelter ads;
- d. Post cards distributed at events, and
- e. DVD of three television spots.

BRINGING NEW ENERGY TO PITTSBURGH.



There's a new energy coming to Pittsburgh. The kind of energy that can help propel this region, and the people who live here, well into the 21st century.

Over the next few years, Duquesne Light is making one of the largest investments southwestern Pennsylvania has ever seen.

An upgrade of this region's electrical infrastructure totaling more than \$500 million, that will ensure all of our customers are connected to a secure, safe and reliable source of electricity. An investment that also is creating new jobs for our community.

All of which will bring a new energy to Pittsburgh and its surrounding communities. To our downtown and shoreline developments. To our universities and medical centers. To our businesses and cultural institutions. To our neighborhoods, schools and homes. And to the people who use that energy to innovate and create, heal and inspire. That's the future of Pittsburgh. And it's looking brighter than ever.

 **Duquesne Light**
Our Energy...Your Power®



BRINGING NEW ENERGY TO PITTSBURGH.

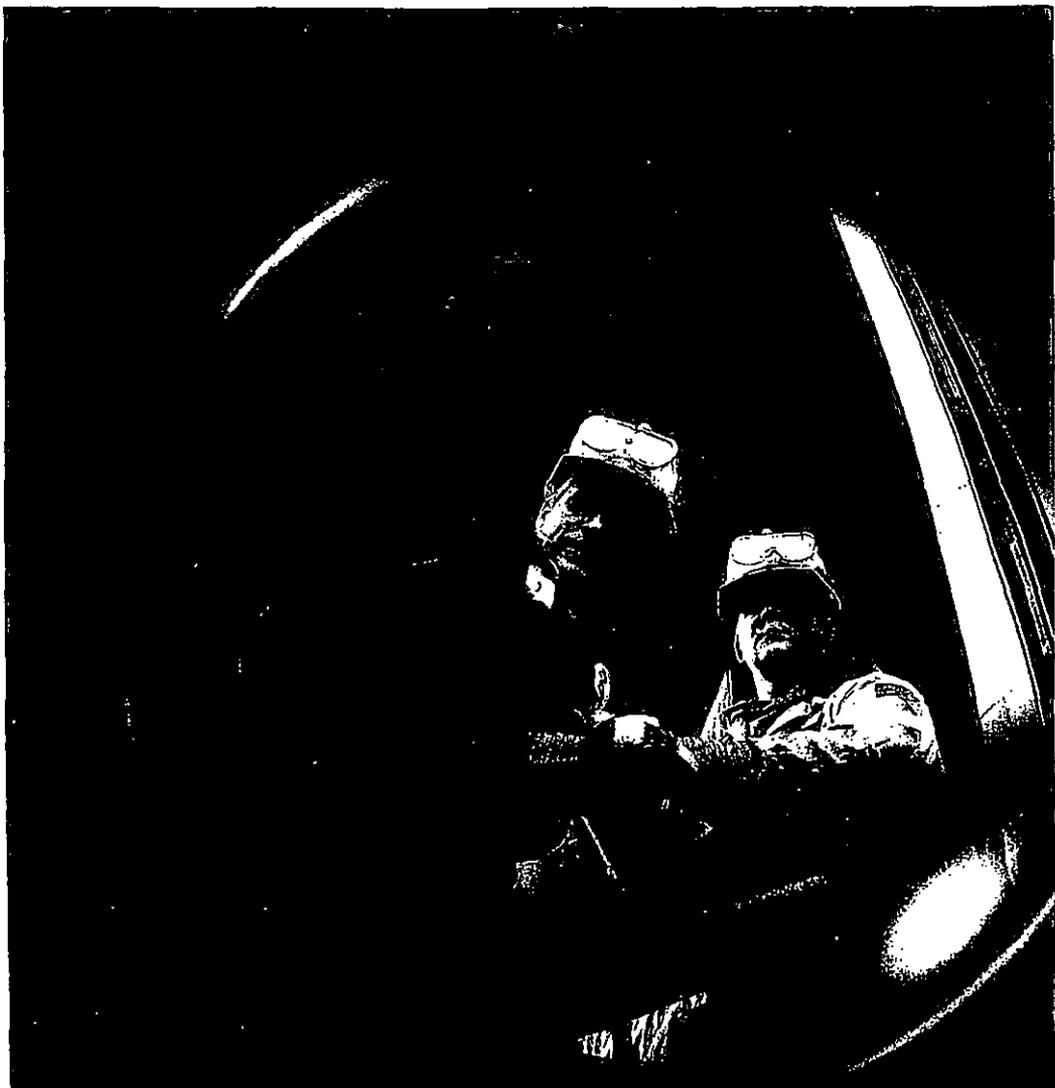
There's a new energy coming to Pittsburgh. The kind of energy that can help propel this region, and the people who live here, well into the 21st century. Over the next few years, Duquesne Light is making one of the largest investments southwestern Pennsylvania has ever seen.

An upgrade of this region's electrical infrastructure totaling more than \$500 million, that will ensure all of our customers are connected to a secure, safe and reliable source of electricity. An investment that also is creating new jobs for our community.

All of which will bring a new energy to Pittsburgh and its surrounding communities. To our downtown and shoreline developments. To our universities and medical centers. To our businesses and cultural institutions. To our neighborhoods, schools and homes. And to the people who use that energy to innovate and create, heat and inspire.

That's the future of Pittsburgh. And it's looking brighter than ever.

 **Duquesne Light**
Our Energy...Your Power®



BRINGING NEW ENERGY TO DOWNTOWN.

We are making a significant investment to upgrade the electric infrastructure here, ensuring the Golden Triangle is connected to a safe and reliable source of energy for generations to come.

Duquesne Light

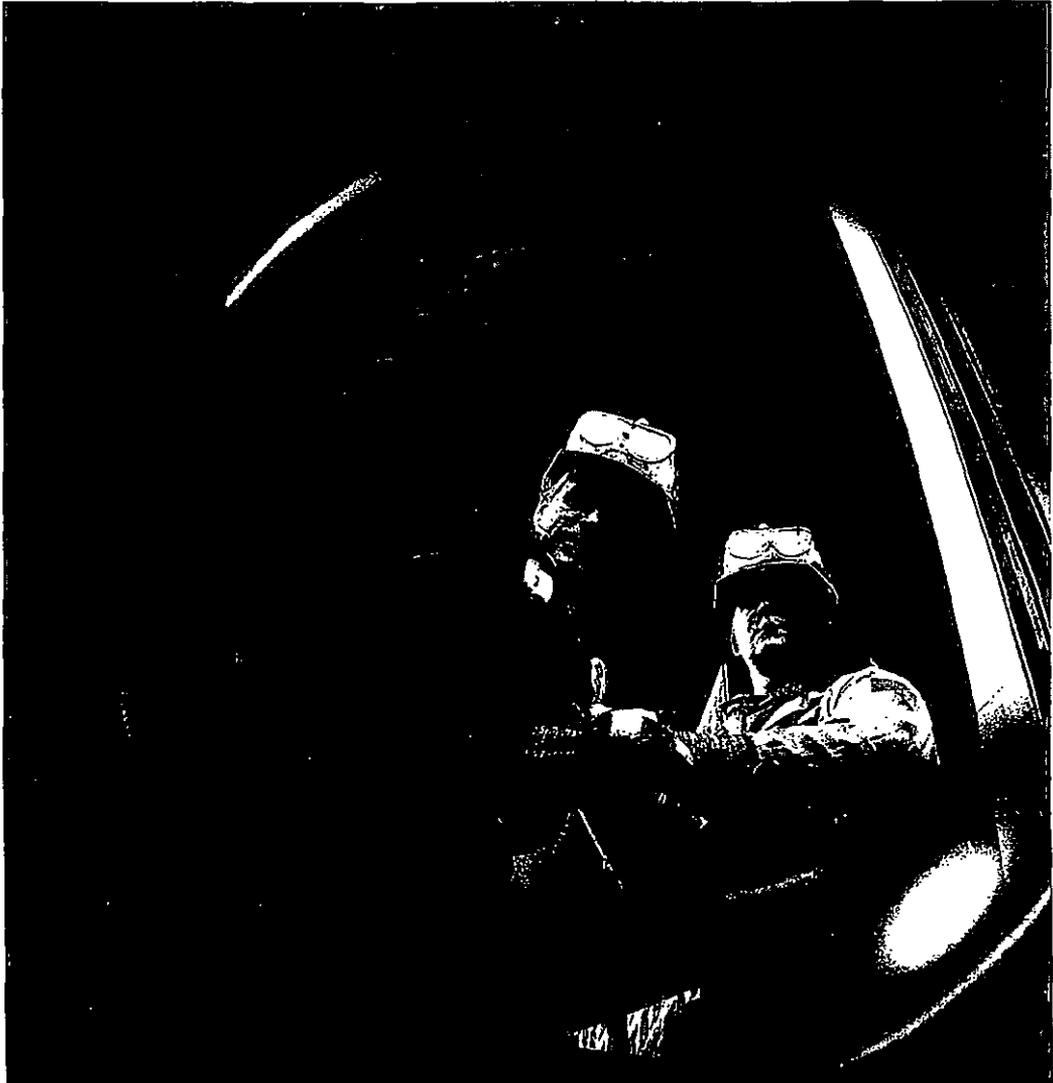
"Our Energy...Your Power."



BRINGING NEW ENERGY TO OAKLAND.

We are making a significant investment to upgrade the electric infrastructure here, ensuring the people, hospitals and universities have a safe and reliable source of energy for generations to come.

Duquesne Light
Our Energy..Your Power



BRINGING NEW ENERGY TO PITTSBURGH.

We are upgrading the region's electric infrastructure with an investment of more than \$500 million to ensure a safe and reliable source of energy for generations to come.

Duquesne Light
Our Energy...Your Power

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission

v.

Duquesne Light Company

:
:
:
:
:

Docket No. R-00061346

SCHEDULES ACCOMPANYING THE
SURREBUTTAL TESTIMONY OF
LAFAYETTE K. MORGAN, JR.

ON BEHALF OF THE
OFFICE OF CONSUMER ADVOCATE

AUGUST 2006

EXETER

ASSOCIATES, INC.
5565 Sterrett Place
Suite 310
Columbia, Maryland 21044

DUQUESNE LIGHT COMPANY

Summary of Operating Income
 For the Test Year Ended December 31, 2006
 (\$000)

	PAPUC Jurisdictional Amount per Co.	OCA Cost of Service Adjustments	Amount After Adjustments	OCA Recommended Change in Revenue	After Proposed Rate Increase
Operating Revenues					
Sales Revenues	\$ 279,955	\$ -	\$ 279,955	\$ 90,122	\$ 370,077
Sales for Resale	-	-	-	\$ -	-
Other Operating Revenue	14,282	-	14,282	-	14,282
Total Operating Revenues	\$ 294,237	\$ -	\$ 294,237	\$ 90,122	\$ 384,359
Operating Expenses					
O&M Expenses	\$ 162,769	\$ (12,875)	\$ 149,894	\$ 964	\$ 150,858
Depreciation Expense	63,532	(1,490)	62,042	-	62,042
Amortization Expense	2,871	-	2,871	-	2,871
Taxes Other Than Income	24,602	(313)	24,289	5,317	29,606
Total Operating Expenses	\$ 253,774	\$ (14,678)	\$ 239,096	\$ 6,281	\$ 245,377
Income Taxes					
State Income Tax	(793)	1,029	236	8,376	8,612
Current Federal Income Tax	(2,500)	3,247	747	26,413	27,160
Deferred Federal Income Tax	10,087	-	10,087	-	10,087
ITC Amortization	(1,142)	-	(1,142)	-	(1,142)
Consolidated Tax Adjustment	(753)	-	(753)	-	(753)
Total Federal Income Tax	5,692	3,247	8,939	26,413	35,352
Total Operating Expenses	\$ 258,673	\$ (10,402)	\$ 248,271	\$ 41,070	\$ 289,341
Net Operating Income	\$ 35,564	\$ 10,402	\$ 45,966	\$ 49,052	\$ 95,018
Rate Base	\$ 1,230,317		\$ 1,210,419		\$ 1,210,419
Return On Rate Base	2.89%		3.80%		7.85%

DUQUESNE LIGHT COMPANY

Summary of Revenue Increase at OCA Rate of Return
 For the Test Year Ended December 31, 2006
 (\$000)

		<u>Amount</u>	
Adjusted Rate Base		\$ 1,210,419	Schedule LKM-2S, Page 2
Required Rate of Return		<u>7.850%</u>	
Net Operating Income Required		\$ 95,018	
Net Operating Income at Present Rates		<u>45,966</u>	Schedule LKM-1S, Page 1
Income Deficiency/(Surplus)		\$ 49,052	
Revenue Multiplier		<u>1.83727</u>	
Required Change in Company Revenue		<u>\$ 90,122</u>	
Proposed Revenue Change		\$ 90,122	
Uncollectibles	1.0700%	964	
Gross Revenues Tax	5.900%	<u>5,317</u>	
Subtotal		\$ 83,841	
State Income Tax	9.990%	<u>8,376</u>	
Subtotal		\$ 75,465	
Federal Income Tax	35.00%	<u>26,413</u>	
Net Income Increase Required		<u>\$ 49,052</u>	

DUQUESNE LIGHT COMPANY

Summary of Rate Base
For the Test Year Ended December 31, 2006
(\$000)

	PAPUC Jurisdictional Amount per Co.	OCA Rate Base Adjustments	Amount After Adjustments
Total Plant in Service	\$ 1,930,872	\$ (13,853)	\$ 1,917,019
Depreciation Reserve	<u>(613,163)</u>	<u>1,490</u>	<u>(611,673)</u>
Net Plant in Service	\$ 1,317,709	\$ (12,363)	\$ 1,305,346
Working Capital Requirements			
Cash Working Capital	\$ 47,633	\$ (5,154)	\$ 42,479
Materials & Supplies	11,296	-	11,296
Total Working Capital Requirements	<u>58,929</u>	<u>(5,154)</u>	<u>53,775</u>
Deductions			
Customer Deposits	(1,500)	-	(1,500)
Settlement Reserve	-	(2,381)	(2,381)
Accumulated Deferred Income Taxes	(144,821)	-	(144,821)
Total Deductions	<u>(146,321)</u>	<u>(2,381)</u>	<u>(148,702)</u>
Total Rate Base	<u>\$ 1,230,317</u>	<u>\$ (19,898)</u>	<u>\$ 1,210,419</u>

DUQUESNE LIGHT COMPANY

Summary of Rate Base Adjustments
For the Test Year Ended December 31, 2006
(\$000)

	<u>Source</u>	PAPUC Jurisdictional Amount per Co.
Rate Base per Company Filing	Schedule LKM-2S, Page 1	\$ 1,230,317
<u>OCA Adjustments:</u>		
Plant in Service	Schedule LKM-4S	\$ (12,363)
Materials & Supplies	Schedule LKM-5S	-
Customer Deposits	Schedule LKM-6S	-
Cash Working Capital	Schedule LKM-7S	(5,154)
Non-Operational Settlement Damage Reserve	Schedule LKM-8S	(2,381)
Total Ratemaking Adjustments		\$ (19,898)
Adjusted Rate Base per OCA		\$ 1,210,419

DUQUESNE LIGHT COMPANY

Summary of Adjustments to Net Income
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>
Net Income per Company	<u>\$ 35,564</u>
<u>OCA Adjustments:</u>	
Remove Pension Contribution Expense	\$ 4,882
Remove 2006 Payroll Increase	1,832
Remove 2006 Employee Benefits Increase	187
Remove Additional 401-K Expense	195
Remove One-Time SFAS 123R Costs	-
Remove Image Advertising	236
Remove Increase in Company Use Energy	-
Normalize Rate Case Expense	248
Remove Storm Normalization Increase	121
Normalize Depreciation Expense	872
Remove Utilities Expense Increase	-
Remove Lobbying from Association Dues	-
Remove Expiring Leases	-
Normalize PURTA	15
Normalize Miscellaneous Revenues	-
Interest Synchronization	<u>1,814</u>
Total Ratemaking Adjustments	<u>\$ 10,402</u>
Total Adjusted Net Income per OCA	<u><u>\$ 45,966</u></u>

DUQUESNE LIGHT COMPANY

Summary of Adjustments to Net Income
 For the Test Year Ended December 31, 2006
 (\$000)

	Operating Revenues	O&M Expenses	Depreciation Expense	Amortization Expense	Taxes Other Than Income	State Income Taxes	Federal Income Tax	Net Operating Income
Amount per Company	\$ 294,237	\$ 162,769	\$ 63,532	\$ 2,871	\$ 24,602	\$ (793)	\$ 5,692	\$ 35,564
<u>OCA Adjustments:</u>								
Remove Pension Contribution Expense	\$ -	\$ (8,344)	\$ -	\$ -	\$ -	\$ 834	\$ 2,629	\$ 4,882
Remove 2006 Payroll Increase	-	(2,844)	-	-	(287)	313	987	1,832
Remove 2006 Employee Benefits Increase	-	(319)	-	-	-	32	101	187
Remove Additional 401-K Expense	-	(334)	-	-	-	33	105	195
Remove One-Time SFAS 123R Costs	-	-	-	-	-	-	-	-
Remove Image Advertising	-	(403)	-	-	-	40	127	236
Remove Increase in Company Use Energy	-	-	-	-	-	-	-	-
Normalize Rate Case Expense	-	(424)	-	-	-	42	134	248
Remove Storm Normalization Increase	-	(207)	-	-	-	21	65	121
Normalize Depreciation Expense	-	-	(1,490)	-	-	149	469	872
Remove Utilities Expense Increase	-	-	-	-	-	-	-	-
Remove Lobbying from Association Dues	-	-	-	-	-	-	-	-
Remove Expiring Leases	-	-	-	-	-	-	-	-
Normalize PURTA	-	-	-	-	(26)	3	8	15
Normalize Miscellaneous Revenues	-	-	-	-	-	-	-	-
Interest Synchronization	-	-	-	-	-	(437)	(1,377)	1,814
Total Ratemaking Adjustments	\$ -	\$ (12,875)	\$ (1,490)	\$ -	\$ (313)	\$ 1,029	\$ 3,247	\$ 10,402
Total Adjusted Income	\$ 294,237	\$ 149,894	\$ 62,042	\$ 2,871	\$ 24,289	\$ 236	\$ 8,939	\$ 45,966

DUQUESNE LIGHT COMPANY

Adjustment to Plant In Service
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>	
Adjusted Plant in Service	\$ 2,356,423	1/
PA Jurisdictional Allocation Factor	<u>81.35%</u>	2/
PA Jurisdictional Plant in Service per OCA	\$ 1,917,019	
PA Jurisdictional Plant in Service per Company	<u>1,930,872</u>	2/
Adjustment to Plant in Service	<u>\$ (13,853)</u>	

Notes:

1/ Schedule LKM-4S, Page 2.

2/ DLC Exhibit 2, Schedule C-1.

DUQUESNE LIGHT COMPANY

Calculation of Adjusted Plant In Service
 For the Test Year Ended December 31, 2006
 (\$000)

	Account No.	2006 Amount Per Company	1/ Remove Budget Variances	2/ Remove Payroll Adjustment	1/ Remove Additional 401-K	1/ Adjusted 2006 Amount
Intangible Plant						
Organization	301	\$ 100	\$ -	\$ -	\$ -	\$ 100
Franchise & Consents	302	7	-	-	-	7
Software	303	29,716	-	162	7	29,547
Total Intangible Plant		<u>29,823</u>	<u>-</u>	<u>162</u>	<u>7</u>	<u>29,654</u>
Transmission Plant						
Land & Land Rights	350	11,035	37	-	-	10,998
Structures & Improvements	352	7,637	25	6	-	7,606
Station Equipment	353	184,824	616	1,425	65	182,718
Towers & Fixtures	354	69,209	231	229	10	68,739
Poles & Fixtures	355	10,066	34	30	1	10,001
Overhead Conductors & Devices	356	43,871	146	50	2	43,673
Underground Conduit	357	55,965	186	649	30	55,100
Underground Conduit & Devices	358	38,767	129	650	30	37,958
Roads & Trails	359	4	0	-	-	4
Total Transmission Plant		<u>421,378</u>	<u>1,404</u>	<u>3,039</u>	<u>138</u>	<u>416,797</u>
Distribution Plant						
Land & Land Rights	360	9,962	33	-	-	9,929
Structures & Improvements	361	47,272	158	-	-	47,114
Station Equipment	362	299,299	997	1,481	68	296,753
Poles, Towers & Fixtures	364	291,340	971	383	17	289,969
Overhead Conductors & Devices	365	301,038	1,003	874	40	299,121
Underground Conduit	366	99,255	331	296	14	98,614
Underground Conduit & Devices	367	190,267	634	135	6	189,492
Line Transformers	368	231,667	772	910	41	229,944
OH & UND Services	369	74,258	247	10	-	74,001
Meters & Appurtenances	370	76,192	254	139	6	75,793
Meter Communication Equipment	370.1	33,237	111	-	-	33,126
Street Lighting	373	32,723	109	17	2	32,595
Total Distribution Plant		<u>1,686,510</u>	<u>5,619</u>	<u>4,245</u>	<u>194</u>	<u>1,676,452</u>
General Plant						
Land & Land Rights	389	5,859	20	-	-	5,839
Structures & Improvements	390	90,728	302	774	35	89,617
Office Equipment	391	14,148	47	-	-	14,101
Transportation Equipment	392	44,982	150	180	8	44,644
Stores Equipment	393	1,883	6	-	-	1,877
Tools, Shop & Garage Equipment	394	10,022	33	26	2	9,961
Laboratory Equipment	395	4,841	16	-	-	4,825
Power Operated Equipment	396	1,016	3	-	-	1,013
Communication Equipment	397	61,777	206	393	18	61,160
Miscellaneous Equipment	398	486	2	-	-	484
Total General Plant		<u>235,742</u>	<u>785</u>	<u>1,373</u>	<u>63</u>	<u>233,521</u>
Total Electric Plant in Service		<u>\$ 2,373,453</u>	<u>\$ 7,809</u>	<u>\$ 8,819</u>	<u>\$ 402</u>	<u>\$ 2,356,423</u>

Notes:

1/ DLC Exhibit 2, Schedule C-2.

2/ Total amount per response to OCA IV-9 and pro rated based budgeted amount excluding intangible plant.

DUQUESNE LIGHT COMPANY

Adjustment to Normalize Materials and Supplies
For the Test Year Ended December 31, 2006
(\$000)

	<u>PAPUC Jurisdictional Amount</u>
HTY Average Materials & Supplies Balance	\$ - 1/
Allocation Factor	<u>64.9% 2/</u>
PA Jurisdictional Amount	\$ -
FTY Average Materials & Supplies Balance	<u>- 3/</u>
Adjustment to Rate Base	<u><u>\$ -</u></u>

Notes:

1/ DLC Exhibit 3, Schedule C-5.

2/ DLC Exhibit 2, Schedule C-5.

3/ DLC Exhibit 2, Schedule C-1.

DUQUESNE LIGHT COMPANY

Adjustment to Normalize Customer Deposits
For the Test Year Ended December 31, 2006
(\$000)

	PAPUC Jurisdictional Amount
HTY Average Customer Deposits Balance	\$ 1,413 1/
FTY Average Materials & Supplies Balance	<u>1,413 2/</u>
Adjustment to Rate Base	<u>\$ -</u>

Notes:

- 1/ DLC Exhibit 3, Schedule B-1, Page 2.
- 2/ DLC Exhibit 2, Schedule B-1, Page 2.

DUQUESNE LIGHT COMPANY

Adjustment to Allowance for Cash Working Capital
 For the Test Year Ended December 31, 2006
 (\$000)

	<u>Amount Per Company</u> 1/	<u>OCA Adjustment</u>	<u>Adjusted Amount</u>	<u>Lag Days</u>	<u>Dollar Days</u>	<u>Weighted Lags</u>
Revenue Lag Days						53.97
<u>Expenses</u>						
Payroll	\$ 58,156	\$ (2,915) 2/	\$ 55,241	10.72	\$ 592,180	
Pension Expense	10,052	(8,911)	1,141	(151.00)	(172,291)	
Purchased Power	358,515	-	358,515	35.00	12,548,025	
Other Expenses	77,574	(1,788) 3/	75,786	45.26 4/	3,430,437	
			\$ 490,683		\$ 16,398,351	33.42
Net (Lead)/Lag Days						20.55
Daily Operating Expenses						\$ 1,344
O&M Working Capital						\$ 27,627
Average Prepayments						4,200
Accrued Taxes						16,467
Interest Payments						(4,635)
Preferred Dividends Payments						169
Total Working Capital Requirement						\$ 43,828
PA Jurisdictional Allocation Factor						96.92%
Cash Working Capital Allowance per OCA						\$ 42,479
Cash Working Capital Allowance per Company						47,633
Adjustment to Cash Working Capital Allowance						\$ (5,154)

Notes:

1/ DLC Exhibit 2R, Schedule C-4, Revised 8-2-06.

2/ Schedule LKM-9, Page 1.

3/ -\$341 (Sch. LKM-11S)-\$357 (Sch.LKM-12S)-\$431 (Sch. LKM-14S)-\$453 (Sch.LKM-16S)-\$207 (Sch.LKM-18S).

4/ Schedule LKM-7, page 2.

DUQUESNE LIGHT COMPANY
Calculation of Other Expense Lag
For the Test Year Ended December 31, 2006
(\$000)

	<u>Payment Amount</u> 1/	<u>Lag Days</u>	<u>Dollar Days</u> 1/
June 2004	\$ 3,794,465		\$ 175,270,008
October 2004	3,485,560		145,833,304
February 2005	4,159,932		202,179,892
April 2005	<u>3,676,084</u>		<u>160,937,767</u>
Total	\$ 15,116,041		\$ 684,220,971
Weighted Lag Days		<u>45.26</u>	

Notes:

1/ Company witness Robert L. O'Brien Rebuttal Schedule RLO-7.

DUQUESNE LIGHT COMPANY

Adjustment to Include Non-Operational Settlement Claims Reserve in Rate Base
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>
Non-Operational Settlement Claims Reserve	\$ 2,543 1/
PA Jurisdictional Allocation Factor	<u>93.64% 2/</u>
Total Adjustment to O&M Expense	<u>\$ 2,381</u>

Notes:

1/ Response to OCA VIII-6.

2/ Calculated based on data presented on DLC Exhibit 2, Schedule D-4, Page 2, Line 80.

DUQUESNE LIGHT COMPANY

Adjustment to Annualize Payroll Expense
 For the Test Year Ended December 31, 2006
 (\$000)

	<u>Amount</u>
Adjusted 2005 Payroll Expense	\$ 58,158 1/
Incentive Compensation	<u>\$ (2,915) 2/</u>
OCA Payroll Expense	\$ 55,243
Company Adjusted 2006 Payroll Expense	<u>58,158</u>
Adjustment to Payroll Expense	\$ (2,915)
PA Jurisdictional Allocation Factor	<u>97.57% 3/</u>
Total Adjustment to O&M Expense	<u><u>\$ (2,844)</u></u>
FICA Taxes	\$ (235)
FUTA	\$ (3)
SUTA	\$ (28)
City of Pittsburgh Payroll Tax	\$ (22)

Notes:

1/ DLC Exhibit 2R, Schedule D-7, Page1.

2/ Schedule LKM-9, Page 2.

3/ Calculated based on data presented on DLC Exhibit 2, Schedule D-4, Page 2, Line 85.

DUQUESNE LIGHT COMPANY

Calculation of Adjustment to Remove Incentive Compensation Expense
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>
Three Year Average Incentive Compensation Portion Associated with Earnings	\$ 4,427 1/ <u>50%</u>
Incentive Compensation Eligible for Recovery 2006 Budgeted Incentive Compensation per Company	\$ 2,214 <u>5,129 2/</u>
Adjustment to Incentive Compensation PA Jurisdictional Allocation Factor	\$ (2,915) <u>97.57% 3/</u>
Total Adjustment to O&M Expense	<u>\$ (2,844)</u>

Notes:

1/ Response to OCA-IV-80.

2/ Response to OCA-IV-1, Page 2.

3/ Calculated based on data presented on DLC Exhibit 2, Schedule D-4, Page 2, Line 85.

DUQUESNE LIGHT COMPANY

Adjustment to Remove Projected Contributions to Pension Expense
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>
Company Adjustment to Pension Expense	\$ 8,911 1/
PA Jurisdictional Allocation Factor	<u>93.64% 2/</u>
Total Adjustment to O&M Expense	<u>\$ (8,344)</u>

Notes:

1/ DLC Exhibit 2, Schedule D-9, Page1.

2/ Calculated based on data presented on DLC Exhibit 2, Schedule D-4, Page 2, Line 77.

DUQUESNE LIGHT COMPANY

Adjustment to Remove Employee Benefits Expense Related to Increased Employees
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>
OCA Adjustment to Payroll	\$ (2,915) 1/
Benefits/Payroll Ratio	<u>11.69% 2/</u>
Adjustment to Employee Benefits	\$ (341)
PA Jurisdictional Allocation Factor	<u>93.64% 3/</u>
Total Adjustment to O&M Expense	<u><u>\$ (319)</u></u>

Notes:

1/ Schedule LKM-17.

2/ Company witness Susan Betta Rebuttal Exhibit SSB-10.

3/ Calculated based on data presented on DLC Exhibit 2, Schedule D-4, Page 2, Line 77.

DUQUESNE LIGHT COMPANY

Adjustment to Remove Additional 401-K Matching
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>
Company Adjustment to Employee Benefits Expense	\$ 357 1/
PA Jurisdictional Allocation Factor	<u>93.45% 2/</u>
Total Adjustment to O&M Expense:	<u><u>\$ (334)</u></u>

Notes:

1/ DLC Exhibit 2, Schedule D-12, Page1.

2/ Calculated based on data presented on DLC Exhibit 2, Schedule D-4, Page 2, Line 84.

DUQUESNE LIGHT COMPANY

Adjustment to Remove One-Time Costs Associated With SFAS 123R
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>
Company Adjustment to Employee Benefits Expense	\$ - 1/
PA Jurisdictional Allocation Factor	<u>93.45% 2/</u>
Total Adjustment to O&M Expense	<u><u>\$ -</u></u>

Notes:

1/ Company Response to OCA V-8.

2/ Calculated based on data presented on DLC Exhibit 2, Schedule D-4, Page 2, Line 84.

DUQUESNE LIGHT COMPANY

Adjustment to Remove Advertising Expenses
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>
Informational Advertising	\$ 861 1/
Disallowance Percentage	<u>50.00%</u>
Adjustment to Advertising Expense	\$ (431)
PA Jurisdictional Allocation Factor	<u>93.67% 2/</u>
Total Adjustment to O&M Expense	<u><u>\$ (403)</u></u>

Notes:

1/ Company witness Susan Betta Rebuttal Exhibit SSB-15.

2/ Calculated based on data presented on DLC Exhibit 2, Schedule D-4, Page 2, Line 79.

DUQUESNE LIGHT COMPANY

Adjustment to Normalize Company Use Energy Expense
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>
Remove Weather-Related Energy Consumption	\$ - 1/
Remove Energy Related to Additional Building	<u>- 1/</u>
Adjustment to Company Use Energy Expense	\$ -
PA Jurisdictional Allocation Factor	<u>93.45% 2/</u>
Total Adjustment to O&M Expense	<u><u>\$ -</u></u>

Notes:

1/ Response to OCA-V-6, Page 1.

2/ Calculated based on data presented on DLC Exhibit 2, Schedule D-4, Page 2, Line 84.

DUQUESNE LIGHT COMPANY

Adjustment to Normalize Rate Case Expenses
 For the Test Year Ended December 31, 2006
 (\$000)

		<u>Amount</u>
Actual Total Costs Incurred Through 5/31/2006		\$ 2,348 1/
Company Revised Estimated Cost of Rate Case	\$ 4,904 2/	
Actual Total Costs Incurred Through 5/31/2006	<u>2,348 1/</u>	
Total Remaining Cost to Complete	2,556	
Less: Preparation of Filing	(325) 3/	
Post Filing Preparation	(425) 3/	
Project Management	(200) 3/	
Strategy & Planning	<u>(200) 3/</u>	
Remaining Cost to Complete	(1,150)	<u>1,406</u>
Total Rate Case Expenses Subject to Recovery Normalization Period (Years)		\$ 3,754 <u>3</u>
Normalized Rate Case Expenses per OCA		\$ 1,251
Normalized Rate Case Expenses per Company		<u>1,704 4/</u>
Adjustment to Rate Case Expenses		\$ (453)
PA Jurisdictional Allocation Factor		<u>93.64% 5/</u>
Adjustment to O&M Expenses		<u><u>\$ (424)</u></u>

Notes:

1/ Response to OCA-V-9.

2/ Response to OTS-RE-7-D.

3/ Response to OCA-XII-1.

4/ DLC Exhibit 2, Schedule D-8.

5/ Company witness Robert L. O'Brien Rebuttal Testimony, Page 16, Line 21.

DUQUESNE LIGHT COMPANY

Adjustment to Remove Incentive Compensation Expense
For the Test Year Ended December 31, 2006
(\$000)

Schedule re-numbered as Schedule LKM-9, Page 2.

DUQUESNE LIGHT COMPANY

Adjustment to Remove Storm Restoration Normalization Costs
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>
2003 - 2005 Average Storm Damage Expense	492 1/
Storm Damage Expense per Company	<u>699 2/</u>
Adjustment to Storm Damage Costs	\$ (207)
PA Jurisdictional Allocation Factor	<u>99.98% 3/</u>
Total Adjustment to O&M Expense	<u><u>\$ (207)</u></u>

Notes:

1/ Company witness Susan Betta Rebuttal Exhibit SSB-14.

2/ DLC Exhibit 2R, Schedule D-13, Revised 8-2-06.

3/ Calculated based on data presented on DLC Exhibit 2, Schedule D-4, Page 2, Line 54.

DUQUESNE LIGHT COMPANY

Adjustment to Depreciation Expense
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>	
Annual Depreciation Expense per OCA	\$ 72,990	1/
PA Jurisdictional Allocation Factor	<u>84.16%</u>	2/
PA Jurisdictional Annual Depreciation Expense per OCA	\$ 61,427	
PA Jurisdictional Annual Depreciation Expense per Company	<u>62,917</u>	2/
Adjustment to Depreciation Expense	<u>\$ (1,490)</u>	
Adjustment to Accumulated Depreciation	<u>\$ 1,490</u>	

Notes:

1/ Schedule LKM-20, Page 2.

2/ DLC Exhibit 2, Schedule D-1, Page 2

DUQUESNE LIGHT COMPANY

Calculation of Annual Depreciation Expense
 For the Test Year Ended December 31, 2006
 (\$000)

	Account No.	OCA Plant in Service	1/ Depreciation Rate	2/ Depreciation Expense
Intangible Plant				
Organization	301	\$ 100		\$ -
Franchise & Consents	302	7		-
Software	303	29,547	7.96%	2,352
Total Intangible Plant		<u>29,654</u>		<u>2,352</u>
Transmission Plant				
Land & Land Rights	350	10,998		-
Structures & Improvements	352	7,606	3.36%	256
Station Equipment	353	182,718	2.80%	5,116
Towers & Fixtures	354	68,739	2.24%	1,540
Poles & Fixtures	355	10,001	1.97%	197
Overhead Conductors & Devices	356	43,673	1.81%	790
Underground Conduit	357	55,100	1.97%	1,085
Underground Conduit & Devices	358	37,958	1.40%	531
Roads & Trails	359	4	3.24%	0
Total Transmission Plant		<u>416,797</u>		<u>9,516</u>
Distribution Plant				
Land & Land Rights	360	9,929		-
Structures & Improvements	361	47,114	2.54%	1,197
Station Equipment	362	296,753	2.32%	6,885
Poles, Towers & Fixtures	364	289,969	2.15%	6,234
Overhead Conductors & Devices	365	299,121	2.29%	6,850
Underground Conduit	366	98,614	2.03%	2,002
Underground Conduit & Devices	367	189,492	2.21%	4,188
Line Transformers	368	229,944	2.98%	6,852
OH & UND Services	369	74,001	1.60%	1,184
Meters & Appurtenances	370	75,793	2.80%	2,122
Meter Communication Equipment	370.1	33,126	12.68%	4,200
Street Lighting	373	32,595	2.19%	714
Total Distribution Plant		<u>1,676,452</u>		<u>42,428</u>
General Plant				
Land & Land Rights	389	5,839		-
Structures & Improvements	390	89,617	3.57%	3,199
Office Furniture	391	4,738	21.49%	1,018
Office Equipment	391.2	2,661	5.76%	153
Office Equipment Post 1-1-05	391.2	6,702	20.00%	1,340
Transportation Equipment	392	44,644	6.77%	3,022
Stores Equipment	393	1,877	7.10%	133
Tools, Shop & Garage Equipment	394	8,806	10.06%	886
Tools, Shop & Garage Equipment Post 1-1-05	394	1,155	4.00%	46
Laboratory Equipment	395	4,685	14.19%	665
Laboratory Equipment Post 1-1-05	395	140	5.00%	7
Power Operated Equipment	396	1,013	1.80%	18
Communication Equipment	397	38,420	17.28%	6,639
Communication Equipment 1-1-05	397	22,740	6.67%	1,517
Miscellaneous Equipment	398	484	10.23%	50
Total General Plant		<u>233,521</u>		<u>18,694</u>
Total Electric Plant in Service		<u>\$ 2,356,423</u>		<u>\$ 72,990</u>

Notes:

1/ Schedule LKM-4S, Page 2.

2/ DLC Exhibit 2, Schedule D-17.

DUQUESNE LIGHT COMPANY

Adjustment to Remove Projected Increase Utilities Expense
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>
Company Adjustment to Increase Utilities Expense	\$ - 1/
PA Jurisdictional Allocation Factor	<u>93.64% 2/</u>
Total Adjustment to O&M Expense	<u><u>\$ -</u></u>

Notes:

1/ DLC Exhibit 1, Attachment II-D-7a.

2/ Calculated based on data presented on DLC Exhibit 2, Schedule D-4, Page 2, Line 80.

DUQUESNE LIGHT COMPANY

Adjustment to Remove Lobbying Portion of Association Dues
 For the Test Year Ended December 31, 2006
 (\$000)

	<u>Amount</u>	1/	Disallowed Lobbying Percentage	1/	<u>Disallowed Amount</u>
2006 EEI Dues	\$ 263		25.0%		\$ 66
Energy Association of Pennsylvania	92		10.0%		9
Pennsylvania Chamber of Business & Industry	13		40.0%		5
Pennsylvania Business Roundtable	10		20.0%		2
National Association of Manufacturers	9		100.0%		9
Pittsburg Technology	9		15.0%		<u>1</u>
Total Disallowed Dues per OCA					\$ 93
Total Disallowed Dues per Company					<u>93</u> 2/
Total Adjustment to O&M Expense					<u><u>\$ -</u></u>

Notes:

1/ Response OCA-IV-59.

2/ DLC Exhibit 2R, Schedule D-3, Page 2, Revised 8-2-06.

DUQUESNE LIGHT COMPANY

Adjustment to Remove Expiring Leases
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>
Total Expiring Leases	\$ - 1/
PA Jurisdictional Allocation Factor	<u>93.45% 2/</u>
Total Adjustment to O&M Expense	<u><u>\$ -</u></u>

Notes:

1/ Response to OCA-VIII-2.

2/ Calculated based on data presented on DLC Exhibit 2, Schedule D-4, Page 2, Line 84.

DUQUESNE LIGHT COMPANY

Adjustment to Annualize Public Utility Realty Tax
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>
OCA Adjustment to Plant in Service Tax Rate	\$ (1,057) 1/ <u>3.00% 2/</u>
Adjustment to PURTA	\$ (32)
PA Jurisdictional Allocation Factor	<u>81.35% 3/</u>
Total Adjustment to Taxes Other Than Income	<u>\$ (26)</u>

Notes:

1/ Company witness Robert L. O'Brien Rebuttal Testimony, Page 14, Line 2.

2/ Response to OTS-RE-39.

3/ DLC Exhibit 2, Schedule C-1.

DUQUESNE LIGHT COMPANY

Adjustment to Annualize Miscellaneous Revenues
For the Test Year Ended December 31, 2006
(\$000)

	<u>Amount</u>
HTY Rent from Electric Property	\$ - 1/
FTY Rent from Electric Property	<u>-</u>
Adjustment to Rent from Electric Property	<u>\$ -</u>
HTY Other Electric Revenue	\$ - 2/
FTY Other Electric Revenue	<u>-</u>
Adjustment to Other Electric Revenue	<u>\$ -</u>
Total Adjustment to Miscellaneous Revenues	<u><u>\$ -</u></u>

Notes:

1/ DLC Exhibit 1, Attachment II-D-9.

2/ Calculated based on data presented on DLC Exhibit 2, Schedule D-4, Page 2, Line 80.

DUQUESNE LIGHT COMPANY

Interest Synchronization Adjustment
For the Test Year Ended December 31, 2006

	<u>Amount</u>
Staff Rate Base	\$ 1,210,419
Weighted Cost of Debt	<u>3.38%</u>
<i>Adjusted Interest Deduction</i>	\$ 40,912
Interest Deduction Per Company	<u>36,540</u>
Adjustment to Synchronize Interest Expense	\$ 4,372
Effective State Income Tax Rate	<u>9.99%</u>
Adjustment to State Income Taxes	<u>\$ (437)</u>
Federal Income Tax Base	\$3,935
Federal Income Tax Rate	<u>35.00%</u>
Adjustment to Federal Income Taxes	<u>\$ (1,377)</u>

DUQUESNE LIGHT COMPANY

Reconciliation of State and Federal Income Taxes
 For the Test Year Ended December 31, 2006

	<u>Test Year Per Company</u>	<u>Ratemaking Adjustments</u>	<u>Test Year at Present Rates</u>	<u>Increase at OCA Rate of Return</u>	<u>After Proposed Increase</u>
CALCULATION OF COMBINED CURRENT INCOME TAX					
Net Operating Income Before Income Taxes	\$ 40,463	\$ 14,678	\$ 55,141	\$ 83,841	\$ 138,982
Adjustments for Income Taxes (Including Interest)	<u>(36,540)</u>	<u>(4,372)</u>	<u>(40,912)</u>	<u>-</u>	<u>(40,912)</u>
Subtotal	\$ 3,923	\$ 10,306	\$ 14,229	\$ 83,841	\$ 98,070
Special Tax Deductions	<u>(11,858)</u>	<u>-</u>	<u>(11,858)</u>	<u>-</u>	<u>(11,858)</u>
State Taxable Income	\$ (7,935)	\$ 10,306	\$ 2,371	\$ 83,841	\$ 86,212
State Income Tax	9.99% <u>\$ (793)</u>	<u>\$ 1,030</u>	<u>\$ 237</u>	<u>\$ 8,376</u>	<u>\$ 8,613</u>
Federal Taxable Income Before State Income Tax	\$ (7,935)	\$ 10,306	\$ 2,371	\$ 83,841	\$ 86,212
State Income Tax	<u>\$ (793)</u>	<u>\$ 1,030</u>	<u>\$ 237</u>	<u>\$ 8,376</u>	<u>\$ 8,613</u>
Federal Taxable Income	\$ (7,142)	\$ 9,277	\$ 2,134	\$ 75,465	\$ 77,600
Federal Income Tax	35.00% <u>\$ (2,500)</u>	<u>\$ 3,247</u>	<u>\$ 747</u>	<u>\$ 26,413</u>	<u>\$ 27,160</u>
Net Combined Current Income Tax	\$ (3,293)	\$ 4,276	\$ 984	\$ 34,789	\$ 35,772
Total Combined Current Income Taxes (Schedule LKM-1, Page 1)	<u>(3,293)</u>	<u>4,277</u>	<u>984</u>	<u>34,789</u>	<u>35,773</u>
Difference/Rounding	<u>\$ 0</u>	<u>\$ (0)</u>	<u>\$ 0</u>	<u>\$ (0)</u>	<u>\$ (0)</u>