

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission :  
v. : Docket No. R-00061346  
Duquesne Light Company :

DIRECT TESTIMONY AND EXHIBITS OF  
ROGER D. COLTON  
ON UNIVERSAL SERVICE ISSUES

*ON BEHALF OF THE*  
Office of Consumer Advocate  
Harrisburg, Pennsylvania

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PA PUBLIC UTILITY COMMISSION  
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1 **Q. PLEASE STATE YOUR NAME AND ADDRESS.**

2 A. My name is Roger Colton. My address is 34 Warwick Road, Belmont, MA 02478.

3

4 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

5 A. I am a principal in the firm of Fisher, Sheehan & Colton, Public Finance and General  
6 Economics. In that capacity, I provide technical assistance to a variety of public utilities,  
7 state agencies and consumer organizations on rate and customer service issues involving  
8 telephone, water/sewer, natural gas and electric utilities.

9

10 **Q. FOR WHOM ARE YOU TESTIFYING IN THIS PROCEEDING?**

11 A. I am testifying on behalf of the Pennsylvania Office of Consumer Advocate (OCA).

12

13 **Q. PLEASE DESCRIBE YOUR PROFESSIONAL BACKGROUND.**

14 A. I work primarily on low-income utility issues. This involves rate and customer service  
15 work. At present, I am working on various projects in the states of New Hampshire, New  
16 Jersey, Pennsylvania, Maryland, Michigan, Indiana, Iowa, Missouri, New Mexico and  
17 Arizona. My clients include state agencies (*e.g.*, Arizona state LIHEAP office,  
18 Pennsylvania Office of Consumer Advocate, Iowa Department of Human Rights), federal  
19 agencies (*e.g.*, the U.S. Department of Health and Human Services), community-based  
20 organizations (*e.g.*, Indiana Community Action Association, Michigan Poverty Law Center,  
21 Community Action of New Mexico), and private utilities (*e.g.*, Entergy Services, NIPSCO,  
22 Citizens Gas and Coke Company). I also work on various issues for the National  
23 Association of State Utility Consumer Advocates (NASUCA).

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**Q. CAN YOU EXPLAIN YOUR EDUCATIONAL BACKGROUND?**

A. I have training in both law and economics. I received my law degree from the University of Florida in 1981. I received my Masters Degree (economics) from the McGregor School (Antioch University) in 1993.

**Q. HAVE YOU EVER PUBLISHED ON PUBLIC UTILITY REGULATORY ISSUES?**

A. Yes. I have published extensively in scholarly and trade journals, primarily on low-income utility issues. I have published more than 100 reports for various clients on energy, water, telecommunications and other associated low-income utility issues.

**Q. HAVE YOU EVER TESTIFIED BEFORE THIS OR OTHER UTILITY COMMISSIONS?**

A. I have testified in regulatory proceedings in more than 35 states and various Canadian provinces on a range of low-income utility issues. A summary of my professional work is presented in Attachment A.

**Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY TODAY?**

A. The purpose of my testimony today is to examine the universal service programs proposed in the Direct Testimony of various Duquesne Light Company witnesses. I review these programs primarily to assess the reasonableness of their cost recovery elements.

1 **Q. WHAT IS DUQUESNE LIGHT REQUESTING FOR UNIVERSAL SERVICE**  
 2 **EXPENSES IN THIS PROCEEDING?**

3 A. Company witness Michele Sandoe explains Duquesne Light’s proposed universal service  
 4 expenses over a multi-year time period. Ms. Sandoe reports that total funding for  
 5 Universal Service Programs in 2005 was \$9,188,667. She states that Duquesne is  
 6 proposing universal service funding of \$12,621,250 in 2006 and \$13,176,250 in 2007.  
 7 (Sandoe Direct, at page 10, lines 26 - 28). According to Ms. Sandoe, “the Company has  
 8 included these costs for funding the programs in its requested increase in revenues in this  
 9 rate case as part of the 2006 operating budget or pro forma adjustments.” (Sandoe Direct,  
 10 at page 11, lines 5 - 7).

11  
 12 Ms. Sandoe disaggregates the total universal service costs the Company is requesting in  
 13 rates as follows (Sandoe Direct, at page 10, line 28 through page 11, line 2):

	2006	2007
CAP expenses	\$10,950,000	\$11,420,000
LIURP	\$1,181,250	\$1,181,250
CARES	\$100,000	\$125,000
Hardship fund	\$390,000	\$450,000
Total universal service	\$12,621,250	\$13,176,250

14  
 15 Finally, Ms. Sandoe states that the costs of the Company’s new Stay Warm Program are  
 16 expected to be \$1.2 million for the Winter 2006-2007 and for subsequent years. (Sandoe  
 17 Direct, at page 8, lines 12 - 14). Ms. Sandoe indicates that the 2006 Stay Warm costs  
 18 were absorbed by Company investors (Sandoe Direct, at page 8, lines 9 - 14).

19

1 **Q. IS THERE A PROBLEM WITH THE UNIVERSAL SERVICE COSTS**  
 2 **REPORTED BY MS. SANDOE AS BEING INCLUDED IN THE COMPANY'S**  
 3 **RATES?**

4 A. Yes. If, indeed, the dollars reported by Ms. Sandoe for the Company's hardship fund are  
 5 included in rates, they should be excluded. These hardship fund dollars are not intended  
 6 to be ratepayer funded. Instead, they are supposed to be the investor contribution to the  
 7 hardship fund. (See, e.g., Bureau of Consumer Services 2004 universal service report, at  
 8 53 ["the Commission defines utility contributions as shareholder or utility grants for  
 9 program administration, outright grants to the funds and grants that match contributions  
 10 of ratepayers"]). Indeed, elsewhere in her direct testimony, Ms. Sandoe reports that  
 11 "Duquesne Light's stockholders match customer contributions up to \$325,000 annually.  
 12 In addition, the Company contributes \$65,000 for administrative support." (Sandoe  
 13 Direct, at page 4, lines 25 - 27) (emphasis added). If, indeed, these hardship fund dollars  
 14 are included in rates, they are neither a stockholder match nor a company contribution.  
 15 These dollars should be excluded from the Company's universal service budget included  
 16 in rates. The Company should clarify in its rebuttal testimony that they have not included  
 17 these hardship fund costs in their requested increase in revenues in this rate case as part  
 18 of the 2006 operating budget or pro forma adjustments. If the Company cannot make that  
 19 clarification, those costs should be removed from rates.

20  
 21 **Q. HAVE YOU REVIEWED THE COST RECOVERY MECHANISM PROPOSED**  
 22 **BY DUQUESNE LIGHT COMPANY?**

1 A. Yes. I have reviewed the Direct Testimony of Nancy Krajovic with respect to the  
2 Company's Rider No. 21 for the Universal Service Charge. Through Rider 21, the  
3 Company collects all universal service charges above its "base universal service charge."  
4 The Base Universal Service Charge is set at 5.656 mils per kWh. (Rider No. 21 as  
5 proposed to be amended). The Company proposes to change Rider 21 so that rather than  
6 allocating costs passed through this Rider to all customers, it allocates costs collected  
7 through the Rider only to the residential customer rate classes. (Krajovic Direct, at 8).

8

9 **Q. WHAT PROBLEMS DO YOU SEE WITH THE PROPOSED RIDER NO. 21 AS**  
10 **PROPOSED?**

11 A. Rider No. 21 should be deleted from the Company's tariffs. Duquesne Light collects its  
12 universal service costs through its base rates. While Rider No. 21 has been in effect since  
13 1998, the Company has never used the Rider as a mechanism through which to pass  
14 costs. The Company's experience with its Rider No. 21 indicates that the Rider should  
15 be eliminated.

16

17 **Q. PLEASE EXPLAIN THE PURPOSE OF A UNIVERSAL SERVICE COST**  
18 **RECOVERY RIDER.**

19 A. A rate rider for universal service cost recovery has a cognizable, but limited, role  
20 in providing for recovery of universal service costs. A rate rider to recover  
21 universal service costs that exceed those costs included in base rates in the most  
22 recent base rate case is appropriate only in extraordinary circumstances. These  
23 circumstances should involve unanticipated, substantial expenses such as rapidly

1 increasing fuel prices outside of the utility's control that place financial pressure  
2 on the utility. There is nothing unique to universal service costs that would merit  
3 a departure from this fundamental ratemaking principle.

4  
5 Should, for whatever reason, the cost structure of universal service change  
6 sufficient to prevent the Company from earning an adequate rate of return, and  
7 these increased costs are expected to continue to be experienced by the utility,  
8 Duquesne Light should respond by filing a base rate case, not by seeking to  
9 recover these costs through a rate rider. Only in extraordinary circumstances  
10 should a rate rider be used to recover universal service costs. The Duquesne  
11 experience with its Rider 21 clearly indicates that its universal service costs do  
12 not meet these tests of eligibility for recovery through a rate rider.

13  
14 **Q. DO YOU HAVE REASON TO BELIEVE THAT THE COMPANY WILL**  
15 **NEED RIDER 21 IN THE FUTURE IN ORDER TO COLLECT ITS**  
16 **UNIVERSAL SERVICE COSTS?**

17 A. No. After experiencing several years of cost reductions, Duquesne Light is now projecting  
18 significant increases in its overall CAP costs. According to Company witness Michele  
19 Sandoe, Duquesne has budgeted the following for its CAP program:

20 ➤ \$10,950,000 for 25,000 CAP participants in 2006.

21 ➤ \$11,420,000 for 27,000 CAP participants in 2007.

22 (Sandoe Direct, at 10 - 11).

23

1 These budget amounts should be more than sufficient to fully recover CAP costs. Consider  
 2 that these CAP costs represent a change in the direction and magnitude of the CAP costs per  
 3 participant that have been experienced by Duquesne Light Company in previous years. The  
 4 Bureau of Consumer Services publishes an analysis of CAP costs in its Universal Service  
 5 annual report. While 2005 BCS figures are not yet available, according to BCS, Duquesne  
 6 Light has seen a decreasing per-participant cost in its CAP program since 2001, reflecting  
 7 the fact that Duquesne's residential rates declined in this time period as stranded cost  
 8 recovery was completed.

9  
 10 In contrast, today, as reported by Ms. Sandoe, "energy is becoming more expensive,"  
 11 (Sandoe Direct, at 11). Because Duquesne is not modifying the CAP payment amount,  
 12 these price increases will drive the per participant program costs up as well. Nonetheless,  
 13 these cost increases should be placed in historical perspective. From 2001 through 2003, the  
 14 Company's CAP bills ranged from \$55 (2002), to \$56 (2003), to \$57 (2001). The CAP costs  
 15 budgeted by the Company are consistent with these historical per participant costs, all of  
 16 which were recovered through base rates. I conclude that the Company has anticipated  
 17 future per participant costs and has accounted for those costs in the universal service costs  
 18 included in base rates. The Rider is not a necessary cost recovery mechanism.

19  
 20 **Q. IS THERE A FINAL REASON NOT TO APPROVE THE RIDER AS A**  
 21 **MECHANISM FOR RECOVERING EXCESS CAP COSTS?**

22 A. Yes. Including universal service costs in base rates has commonly recognized  
 23 regulatory advantages. Including CAP expenses in base rates will force the

1 Company to find efficiencies in its program should per participant costs become  
2 excessive. Promoting outreach for the Earned Income Tax Credit (EITC), for  
3 example, as a mechanism to increase household resources for low-income  
4 customers, can be an effective mechanism through which customer payments can  
5 be increased and, accordingly, pre-program arrearages brought into CAP reduced.  
6 Allowing excess CAP costs to be automatically passed through a rider eliminates  
7 this incentive to seek out program efficiencies.

8  
9 **Q. DO YOU HAVE A SECOND ISSUE WITH THE COMPANY'S RIDER NO.**  
10 **21?**

11 A. Yes. In the event that Duquesne Light experiences extraordinary CAP costs sufficient to  
12 trigger a between-rate-case rate rider, the costs recoverable through that rate rider should  
13 be limited by basic regulatory principles. The primary principle, of course, should be that  
14 only costs that fluctuate for reasons beyond the company's control or are difficult to  
15 predict should be recoverable through the rate rider. Costs that do not meet these two  
16 criteria should be collected through base rates. More specifically, only the incremental  
17 CAP credits found to be extraordinary as defined above should be subject to recovery. In  
18 addition, incremental fees paid to outside administrative agencies associated with the  
19 rapid and unexpected enrollment of additional CAP customers could be included. Costs  
20 associated with CARES, Smart Comfort, Stay Warm, hardship fund administration, and  
21 Consumer Credit Counseling Services (CCCS) are not beyond the ability of the Company  
22 to control and, accordingly, do not vary in a way making them eligible for recovery  
23 through a rate rider. These costs should be removed from Rider No. 21.

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In contrast, certain costs should not be included in such a cost recovery mechanism.

First, the recovery of incremental arrearage forgiveness costs should not occur through a rate rider. Arrearage forgiveness credits for preprogram arrears are in the nature of bad debt expenses. These expenses meet neither the criterion of being beyond the company’s control nor the criterion of being difficult to predict. Second, bad debt expenses (or uncollectible dollars) have not historically been viewed as appropriately subjected to between-rate-case rate riders. Third, low-income collection costs do not vary as extraordinary expenses and are not appropriate to be included in a universal service rate rider. Moreover, neither bad debt expenses nor low-income collection costs are “universal service program costs” that should be recoverable through a rate rider.

**Q. DO YOU HAVE A THIRD ISSUE WITH RIDER NO. 21?**

A. Yes. Rider No. 21 is a reconcilable rider. The Rider has an “e” component, which consists of “the experienced net over-collection or under-collection of the universal service program costs as computed for each rate schedule as of the end of the reconciliation period.” The reconcilable nature of Rider No. 21 makes it objectionable.

Collection of costs through distribution base rates creates an incentive for Duquesne Light to be efficient in the expenses that it incurs. For those costs that are both controllable and not difficult to predict, this is appropriate regulatory policy. For several reasons, it is inappropriate to deviate from this basic ratemaking principle for universal service costs.

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First, as a general rule, it would be inappropriate to allow a company to collect its entire universal service costs in the absence of a full rate inquiry into the costs and revenues of the Company. To the extent that universal service programs assist the Company in the effective and efficient collection of low-income bills, in addition to causing the Company to incur the costs of the additional discounts, the universal service costs will generate offsetting expense savings to the utility as well. One of the most significant aspects of those cost savings will be the reduction in working capital associated with the arrears that are avoided by the universal service programs. It is improper to isolate one component of the Company's cost-of-service for special rate recovery without considering the corresponding cost savings.

Second, it is standard regulatory practice that the Company should only be provided a reasonable opportunity to earn a fair rate of return. The expenses upon which the revenue requirement is based will change the day the rates go into effect. Even then, some costs will go up while others go down. Consider, for example, the increased postage rates placed into effect at the beginning of 2006. Even if postage cost increases substantially in 2006, with those increased expenses not having been included in the immediately preceding base rate case, the utility is not *automatically* allowed to pass those costs through to ratepayers.

Indeed, total postage expense may actually go down as businesses use more electronic mail.

Third, in a related vein, recovery of expenses from ratepayers is merely the means to allow the Company a reasonable opportunity to earn an adequate rate of return; not to

1 allow specific dollars to be passed through to ratepayers. Duquesne Light is not entitled  
2 to institute a separate charge to collect some discrete expense component that it has  
3 segregated out for individual analysis. Increased universal service program costs do not  
4 necessarily threaten the ability of the Company to earn an adequate rate of return. The  
5 various individual cost and revenue components of the Company's cost of service are  
6 constantly increasing and decreasing.

7  
8 Fourth, merely because certain expenses increase does not mean that the relationship  
9 between costs and revenues has changed. Even if dollars of CAP costs exceed the dollar  
10 amount that was included in cost-of-service in the most recent base rate case, in other words,  
11 it cannot be automatically concluded that the company is not recovering its costs. CAP costs  
12 might, for example, increase due to severe weather (or decrease due to mild weather) but  
13 retain the same overall relationship to total revenues found in the base rate case.

14  
15 Finally, universal service cost recovery need not occur through a reconcilable surcharge  
16 in order to "fully recover" the costs of universal service and energy conservation as  
17 provided by statute. (66 Pa.C.S. §2804(9) (electricity)). Universal service costs are not to  
18 be considered the last costs incurred in the Company's total cost of service. Even in  
19 those instances where the Company is *not* earning an adequate rate of return, one cannot  
20 *a priori* assign the cause of the revenue deficit to the universal service programs. The  
21 PUC addressed a similar issue in the electric utility restructuring proceedings. In those  
22 proceedings, the PUC directly faced the issue of whether universal service programs  
23 (including CAP programs) should be ramped up in light of statutorily-imposed rate caps.

1 The Pennsylvania PUC held that universal service programs must expand  
2 notwithstanding the price caps. The PUC held that universal service program costs could  
3 not be deemed to be the incremental costs that cause the Company to exceed the price  
4 caps. If the Company incurs \$120 in costs, in other words, against a price cap of \$100,  
5 the universal service costs could just as easily be deemed to be costs \$16 through \$40 as  
6 to be deemed costs \$96 through \$120. According to the PUC:

7 The expenditures for universal service and energy conservation programs  
8 must be examined in conjunction with the costs of distribution rates, and  
9 competitive and intangible transition charges. Funding of universal  
10 service and energy conservation programs should not be determined after  
11 all other requirements are met. The total dollars available under the rate  
12 cap should be adjusted to meet all the requirements of the Act including  
13 universal service and energy conservation.  
14

15 (RE: Guidelines for Universal Service and Energy Conservation Programs, Docket M-  
16 00960890F0010 (July 11, 1997)).  
17

18 The same principle should be applicable to the relationship of universal service program  
19 costs to Duquesne Light's rate of return. Even if Duquesne Light is not earning an  
20 adequate rate of return, it cannot be *a priori* argued that it is the costs of the Company's  
21 universal service programs that are the incremental costs that are causing the income  
22 deficit. If the Company determines that its return is insufficient, it should file a base rate  
23 case. Accordingly, if universal service program costs exceed those found in the last base  
24 rate case, at a time when Duquesne Light is not earning an adequate rate of return, it is  
25 the decision of the Company whether to accept those continuing circumstances or  
26 whether to seek base rate relief. In either case, it is not appropriate to isolate universal

1 service program costs for single issue rate recovery. It cannot simply be assumed that any  
2 earnings deficit is caused by the Company's universal service program costs.

3  
4 **Q. PLEASE SUMMARIZE WHY RIDER NO. 21 SHOULD BE REMOVED FROM**  
5 **THE COMPANY'S TARIFFS.**

6 A. Rider No. 21 should be removed for several reasons. First, as Pennsylvania's CAP  
7 programs mature and become more stabilized, the costs that a utility such as Duquesne  
8 incurs as a result of the CAP can be determined with more certainty at the time of a base rate  
9 case. With Duquesne, we are no longer in the position of ramping-up programs with little or  
10 no notion of the extent to which, if at all, enrollment will or will not succeed or the extent to  
11 which expected enrollment figures will or will not occur in fact. As this uncertainty goes  
12 out of the development of CAPs, the justification for allowing between rate case rate  
13 adjustments dissipates as well. Second, even setting aside this first reason, the specific  
14 proposal for Rider No. 21 includes costs that are inappropriately collected through a rider.  
15 CAP costs not involving either incremental CAP costs found to be extraordinary or  
16 incremental fees paid to outside administrative agencies associated with the rapid and  
17 unexpected enrollment of additional CAP customers should not be funded through a Rider.  
18 No program costs for CARES, Stay Warm, hardship fund administration, or CCCS should  
19 be included. Moreover, low-income collection costs, as well as low-income write-offs, are  
20 inappropriate costs to be collected through a rider. Finally, the reconcilable nature of Rider  
21 No. 21 makes it objectionable.

1 **Q. HOW SHOULD DUQUESNE'S EXCESS UNIVERSAL SERVICE COSTS BE**  
2 **ALLOCATED AMONG CUSTOMER CLASSES SHOULD RIDER 21 BE**  
3 **APPROVED?**

4 A. While I recommend that Rider 21 be eliminated in its entirety, should that  
5 recommendation not be adopted, no change should be made from the allocation of Rider  
6 21 costs as approved in the Company's Restructuring proceeding. The litigated result of  
7 the Duquesne Light restructuring proceeding was to allocate Rider 21 costs among all  
8 customer classes. In deciding to recover the costs of universal service from all customer  
9 classes, guidance can be obtained from the original reasoning of the Bureau of Consumer  
10 Services (BCS) in recommending recovery from all classes. When BCS submitted its  
11 report on the PUC's investigation into the control of uncollectible balances, it found that  
12 "the problem of the inability of some low income customers to pay their entire home  
13 energy bills is caused primarily by societal economic conditions that are unrelated to any  
14 one rate class." (emphasis added).<sup>1</sup> BCS continued to find:

15 Until such time as sufficient public revenues are available to address the  
16 poverty/energy problem, the costs for CAP programs should be viewed as a  
17 cost of operating as a public utility for which all ratepayers must share the  
18 costs. The Bureau does not find any logic to the argument that because the  
19 larger societal economic conditions are negatively affecting the ability of  
20 some low income residential customers to pay their bills, that the problem is  
21 somehow caused by the residential class and should therefore be paid for by  
22 that class. If the Commission, as a regulatory authority, decides that it is in  
23 the public interest to provide home energy services for necessities of life to  
24 disadvantaged ratepayers without full payment, then the costs should be  
25 borne by all ratepayers who benefit from the companies operating as public  
26 utilities.  
27

28 \* \* \*

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<sup>1</sup> Bureau of Consumer Services, Final Report on the Investigation of Uncollectible Balances, at 157, Docket I-900002 (February 1992).

1 The Commission employed a similar logic for cost allocation when it passed  
2 the Chapter 69 regulations providing funding for the Low Income Usage  
3 Reduction Program (LIURP). The LIURP program provides weatherization,  
4 energy conservation and usage reduction services to low income residential  
5 customers across the Commonwealth. The revenues to support LIURP are  
6 based on two-tenths of one percent of revenues from all utility classes.  
7 LIURP costs are allocated across all rate classes. (Bureau of Consumer  
8 Services, at 157 - 158).  
9

10 The proper allocation of universal service costs among rate classes, of course, is currently  
11 being considered on a generic basis in the CAP design proceeding now pending before the  
12 PUC. OCA presented extensive evidence and reasoning supporting its proposed allocation  
13 among all customer classes in that generic proceeding. I concur with the evidence and  
14 reasoning presented in that proceeding and urge its applicability to Rider 21 as well, should  
15 Rider 21 not be disapproved in its entirety. Clearly, at this time, there is no reason to change  
16 the allocation approved for Rider 21 in the restructuring case if the Rider remains.  
17

18 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

19 **A.** Yes it does.

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Roger Colton is a partner in the firm Fisher, Sheehan & Colton, Public Finance and General Economics (FSC) of Belmont, Massachusetts. An attorney and an economist, Roger engages in legal and technical research, program design and program evaluation. His work on helping to design, implement and fund low-income affordability programs has been with state and local governments; with the federal government; with natural gas, electric and water utilities; and with a variety of community-based organizations in more than 35 states and in numerous provinces in Canada.

Roger authors the annual Home Energy Affordability Gap, which calculates the dollar difference between actual home energy bills and affordable home energy bills on a county-by-county basis for the entire country. In 2003, he created the Home Energy Insecurity Scale for the federal LIHEAP office, a tool for measuring the outcomes of energy assistance programs that is being incorporated into program evaluation nationwide.

Roger was the recipient of the 1998 National Low-Income Energy Consortium (NLIEC) individual achievement award for career accomplishment with respect to low-income energy issues. He received the 2001 Sister Pat Kelley Award from the National Fuel Funds Network (NFFN) for his career-long work in helping to create and support fuel funds nationwide.

Roger has authored more than 80 articles in academic journals and trade publications. He has authored more than 100 reports for various public and private clients regarding low-income energy and housing issues. He has appeared as an expert witness in regulatory, legislative and judicial proceedings in more than 30 jurisdictions at the state, federal and provincial levels throughout the United States and Canada.

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SECRETARY'S BUREAU

1 **Q. PLEASE STATE YOUR NAME AND ADDRESS.**

2 A. My name is Roger Colton. My address is 34 Warwick Road, Belmont, MA 02478.

3

4 **Q. ARE YOU THE SAME ROGER COLTON THAT PREVIOUSLY SUBMITTED**  
5 **DIRECT TESTIMONY IN THIS PROCEEDING?**

6 A. Yes.

7

8 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY TODAY?**

9 A. The purpose of my testimony today is to respond to the Direct Testimony of Direct  
10 Energy (Frank Lacey). Moreover, I will provide responses to certain aspects of the  
11 “directed questions” propounded by Commissioner Cawley as they relate to low-income  
12 customers.

13

14 **I. Response to Other Parties.**

15 **Q. WHAT ISSUES DOES MR. LACEY RAISE FOR DIRECT ENERGY TO WHICH**  
16 **YOU WISH TO RESPOND?**

17 A. Mr. Lacey makes two proposals in his Direct Testimony that I recommend be  
18 disapproved by the Commission:

19       ➤ First, he proposes that a portion of uncollectible expenses and CAP costs (as  
20       well as other expenses) be removed from distribution rates and placed in the  
21       POLR rate (Lacey Direct, at 11, lines 16 - 18); and

22       ➤ Second, he proposes that if uncollectible expenses are not transferred to the  
23       POLR rate, that Duquesne pay the suppliers in full for the generation service

1           they provide whether or not the customer pays in full, and that Duquesne  
2           retain the right to terminate the service for any customer not paying his/her  
3           supplier charges.<sup>1</sup> This is referred to as the purchase of receivables.  
4

5 **Q.   WHY ARE YOU CONCERNED WITH REMOVING CAP COSTS FROM**  
6 **DISTRIBUTION RATES AND PLACING THEM IN THE POLR RATE?**

7 A.   Customer Assistance Programs (CAPs) are provided by the electric distribution  
8       companies in Pennsylvania for the benefit of low income customers. CAP costs are not  
9       avoidable by the EDC when customers switch suppliers. By transferring CAP costs to  
10      the POLR rate and then losing the CAP revenue when customers shop, the EDC will not  
11      have sufficient revenue to meet its CAP obligations. While I agree that the CAP credit  
12      should be “portable” if a residential CAP customer chooses to switch suppliers, this could  
13      require significant changes in the CAP program. To date, the Commission has not  
14      resolved the issue as to how best to make the CAP credit portable.  
15

16 **Q.   MR. LACEY HAS ALSO PROPOSED TO MOVE A PORTION OF**  
17 **UNCOLLECTIBLE EXPENSE FROM THE DISTRIBUTION RATES TO THE**  
18 **POLR RATE. WHAT ARE YOUR CONCERNS WITH THIS PROPOSAL?**

19 A.   Mr. Lacey recognizes in his testimony that it is not possible with certainty to determine  
20      what level of uncollectible expense should be transferred to the generation rate without  
21      detailed study. Again, it is important that only an amount of uncollectible expense that is  
22      avoidable by the EDC be placed in the generation rate.

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<sup>1</sup> This proposal applies to the extent that an EGS customer opts for utility consolidated billing. (Lacey Direct, at page 20, line 11).

1 The risk of uncollectible expense may not be the same for an EDC and a competitive  
2 service provider. The competitive service provider retains the ability to refuse service to  
3 its bad paying customers, thus transferring the customer (along with the accompanying  
4 risk of nonpayment) back to the provider of last resort. The only reason that a  
5 competitive service provider would continue to provide service to a nonpaying customer  
6 would be if the provider reasonably expected future customer payment, or if the provider  
7 believed it would derive some other business advantage from retaining the customer. In  
8 contrast, the distribution company operates under an obligation to serve. It has a duty to  
9 provide electricity to those customers that the competitive service provider refuses to  
10 serve on the grounds of nonpayment. Since uncollectible accounts for the EDC and the  
11 competitive service provider are not "equal," and do not arise on an equal basis,  
12 misallocating uncollectible expense could result in non-shopping customers having to pay  
13 twice for the same expenses. I would also note that competitive suppliers can request  
14 deposits from customers.

15  
16 As a result of these various factors, I recommend that the proposal by Mr. Lacey to  
17 remove any level of uncollectibles from distribution rates be disapproved at this time.  
18 This issue requires detailed analysis to ensure that customers do not end up overpaying  
19 for uncollectibles as a result of moving unavoidable expenses to the POLR rate.

1 **Q. WHY DO YOU RECOMMEND THAT MR. LACEY'S PROPOSAL REGARDING**  
2 **THE SALE OF RECEIVABLES BE DISAPPROVED?**

3 A. Under a purchase of receivables program as proposed by Mr. Lacey, Duquesne would  
4 have the right to terminate customers for non-payment of the electric generation supplier  
5 (EGS) charges. The Commission does not allow for termination of essential utility  
6 service for non-payment of supplier charges.<sup>2</sup> The policy basis for this regulation is  
7 sound in that the price that can be charged by an EGS is not regulated by the Public  
8 Utility Commission. EGSs can, and do, charge prices that are higher than the regulated  
9 rates of the provider of last resort. In Duquesne's service territory, for example,  
10 Dominion, an EGS that serves nearly 100,000 Duquesne residential customers, charged  
11 over 2¢/kwh more than Duquesne for the first six months of this year.<sup>3</sup> Under Mr.  
12 Lacey's proposal, customers could lose their essential utility service if they had been  
13 unable to pay these higher charges and ended up in arrears.

14  
15 Customers with higher arrears have a more difficult time paying their bills, even if those  
16 customers move to a universal service program. Recent data from the evaluation of the  
17 New Jersey Universal Service Fund (USF)<sup>4</sup> found that the payment of reduced bills  
18 (supported, in part with payments through the state universal service program) was  
19 impeded by pre-existing arrears. While only five percent of households without arrears

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<sup>2</sup> Final Order Re: Guidelines for Maintaining Customer Services at the same level of quality pursuant to 66 Pa.C.S. § 2807(b) and Assuring Conference with 52 Pa. Code Chapter 56 pursuant to 66 Pa.C.S. § 2809(E) or (F); order of July 11, 1997, p. 44 Guideline III.L.5.

<sup>3</sup> *Dominion to Cut Electric Rate*, Pittsburgh Tribune Review, May 27, 2006.

<sup>4</sup> Apprise, Inc. (April 2006). *Impact Evaluation and Concurrent Process Evaluation of the New Jersey Universal Service Fund: Final Report*, at 90, Apprise, Inc: Princeton (NJ) (prepared for New Jersey Board of Public Utilities).

1 paid less than 90% of their bills under the New Jersey USF, about 35% of the customers  
2 with pre-existing arrears paid less than 90% of their bill. In addition, a study of Iowa low-  
3 income customer payment problems that I performed in 2002 supports these findings.<sup>5</sup>  
4 One can conclude for purposes here, therefore, that if a low-income customer incurs  
5 arrears through high EGS rates, if the EGS can pass on its receivables to be collected  
6 through the POLR, including through the disconnection of service for nonpayment, that  
7 customer is subjected to the potential loss of essential electric service due to high, and  
8 unregulated, rates for generation service.

9  
10 **II. Directed Questions from Commissioner Cawley.**

11 **Q. TO WHICH OF THE "DIRECTED QUESTIONS" PROPOUNDED BY**  
12 **COMMISSIONER CAWLEY DO YOU WISH TO RESPOND?**

13 A. Commissioner Cawley propounded four questions with respect to rate design and incentives  
14 for customer investment in energy efficiency. Two of those questions relate to residential  
15 customer pursuit of energy efficiency investments. The two questions to which I offer  
16 insights regarding low income customers include:

- 17 1. Do fixed charges for residential and small or medium commercial customer  
18 distribution services discourage conservation of energy? If so, what other revenue  
19 decoupling models can be implemented that would optimally meet the dual needs of  
20 providing incentives for consumers to conserve energy, while providing reasonably  
21 stable revenues for utilities?  
22  
23 2. Do declining block rate designs remove the incentive for consumers, especially RA  
24 and RH residential consumers and small to medium sized commercial and industrial  
25 customers ("C&I"), to conserve energy? If so, should declining block rates for  
26 supply and distribution services be phased out over time?  
27

---

<sup>5</sup> Roger Colton (May 2002). *Payment Problems, Income Status, Weather and Prices: Costs and Savings of a Capped Bill Program*, Fisher, Sheehan & Colton: Belmont (MA).

1 **A. Fixed Charges and Block Rate Structures**

2 **Q. WITHIN THE CONTEXT OF LOW-INCOME CONSUMERS, WHAT IMPACT**  
3 **DO FIXED CHARGES AND THE DESIGN OF THE RATES HAVE ON**  
4 **CUSTOMER USAGE?**

5 A. In general, to the extent that customers have discretionary usage, high customer charges  
6 discourage conservation and are frustrating to consumers. It is important to recognize,  
7 though, that simply increasing usage charges will not necessarily have the effect of incenting  
8 conservation efforts by many low income customers. Low-income energy consumption can  
9 be divided into two different categories: (a) discretionary consumption; and (b)  
10 nondiscretionary consumption. Nondiscretionary consumption is by far the biggest block of  
11 the two.

12  
13 **Q. PLEASE DISCUSS THE NON-DISCRETIONARY NATURE OF LOW-INCOME**  
14 **ENERGY CONSUMPTION.**

15 A. According to the U.S. Department of Energy (DOE), while low-income households use less  
16 energy in their homes overall, their rate of consumption is much higher than their higher  
17 income counterparts. The DOE study found that the "intensity" of energy use is directly  
18 related to income, with low-income households consuming 14% more energy per square  
19 foot than the average household, while spending 11% more per square foot on energy than  
20 higher income households. DOE explained that the higher intensity of energy use arises  
21 because of less efficient housing.

22

1 Energy usage in low-income households, however, is generally driven by factors largely  
2 outside of the ability of the household to control. The age and efficiency of the dwelling  
3 unit, the size of the dwelling unit, the number of household members, and the extent to  
4 which household members are home during the day are all factors that are beyond the  
5 household's ability to control. Moreover, the condition of the physical structure, including  
6 not only the structural integrity of the unit but factors such as the location of an apartment  
7 within a multifamily structure, the condition of the HVAC system in any particular home,  
8 and the orientation of a home or apartment *vis a vis* direct sunlight, are all factors beyond a  
9 household's ability to control.

10  
11 **Q. PLEASE DISCUSS ELECTRIC APPLIANCE CONSUMPTION.**

12 **A.** The largest use of electricity in the average U.S. household was for appliances (including  
13 refrigerators and lights), which consume approximately two thirds of all the electricity  
14 used in the residential sector. Refrigerators consume the most electricity (14 percent of  
15 total electricity use for all purposes), followed by lighting (9 percent). Low-income  
16 households are significantly conserving already in these two areas, however. According  
17 to the Department of Energy's Residential Energy Consumption Survey (RECS), while  
18 households living with income at or below the Federal Poverty Level (FPL) consume  
19 1,238 kWh each year for refrigerators, households with annual income over \$50,000  
20 consume 1,663 kWh. While households with income at or below the FPL consume 3,889  
21 kWh each year for lighting, households with annual income over \$50,000 consume 6,998  
22 kWh.

23

1 As with other energy consumption, this lower energy consumption occurs even though on  
2 a per-square-foot basis, low-income households have a higher “intensity” of electric  
3 appliance energy consumption.<sup>6</sup> As with space heating, the amount of appliance usage  
4 within the low-income population is largely non-discretionary. While low-income  
5 households have less efficient usage for lighting and electric appliances due to older and  
6 less efficient equipment, the primary driving force behind total consumption of electric  
7 appliance and lighting is the number of square feet in the home.

8  
9 **Q. ARE THERE SPECIFIC CHARACTERISTICS OF A LOW INCOME**  
10 **HOUSEHOLD THAT IMPEDE THEIR ABILITY TO RESPOND TO INCREASED**  
11 **CHARGES?**

12 A. Substantial market barriers exist that severely restrict the availability of energy efficiency  
13 measures to low-income households. While public programs such as the federal  
14 Weatherization Assistance Program (WAP) and the state Low-Income Usage Reduction  
15 Program (LIURP) can help overcome these market barriers through direct public  
16 investment, given the funding available through programs such as LIURP and WAP, it  
17 would take decades to allow for a comprehensive treatment of low-income households.

18 **Q. CAN YOU ILLUSTRATE WHAT YOU MEAN WHEN YOU REFER TO**  
19 **“MARKET BARRIERS” THAT PREVENT THE IMPLEMENTATION OF**  
20 **ENERGY CONSERVATION IN RESPONSE TO PRICE SIGNALS?**

21 A. Yes. I discuss two illustrative “market barriers” below: (1) discount rates/payback periods,  
22 and (2) liquidity.

---

<sup>6</sup> “Appliance” consumption includes lighting.

- 1           ➤ **Discount Rates:** Low-income households tend to have extremely high implicit  
2 discount rates (also sometimes known as hurdle rates or internal rates of return). In a  
3 report for the Electric Power Research Institute (EPRI), Cambridge Systematics  
4 found that the implicit discount rate for low-income households ranged up to the 80 -  
5 90 percent level. For residential households in general, however, the hurdle rate for  
6 energy efficiency investments was 30 percent; that translates into a payback period  
7 of roughly three years. To the extent that efficiency investments have payback  
8 periods of longer than one year, those payback periods exclude by implication all  
9 households which have a higher hurdle rate than 30%. One entire category of  
10 excluded households consists of low-income households.  
11
- 12           ➤ **Liquidity:** Low-income households tend to have extremely low liquidity. In these  
13 circumstances, the payback period for any particular energy efficiency measure  
14 becomes irrelevant if the household does not have the investment capital with which  
15 to begin. The impact of this market barrier significantly restricts the ability of low-  
16 income households to seek more energy efficient appliances. Energy efficiency  
17 programs often pay the incremental cost of moving a customer from the purchase of  
18 a less energy efficient new refrigerator to a more energy efficient new refrigerator.  
19 In such a program, if the less efficient refrigerator costs \$600 and the more efficient  
20 refrigerator costs \$700, the utility often pays the \$100 difference to prompt the  
21 purchase of the more efficient appliance. Discussions about appliance efficiency,  
22 however, simply do not account for the fact that low-income households tend not to  
23 be in the market to purchase new refrigerators to begin with. It is axiomatic to note  
24 that not many low-income households recently spent \$600 for a new refrigerator.  
25

26 **Q.     WHAT DO YOU CONCLUDE?**

27 A.     Pennsylvania needs to be very careful about the impact on low-income customers from  
28 raising rates as a mechanism to create incentives for pursuing energy conservative behavior.  
29 A careful balancing is needed. Moving substantial cost recovery into fixed charges would  
30 eliminate the incentive that does exist for low-income customers to pursue those measures  
31 that are both technically and economically available, and that can affect their discretionary  
32 use. In addition, moving substantial cost recovery into fixed charges would  
33 disproportionately place the recovery of a utility's cost of service on low-use customers.  
34 These low-use customers tend, also, to be low-income customers. Due to the large non-  
35 discretionary usage of low-income households, and the substantial barriers that impede

1 conservation investments by these households, going too far in the other direction also  
2 would not be appropriate.

3

4 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

5 **A.** Yes it does.

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission :  
 :  
 v. : Docket No. R-00061346  
 :  
 Duquesne Light Company :  
 :

SURREBUTTAL TESTIMONY OF  
ROGER D. COLTON  
ON UNIVERSAL SERVICE ISSUES

**RECEIVED**

SEP 28 2006

PA PUBLIC UTILITY COMMISSION  
SECRETARY'S BUREAU

*ON BEHALF OF THE*  
Office of Consumer Advocate  
Harrisburg, Pennsylvania

**RECEIVED**

August 16, 2006

SEP 20 2006

PA PUBLIC UTILITY COMMISSION  
SECRETARY'S BUREAU

1 **Q. PLEASE STATE YOUR NAME AND ADDRESS.**

2 A. My name is Roger Colton. My address is 34 Warwick Road, Belmont, MA 02478.

3

4 **Q. ARE YOU THE SAME ROGER COLTON THAT PREVIOUSLY SUBMITTED**  
5 **DIRECT AND REBUTTAL TESTIMONY IN THIS PROCEEDING?**

6 A. Yes.

7

8 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY TODAY?**

9 A. *The purpose of my testimony today is to respond to the Rebuttal Testimony of three*  
10 *witnesses: William Pfrommer (Duquesne Light); Brian Kalcic (OSBA), and Stephen*  
11 *Baron (Duquesne Industrial Intervenors/Industrial Energy Consumers of Pennsylvania).*  
12 *The rebuttal testimony of each of these witnesses recommended that the costs of the*  
13 *Duquesne Universal Service Programs be allocated exclusively to the residential*  
14 *customer class.*

15

16 **Q. ARE MR. KALCIC AND MR. BARON CORRECT IN ASSERTING THAT THE**  
17 **COMMISSION HAS PREVIOUSLY CONCLUSIVELY DETERMINED THE**  
18 **PROPER ALLOCATION OF UNIVERSAL SERVICE COSTS?**

19 A: *No. Mr. Kalcic (Kalcic Rebuttal, at 5 - 6) and Mr. Baron (Baron Rebuttal, at 12 - 13) both*  
20 *assert that allocating universal service costs exclusively to residential ratepayers is required*  
21 *by PUC precedent. This argument should be rejected. It is clear that the Commission, itself,*  
22 *does not believe that it has decided the issue of the allocation of universal service costs*  
23 *among customer classes. In its pending proceeding on CAP design (Docket No. M-*

1 00051923), the Commission specifically posed the question (Appendix B, Question 2(d)) as  
2 follows: “d. *Should CAP costs be allocated among different rate classes? Most utilities*  
3 *recover CAP costs solely from residential customers. Three utilities assess a portion of CAP*  
4 *costs on other rate classes: commercial, industrial, general service, interruptible, and HV*  
5 *firm. Should all classes of customers share the cost of these programs?” The Commission*  
6 *has not rendered a decision in this docket. The allocation of universal costs between*  
7 *customer classes is an open question before the Commission.*

8  
9 **Q. IS THERE ANY OTHER FLAW IN THE REASONING PRESENTED BY MR.**  
10 **KALCIC, MR. BARON AND MR. PFROMER?**

11 A. Yes. The regulatory decisions cited by these witnesses involve circumstances where a  
12 utility had been allocating universal service costs solely to the residential class. The  
13 cases represent decisions where the PUC found that the OCA had presented insufficient  
14 evidence to merit *changing* the historic allocation methodology. With Duquesne, no  
15 change should be made from the historic allocation of universal service costs as approved  
16 in the Company’s Restructuring proceeding. The litigated result of the Duquesne Light  
17 restructuring proceeding was to allocate universal service costs among all customer  
18 classes. The proposal of these witnesses is to change the status quo, not to preserve it.  
19 That proposed change in the status quo should be rejected.

20

1 **Q. WHAT IS THE GENERAL STATUTORY FRAMEWORK FOR ALLOCATING**  
2 **UNIVERSAL SERVICE COSTS?**

3 **A.** Section 2804(9) of the Electricity Generation Customer Choice and Competition Act  
4 provides that universal service program costs are to be recovered through a  
5 “nonbypassable, competitively neutral” mechanism in the Pennsylvania utility’s rates.  
6 The common understanding of the bypass problem is that some customers will either  
7 leave the system entirely (and leave their share of system costs behind) or that those  
8 customers will negotiate a discount off their charges by raising the threat that they will  
9 leave the system entirely. Use of the term “nonbypassable,” therefore, incorporates the  
10 concept that all customers should help pay for universal service costs.

11  
12 **Q. HOW DO YOU RESPOND TO THE ASSERTION THAT RESIDENTIAL**  
13 **CUSTOMERS ARE THE SOLE BENEFICIARIES OF UNIVERSAL SERVICE**  
14 **PROGRAMS?**

15 **A.** Mr. Baron (Baron Rebuttal, at 11 - 12), Mr. Kalcic (Kalcic Rebuttal, at 5) and Mr.  
16 Pfrommer (Pfrommer Rebuttal, at 17) all argue that residential customers are the only  
17 customers to derive benefits from the Company’s universal service programs and that,  
18 accordingly, all universal service costs should be allocated to residential customers. The  
19 assertion that all universal service costs should be assigned to residential customers because  
20 only residential customers (that is low-income customers) benefit from the program proves  
21 too much (even accepting solely for purposes of analysis the premise that only low-income  
22 customers benefit). If one assumes that only low-income customers benefit, and then follow  
23 the rule that costs should be allocated only to those who directly benefit, the PUC is brought

1 to the conclusion that universal service costs should be directly assigned pro rata to  
2 customers who participate in the universal service programs (such as CAP). Clearly this  
3 would be an absurd result, and one that could not logically have been intended by the  
4 General Assembly. In addition, there is no more reason to allocate costs to non-low-income  
5 residential customers under this reasoning than there is to allocate them to non-residential  
6 customers. Non-low-income residential customers benefit, as they do, in the same ways that  
7 non-residential customers benefit.

8  
9 **Q. DO ALL CUSTOMERS DERIVE BENEFITS FROM A UNIVERSAL SERVICE**  
10 **PROGRAM?**

11 A. Yes. Contrary to the assertions by witnesses Baron, Kalcic and Pfrommer, the  
12 commercial and industrial classes derive direct economic benefits from universal service  
13 programs. One comprehensive study published in 2004 concluded:

14 Why the under-use of public benefits is a problem. When most people hear  
15 about the idea of marketing public benefits through employers, their initial  
16 reaction is “why would a company want to get involved with a social service  
17 program?”

18  
19 In fact, employers have good reason to be concerned that large numbers of  
20 working people with low family incomes do not take advantage of the public  
21 benefits intended to help them and their families achieve economic  
22 sufficiency--benefits that also help employers by contributing to the  
23 economic stability of their workforces. These public benefits bolster ability  
24 of low-income workers to meet their basic needs, in effect providing a wage  
25 supplement to employers.<sup>1</sup>  
26

---

<sup>1</sup> Geri Scott (2004). “Private Employers and Public Benefits,” Workforce Innovation Networks (WINS): Boston (MA) and Washington D.C. WINS is a collaboration of Jobs for the Future, the Center for Workforce Preparation of the U.S. Chamber of Commerce, and the Center for Workforce Success, The Manufacturing Institute of the National Association of Manufacturers.

1 This joint study, performed in collaboration with the Center for Workforce Preparation of  
2 the U.S. Chamber of Commerce and the Center for Workforce Success of the National  
3 Association of Manufacturers, reports that many low wage workers fail to access public  
4 benefits.

5 *This not only hurts the workers who miss out on income and benefits; it also*  
6 *hurts their employers through higher turnover and increased absenteeism.*  
7 *Unreliable transportation, inadequate child care, and poor health are leading*  
8 *contributors to absenteeism, tardiness, and turnover among low-income*  
9 *workers. An evaluation of [households leaving the TANF program] in New*  
10 *Jersey by Mathematica Policy Research reported that 52 percent had been*  
11 *fired as a result of frequent tardiness or absenteeism related to child care or*  
12 *health problems. In the words of a call center manager who has hired many*  
13 *entry-level workers through the Annie E. Casey Foundation's Jobs Initiative,*  
14 *"these peoples' lives are in chaos. They have so many problems they cannot*  
15 *pay attention to work."*

16  
17 An unpublished survey conducted by ASE in Detroit, Michigan, highlights  
18 workplace problems that employers can experience when employees' non-  
19 work needs are not addressed. ASE asked entry-level workers and their  
20 supervisors in five companies about barriers to employee advancement. After  
21 "caring for a dependent," "money problems" were reported more frequently  
22 than 19 other potential problems ranging from "understanding work  
23 assignments" to "getting along with colleagues." "Financial worry about  
24 making ends meet" appears to contribute to absenteeism, distraction on the  
25 job, strained relations with supervisors and co-workers, and a number of  
26 other factors that reduce productivity.

27  
28 Clearly, it is in the employers' self-interest to help low-income workers  
29 overcome such problems.<sup>2</sup>

30  
31 The conclusion that programs such as low-income programs improve the competitiveness of  
32 local businesses does not come solely out of the business community. It is supported by  
33 academic research as well. For example, one professor at Johns Hopkins University found  
34 that increased minimum wages did not simply result in increased costs to business. Instead,  
35 she found a variety of offsets, reporting:

36  

---

<sup>2</sup> "Private Employers and Public Benefits," at 5.

1 Poverty. . produces ill-prepared workers whose lives are easily disrupted by  
2 small catastrophes. If the car breaks down, if the kid gets sick, it suddenly  
3 becomes impossible to be a reliable worker. Poverty also generates poor  
4 health among workers, making them less reliable still and raising the cost of  
5 employing them.<sup>3</sup>  
6

7 The offer of universal service programs provides benefits far beyond the participating  
8 residential customers. As can be seen, such programs help increase the competitiveness  
9 of local commercial and industrial businesses and offers benefits to the business and  
10 industrial customers.

11  
12 **Q. ASIDE FROM THESE DIRECT BENEFITS, IS THERE ANY OTHER REASON**  
13 **WHY UNIVERSAL SERVICE COSTS SHOULD BE ALLOCATED BETWEEN**  
14 **ALL CUSTOMER CLASSES?**

15 A. Yes. One well-accepted tenet of utility ratemaking is that certain expenses incurred by a  
16 public utility are for “public goods.” Due to the nature of public goods, all customers  
17 receive benefits from public goods and, accordingly, the costs of such goods are spread  
18 over all customer classes. Each end-user makes a financial contribution to the utility’s  
19 delivery of public goods. The “public goods” doctrine is applied in a variety of settings  
20 as a justification to spread designated utility costs over all customer classes. Subway  
21 service has been found to be a public good. The basic telecommunications network has  
22 been found to be a “public good” as a justification for spreading network costs over all  
23 customer classes.  
24

---

<sup>3</sup> Erica Schoenberger (1999). *The Living Wage in Baltimore: Impacts and Reflections*, John Hopkins University Department of Geography and Environmental Engineering: Baltimore (MD).

1 **Q. HAS ANY PUBLIC REGULATORY OR LEGAL BODY RECOGNIZED**  
2 **“UNIVERSAL SERVICE” WITHIN THE GAS AND/OR ELECTRIC**  
3 **INDUSTRIES TO BE A “PUBLIC GOOD”?**

4 A. Yes. The definition of “public good” articulated by the National Regulatory Research  
5 Institute (NRRRI) at Ohio State University. NRRRI states:

6 A public good can be defined as “any publicly induced or provided collective  
7 good” that “arise[s] whenever some segment of the public collectively wants  
8 and is prepared to pay for a different bundle of goods and services than the  
9 unhampered market will produce.” (note omitted). In sharp contrast to the  
10 private-good model. . . , the emphasis of the public-good model is on the *total*  
11 societal benefits—both direct and indirect—associated with network  
12 modernization. As applied to the telecommunications network, the public-good  
13 model is based upon the premise that the costs of achieving and supporting a  
14 modern, state-of-the-art network infrastructure are ultimately borne by the  
15 general body of ratepayers as opposed to limited subsets of customers who  
16 exhibit a high demand for specific new services. The public-good model is  
17 conducive to establishing social policies that provide for a “supply driven  
18 definition” of infrastructure.

19  
20 \* \* \*

21  
22 Under the public-good model, infrastructure investment[s] that are in the  
23 “public interest” are mandated by regulatory commissions, which act as  
24 surrogates for marketplace forces for the very reason that those forces break  
25 down either because of the enormous risks involved because of uncertainty with  
26 respect to costs and demand or both, or because of the intangible or  
27 unmeasurable society benefits which are not valued by the marketplace.  
28 (emphasis in original).<sup>4</sup>

29  
30  
31 **Q. IN WHAT WAYS IS THIS NRRRI DISCUSSION HELPFUL IN THE CURRENT**  
32 **PROCEEDING?**

33 A. This NRRRI discussion helps guide the PUC’s consideration of universal service cost  
34 allocations in several ways.

---

<sup>4</sup> National Regulatory Research Institute (October 1991). The Public Good/Private Good Framework for Identifying POTS Objectives for the Public Switched Network, NRRRI: Columbus (OH).

- 1           ➤ First, universal service is a “publicly induced or provided collective good” as  
2 described by the NRRI.  
3
- 4           ➤ Second, it is clear from prior Pennsylvania proceedings, that NRRI was correct in  
5 referring to such a “collective good” as one that not all ratepayers would choose to  
6 pay for. Indeed, the fact that the Pennsylvania General Assembly mandated that a  
7 universal service charge be “nonbypassable” indicates that the General Assembly  
8 understood this aspect of a “public good” and that it affirmatively decided that all  
9 ratepayers should help pay for this collective good.  
10
- 11          ➤ Third, the Pennsylvania universal service programs are consistent with NRRI’s  
12 statement that the emphasis is on “the *total* societal benefits.” Indeed, these benefits  
13 include not simply the benefits to participating customers, but also, in the words of  
14 NRRI, the benefits “both direct and indirect.” Pennsylvania’s CAP programs, as a  
15 public good, clearly fit this notion of generating not only direct social benefits, but  
16 also a wide range of indirect social benefits to all customer classes.  
17
- 18          ➤ Fourth, the finding that universal service is a “public good” has cost allocation  
19 implications to it. As NRRI points out, “the costs of achieving and supporting a  
20 modern, state-of-the-art network infrastructure are ultimately borne by the general  
21 body of ratepayers.” While some ratepayer groups would limit the allocation of  
22 costs only to those customers who “use” the service of a universal service program,  
23 accepting this decision is at fundamental odds with universal service being  
24 determined to be a “public good.” As NRRI points out, having the costs of universal  
25 service be “borne by the general body of ratepayers” is “opposed to limited subsets  
26 of customers who exhibit a high demand for specific new services.”  
27
- 28          ➤ Finally, the very fact that the public benefits of Pennsylvania’s universal service  
29 programs such as CAP are hard to quantify is one of the reasons that universal  
30 service should be found to be a public good with costs allocated to all ratepayers. As  
31 NRRI points out, the public good approach applies “for the very reason that those  
32 [market] forces break down. . .because of . . .the intangible or unmeasurable society  
33 benefits which are not valued by the marketplace.”  
34

35 It is not merely state utility regulatory commissions, however, that recognize universal  
36 service as a “public good.” In addition to the National Regulatory Research Institute  
37 (NRRI) discussion cited above, the National Association of Attorneys General (NAAG)  
38 has reached this same conclusion:

39           At its spring 1998 meeting, the National Association of Attorneys General  
40 (NAAG) adopted a resolution addressing competition issues in electric utility  
41 transactions. . .NAAG endorsed the following principles: . . .(11) Any system  
42 benefit charges which are imposed to support public goods such as . . .universal



1 energy conservation and usage reduction services to low income residential  
2 customers across the Commonwealth. The revenues to support LIURP are  
3 based on two-tenths of one percent of revenues from all utility classes.  
4 LIURP costs are allocated across all rate classes.<sup>8</sup>  
5

6 As can be seen, allocating the costs of universal service programs to all customer classes  
7 is not a unique notion in Pennsylvania, nor around the country. Such an allocation should  
8 be adopted for CAP costs in this proceeding.  
9

10 **Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

11 **A.** Yes it does.

---

<sup>8</sup> Bureau of Consumer Services, at 158.

OTS Statement No. 1  
Witness: Robert Plonski

**PENNSYLVANIA PUBLIC UTILITY COMMISSION**

v.

**DUQUESNE LIGHT COMPANY**

Docket No. R-00061346

**RECEIVED**

SEP 28 2006

Direct Testimony

PA PUBLIC UTILITY COMMISSION  
SECRETARY'S BUREAU

of

Robert Plonski

Office of Trial Staff

Concerning:

Rate of Return

1 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A. My name is Robert Plonski. My business address is P.O. Box 3265, Harrisburg,  
3 Pa. 17105-3265.

4

5 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

6 A. I am currently employed by the Pennsylvania Public Utility Commission as a  
7 Fixed Utility Financial Analyst. I am assigned to the Office of Trial Staff as an  
8 expert witness.

9

10 **Q. PLEASE DESCRIBE THE ROLE OF OTS IN RATE PROCEEDINGS?**

11 A. OTS was established by the Pennsylvania Legislature and is responsible for  
12 representing the public interest in rate proceedings and certain other matters. The  
13 OTS analysis in this proceeding is based on its responsibility to represent the  
14 public interest. This responsibility requires the balancing of the interests of  
15 ratepayers and the Company.

16

17 **Q. WHAT IS YOUR EDUCATIONAL AND PROFESSIONAL**  
18 **BACKGROUND?**

19 A. I have prepared this information in Appendix A attached to my direct testimony.

1 I. **Subject of Testimony**

2 Q. **PLEASE IDENTIFY THE ISSUES ADDRESSED IN YOUR TESTIMONY.**

3 A. The main issue addressed in my direct testimony concerns rate of return, including  
4 the cost of common equity and the overall fair rate of return for Duquesne Light  
5 Company (DLC or Company).

6

7 Q. **DOES YOUR DIRECT TESTIMONY INCLUDE AN EXHIBIT THAT**  
8 **SUPPORTS YOUR RECOMMENDATIONS WITH RESPECT TO A FAIR**  
9 **RATE OF RETURN?**

10 A. Yes. OTS Exhibit. No. 1 presents the analyses that I have conducted regarding the  
11 determination of a fair and reasonable overall rate of return for DLC.

1 **II. Background Discussion**

2 **Q. HOW DOES THE RATE OF RETURN COMPONENT FIT WITHIN THE**  
3 **REVENUE REQUIREMENT FORMULA?**

4 A. The revenue requirement formula is as follows:

5 
$$RR = E + D + T + (V-d) \times R$$

6 Where:

7 RR = Revenue Requirement

8 E = Operating Expense

9 D = Depreciation Expense

10 T = Taxes

11 V = Gross Rate Base

12 d = Accrued Depreciation

13 R = Overall Rate of Return

14 In the above formula, the rate of return is expressed as a percentage. The  
15 calculation of that rate is independent of the determination of the appropriate rate  
16 base value for ratemaking purposes. As such, the appropriate total dollar return is  
17 dependent upon the proper computation of the rate of return and the proper  
18 valuation of the Company's rate base.

1 Q. WHAT CONSTITUTES A FAIR AND REASONABLE OVERALL RATE  
2 OF RETURN?

3 A. A fair and reasonable overall rate of return is one which will allow the utility the  
4 opportunity to recover those costs prudently incurred by all classes of capital used  
5 to finance the rate base during the prospective period its rates will be in effect.

6 The Bluefield Water Works and Hope Natural Gas cases of 1923 and 1944,  
7 respectively (cited below), set forth the principles that are generally accepted by  
8 regulators throughout the country as the appropriate criteria for measuring a fair  
9 rate of return:

10 A public utility is entitled to such rates as will permit it to earn a  
11 return on the value of the property which it employs for the  
12 convenience of the public equal to that generally being made at the  
13 same time and in the same general part of the country on  
14 investments in other business undertakings which are attended by  
15 corresponding risks and uncertainties; but it has no constitutional  
16 right to profits such as are realized or anticipated in highly profitable  
17 enterprises or speculative ventures. The return should be reasonably  
18 sufficient to assure confidence in the financial soundness of the  
19 utility and should be adequate, under efficient and economical  
20 management, to maintain and support its credit and enable it to raise  
21 the money necessary for the proper discharge of its public duties. A  
22 rate of return may be reasonable at one time and become too high or  
23 too low by changes affecting opportunities for investment, the  
24 money market and business conditions generally.

25  
26 Bluefield Water Works & Improvements Co. v. Public Service Comm. of West  
27 Virginia, 262 U.S. 679, 692-93 (1923).

1 It is important that there be enough revenue not only for operating  
2 expenses but also for the capital costs of the business. These  
3 include service on the debt and dividends on the stock. By that  
4 standard the return to the equity owner should be commensurate  
5 with risks on investments in other enterprises having corresponding  
6 risks. That return, moreover, should be sufficient to assure  
7 confidence in the financial integrity of the enterprise, so as to main-  
8 tain its credit and to attract capital.  
9

10 FPC v. Hope Natural Gas Co., 320 U.S. 591, 603 (1944).

11 While interpretations of these excerpted citations may vary somewhat, they  
12 provide general guidelines for the regulator to determine a fair rate of return.  
13

14 **Q. WOULD YOU PLEASE EXPLAIN HOW YOU CALCULATED YOUR**  
15 **OVERALL RATE OF RETURN?**

16 **A.** Yes. The overall rate of return in this rate proceeding is calculated using the  
17 weighted average cost of capital method, which is the interaction of the following  
18 components: the percentage of short-term and long-term debt, the percentage of  
19 preferred stock, the percentage of common equity, the cost of short-term and long-  
20 term debt, the cost of preferred stock, and the cost rate of common equity. First, it  
21 is necessary to determine the proportion of each type of capital (referred to as the  
22 capital structure) which has financed the rate base and assign the appropriate cost  
23 rate to each. The capital structure may be actual or imputed if the actual capital  
24 structure is not representative of the industry norm. The cost rate of debt is fixed

1 and can be computed accurately. The cost rate of common equity is not fixed and  
2 is much more difficult to measure.

3 The overall rate of return is then calculated using the proportions of capital  
4 and cost rates for each type of capital. OTS Exhibit No. 1, Schedule 1 demon-  
5 strates the interaction of the capital structure and the cost rates of each type of  
6 capital. By multiplying each capital component's capital ratio by its associated  
7 cost rate, a weighted cost rate is derived for each capital component. The overall  
8 rate of return is the sum of weighted cost rates.

9  
10 **III. Company Position**

11 **Q. WHAT IS THE COMPANY'S RATE OF RETURN CLAIM IN THIS**  
12 **CASE?**

13 **A.** Mr. Paul R. Moul, the Company's cost of capital witness, recommended the  
14 following rate of return for DLC:

	<u>Capital</u>	<u>Cost</u>	<u>Weighted</u>
	<u>Structure</u>	<u>Rate</u>	<u>Cost</u>
	<u>-(%)</u>	<u>(%)</u>	<u>Rate</u>
			<u>(%)</u>
19 Debt	43.03	6.90	2.97
20 Preferred Stock	9.04	5.37	0.49
21 Common Equity	<u>47.93</u>	11.75	<u>5.63</u>
22 Total	<u>100.00</u>		<u>9.09</u>

23  
24 Source: Exhibit PRM-1, p. 1 of 36.

1 Q. WHAT IS THE BASIS FOR THE DLC'S CLAIMED CAPITAL  
2 STRUCTURE?

3 A. Mr. Moul recommends using a pro forma capital structure as of December 31,  
4 2006 consisting of 47.93% common equity, 9.04% preferred stock, and 43.03%  
5 debt. Mr. Moul recommends using the pro forma capital structure because it is the  
6 best approximation of the capital mix the company will employ during the period  
7 of new rates (DLC St. No. 6, p. 23).

8  
9 IV. OTS Position

10 Q. WILL YOU PLEASE SUMMARIZE YOUR RECOMMENDATION?

11 A. The following is a summary of my rate of return recommendation:

	Capital Structure (%)	Cost Rate (%)	Weighted Cost Rate (%)
12			
13			
14			
15			
16	Total Debt	46.88	6.90
17	Preferred Stock	8.91	5.37
18	Common Equity	44.21	9.85
19	Total	100.00	8.06
20			

21 Source: OTS Ex. No. 1, Sch. No. 1.

22

23 Q. HAVE YOU ADOPTED ANY ELEMENTS OF THE COMPANY'S  
24 RECOMMENDATION IN ARRIVING AT YOUR POSITION?

25 A. Yes. I have adopted the Company's recommended cost rate of debt. I have also  
26 adopted the cost rate of preferred stock for the Company.

1 Q. **HOW DOES YOUR RECOMMENDATION DIFFER FROM THE**  
2 **COMPANY'S CLAIM?**

3 A. In the table above, I have italicized and bolded the numbers where my  
4 recommendation differs from DLC Witness Moul's rate of return claim. My  
5 recommendation differs in three areas: The capital structure, the cost rate of  
6 common equity, and the overall rate of return. I recommend a capital structure  
7 consisting of 55.79% debt, including preferred stock, and 44.21% of common  
8 equity. Mr. Moul is recommending a capital structure consisting of 43.03% debt;  
9 9.04% preferred stock; and 47.93% common equity. I recommend a 9.85% cost  
10 rate of common equity in lieu of Mr. Moul's 11.75 percent recommendation. My  
11 overall rate of return recommendation is 8.06%, as opposed to Mr. Moul's 9.09%  
12 recommendation.

13

14 V. **Capital Structure**

15 Q. **WHAT IS DLC'S RECOMMENDED CAPITAL STRUCTURE?**

16 A. DLC Witness Moul is recommending a capital structure consisting of 43.03%  
17 debt; 9.04% preferred stock; and 47.93% common equity (PRM-1, Schedule 1).

1 **Q. WHAT IS THE BASIS FOR DLC'S CAPITAL STRUCTURE CLAIM?**

2 A. Mr. Moul is basing his recommendation on the pro forma mix of long-term debt  
3 and equity as of December 31, 2006 (DLC Ex. No. 4, Ex. PRM-1, Sch. No. 5).

4 Mr. Moul's recommendation includes:

- 5 • A future test year upward adjustment for minimum pension liability  
6 (MPL) of \$24,864,406.
- 7
- 8 • A long-term debt issuance of \$43,155,000, to be issued in November  
9 2006.
- 10
- 11 • An adjustment to common equity to reflect a \$20,248,000 increase  
12 to retained earnings.
- 13

14 **Q. ARE YOU IN AGREEMENT WITH INCLUDING A MPL ADJUSTMENT**  
15 **TO COMMON EQUITY?**

16 A. No. "MPLs arise due to an underfunding of the pension trust. When the  
17 underfunding exceeds the accumulated benefit obligation, a liability must be  
18 recognized. The liability must take into account any existing prepaid or accrued  
19 pension costs, and, while these accounts cannot be diminished, the minimum  
20 liability can be affected. The debit created to match the liability credit is an  
21 *intangible asset which cannot exceed a maximum pension intangible. Debits*  
22 *required in excess of the maximum intangible must be made net of tax to a contra-*  
23 *equity account, and deferred taxes must also be updated". See OTS Exhibit No. 1,*  
24 *Schedule 10.*

1           For example, the State’s teacher’s pension fund is under funded. The  
2           actuary has determined that the book value of the teacher’s pension fund is  
3           \$200,000,000. An expert has determined that the market value of the teacher’s  
4           pension fund to be \$300,000,000. According to MPL the State would have a  
5           liability of \$100,000,000 to cover the liability for the pension fund currently since  
6           it is under funded. In reality, because the State will never be “bankrupt” this  
7           liability never actually exists. Because of the State’s taxing authority, there will  
8           never be a financial disaster in order for this liability to truly exist. Similarly, in  
9           the case of a utility, the liability will never actually exist. Under this scenario,  
10          Duquesne could file either a base rate case or a petition for extraordinary rate  
11          relief. If we follow Mr. Moul’s theory, adjusting the capital structure of Duquesne  
12          would allow the Company to over collect its pension cost, since the Commission  
13          permits Duquesne to recover its pension cost as an O&M expense.

14                 In my judgment, the above definition defines MPL as a liability provided to  
15          protect the pension funds in the event of a financial disaster. By adjusting the  
16          capitol structure for MPL, DLC would be granted “equity’ return dollars on what  
17          is a liability. Since by definition this transaction involves an intangible asset, I  
18          would point out that these funds are not financing any of the Company’s rate base  
19          and DLC should not be awarded “equity” return dollars on these funds.

1 **Q. ARE YOU IN AGREEMENT WITH THE INCREASE OF LONG-TERM**  
2 **DEBT?**

3 A. Yes. It is my understanding that the Company will issue \$43,155,000 in additional  
4 long-term debt by November 2006.

5  
6 **Q. PLEASE EXPLAIN MR. MOUL'S ADJUSTMENT TO RETAINED**  
7 **EARNINGS AS OF DECEMBER 31, 2006?**

8 A. Mr. Moul has made an upward adjustment to retained earnings in the future test  
9 year for \$20,248,000.

10

11 **Q. IN YOUR PROFESSIONAL OPINION, IS THE UPWARD ADJUSTMENT**  
12 **TO COMMON EQUITY BY \$20,248,000 APPROPRIATE?**

13 A. No. This is speculative in nature on the Company's witness Cannell's part. It is  
14 my understanding that in prior years DLC has given dividends of \$65,000,000 to  
15 \$58,000,000 to its parent Company. In order to achieve this goal of retained  
16 earnings, the dividend from DLC would have to be severely cut. The dividend  
17 would decrease from \$58,000,000 to about \$8,000,000 (DLC Exhibit 1,  
18 Consolidated Statements of Comprehensive Income, page 49).

1 **Q. WHAT IS YOUR CAPITAL STRUCTURE RECOMMENDATION?**

2 A. I recommend a pro forma capital structure for DLC at December 31, 2006,  
3 consisting of 44.44% debt, 9.34% preferred stock and 46.22% common equity  
4 (OTS Ex. No. 1, Sch. 6).

5  
6 **Q. WHAT IS THE BASIS FOR USING A PRO FORMA CAPITAL**  
7 **STRUCTURE FOR THE COMPANY?**

8 A. I have chosen to use a pro forma capital structure of the Company for the  
9 following reasons. First, Mr. Moul has made adjustments to include the minimum  
10 pension liability that, in my opinion, has understated debt and overstated equity.  
11 Second, Mr. Moul has made an adjustment to the future test year retained earnings  
12 that at best would be considered speculative, based on DLC cutting its dividend to  
13 Duquesne Light Holdings by \$52,000,000.

14  
15 **Q. ARE THERE ADJUSTMENTS MR. MOUL MADE THAT YOU**  
16 **DISAGREE WITH?**

17 A. Yes. As previously stated, Mr. Moul has made adjustments to include the  
18 minimum pension liability that, in my opinion, has understated the debt ratio and  
19 overstated the common equity ratio. Second, Mr. Moul has mad an adjustment to  
20 the future test year retained earnings that at best would be considered speculative,  
21 based on DLC cutting its dividend to Duquesne Light Holdings by \$52,000,000.

1 VI. Cost of Common Equity

2 Q. WHAT IS THE BASIS FOR THE DLC'S COST RATE OF COMMON  
3 EQUITY CLAIM?

4 A. Regarding the cost rate of common equity, Mr. Moul summarizes his analysis on  
5 p. 26 of his direct testimony (DLC St. No. 6) where he recommends that an  
6 11.75% common equity cost rate be used in this proceeding. To determine his  
7 cost of common equity, Mr. Moul states on page 3 of his direct testimony that he  
8 reviewed the results of four cost of common equity models in making this  
9 recommendation: the Discounted Cash Flow (DCF) model, The Risk Premium  
10 model (RP), the Capital Asset Pricing Model (CAPM), and the Comparable  
11 Earnings Model (CEM).

12

13 Q. WHAT IS THE BASIS FOR YOUR 9.85% COST OF COMMON EQUITY  
14 RECOMMENDATION?

15 A. I used the Discounted Cash Flow (DCF) method which I applied to Mr. Moul's  
16 barometer group of electric distribution companies to determine my 9.85% cost  
17 rate of common equity.

1 **Q. HAVE YOU INCLUDED AN ANALYSIS OF DUQUESNE'S MARKET**  
2 **DATA?**

3 A. No. The Company has no common stock publicly traded; therefore, no  
4 meaningful financial data is available to directly determine the cost of common  
5 equity for DLC.

6  
7 **Q. WHY DO YOU USE A BAROMETER GROUP AS YOUR PRIMARY**  
8 **SOURCE TO DETERMINE THE COST RATE OF COMMON EQUITY?**

9 A. The use of data for one company may be less reliable than using a barometer  
10 group, because the data for one company may be subject to particular events that  
11 can cause short-term aberrations in the marketplace. The rate of return on  
12 common equity for a single company could become distorted in such  
13 circumstances. The use of a barometer group has the effect of smoothing out any  
14 event aberrations associated with a single company. A barometer group of  
15 companies is also used as a benchmark to satisfy the long established guideline of  
16 providing a utility the opportunity to earn a return equal to that of similar risk  
17 enterprises.

1 **Q. HAS MR. MOUL MADE ADJUSTMENTS TO HIS RECOMMENDED**  
2 **COST OF COMMON EQUITY?**

3 A. Yes. In his direct testimony, Mr. Moul has recommended a twenty-five (25) basis  
4 point adjustment to cost rate of common equity due to the Company's claimed  
5 excellent management performance (DLC Ex. 4, St. No. 6, page 2, line 2).

6  
7 **Q. DO YOU AGREE WITH THIS ADJUSTMENT?**

8 A. No. Mr. Moul is trying to quantify something that is entirely too subjective to  
9 deserve such treatment. To the best of my knowledge, Mr. Moul has not  
10 completed or shown any definitive study conducted by him or the Company that  
11 can support his recommended subjective adjustment.

12  
13 **Q. WHAT IS YOUR RECOMMENDATION CONCERNING THIS**  
14 **ADJUSTMENT?**

15 A. It should be denied for the reason that I have just stated. DLC has submitted no  
16 study or other concrete evidence to support such an adjustment.

1 **Q. HAS MR. MOUL INCLUDED ANY OTHER ADJUSTMENTS BESIDES**  
2 **THE TWENTY-FIVE BASIS POINT ADJUSTMENT FOR EXCELLENT**  
3 **MANAGEMENT?**

4 A. Yes. Mr. Moul has included a thirty-one basis point adjustment, which he calls a  
5 "credit quality adjustment".

6  
7 **Q. ARE YOU IN AGREEMENT WITH THIS ADJUSTMENT?**

8 A. No. This adjustment is based on the testimony of Julie Cannell. At page 58 lines  
9 10-11 Mr. Moul in his direct testimony states that the credit quality risk is  
10 based on Ms. Cannell's testimony. In response to OTS-RR-6 and 7 Ms. Cannell  
11 states that there was no attempt to quantify this risk. Therefore, this adjustment  
12 should not be allowed. (OTS Exhibit No. 1 Schedules 8 and 9)

13  
14 **Q. HAS MR. MOUL INCLUDED ANY OTHER ADJUSTMENTS TO HIS**  
15 **RECOMMENDATION?**

16 A. Yes. Mr. Moul has added a forty-three (43) basis point adjustment for what he has  
17 termed leverage.

1 **Q. ARE YOU IN AGREEMENT WITH THIS ADJUSTMENT?**

2 A. No. This adjustment is simply a market to book adjustment. On page 28, lines 16  
3 and 17, DLC Witness Moul states that this adjustment is necessary when market  
4 and book values diverge.

5 The mere fact that a gas company's M/B ratio is in excess of 1 is an  
6 indicator that the company is earning in excess of required return, rather than  
7 under earning. An investor earning exactly his rate of return would price the stock  
8 at book value. Only when the earnings on book exceed the required rate of return  
9 will an investor bid the price of the stock above book value.

10

11 **Q. WHAT BAROMETER GROUP DID YOU USE FOR YOUR ANALYSIS?**

12 A. I adopted Mr. Moul's barometer group of nine electric distribution companies that  
13 are presented in Exhibit PRM-1, Schedule 3, p. 2 of 2. I found his selection of  
14 these companies to be representative of the electric distribution industry.

1 Q. DOES YOUR COST OF EQUITY ANALYSIS TAKE CHANGING  
2 BUSINESS AND ECONOMIC CONDITIONS INTO ACCOUNT?

3 A. Yes. The financial markets take all factors into account when assessing  
4 investments. The aggregate risks of an investment are reflected in the stock price  
5 per share. The data for the barometer groups that I have utilized is market based;  
6 therefore, assuming that the equity markets are reasonably efficient, my results  
7 have implicitly accounted for all these factors.

8  
9 Q. WHAT ECONOMIC FACTORS DO YOU CONSIDER IMPORTANT IN  
10 YOUR ANALYSIS OF COST OF CAPITAL?

11 A. I have made comparisons of important economic variables and have examined  
12 their impact on electric distribution utilities over the past twenty-five (25) years.  
13 Sch. No. 2 of OTS Ex. No. 1 presents a historical perspective of the Moody's  
14 "Aaa" Corporate Bond Yield, the U.S. T-Bills rate, the prime rate, and the percent  
15 change in the Consumer Price Index (CPI) compared to the average dividend yield  
16 of the nine-company barometer group for the same period. This schedule also  
17 presents a sampling of economic experts' quarterly forecasts for 2006 (2nd  
18 quarter) through 2007 (3rd quarter) and yearly forecasts for the period 2007 to  
19 2016.

1 **Q. IS THERE A RELATIONSHIP BETWEEN DIVIDEND YIELDS OF**  
2 **ELECTRIC DISTRIBUTION COMPANIES AND “Aaa” BOND YIELDS?**

3 A. Yes. A comparison of the “Aaa” bond yields and dividend yields in Sch. No. 2 of  
4 OTS Ex. No. 1 reveals a direct relationship between these two variables. The  
5 correlation coefficient of the two arrays is .95, which indicates an extremely strong  
6 relationship<sup>1</sup>. This high correlation should be expected since all capital costs are  
7 extremely competitive. As a result, I consider it important in determining an  
8 appropriate cost rate of common equity to recognize this relationship. Any  
9 potential impact related to a projected change in bond yields should be considered  
10 in recommending a representative dividend yield for the prospective period.

11

12 **Q. WHAT HAS BEEN THE HISTORICAL TREND OF BOND YIELDS AND**  
13 **THE BAROMETER GROUP’S DIVIDEND YIELDS?**

14 A. The trend in “Aaa” rated bond yields and electric utility dividend yields presented  
15 in OTS Ex. No. 1, Sch. 2 has been a steady decline over the past 25 years. Since  
16 1981, “Aaa” rated bond yields have decreased from 14.17% to 5.24% through  
17 2005, or 893 basis points. Over the same time period, the nine company  
18 barometer group's average dividend yield declined from 12.81% to 4.29%  
19 resulting in a decline of 852 basis points.

---

<sup>1</sup> Correlation coefficients range between 1 and -1. A correlation coefficient of 1 indicates a perfect positive relationship. A correlation coefficient of -1 indicates a perfect negative relationship. A correlation coefficient of 0 indicates no relationship exists.

1 **Q. WHAT IS THE OUTLOOK FOR INTEREST RATES IN RELATION TO**  
2 **THE FORECASTED INFLATION RATE?**

3 A. OTS Ex. No. 1, Sch. No. 2 also presents short-term and long-term forecasts  
4 published by Blue Chip Financial Forecasts. Forecasting professionals are  
5 expecting Treasury Bill (T-Bill) yields to be between 4.80% and 5.10% and  
6 forecasted inflation to be between 3.70% and 2.40%. As a result, the real rate of  
7 interest<sup>2</sup> is expected to be in the 1.10% (2006 – 2nd quarter) to 2.80% (2006 – 4th  
8 quarter) range for this period.

9 Forecasting professionals are also expecting interest rates on long-term  
10 “Aaa” rated corporate bonds to remain fairly stable with a slight increase from  
11 6.00% in the second quarter of 2006 to 6.40% by 2007. These forecasts are  
12 dependent upon forecasters' belief that investors can expect a slight downturn in  
13 the economy with real GDP growth decreasing from a moderate 5.3% in the first  
14 quarter of 2006 to an average of 3.00% over the year and a half<sup>3</sup>.

15 Investors' expectations are, however, continually changing and influenced  
16 by Federal Reserve policy. The Federal Reserve's tight monetary policy of recent  
17 years has done much to alleviate inflationary fear. If the Federal Reserve  
18 continues to maintain its current anti-inflationary bias in monetary policy and  
19 manages to attain its interest rate and monetary targets, investors' inflationary

---

<sup>2</sup> Real rate of interest is the actual rate of interest minus the inflation rate.

1 expectations will continue to decrease, resulting in lower and more stable interest  
2 rates.

3  
4 **Q. WHAT IS THE OUTLOOK FOR INTEREST RATES FOR THE LONGER-  
5 TERM?**

6 A. Sch. No. 2 of OTS Ex. No. 1 further presents extended forecasts for the various  
7 interest rates for the period 2007 through 2016. Expectations are for the "Aaa"  
8 corporate bond yield to be in the range of 6.4% to 6.5% and the U.S. Treasury  
9 Bills to be in the range of 4.6% to 5.0%.

10  
11 **Q. WILL YOU PLEASE EXPLAIN YOUR DCF METHOD OF ANALYSIS?**

12 A. My analysis employs the standard DCF model,  $k = D_1/P_0 + g$ , where  $D_1$  is the  
13 dividend expected during the year,  $P_0$  is the current price of the stock, and  $g$  is the  
14 expected growth rate of dividends. For purposes of calculating a dividend yield  
15 applicable to the formula,  $D_0/P_0$  (the current dividend divided by the current  
16 price) must be adjusted by  $\frac{1}{2}$  the expected growth rate<sup>4</sup> in order to account for  
17 changes in the dividend rate in period 1.

---

<sup>3</sup> Blue Chip Financial Forecasts, December 1, 2006.

<sup>4</sup> The adjustment of  $\frac{1}{2}$  the growth rate is used when the timing of the dividend increase is not known for certain. It could occur next month or the twelfth month. On average it is safe to assume that the increase will occur half way through the prospective year. Therefore, an adjustment by  $\frac{1}{2}$  the expected growth rate is appropriate.

1 Q. PLEASE STATE THE RESULTS OF YOUR DISCOUNTED CASH FLOW  
 2 (DCF) ANALYSIS.

3 A. The following table summarizes the results of my DCF analysis:

	<u>Range</u>	<u>Recommendation</u>
Nine-Company Barometer Group	9.74% - 9.96%	9.85%

9 Source: OTS Ex. No. 1, Sch. No. 3, Col. 3.

11 Q. PLEASE EXPLAIN HOW YOU DEVELOPED THE DIVIDEND YIELDS  
 12 THAT YOU USED IN YOUR DCF ANALYSIS?

13 A. A representative dividend yield must be calculated over a time frame that avoids  
 14 the problems of short-term aberrations and "stale" data series. For purposes of my  
 15 DCF analysis, I placed equal emphasis on the most recent spot and 52-week  
 16 average dividend yields. The following table summarizes my dividend yield  
 17 computation for the barometer group:

18 Dividend Yields (Adjusted)

	<u>Spot</u> <u>5/4/06</u> <u>(%)</u>	<u>52-week</u> <u>Average</u> <u>(%)</u>	<u>Recommendation</u> <u>(%)</u>
Nine-Company Barometer Gp.	4.74	4.96	4.85

26 Source: OTS Ex. No. 1, Sch. 3, Col. 1.

1 **Q. PLEASE EXPLAIN WHY YOU DID NOT PRESENT A SEPARATE**  
2 **CALCULATION FOR THE NEXT PERIOD GROWTH ADJUSTMENT TO**  
3 **YOUR DIVIDEND YIELD.**

4 A. In this case, the dividends used in the dividend yield calculations are Value Line's  
5 projected dividends ( $D_1$ ) which reflect a full year's growth. Therefore, the  
6 standard adjustment by  $\frac{1}{2}$  the growth rate that I previously discussed has already  
7 been accounted for in this analysis.

8  
9 **Q. WHAT INFORMATION DID YOU RELY UPON TO DETERMINE YOUR**  
10 **EXPECTED GROWTH RATE?**

11 A. To arrive at a representative dividend growth rate, I surveyed several series of  
12 projected growth rates. These growth rates are presented in OTS Ex. No. 1, Sch.  
13 No. 4. My growth rate estimates are based on a survey of established forecasting  
14 entities including Value Line Investment Survey, S&P, MSN Money, and Smart  
15 Money.

1 **Q. WHY HAVE YOU LIMITED YOUR SURVEY TO ANALYSTS' GROWTH**  
2 **RATE FORECASTS IN YOUR DETERMINATION OF AN**  
3 **APPROPRIATE GROWTH RATE?**

4 A. The bulk of the research evidence has indicated analysts' growth forecasts to be  
5 superior to historically oriented growth measures in forecasting growth.  
6 Forecasting professionals have already accounted for historical data in their  
7 estimates along with expectations of a wide array of economic variables. In my  
8 opinion, giving significant weight to historical growth rates would result in a  
9 double count.

10

11 **Q. WHAT DO YOU CONCLUDE TO BE A REASONABLE GROWTH RATE**  
12 **FOR THE NINE-COMPANY BAROMETER GROUP?**

13 A. I conclude that investors could reasonably expect to achieve a growth rate of  
14 5.00% for this barometer group.

1 **Q. WHAT LEADS YOU TO CONCLUDE THAT INVESTORS SHOULD**  
2 **EXPECT TO ACHIEVE A GROWTH RATE OF 5.00% FOR THE NINE-**  
3 **COMPANY BAROMETER GROUP?**

4 A. The expected growth rates for the barometer group are presented on OTS Ex. No.  
5 1, Sch. 4. The barometer group average earnings growth rates range between  
6 3.0% and 6.1%. Four of the five growth rates averages are between 3.0% and  
7 3.9%. While I believe growth rates ranging between 3.0% and 3.9% understate  
8 the long-term growth potential, I also believe that Value Line's estimate of 6.1% is  
9 overly optimistic. I have concluded that a reasonable growth rate lies somewhere  
10 between the range I have presented. Therefore, I have chosen 5.0% as a  
11 reasonable growth rate for the barometer group.

12  
13 **Q. WHAT IS THE COST RATE OF COMMON EQUITY RANGE THAT**  
14 **RESULTS FROM YOUR DCF ANALYSIS?**

15 A. Given these representative dividend yields and my recommended growth rates, I  
16 calculated the DCF return with the results presented on OTS Ex. No. 1, Sch. No.  
17 3. The nine-barometer group results range from 9.74% to 9.96%.

18  
19 **Q. WHAT COST RATE OF EQUITY DO YOU RECOMMEND FOR DLC?**

20 A. I recommend a 9.85% cost rate on common equity for DLC. This is the mid point  
21 of my range.

1 **Q. HAVE YOU TAKEN INTO CONSIDERATION MARKET PRESSURE,**  
2 **SELLING AND ISSUANCE EXPENSES IN MAKING YOUR**  
3 **RECOMMENDATION?**

4 A. Yes. I have considered these items but have not made any adjustments to account  
5 for them. I believe that market pressure, selling and issuance expenses are an  
6 additional cost of capital that is incurred at the time of issuance. However, the  
7 current market price of common stock already reflects these items, as investors  
8 have already capitalized market pressure and issuance expenses in determining the  
9 value of the stock at the time of purchase. Since my analyses are market based,  
10 these items have inherently already been taken into consideration. As a result I  
11 have made no additional adjustments to account for such market pressure and  
12 issuance expenses.

13  
14 **Q. ARE THERE ANY OTHER ISSUES THAT YOU WANT TO NOTE**  
15 **ABOUT THE COST OF COMMON EQUITY?**

16 A. Yes. Company witness Morgan O'Brien in direct testimony has testified that the  
17 company has applied for a distribution system improvement charge {DSIC}\_{DLC  
18 Ex. No. 4, St. 1, p. 10, Lns. 5 – 12). If the Commission were to allow the DSIC, I  
19 recommend that DLC be awarded the low-end of the cost rate for common equity,  
20 9.74%. This is due to the fact that the DSIC would reduce regulatory lag and thus

1 reduce the risk associated with the Company and thereby justify a lower cost rate  
2 for common equity had no such DSIC been allowed.

3  
4 **VII. Overall Weighted Cost of Capital**

5 **Q. WHAT IS THE OVERALL WEIGHTED COST OF CAPITAL FOR DLC?**

6 A. OTS Ex. No. 1, Sch. No. 1 presents the calculation of DLC's overall weighted cost  
7 of capital. Based upon my 9.85% cost rate of common equity, the overall  
8 weighted cost of capital is 8.12%.

9  
10 **VIII. Critique of the Duquesne Light Company Cost of Capital Testimony**

11 **Q. PLEASE SUMMARIZE YOUR CRITIQUE OF DLC'S COST OF CAPITAL  
12 TESTIMONY?**

13 A. I have four primary areas of disagreement concerning the representations made in  
14 Mr. Moul's testimony.

- 15 • First, Mr. Moul's proposed capital structure is not appropriate for  
16 ratemaking in this proceeding.
- 17  
18 • Second, Mr. Moul has incorrectly given equal weight to the Risk Premium, CAPM and Comparable Earnings methods in his recommendation.
- 19  
20  
21 • Third, Mr. Moul's upward adjustment to the common equity ratio to  
22 include the minimum pension liability is completely inappropriate.
- 23  
24 • Fourth, Mr. Moul has made a market to book adjustment of forty-three (43)  
25 basis points to his cost rate of common equity.

1 **Q. WHY IS MR. MOUL'S PROPOSED CAPITAL STRUCTURE**  
2 **INAPPROPRIATE FOR RATEMAKING PURPOSES?**

3 A. Mr. Moul and the Company have made adjustments to project a pro forma capital  
4 structure at December 31, 2006 to be at 43.03% debt; 9.04% preferred stock; and  
5 47.93% equity. My analysis shows that the capital structure is closer to 44.44%  
6 debt; 9.34% preferred stock and 46.22% equity (OTS Ex. No. 1, Sch. 6). It is my  
7 opinion that the adjustments made by Mr. Moul and the Company have overstated  
8 equity and understated debt. Since DLC's capital is atypical of industry averages,  
9 I would recommend the actual capital structure as presented in OTS Ex. No. 1,  
10 Sch. 6, in this instance.

11  
12 **Q. WHY SHOULD MR. MOUL'S METHOD, WHICH WEIGHTS THE RISK**  
13 **PREMIUM, COMPARABLE EARNINGS AND CAPM RESULTS**  
14 **EQUALLY WITH THE DCF RESULTS, BE REJECTED FOR THE**  
15 **DETERMINATION OF THE APPROPRIATE COST OF CAPITAL?**

16 A. To understand why his methods should be rejected for determining an appropriate  
17 cost of capital for DLC, it must first be understood how investors use these  
18 methods in their decision making process. The Capital Asset Pricing Model  
19 (CAPM), Comparable Earnings (CE), and Risk Premium (RP) methods give  
20 results that indicate to an investor what the equity cost rate should be if current  
21 economic and regulatory conditions are the same as those present during the

1 historical period the risk premiums were determined. By comparing CAPM and  
2 RP results with current expected equity returns (DCF results), an investor can  
3 make rational buy and sell decisions. When expected DCF returns are higher than  
4 those indicated by the CAPM and RP historical norms, an investor would have an  
5 incentive to buy, and vice versa.

6 The relevancy of these methods does not carry over from the investment  
7 decision making process to the regulatory process because we can never be certain  
8 that economic and regulatory conditions underlying the historical period during  
9 which the risk premiums were calculated are the same today or in the future<sup>5</sup>.

10  
11 **Q. GIVEN THE FACT THAT ECONOMIC AND REGULATORY**  
12 **CONDITIONS TODAY ARE DIFFERENT FROM THE HISTORICAL**  
13 **PERIOD, HOW DOES THIS AFFECT THE RISK PREMIUMS USED IN**  
14 **MR. MOUL'S RP AND CAPM MODELS?**

15 A. The CAPM and RP models do not measure the current rate of return on common  
16 equity directly, as does the DCF model. These methods determine the rate of  
17 return on common equity indirectly by observing the current cost of debt. An  
18 implicit assumption when using these methods is that the variables determining  
19 the equity cost rate and debt cost rate are the same, which allows the analyst to

---

<sup>5</sup> Half of Mr. Maul's risk premium relied upon historical data back to 1928 while the beta approach relies upon five-year historical returns.

1 apply a constant risk premium. Actually, the variables determining the cost rates  
2 in the two markets are different. Changing economic conditions cause these  
3 variables in the two markets to change resulting in changing risk premiums over  
4 time. As such, the use of a constant risk premium fails to capture the effect of  
5 changing economic conditions on risk premiums over time.

6  
7 **Q. IS THERE ANY ACADEMIC EVIDENCE THAT QUESTIONS THE**  
8 **CREDIBILITY OF THE CAPM MODEL?**

9 A. Yes. An article, which appeared in the New York Times on February 18, 1992,  
10 summarizes a CAPM study conducted by professors Eugene F. Fama and Kenneth  
11 R. French (OTS Ex. No. 1, Sch. No. 7). Their study examined the importance of  
12 beta (CAPM's risk factor) in explaining returns on common stock. In CAPM  
13 theory, the higher a stock's beta the higher the expected return on that stock. They  
14 found that the model did not do well in predicting actual returns and suggest the  
15 use of more elaborate multi-factor models. As a result of this information, I  
16 believe that rational investors will give less credibility to expected equity returns  
17 that are calculated using the simple CAPM model.

1 Q. MR. MOUL ALSO CONTENDS THAT THE COMPARABLE EARNINGS  
2 MODEL (CEM) SHOULD BE GIVEN EQUAL WEIGHT. WHY SHOULD  
3 THIS METHOD BE REJECTED FOR RATEMAKING PURPOSES?

4 A. I have several problems with Mr. Moul's CEM. First, Mr. Moul measured the  
5 historical earnings/book value ratios of non-utility companies. Mr. Moul has  
6 provided absolutely no evidence that these *accounting* returns for non-utilities bear  
7 any relationship to a *market* based return for electric distribution utilities.  
8 Moreover, this method completely contradicts the premise underlying his other  
9 methods. In all of the other methods, Mr. Moul measured returns based upon  
10 market values, including the bond returns that he subtracted from the common  
11 stock returns to determine his risk premiums.

12  
13 Q. HAS THE COMMISSION RECOGNIZED THE SHORTFALL  
14 ASSOCIATED WITH THE EARNINGS APPROACH?

15 A. The Commission long ago recognized the problem with this method. With respect  
16 to the use of non-utility companies' historical book earnings in an attempt to  
17 determine a cost of equity for a utility the Commission stated:                                 

18           The use of nonregulated companies as a comparable group for  
19           regulated firms under the comparable earnings method of computing  
20           a rate of return on common equity requires numerous unsupportable  
21           assumptions and results in a highly speculative finding.

22  
23 Pennsylvania Public Utility Commission v. Philadelphia Electric Co. (1980) 33

24 Pur4th 319, 341.

1 **Q. WHY IS AN UPWARD ADJUSTMENT TO COMMON EQUITY WITH**  
2 **THE ADDITION OF THE MINIMUM PENSION LIABILITY**  
3 **INAPPROPRIATE?**

4 A. My interpretation of this definition suggests that Mr. Moul is trying to obtain  
5 return dollars on what is in essence a liability for DLC. Again, I would like to  
6 point out that the MPL deals with an intangible asset. Since these funds are not  
7 financing DLC's rate base, this money should not be included in the Company's  
8 capital structure.

9  
10 **Q. CONCERNING YOUR LAST ISSUE, WHY MUST MR. MOUL'S**  
11 **MARKET TO BOOK ADJUSTMENT BE REJECTED?**

12 A Mr. Moul has argued for a market to book adjustment in previous cases, Aqua  
13 Pennsylvania R-00038805 and R-00016750. In the R-00016750 case, Mr. Moul  
14 argued for seventy-seven (77) basis point adjustment. In the latter case, R-  
15 00038805, Mr. Moul argued for a one hundred and three (103) basis point  
16 adjustment to cost of common equity. Following Mr. Moul's logic, every case in  
17 the future would have an ever increasing adjustment for market to book ratios.  
18 The fact that electric distribution companies' M/Bs are in excess of 1.0 is more an  
19 indicator that these companies are earning in excess of the required rate of return,  
20 rather than under earning. An investor earning exactly his rate of return would  
21 price the stock at book value. Only when the earnings on book exceed the

1 required rate of return will an investor bid the price of the stock above book value.  
2 Thus the problem becomes one of circularity. Thus, if this adjustment were to be  
3 granted in this instance, DLC and Mr. Moul would argue for a larger increase in  
4 future proceedings.

5

6 **Q. DOES THIS COMPLETE YOUR TESTIMONY?**

7 **A. Yes.**

## APPENDIX A

### **Robert J. Plonski** Educational and Professional Background

#### **Education**

M.S., Finance, King's College, 1998-2001  
B.S., Accounting, Marywood University, 1995-1998

#### **Training**

NARUC Utility Rate School, Clearwater, FL, October 24-29, 2004

#### **Professional**

Currently- Fixed Utility Financial Analyst  
Pa. PUC-Office of Trail Staff 2004 – Present

Previous- Adjunct Professor  
McCann Business School-Scranton, PA 2003 – 2004  
Instructed students in a wide range of Business subjects including  
Investments and Intermediate Accounting I & II

#### **Case History**

I have testified on behalf of the Office of Trail Staff in the following case:  
City of Lancaster – Sewer R-00049862

I have been involved in the following cases for the Office of Trail Staff:

Little Washington Wastewater	R-00040189 R-00040191 R-00040192
National Fuel Gas Company	R-00050216
Pike County Gas	R-00049884
Falls Township Sewer	R-00049557

Buss Water Company	R-00049559
Myers Gas Company	R-00050259
City of DuBois-Water	R-00050671
T.W. Phillips Gas and Oil Co.	R-00051178
UGI acquisition of Southern Co.	A-1200F2000
City of Bethlehem-Water	R-00050680
CMV Sewage Company, Inc.	R-00050677
Duquesne Light Company	R-00061346
TW Phillips Gas and Oil Co.	R-00051178

**OTS Exhibit No. 1  
Witness: Robert Plonski**

**PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**v.**

**DUQUESNE LIGHT COMPANY**

**Docket No. R-00061346**

**Exhibit to Accompany**

**the**

**Direct Testimony**

**of**

**Robert Plonski**

**Office of Trial Staff**

**Concerning:  
Rate of Return**

**RECEIVED**  
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**SECRETARY'S BUREAU**

**Duquesne Light Company**  
**OTS Recommended Weighted Cost of Capital**  
**at December 31, 2006**

		<u>Capital Structure</u> (1)	<u>Cost Rates</u> (2)	<u>Weighted Cost of Capital</u> (3=1x2)
[1]	Debt	44.44%	6.90%	3.07%
[2]	Preferred Stock	9.34%	5.37%	0.50%
[3]	Common Equity	<u>46.22%</u>	<b>9.85%</b>	<u>4.55%</u>
[4]	Total	<u>100.00%</u>		<u><b>8.12%</b></u>

Comparison of Key Economic Variables to the Dividend Yields for the  
Barometer Group of Electric Companies  
for 1981 to 2005 and Estimates for 2006 to 2016

	Year	Moody's 'Aaa' Corporate Bond Yield (1)	U.S. Treasury Bills (2)	Prime Rate (3)	CPI Percent Change (4)	Barometer Group Dividend Yields (5)
(1)	1981	14.17	14.03	18.87	8.90	12.81
(2)	1982	13.79	10.69	14.86	3.80	11.79
(3)	1983	12.04	8.63	10.79	3.80	10.67
(4)	1984	12.71	9.58	12.04	4.00	11.78
(5)	1985	11.37	7.48	9.93	3.80	9.54
(6)	1986	9.02	5.98	8.33	1.10	7.41
(7)	1987	9.38	5.82	8.21	4.40	8.09
(8)	1988	9.71	6.69	9.32	4.40	8.33
(9)	1989	9.26	8.12	10.87	4.60	7.78
(10)	1990	9.32	7.51	10.01	6.10	7.84
(11)	1991	8.77	5.42	8.46	3.10	7.38
(12)	1992	8.14	3.45	6.25	2.90	6.56
(13)	1993	7.22	3.02	6.00	2.70	5.98
(14)	1994	7.96	4.29	7.15	2.70	7.59
(15)	1995	7.59	5.51	8.83	2.50	6.88
(16)	1996	7.37	5.02	8.27	3.30	6.89
(17)	1997	7.26	5.07	8.44	1.70	5.92
(18)	1998	6.53	4.81	8.35	1.60	4.63
(19)	1999	7.04	4.66	8.00	2.70	4.66
(20)	2000	7.62	5.85	9.23	3.40	5.50
(21)	2001	7.08	3.45	6.99	1.60	4.87
(22)	2002	6.49	1.62	4.67	2.40	4.51
(23)	2003	5.67	1.02	4.12	1.90	4.84
(24)	2004	5.63	1.38	4.36	3.30	4.47
(25)	2005	5.24	3.16	6.23	3.80	4.29
(26)	2006 (1st Qtr)	5.39	4.50	7.43	2.20	
Recent Forecasts:						
(27)	2006-2nd Qtr	6.00	4.80	7.90	3.70	
(28)	2006-3rd Qtr	6.20	5.00	8.10	2.50	
(29)	2006-4th Qtr	6.30	5.10	8.20	2.40	
(30)	2007-1st Qtr	6.30	5.00	8.20	2.50	
(31)	2007-2nd Qtr	6.30	4.90	8.10	2.40	
(32)	2007-3rd Qtr	6.20	4.80	7.90	2.40	
Extended Forecasts:						
(33)	2007	6.40	5.00	8.10	2.80	
(34)	2008	6.30	4.80	7.90	2.50	
(35)	2009	6.30	4.60	7.70	2.40	
(36)	2010	6.20	4.50	7.60	2.50	
(37)	2011	6.30	4.60	7.60	2.50	
(38)	2012-16	6.50	4.60	7.70	2.50	

Note: Correlation of C1 and C5 = .95.

Sources: Economic Indicators, April 2006  
Mergent Bond Record, Various Issues  
Blue Chip Financial Forecasts, June. 1, 2006

**Expected Market Cost Rate of Equity**  
**Using Data for the Barometer Group of Nine Electric Distribution Companies**

<u>Time Period</u>	<u>Adjusted Dividend Yield(1)</u> (1)	<u>Growth Rate</u> (2)	<u>Expected Rate of Return</u> (3=1+2)
(1) 52 Week Average (ending 6/13/06)	4.74%	5.00%	9.74%
(2) Spot Price (ending 6/13/06)	<u>4.96%</u>	<u>5.00%</u>	<u>9.96%</u>
(3) Average:	<u>4.85%</u>	<u>5.00%</u>	<u>9.85%</u>

Notes: (1) Value Line's reported dividends are projected for the year ahead. The dividends not estimated by Value Line were increased by 1/2 the growth rate.

Sources: Value Line, Ratings and Reports, June 9, 2006  
 SmartMoney.com

**Expected Growth Rates**  
**for the Barometer Group of Electric Distribution Companies**

<u>Company</u>	<u>S &amp; P Earnings Growth</u> (1)	<u>Value Line Earnings Growth</u> (2)	<u>MSN Money Growth</u> (3)	<u>Morningstar Growth</u> (4)	<u>Smart Money Earnings Growth</u> (5)	<u>Smart Money Earnings 5yr Historic Growth</u> (6)
[1] CH Energy Group	0.0	3.0	0.0	0.0	0.0	0.0
[2] Central Vermont PS	N/L*	11.5	0.0	0.0	0.0	0.0
[3] Consolidated Edison	3.0	3.0	3.9	3.7	3.9	-1.3
[4] Duquesne Light Holdings	2.0	5.0	0.0	3.0	0.0	-9.6
[5] Energy East Corporation	4.0	4.0	4.5	4.3	4.5	-2.7
[6] Green Mountain Power	N/L*	3.5	0.0	0.0	0.0	0.0
[7] Northeast Utilities	8.0	11.0	8.7	7.3	8.7	-7.3
[8] NSTAR	5.0	6.0	5.0	5.0	5.0	-1.8
[9] Pepco Holdings	5.0	7.5	4.7	5.4	4.7	-2.7
[10] <b>Nine Company Avg.</b>	<b>3.9</b>	<b>6.1</b>	<b>3.0</b>	<b>3.2</b>	<b>3.0</b>	<b>-4.2</b>

\*= not listed and not used in calculation

Sources: Value Line Investment Survey, June 9, 2006  
Morningstar.com June 13, 2006  
Standard & Poor's Earnings Guide, June 2006  
Smartmoney.com

Comparison of Capital Structures

Barometer Group

Duquesne Light Company R-00061346

	2005	2004	2003	2002	2001	2000
<b>CH Energy Group</b>						
B/S - Long-Term Debt (Total) (MM\$)	\$ 343.886	\$ 319.883	\$ 278.880	\$ 269.877	\$ 216.124	\$ 320.369
Total Debt	\$ 343.89	\$ 319.88	\$ 278.88	\$ 269.88	\$ 216.12	\$ 320.37
B/S - Common Equity-Total (MM\$)	\$ 503.83	\$ 493.47	\$ 485.42	\$ 486.92	\$ 496.31	\$ 480.74
Total Debt and Equity	\$ 847.72	\$ 813.35	\$ 764.30	\$ 756.79	\$ 712.43	\$ 801.11

Average	
\$ 291.50	37.25%
\$ 491.11	62.75%
\$ 782.62	100.00%

	2005	2004	2003	2002	2001	2000
<b>Central Vermont PS</b>						
Long-Term Debt (Total) (MM\$)	\$ 133.84	\$ 133.84	\$ 137.44	\$ 149.67	\$ 172.67	\$ 166.95
Total Debt	\$ 133.84	\$ 133.84	\$ 137.44	\$ 149.67	\$ 172.67	\$ 166.95
B/S - Preferred Stock at Carrying Value (MM\$)	\$ 14.05	\$ 14.05	\$ 17.05	\$ 18.05	\$ 23.05	\$ 24.05
Common Equity-Total (MM\$)	\$ 225.46	\$ 225.46	\$ 211.25	\$ 197.61	\$ 183.51	\$ 190.70
Total Debt and Equity	\$ 373.36	\$ 373.36	\$ 365.75	\$ 365.33	\$ 379.24	\$ 381.70

\$ 152.12	40.77%
\$ 19.25	5.16%
\$ 201.71	54.07%
\$ 373.08	100.00%

Note: Information only available 2000 - 2004

	2005	2004	2003	2002	2001	2000
<b>Consolidated Edison</b>						
Long-Term Debt (Total) (MM\$)	\$ 7,428.00	\$ 6,594.00	\$ 6,769.00	\$ 6,206.92	\$ 5,542.31	\$ 5,446.91
Total Debt	\$ 7,428.00	\$ 6,594.00	\$ 6,769.00	\$ 6,206.92	\$ 5,542.31	\$ 5,446.91
B/S - Common Equity-Total (MM\$)	\$ 7,310.00	\$ 7,054.00	\$ 6,423.00	\$ 5,921.08	\$ 5,666.27	\$ 5,472.39
Total Debt and Equity	\$ 14,738.00	\$ 13,648.00	\$ 13,192.00	\$ 12,128.00	\$ 11,208.57	\$ 10,919.30

\$ 6,331.19	50.09%
\$ 6,307.79	49.91%
\$ 12,638.98	100.00%

Source: Compustat Database

Comparison of Capital Structures

Barometer Group

Duquesne Light Company R-00061346

	2005	2004	2003	2002	2001	2000
<b>Duquesne Light Holdings</b>						
Long-Term Debt (Total) (MM\$)	\$ 957.80	\$ 958.00	\$ 977.50	\$ 1,232.00	\$ 1,348.76	\$ 1,499.30
Total Debt	\$ 957.80	\$ 958.00	\$ 977.50	\$ 1,232.00	\$ 1,348.76	\$ 1,499.30
Common Equity-Total (MM\$)	\$ 655.90	\$ 610.40	\$ 575.40	\$ 452.60	\$ 508.46	\$ 783.75
Total Debt and Equity	\$ 1,613.70	\$ 1,568.40	\$ 1,552.90	\$ 1,684.60	\$ 1,857.22	\$ 2,283.04

Average	
\$ 1,162.23	66.04%
\$ 597.75	33.96%
\$ 1,759.98	100.00%

	2005	2004	2003	2002	2001	2000
<b>Energy East Corp</b>						
Long-Term Debt (Total) (MM\$)	\$ 3,667.07	\$ 3,797.69	\$ 4,017.85	\$ 3,696.96	\$ 2,816.28	\$ 2,346.81
Total Debt	\$ 3,667.07	\$ 3,797.69	\$ 4,017.85	\$ 3,696.96	\$ 2,816.28	\$ 2,346.81
Common Equity-Total (MM\$)	\$ 2,872.67	\$ 2,631.26	\$ 2,572.32	\$ 2,460.61	\$ 1,781.18	\$ 1,716.52
Total Debt and Equity	\$ 6,539.74	\$ 6,428.94	\$ 6,590.17	\$ 6,157.57	\$ 4,597.46	\$ 4,063.34

\$ 3,390.44	59.17%
\$ 2,339.09	40.83%
\$ 4,572.54	100.00%

	2005	2004	2003	2002	2001	2000
<b>Green Mountain Power</b>						
Long-Term Debt (Total) (MM\$)	\$ 82.94	\$ 97.49	\$ 97.96	\$ 98.29	\$ 80.36	\$ 78.55
Total Debt	\$ 82.94	\$ 97.49	\$ 97.96	\$ 98.29	\$ 80.36	\$ 78.55
Common Equity-Total (MM\$)	\$ 117.37	\$ 109.58	\$ 99.92	\$ 91.72	\$ 101.28	\$ 92.04
Total Debt and Equity	\$ 200.32	\$ 207.07	\$ 197.88	\$ 190.01	\$ 181.64	\$ 170.59

\$ 89.27	46.67%
\$ 101.99	53.33%
\$ 191.25	100.00%

Source: Compustat Database

Comparison of Capital Structures

Barometer Group

Duquesne Light Company R-00061346

	2005	2004	2003	2002	2001	2000
<u>Northeast Utilities</u>						
Long-Term Debt (Total) (MM\$)	\$ 4,377.79	\$ 4,336.46	\$ 4,211.29	\$ 4,186.46	\$ 4,310.91	\$ 2,076.83
Total Debt	\$ 4,377.79	\$ 4,336.46	\$ 4,211.29	\$ 4,186.46	\$ 4,310.91	\$ 2,076.83
Common Equity-Total (MM\$)	\$ 2,429.24	\$ 2,296.71	\$ 2,264.12	\$ 2,210.52	\$ 2,117.64	\$ 2,218.58
Total Debt and Equity	\$ 6,807.03	\$ 6,633.18	\$ 6,475.41	\$ 6,396.98	\$ 6,428.55	\$ 4,295.41

Average	
\$ 3,916.62	63.45%
\$ 2,256.14	36.55%
\$ 6,172.76	100.00%

	<u>NSTAR</u>					
Long-Term Debt (Total) (MM\$)	\$ 2,402.38	\$ 2,101.40	\$ 1,982.53	\$ 2,091.36	\$ 1,891.80	\$ 2,024.56
Total Debt	\$ 2,402.38	\$ 2,101.40	\$ 1,982.53	\$ 2,091.36	\$ 1,891.80	\$ 2,024.56
B/S - Preferred Stock at Carrying Value (MM\$)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Common Equity-Total (MM\$)	\$ 1,535.02	\$ 1,440.88	\$ 1,361.59	\$ 1,299.31	\$ 1,262.60	\$ 1,342.23
Total Debt and Equity	\$ 3,937.39	\$ 3,542.28	\$ 3,344.12	\$ 3,390.66	\$ 3,154.40	\$ 3,366.79

\$ 2,082.34	60.25%
\$ 1,373.60	39.75%
\$ 3,455.94	100.00%

	<u>Pepco Holdings</u>					
Long-Term Debt (Total) (MM\$)	\$ 4,839.30	\$ 5,072.80	\$ 5,372.80	\$ 5,122.40	\$ 1,847.40	\$ 1,984.60
Total Debt	\$ 4,839.30	\$ 5,072.80	\$ 5,372.80	\$ 5,122.40	\$ 1,847.40	\$ 1,984.60
B/S - Preferred Stock at Carrying Value (MM\$)	\$ -	\$ -	\$ -	\$ -	\$ 84.80	\$ 90.30
Common Equity-Total (MM\$)	\$ 3,584.10	\$ 3,366.30	\$ 3,003.30	\$ 2,995.80	\$ 1,823.20	\$ 1,862.50
Total Debt and Equity	\$ 8,423.40	\$ 8,439.10	\$ 8,376.10	\$ 8,118.20	\$ 3,755.40	\$ 3,937.40

\$ 4,039.88	59.05%
\$ 29.18	0.43%
\$ 2,772.53	40.52%
\$ 6,841.60	100.00%

Source: Compustat Database

Comparison of Capital Structures

Barometer Group

Duquesne Light Company R-00061346

Debt

CH Energy Grpoup	\$ 291.50	37.25%
Central Vermont PS	\$ 152.12	40.77%
Consolidated Edison	\$ 6,331.19	50.09%
Duquesne Light Holdings	\$ 1,162.23	66.04%
Energy East Corp	\$ 3,390.44	59.17%
Green Mountain Power	\$ 189.27	46.67%
Northeast Utilites	\$ 3,916.62	63.45%
NSTAR	\$ 2,082.34	60.25%
Pepco Holdings	\$ 4,039.88	59.05%

Six year average percentage of Debt Nine Company Group 53.64%

Median 59.05%

Equity

CH Energy Grpoup	\$ 491.11	62.75%
Central Vermont PS	\$ 220.96	59.23%
Consolidated Edison	\$ 6,307.79	49.91%
Duquesne Light Holdings	\$ 597.75	33.96%
Energy East Corp	\$ 2,339.09	40.83%
Green Mountain Power	\$ 101.99	53.33%
Northeast Utilites	\$ 2,256.14	36.55%
NSTAR	\$ 1,373.60	39.75%
Pepco Holdings	\$ 2,801.72	40.95%

Six year average percentage of Equity Nine Company Group 46.36%

Median 40.95%

Duquesne Light Company  
Actual Capital Structure  
As of 12/31/2006

OTS Exhibit No. 1  
Schedule 6  
Page 1 of 2

Capitalization as of 12/31/2005

Capitalization as of 12/31/2006

		Adjustments			Adjustments			
Short Term Debt	\$ -	0.00%	\$ -	0.00%	\$ 26,395,000	1.76%	\$ 26,395,000	1.76%
Long Term Debt	\$ 589,144,535	42.64%	\$ 589,144,535	43.47%	\$ 632,299,535	42.18%	\$ 675,454,535	45.12%
Preferred Stock	\$ 133,434,357	9.66%	\$ 133,434,357	9.85%	\$ 133,434,357	8.90%	\$ 133,434,357	8.91%
	<u>\$ 722,578,892</u>	<u>52.29%</u>	<u>\$ 722,578,892</u>	<u>53.32%</u>	<u>\$ 792,128,892</u>	<u>52.84%</u>	<u>\$ 835,283,892</u>	<u>55.79%</u>
Common Equity								
Capital Surplus	\$ 571,117,012	41.33%	\$ 571,117,012	42.14%	\$ 598,679,512	39.94%	\$ 573,815,106	38.33%
Retained Earnings	\$ 88,071,262	6.37%	\$ (26,473,388) (a) \$ 61,597,874	4.54%	\$ 108,319,996	7.23%	\$ 88,071,262	5.88%
	<u>\$ 659,188,274</u>	<u>47.71%</u>	<u>\$ 632,714,886</u>	<u>46.68%</u>	<u>\$ 706,999,508</u>	<u>47.16%</u>	<u>\$ 661,886,368</u>	<u>44.21%</u>
Total Capitalization	<u>\$ 1,381,767,166</u>	<u>100.00%</u>	<u>\$ 1,355,293,778</u>	<u>100.00%</u>	<u>\$ 1,499,128,400</u>	<u>100.00%</u>	<u>\$ 1,497,170,260</u>	<u>100.00%</u>

Adjustments

(a) equals a \$26,473,388 reduction to retained earnings due to (MPL) minimum pension liability

(b) equals a \$24,864,406 reduction to retained earnings due to (MPL) minimum pension liability

(c) equals a \$20,248,734 Company projection due to increase of retained earnings

(d) equals long-term debt to be issued in November 2006

Source: DLC Exhibit 4; PRM-1; Schedule 5

**Duquesne Light Company**  
**Pro Forma Capital Structure**  
**As of 12/31/2006**

**OTS Exhibit No. 1**  
**Schedule 6**  
**Page 2 of 2**

**Capitalization as of 12/31/2006**

		<i>W/STD</i>	<i>WO/STD</i>	<b>Adjustments</b>		<i>WO/STD</i>
<b>Short Term Debt</b>	\$ 26,395,000.00	1.76%	0.00%		\$ 26,395,000.00	1.76%
<b>Long Term Debt</b>	\$ 634,801,775.00 (a)	42.27%	43.03%		\$ 634,801,775.00	44.44%
	\$ 661,196,775.00	44.03%	43.03%		\$ 661,196,775.00	44.44%
<b>Preferred Stock</b>	\$ 133,434,357.00	8.89%	9.04%		\$ 133,434,357.00	9.34%
<b>Common Equity</b>						
<b>Capital Surplus</b>	\$ 598,679,512.00 (b)	39.87%	40.58%	\$ (26,473,388.00) (d)	\$ 598,679,512.00	41.91%
<b>Retained Earnings</b>	\$ 108,319,996.00	7.21%	7.34%	\$ (20,248,734.00) (c)	\$ 61,597,874.00	4.31%
	\$ 706,999,508.00	47.08%	47.92%		\$ 660,277,386.00	46.22%
<b>Capitalization excl short term debt</b>	\$ 1,475,235,640.00	98.24%				
<b>Total Capitalization</b>	\$ 1,501,630,640.00		100.00%		\$ 1,428,513,518.00	100.00%

**Adjustments**

- (a) includes a long-term debt issuance, \$43,155,000, to be issued in November 2006
- (b) includes a \$27,562,500 infusion of capital from Duquesne Light Holdings
- (c) equals a \$20,248,734 Company projection due to increase of retained earnings
- (d) equals a \$26,473,388 reduction to retained earnings due to (MPL) minimum pension liability

Source: DLC Exhibit 4; PRM-1; Schedule 5

**Duquesne Light Company**  
**Capital Structure for 2004 through 2006**  
(\$ in thousands)

**OTS Exhibit No. 1**  
**Schedule 6a**

Capitalization	2004	2005	2006
Long-Term Debt	\$ 908,722	\$ 589,145	\$ 634,802
Preferred Stock	\$ 133,434	\$ 133,434	\$ 133,434
Common Equity	\$ 534,553	\$ 659,188	\$ 707,000
<b>Total</b>	<b>\$ 1,576,709</b>	<b>\$ 1,381,767</b>	<b>\$ 1,475,236</b>

**Capitalization Ratios**

Long-Term Debt	57.63%	42.64%	43.03%
Preferred Stock	8.46%	66.10%	9.04%
Common Equity	33.90%	47.71%	47.92%
<b>Total</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>

**Percentage Change**

Long-Term Debt	-15.00%	+0.39%
Preferred Stock	+1.19%	-0.61%
Common Equity	+13.80%	+0.22%

Source: DLC Exhibit 2 (Future); Schedule B8

## OTS Exhibit No. 1 Schedule 7a



# Deficient Market Theory

**H**OW NICE LIFE WOULD BE IF ALL BAD IDEAS WENT OUT of style, like the divine right of kings, medicinal bloodletting and leisure suits. Unfortunately, a muddled notion called the efficient market hypothesis refuses to go away. This absurd thesis holds that nobody can beat the market, stocks always are correctly priced according to what's publicly known about them and any mispricings are chimeras.

Such blind faith in the market's omniscient rationality led to investor losses of \$1 trillion in the 1987 crash and \$7 trillion in the 2000-02 postbubble slump. It ignores the commonsense effects of fads and manias. Every year or so I take another look to see if this silliness is on the way out (*see my Mar. 1, 2004 column*). But then I find that, like Dracula emerging from his tomb, efficient market dogma keeps returning to do harm. Many investment advisers still believe in it; their clients should beware.

Lately the most common failings of efficient market practitioners have been:

• **Overdiversifying.** Sure, it's wise to spread your holdings into several investment classes. But efficient market acolytes believe you should have a slice of every investment available, from iffy junk bonds to Kazakhstan stocks. Such thinking led throngs of investors to the Russian market in 1998, before it dropped 90%. The same sad story replays endlessly in South American markets, right before a currency devaluation or government-mandated asset expropriation.

Today a torrent of dollars is washing through European, Japanese and other foreign bourses, attracted by a few years of glittering performance. Don't let a short period of superior investment returns abroad fool you. Most recently the well-followed EAFE Index (Morgan Stanley Capital International's 21-nation basket for equities in Europe, Australasia and the Far East) has sharply outrun the S&P 500. EAFE has outperformed the S&P by 9.8 percentage points annually for the past three years.

During longer periods, however, the story is very different. Over the last 15 years the S&P outdistanced the EAFE, 11.5% to 7.3% annually.

• **Not bottom-feeding.** Baron Rothschild once



David Dreman is chairman of Dreman Value Management of Jersey City, N.J. His latest book is *Contrarian Investment Strategies: The Next Generation*. Visit his home page at [www.forbes.com/dreman](http://www.forbes.com/dreman).

advised that the best time to invest is when "blood is running in the streets." That's when prices are the lowest for good stocks. But efficient market devotees believe that one shouldn't try to take advantage of any crises. After all, they claim markets are always correctly priced. So the best plan, they say, is to wait until things settle down. Of course, prices are typically higher then.

In the real world, though, emotion trumps rationality, resulting in large opportunities for those who can keep a cool head and can properly assess risks and rewards. My Oct. 29, 2001 column in FORBES, entitled "Doomsday It Isn't," presented a table of nine stock market rises since World War II. The average gain two years after the lows was 33%.

• **Using beta as a benchmark.** This keeps turning up. Beta measures how much a stock rises or falls with the broad market. It is not a gauge of volatility. To efficient market folk, high-beta stocks are riskier than low-beta issues but have better long-term

**This old canard is still around. It tells us to invest in funky foreign stocks and also to avoid great values during a market slump. Don't believe it.**

results. Baloney. Eugene Fama, a prominent efficient market theorist, trashed the beta-myth in a 1992 paper with fellow academic Kenneth French. They showed that in a tabulation of stocks no correlation exists between high beta and good returns.

A better approach is to buy fine stocks like these:

• **Chevron (58, CVX)**, the world's fourth-largest oil company, is riding the oil boom. Beyond that, it has acquired Unocal, which adds 15% to its reserves.

Chevron also is upgrading refineries, a move that will boost production. The company is strong financially, with debt comprising merely 17% of capital, making prospects for stock buybacks and dividend hikes high. Chevron trades at a trailing price/earnings multiple of 9 and yields 3.1%.

• **Tyco (25, TYC)** has put rogue chief Dennis Kozlowski far behind. Still, it is suffering hard times along with other conglomerates.

The company's recent decision to split up in late January, accompanied by lower-than-expected earnings, has dropped the stock 31% from its 12-month high. With improving results likely in its large fire-protection business and a breakup value estimated to be in the \$30-to-\$35 range, the stock is undervalued. It trades at 13 times earnings and yields 1.6%.

• **UST (39, UST)**, the leading U.S. producer and marketer of smokeless tobacco, with 65% of the market, is the subject of takeover rumors. (A plausible buyer would be any cash-rich cigarette producer.) UST is trading at 12 times earnings; its yield is 5.7%. **F**

A child con-  
sadly, than  
Army make:

DISASTER-REL

# In the Volatile-Stock Theory

By ERIC N. BERG

One of the most enduring ideas of modern finance is facing its most serious challenge. Two scholars of finance say they have disproved the theory, common among investors, that stocks more volatile than the market as a whole are the best performers.

Eugene F. Fama and Kenneth R. French, business professors at the University of Chicago, traced the performance of thousands of stocks over 30 years but found no link between relative volatility and long-term returns. The many investors who try to beat the market by buying widely swinging issues are misguided, they say.

The importance of "beta," the investment community's term for a stock's volatility relative to the market, has long been under challenge. But it is still closely watched by ana-

lysts, and business students are still taught that they can earn higher returns by buying stocks whose swings are wider than the market's.

"The fact is," Professor Fama said in a recent telephone interview, "beta as the sole variable explaining returns on stocks is dead."

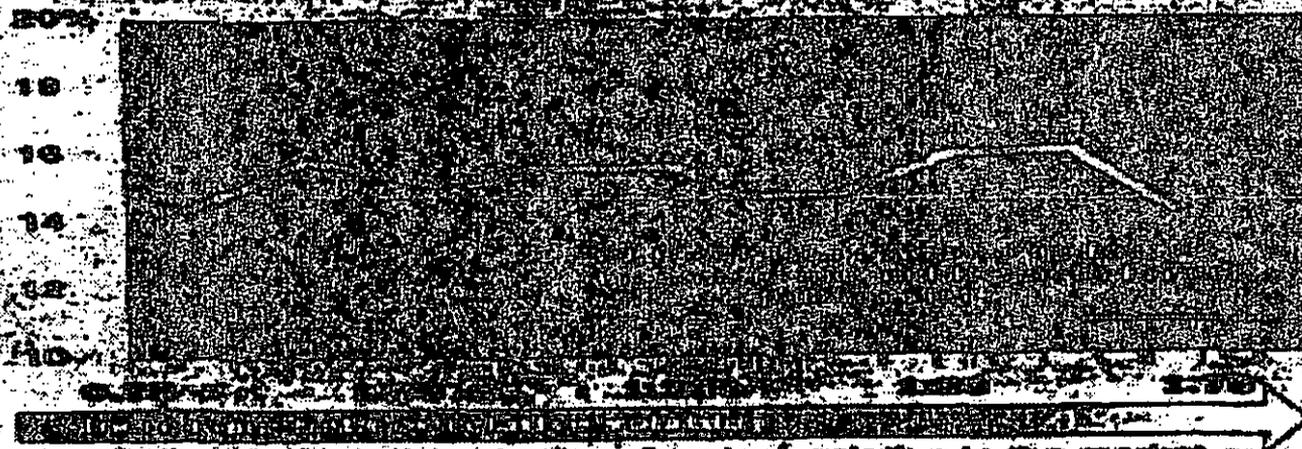
Some still favor relatively volatile stocks, among them William F. Sharpe, a retired Stanford University professor who won the 1988 Nobel Memorial Prize in Economic Science for theories based on beta. "It is a remarkable set of empirical results about what happened in the past," he said at the University of Chicago study. "But I am not willing to make investment decisions based on the theory that there is no relationship between beta, properly measured, and expected returns."

If Professors Fama and French

Continued on Page D6

## Knocking Down a Popular Theory

Annual returns on stock investments, based on relative volatility



Beta measures the volatility of a stock relative to the market.

Returns are based on average one-month Treasury bill yields, annualized, and average market returns, July 1950 to December 1980.

Source: Eugene F. Fama and Kenneth R. French, University of Chicago

returns. But recognizing that their low beta tend to argue against large role increases, a growing number of studies has already turned to other approaches. More will probably do so if the research of Professors Fama and French gains currency.

And if investors decide to quit following beta, other theories of market behavior are likely to gain influence. "What we are really talking about is opening the floodgates to a whole new generation of research into what truly drives stock prices," said Anthony A. Bonner, an Ohio State University professor of finance who is currently a visiting professor at the University of Chicago. "Once you hammer a model like the old one down, you generate all sorts of additional empirical interest."

Professor Fama has already won worldwide recognition for his efficient-market theory — the notion that because investors all have essentially the same information it is impossible to consistently earn returns greater than those justified by the risks.

Professor Sharpe used Professor Fama's theory as an assumption to develop the capital-asset pricing model, which links returns to risk, as measured by beta.

Professor Sharpe says that a diversified portfolio can reduce the risks available to individual companies — that General Motors stock, for example, will be hurt by a nuclear accident. Therefore, earn no rewards for bearing this risk, according to the Sharpe theory.

But investors do earn higher returns for bearing the other type of risk, known as market risk. Professor Sharpe says. This risk, which re-

measured by the market value of their shares, and those with low prices relative to their book values have in fact outperformed the market, they say.

The professors theorize that investors view smaller companies as more vulnerable to economic downturns and therefore demand higher returns. They also say that low price-to-book ratios typically reflect financial problems, another reason for investors to demand higher returns.

Professors Fama and French are by no means the first to fire an intellectual salvo at the capital-asset pricing model. Even Professor Sharpe developed the model in the early 1960's, a broad array of rival theories has emerged to explain both price movements: the January effect, which says that stocks usually gain at the beginning of the year, to the weekend effect, which says stocks generally perform poorly on Mondays. Most recently, the arbitrage pricing theory says that prices are driven by powerful economy-wide forces like unanticipated inflation and shifts in interest rates.

But finance experts say that Professors Fama and French have presented the most convincing evidence against beta.

"What they have proven fairly rigorously is what other academics have been talking about for some time," said Richard Roll, a finance professor at the University of California at Los Angeles, who with others developed the arbitrage pricing theory.

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## Equity Issues This Week

**OTS Exhibit No. 1**  
**Schedule No. 8**

Office of Trial Staff  
Interrogatories Set RR

6. Please reference Statement 7, page 9, lines 1-9. Provide the data that supports the increase of risk that occurred with Duquesne Light switched to an energy delivery business.

Response:

Ms. Cannel has not attempted to quantify the increasing risk associated with a decrease in the size and scope of Duquesne Light's business. However, it is clear that with a fully integrated business model, the company was in a better position to be able to buffer itself against numerous changes in circumstances, including economic downturns.

**OTS Exhibit No. 1**  
**Schedule No. 9**

Office of Trial Staff  
Interrogatories Set RR

7. Please reference Statement 7, page 9, lines 1-9. Provide the data that indicates the increased risk from competition. Also, please provide the names of two (2) competing companies and data that indicate the loss of sales or revenue from those companies.

Response:

While Ms. Cannel has not quantified the risk associated with not being able to control the total price to the customer, the company has been faced with several instances where major customers raised the possibility of moving facilities or building new facilities in other jurisdictions due to Duquesne Light's inability to control the total electric price.

**Report  
a  
Problem**

# The CPA Journal

**OTS Exhibit No. 1  
Schedule No. 10  
Page 1 of 3**

The CPA Journal Online  
May 1989

## The calculation and presentation of the minimum pension liability.

by Sanborn, Robert H.

**Abstract-** Accountants need to calculate corporate minimum pension liabilities for fiscal years beginning after December 15, 1988. The determination of minimum pension liability is dependent on whether pension plan asset fair values are exceeded by accumulated benefit obligations. The recognized liability needs to account for any existing accrued or prepaid pension costs. Liability credit matching debits are intangible assets and they cannot exceed maximum pension intangibles. Any debits that are made in excess of maximum intangibles must be placed in a contra-equity account net of tax.

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For fiscal years that begin after December 15, 1988, corporations must calculate whether a minimum pension liability (MPL) exists for that year and must determine the correct presentation of any resulting liability on the statement of financial position. This article will assist in the computation of MPL and in the presentation of the liability on the balance sheet.

### Existence of a Minimum Liability

The determination of the existence of MPL depends on whether the accumulated benefit obligation of the pension plan exceeds the fair value of the pension plan assets. Throughout most of SFAS No. 87, the guidelines use the projected benefit obligation or the actuarial present value of all pension benefits due employees using assumptions to estimate future employee compensation levels upon which their benefits will be computed. The calculation of the existence of MPL departs from the use of the projected obligation and instead relies on the more modest figure of an accumulated obligation. The accumulated benefit obligation computes all future pension obligations using current compensation levels instead of estimating future compensation levels. Because employee compensation rates will usually increase, the use of future salary rates would result in a higher pension obligation than if current salaries were used. The MPL, therefore, is truly a minimum liability that is due employees based only on current information.

The fair value of the pension plan assets is defined in SFAS No. 87, in much the same manner that it was under the old pension guidelines, as the amount that could be expected to be received for the pension investments in a non-forced sale between a willing buyer and a willing seller. The fair value then has been interpreted as the market value of the pension plan assets kept in trust to satisfy the future pension claims. Therefore, MPL will exist for any pension plans that are underfunded in respect to their current obligation.

Corporations that have pension plans that are not under-funded with respect to their accumulated benefit obligations do not have MPL, and must be sure to eliminate any existing MPL remaining from prior periods. Elimination entries will be the opposite of any of the three entries (explained later) which gave rise to the old MPL.

#### Existence of an Additional Liability

Corporations which have an underfunded pension plan next need to determine whether an additional liability will enter the calculation and presentation process. An additional liability will exist if prepaid or accrued pension costs exist at year end. Prepaid pension costs arise if employers contribute an amount in excess of the net pension costs, and accrued pension costs represent the accumulated net pension cost not yet funded by employers. Since pension accounting methods for GAAP purposes and for tax purposes often differ, the funding requirements of the pension plan agreement often will not coincide with pension expenses, and prepaids or accruals will result. The additional liability will be the MPL plus any prepaid pension cost balance or minus any accrued pension cost balance. If the accrued pension cost is greater than the MPL, no additional liability will exist, and no liability other than the accrued pension cost need be booked. If an additional liability does not exist because no prepaid or accrued pension costs exist, the only entry that need be made is to debit an intangible asset account called "deferred pension cost" and to credit a long-term liability account called "minimum pension liability" for the amount computed for the MPL.

The existence of an additional liability because of an accrued pension cost balance again requires that the "deferred pension cost" account be debited and the "minimum pension liability" account be credited. However, the amount involved in this situation is the amount calculated for the additional liability. The same presentation is required if a prepaid pension cost exists and the additional liability is less than the maximum pension intangible.

#### The Maximum Pension Intangible

The maximum pension intangible is the amount by which the projected benefit obligation exceeds the fair value of the plan assets when SFAS No. 87 was adopted by the employer. This amount represents the maximum amount that can be recorded due to unrecognized prior service cost. The FASB limited the pension intangible to this amount so that the asset recognized would have some basis of value (that of the promised future payments) and would not include any amounts which might arise due to a post-actuarial loss.

Additional liabilities that are larger than the maximum pension intangible necessitate the establishment of a contra-equity account called "net loss not recognized as pension expense." The debit to this account must be the net of the tax difference between the total additional liability and the maximum pension intangible. The deferred tax account must be debited for the difference times the tax rate so that the pension accounting guidelines conform to APB Opinion No. 11, Accounting for Income Taxes. The maximum pension intangible amount is then debited to the "deferred pension cost" account, and the entire additional liability is credited to the "minimum pension liability" account.

Application of the following Flowchart using the principles described in the above article should uncomplicate and ease the process of complying with this last requirement of SFAS No. 87.

#### Conclusion

MPLs arise due to an underfunding of the pension trust. When the underfunding exceeds the accumulated benefit obligation, a liability must be recognized. The liability must take into account any existing prepaid or accrued pension costs, and, while these accounts cannot be diminished, the minimum liability can be effected. The debit created to match the liability credit is an intangible asset which cannot exceed a maximum pension intangible. Debits required in excess of the maximum intangible must be made net of tax to a contra-equity account, and deferred taxes must also be updated.

The MPL must be calculated and presented for all corporations having domestic defined benefit pension plans for years beginning after December 15, 1988.

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**OTS Exhibit No. 1**  
**Schedule No. 10**  
**Page 3 of 3**

**OTS Statement No. 1-SR  
Witness: Robert Plonski**

**PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**v.**

**DUQUESNE LIGHT COMPANY**

**Docket No. R-00061346**

**Surrebuttal Testimony**

**of**

**Robert Plonski**

**Office of Trial Staff**

**RECEIVED**

**SEP 28 2006**

**PA PUBLIC UTILITY COMMISSION  
SECRETARY'S BUREAU**

**Concerning:**

**Rate of Return**

1 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A. My name is Robert Plonski. My business address is P.O. Box 3265, Harrisburg,  
3 Pa. 17105-3265.

4  
5 **Q. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY IN THIS**  
6 **PROCEEDING?**

7 A. Yes, I have. Please refer to OTS Statement No. 1 and OTS Exhibit No. 1.

8  
9 **Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?**

10 A. I have two reasons for presenting surrebuttal testimony. First, I want to update my  
11 recommended rate of return to account for changes that have occurred since I  
12 prepared my direct testimony. Second, I want to briefly respond to Duquesne  
13 Light Witness Paul Moul's rebuttal testimony, DLC Statement No. 6-R.

14  
15 **Q. WHAT IS YOUR UPDATED RECOMMENDED RATE OF RETURN AND**  
16 **HOW DID YOU CALCULATE IT?**

17 A. My updated recommended overall rate of return is 8.18%. OTS Exhibit No. 1-SR,  
18 Schedule No. 1 presents this calculation. The increase in the overall rate of return  
19 is the result of my recommended cost of equity increasing from 9.85% to 9.97%.  
20 This revision was in response to my answer to an interrogatory to OTS, DLC  
21 Interrogatory No. 9, propounded by Mr. Moul.

1 Q. MR. MOUL HAS TAKEN EXCEPTION TO YOUR EXCLUSION OF HIS  
2 OCI (OTHER COMPREHENSIVE INCOME) ADJUSTMENT. WOULD  
3 YOU PLEASE COMMENT ON HIS CONTENTION AS TO WHY THIS  
4 ADJUSTMENT SHOULD BE ALLOWED?

5 A. Beginning on page 11, line 10 and continuing through page 13, line 4 of his  
6 rebuttal testimony, DLC Statement No. 6-R, Duquesne Light Witness Moul  
7 presents his contentions as to why I have misinterpreted his OCI adjustment.  
8

9 Q. WHAT ARE DUQUESNE LIGHT WITNESS MOUL'S SPECIFIC  
10 OBJECTIONS TO YOUR EXCLUSION OF OCI?

11 A. First, Mr. Moul states that the Company's position supports my position. The  
12 funds, in question, do not finance any of the Company's rate base. Second, Mr.  
13 Moul presents a tedious and verbose explanation on how these funds are not funds  
14 in reality.  
15

16 Q DOU YOU AGREE WITH DUQUESNE WITNESS MOUL'S  
17 OBJECTIONS?

18 A. No.

1 Q. PLEASE ELABORATE WHY?

2 A. Duquesne Light Witness Moul would have the ALJ and the Commission believe  
3 that the funds in question associated with this adjustment are income. However,  
4 upon closer observation, the main objective of this adjustment is to eliminate a  
5 loss and add it back to the capital mix of DLC. Review of the Company's fourth  
6 quarterly filing indicates that a \$26,500,000 Accumulated Other Loss has been  
7 subtracted from the returned earnings account of DLC, due to an accumulated  
8 other comprehensive loss, DLC Exhibit 1, page 47. OTS Exhibit SR No. 1,  
9 Schedule No. 3 and Schedule No. 4, indicates that Mr. Moul has added this loss  
10 back into the capital structure mix. The effect of Mr. Moul's adjustment is to  
11 increase the equity ratio. Mr. Moul has termed his adjustment OCI (Other  
12 Accumulated Income). The account can be termed Other Accumulated  
13 Income/Loss.

14 Simply put, if this adjustment is allowed, it would enable the Company to  
15 collect return dollars on an accounting loss that has been added back to the capital  
16 structure of DLC.

1 Q. IN DLC STATEMENT NO. 6-R, PAGE 13, MR. MOUL ATTEMPTS TO  
2 REBUKE YOUR ELIMINATION OF THE ESTIMATED INCREASE IN  
3 THE COMPANY'S RETAINED EARNINGS. WOULD YOU PLEASE  
4 COMMENT?

5 A. Yes. I would point out that a review of the Company's financial statements  
6 indicates that a severe reduction of the dividend paid to the parent company by  
7 DLC would be needed in order to accomplish this increase. Since it is the practice  
8 of a parent company to extract money out of its subsidiary in the form of  
9 dividends, it is very unlikely that this will occur on a recurring basis.

10

11 Q. IN DLC STATEMENT NO. 6-R, PAGE 27, LINE 9 MR. MOUL STATES  
12 THAT YOU HAVE NOT GIVEN ENOUGH WEIGHT TO THE VALUE  
13 LINE ESTIMATES. WOULD YOU PLEASE RESPOND?

14 A. Witness Moul has erred in how much weight I have given to the Value Line. Mr.  
15 Moul is under the belief that I have given 20% or less weight to the Value Line  
16 Estimates.

17

18 Q. PLEASE EXPLAIN HOW YOU REACH YOUR FINAL GROWTH RATE?

19 A. I took the Value Line estimate and the S&P estimate added the two and divided  
20 the sum by two thus averaging the two numbers.

1 Q. HOW MUCH WEIGHT DOES THAT EQUATION GIVE THE VALUE  
2 ESTIMATE?

3 A. Fifty percent (50%).  
4

5 Q. IN DLC STATEMENT NO. 6-R, PAGE 27, LINE 14, MR. MOUL  
6 PRESENTS AN ALTERNATIVE DCF EQUATION TO YOUR  
7 TRADITIONAL DCF EQUATION. DO YOU AGREE WITH HIS  
8 PRESENTED EQUATION?

9 A. No. Mr. Moul has inserted a market to book adjustment to the equation. Mr.  
10 Moul has stated in rebuttal testimony that his "leverage" adjustment is not a  
11 market to book adjustment. I contend that it is. Below is a definition of leverage  
12 taken from, <http://www.investorwords.com/2786/leverage.html>;

13 **Leverage**  
14 Definition

15  
16 The degree to which an investor or business is  
17 utilizing borrowed money. Companies that are  
18 highly leveraged may be at risk of bankruptcy if  
19 they are unable to make payments on their debt;  
20 they may also be unable to find new lenders in  
21 the future. Leverage is not always bad,  
22 however; it can increase the shareholders' return  
23 on their investment and often there are tax  
24 advantages associated with borrowing. Also  
25 called financial leverage.

26  
27 Definition 2

28  
29 What the debt/equity ratio measures.

1           The above definition is substantially different than the definition that Mr. Moul  
2           has testified to in his direct testimony, “the divergence between market and book  
3           values”, DLC Statement No. 6, page 28, lines 16 and 17.

4

5   **Q.    DOES THIS COMPLETE YOUR SURREBUTTAL TESTIMONY?**

6   **A.    Yes.**

**OTS Exhibit No. 1-SR  
Witness: Robert Plonski**

**PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**v.**

**DUQUESNE LIGHT COMPANY**

**Docket No. R-00061346**

**Exhibit to Accompany**

**the**

**Surrebuttal Testimony**

**of**

**Robert Plonski**

**Office of Trial Staff**

**RECEIVED**

**SEP 28 2006**

**PA PUBLIC UTILITY COMMISSION  
SECRETARY'S BUREAU**

**Concerning:**

**Rate of Return**

**OTS Exhibit SR No. 1**  
**Schedule No. 1**

**Duquesne Light Company**  
**OTS Recommended Weighted Cost of Capital**  
**at December 31, 2006**

	<u>Capital Structure</u>	<u>Cost Rates</u>	<u>Weighted Cost of Capital</u>
	(1)	(2)	(3=1x2)
[1] Debt	44.44%	6.90%	3.07%
[2] Preferred Stock	9.34%	5.37%	0.50%
[3] Common Equity	<u>46.22%</u>	<u>9.97%</u>	<u>4.61%</u>
[4] Total	<u>100.00%</u>		<u>8.18%</u>

**OTS Exhibit SR No.1  
Schedule No. 2**

**Expected Market Cost Rate of Equity  
Using Data for the Barometer Group of Nine Electric Distribution Companies**

<u>Time Period</u>	<u>Unadjusted Dividend Yield(1)</u>	<u>Adjusted Dividend Yield(2)</u> (1)	<u>Growth Rate</u> (2)	<u>Expected Rate of Return</u> (3=1+2)
(1) 52 Week Average (ending 6/13/06)	4.74%	4.86%	5.00%	9.86%
(2) Spot Price (ending 6/13/06)	<u>4.96%</u>	<u>5.08%</u>	<u>5.00%</u>	<u>10.08%</u>
(3) Average:	<u>4.85%</u>	<u>4.97%</u>	<u>5.00%</u>	<u>9.97%</u>

Notes: (1) Value Line's reported dividends are projected for the year ahead. The dividends not estimated by Value Line were increased by 1/2 the growth rate.

Sources: Value Line, Ratings and Reports, June 9, 2006  
SmartMoney.com

# OTS Exhibit SR No. 1 Schedule No. 3

**Duquesne Light Company  
Consolidated Balance Sheets**

(Millions of Dollars)  
As of December 31,

Liabilities and Capitalization	2005	2004
<b>Current Liabilities:</b>		
Accounts payable	\$ 46.8	\$ 85.7
Payable to affiliates	42.6	4.4
Pension liability	20.0	—
Accrued compensation	17.9	17.0
Accrued interest	9.3	9.8
Other	12.7	14.2
<b>Total Current Liabilities</b>	<b>149.3</b>	<b>130.9</b>
<b>Non-Current Liabilities:</b>		
Deferred income taxes – net	336.6	323.1
Pension liability	92.8	62.9
Other postretirement benefits	40.7	38.1
Legacy liabilities	29.8	32.1
Other	60.3	72.2
<b>Total Non-Current Liabilities</b>	<b>560.2</b>	<b>528.4</b>
<b>Commitments and Contingencies (Note 13)</b>		
<b>Capitalization:</b>		
<b>Long-term debt</b>	<b>636.5</b>	<b>958.4</b>
<b>Preferred and Preference Stock:</b> (aggregate involuntary liquidation value of \$148.8 and \$150.0):		
Non-redeemable preferred stock	135.6	135.6
Non-redeemable preference stock	13.3	14.5
Total preferred and preference stock before deferred ESOP benefit	148.9	150.1
Deferred ESOP benefit	(2.4)	(4.2)
<b>Total Preferred and Preference Stock</b>	<b>146.5</b>	<b>145.9</b>
<b>Common Shareholder's Equity:</b>		
Common stock (authorized – 90,000,000 shares; issued and outstanding – 10 shares)	—	—
Capital surplus	568.9	486.4
Retained earnings	88.2	46.0
Accumulated other comprehensive loss	(26.5)	(1.0)
<b>Total Common Stockholder's Equity</b>	<b>630.6</b>	<b>531.4</b>
<b>Total Capitalization</b>	<b>1,413.6</b>	<b>1,633.7</b>
<b>Total Liabilities and Capitalization</b>	<b>\$2,123.1</b>	<b>\$2,293.0</b>

See notes to consolidated financial statements.

# OTS Exhibit SR No. 1

## Schedule No. 4

Exhibit PRM-1  
Page 9 of 36  
Schedule 5 [1 of 1]

**Duquesne Light Company**  
Capitalization and Related Capital Structure Ratios  
Actual at December 31, 2005 and Estimated at December 31, 2008

	Actual at December 31, 2005			Estimated at December 31, 2008		
	Amount Outstanding	Ratios		Amount Outstanding	Ratios	
		Excl. S-T Debt	Incl. S-T Debt		Excl. S-T Debt	Incl. S-T Debt
Long-Term Debt <sup>(1)</sup>	\$ 588,144,535	42.64%	42.64%	\$ 634,801,775 <sup>(2)</sup>	43.03%	42.27%
Preferred Stock	133,434,357	9.86%	9.86%	133,434,357	9.04%	8.89%
Common Equity						
Capital Surplus	571,117,012			588,879,512 <sup>(4)</sup>		
Retained earnings <sup>(3)</sup>	88,071,282			108,318,998 <sup>(3)</sup>		
Total Common Equity	659,188,274	47.71%	47.71%	708,998,508	47.93%	47.08%
Total Permanent Capital	1,381,767,166	100.00%	100.00%	1,478,235,840	100.00%	98.24%
Short-Term Debt			0.00%	26,395,000		1.76%
Total Capital Employed	\$ 1,381,767,166		100.00%	\$ 1,501,830,840		100.00%

Notes: (1) Includes current portion of long-term debt.

(2) Excluding Accumulated Other Comprehensive Income, related to:

Unrealized loss on DLH stock	\$ -2,829,640
Minimum pension liability ("MPL")	23,643,848
Total at December 31, 2005	\$ 20,814,208
Unrealized loss on DLH stock	\$ -2,829,640
Minimum pension liability ("MPL")	23,024,898
Total at December 31, 2008	\$ 20,195,258

(3) Reflects changes in the principal amount of long-term debt as follows:

Date	Series	Amount
11/01/06	Ohio Water 1999 Series B due 3/31/31 (AMT)	\$ 13,500,000
11/01/06	Ohio AIR 1999 Series C due 3/01/31 (non-AMT)	\$ 4,655,000
11/01/06	Beaver County 1999 Series A due 4/01/31 (AMT)	25,000,000
	Total	\$ 43,155,000
		\$ 27,882,500

(4) Reflects capital contribution from Parent Company of:

(5) Projection provided by the Company of a build-up of retained earnings of:

\$ 20,248,734

Source of Information: Company provided data

**OTS Statement No. 2**  
**Witness: Janet M. Markovich**

**PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**v.**

**DUQUESNE LIGHT COMPANY**

**Docket No. R-00061346**

**Direct Testimony**

**of**

**Janet M. Markovich**

**Office of Trial Staff**

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**SEP 28 2006**

**PA PUBLIC UTILITY COMMISSION  
SECRETARY'S BUREAU**

**Concerning:**

**Operation & Maintenance Expenses**

1 **Q. STATE YOUR FULL NAME, EMPLOYER AND BUSINESS ADDRESS.**

2 A. My name is Janet M. Markovich. I am employed by the Pennsylvania Public  
3 Utility Commission, P.O. Box 3265, Harrisburg, PA 17105-3265.

4

5 **Q. WHAT IS YOUR POSITION WITH THE PENNSYLVANIA PUBLIC**  
6 **UTILITY COMMISSION?**

7 A. *I am a Fixed Utility Financial Analyst in the Office of Trial Staff (OTS).*

8

9 **Q. PLEASE DESCRIBE THE ROLE OF OTS IN RATE PROCEEDINGS.**

10 A. OTS was established by the Pennsylvania Legislature in 1986 and is responsible  
11 for representing the public interest in rate proceedings. The OTS analysis in this  
12 proceeding is based on its responsibility to represent the public interest. This  
13 responsibility requires the balancing of the interests of the ratepayers and the  
14 Company.

15

16 **Q. WHAT ARE YOUR DUTIES AS AN ANALYST IN OTS?**

17 A. My duties as an OTS Analyst include participation in formal base rate proceedings  
18 as an expert witness. In that capacity, I prepare and present OTS testimony and  
19 exhibits. My education and professional background are set forth in the attached  
20 Appendix A.

1 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

2 A. Based upon my review of the Duquesne Light Company (DLC or Company) base  
3 rate filing, I am recommending adjustments to the Company's claimed operation  
4 and maintenance (O&M) expenses and cash working capital (CWC) claim for the  
5 test year ended December 31, 2006.

6  
7 Q. PLEASE SUMMARIZE YOUR PROPOSED ADJUSTMENTS.

8 A. I am recommending the following adjustments:

9	<u>Issue</u>	<u>Reduction</u>
10		
11	<u>Rate Case Expense</u>	
12	Normalization	\$ 612,248
13	Company Revision	69,000
14	<u>Company CAP Adjustments</u>	
15	Annualization to Year End Customer Level	(258,000)
16	Add Discount for Same Customer Payment	1,885,920
17	Increase for 2007-2008 Average	210,000
18	Storm Restoration	858,346
19	Bonus and Incentive Program	2,401,270
20		
21		
22	<b>Total</b>	<u>\$5,778,784</u>

1           **RATE CASE EXPENSE**

2   **Q.    IN THIS PROCEEDING, THE COMPANY HAS MADE A CLAIM FOR**  
3           **RATE CASE EXPENSE. WOULD YOU BRIEFLY EXPLAIN THE**  
4           **NATURE AND TYPE OF EXPENSES CLASSIFIED AS RATE CASE**  
5           **EXPENSE?**

6    A.    *The estimated costs that comprise a company's allowable claim for rate case*  
7           *expense are those that are incurred to compile, present and defend a request for a*  
8           *base rate increase before the Commission. The estimated costs that are typically*  
9           *found in a rate case expense claim include legal fees for outside counsel, fees to*  
10          *outside consultants and printing, collating and postal expenses.*

11  
12   **Q.    A KEY ISSUE CONCERNING THE RECOVERY OF RATE CASE**  
13          **EXPENSE IS WHETHER THE CLAIM SHOULD BE NORMALIZED.**  
14          **WOULD YOU BRIEFLY DISCUSS THE CONCEPT OF**  
15          **NORMALIZATION?**

16   A.    *Normalization is a ratemaking concept that describes the transformation of an*  
17          *operating expense that recurs at irregular intervals into a "normal" annual test year*  
18          *expense allowance. Normalization specifically addresses the prospective recovery*  
19          *of an ongoing expense that recurs sporadically. Allowed normalized expenses are*  
20          *no different than any other O&M expense in that the company is given the*  
21          *opportunity to achieve full recovery.*

1 **Q. HOW DOES THE COMMISSION TREAT RATE CASE EXPENSE FOR**  
2 **RATEMAKING PURPOSES?**

3 A. The Commission views prudently incurred rate case expense as an ongoing,  
4 although recurring at irregular intervals, expense related to the rendering of utility  
5 service. As such, rate case expense is subject to normalization for ratemaking  
6 purposes. A company's history regarding the frequency of rate case filings is an  
7 essential element in determining the normalized level of rate case expense for  
8 ratemaking purposes.

9  
10 **Q. HOW IS THE FREQUENCY OF RATE CASE FILINGS DETERMINED?**

11 A. The frequency is properly determined by computing the average number of  
12 months that expire between the filing dates of a company's base rate case filings.  
13 The number of base rate case filings used to compute the average is a matter of  
14 judgment.

15  
16 **Q. AFTER DETERMINING THE FILING FREQUENCY OF BASE**  
17 **RATE FILINGS, HOW IS THE NORMALIZED EXPENSE CLAIM**  
18 **DETERMINED?**

19 A. The estimated prudently incurred rate case expenses are multiplied by a fraction,  
20 the numerator being 12 months and the denominator the number of months  
21 representing the frequency of filings.

1 **Q. WHAT IS THE COMPANY'S CLAIM FOR RATE CASE EXPENSE IN**  
2 **THIS PROCEEDING?**

3 A. The Company's future test year (FTY) claim for rate case expense in the current  
4 proceeding was originally \$1,704,000 annually. The PA jurisdictional claim is  
5 \$1,595,540 based on the LABOR allocation factor of 93.635%

6  
7 **Q. WHAT IS THE BASIS FOR THE COMPANY'S FUTURE TEST YEAR**  
8 **CLAIM OF \$1,704,000?**

9 A. The Company estimated its rate case expense to be \$5,111,000 for this proceeding.  
10 DLC requested a normalization period of 3 years resulting in the annual claim of  
11 \$1,704,000 ( $\$5,111,000 \div 3$ ) as shown in the Company's filing at DLC Exhibit 2,  
12 Schedule D-8.

13  
14 **Q. HAS THE COMPANY REVISED ITS FTY CLAIM FOR RATE CASE**  
15 **EXPENSE?**

16 A. Yes. In response to OTS Data Requests OTS-RE-7-D and OTS-RE-8-D, the  
17 Company revised its estimated rate case expense amount from \$5,111,000 to  
18 \$4,904,000, a reduction of \$207,000 (see OTS Ex. No. 2, Sch.1, p 1-3).  
19 Therefore, the Company is expected to revise its FTY claim to \$1,634,667  
20 ( $\$4,904,000 \div 3$ ). The Jurisdictional claim is \$1,530,620 ( $\$1,634,667 \times .93635$ ).  
21 This will reduce rate case expense by \$69,000 to reflect DLC's revision.

1 **Q. DO YOU AGREE WITH THE COMPANY'S CLAIM FOR RATE CASE**  
2 **EXPENSE?**

3 A. No. I disagree with the Company's claimed normalization period.  
4

5 **Q. WHAT IS YOUR RECOMMENDATION FOR RATE CASE EXPENSE?**

6 A. Based upon my determination explained below that it is more appropriate to use a  
7 five (5) year normalization period rather than the three (3) year period as proposed  
8 by the Company, I recommend a total test year allowance of \$980,800 for rate  
9 case expense that results in a jurisdictional allowance of \$918,372 ( $\$980,800 \times$   
10  $.93635$ ) and therefore, results in a reduction to the Company's jurisdictional claim  
11 of \$612,248 ( $\$1,530,620 - \$918,372$ ).  
12

13 **Q. WHAT IS THE BASIS FOR YOUR RECOMMENDED NORMALIZATION**  
14 **PERIOD?**

15 A. My recommendation is based on my review of the Company's history of filing  
16 rate cases. DLC has not filed a rate case since 1987. Therefore, the most recent  
17 interval for rate case filings is nineteen (19) years. Since 19 years is an  
18 extraordinary amount of time between filings and due to the fact that DLC's rates  
19 were capped in 1997, I recommend that a five (5) year normalization period be  
20 adopted as appropriate and reasonable. My recommended total test year  
21 allowance of \$980,800 is calculated and results from the use of this 5-year period  
22 ( $\$4,904,000 \div 5$ ).

1 Q. WHY IS YOUR RECOMMENDATION BASED ON THE COMPANY'S  
2 HISTORY OF RATE FILINGS?

3 A. My recommendation is based on the Company's history of rate filings because a  
4 company's history regarding the frequency of base rate filings is the primary  
5 consideration in determining the time period for the normalizing of rate case  
6 expense. Although, the Company has claimed the intention to file a rate case in  
7 three years, the Commission does not make this decision based on a company's  
8 intentions.

9  
10 **COMPANY ADJUSTMENTS - CUSTOMER ASSISTANCE PROGRAM**  
11 **(CAP) EXPENSE**

12 Q. WHAT ADJUSTMENTS TO CAP EXPENSES HAS DLC IDENTIFIED?

13 A. In response to OTS Data Request OTS-RE-16-D, the Company identified the  
14 following adjustments to its claimed CAP expenses:

15	Annualization of Customer Participation	\$ (258,000)
16	Additional Discount – Customer Payment	1,885,920
17	Increase to reflect 2007-2008 Participation	<u>210,000</u>
18	<b>Total</b>	<b><u>\$ 1,837,920</u></b>

1 **Q. PLEASE EXPLAIN THE ADJUSTMENT FOR ANNUALIZATION OF**  
2 **CUSTOMER PARTICIPATION.**

3 A. In the original filing, the Company made a FTY claim of \$1,430,000 to annualize  
4 CAP program expenses to the planned 2006 customer participation level.

5 However, in response to OTS Data Request OTS-RE-16-D, the Company stated

6 that the original claim was based on preliminary estimates for 2005 actual year

7 end participation and 2006 planned participation. Therefore, the Company

8 updated its calculation using the recorded expenses for 2005 and the budget for

9 2006. The revised DLC FTY claim is \$1,688,000 (see OTS Ex.No.2, Sch. 2, p.1).

10 The adjustment is an increase of \$258,000 (\$1,688,000 - \$1,430,000). The

11 jurisdictional allocation of this expense is 100%.

12

13 **Q. PLEASE EXPLAIN THE ADJUSTMENT FOR THE ADDITIONAL**  
14 **DISCOUNT TO MAINTAIN THE SAME CUSTOMER PAYMENT?**

15 A. In the original filing, the Company made a FTY claim of \$5,970,000 to increase  
16 the discount given to CAP customers so that those customers can maintain the

17 same payment under DLC's proposed rate structure. However, in response to

18 OTS-RE-17-D, the Company stated that the original claim was based on

19 preliminary estimates. DLC revised its FTY claim to \$4,084,080 (see OTS Ex.

20 No.2, Sch 2, p.2-3). The adjustment is a reduction of \$1,885,920 (\$5,970,000 -

21 \$4,084,080). The jurisdictional allocation of this expense is 100%.

1 **Q. PLEASE EXPLAIN THE ADJUSTMENT TO REFLECT AN AVERAGE**  
2 **INCREASE IN CAP CUSTOMER PARTICIPATION IN 2007 AND 2008.**

3 A. In the original filing, the Company made a FTY claim of \$2,040,000 to reflect the  
4 average increase in CAP customers in 2007 and 2008 under DLC's proposed rate  
5 structure. However, in response to OTS-RE-18-D, the Company stated that the  
6 original claim was based on preliminary estimates. DLC revised its FTY claim to  
7 \$1,830,000 (see OTS Ex. No. 2, Sch 2, p.4). The adjustment is a reduction of  
8 \$210,000 (\$2,040,000 - \$1,830,000). The jurisdictional allocation of this expense  
9 is 100%.

10

11 **STORM RESTORATION EXPENSE NORMALIZATION**

12 **Q. WHAT IS STORM RESTORATION EXPENSE NORMALIZATION?**

13 A. Storm restoration expenses include the expenses the Company incurred to restore  
14 service in areas that experienced a disruption of service due to a weather related  
15 incident. These expenses include labor, benefits, equipment, materials, etc.

16 Normalization is a ratemaking concept that describes the transformation of an  
17 operating expense that recurs at irregular intervals into a "normal" annual test year  
18 expense allowance. In this case, the normalization was achieved by averaging  
19 insurance premium expenses over a four year period.

1 **Q. WHAT IS THE COMPANY'S CLAIM FOR STORM RESTORATION**  
2 **EXPENSE NORMALIZATION?**

3 A. The Company's claim for storm restoration expense is \$897,000. The  
4 jurisdictional claim is \$858,346.

5  
6 **Q. WHAT IS THE BASIS FOR THE COMPANY'S CLAIM FOR STORM**  
7 **RESTORATION EXPENSE NORMALIZATION?**

8 A. The Company's stated claim of \$897,000 is based on a four-year average of actual  
9 and estimated Insurance premiums as shown in DLC's Exhibit 2, Schedule D-13.  
10 However, the Company decided to self-insure after the conclusion of the most  
11 recent insurance policy on April 1, 2006. DLC budgeted only \$206,000 in 2006 to  
12 cover the last three months of the policy in FERC Account 924 – Property  
13 Insurance. Additionally, the Company made a Pro Forma adjustment to  
14 Distribution Maintenance Expenses for the difference of \$691,000 (\$897,000 -  
15 \$206,000). The jurisdictional allocation factor for Distribution Maintenance  
16 Expenses is 99.96% or \$690,724 (\$691,000 X 99.96%). The jurisdictional  
17 allocation factor for FERC Account 924 is 81.37% or \$167,622 (\$206,000 X  
18 81.37%). Therefore, the total jurisdictional FTY claim is \$ 858,346(\$690,724 +  
19 167,622).

1 **Q. DO YOU AGREE WITH THE COMPANY'S CLAIM FOR STORM**  
2 **RESTORATION NORMALIZATION?**

3 A. No.

4  
5 **Q. WHAT IS YOUR RECOMMENDATION FOR STORM RESTORATION**  
6 **EXPENSE NORMALIZATION?**

7 A. I recommend that the Company's claim for Storm Restoration Expense  
8 normalization be denied. This recommendation results in a reduction to the total  
9 Company FTY claim of \$897,000 and a reduction to the jurisdictional FTY claim  
10 of \$858,346 ( $\$206,000 \times 81.37\% + \$691,000 \times 99.96\%$ ).

11  
12 **Q. WHAT IS THE BASIS FOR YOUR RECOMMENDATION FOR STORM**  
13 **RESTORATION EXPENSE?**

14 A. My recommendation is based on several factors. First, the Company will not be  
15 incurring any storm restoration insurance costs beyond the first three months of  
16 the test year. Therefore, the \$206,000 the Company budgeted in 2006 and  
17 included in its FTY claim should be eliminated. Second, I disagree with using the  
18 normalized cost of insurance premiums as a proxy for the expected future  
19 expenses of storm restoration. Third, only expenses actually incurred for storm  
20 restoration should be the basis for determining the reasonably expected future  
21 expenses for storm restoration. Fourth, the Company has already included a claim  
22 for storm restoration costs in the accounts that the Company has recorded these

1 expenses in the past. DLC's FTY adjustment of \$858,346 is double counting for  
2 expenses already included in the FTY.

3  
4 **Q. HAS THE COMPANY SUBMITTED INSURANCE CLAIMS AND/OR**  
5 **EXPERIENCED EXPENSES FOR STORM RESTORATION IN RECENT**  
6 **YEARS?**

7 A. No. Although the Company has not submitted any claims to its insurance carrier,  
8 the Company has recorded both O&M expenses and capital expenditures for storm  
9 restoration in previous years (see OTS Ex.No.2, Sch 3, p.1). The total amount  
10 recorded related to storms in the twelve months ended (TME) December 31, 2005  
11 was \$5,944,560 and the amount expensed \$547,091(see OTS Ex. No.2, Sch.3,  
12 p.2).

13  
14 **Q. DID THE COMPANY CONSIDER THE 2005 EXPENSES IN ITS 2006**  
15 **BUDGET AND/OR FTY CLAIM?**

16 A. Yes, I am of the opinion that the Company included these expenses in the accounts  
17 in which they were recorded in 2005. In the direct testimony of DLC Witness  
18 Susan S. Betta, DLC Statement No. 2, page 10, lines 17-31, Ms. Betta describes  
19 the budget process and states that cost center managers are provided monthly  
20 reports of their actual expenses and that these reports help the managers to budget  
21 for the following year by identifying the various costs they actually incur during  
22 the year. Additionally, in response to OCA Interrogatory OCA-IV-60 (see also

1 OTS Ex. No. 2, Sch. 3, p.3), DLC Witness Jeffrey Coward states that the  
2 Company forecasts capital additions needed for service restoration based on need  
3 and a review of the previous year's experience. He also states that DLC's actual  
4 spending for service restoration, although it varies by needs and the number of  
5 storms the system encounters, averaged expenditures of \$18 million per year  
6 during the period 2003 through 2005. This is the same amount included in DLC's  
7 2006 budget. Therefore, since DLC's 2006 budget for each account plus any Pro  
8 Forma adjustments equals the FTY claim in this proceeding, I conclude that a  
9 claim for service restoration expenses is included in DLC's FTY claim in the  
10 accounts it was previously charged.

11  
12 **INCENTIVE COMPENSATION/BONUS PLAN**

13 **Q. WHAT IS INCENTIVE COMPENSATION/BONUS PLAN EXPENSE?**

14 A. Incentive compensation/bonus plan expenses include those payments made to  
15 eligible employees based on the achievement of target levels of performance  
16 measures for both company and individual performance.

17  
18 **Q. WHAT IS THE COMPANY'S FTY CLAIM FOR INCENTIVE**  
19 **COMPENSATION/BONUS PLAN EXPENSE?**

20 A. The Company's FTY claim for incentive compensation/bonus plan expenses is  
21 \$5,129,000 (see OTS Ex. No. 2, Sch 4, p.1). The allocation factor is 93.635%.  
22 Therefore, the FTY jurisdictional claim is \$4,802,539 (\$5,129,000 X 93.635%).

1 **Q. WHAT IS THE BASIS FOR THE COMPANY'S FTY CLAIM FOR**  
2 **INCENTIVE COMPENSATION/BONUS PLAN EXPENSE?**

3 A. The claimed basis for the Company's FTY claim for incentive  
4 compensation/bonus plan expenses is the Cash Incentive Compensation Program  
5 of Duquesne Light Holdings, Inc., dated June 2005 (see OTS Ex. No. 2, Sch. 5,  
6 pp. 2-8) and the Duquesne Light Holdings, Inc. Compensation Standards (see OTS  
7 Ex. No. 2, Sch. 6, pp. 1-5). The plan is administered by senior management  
8 through Human Resources. For each program year, senior management  
9 determines which employees are eligible and the target incentive opportunities for  
10 each grade of employee. Performance measures are established for individual and  
11 company performance at the beginning of the program year and communicated to  
12 eligible staff. At the end of each year, the level of achievement for all company  
13 and individual performance measures are determined. Awards are calculated in a  
14 two-step process, using the year end base salary and any pro-rations for time spent  
15 in positions at different target levels. In step-one the award determination is  
16 calculated based on the company performance. In step-two the total award paid is  
17 determined by adjusting the amount of eligible award based on achievement of  
18 individual performance measures. Expenses for incentive compensation/bonuses  
19 are recorded in FERC account 920 - Administrative and General Salaries.

1 **Q. DO YOU AGREE WITH THE COMPANY'S FTY CLAIM FOR**  
2 **INCENTIVE COMPENSATION/BONUS PLAN EXPENSE?**

3 A. No. In my professional opinion, the plan expenses should be split equally between  
4 ratepayers and stockholders.

5  
6 **Q. WHAT DO YOU RECOMMEND FOR THE COMPANY'S FTY CLAIM**  
7 **FOR INCENTIVE COMPENSATION/BONUS PLAN EXPENSE?**

8 A. I recommend a FTY allowance of \$2,564,500 and a jurisdictional allowance of  
9 \$2,401,270. This recommendation results in a reduction of \$2,564,000  
10 (\$5,129,000 - \$2,564,500) to the Company's total FTY claim and a reduction of  
11 \$2,401,270 (\$4,802,539 - \$2,401,270) to the Company's Jurisdictional Claim.

12  
13 **Q. WHAT IS THE BASIS FOR YOUR RECOMMENDED FTY CLAIM FOR**  
14 **INCENTIVE COMPENSATION/BONUS PLAN EXPENSE?**

15 A. My recommendation is based on the sound and fair conclusion that both ratepayers  
16 and shareholders should equally bear the expenses for payments under the  
17 incentive compensation/bonus plan. Therefore, the remaining half of these  
18 expenses should be treated as below the line expenses.

1 **Q. WHY DO YOU RECOMMEND SHARING INCENTIVE**  
2 **COMPENSATION/BONUS PLAN EXPENSES BETWEEN RATEPAYERS**  
3 **AND SHAREHOLDERS?**

4 A. My recommendation is based primarily upon the recognition of the fact that the  
5 incentive compensation/bonus plan maintains a stronger importance on the  
6 company's financial performance than it does on any other performance measures  
7 including those that concern service and reliability. According to Duquesne Light  
8 holdings, Inc. Compensation Standards, no payments relating to the incentive  
9 compensation/bonus plan are made unless a minimum threshold of financial  
10 performance is achieved, regardless of the achievement level of other company  
11 and individual performance measures (see OTS Ex. No. 2, Sch. 6, p.4). Further,  
12 according to the Cash Incentive Compensation Program of Duquesne Light  
13 Holdings, Inc., dated June 2005, an aspiration level for overall DLH financial  
14 performance is established annually and after company/corporate objectives are  
15 met at 100%, the aspiration target allows for achievement of up to 150% of the  
16 target award (see OTS Ex. No. 2, Sch. 5, p.7). As such, shareholders experience  
17 the benefits of the Company's improved financial performance by realizing a  
18 higher return on their investment due to increased dividends and/or stock prices.  
19 Similarly, ratepayers experience the benefits of the Company's improved financial  
20 performance when rates are maintained at existing levels or future increases are  
21 minimized. Therefore, since both shareholders and ratepayers experience the  
22 benefits of incentive compensation/bonus plans that emphasize the importance of

1 financial performance goals, then both should share in the cost of the plans.

2

3 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

4 A. Yes. However, I reserve the right to submit supplemental testimony as  
5 interrogatory responses are provided by the Company and other parties during the  
6 course of this proceeding.

**Janet M. Markovich**

**Applicable Educational and Professional Background**

**Education:**

Master of Science in Business Administration, Concentration in Finance,  
St. Joseph's University, Philadelphia, Pa. 1994

Bachelor of Science in Business Administration, Elmhurst College, Elmhurst Ill. 1981

**Additional Education:**

NARUC Utility Rate School - October 2004

The Many Voices of Wall Street – October 2004

Telephony and Telecommunications – December 2004

**Business Experience:**

Commonwealth of Pennsylvania

Public Utility Commission

Office of Trial Staff

Fixed Utility Financial Analyst 2004 - Present

Responsible for performing studies and analysis of revenues and expenses and other related financial and economic data as required to process rate increase requests, 1307 (f) purchased gas cost filings and general tariff revisions.

Commonwealth of Pennsylvania

Department of Corrections

Budget Analyst I and II 2003-2004

Responsible for coordinating the General Fund section of the business office as required to monitor spending, collect data and generate budgets, re-budgets and various projections.

Borough of Minersville

Borough Manager 1997-2000

Responsibilities under the direction of the Borough Council included the supervision of the business office, and the coordination of the activities of the following departments:

Streets, Sewer Treatment Plant and Collection System, Code, Health, and Grant Administration. Addition responsibilities included the development and administration of budgets for the General, Water, and Sewer Funds.

Pepperidge Farm, Inc  
Plant Manager 1982-1991

As Resident Executive, my responsibilities included all activities related to the manufacture and distribution of fresh and frozen bakery, cookie and cracker products at facilities in Downers Grove, Illinois and Lakeland, Florida. Major responsibilities included the development and administration of plant operating and capital budgets and the coordination of the following functions: Engineering, Maintenance, Production, Distribution, Accounting, Purchasing, Human Resources, and Information Systems.

**Assisted in the following Cases :**

Borough of Quakertown – Rate Case – R-00049555  
National Fuel Gas Distribution – Rate Case – R-00049656  
TW Phillips Gas and Oil Co. – 1307(f) – R- 00040059  
Myers Gas Company – Rate Case – R-00050259  
PECO Energy Company – 1307(f) – R – 00050537  
UGI Utilities, Inc. Gas Division – 1307(f) – R – 00050539  
Trigen- Philadelphia Energy Corporation – R – 00050781

**Participated in the following Cases:**

City of Bethlehem Water Fund – Rate Case - R-00050671  
Wonderview Water Inc. – Rate Case - R-00050659  
Meadows Sewer Co. – Rate Case – R-00050672  
Wilcox Water Co. – Rate Case – R-00050781  
Lancaster Water Fund – Rate Case – R-000501167  
City of Dubois – Water Bureau – R-00050671

**Testified in the following Cases:**

City of Lancaster Sewer Fund – Rate Case – R-00049862  
Mesco Inc. – Rate Case – R- 00050678  
TW Phillips 1307(f) – R-00051134  
Aqua Pa – Rate Case – R-00051030

**OTS Exhibit No. 2**  
**Witness: Janet M. Markovich**

**PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**v.**

**DUQUESNE LIGHT COMPANY**

**Docket No. R-00061346**

**Exhibit to Accompany**

**the**

**Direct Testimony**

**of**

**Janet M. Markovich**

**Office of Trial Staff**

**RECEIVED**

**SEP 28 2006**

**PA PUBLIC UTILITY COMMISSION  
SECRETARY'S BUREAU**

**Concerning:**

**Operations & Management Expenses**

Duquesne Light Company  
 Docket No. R-00061346

OTS-RE-7-D  
 Susan S. Betta  
 Page 1 of 2

Office of Trial Staff  
 Interrogatories Set I

OTS-RE-7-D: Reference DLC Exhibit 2, Schedule D-8, page 1. Please provide a breakdown of the expenses included in the estimated rate case expense amount of \$5,111,000. Include an estimate by category of the amount of rate case expense if the case is settled and if the case is litigated. Please provide the amount of rate case expense, which is also included in the salaries of DLC employees. Indicate the positions referred to in the response to OTS-RE-3-D.

Response: The estimated rate case expenses, if the case is litigated are estimated to be \$4,904,000. At the time Schedule D-8 was prepared, the costs to be incurred in 2005 were estimated at \$1,796,000, however the incremental costs of \$207,000 were not incurred, and therefore this filing schedule should be revised. The estimated total rate case expenses include the following:

	(\$ Thousands)
Outside consulting expenses for necessary rate case preparation, including Jurisdictional Separation, Revenue Requirement, Cost of Service and Cash Working Capital Studies, as well as providing testimony, responses to interrogatories, and witness services	\$ 2,525
Outside legal counsel	1,800
Outside information technology services	236
Outside "Rate of Return" witness services	200
Customer Communication regarding rate case filing and requested increase	40
Employee travel costs/lodging costs for Rate case – Harrisburg	57
Other costs including reproduction, presentations, rate case documents, conferencing, etc.	46
Total	<u>\$ 4,904</u>

Duquesne Light Company  
Docket No. R-00061346

OTS-RE-7-D  
Susan S. Betta  
Page 2 of 2

Office of Trial Staff  
Interrogatories Set I

Duquesne Light has not estimated the cost of the rate case if it is settled. This estimate would have to be based on when and under what circumstances the case would be settled. There are too many variables to provide a meaningful estimate unless more specifics are provided.

No salaries of Duquesne Light Company employees were charged to the rate case, and therefore there are no positions referenced in OTS-RE-3-D included in the amount of rate case expenses detailed above.

Duquesne Light Company  
Docket No. R-00061346

OTS-RE-8-D  
Susan S. Betta  
Page 1 of 1

Office of Trial Staff  
Interrogatories Set I

OTS-RE-8-D      Reference DLC Exhibit 2, Schedule D-8, page 1. Please provide a breakdown of the expenses included in the rate case expense amount of \$1,796,000 expended in the TME December 31, 2005. Please provide the amount of rate case expense, which is also included in the salaries of DLC employees. Indicate the position referred to in the response to OTS-RE-3-D.

Response:      Actual rate case expenses expended in the twelve months ended December 31, 2005 was approximately \$1,589,000. At the time Schedule D-8 was prepared, the costs to be incurred in 2005 were estimated at \$1,796,000, however the incremental costs of \$207,000 were not incurred, and therefore this filing schedule should be revised. The actual rate case expenses include the following:

	(\$ Thousands)
Outside consulting expenses for necessary rate case preparation, including Jurisdictional Separation, Revenue Requirement, Cost of Service and Cash Working Capital studies	\$ 1,022
Outside legal counsel	447
Outside information technology services	74
Other costs including reproduction, presentations, rate case documents, conferencing, etc.	46
Total	<u>\$ 1,589</u>

No salaries of Duquesne Light Company employees were charged to the rate case, and therefore there are no positions referenced in OTS-RE-3-D included in the amount of rate case expenses detailed above.

Duquesne Light Company  
Docket No. R-00061346

OTS-RE-16-D  
Robert O'Brien  
Michele Sandoe  
Page 1 of 1

Office of Trial Staff  
Interrogatories Set I

16. Reference DLC Exhibit 2, Schedule D-10, page 1, Uncollectible Accounts, line 8. Please provide an explanation and a detailed breakdown of the annualized CAP expense of \$1,430,000. Include all supporting calculations.

Response:

The annualization calculation was based on preliminary closing and original estimates for the change in CAP from recorded 2005 to estimated 2006.

Based on final amounts for recorded 2005 and recorded 2006, the annualization adjustment should be \$1,688,000, which is calculated as follows:

Budget CAP for 2006	\$9,800,000
Recorded CAP for 2005	<u>\$6,424,000</u>
Increase in CAP for 2006	\$3,376,000
One-Half of 2006 increase	\$1,688,000

The addition of the \$1,688,000 to the Budget 2006 amount will approximate the end-of-year CAP level for the 2006 test year.

Duquesne Light Company  
 Docket No. R-00061346

OTS-RE-17-D  
 Robert O'Brien  
 Michele Sandoe  
 Page 1 of 1

Office of Trial Staff  
 Interrogatories Set 1

17. Reference DLC Exhibit 2, Schedule D-10, page 1, Uncollectible Accounts, line 9. Please provide an explanation and a detailed breakdown of the Additional discount expense of \$5,970,000 to keep CAP customer payments at the present levels. Include all supporting calculations.

**Response:**

The additional discount expense of \$5,970,000 was based on preliminary estimates. Under our proposed rate structure, the additional discount expense for CAP customers would be reduced to \$4,084,080. This discount was calculated based on an average use of 732kWh as shown in Figure 1.1. The usage was based on the total kWh used divided by the number of bills. Under the current rate structure, a customer using 732kWh would have an average bill of \$76.92 as shown in Figure 1.2. CAP payment arrangements require the customer to pay 35%, 70% or 90% of their total bill. A CAP customers average affordable payment level would range from \$27, \$54, or \$69 respectively as shown in Figure 1.3.

Under the new proposed rate structure, the average bill would increase to \$90.00 based on an average use of 732kWh as shown in Figure 1.2. To maintain the same level of bill affordability, CAP discounts would need to be increased by an additional \$13.09 for each payment arrangement level to remain the same as current payment levels shown in Figure 1.2.

The additional discount of \$13.09 per month for 12 months multiplied by our estimated CAP participation level of 26,000 would total the estimated \$4,084,080 for 2006. The calculation is show in Figure 1.4.

Figure 1.1 Average CAP Usage (Based on 12 month period)						
Yearly	Bills	kWh		Monthly	Bills	KWh
RS	218,616	159,983,528		RS	18,218	732
RH	12,447	15,367,158		RH	1,037	1,235
RA	403	421,264		RA	34	1,045
<b>Total</b>	<b>231,466</b>	<b>175,771,950</b>		<b>Total</b>	<b>19,289</b>	<b>3,012</b>

<b>Additional Discount to keep CAP customer Payment the Same</b>						
<b>Monthly Bill Calculation</b>						
Figure 1.2	Current		Proposed		Increase	
Average Usage		732		732		732
Customer Charge	\$6.48	\$6.48	\$11.50	\$11.50	\$5.02	77.5%
Distribution Energy/kWh	\$0.030694	\$22.46	\$0.037542	\$27.47	\$5.01	22.3%
Subtotal Distribution Charges		\$28.94		\$38.97	\$10.03	34.7%
Transmission Energy/kWh	\$0.002523	\$1.85	\$0.006701	\$4.90	\$3.06	165.6%
Generation Energy/kWh	\$0.063031	\$46.13	\$0.063031	\$46.13	\$0.00	0.0%
Total Monthly Bill	\$0.096248	\$76.91	\$0.107274	\$90.00	\$13.09	17.0%
<b>Contribution to Distribution Business (assume actual bill = budget bill)</b>						
Figure 1.3	Current			Proposed		
CAP Bill Payment Arrangement	35%	70%	90%	30%	60%	77%
Bill	\$ 76.91	\$ 76.91	\$ 76.91	\$ 90.00	\$ 90.00	\$ 90.00
Current Discount	\$ 49.99	\$ 23.07	\$ 7.69	\$ 49.99	\$ 23.07	\$ 7.69
Additional Benefit to Customer				\$ 13.09	\$ 13.09	\$ 13.09
Adjusted Discount				\$ 63.08	\$ 36.16	\$ 20.78
Affordable Bill	\$ 26.92	\$ 53.84	\$ 69.22	\$ 26.92	\$ 53.84	\$ 69.22
<b>Estimated Annual Cost</b>						
Figure 1.4						
(26,000*13.09*12)						
Additional CAP discount expense needed for 2006 = \$4,084,080						

Duquesne Light Company  
 Docket No. R-00061346

OTS-RE-18-D  
 Robert O'Brien  
 Michele Sandoe  
 Page 1 of 1

Office of Trial Staff  
 Interrogatories Set I

18. Reference DLC Exhibit 2, Schedule D-10, page 1, Uncollectible Accounts, Line 10.  
 Please provide an explanation and a detailed breakdown of the increase to reflect 2007-  
 2008 average expense of \$2,040,000. Include all supporting calculations.

Response:

The average expense of \$2,040,000 was based on preliminary estimates. The \$1,830,000 reflects the projected increase in the four components of CAP from Budget 2007 to 2008 based on the proposed rate structure.

		\$MM		
	<u>Monthly</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>
Current Average CAP Discount	\$26.60	\$ 8.30	\$ 9.26	\$10.21
Add'l Discount to keep pay same	\$13.09	\$ 4.08	\$ 4.55	\$5.03
Administrative Costs	\$ 1.00	\$ 0.31	\$ 0.35	\$0.38
Frozen Arrearage	<u>\$10.00</u>	<u>\$ 3.12</u>	<u>\$ 3.48</u>	<u>\$3.84</u>
Total Avg. Cost with Rate Increase	\$50.69	\$15.82	\$17.64	\$19.47
Increase for 2007			\$ 1.83	

It is anticipated that CAP enrollment will increase by 3,000 participants in 2007 and by another 3,000 in 2008. The effect of the adjustment is to reflect the average number of customers for the two years following the rate increase ( $\$50.69 \times 12 \times 3,000$ ).

Duquesne Light Company  
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OTS-RE-29  
Susan S. Betta  
Page 1 of 1

Office of the Trial Staff  
Interrogatories Set II

OTS-RE-29-DReference DLC Exhibit 2, Schedule D-13, page 1, Storm restoration normalization. Please provide an explanation and breakdown by department of the actual claims submitted to insurance carrier for storm restoration in the TME December 31, 2003, 2004 and 2005. Indicate the expenses that satisfied the deductible amount in each year. Additionally, indicate the amount of that deductible that is included in payroll accounts by department.

Response:

Although there were no claims submitted to the insurance carrier for storm restoration in the TME December 31, 2003, 2004 and 2005 we did have expenses for storms in each of those years.

Duquesne Light Company  
Docket No. R-00061346

OTS-RE-61  
Susan Betta  
Page 1 of 1

Office of Trial Staff  
Interrogatories Set I

61. Reference DLC's response to OTS-RE-29, storm restoration. Since no claims were submitted to insurance companies but expenses were incurred, please provide the actual expenses incurred for storm restoration in the TME December 31, 2003, 2004 and 2005.

**Response:**

The amount of expense recorded for the TME December 31, 2003, 2004 and 2005 related to storms was as follows:

	<u>Total</u>	<u>Amount Expensed</u>
2003	\$ 5,762,357	\$652,330
2004	9,082,295	277,676
2005	5,944,560	547,091

The total in 2002 was \$6,887,714 with \$1,593,940 expensed.

Duquesne Light Company  
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OCA-IV-60  
Jeffrey L. Coward  
Page 1 of 1

Office of Consumer Advocate  
Interrogatories Set IV

60. According to the direct testimony of Jeffery Coward, certain construction projects are budgeted based upon the previous year's activity. To the extent that an escalation rate is applied to the previous year's activity to derive the budgeted amount, please identify those costs that were derived by this method and provide the base amount and the escalation rate used, including the supporting data.

Response: The Company forecasts capital additions needed for Service Restoration based on an analysis and review of the previous years' experience. Duquesne Light does not just apply an escalation rate to the previous year's activity to derive the budgeted amount for Service Restoration. Instead, the Company forecasts the budget needed based significantly upon the previous years' spending and breakdown by category. An escalation rate is used for an annual contractual bargaining unit labor wage rate increase, which for 2006 was 3.5%. In 2006, Duquesne Light's budget includes approximately \$18.0 million for Service Restoration. During the period 2003 through 2005, actual spending for Service Restoration also averaged approximately \$18.0 million per year. However, while the total expenditure is about the same, it will vary based upon the need and the number of storms the system encounters.

Duquesne Light Company  
Docket No. R-00061346

OCA-IV-80  
Maureen Meehan / Susan Betta  
Page 1 of 1

Office of Consumer Advocate  
Interrogatories Set IV

80. Please provide a copy of all incentive compensation/bonus plans and provide the level of payments under those plans included in expenses for the test year, 2005, 2004, and 2003.

Response:

Copies of Incentive compensation /bonus plans were provided in response to OTS-RE-2-D. The incentive compensation included in expenses for the test year, 2005, 2004 and 2003 is as follows (\$ in thousands):

Test year	\$ 5,129
2005	\$ 5,493
2004	\$ 4,888
2003	\$ 2,901

Duquesne Light Company  
Docket No. R-00061346

OTS-RE-2-D  
Maureen Meehan

Office of Consumer Advocate  
Interrogatories Set I

Reference DLC Exhibit 2, Schedule D7, page 2. Please provide a copy of all union contracts and/or compensation plans showing salary/wage increases and bonus and/or incentive payments including effective dates for any DLC employees during the TME December 2003, 2004, 2005, and 2006.

Response: See the attached, as following:

- Cash Incentive Compensation Program for non-union employees ✓
- Duquesne Light Holdings, Inc. Compensation Standards ✓
- Duquesne Light Company Salary Administration Procedure

The Collective Bargaining Agreement with the IBEW, Local 29 can be viewed at the Company's Pittsburgh office or at Post Schell Harrisburg offices.

Previous year plans are not available as copies are not maintained. However, programs for the most recent prior periods (2003-2005) mirrored the current plans.

Plan dates are included as an attachment.



Hewitt Associates LLC

**OTS-RE-2-D**

**Cash Incentive  
Compensation  
Program**

Duquesne Light  
Holdings, Inc.

June 2005

*[Faint, illegible text, likely bleed-through from the reverse side of the page]*

## About This Material

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Duquesne Light Holdings (DLH), Inc. has a short-term cash incentive compensation plan covering non-represented employees identified in this document. This document explains the eligibility and plan provisions for the short-term incentive plan.

## Incentive Compensation Plan Design

---

The incentive compensation program ("program") outlined in this document was developed for all non-union (and non-executive) staff. It has been implemented in conjunction with a move toward a greater emphasis on comparing base pay to market.

### Program Objectives

The objectives of the program are to:

- Link total cash compensation to individual contribution and overall company performance;
- Focus each employee on supporting overall company performance;
- Share in the financial results of company with employees; and
- Provide competitive total compensation opportunity for management and supervisory staff.

### Program Administration

Senior management (through Human Resources) will be responsible for administration of the program. They are authorized to:

- Determine individual eligibility;
- Review payments recommended by senior management for submission to the Chief Executive Officer of DLH;
- Interpret program provisions in individual situations; and
- Recommend continuation of the program from year to year and recommend substantive modifications to the language of the program.

### Program Year

The program year will be the calendar year. Performance will be measured on an annual program year cycle.

**Eligibility**

Non-union (and non-officer) staff are eligible for the plan.

Eligible staff will participate in any program year in which they:

- Are employed in an eligible position for at least 90 days of the program year; and
- Are employed in an eligible position at the end of the program year (December 31), and
- Must be actively employed on the date of program payout (except as noted in the matrix below); and
- Must have established/approved objectives (in order to be paid).

Senior management reserves the right to make final determinations regarding eligibility and participation.

**Special Events and Situations**

There will be special events and situations, which may impact eligibility and award opportunity, consistent with the eligibility requirements above. The company will determine award payments for program participants in special situations, as follows:

**Eligibility:**

Event	Prorated	Forfeited	Comments
Transfer between companies, promotion or new hire	X		Prorated if in position >90 days of plan year
Transfer to/from an incentive eligible position	X		Prorated if in position >90 days of plan year
Retirement		X	Retiree must be an active employee on the last day of the plan year in order to be paid
Reduction in Force		X	See comments below
Disability	X		Prorated based on the time in the program. If occurs before June 30, no incentive will be paid.
Death	X		Prorated based on the time in the program. If occurs before June 30, no incentive will be paid.
Resignation		X	See comments below
Other Termination (For Cause, For Performance, etc.)		X	See comments below

**Termination of Employment**

Termination of employment due to resignation, for cause, and performance will result in the forfeiting of any incentive award. Reduction in force may result in the forfeiting of an incentive award.

**Target Incentive Opportunities**

Target incentive opportunities will be based on market competitive practices. They may be revised in the future in response to changes in the market. The table below outlines six levels of incentive award opportunities established for the plan. Positions are assigned an incentive award opportunity level based on salary grade and position responsibilities. *While salary grade will be the general criteria for assigning positions to an incentive target level, senior management may make exceptions for selected positions:*

Salary Grade/Position	Target Incentive Award Opportunity
Other senior, non-officer positions	25% - 30%
Director (or equivalent)	20%
Grade I and Above and/or Manager position	15%
Grade H and supervisory positions grade G and below	10%
Grade G (non-supervisory)	7%
Grade F and below (non-supervisory)	5%

**Award Opportunity:**

Event	Prorated	Forfeited	Comments
Transfer between companies, promotion, demotion, transfer to/from an incentive eligible position	X		Prorated if in position >90 days of plan year

The award opportunity will be prorated based on the time spent in positions with different target levels. Awards will be based on the year-end salary.

**Performance Measurement and Award Determination**

Both individual and company performance will determine award amounts. Performance measures will be established for individual and company performance at the beginning of the program year and communicated to all eligible staff.

**Individual Performance**

Individual performance will be measured using several performance measures. Each measure will be weighted. The weights should be stated in multiples of 5% and total 100%. In general, achievement for each measure will be in terms of meeting a specified target level of performance.

**Company Performance**

Performance measures will be established annually for each DLH company. These measures will be weighted and will indicate the level of company performance that must be attained for the target award opportunity of 100%. If the company fails to achieve its target level of corporate performance the award opportunity will be less than 100%, as determined by the specific objectives that are met.

An aspiration level for overall DLH financial performance will be established annually. After the corporate objectives are met at 100%, the aspiration target allows for achievement of up to 150% of the target award. The award opportunity will be prorated if the results are between the target level and the aspiration level.

**Award Determination**

At the end of the program year, the level of achievement for all individual and company performance measures will be determined. Awards will be calculated in a two-step process, and using the year-end base salary and pro-rated for time spent in a position at a different target level (where applicable).

**Step One:** Determine the eligible award based on company performance using the following calculation for each performance measure:

**Illustration**

$$\begin{array}{ccccccc}
 \text{Year End} & & \text{Target Award} & & \text{Perf. Measure} & & \text{Perf. Measure} & = & \text{Eligible} \\
 \text{Base Salary} & \times & \text{Opportunity} & \times & \text{Weight} & \times & \text{Achievement} & & \text{Award}
 \end{array}$$

The total eligible award is determined by totaling the amounts calculated for each performance measure.

**Step Two:** Determine the amount of the eligible award paid by multiplying the eligible award by the percentage of individual performance measures achieved:

$$\begin{array}{cccc}
 \text{Total Eligible} & & \text{\% Of Perf. Measures} & = & \text{Total} \\
 \text{Award} & \times & \text{Achieved} & & \text{Award}
 \end{array}$$

*The total award calculated may be increased, decreased, or eliminated, at the sole discretion of the CEO, based on such other performance factors deemed relevant.*

**Example Calculation**

The two-step process is illustrated in the example calculation below (this is only an example and measures may change annually):

<i>Step 1 DLH Performance: Aspiration level performance met on Net Income, did not achieve performance on Reliability, and target performance met for Customer Satisfaction</i>					
<u>Year End</u> Base Salary	Target Award Opportunity	Performance Measure	Perf. Measure Weight	Perf. Measure Achievement	Eligible Award
85,000	15%	Net Income	50%	150%	9,563
85,000	15%	Reliability	25%	0%	0
85,000	15%	Customer Satf.	25%	100%	3,188
<b>Total Eligible Award:</b>					12,751

<i>Step 2 Individual Performance: Met 60% of Performance Measures</i>				
Total Eligible Award		% Of Perf. Measures Met	=	Total Award
12,751	X	60%	=	7,651

**Payment of Awards**

Awards generally are paid in cash through the payroll system no later than March 15 of the year following the performance year. They will be paid as soon as possible after the company's financial audit is complete and senior management and CEO assess performance and approve incentive awards.

**Performance Updates**

Participants will receive updates on their company's performance relative to targets periodically.

**Impact on Benefits**

For benefit pay purposes, short-term incentive awards will be included in calculating current pension plan benefits. They will not be included for the purposes of calculating life insurance, disability insurance, or 401(k) plan benefits.

**Terms of Employment**

Nothing in this Program shall limit DLH's right to either terminate a participant's employment at any time, or confer upon him or her any right to continue in its employ.

**Amendment or Termination of the Program**

DLH, by action of its senior management, reserves the right to adopt, amend, modify, or terminate this program at any time.

# **Duquesne Light Holdings, Inc. (DLH) Compensation Standards**

**(For Human Resources Personnel Only)**

# DLH Compensation Standards

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## Background

The purpose of this document is to outline compensation standards that provide a simplified, flexible and consistent approach to compensation management. This approach provides DLH with a sound core compensation program.

The DLH Compensation Standards apply to all employees (excluding corporate officers and employees governed by collective bargaining).

## DLH Compensation Standards

The Compensation Standards at DLH are to:

- Ensure DLH can attract and retain high quality staff needed to meet its organizational objectives;
- Incorporate flexibility and efficiency in design to enable DLH to respond to changing business needs;
- Provide competitive total compensation, including base pay and variable pay;
- Align the compensation program with the vision, strategies, and culture of DLH; and
- Reward employees for both individual and organizational performance.

## External Market Position

External market position refers to how DLH will target pay in the market. "Market" refers to the pay provided by organizations in which DLH competes for talent. The external market position specifies the role categories and the appropriate competitive markets with which to compare current pay levels for each role category, as well as DLH's strategy for how competitive pay will be positioned in that market. Decisions regarding salary grades and incumbent pay will be based on this information.

Pay will be competitive with the market (50<sup>th</sup> percentile). Because the target market will be the market where DLH competes for talent, it will include both the utility industry and general industry. For non-union jobs, DLH will focus on market data representing similar size organizations as indicated by revenue and/or regional/local data (based on the level of the job). The table below summarizes target by role:

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<b>Role Category</b>	<b>Target Market</b>	<b>Scope</b>
Management	National/Regional	Similar size organization Cross Industry
Professional	Regional/Local	Cross Industry
Technical	Regional/ Local	Cross Industry
Service	Local	Cross Industry
Clerical	Local	Cross Industry

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### **Salary Structure**

A single salary structure will be used for all non-union positions across the organization. The salary structure will be designed to be:

- Simple (i.e., no regression or overly complex design methodologies); and
- Flexible (i.e., wider salary ranges)
- Consistent Other business subsidiaries will use this single salary structure; however, it may be adjusted, if necessary, to reflect regional pay differences based on market and geographic differential data. A copy of the salary structure is attached.

A market assessment will be performed periodically to maintain market competitiveness. The salary structure will be adjusted as appropriate per the market assessment. Ad hoc adjustments may be made to respond to "hot jobs" in the market.

### **Job Valuing**

External market data will be the primary determinant of where jobs are slotted into the salary structure. A simple job-slotting methodology will determine the appropriate salary range for jobs without market data. Job valuing will be a collaborative process between human resources and the appropriate manager.

### **Pay Delivery**

Pay delivery will focus on DLH's vision of linking pay and performance and maintaining market competitiveness. Pay delivery will consist of two primary components:

- Base pay increases; and
- Incentive compensation.

### **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.**

## Salary Structure

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### Salary Structure (Effective 01/01/2006)

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Salary Grade	Minimum	Midpoint	Maximum	Midpoint Progression	Width
A	29,511	36,889	44,267		50%
B	33,053	41,316	49,579	12.0%	50%
C	37,019	46,274	55,529	12.0%	50%
D	41,461	51,827	62,192	12.0%	50%
E	46,437	58,047	69,656	12.0%	50%
F	50,009	65,012	80,014	12.0%	50%
G	56,010	72,813	89,616	12.0%	50%
H	62,731	81,551	100,370	12.0%	60%
I	70,259	91,337	112,414	12.0%	60%
J	78,690	102,297	125,904	12.0%	60%
K	88,132	114,573	141,012	12.0%	60%
L	98,709	128,321	157,933	12.0%	60%
M	110,555	143,719	176,885	12.0%	60%
N	123,822	160,966	198,112	12.0%	60%
Z	OFFICER	OF	DLH		

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**OTS Statement No. 2 SR  
Witness: Janet M. Markovich**

**PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**v.**

**DUQUESNE LIGHT COMPANY**

**Docket No. R-00061346**

**RECEIVED**

**SEP 28 2006**

**PA PUBLIC UTILITY COMMISSION  
SECRETARY'S BUREAU**

**Surrebuttal Testimony**

**of**

**Janet M. Markovich**

**Office of Trial Staff**

**Concerning:**

**Operation & Maintenance Expenses**

1 **Q. STATE YOUR FULL NAME, EMPLOYER AND BUSINESS ADDRESS.**

2 A. My name is Janet M. Markovich. I am employed by the Pennsylvania Public  
3 Utility Commission, P.O. Box 3265, Harrisburg, PA 17105-3265.

4  
5 **Q. HAVE YOU PREVIOUSLY SUBMITTED DIRECT TESTIMONY IN THIS**  
6 **PROCEEDING?**

7 A. Yes, I have submitted OTS Statement No. 2 and OTS Exhibit No. 2.

8  
9 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

10 A. *The purpose of my surrebuttal testimony is to respond to two of the Duquesne*  
11 *Light Company's ("Duquesne" or "Company") rebuttal testimonies and*  
12 *specifically the Rebuttal Testimony of Susan S. Betta (DLC Statement No. 2R)*  
13 *and Robert L. O'Brien (DLC Statement No. 8R) submitted in this instant rate case*  
14 *proceeding. My surrebuttal testimony will address the following items:*

- 15 • Rate Case Normalization
- 16 • Incentive Compensation
- 17 • Storm Normalization Expense

1           **Rate Case Expense**

2   **Q.   PLEASE SUMMARIZE YOUR RECOMMENDATION FOR RATE CASE**  
3   **EXPENSE NORMALIZATION AS PRESENTED IN YOUR DIRECT**  
4   **TESTIMONY.**

5   A.   In my Direct Testimony submitted in this proceeding, I recommended a five (5)  
6   year normalization period rather than the three (3) year period as proposed by the  
7   Company. My total test year recommendation of \$980,800 for rate case expense  
8   is calculated based on the total costs the Company documented in DLC Exhibit 2R  
9   (Future), Revised Schedule D-8 and the use of this 5-year normalization period  
10   (\$4,904,000 ÷ 5). This allowance results in a jurisdictional allowance of \$918,372  
11   (\$980,800 X .93635) and therefore, results in a reduction to the Company's  
12   jurisdictional claim of \$612,248 (\$1,530,620 - \$918,372).

13  
14   **Q.   DID THE COMPANY SUBMIT REBUTTAL TESTIMONY BASED ON**  
15   **THE OTS RATE CASE EXPENSE NORMALIZATION**  
16   **RECOMMENDATION?**

17   A.   Yes.

18  
19   **Q.   PLEASE ADDRESS THE COMPANY'S REBUTTAL TESTIMONY**  
20   **CONCERNING NORMALIZATION OF RATE CASE EXPENSE.**

21   A.   Duquesne Witness Robert L. O'Brien (DLC Statement No. 8R, pages 35-38) states  
22   that I only used one rate case in my historical determination of a reasonable

1           normalization period and that history should not be the only component to  
2           consider when determining a reasonable normalization period. Mr. O'Brien  
3           further argued that external issues such as regulatory and financial market  
4           requirements as well as internal issues such as construction and operational  
5           requirements should be important considerations when recommending a  
6           normalization period for rate case expense in a base rate case.

7  
8   **Q.   PLEASE EXPLAIN WHY YOUR RECOMMENDATION IS BASED ON**  
9   **THE COMPANY'S HISTORY.**

10  A.   My recommendation is based on the Company's history of rate filings because a  
11       company's history regarding the frequency of base rate filings has traditionally  
12       been the Commission's stated determining factor when determining the proper  
13       normalizing of rate case expense.

14  
15  **Q.   PLEASE EXPLAIN WHY YOU ONLY USED ONE RATE CASE IN**  
16  **DETERMINING THE OTS RECOMMENDATION FOR A**  
17  **NORMALIZATION PERIOD FOR RATE CASE EXPENSE.**

18  A.   As stated by Duquesne Witness O'Brien in DLC Statement No. 1, page 2, the  
19       Company had not filed a rate case since 1987. Since, this was nineteen years ago  
20       and 10 years before a rate freeze (beginning in 1997) prohibited DLC from filing a  
21       rate case, the 5 year period was recommended as a reasonable reflection of the

1 Company's history for filing rate cases. Based upon the actual duration of rate  
2 case filings, my recommendation could have been for ten years rather than five.

3  
4 **Q. DID YOU AND WOULD YOU CONSIDER THE EXTERNAL AND**  
5 **INTERNAL INFLUENCES THAT WITNESS O'BRIEN HAS SUGGESTED**  
6 **IN DETERMINING THE PROPER NORMALIZATION OF RATE CASE**  
7 **EXPENSE?**

8 A. No. The influences cited by Mr. O'Brien could fluctuate in many ways and  
9 therefore, the Company's predicted reaction to them (filing a rate case in three  
10 years) is speculative. For instance, the Company has referenced its current  
11 construction program for infrastructure improvement and the Company's need to  
12 recover these costs as a reason for their prediction that they will file a rate case in  
13 three years. Instead the Company may find that the effect of this program  
14 improves its operational efficiencies to the extent that it experiences reduced  
15 O&M expenses (labor, materials, outside contractors, etc.) and therefore  
16 acceptable returns to the extent that the Company will not need to file in three  
17 years. The Company's history is a verifiable fact and should be considered a valid  
18 predictor of a Company's future actions for purposes of establishing a  
19 normalization period for rate case expense.

1           **INCENTIVE COMPENSATION**

2   **Q.   PLEASE SUMMARIZE YOUR INCENTIVE COMPENSATION EXPENSE**  
3   **RECOMMENDATION AS PRESENTED IN DIRECT TESTIMONY.**

4   A.   In my Direct Testimony, OTS Statement No. 2, pp, 13-17, I recommend that both  
5   ratepayers and shareholders should equally bear the expenses for payments under  
6   the incentive compensation/bonus plan. Therefore, a future test year (FTY)  
7   allowance of \$2,564,500 and a jurisdictional allowance of \$2,401,270 results in  
8   the Company's FTY claim of \$5,129,000 being charged 50% to expense and the  
9   remaining half of these expenses should be treated as below the line expenses.

10   This recommendation results in a reduction of \$2,564,000 (\$5,129,000 -  
11   \$2,564,500) to the Company's total FTY claim and a reduction of \$2,401,270  
12   (\$4,802,539 - \$2,401,270) to the Company's jurisdictional claim.

13  
14   **Q.   WHY DO YOU CONCLUDE THAT RATEPAYERS AND**  
15   **SHAREHOLDERS SHOULD EQUALLY BEAR THE INCENTIVE/BONUS**  
16   **PLAN EXPENSE?**

17   A.   According to Duquesne Light Holdings, Inc. Compensation Standards, no  
18   payments relating to the incentive compensation/bonus plan are made unless a  
19   minimum threshold of financial performance is achieved, regardless of the  
20   achievement level of other Company and individual performance measures (OTS  
21   Ex. No. 2, Sch. 6, p. 4).

1 **Q. DID ANY COMPANY WITNESS SUBMIT REBUTTAL TESTIMONY**  
2 **BASED ON THE OTS INCENTIVE COMPENSATION**  
3 **RECOMMENDATION?**

4 A. Yes. The rebuttal testimony of Susan S. Betta, DLC Statement No. 2-R, pp.  
5 16-18 addresses the OTS Incentive Compensation recommendation.

6  
7 **Q. DO YOU WISH TO RESPOND TO THE DUQUESNE REBUTTAL**  
8 **TESTIMONY CONCERNING INCENTIVE COMPENSATION EXPENSE?**

9 A. Yes. First, Witness Betta responds to the question “Do you agree that 50% of the  
10 incentive compensation/bonus plan expense is related to financial goals of  
11 Duquesne Light Holdings?” Witness Betta answers “no” and continues to explain  
12 how employees must perform their individual goals in order to be eligible for  
13 incentive compensation. On the contrary, she admits that achievement of a  
14 percentage of company-wide objectives are limitations on the availability of  
15 incentive compensation. She states that it isn’t fair to characterize the incentive  
16 compensation program as being based on financial performance simply because  
17— 50% of the company objective in 2006 is based on financial performance. Finally  
18 she states that the portion of the incentive compensation that is strictly financial  
19 performance related is the aspiration level of payout from 101% to 150% which  
20 witness Betta contends is not included in the future test year claim.

1 **Q. DO YOU HAVE A FURTHER RESPONSE TO DUQUESNE WITNESS**  
2 **BETTA'S TESTIMONY?**

3 A. Yes. It is my opinion that the 50% of the incentive compensation/bonus plan  
4 expense is not related to financial goals of Duquesne Light Holdings. I believe  
5 that all or 100% of the incentive compensation/bonus plan expense is related and  
6 contingent upon meeting some predetermined percentage of Duquesne Light  
7 Holdings company-wide financial goals as set in any given year. If that  
8 percentage of financial goals is not met then zero incentive compensation is paid  
9 as stated in the Duquesne Light Holdings, Inc. Compensation Standards (OTS Ex.  
10 No. 2, Sch. 6, p. 4). Additionally, if that goal is surpassed, it can increase the  
11 bonus payment by 101% to 150% no matter what the level of individual employee  
12 performance as stated in Duquesne Light Holdings, Inc. Cash incentive  
13 Compensation Program (OTS Ex. No. 2, Sch. 5, p. 7).

14  
15 **Q. COULD YOU EXPLAIN AN INCENTIVE BONUS CALCULATION?**

16 A. Yes. If the company wide-objectives of financial performance are met and at  
17 whatever percentage of the objectives are met, then the payout of incentive  
18 compensation available for a particular job category (based on a percentage of  
19 salary) is determined. For example, if your job is a Production Management  
20 Scheduler at a salary of \$90,768 per year and the incentive level for your job is set  
21 at 15%, and the company-wide objectives of financial performance are met at  
22 100%, then you are eligible for a bonus payment of \$13,615 ( $\$90,768 \times 15\% \times$

1 100%). If the company-wide objectives of financial performance are met at 90%  
2 then you are eligible for a bonus payment of \$12,253 ( $\$90,768 \times 15\% \times 90\%$ ). On  
3 the other hand, if the threshold for the minimum percentage of company-wide  
4 objectives for financial performance is set at 80% and it is not met then you are  
5 eligible for zero bonus payment. Any level of individual performance will not  
6 change the incentive bonus payment from zero. It is after this eligible bonus  
7 payment is established that the percentage of individual performance is used to  
8 calculate the award. For example if the company-wide objectives of financial  
9 performance are met at 100%, and the employee is eligible for a bonus payment of  
10 \$13,615, but the employee individual performance is only met at 52% then the  
11 actual bonus amount is \$7,080 ( $13,615 \times 52\%$ ). It should be noted that that the  
12 policy does not cite setting a minimum threshold for individual performance.  
13 Additionally, if the company-wide objectives of financial performance are met at  
14 the aspiration level of 150%, then the bonus amount of \$7,080 increases to that  
15 level. The bonus award amount becomes \$10,620 ( $\$7,080 \times 150\%$ ). This  
16 example assumes the employee was employed in this position for the whole year.  
17 -- For additional examples reference the company's response to OTS-RE-46 (OTS  
18 Ex. No. 2-SR, Sch.1, p. 2).

1 **Q. DO YOU AGREE WITH THE COMPANY THAT THE ASPIRATION**  
2 **LEVEL IS NOT BUDGETED AND THEREFORE NOT INCLUDED IN**  
3 **RATES?**

4 A. I cannot agree to the Company's contention without detailed documentation  
5 regarding the claim calculation. The Company's claim for incentive compensation  
6 expense is not clearly stated in the filing. It is included in FERC Account 920.  
7 The Company provided the FTY claim for the TME December 2006 of  
8 \$5,129,000 in a response to an interrogatory that did not include documentation.

9  
10 **Q. DO YOU HAVE REASON TO BELIEVE THAT THE ASPIRATION**  
11 **LEVEL COULD BE INCLUDED IN THE COMPANY'S FTY CLAIM?**

12 A. Yes. In response to OCA Interrogatory OCA-IV-80, the Company reported that  
13 \$5,493,000 was included in expense for the TME December 2005 (OTS Ex. No.  
14 2-SR, Sch 2, p.1). Further, as can be derived from the Company's response to  
15 OTS Interrogatory OTS-RE-46, the 2005 incentive bonuses were paid at the  
16 aspiration level of 150% (OTS Ex. No. 2-SR, Sch.1, p. 2). The bonus amount  
17 calculated without the aspiration level adjustment was \$3,662,000 ( $\$5,493,000 \div$   
18  $150\%$ ). If Duquesne's FTY claim is \$5,129,000 without the aspiration level  
19 included then they expect an increase in incentive bonus payments of 40%  
20 ( $\$5,129,000 \div \$3,662,000$ ). In addition, if an aspiration amount is not included  
21 and the Company achieves the 150% aspiration level, bonus payments could reach  
22 \$7,693,500 ( $\$5,129,000 \times 150\%$ ).

1 **Q. IF THE ASPIRATION LEVEL OF INCENTIVE COMPENSATION**  
2 **BONUS EXPENSE IS NOT INCLUDED IN THE COMPANY'S CLAIM,**  
3 **DO YOU CONTINUE TO RECOMMEND THAT THE EXPENSE BE**  
4 **SHARED BETWEEN THE RATE PAYERS AND THE SHAREHOLDERS?**

5 A. Yes. I continue to recommend that an equal share of the claim is shared between  
6 the rate payer and the shareholders because of the importance the plan imparts to  
7 the company-wide financial objectives in determining the availability of any bonus  
8 payments. Additionally, both stakeholders share the benefits when those company  
9 wide financial objectives are met and therefore, they should bear the costs.

10

11 **Q. DID THE COMPANY CITE ANY OTHER ISSUES TO SUPPORT ITS**  
12 **CLAIM?**

13 A. Yes. The Company states that they do not give performance, merit, or inflation  
14 based increases and therefore the incentive bonus program allows them to remain  
15 competitive in the employee marketplace.

16

17 **Q. DO YOU AGREE THAT THIS ISSUE SUPPORTS DLC'S CLAIM?**

18 A. No. The Company granted the following market pay increases to non-union  
19 employees (OTS Ex. No. 2-SR, p. 1-2):

- 20 • 3/1/2006 3.0%
- 21 • 2/1/2005 2.6%
- 22 • 1/1/2004 2.5%

- 1                   • 4/1/2003     1.1%

2           The Company has included a 4% increase effective 1/1/2007 for the Non-union  
3           employees. It is my understanding that these market pay increases reflect the  
4           increases given in the Company's competitive market and that each increase was  
5           given to all salaried and hourly non-union employees.

6  
7           **STORM RESTORATION EXPENSE NORMALIZATION**

8   **Q.   PLEASE SUMMARIZE YOUR STORM RESTORATION EXPENSE**  
9           **NORMALIZATION RECOMMENDATION AS PRESENTED IN DIRECT**  
10          **TESTIMONY.**

11   A.   In my Direct Testimony, OTS Statement. No. 2, pp, 9-13, I recommend that the  
12          Company's claim for Storm Restoration Expense normalization be denied. This  
13          recommendation results in a reduction to the total Company FTY claim of  
14          \$897,000 and a reduction to the jurisdictional FTY claim of \$858,346 (\$206,000 X  
15          81.37% + \$691,000 X 99.96%).

16  
17 -- **Q.   WHAT IS THE BASIS FOR YOUR RECOMMENDATION FOR STORM**  
18          **RESTORATION EXPENSE?**

19   A.   My recommendation is based on several factors. First, the Company will not be  
20          incurring any storm restoration insurance costs beyond the first three months of  
21          the test year. Therefore, the \$206,000 the Company budgeted in 2006 and  
22          included in its FTY claim should be eliminated. Second, I disagree with using the

1 normalized cost of insurance premiums as a proxy for the expected future  
2 expenses of storm restoration. Third, only expenses actually incurred for storm  
3 restoration should be the basis for determining the reasonably expected future  
4 expenses for storm restoration. Fourth, the Company has already included a claim  
5 for storm restoration costs in the accounts that the Company has recorded these  
6 expenses in the past. DLC's FTY adjustment of \$858,346 is double counting for  
7 expenses already included in the FTY.

8  
9 **Q. DID ANY COMPANY WITNESS SUBMIT REBUTTAL TESTIMONY**  
10 **BASED ON YOUR STORM RESTORATION EXPENSE**  
11 **NORMALIZATION RECOMMENDATION?**

12 **A.** Yes. Duquesne Witness Betta provided such rebuttal testimony. (Statement No. 2-  
13 R, pp. 20-23)

14  
15 **Q. PLEASE ADDRESS THE COMPANY'S REBUTTAL TESTIMONY**  
16 **CONCERNING STORM RESTORATION EXPENSE NORMALIZATION.**

17 **A.** Duquesne Witness Betta (Statement No. 2-R, pages 20-23) concedes that actual  
18 historic storm costs incurred should be used as the basis for determining the  
19 reasonably expected future expenses for storm restoration. Witness Betta has  
20 provided Exhibit SSB-14 which shows the calculation for Storm expense  
21 normalization of \$699,000 by averaging 6 years of actual amounts expended.

1 **Q. HAS THE COMPNAY ADJUSTED ITS FTY CLAIM FOR STORM**  
2 **RESTORATION NORMALIZATION EXPENSE?**

3 A. Yes. Duquesne Witness O'Brien has submitted Exhibit 2R (Future) and revised  
4 Schedule D-13, p. 1, to reflect a reduction in the claim from \$897,000 to \$699,000  
5 by basing the FTY claim on actual expenses for storm restoration instead of  
6 insurance premium costs. Then, the Company reduced the claim for amounts  
7 already included in the operating budget (\$306,000) and made a Pro Forma  
8 adjustment to the test year of \$393,000 (\$699,000 – \$306,000).

9  
10 **Q. DO YOU AGREE WITH THE COMPANY'S REVISED FTY CLAIM FOR**  
11 **STORM RESTORATION NORMALIZATION EXPENSE?**

12 A. No. I agree with the normalization of storm restoration expenses based on the  
13 average of storm restoration costs that were actually expensed over the most recent  
14 6-year period. However, I disagree with the adjustments the Company used to  
15 consider the amounts already in the budget. In my judgment, DLC has included  
16 \$547,000 in the 2006 Budget instead of the \$100,000 witness Betta introduced in  
17 her rebuttal testimony. Therefore, I recommend an adjustment of \$753,000  
18 (\$547,000 + \$206,000) which results in an adjustment to the FTY of (\$54,000)  
19 (\$699,000 - \$753,000).

1 **Q. WHAT ITEMS DID THE COMPANY USE TO REDUCE THE FTY**  
2 **NORMALIZED CLAIM THAT ARE ALREADY IN THE FTY BUDGET?**

3 A. The Company made adjustments for two items. First, they reduced the FTY claim  
4 by \$206,000 or the cost of the three month continuation of the insurance policy.  
5 Second, they reduced the FTY claim by \$100,000 for the amount witness Betta  
6 testified that is included in the expense budget each year for some level of storm  
7 expenses to be incurred related to outside services.

8  
9 **Q. ARE YOU IN AGREEMENT WITH THE COMPANY'S PROPOSED**  
10 **REDUCTIONS TO THEIR CLIM TO ACCOUNT FOR AMOUNTS FOR**  
11 **AMOUNTS INCLUDED IN THE BUDGET?**

12 A. No. I agree with the insurance adjustment of \$206,000. However, I disagree that  
13 the \$100,000 represents the total budgeted expense level for storm damage in the  
14 2006 budget. I conclude that the total amount in the 2006 expense budget is  
15 \$547,000.

16  
17 **Q. PLEASE EXPLAIN WHY YOU CONCLUDED THAT THE COMPANY**  
18 **HAS INCLUDED MORE THAN \$100,000 OR A TOTAL OF \$547,000 IN**  
19 **ITS EXPENSE BUDGET FOR STORM RESTORATION COSTS.**

20 A. As shown in Duquesne Witness Betta's Exhibit SSB-14, the amount that the  
21 Company expensed in the historic year of 2005 is \$547,000. The Company did

1 not indicate any reductions in any expense account based on an adjustment for  
2 storm costs (DLC Exhibit 3 (Historic), Schedule D-3, pages1-2).

3  
4 **Q. DO YOU HAVE A FURTHER REASON TO CONCLUDE THAT THE**  
5 **COMPANY INCLUDED THE 2005 EXPENSES OR \$547,000 IN ITS 2006**  
6 **BUDGET AND/OR FTY CLAIM?**

7 A. Yes, I am of the opinion that the Company included these expenses in the accounts  
8 in which they were recorded in 2005. In the direct testimony of DLC Witness  
9 Susan S. Betta, DLC Statement No. 2, page 10, lines 17-31, Ms. Betta describes  
10 the budget process and states that cost center managers are provided monthly  
11 reports of their actual expenses and that these reports help the managers to budget  
12 for the following year by identifying the various costs they actually incur during  
13 the year. Additionally, in response to OCA Interrogatory OCA-IV-60 (OTS Ex.  
14 No. 2, Sch. 3, p.3), Duquesne Witness Jeffrey Coward states that the Company  
15 forecasts capital additions needed for service restoration based on need and a  
16 review of the previous year's experience. He also states that DLC's actual  
17 -- spending for service restoration, although it varies by needs and the number of  
18 storms the system encounters, averaged expenditures of \$18 million per year  
19 during the period 2003 through 2005. This is the same amount included in DLC's  
20 2006 budget. Therefore, since DLC's 2006 budget for each account plus any Pro  
21 Forma adjustments equals the FTY claim in this proceeding, I conclude that a

1 claim for service restoration expenses is included in DLC's FTY claim in the  
2 accounts it was previously charged.

3

4 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

5 **A. Yes.**

**OTS Exhibit No. 2 SR**  
**Witness: Janet M. Markovich**

**PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**v.**

**DUQUESNE LIGHT COMPANY**

**Docket No. R-00061346**

**Exhibit to Accompany**

**the**

**Surrebutal Testimony**

**of**

**Janet M. Markovich**

**Office of Trial Staff**

**RECEIVED**

**SEP 28 2006**

**PA PUBLIC UTILITY COMMISSION  
SECRETARY'S BUREAU**

**Concerning:**

**Operations & Management Expenses**

Duquesne Light Company  
Docket No. R-00061346

OTS-RE-46  
Maureen Meehan

Office of the Trial Staff  
Interrogatories Set I

Reference DLC's response to OTS-RE-2-D, attachment "Cash Incentive Compensation program for Non-Union Employees". Provide several examples of actual "Employee Performance Measures and Award Determination". Names and other personal data should be redacted.

**Response:** See attached.

Please see attachment OTS-RE-46-data, which includes several examples of employee incentive award calculations for 2005, which were payable in 2006.

PL	Dept	DEPARTMENT	Title	SG	Annual Salary 12/31/05	Incentive Level	Incentive Results	Incentive @ 100%	Incentive @ Results	Incentive @ 150%	Pro Factor	2005 Incentive Award	
400	423	Payroll	Payroll Analyst	D	48,500.00	5%	85%	\$2,425	\$2,061	\$3,092	1.00	\$3,092	
803	493	Credit & Collect/Univer S	Sr. Analyst - Credit&Collectns	G	88,283.00	7%	90%	\$4,780	\$4,302	\$6,453	1.00	\$6,453	
803	503	Construction Management	Construction Admin	F	70,735.00	10%	90%	\$7,074	\$6,366	\$9,549	1.00	\$9,549	
803	830	Underground Transition	Production Mgmt Scheduler	I	90,768.00	15%	52%	\$13,615	\$7,080	\$10,620	1.00	\$10,620	
803	560	Support Services	Director	K	110,250.00	20%	92%	\$22,050	\$20,286	\$30,429	0.92	\$27,995	H-NEW HIRE 02/01/2005

Duquesne Light Company  
Docket No. R-00061346

OCA-IV-80  
Maureen Meehan / Susan Betta  
Page 1 of 1

Office of Consumer Advocate  
Interrogatories Set IV

80. Please provide a copy of all incentive compensation/bonus plans and provide the level of payments under those plans included in expenses for the test year, 2005, 2004, and 2003.

Response:

Copies of Incentive compensation /bonus plans were provided in response to OTS-RE-2-D. The incentive compensation included in expenses for the test year, 2005, 2004 and 2003 is as follows (\$ in thousands):

Test year	\$ 5,129
2005	\$ 5,493
2004	\$ 4,888
2003	\$ 2,901

Duquesne Light Company  
Docket No. R-00061346

OCA-IV-23  
Maureen Meehan  
Page 1 of 2

Office of Consumer Advocate  
Interrogatories Set IV

23. For calendar years 2003 through 2005, provide the annual salary and wage increase granted to non-union employees. If different, separately provide the increase granted to salaried and hourly employees.

Response:

This information was included in response to OTS Interrogatory RE-45. A copy of the attachment that was provided in response to that interrogatory is attached.

Duquesne Light Company  
Docket No. R-00061346

OCA-IV-23  
Maureen Meehan  
Page 2 of 2

Office of Consumer Advocate  
Interrogatories Set IV

PUC INTERROGATORIES				
OTS-RE-45				
MANAGEMENT				TOTAL PERCENT
MARKET INCREASE	EFFECTIVE	* PAID		INCREASE
2006	3/1/2006	3/15/2006		3.0
2005	2/1/2005	2/28/2005		2.6
2004	1/1/2004	3/16/2004		2.5
2003	4/1/2003	4/15/2003		1.1
* First paycheck to reflect pay increase back to effective date.				
				AVERAGE
INCENTIVE			PAID	DOLLAR AWARD *
2006		3/15/2006		13,511.23
2005		2/28/2005		13,990.23
2004		3/16/2004		16,980.80
2003		3/28/2003		14,865.53
* Payout for previous year performance target				
				TOTAL PERCENT
UNION	EFFECTIVE	PAID		INCREASE
GENERAL INCREASE	DATE	HOURLY *	SALARY *	
2006	10/1/2006	10/4/2006	10/15/2006	4.0
2005	10/1/2005	11/2/2005	10/15/2005	3.5
2004	10/1/2004	10/20/2004	10/15/2004	3.5
2003	10/1/2003	11/5/2003	10/15/2003	3.0
*First paycheck to reflect pay increase back to effective date.				
				AVERAGE
INCENTIVE			PAID	DOLLAR AWARD *
		HOURLY	SALARY	
2006		3/15/2006	3/15/2006	1,422.25
* For 2005 performance				

**OTS Statement No. 3**  
**Witness: Michael J. Gruber**

**PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**v.**

**Duquesne Light Company**

**Docket No. R-00061346**

**Direct Testimony**

**of**

**Michael J. Gruber**

**Office of Trial Staff**

**RECEIVED**

**SEP 28 2006**

**PA PUBLIC UTILITY COMMISSION  
SECRETARY'S BUREAU**

**Concerning:**

**Distribution System Improvements Charge**  
**Transmission Service Charge**  
**Allowance for Funds Used During Construction**  
**Customer Distribution Charge**

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

3 A. My name is Michael J. Gruber. My business address is P. O. Box 3265,  
4 Harrisburg, Pennsylvania 17105-3265.

5  
6 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

7 A. I am employed by the Pennsylvania Public Utility Commission (Commission) in  
8 the Technical Division of the Office of Trial Staff as a Fixed Utility Valuation  
9 Engineer.

10  
11 **Q. PLEASE DESCRIBE THE ROLE OF OTS IN UTILITY PROCEEDINGS.**

12 A. OTS was established by the Pennsylvania Legislature in 1986 and is responsible  
13 for representing the public interest in specified Commission proceedings. The  
14 OTS analysis in this proceeding is based on that responsibility to represent the  
15 public interest. This responsibility requires the balancing of the interests of  
16 ratepayers and the Company.

17  
18 **Q. WHAT IS YOUR EDUCATIONAL AND PROFESSIONAL**  
19 **BACKGROUND?**

20 A. Attached to my testimony as Appendix A is a statement which describes my  
21 educational background and my employment experience.

1 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

2 A. The purpose of my testimony is to address four areas of the Duquesne Light  
3 Company's (DLC or Company) filing. The first is the Company's request to  
4 establish a Distribution System Improvements Charge (DSIC). The second is the  
5 Company's request to establish a Transmission Service Charge (TSC), the third is  
6 the Company's request to start accruing an Allowance for Funds Used During  
7 Construction (AFUDC) on plant which should be placed in plant held for future  
8 use, and the fourth is the level of the Customer Distribution Charge.

9

10 **Q. WHAT IS THE COMPANY REQUESTING IN THIS PROCEEDING?**

11 A. The Company is requesting permission to add a new rider to its tariff which  
12 establishes a DSIC.

13

14 **Q. WHAT IS A DSIC?**

15 A. A DSIC is a surcharge added to the customer's bill which compensates a utility for  
16 the return on and the return of the investment in distribution plant placed in service in  
17 between base rate proceedings.

1 **Q. WHAT REASONS DOES THE COMPANY GIVE FOR REQUESTING TO**  
2 **IMPLEMENT A DSIC?**

3 A. According to the Company, establishing a DSIC will enable it to recover the cost  
4 of critical infrastructure investments on a timely basis. The Company also claims  
5 that a DSIC will mitigate rate impacts to customers and allow rates to increase  
6 more gradually than through larger base rate increases (DLC St. No. 12 p. 25).

7  
8 **Q. WHAT PROPERTY WOULD BE COVERED UNDER THE COMPANY'S**  
9 **PROPOSED DSIC PROGRAM?**

10 A. The Company is proposing to include non-revenue producing system improvements  
11 to replace facilities that are deteriorated or are to meet new regulation. The  
12 Company's proposed tariff, contained in DLC Ex. NJDC-1, lists the following  
13 FERC accounts – Account 361,362, 364, 365, 366, 367, 368, 369, 370, 373, 394, and  
14 397 as the accounts which will be included in the Company's proposed DSIC  
15 recovery. It is important to first emphasize that no electric or gas utility in  
16 Pennsylvania has such a surcharge.

1 **Q. WHAT COSTS WOULD BE RECOVERED UNDER THE PROPOSED**  
2 **DSIC?**

3 A. The Company is asking to recover the calculated return on and return of its eligible  
4 investment, adjusted for any over or under collection from the previous year ending  
5 November 30, grossed up for the Pennsylvania Gross Receipts Tax (See Original  
6 Page 109 of the Company's proposed tariff).

7  
8 **Q. HOW WOULD THE COMPANY CHARGE FOR THE DSIC?**

9 A. The Company is proposing to apply the DSIC, calculated to the nearest one-  
10 thousandth of a mill, to all kilowatt-hours billed for all electric service during the  
11 billing month.

12  
13 **Q. HOW WOULD THE RIDER FOR THE PROPOSED DSIC OPERATE?**

14 A. The proposed rider for the DSIC would be applied to an electric customer's  
15 distribution bill on a per kwh basis and is claimed to be designed to recover the  
16 depreciation expense and return dollars on the Company's investment in certain  
17 non-revenue producing electric distribution plant. The DSIC would be limited to  
18 5 percent of a customer's distribution bill (Original Page No. 109 of the  
19 Company's proposed tariff).

1 **Q. DOES THE COMPANY CLAIM THAT THERE IS PRECEDENT FOR A**  
2 **DSIC?**

3 A. No. In fact the Company even states that there is substantial doubt as to the  
4 Commissions authority to approve a DSIC mechanism for electric distribution  
5 (DLC St. No. 12 p. 26) but claims to be seeking to establish one in the event that  
6 pending legislation passes during the course of this proceeding.

7  
8 **Q. WHAT IS THE POSITION OF OTS ON THE COMPANIES REQUEST**  
9 **FOR A DSIC?**

10 A. OTS is opposed to the Company being allowed to establish a DSIC rider.

11  
12 **Q. WHAT DO YOU RECOMMEND REGARDING THE COMPANY'S**  
13 **REQUEST TO IMPLEMENT A DSIC?**

14 A. I recommend that the request be denied.

15  
16 **Q. ARE THERE ANY UTILITIES IN PENNSYLVANIA WHICH HAVE A**  
17 **DSIC MECHANISM?**

18 A. Yes. Water utilities are permitted to have a DSIC mechanism and that authority is  
19 expressly provided by statute.

1 **Q. HAS THE COMMISSION EVER ALLOWED ANY NON-WATER**  
2 **UTILITY TO ESTABLISH A DSIC?**

3 A. No, however, the Commission allowed the PA American Water Company to  
4 establish a Collection System Improvement Charge (CSIC) for three wastewater  
5 systems, A Pocono Country Place, in Monroe County, the City of Coatesville, in  
6 Chester County, and the Lehman Pike system in Monroe and Pike Counties, which  
7 includes the Saw Creek Estates in its decision at R-00027982 on September 5,  
8 2003.

9  
10 **Q. WHAT IS A CSIC?**

11 A. A CSIC is the wastewater company's equivalent of a water company's DSIC.

12  
13 **Q. IS THIS CSIC STILL IN PLACE?**

14 A. No. The Office of Consumer Advocate appealed the Commission's decision and  
15 the Commonwealth Court of Pennsylvania at 869 A.2d 1144; 2005 Pa. Commw.  
16 LEXIS 137 reversed the Commission decision.

17  
18 **Q. HAS THE COMMISSION EVER DENIED A COMPANY'S REQUEST**  
19 **FOR A DSIC?**

20 A. Yes. The Commission's in its order at Docket No. R-00049255 on December 2,  
21 2004, The Commission denied PPL Electric Company's request to establish a  
22 DSIC for its electric distribution system.

1 **Q. COULD THE COMMISSION ALLOW THE COMPANY TO IMPLEMENT**  
2 **A DSIC?**

3 A. I am advised by counsel that there is no statutory authority for the Commission to  
4 allow or other wise authorize a DSIC for electric distribution companies.

5  
6 **Q. WHAT IS YOUR OVERALL RECOMMENDATION?**

7 A. It is my recommendation that the Commission deny the Company's request for a  
8 DSIC.

9  
10 **Q. HOW DOES THE COMPANY PROPOSE TO RECOVER ITS**  
11 **TRANSMISSION-RELATED COSTS?**

12 A. The Company proposes to recover, on a dollar for dollar basis, the transmission-  
13 related expenses it incurs from the PJM OATT from its retail customers taking  
14 POLR service from the Company through a mechanism they have designated as  
15 the Transmission Service Charge (TSC).

16  
17 **Q. DESCRIBE HOW THE TSC IS PROPOSED TO OPERATE.**

18 A. The proposed TSC will establish new retail transmission rates based on the  
19 expected PJM OATT and the budgeted kwh usage by the Company's POLR  
20 customers. The rates established in this proceeding will become effective on  
21 January 1, 2007 and succeeding periods will run from June 1 through May 31 of  
22 the following year. The charge will be calculated using all projected transmission-

1 related expenses and the budgeted sales during the period. In addition, the  
2 Company is proposing a reconciliation at the end of each 12-month billing period  
3 to identify any over collections or under collections, which will be subject to  
4 Commission review and verification. Finally, the Company proposes that any  
5 applicable over collections or under collections, including interest, will be  
6 included in the calculation of the subsequent computation year's TSC. The  
7 revenue requirement and the over/under collection will be assigned based on the  
8 each classes contribution to the Company's coincident peak from the previous  
9 year.

10  
11 **Q. WHAT IS YOUR POSITION ON THE PROPOSED TSC?**

12 A. It is the OTS position that the proposed TSC should be rejected, and that all  
13 transmission-related charges be collected through an unbundled transmission rate  
14 that is non-reconcilable. Furthermore, the Company should not be permitted to  
15 automatically pass transmission-related costs through to POLR customers. The  
16 proposed transmission charge should be adjusted based on the final transmission-  
17 related costs and kWh sales figure determined at the end of this proceeding. To  
18 the extent that the transmission expenses change the Company should be required  
19 to file a new rate proceeding to adjust its rates.

1 **Q. WHAT IS THE BASIS FOR YOUR RECOMMENDATION?**

2 A. The main basis for rejecting the Company's proposed TSC is that transmission-  
3 related costs are an integral part of the business of supplying electric service to  
4 customers. They are no different, from a regulatory point-of-view, than  
5 distribution-related costs. As such, they should be treated no differently from  
6 normal operating costs. That is, they should be reviewed as part of the entire cost  
7 of doing business. The Company should not be permitted to bypass traditional  
8 ratemaking rules to recover selected expenses without going through a full base-  
9 rate case where every aspect of the utility's operations will be examined. The  
10 Company wants complete freedom to automatically increase its transmission rates.  
11 This should not be permitted.

12  
13 **Q. ARE THESE CHARGES APPROVED BY THE FEDERAL ENERGY**  
14 **REGULATORY COMMISSION (FERC)?**

15 A. Yes, these charges are based on costs for transmission service consistent with the  
16 PJM Open Access Transmission Tariff (OATT), as accepted or approved by the  
17 FERC. According to the Company's proposal, changes in these charges will  
18 automatically be passed on to POLR customers annually.

1 **Q. DO YOU AGREE WITH THE ABOVE ASSESSMENT OF THE STATUS**  
2 **OF TRANSMISSION-RELATED CHARGES TO COMPANY'S POLR**  
3 **CUSTOMERS?**

4 A. No. The Company is basically requesting an ECR type mechanism which is  
5 intended to make them whole. Electric utilities were required to eliminate this  
6 mechanism as part of the restructuring process. The proposed TSC is also very  
7 similar to the current 1307(f) mechanism for recovery of natural gas costs. But,  
8 the Company fails to recommend a prudence review of the transmission-related  
9 costs it proposes to automatically pass through. The gas costs included in the  
10 1307(f) filings are based on FERC approved rates. The Commission, however,  
11 retains the authority to review those costs to ensure that they were incurred in a  
12 prudent manner consistent with Commission Regulations. If the Commission  
13 were to approve the proposed TSC, it should, at a minimum, order a 1307(f) style  
14 prudence review in addition to any proposed audits of the costs involved.

15 It is my opinion that while the Commission acknowledges that the FERC  
16 has authority to set transmission rates, it has the final authority to approve these  
17 rates in the Company's Pennsylvania jurisdictional tariff. Finally, the Electric  
18 Generation Customer Choice & Competition Act states in Section 2802. (16):

1 It is in the public interest for the transmission and distribution  
2 of electricity to continue to be regulated as a natural  
3 monopoly subject to the jurisdiction and active supervision of  
4 the Commission. Electric distribution companies should  
5 continue to be the provider of last resort in order to ensure the  
6 availability of universal service in this Commonwealth unless  
7 another provider of last resort is approved by the  
8 Commission.  
9

10 In my opinion, the Commission should not give up its rate-setting authority over  
11 transmission-related costs. Furthermore, the Company's proposed TSC tariff  
12 creates a lot of administrative and auditing oversight that is unnecessary in a  
13 normal rate setting situation.  
14

15 **Q. DO YOU HAVE ANY OTHER ISSUES YOU WISH TO ADDRESS?**

16 A. Yes. The Company has not made a claim for plant held for future use in this  
17 proceeding instead it is planning to charge an Allowance for Funds Used During  
18 Construction (AFUDC) on the land and land rights which should have placed into  
19 plant held for future use (Duquesne Light Company St. No. 2, p. 7).

1 **Q. WHAT IS AFUDC?**

2 A. AFUDC is a non-cash return allowance which supplies the Company with a  
3 delayed return on plant investment which is still under construction. The AFUDC  
4 accrued during active construction is capitalized and spread over the plant  
5 accounts to which plant is added at the end of construction. The purpose is to  
6 allow the Company to recover the net cost of borrowed funds used for  
7 construction purposes while plant is under construction. AFUDC is only accrued  
8 against plant which is not in rate base and where active construction is taking  
9 place.

10

11 **Q. WHAT IS PLANT HELD FOR FUTURE USE?**

12 A. Plant held for future use is usually land. It is land which must be purchased long  
13 before construction is scheduled to begin so as to insure the company's ability to  
14 acquire it as needed for future construction at a reasonable price. The value of the  
15 plant can be included in the Company's original cost measure of value where it  
16 will earn a return on the Company's investment.

17

18 **Q. WHY IS THE COMPANY ASKING TO ACCRUE AFUDC ON LAND AND**  
19 **LAND RIGHTS?**

20 A. The Company is asking to collect AFUDC on the land and land rights which  
21 should be in plant held for future use because the plant is not currently providing  
22 service to its customers (Duquesne Light Company St. No. 2, p. 7).

1 **Q. DO YOU AGREE WITH THE COMPANY'S POSITION?**

2 A. No. The Company should not be permitted to accrue AFUDC on land and land  
3 rights. The Commission has acknowledges that there are long lead times in  
4 construction and that a utility must sometimes purchase land and land rights far in  
5 advance of the actual construction. The solution is to allow land and land rights in  
6 rate base as plant held for future use. The Company should not be permitted to  
7 change the regulatory treatment of land and land rights. The land should be  
8 included in the Company's investment in plant held for future use, and added to  
9 rate base.

10

11 **Q. WHY DO YOU DISAGREE WITH ACCRUING AFUDC ON LAND AND**  
12 **LAND RIGHTS?**

13 A. There is already an acceptable remedy for the long lead times of construction for  
14 land and land rights. Plant held for future use is usually land and as such when it  
15 is placed into service it is not depreciable. The long lead times, which necessitate  
16 acquiring the land long in advance of the actual construction, would cause highly  
17 inflated values for the land if AFUDC were allowed to be charged against its  
18 value. When it is finally added to rate base its inflated value will remain in rate  
19 base at its inflated value because there is no depreciation accrued against it.  
20 Therefore, allowing the Company to accrue AFUDC on land would increase the  
21 value of it to something more than the purchase price and it would go into rate  
22 base at an inflated value, thereby giving the Company an inflated return.

1 **Q. WHAT IS YOUR RECOMMENDATION CONCERNING AFUDC ON**  
2 **LAND AND LAND RIGHTS?**

3 A. I recommend that the Commission reject the Company's plan to accrue AFUDC  
4 on land and land rights.

5  
6 **Q. HAVE YOU EXAMINED THE COMPANY'S PROPOSED CUSTOMER**  
7 **CHARGE FOR THE RS, RH AND RA RATE CLASSES?**

8 A. Yes.

9  
10 **Q. WHAT IS THE COMPANY PROPOSING FOR THE RESIDENTIAL**  
11 **CUSTOMER CHARGE?**

12 A. The Company is proposing to raise the Customer Distribution Charge from \$6.48  
13 to \$11.50 for the RS, RH and RA rate classes. This is approximately a 77%  
14 increase in the Customer Distribution Charge and by default the Minimum charge.

15  
16 **Q. WHAT JUSTIFICATION DOES THE COMPANY GIVE FOR THIS 77%**  
17 **INCREASE IN THE CUSTOMER DISTRIBUTION CHARGE?**

18 A. On page 10 of Duquesne Light Company Statement No. 12, Company Witness  
19 Pfrommer states that he is proposing to increase the Customer Distribution Charge  
20 to \$11.50 which is approximately 50% of the customer-classified cost for the  
21 residential class from the Company's class cost of service study. He further states  
22 that he has limited the increase because, while it might be appropriate to have the

1 customer charge cover all costs associated with the fixed monthly charge, the  
2 increase would have created substantial cost shifts and impose relatively higher  
3 increases on low usage customers.

4  
5 **Q. DO YOU AGREE WITH COMPANY WITNESS PFROMMER?**

6 A. I agree with the portion of his testimony where he states that the increase in the  
7 customer distribution charge necessary to cover all costs associated with it would  
8 be much too high.

9  
10 **Q. DO YOU AGREE WITH COMPANY WITNESS PFROMMER DECISION**  
11 **TO RAISE THE CUSTOMER DISTRIBUTION CHARGE to \$11.50 AN**  
12 **INCREASE OF MORE THAN 77%?**

13 A. No. A 77% an increase is too high.

14  
15 **Q. WHY IS AN INCREASE OF 77% IN THE CUSTOMER DISTRIBUTION**  
16 **CHARGE TOO HIGH AN INCREASE?**

17 A. The Company's minimum monthly charge is equal to the Customer Distribution  
18 Charge. Therefore, any increase in the customer charge will have a direct affect  
19 on those customers whose usage is low. A greater than 77% increase in the  
20 customer charge will provide a higher than acceptable overall increase for low  
21 usage customers.

1 **Q. WHAT DO YOU RECOMMEND AS AN ACCEPTABLE INCREASE FOR**  
2 **THE CUSTOMER DISTRIBUTION CHARGE?**

3 A. The residential Customer Distribution Charge should be increased no more than  
4 the *average overall increase for the residential class*. This would limit the increase  
5 to the customer distribution charge to a 51.3% increase, or a rate of \$9.80, if the  
6 Company gets the entire increase it has requested. However, if the Company gets  
7 less than it has requested the increase in the Customer Distribution Charge would  
8 be proportionally less as well.

9

10 **Q. DOES THIS COMPLETE YOUR TESTIMONY?**

11 A. Yes.

## MICHAEL J. GRUBER

### Appendix A

#### **Education and Professional Background**

In May 1976, I received a B. S. in Civil Engineering from The Pennsylvania State University. After graduation, I was hired by the Pennsylvania Public Utility Commission and worked in the Valuation Section of the Bureau of Rates and Research in the area of electric and telephone valuation and depreciation. When the Bureau was realigned into Divisions, I specialized in telephone valuation and depreciation. Later, I was transferred to the Engineering Section of the Electric Division to work on electric company valuation and depreciation.

In October 1977, I participated in a special depreciation training program sponsored by Western Michigan University in Kalamazoo, Michigan, entitled "Fundamentals of Service Life Forecasting".

In the fall of 1977 and spring of 1979, I successfully completed accounting courses at the Harrisburg University Center, which were sponsored by Elizabethtown College.

From 1977 through early 1987, I was a Fixed Utility Valuation Engineer responsible for review and evaluation of claims for depreciation, original and trended original cost valuations, construction work in progress, plant held for future use, materials and supplies, and extraordinary property loss claim in many electric and telephone rate proceedings before this Commission.

In July 1978, I participated in a special depreciation training program sponsored by Western Michigan University at Calvin College in Grand Rapids, Michigan, entitled "Dynamics of Life Estimation".

I took part in the early stages of the "*1979 Triennial Review of The Bell Telephone Company of Pennsylvania Depreciation Review*", which was submitted to this Commission and the Federal Communications Commission (FCC) for review and comment prior to the FCC's prescribing of annual depreciation rates for the next three-year period.

Under the Commission's reorganization in 1987, I was assigned to the Office of Trial Staff, Engineering Section, and Analysis Division. In May of 1987, I was appointed as Supervisor of the Engineering Section, Engineering and Rate Design Division of the Office of Trial Staff, and was responsible for all rate-base, engineering and depreciation issues.

When the Office of Trial Staff reorganized in February of 1994, I was assigned the position of Assistant to the Division Chief, (of the newly formed) Telecommunications/Water Division of the Office of Trial Staff.

My duties, as Assistant to the Division Chief of the Telecommunications/Water Division of the Office of Trial Staff, involved informal training of entry level engineers and work on unusual issues which occur in the various rate proceedings before the Commission in which the Office of Trial Staff becomes involved.

I currently work as a Fixed Utility Valuation Engineer III working on a variety of utility filings.

Early in my time at the Public Utility Commission, I was a Fixed Utility Valuation Engineer in the following major rate proceedings before the Pennsylvania Public Utility Commission:

- 1) The Duquesne Light Company at Docket No. R.I.D 373
- 2) The Pennsylvania Electric Company at Docket No. R.I.D 392
- 3) The Metropolitan Edison Company at Docket No. R.I.D 434
- 4) The Bell Telephone Company of Pennsylvania at Docket Nos. R.I.D 367 and R-79060719
- 5) The Bethel and Mt. Aetna Telephone and Telegraph Co. at Docket No. R-77090452
- 6) The Mid-Penn Telephone Corporation at Docket No. R-77090462
- 7) The Commonwealth Telephone Company at Docket No. R-77090482

In addition, I have been a Fixed Utility Valuation Engineer in various other informal rate investigations.

I have testified in the following cases:

General Telephone Company of Pennsylvania at R-7910062  
West Penn Power Company at R-80021082, F-842632, and R-850220  
Pennsylvania Power & Light Company at R-8003114, R-822169,  
R-842651, and R-00973954  
Philadelphia Electric Company at R-80061225, and R-842590  
Metropolitan Edison Company at R-80051196, R-811601, and R-842770  
Pennsylvania Electric Company at R-80051197, R-811602, and R-842771  
Pennsylvania Power Company at R-811510, R-832409, R-850267, and  
R-870732  
UGI Gas at R-821899, and R-870602  
Duquesne Light Company at R-850021, R-860378, and R-870651  
Shickshinny Water Company at R-870764  
Marion Height Water Company at R-870774  
National Fuel Gas Distribution Company at R-881125, R-891218,  
R-00942991, and R-00963779  
Arrowhead Public Service Corporation at R-891557  
Duquesne Light Company at P-900485  
General Public Utilities at P-910502, and G-900240  
LP Water & Sewer at G-910255, A-230242, A-211770  
Sunshine Hills Water Company at R-912023  
West Penn Power at R-00922378  
MPW Utilities Inc. at A-230026  
Public Service Water Company at A-210025F002  
UGI Utilities Inc., (Electric) at R-00932862, and R-00973975  
Pennsylvania American Water Company at R-00932670  
National Utilities Inc. at R-00932670  
Newtown Artesian Water Company at R-00943157  
IntraLATA Interconnection Investigation at I-00940034  
MFS Intelenet of PA at A-310203  
Alltel at P-981423  
Equitable Gas Co., 1307(f), Docket Nos. R-00016132, and R-00005067  
Pike County Power & Light, Docket No. R-00011872  
UGI Utilities, Inc. – Gas Division, Docket No. R-00016376  
Wellsboro Electric Company, Docket No. R-00016356  
T. W. Phillips Gas and Oil Company, Docket No. R-0005807  
Equitable Gas Co. Restructuring Filing, Docket No. R-00099784  
P.F.G. Gas, Inc. and North Penn Gas Companies, Docket No. R-0005277  
T. W. Phillips Gas and Oil Company – Restructuring Filing, R-994790  
T. W. Phillips Gas & Oil Company, R-00016898  
The Peoples Natural Gas Company d/b/a Dominion Peoples, R-00027134;  
The Peoples Natural Gas Company, P-00021952

Philadelphia Gas Works – Restructuring Filing, M-00021612  
Duquesne Light Company - POLR, P-00032071  
Penn Estates Utilities-Water, R-00038429  
Penn Estates Utilities-Sewer, R-00038498  
National Fuel Gas Distribution, R-00049108  
Equitable Gas Company, R-00049154  
PPL Electric Utilities Corporation, R-00049255  
Valley Energy, Inc., R-00049345  
UGI Utilities, Inc., R-00049422  
Township of Falls - Sewer, R-00049557  
National Fuel Gas Distribution Corp., R-00049656  
National Fuel Gas Distribution Corp., R-00050216  
Equitable Gas Company, R-00050272  
UGI Utilities Inc., A-120011F2000

Some of the issues I have testified on include:

- 1) Depreciation and Service Life Analysis
- 2) Customer Contributions In Aid of Construction
- 3) Customer Advances for Construction
- 4) Construction Work in Progress
- 5) Material and Supplies
- 6) Post Test Year Plant Additions
- 7) Loan Financing and Repayment
- 8) Utility Plant Used and Useful in the Public Service
- 9) Cost of Gas
- 10) Take or Pay Obligations of Gas Utilities
- 11) Rules and Regulations for New Telecommunications Services
- 12) Contractual Obligations Between Utilities
- 13) Rate Structure and Tariff Issue
- 14) Excess Utility Plant Investment
- 15) Cost of Service and
- 16) General Prudence Issues
- 17) 1307(f) Gas Purchase Issues
- 18) Stranded Electric Costs
- 19) Chapter 30 Issues

**OTS Statement No. 3-R  
Witness: Michael J. Gruber**

**PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**v.**

**DUQUESNE LIGHT COMPANY**

**Docket No. R-00061346**

**Rebuttal Testimony**

**of**

**Michael J. Gruber**

**Office of Trial Staff**

**RECEIVED**

**SEP 28 2006**

**PA PUBLIC UTILITY COMMISSION  
SECRETARY'S BUREAU**

**Concerning:**

**Responses to Directed Questions of  
Commission Vice Chairman Cawley**

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

3 A. My name is Michael J. Gruber. My business address is P.O. Box 3265,  
4 Harrisburg, Pennsylvania 17105-3265.

5  
6 Q. ARE YOU THE SAME MICHAEL GRUBER WHO SUBMITTED OTS  
7 STATEMENT NO. 3?

8 A. Yes, I am.

9  
10 Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

11 A. The purpose of this testimony is to provide the OTS responses to Vice Chairman  
12 Cawley's directed questions.

13  
14 Q. HAVE YOU EXAMINED VICE CHAIRMAN CAWLEY'S FOUR (4)  
15 DIRECTED QUESTIONS?

16 A. Yes.

17  
18 Q. WHAT IS YOUR RESPONSE TO THE FIRST DIRECTED QUESTION?

19 A. The first question is:

20 Do fixed charges for residential and small or medium  
21 commercial customer distribution services discourage  
22 conservation of energy? If so, what other revenue  
23 decoupling models can be implemented that would  
24 optimally meet the dual needs of providing incentives

1 for consumers to conserve energy, while providing  
2 reasonably stable revenues for utilities?  
3

4 I would first note that any increase in a customer's bill will generally  
5 promote conservation by that customer in response to the increase. It has been my  
6 experience that customers are primarily focused on the total amount of their bill  
7 and not necessarily upon the individual components of their bill. If, you accept  
8 this proposition, and absent any intensified customer education explaining that  
9 bills in the future will be more usage sensitive, eliminating or reducing the fixed  
10 customer charges as a bill component will not result in any significant increase in  
11 energy conservation as long as the total amount of the bill remains the same.  
12 However, if sufficient information is provided to customers in the future  
13 explaining that their new bills have reduced the fixed charges portion of the bill  
14 and that conservation will now result in even greater savings to them, an increase  
15 in conservation by customers may occur to a degree that may be significant.  
16

17 **Q. WHAT IS THE SECOND QUESTION AND WHAT IS YOUR RESPONSE?**

18 A. The second question is:

19 Do declining block rate designs remove the incentive  
20 for consumers, especially RA and RH residential  
21 consumers and small to medium sized commercial and  
22 industrial customers ("C&I"), to conserve energy? If  
23 so, should declining block rates for supply and  
24 distribution services be phased out over time?  
25

1 I would first note that there is a direct incentive to conserve whenever an  
2 increase in usage results in a higher total bill to any customer. I would agree that  
3 the existence of declining block rates does reduce to some degree, but does not  
4 completely eliminate, the incentive for consumers to conserve energy. The  
5 declining block provides less incentive for conservation as would a single block or  
6 increasing block rate structure because the savings connected with reducing usage  
7 is not as great. In general, the theory behind declining block rates is that the  
8 allocated fixed charges are being recovered in the first blocks so that additional  
9 blocks can be lower in price.

10 There could be significant economic impacts to raising the tail block,  
11 without sufficient cause, just to provide a greater incentive to customers to  
12 conserve. This type of regulation could cause the loss of a significant portion of a  
13 commercial or industrial customer's own profit margin making its operation in  
14 Pennsylvania a less profitable operation than in some other jurisdiction. It is not  
15 inconceivable that this loss in profit margin could motivate a particular small to  
16 medium-sized commercial or industrial customers ("C&I") customer to curtail or  
17 even close its operation in Pennsylvania -- causing the loss of not only revenues to  
18 the utility from that customer (i.e. contribution to fixed costs) but also likely the  
19 revenues received from former employees who move out of the service territory  
20 seeking employment elsewhere. In my professional opinion, such ramifications  
21 should be thoroughly investigated prior to any decision to phase out declining  
22 block rates for supply and distribution services for any class of customer.

1           As such, I am not convinced that sufficient evidence currently exists to  
2 justify phasing out declining block rates for supply and distribution service – that  
3 serve useful purposes under traditional ratemaking criteria -- as a means of  
4 substantially reducing energy consumption.

5  
6 **Q.   WHAT IS THE THIRD QUESTION AND WHAT IS YOUR RESPONSE?**

7 **A.**   The third question is:

8           Do demand based charges, and in particular demand  
9 based charges for default supply service, remove the  
10 incentive for consumers, especially small to medium  
11 sized C&I customers, to conserve energy? If so,  
12 should demand based rates for such customers be  
13 phased out over time?  
14

15           Similar to my response to the First Directed Question, it has been my  
16 observation that a higher total bill will promote some conservation by a customer.  
17 This phenomenon is true whether such increase is the result of higher costs from  
18 demand or energy charges. By way of background, demand based charges are  
19 established for a customer based upon maximum demand levels and the total bill  
20 to a customer can correspondingly be lowered by lowering a customer's maximum  
21 demand. However, it is important to emphasize that a lower demand charge does  
22 not necessarily translate into lower energy usage as a customer might simply have  
23 the same usage -- but move some of its usage from a peak period to an off peak  
24 period. This activity will reduce the pressure to acquire more capacity which  
25 lowers the total overall costs to the utility and thereby keeps the utility's overall

1 future costs lower than they would be otherwise. A rate structure devoid of  
2 demand charges may promote more conservation because the customer will  
3 endeavor to use less energy to save money.

4 However, if in response to the elimination of the demand charge, one or  
5 more small to medium sized C&I customers (with the ability to do so) cuts back  
6 on off peak usage and transfers the usage to peak periods, the result could be that  
7 the utility would then have an increased need for more capacity (since capacity is  
8 based upon peak demand considerations) at a higher cost. As such, the potential  
9 for such a result should also be investigated prior to any action to reduce or  
10 eliminate demand charges.

11  
12 **Q. WHAT IS THE FOURTH QUESTION AND WHAT IS YOUR RESPONSE?**

13 **A.** *The fourth question is:*

14 Can and should rate designs vary among customer  
15 classes? For example, larger industrial and  
16 commercial ("C&I") customers generally have a much  
17 smaller percentage of their revenues attributable to  
18 distribution services. Given this dynamic, does the  
19 commodity design of supply service rates provide  
20 adequate incentive for larger C&I customers to  
21 conserve energy?

22  
23 Yes. Each customer rate class has its own specific needs and requirements  
24 for paying the portion of the cost of service allocated to it. With three types of  
25 costs to be considered for each customer class, i.e., demand, commodity and the  
26 fixed customer charges, the level of the recovery of the costs to serve each class

1 needs to differ to reflect the way in which each class contributes to the subject  
2 utility's total costs.

3

4 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

5 **A. Yes.**

**OTS Statement No. 3-SR  
Witness: Michael J. Gruber**

**PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**v.**

**DUQUESNE LIGHT COMPANY**

**Docket No. R-00061346**

**Surrebuttal Testimony**

**of**

**Michael J. Gruber**

**Office of Trial Staff**

**RECEIVED**

**SEP 28 2006**

**PA PUBLIC UTILITY COMMISSION  
SECRETARY'S BUREAU**

**Concerning:**

**Allowance for Funds Used During Construction  
("AFUDC")**

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

3 A. My name is Michael J. Gruber. My business address is P.O. Box 3265,  
4 Harrisburg, Pennsylvania 17105-3265.

5

6 Q. ARE YOU THE SAME MICHAEL GRUBER WHO SUBMITTED  
7 OTS STATEMENT NO. 3 AND OTS STATEMENT NO. 3-R?

8 A. Yes, I am.

9

10 Q. WHAT IS THE PURPOSE OF YOUR SUR-REBUTTAL  
11 TESTIMONY?

12 A. The purpose of this testimony is to present my position on the Company's  
13 request to accrue **Allowance for Funds Used During Construction**  
14 ("AFUDC") on land held for future use.

15

16 Q. HAVE YOU READ DLC STATEMENT NO. 2-R AS IT CONCERNS  
17 AFUDC ON LAND HELD FOR FUTURE USE?

18 A. Yes.

19

20 Q. WHAT IS THE COMPANY POSITION ON AFUDC?

21 A. On Page 7 of Statement 2-R, Company Witness Betta states that on advise  
22 of counsel she understands that the Commission does not allow the

1 inclusion of Land Held for Future use in rate base, but that the Commission  
2 does allow an accounting treatment whereby the Company will book  
3 AFUDC on land held for future use subject to a later determination of  
4 inclusion in rate base when the projects are completed.

5  
6 **Q. DO YOU AGREE WITH THE COMPANY POSITION?**

7 A. No.

8  
9 **Q. WHAT IS LAND HELD FOR FUTURE USE?**

10 A. Land held for future use is property which, by necessity, is purchased long  
11 before the construction begins. Some of the reasons for an early purchase  
12 requirement could be the length of time to acquire permits and or the need  
13 to know where plant will be sighted before design can begin.

14  
15 **Q. DOES THE COMMISSION ALLOW LAND HELD FOR FUTURE  
16 USE IN RATE BASE?**

17 A. Yes. Contrary to what the Company witness understands, land held for  
18 future use is one of the exceptions to the used and useful test for plant  
19 included in rate base. My research and personal knowledge of prior  
20 Commission Orders disclose that the Commission has historically allowed  
21 utilities to include land held for future use in rate base for projects that are  
22 scheduled to be in service within ten years of the date of purchase.

1 **Q. IS AFUDC ACCRUED AGAINST LAND HELD FOR FUTURE USE?**

2 A. No. My research and personal knowledge of prior Commission Orders  
3 disclose that the Commission has historically not permitted AFUDC to be  
4 accrued against plant held for future use.

5

6 **Q. WHY IS IT INAPPROPRIATE TO ACCRUE AFUDC ON LAND  
7 HELD FOR FUTURE USE?**

8 A. Land and land rights are included in rate base at the original cost not an  
9 inflated value. If a utility was allowed to accrue AFUDC on land or land  
10 rights, the value of the land included in rate base at some future point  
11 would be in excess of the purchase price. Such a practice would therefore  
12 artificially and improperly inflate the land value and would therefore be  
13 inconsistent with proper rate making.

14

15 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

16 A. Yes.

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY COMMISSION	:	
	:	
v.	:	DOCKET NO. R-00061346
	:	
DUQUESNE LIGHT COMPANY	:	

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Direct Testimony of  
BRIAN KALCIC

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On Behalf of the  
Office of Small Business Advocate

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**Direct Testimony of Brian Kalcic**

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

A. Brian Kalcic, 225 S. Meramec Avenue, St. Louis, Missouri 63105.

**Q. What is your occupation?**

A. I am an economist and consultant in the field of public utility regulation, and principal of Excel Consulting. My qualifications are described in the Appendix to this testimony.

**Q. On whose behalf are you testifying in this case?**

A. I am testifying on behalf of the Office of Small Business Advocate (“OSBA”), which is representing small business customers served by Duquesne Light Company (“Duquesne” or “Company”).

**Q. What is the subject of your testimony?**

A. My testimony will examine the Company’s proposal to establish a Distribution System Improvement Charge (“DSIC”).

**Q. Please summarize your conclusions and recommendation.**

A. Based upon my analysis of the Company’s filing, I conclude that the proposed DSIC is inconsistent with sound regulatory practice. The DSIC would present Duquesne with automatic base revenue increases related to but one aspect of the Company’s cost structure, while ignoring the potential for offsetting cost reductions in areas not covered by the DSIC mechanism. As such, I conclude that the proposed DSIC is biased against ratepayers. I am also advised by counsel that the proposed DSIC conflicts with current Pennsylvania law. Accordingly, I recommend that the Commission reject Duquesne’s proposed DSIC mechanism.

1            **Distribution System Improvement Charge (“DSIC”)**

2  
3            **Q. Mr. Kalcic, please provide a general overview of Duquesne’s DSIC**  
4            **proposal.**

5            A. Duquesne explains that the DSIC mechanism would allow the  
6            Company to recover the costs associated with certain “eligible  
7            investments” without the need for a base rate case. For DSIC purposes,  
8            eligible investments would be defined as non-revenue producing  
9            expenditures related to the replacement or relocation of certain existing  
10           facilities.<sup>1</sup> The DSIC-eligible annual costs associated with these types  
11           of capital expenditures would include depreciation and a pre-tax return  
12           on rate base. Also, any over- or under-recovery of DSIC costs would  
13           be reconciled on an annual basis. The Company’s proposed DSIC  
14           surcharge would be expressed as a percentage, not to exceed 5%, which  
15           would be applied to the amount billed to all customers for electric  
16           *distribution* service.

17  
18           **Q. Why does Duquesne believe that a DSIC is appropriate?**

19           A. Duquesne maintains that a DSIC would mitigate rate impacts to  
20           customers and ensure that the Company would receive “fair recovery in  
21           rates of the costs of critical infrastructure investments” in a timely  
22           manner.

23  
24           **Q. Has Duquesne provided an estimate of the impact of its proposed**  
25           **DSIC on ratepayers?**

26           A. Yes. Based upon its current capital investment plan, and assuming  
27           quarterly filings, the Company states that its initial DSIC would go into  
28           effect in April 2007, to reflect capital improvements placed into service  
29           over the January 1, 2007 through February 28, 2007 period. Overall,  
30           Duquesne estimates that the DSIC would produce additional

---

<sup>1</sup> Duquesne proposes to include the following types of plant investment in the DSIC: a) distribution plant investment booked to FERC accounts 361 through 370; and b) general plant investment booked to FERC accounts 394 and 397.

1 distribution revenues of \$3.1 million in 2007 and \$12.3 million in  
2 2008.

3  
4 **Q. Mr. Kalcic, is the Company's DSIC proposal consistent with sound  
5 ratemaking practice?**

6 A. No. The Company's DSIC proposal is flawed in that it equates to  
7 "single-issue ratemaking." The proposed DSIC would provide  
8 Duquesne with an opportunity to increase its revenues as a result of a  
9 particular investment, without giving ratepayers the opportunity to reap  
10 the benefits that may otherwise be associated with net gains in revenues  
11 (or cost reductions) that are not reflected in the mechanism.

12 In contrast, a base rate proceeding allows the Commission to  
13 address all areas of a utility's cost structure for the purpose of setting  
14 just and reasonable rates. For example, load growth in Duquesne's  
15 service territory may present the utility with an opportunity to lower  
16 unit distribution costs. In a base rate proceeding, the Commission  
17 would be able to offset, say, the capital costs of replacing depreciated  
18 equipment with the lower unit costs related to load growth, when  
19 determining its overall, allowed revenue requirement level. Under the  
20 proposed DSIC mechanism, however, ratepayers would see none of the  
21 benefits inherent in any such distribution cost offsets, and would  
22 instead pay for the single cost item that the mechanism addresses.

23  
24 **Q. Is it possible for the DSIC to double-count costs that are already  
25 reflected in Duquesne's base rates?**

26 A. Yes. Consider that Duquesne's current rate case may include a claim  
27 for depreciation expense and a rate of return on certain assets whose  
28 depreciable life will end in the next few years. If the Company were  
29 able to replace those assets with DSIC-eligible investment capital, its  
30 rates will inappropriately reflect the costs of those assets twice: a) once  
31 for the assets that have been fully depreciated, whose costs continue to  
32 be reflected in current base rates; and b) once for the replacement  
33 assets, whose costs would be recovered in the DSIC surcharge.

34

1 **Q. What is your recommendation with respect to Duquesne's**  
2 **proposed DSIC?**

3 A. I recommend that the Commission reject the Company's DSIC proposal  
4 on the grounds that it is equivalent to single-issue ratemaking. In  
5 addition, counsel informs me that there are also legal arguments why a  
6 DSIC should not be approved in this proceeding, and that the OSBA  
7 will present such arguments in its briefs.

8

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

10 A. Yes.

11

## APPENDIX

### Qualifications of Brian Kalcic

Mr. Kalcic graduated from Illinois Benedictine College with a Bachelor of Arts degree in Economics in December, 1974. In May, 1977 he received a Master of Arts degree in Economics from Washington University, St. Louis. In addition, he has completed all course requirements at Washington University for a Ph.D. in Economics.

From 1977 to 1982, Mr. Kalcic taught courses in economics at both Washington University and Webster University, including such subjects as Microeconomic and Macroeconomic Theory, Labor Economics and Public Finance.

During 1980 and 1981, Mr. Kalcic was a consultant to the Equal Employment Opportunity Commission, St. Louis District Office. His responsibilities included data collection and organization, statistical analysis and trial testimony.

From 1982 to 1996, Mr. Kalcic joined the firm of Cook, Eisdorfer & Associates, Inc. During that time, he participated in the analysis of electric, gas and water utility rate case filings. His primary responsibilities included cost-of-service and economic analysis, model building, and statistical analysis.

In March 1996, Mr. Kalcic founded Excel Consulting, a consulting practice which offers business and regulatory services.

Mr. Kalcic has previously testified before the state regulatory commissions of Delaware, Kansas, Kentucky, Maine, Massachusetts, Minnesota, Missouri, New Jersey, New York, Ohio, Oregon, Pennsylvania, Texas, and the Bonneville Power Administration.

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY :  
COMMISSION :  
v. : DOCKET NO. R-00061346  
DUQUESNE LIGHT COMPANY :

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Rebuttal Testimony of

BRIAN KALCIC

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On Behalf of the

Office of Small Business Advocate

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PA PUBLIC UTILITY COMMISSION  
SECRETARY'S BUREAU

Date Served: August 2, 2006

Date Submitted for the Record: \_\_\_\_\_

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SEP 26 2006

PA PUBLIC UTILITY COMMISSION  
SECRETARY'S BUREAU

1 Rebuttal Testimony of Brian Kalcic

2  
3  
4 **Q. Please state your name and business address.**

5 A. Brian Kalcic, 225 S. Meramec Avenue, St. Louis, Missouri 63105.

6  
7 **Q. Have you previously submitted direct testimony in this proceeding?**

8 A. Yes, I have.

9  
10 **Q. What is the subject of your rebuttal testimony?**

11 A. My rebuttal testimony responds to certain points raised in the direct testimony  
12 of the following witnesses: 1) Mr. James T. Selecky on behalf of Wal-Mart  
13 Stores East, LP ("Wal-Mart"); 2) Mr. Richard A. Galligan and Mr. Roger D.  
14 Colton on behalf of the OCA; 3) Mr. Stephen J. Baron on behalf of Duquesne  
15 Industrial Intervenors and the Industrial Energy Consumers of Pennsylvania  
16 ("DII"); 4) Mr. John Hanger, Mr. John J. Plunkett and Mr. Paul L. Chernick  
17 on behalf of Citizens for Pennsylvania's Future ("PennFuture"); and 5) Mr.  
18 Frank P. Lacey on behalf of Direct Energy Services, LLC ("Direct Energy").

19 I will also respond to the Directed Questions that were propounded by  
20 Vice Chairman James H. Cawley on July 12, 2006.

21  
22 Wal-Mart

23  
24 **Q. On page 15 of his direct testimony, Mr. Selecky indicates that while his**  
25 **preference would be to move all rate classes to cost of service, he would**  
26 **recommend an equal percentage increase in present distribution**  
27 **revenues to all rate classes, if Duquesne were to be awarded its requested**  
28 **level of rate relief in this proceeding. Would an equal percentage**  
29 **increase in class distribution revenues result in any movement toward**  
30 **cost of service in this case?**

31 A. No, it would not. In fact, an across-the-board increase would be totally  
32 inconsistent with Mr. Selecky's professed goal.

33  
34 **Q. What is Mr. Selecky's rationale for supporting an across-the-board**  
35 **distribution rate increase in the above instance?**

1 A. I can't say, since Mr. Selecky does not provide any argument in support of his  
2 proposal.

3  
4 **Q. Does Mr. Selecky propose to move Duquesne's rate classes closer to cost**  
5 **if the Commission awards the Company less than its requested increase**  
6 **in distribution revenue?**

7 A. Yes.

8  
9 **Q. How?**

10 A. Mr. Selecky proposes to assign first dollar relief to those rate classes that  
11 exhibit distribution rates of return in excess of the system average.<sup>1</sup>  
12 However, the degree to which Mr. Selecky's alternative class revenue  
13 distribution would move classes toward cost is critically dependent upon the  
14 final revenue level awarded by the Commission. For example, the illustration  
15 provided by Mr. Selecky posits a final award that is \$70.0 million less than  
16 the Company's request, or approximately \$74.0 million. However, to my  
17 knowledge, no party to this proceeding has recommended an overall  
18 distribution rate increase that low.

19  
20 **Q. Would Mr. Selecky's proposed revenue distribution move the GS/GM**  
21 **class in the right direction?**

22 A. No, or at least not initially.

23  
24 **Q. Please explain.**

25 A. As previously discussed, Mr. Selecky recommends that all rate classes receive  
26 a system average distribution rate increase of 51.3% if Duquesne is awarded  
27 its requested level of rate relief in this proceeding. Mr. Selecky would then  
28 use the first dollar rate relief that might be available to those rate classes that  
29 are over-contributing, if any, to reduce his initial recommended rate increase  
30 of 51.3% for such classes.

31 In the case of the GS/GM class, however, Mr. Selecky's starting point  
32 would cause the GS/GM class subsidy to increase from \$22.7 million at  
33 Company proposed rates to \$33.0 million.<sup>2</sup> Therefore, depending upon the

---

<sup>1</sup> Mr. Selecky provides an illustration of Wal-Mart's proposed class revenue distribution in Exhibit JTS-3.

<sup>2</sup> These subsidy figures are taken from Exhibit JTS-1 and Exhibit JTS-2.

1 level of the rate increase granted to Duquesne in this proceeding, the GS/GM  
2 class could end up further away from cost than under the Company's  
3 proposal.  
4

5 **Q. What do you recommend?**

6 A. If Mr. Selecky's proposed revenue distribution is adopted, I recommend that  
7 no rate class with a rate of return in excess of the system average at Company  
8 proposed rates be assigned a final rate increase greater than it would have  
9 received under Duquesne's revenue distribution proposal. This condition  
10 would insure that no rate class that is over-contributing would wind up  
11 making *less* progress towards cost than under the Company's proposal.  
12

13 **Q. On pages 18-19 of his direct testimony, Mr. Selecky recommends an**  
14 **alternative distribution rate design for the GM portion of the GS/GM**  
15 **class. In particular, Mr. Selecky recommends that the GM demand**  
16 **charge be increased so that 82% of the class revenue requirement is**  
17 **recovered through demand and customer charges, with the remaining**  
18 **18% recovered through the distribution energy charge. Do you have any**  
19 **comments?**

20 A. Yes. Mr. Selecky bases his recommended 82% target on the Company's  
21 proposed rate design for the GL class. This is inappropriate. The GM class  
22 consists of approximately 40,700 customers with monthly billing demands  
23 ranging from 5 kW to 300 kW. Rate GL consists of approximately 745  
24 customers with monthly billing demands in excess of 300 kW. As such, one  
25 may conclude that the GM class contains a much more diverse mix of  
26 customers than Rate GL.

27 The diversity within the GM class is important because the relative  
28 increase assigned to the demand charge versus energy charge will have  
29 disproportionate impacts among GM customers. Mr. Selecky's proposal  
30 would shift revenue responsibility from higher to lower load factor customers  
31 within the GM class, and upset the balance of intraclass rate impacts inherent  
32 in the Company's proposed GM rate design.  
33

34 **Q. Would Duquesne's proposed rate design increase the percentage of GM**  
35 **distribution revenues recovered from demand and/or customer charges?**

1 A. Yes. At present rates, approximately 54% of GM revenues are recovered via  
2 demand and customer charges. At proposed rates, the equivalent percentage  
3 would rise to 67%. This already represents a significant movement in the  
4 direction that Mr. Selecky would like to go.

5  
6 **Q. What do you recommend in this area?**

7 A. I find no valid reason to adjust the Company's proposed GM rate design  
8 simply to match a Rate GL outcome. I recommend that the Commission  
9 reject Mr. Selecky's rate design proposals for the GM class.

10  
11 **Q. On pages 21-22 of his direct testimony, Mr. Selecky recommends an**  
12 **alternative transmission rate design for the GM portion of the GS/GM**  
13 **class. In particular, Mr. Selecky recommends that GM transmission**  
14 **costs be recovered solely via a demand charge. Do you have any**  
15 **comments?**

16 A. Yes. As in the case of his proposed distribution rate design, Mr. Selecky's  
17 proposed transmission rate design would shift revenue responsibility from  
18 higher to lower load factor customers within the GM class, and upset the  
19 balance of intraclass rate impacts inherent in the Company's rate design  
20 proposal. Duquesne shows various typical bill impacts that would result from  
21 its proposed GS/GM rate design in Attachment DFR IV-D-2, pages 1-4. In  
22 general, the lower load factor GS/GM customers would already receive a  
23 greater percentage increase than higher load factor customers. Any further  
24 intraclass cost shifting would be unwarranted.

25  
26 **Q. What is your recommendation with respect to Wal-Mart's proposed**  
27 **transmission rate design for GM customers?**

28 A. I recommend that the Commission reject it in favor of the Company's  
29 proposed rate design.

30  
31 **OCA**

32  
33 **Q. On page 23 of his direct testimony, Mr. Galligan indicates his**  
34 **disagreement with Duquesne's cost-of-service methodology whereby**  
35 **universal service costs are allocated solely to residential customers. In**

1 **Mr. Galligan's view, universal service costs should be allocated to all**  
2 **customer classes on an energy or total delivery cost basis. Similarly, on**  
3 **pages 15-16 of his direct testimony, Mr. Colton argues that if a Universal**  
4 **Service Charge Rider No. 21 is retained, the rider should apply to all**  
5 **customer classes, rather than just residential customers. Do you agree**  
6 **with these witnesses that it would be appropriate to recover universal**  
7 **service costs from all of Duquesne's rate classes?**

8 A. No. The Company's universal service costs arise from the operation of its  
9 customer assistance programs. Such programs are available to payment  
10 troubled *residential* customers who apply and demonstrate an annual  
11 household gross income at or below certain Federal poverty guidelines. As a  
12 strictly residential program, all associated benefits accrue to residential  
13 customers. Likewise, all associated costs are incurred on behalf of the  
14 residential class. Therefore, from either a cost-causation or benefits-received  
15 perspective, the residential class should be assigned 100% of universal  
16 service cost responsibility.

17  
18 **Q. Has the Commission affirmed that universal service cost recovery should**  
19 **be restricted to the residential class?**

20 A. Yes. Counsel informs me that the Commission has specifically declined to  
21 allocate such costs to non-residential customers in the following gas  
22 proceedings: a) Equitable Gas Company at Docket No. R-00994784; b)  
23 Valley Energy, Inc. at Docket No. R-00049345; and c) Equitable Gas  
24 Company at Docket No. P-00052192.

25  
26 **Q. Has the Commission reached the same conclusion regarding universal**  
27 **service cost recovery in any recent electric proceeding?**

28 A. Yes, in the PPL Electric Utilities Corporation proceeding at Docket No. R-  
29 00049255. Counsel informs me that while the OCA argued that universal  
30 service costs should be allocated to all customer classes in that proceeding,  
31 the Commission rejected the OCA's proposal, stating:

32  
33 Universal service programs, by their nature, are narrowly tailored to the  
34 residential customers and therefore, should be funded only by the  
35 residential class. We note that neither the OCA nor Mr. Epstein have

1 presented any concrete evidence in the form of costs studies to support  
2 their respective proposals that the universal service program cost should  
3 be more broadly allocated. Accordingly, we will adopt the ALJ's  
4 recommendation on this issue. (Order at pp. 97-98.)  
5

6 **Q. How should the Company's universal service costs be allocated to rate**  
7 **classes in this proceeding?**

8 A. Consistent with the previously identified Commission precedent, the  
9 Company's universal service costs should be allocated solely to residential  
10 customers. Furthermore, to insure that Duquesne's universal service costs are  
11 recovered solely from residential customers, the Commission should approve  
12 Rider 21, as amended by the Company.  
13

14 **Q. On pages 18-21 of his direct testimony, Mr. Galligan argues that the Peak**  
15 **and Average ("P&A") cost-of-service methodology should be employed**  
16 **to allocate distribution plant to rate classes. Do you agree?**

17 A. No. The P&A cost-of-service methodology allocates a utility's Primary and  
18 Secondary Distribution Plant partially on the basis of class average demands,  
19 and partially on the basis of class peak demands.<sup>3</sup> However, in doing so, the  
20 methodology effectively counts a class' average demand component twice,  
21 i.e., once in the average demand component and once again in the peak  
22 demand component. This double counting of the average demand component  
23 is inappropriate since it requires a class to "pay" for the average demand  
24 component of its load a second time. The end result of the P&A methodology  
25 is to shift cost responsibility from lower load factor classes to higher load  
26 factor classes in a cost-of-service study.  
27

28 **Q. Have you reviewed the results of Mr. Galligan's recommended P&A cost-**  
29 **of-service study in this proceeding?**

30 A. Yes, I have.  
31

32 **Q. Do you have any comments?**

---

<sup>3</sup> In his recommended P&A cost-of-service study, Mr. Galligan assigns a 56% weight to average demand and a 44% weight to peak demand.

1 A. Yes. In spite of the deficiencies inherent in the P&A methodology, I note that  
2 the GS/GM rate class continues to exhibit a rate of return well above the  
3 system average, at both present and Company proposed rate levels, in Mr.  
4 Galligan's study. Schedule RAG-2 reports a GS/GM rate of return of 8.08%  
5 at present rates and 10.84% at proposed rates. These results may be  
6 compared to Duquesne's system average rate of return of 2.74% and 9.07%,  
7 respectively, at present and proposed revenue levels.

8  
9 **Q. What do you conclude from the above?**

10 A. The above results not only confirm that the GS/GM class is subsidizing other  
11 rate classes on Duquesne's system, but also that this outcome *is invariant*  
12 *with respect to the cost-of-service methodology employed in this proceeding.*  
13 As such, I conclude that it would be totally inappropriate for the GS/GM class  
14 to receive a distribution rate increase greater than that proposed by the  
15 Company in this proceeding.

16  
17 **DII**

18  
19 **Q. On pages 44-45 of his direct testimony, Mr. Baron discusses the**  
20 **Company's proposal to modify tariff Rule 4 so as to eliminate the ability**  
21 **of the Company to enter into special contracts with customers with loads**  
22 **in excess of 100 kW. Mr. Baron recommends that the special contract**  
23 **provisions of tariff Rule 4 be retained. Does the OSBA oppose Mr.**  
24 **Baron's recommendation?**

25 A. No. However, if the special contract provisions of tariff Rule 4 are retained,  
26 the tariff should be amended to include a provision that any ratepayer-funded  
27 special contract discounts are to be recovered from within the rate class where  
28 the special contract customer takes service.

29  
30  
31 **PennFuture**

32  
33 **Q. Mr. Kalcic, have you reviewed the direct testimony submitted by Mr.**  
34 **Hanger and Mr. Plunkett on behalf of PennFuture?**

35 A. Yes.

1  
2 **Q. What do these witnesses advocate as conditions for resolution of this**  
3 **proceeding?**

4 A. Mr. Hanger advocates that the Commission direct Duquesne to provide a total  
5 of \$15 million in incentive financing for renewable energy development over  
6 the period from January 1, 2007 through December 31, 2010. Mr. Plunkett  
7 recommends that the Commission order Duquesne to provide an additional  
8 \$44.0 million over three (3) years to fund energy efficiency programs.  
9

10 **Q. How would such expenditures be financed?**

11 A. Mr. Hanger advocates that the \$15 million for renewable energy be recovered  
12 through distribution rates via a uniform per kWh charge applicable to all rate  
13 classes. Mr. Plunkett recommends that the Commission include the \$44.0  
14 million in energy efficiency funding in Duquesne's allowed cost of service, to  
15 be recovered through distribution rates.  
16

17 **Q. Mr. Kalcic, should Duquesne's ratepayers be required to fund \$59.0**  
18 **million for renewable energy development and energy efficiency**  
19 **programs?**

20 A. No. The Alternative Energy Portfolio Standards Act ("Act 213" or  
21 "Act") requires that all Pennsylvania generation suppliers meet a  
22 statewide standard with respect to renewable energy via an established  
23 timetable. The above witnesses appear intent on holding Duquesne to a  
24 separate and distinct standard, rather than the one spelled out in Act  
25 213.  
26

27 **Q. Please discuss some of the ways in which PennFuture's proposals**  
28 **differ from the requirements of Act 213.**

29 A. First, Act 213 anticipates that an EDC will buy renewable energy at  
30 competitive prices established in the marketplace. As such, there is no  
31 requirement that EDCs invest in renewable energy projects. In  
32 contrast, PennFuture would require Duquesne to invest in (i.e., fund)  
33 clean energy development, which would be inconsistent with the Act.  
34 Second, the Act's reliance on the marketplace to supply clean energy is  
35 intended to insure a level playing field for all technologies. Those

1 technologies (and companies) that supply the requirements of Act 213  
2 at lowest cost will grow and prosper, while those that cannot compete  
3 will exit the market. In contrast, PennFuture seeks to incent certain  
4 technologies, in effect, to create a non-level playing field.

5  
6 **Q. What technologies does PennFuture favor?**

7 A. Mr. Hanger would allocate \$10.0 million of his proposed \$15 million  
8 in incentive funding to wind power and solar projects, which comprise  
9 only two (2) of the eight (8) Tier I alternative energy sources  
10 recognized in Act 213. Mr. Plunkett would apply 100% of his  
11 recommended \$44.0 million toward energy efficiency (i.e., demand-  
12 side management) programs, which is but one (1) of seven (7)  
13 allowable Tier II alternative energy sources in Act 213.

14  
15 **Q. On page 16 of his direct testimony, Mr. Hanger argues that one of**  
16 **the reasons why Duquesne should be required to provide incentive**  
17 **funding for renewable energy today is that the penalty phase for**  
18 **non-compliance with Act 213 does not begin until 2011, i.e.,**  
19 **without incentive financing, the renewable energy market is**  
20 **unlikely to develop much in advance of 2011. Do you agree?**

21 A. No. First, Duquesne will be subject to Act 213 penalties beginning  
22 January 1, 2008, not January 1, 2011. Second, the Act provides for the  
23 banking of Alternative Energy Credits (“AECs”) in advance of 2011 by  
24 those EDCs subject to generation rate caps. Third, the renewable  
25 energy market is not restricted to Pennsylvania, i.e., a number of states  
26 with alternative energy requirements are / will be driving demand for  
27 AECs in advance of 2011.

28  
29 **Q. On page 18 of his direct testimony, Mr. Hanger states that**  
30 **Duquesne is the only major electric service territory that does not**  
31 **contribute to a sustainable energy fund, an outcome that he**  
32 **characterizes as a “quirk of the restructuring process.” Do you**  
33 **agree?**

34 A. Certainly not. Far from being a “quirk” outcome, the fact that the  
35 Company did not come out of its restructuring proceeding with a

1 sustainable energy fund is easily explained by the fact that Duquesne's  
2 restructuring case was fully litigated. All the other utilities referenced  
3 by Mr. Hanger, i.e., Exelon, PPL, First Energy and Allegheny Energy,  
4 had their restructuring cases resolved via settlement.

5  
6 **Q. What is your recommendation with respect to PennFuture's**  
7 **proposals to require Duquesne to contribute \$59.0 million to**  
8 **renewable energy and energy efficiency programs, as a condition**  
9 **for resolution of this proceeding?**

10 A. PennFuture's proposals would impose unique and costly renewable  
11 energy and energy efficiency requirements on Duquesne that are  
12 inconsistent with Act 213. As such, I recommend that the Commission  
13 reject PennFuture's funding proposals.

14  
15 **Q. Mr. Chernick also submitted direct testimony on behalf of**  
16 **PennFuture. Have you reviewed his testimony?**

17 A. Yes, I have.

18  
19 **Q. What is Mr. Chernick's principal recommendation?**

20 A. Mr. Chernick recommends that the Commission require Duquesne to  
21 expand its offerings of market-responsive rates to include smaller  
22 customers.

23  
24 **Q. What would such an undertaking entail?**

25 A. In part, Mr. Chernick envisions Duquesne working with a group of  
26 stakeholders to: a) evaluate the cost-effectiveness of alternative real-  
27 time metering and to select appropriate metering options that would  
28 allow the sharing of metering data with competitive suppliers; and b)  
29 develop alternative real-time rate designs for delivery and POLR rates.  
30 Duquesne would also be expected to install improved metering for all  
31 customer groups for which such metering would be cost-effective.

32  
33 **Q. How would Duquesne recover its associated costs?**

34 A. Mr. Chernick recommends that the Commission order Duquesne to  
35 track and defer the net costs associated with implementing alternative

1 real-time rate designs, with the understanding that Duquesne would be  
2 allowed to recover such costs from ratepayers in the future.

3  
4 **Q. Does Mr. Chernick give any indication of the total cost of providing**  
5 **time-of-use meters to those Duquesne customers that do not**  
6 **presently have such metering capability?**

7 A. No. However, I note that Duquesne provided a preliminary estimate of  
8 the costs of such an undertaking in its comments submitted to the  
9 Commission in Docket No. M-00061957. The Company estimated that  
10 the price tag could be "as much as \$235 million."<sup>4</sup>

11  
12 **Q. Are small business customers likely to embrace real-time pricing**  
13 **options?**

14 A. No, for the simple reason that retail business must generally be  
15 conducted during normal business hours. For example, a restaurant is  
16 not in a position to switch its hours of operation from 11:00 am through  
17 10:00 pm to, say, 6:00 pm through 5:00 am, just to avoid the bulk of  
18 PJM's on-peak period.

19  
20 **Q. Have Duquesne's larger C&I customers embraced real-time**  
21 **pricing?**

22 A. Apparently not. Again, in its submission to the Commission in Docket  
23 No. M-00061957, Duquesne provided the following comments:

24  
25 Another problem with the large customer [POLR] plan is that  
26 our large C&I customers have been forced to receive hourly price  
27 service (HPS) as their default service. We have learned that our  
28 customers, by and large, do not want hourly pricing.

29 While hourly service can be a viable option for a few  
30 sophisticated customers, Duquesne Light has found that probably  
31 less than 10% of its large C&I customers have the sophistication  
32 and financial wherewithal to administer it effectively. Hourly  
33 priced service exposes customers to price volatility and financial

---

<sup>4</sup> See *Policies to Mitigate Potential Electricity Price Increases*, Docket No. M-00061957, Duquesne Comments, p. 7.

1           uncertainty that most are unwilling to tolerate. For the most part,  
2           Duquesne has found that customers want certainty. They need to  
3           budget for expenses, and they don't want to be surprised by rapidly  
4           escalating prices or extreme volatility. Volatile hourly prices are  
5           not a necessary or desirable part of a competitive market.  
6           (Comments at 3.)

7  
8       **Q. Do you recommend that the Commission adopt Mr. Chernick's**  
9       **proposal to require Duquesne to expand its offerings of market-**  
10      **responsive rates to smaller customers?**

11     A. No. The Commission should reject his recommendation since real-time  
12     rate designs would appear to be costly to implement in Duquesne's  
13     service territory, and would be *very* unlikely to elicit any meaningful  
14     load shifting response, at least from small business customers.

15  
16     **Direct Energy**

17  
18     **Q. On page 18 of his direct testimony, Mr. Lacey recommends that the**  
19     **Commission order Duquesne to conduct a POLR cost allocation**  
20     **study to identify all of the Company's claimed distribution-related**  
21     **costs that are, instead, directly or indirectly associated with the**  
22     **provision of POLR service. In Mr. Lacey's view, such costs should**  
23     **be removed from Duquesne's distribution charges and recovered in**  
24     **the Company's POLR generation rates. Do you have any**  
25     **comment?**

26     A. Yes. To the extent that the above-identified costs were to be limited to  
27     the incremental costs that Duquesne incurs in its role as the POLR  
28     supplier, I would agree with Mr. Lacey.<sup>5</sup> In that situation, any  
29     hypothetical POLR generation rate increase could be exactly offset by a  
30     distribution rate decrease, leaving both POLR customers and Duquesne  
31     indifferent to the new rates, i.e., unharmed.

32  

---

<sup>5</sup> Examples of POLR-related incremental costs would include generation-related revenue taxes and regulatory assessments, and generation-related uncollectible expense.

1 **Q. Would Mr. Lacey restrict any potential reallocation of costs from**  
2 **distribution to POLR service to those costs that Duquesne would avoid,**  
3 **but for its role as POLR provider?**

4 A. No. Mr. Lacey also recommends that a share of Duquesne's joint and  
5 common costs, such as overhead and administrative and general  
6 expenses, be moved from Duquesne's distribution rates to POLR  
7 service.

8  
9 **Q. What would be the effect of assigning a portion of Duquesne's joint and**  
10 **common distribution costs to POLR service?**

11 A. In that situation, Duquesne would experience a revenue shortfall, i.e.,  
12 see its revenues decline without a corresponding reduction in its costs,  
13 any time POLR customers were to switch to a competitive supplier.

14  
15 **Q. How might this revenue shortfall impact Duquesne's remaining POLR**  
16 **customers?**

17 A. Presumably, Duquesne would petition the Commission to recover the  
18 revenue shortfall from its remaining POLR customers. If approved,  
19 POLR generation rates would again be adjusted upward, which could  
20 cause still more customers to leave POLR service, leaving those POLR  
21 customers that remain saddled with ever-greater costs.

22  
23 **Q. Would such cost shifting from shopping customers to POLR customers**  
24 **be appropriate?**

25 A. No. POLR customers should not have to pay two (or more) times for  
26 the administrative services supplied by Duquesne.

27  
28 **Q. What is your recommendation in this area?**

29 A. I recommend that any further unbundling of Duquesne's distribution  
30 rates be limited to those costs that are purely incremental in nature, i.e.,  
31 those costs that would not be incurred but for Duquesne's role as  
32 POLR provider.

33  
34 **Q. On page 21 of his direct testimony, Mr. Lacey recommends that**  
35 **Duquesne study the costs and benefits of developing and**

1 **implementing an advanced metering infrastructure in its service**  
2 **territory. Mr. Lacey claims “advanced metering will give**  
3 **customers greater tools to control costs, engage in conservation and**  
4 **track real time market prices for energy.” Mr. Lacey advocates**  
5 **moving all customers above 300 kW to advanced meters by the end**  
6 **of 2007, and migrating one-third of the Company’s remaining**  
7 **customers (i.e., residential and smaller C&I) to advanced meters in**  
8 **each of the years 2008, 2009, and 2010. Do you have any**  
9 **comments?**

10 A. Yes. My previous comments with respect to Mr. Chernick’s advanced  
11 metering proposals are applicable here. I would also simply point out  
12 that Direct Energy has a vested interest in enabling real-time pricing for  
13 Duquesne’s residential and smaller C&I customers. The greater the  
14 number of customers subject to HPS default service, the more likely  
15 customers will choose to switch to an alternative supplier such as  
16 Direct Energy.

17  
18 **Directed Questions**

19  
20 **Q. Mr. Kalcic, please read Directed Question No. 1 for the record.**

21 A. Directed Question No. 1 reads as follows:

22  
23 Do fixed charges for residential and small or medium  
24 commercial customer distribution services discourage  
25 conservation of energy? If so, what other revenue decoupling  
26 models can be implemented that would optimally meet the dual  
27 needs of providing incentives for consumers to conserve energy,  
28 while providing reasonably stable revenue for utilities?

29  
30 **Q. Do you have any comments?**

31 A. Yes. In theory, any fixed charge will diminish a conservation price  
32 signal simply because the charge is unavoidable. However, whether or  
33 not the hypothetical conversion of a fixed distribution charge into a  
34 variable or usage-based charge would lead to more conservation is

1 unclear. While the resulting price signal would be stronger, the  
2 *incremental* increase in that price signal may or may not be significant.

3 For example, at present rates, the Company's total revenues are  
4 broken down as follows: distribution – 22.9%, transmission – 2.9% and  
5 generation – 74.2%.<sup>6</sup> These figures represent system averages. The  
6 actual weight given to distribution charges will vary by rate class, and  
7 by customer within each rate class. However, for most customers, the  
8 decision to conserve is more likely to be driven by potential savings in  
9 generation costs than by distribution costs, due to the much greater  
10 (relative) weight given to generation charges on a customer's monthly  
11 bill.

12  
13 **Q. Where does a revenue-decoupling mechanism enter into this**  
14 **discussion?**

15 A. Consider the case where a utility's fixed distribution charges were to be  
16 abandoned in favor of usage-based charges, *and* usage per customer  
17 were to decline due to a conservation response. In such circumstances,  
18 the utility would experience revenue erosion. A revenue decoupling  
19 mechanism is intended to sever the link between a utility's kWh sales  
20 and revenues, and provide some measure of revenue stability.

21 Generally, with a revenue decoupling mechanism in place, a  
22 utility would be allowed to track and to recover lost usage-related  
23 revenues from ratepayers in a subsequent period(s). In practice,  
24 however, the mechanism does more than keep the utility "whole." By  
25 severing the link between sales and revenues, a revenue decoupling  
26 mechanism drastically reduces a utility's underlying business risk.<sup>7</sup>  
27 Therefore, if the Commission were to adopt a revenue decoupling  
28 mechanism, it should also implement a commensurate reduction in the  
29 utility's allowed return on equity.

30  
31 **Q. Mr. Kalcic, please read Directed Question No. 2 for the record.**

32 A. Directed Question No. 2 reads as follows:  
33

---

<sup>6</sup> This figure assumes 100% POLR load, i.e., no shopping. See Attachment DFR IV-A Future, page 6 of 10.

<sup>7</sup> For example, a utility's sales (and earnings) would no longer be impacted by weather or economic conditions.

1 Do declining block rate designs remove the incentive for  
2 consumers, especially RA and RH residential consumers and  
3 small to medium sized commercial and industrial customers  
4 (“C&I”), to conserve energy? If so, should declining block rates  
5 for supply and distribution services be phased out over time?  
6

7 **Q. Please comment.**

8 A. All changes in consumption occur at the margin, e.g., it is the *last* 500  
9 kWh per month that might be conserved by (say) more efficient  
10 lighting fixtures, not the first 500 kWh. To the extent that a customer’s  
11 first 500 kWh of usage cost more than the last 500 kWh due to  
12 declining block rates, such rates do, in theory, act to diminish the  
13 customer’s incentive to conserve. However, as in the case of fixed  
14 charges, whether or not the elimination of declining block rates would  
15 lead to more conservation is unclear.

16 I note that Duquesne has proposed to eliminate declining block  
17 distribution rates for GS/GM customers in this proceeding, as part of its  
18 efforts to address the diverse types of load within the class. The OSBA  
19 supports this proposal, since the Company’s existing declining block  
20 rate structure is not cost based.  
21

22 **Q. Does the OSBA favor the elimination of declining block rates for supply  
23 service?**

24 A. Yes. As in the case of distribution service, a declining block rate  
25 structure for supply service is not cost based, and discriminates against  
26 the smaller users within the class.  
27

28 **Q. Mr. Kalcic, please read Directed Question No. 3 for the record.**

29 A. Directed Question No. 3 reads as follows:  
30

31 Do demand based charges, and in particular demand based  
32 charges for default supply service, remove the incentive for  
33 consumers, especially small to medium sized C&I customers, to  
34 conserve energy? If so, should demand based rates for such  
35 customers be phased out over time?

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**Q. Please comment.**

A. To some extent, a demand-based distribution charge is similar to the fixed charge discussed earlier. While demand charges are not completely unavoidable, *energy* conservation measures may leave a customer's monthly demand relatively unaffected. If so, the incentive to conserve energy would be theoretically diminished, compared to the case where demand charges were eliminated in favor of energy charges.

**Q. Does the OSBA favor the elimination of demand charges for supply service?**

A. Yes. Such charges are a remnant of the pre-restructuring era, and are generally inconsistent with today's market prices for generation service.

**Q. Mr. Kalcic, please read Directed Question No. 4 for the record.**

A. Directed Question No. 4 reads as follows:

Can and should rate designs vary among customer classes? For example, larger industrial and commercial ("C&I") customers generally have a much smaller percentage of their revenues attributable to distribution services. Given this dynamic, does the commodity design of supply service rates provide adequate incentive for larger C&I customers to conserve energy?

**Q. Do you agree that rate designs should vary among customer classes?**

A. Yes. In fact, I am unaware of any electric utility that recovers its distribution revenue requirement solely from kWh-based charges within each of its rate schedules. I would also agree that, all else equal, one would expect that larger C&I customers would be least affected by distribution-related conservation price signals, given the much smaller weight given to distribution charges on such customers' bills.

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

A. Yes.

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY	:	
COMMISSION	:	
	:	
v.	:	DOCKET NO. R-00061346
	:	
DUQUESNE LIGHT COMPANY	:	

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Surrebuttal Testimony and Exhibits of  
BRIAN KALCIC

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On Behalf of the  
Office of Small Business Advocate

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SECRETARY'S BUREAU

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PA PUBLIC UTILITY COMMISSION  
SECRETARY'S BUREAU

Date Served: August 16, 2006

Date Submitted for the Record: \_\_\_\_\_

1 Surrebuttal Testimony of Brian Kalcic

2  
3  
4 **Q. Please state your name and business address.**

5 A. Brian Kalcic, 225 S. Meramec Avenue, St. Louis, Missouri 63105.

6  
7 **Q. Have you previously submitted testimony in this proceeding?**

8 A. Yes, I have.

9  
10 **Q. What is the subject of your surrebuttal testimony?**

11 A. My surrebuttal testimony responds to certain points raised in the rebuttal  
12 testimony of Company witnesses William V. Pfrommer, Neil S. Fisher and  
13 Howard S. Gorman.

14  
15 Witness Pfrommer

16  
17 **Q. On pages 8-9 of his rebuttal testimony, Mr. Pfrommer indicates that**  
18 **Wal-Mart's proposal to increase the GM distribution demand charge is**  
19 **consistent with Duquesne's long-term plan to migrate toward rates that**  
20 **reflect the services provided by a delivery company. As such, Mr.**  
21 **Pfrommer states that he does not object to Mr. Selecky's rate design**  
22 **proposal. Is Mr. Pfrommer's acquiescence to Wal-Mart's proposal**  
23 **consistent with the position he presented in direct testimony?**

24 A. No. On pages 12-14 of his direct testimony, Mr. Pfrommer discusses the  
25 Company's proposed GS/GM rate design. He also discusses the diversity  
26 inherent in the GS/GM rate class, and the role that this diversity plays in the  
27 Company's proposed rate design. In particular, Mr. Pfrommer states that the  
28 Company's proposed GS/GM rate design is intended to move toward  
29 Duquesne's goal of recovering a greater percentage of GS/GM distribution  
30 revenues via fixed charges, while mitigating the impact of the rate design on  
31 the smallest GS/GM customers. He concludes his discussion by stating:

32  
33 Combined, this proposed rate design addresses the class diversity  
34 and achieves the objectives by mitigating rate impacts to the  
35 smallest customers, simplifying the rate structure, and

1 [implementing] a gradual movement to recover a higher share of  
2 costs from the monthly fixed and demand charges.  
3

4 As will be demonstrated below, Wal-Mart's proposed rate design would, in  
5 fact, shift a significant amount of costs from higher load factor GS/GM  
6 customers to lower load factor customers, and completely negate the  
7 "balancing of interests" that the Company sought to achieve in its filed rate  
8 design.  
9

10 **Q. On page 8 of his rebuttal testimony, Mr. Pfrommer states that the**  
11 **Company's proposed GM distribution demand charge would have to be**  
12 **increased from \$5.14 per kW to \$6.79 per kW in order to implement**  
13 **Wal-Mart's rate design proposal. Do you agree?**

14 A. No. On page 19 of his direct testimony, Mr. Selecky states that "82% of the  
15 overall distribution revenue requirement for Rate GM should be recovered  
16 through the demand *and customer charges*, and the remaining 18% should be  
17 recovered through the energy charge." Mr. Pfrommer has incorrectly  
18 interpreted Wal-Mart's proposal to entail recovering 82% of the Rate GM  
19 revenue requirement *solely* from the GM demand charge. As a result, the  
20 \$6.79 per kW demand charge identified by Mr. Pfrommer is too high.  
21

22 **Q. By how much would the Company's proposed GM distribution demand**  
23 **charge actually have to increase in order to implement Wal-Mart's rate**  
24 **design proposal?**

25 A. At the Company's requested revenue requirement level, the actual increase  
26 would be from \$5.14 per kW to \$6.67 per kW.  
27

28 **Q. On page 8 of his rebuttal testimony, Mr. Pfrommer presents a**  
29 **comparison (i.e., Table No. 1) of the monthly bill impacts at various**  
30 **demand and load factors that would result from implementing Wal-**  
31 **Mart's rate design proposal. Do you agree that Table No. 1 accurately**  
32 **reflects such impacts?**

33 A. No, I do not. Besides using an incorrect alternative GM rate design in his  
34 analysis, Mr. Pfrommer has employed too narrow a view of how Wal-Mart's  
35 proposed rate design would impact GM customers with various load factors.

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**Q. Have you prepared an appropriate analysis of the impact of Wal-Mart's proposed rate design on GM customers?**

A. Yes, I have. My analysis is shown in Schedules BK-1S and BK-2S.

**Q. Please explain Schedules BK-1S and BK-2S.**

A. Schedule BK-1S shows the monthly distribution rate impacts associated with the Company's filed GM rate design, for customers with the same four (4) demand levels shown in Mr. Pfrommer's Table No. 1. However, rather than assigning a *single* load factor to each of the four customers, I have calculated the resulting bill impacts at load factors ranging from 0% to 100%.

The same type of analysis is repeated in Schedule BK-2S, using Wal-Mart's proposed GM rate design.

**Q. What do you conclude from Schedules BK-1S and BK-2S?**

A. A comparison of the typical bill impacts across the two schedules shows that Wal-Mart's proposed rate design would produce a substantial shift in revenue responsibility from high- to low-load factor GM customers, independent of the size of the customer's average load.

**Q. Would such an outcome be appropriate?**

A. No. The Company's filed rate design already assigns a greater than class average increase to lower load-factor GM customers. There is no valid reason, or need, to exacerbate that outcome in this proceeding.

**Q. On pages 20-21 of his rebuttal testimony, Mr. Pfrommer discusses the Company's proposal to establish an Energy Conservation and Economic Development Rider ("ECR"). Why is the Company proposing to establish a rider at this time?**

A. The Company states that it is responding to the concerns raised by several parties about energy conservation and economic development. To avoid delay in implementing appropriate projects, Mr. Pfrommer claims that "it is important to have a flexible and readily available funding mechanism" in place.

1 **Q. Does Duquesne propose to contribute toward the funding of applicable**  
2 **projects?**

3 A. No. All funding would be provided by ratepayers through a non-bypassable  
4 distribution charge.

5  
6 **Q. Would that be a reasonable method of funding such initiatives?**

7 A. No, it would not. In essence, Duquesne is agreeing to the demands of parties  
8 like PennFuture, on the simple condition that its shareholders *not* have to  
9 contribute toward program costs. Under such circumstances, Duquesne  
10 would have no incentive to evaluate claimed program benefits versus costs, or  
11 to control spending on any programs that are implemented.

12  
13 **Q. Is the OSBA in favor of ratepayer funding for energy efficiency and**  
14 **economic development projects?**

15 A. No. As I discussed in my rebuttal testimony, Duquesne's ratepayers will be  
16 subject to all of the requirements of Act 213 beginning January 1, 2008. They  
17 should not be required to shoulder responsibility for 100% of the costs of  
18 discretionary energy efficiency and economic development projects at the  
19 same time, particularly at the levels envisioned by PennFuture.

20  
21 **Q. What do you recommend?**

22 A. If Duquesne's proposed ECR were to be approved in this proceeding, I would  
23 recommend that the Commission require ECR contributions from both the  
24 Company's ratepayers and its shareholders, preferably in matching amounts.

25  
26 **Witness Fisher**

27  
28 **Q. On pages 31-32 of his rebuttal testimony, Mr. Fisher discusses the**  
29 **Commission's current investigation of policies to mitigate potential**  
30 **electricity price increases in Docket No. M-00061957. Mr. Fisher notes**  
31 **that the Commission also asked for comments on how price signals or**  
32 **changes in rate design could be implemented to encourage conservation**  
33 **by electricity consumers. Mr. Fisher states that "Duquesne agrees, as a**  
34 **general matter, that new innovative pricing and other energy efficiency**

1 **management programs should be available to all customers to help**  
2 **alleviate high energy costs.” Do you have any comment?**

3 A. Yes, I do. If Mr. Fisher is speaking accurately for Duquesne, then the  
4 Company has undergone a complete reversal in its viewpoint in the  
5 short time since it filed comments in Docket No. M-00061957. As I  
6 indicated on pages 11-12 of my rebuttal testimony, the Company’s  
7 comments in Docket No. M-00061957 cautioned the Commission that  
8 the time-of-use metering necessary to implement alternative,  
9 conservation-oriented rate designs could cost as much as \$235.0  
10 million. In addition, Duquesne indicated that its large C&I customers  
11 appeared to have little interest in such pricing alternatives, preferring  
12 certainty in their monthly electric bills. Mr. Fisher offers no  
13 explanation for the change in the Company’s position on this matter,  
14 and, more importantly, he offers no reason(s) why spending vast  
15 amounts of money on advanced metering technology would *now* be a  
16 wise investment for Duquesne’s ratepayers.

17  
18  
19 **Witness Gorman**

20  
21 **Q. On pages 8-9 of his rebuttal testimony, Mr. Gorman discusses Wal-**  
22 **Mart’s proposal to split the GS/GM rate class into two (2) classes, with**  
23 **separate tariffs, in the Company’s next rate proceeding. Do you have**  
24 **any comment?**

25 A. Yes. First, I would note that Duquesne has already proposed to  
26 separate the demand- and non-demand-metered portions of the GS/GM  
27 class in this proceeding.<sup>1</sup> However, the demand-metered portion of the  
28 class remains quite diverse. Mr. Gorman indicates that the Company  
29 should evaluate whether a further splitting of the class is appropriate in  
30 its next proceeding.

31 Given the controversy surrounding the GM rate design in this  
32 proceeding, I concur with Mr. Selecky that a further separation of the

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<sup>1</sup> Demand metered customers would reside on the Company’s GM rate schedule. Non-demand metered customers would take service on Duquesne’s GS rate schedule.

1 GM class is warranted, and that the Company should propose such a  
2 split in its next proceeding.

3

4 **Q. Does this conclude your surrebuttal testimony?**

5 A. Yes.

**EXHIBITS**

**Duquesne Light Company  
Monthly Distribution Charges  
Rate Schedule GSGM  
Basis: DLC Filed Rate Design**

**Average Demand of 10 kW**

A	B	C	D	E	F=E-D	G=F/D
<u>Hours Use</u>	<u>Load Factor</u>	<u>KWH</u>	<u>Monthly Bill Current Distribution</u>	<u>Monthly Bill Proposed Distribution</u>	<u>Distribution Increase Only</u>	<u>% Difference Distribution Only</u>
0	0.0%	0	\$27.06	\$55.70	\$28.64	105.9%
10	1.4%	100	\$29.71	\$56.61	\$26.90	90.5%
20	2.7%	200	\$32.37	\$57.53	\$25.16	77.7%
30	4.1%	300	\$35.02	\$58.44	\$23.42	66.9%
40	5.5%	400	\$37.68	\$59.35	\$21.68	57.5%
50	6.8%	500	\$40.33	\$60.27	\$19.94	49.4%
60	8.2%	600	\$42.90	\$61.18	\$18.28	42.6%
70	9.6%	700	\$45.38	\$62.09	\$16.71	36.8%
80	11.0%	800	\$47.86	\$63.00	\$15.14	31.6%
90	12.3%	900	\$50.35	\$63.92	\$13.57	27.0%
100	13.7%	1,000	\$52.83	\$64.83	\$12.00	22.7%
200	27.4%	2,000	\$64.97	\$73.96	\$8.99	13.8%
300	41.1%	3,000	\$71.68	\$83.09	\$11.41	15.9%
400	54.8%	4,000	\$78.38	\$92.22	\$13.84	17.7%
500	68.5%	5,000	\$85.09	\$101.35	\$16.26	19.1%
600	82.2%	6,000	\$91.79	\$110.48	\$18.69	20.4%
700	95.9%	7,000	\$98.50	\$119.61	\$21.11	21.4%
730	100.0%	7,300	\$100.51	\$122.35	\$21.84	21.7%

**Duquesne Light Company  
Monthly Distribution Charges  
Rate Schedule GSGM  
Basis: DLC Filed Rate Design**

**Average Demand of 25 kW**

A	B	C	D	E	F=E-D	G=F/D
<u>Hours Use</u>	<u>Load Factor</u>	<u>KWH</u>	<u>Monthly Bill Current Distribution</u>	<u>Monthly Bill Proposed Distribution</u>	<u>Distribution Increase Only</u>	<u>% Difference Distribution Only</u>
0	0.0%	0	\$80.76	\$132.80	\$52.04	64.4%
10	1.4%	250	\$87.39	\$135.08	\$47.69	54.6%
20	2.7%	500	\$94.03	\$137.37	\$43.34	46.1%
30	4.1%	750	\$100.32	\$139.65	\$39.33	39.2%
40	5.5%	1,000	\$106.53	\$141.93	\$35.40	33.2%
50	6.8%	1,250	\$112.73	\$144.21	\$31.48	27.9%
60	8.2%	1,500	\$115.32	\$146.50	\$31.18	27.0%
70	9.6%	1,750	\$116.99	\$148.78	\$31.79	27.2%
80	11.0%	2,000	\$118.67	\$151.06	\$32.39	27.3%
90	12.3%	2,250	\$120.34	\$153.34	\$33.00	27.4%
100	13.7%	2,500	\$122.02	\$155.63	\$33.60	27.5%
200	27.4%	5,000	\$138.78	\$178.45	\$39.67	28.6%
300	41.1%	7,500	\$155.55	\$201.28	\$45.73	29.4%
400	54.8%	10,000	\$172.31	\$224.10	\$51.79	30.1%
500	68.5%	12,500	\$189.07	\$246.93	\$57.85	30.6%
600	82.2%	15,000	\$205.84	\$269.75	\$63.92	31.1%
700	95.9%	17,500	\$222.60	\$292.58	\$69.98	31.4%
730	100.0%	18,250	\$227.63	\$299.42	\$71.80	31.5%

**Duquesne Light Company  
Monthly Distribution Charges  
Rate Schedule GSGM  
Basis: DLC Filed Rate Design**

**Average Demand of 50 kW**

A	B	C	D	E	F=E-D	G=F/D
Hours Use	Load Factor	KWH	Monthly Bill Current Distribution	Monthly Bill Proposed Distribution	Distribution Increase Only	% Difference Distribution Only
0	0.0%	0	\$170	\$261	\$91	53.5%
10	1.4%	500	\$184	\$266	\$82	44.9%
20	2.7%	1,000	\$196	\$270	\$74	38.0%
30	4.1%	1,500	\$205	\$275	\$70	34.3%
40	5.5%	2,000	\$208	\$280	\$71	34.3%
50	6.8%	2,500	\$212	\$284	\$73	34.3%
60	8.2%	3,000	\$215	\$289	\$74	34.4%
70	9.6%	3,500	\$218	\$293	\$75	34.4%
80	11.0%	4,000	\$222	\$298	\$76	34.4%
90	12.3%	4,500	\$225	\$302	\$77	34.4%
100	13.7%	5,000	\$228	\$307	\$79	34.5%
200	27.4%	10,000	\$262	\$353	\$91	34.7%
300	41.1%	15,000	\$295	\$398	\$103	34.8%
400	54.8%	20,000	\$329	\$444	\$115	35.0%
500	68.5%	25,000	\$362	\$490	\$127	35.1%
600	82.2%	30,000	\$396	\$535	\$139	35.2%
700	95.9%	35,000	\$429	\$581	\$151	35.3%
730	100.0%	36,500	\$439	\$595	\$155	35.3%

**Duquesne Light Company  
Monthly Distribution Charges  
Rate Schedule GSGM  
Basis: DLC Filed Rate Design**

**Average Demand of 100 kW**

A	B	C	D	E	F=E-D	G=F/D
Hours Use	Load Factor	KWH	Monthly Bill Current Distribution	Monthly Bill Proposed Distribution	Distribution Increase Only	% Difference Distribution Only
0	0.0%	0	\$349	\$518	\$169	48.4%
10	1.4%	1,000	\$375	\$527	\$152	40.6%
20	2.7%	2,000	\$387	\$537	\$149	38.6%
30	4.1%	3,000	\$394	\$546	\$152	38.5%
40	5.5%	4,000	\$401	\$555	\$154	38.5%
50	6.8%	5,000	\$407	\$564	\$157	38.5%
60	8.2%	6,000	\$414	\$573	\$159	38.4%
70	9.6%	7,000	\$421	\$582	\$162	38.4%
80	11.0%	8,000	\$427	\$591	\$164	38.4%
90	12.3%	9,000	\$434	\$600	\$166	38.3%
100	13.7%	10,000	\$441	\$610	\$169	38.3%
200	27.4%	20,000	\$508	\$701	\$193	38.0%
300	41.1%	30,000	\$575	\$792	\$217	37.8%
400	54.8%	40,000	\$642	\$884	\$242	37.6%
500	68.5%	50,000	\$709	\$975	\$266	37.5%
600	82.2%	60,000	\$776	\$1,066	\$290	37.4%
700	95.9%	70,000	\$843	\$1,157	\$314	37.3%
730	100.0%	73,000	\$863	\$1,185	\$322	37.3%

**Duquesne Light Company  
Monthly Distribution Charges  
Rate Schedule GSGM  
Basis: Wal-Mart Proposed Rate Design**

**Average Demand of 10 kW**

A	B	C	D	E	F=E-D	G=F/D
<u>Hours Use</u>	<u>Load Factor</u>	<u>KWH</u>	<u>Monthly Bill Current Distribution</u>	<u>Monthly Bill Proposed Distribution</u>	<u>Distribution Increase Only</u>	<u>% Difference Distribution Only</u>
0	0.0%	0	\$27.06	\$63.35	\$36.29	134.1%
10	1.4%	100	\$29.71	\$63.85	\$34.14	114.9%
20	2.7%	200	\$32.37	\$64.35	\$31.98	98.8%
30	4.1%	300	\$35.02	\$64.85	\$29.83	85.2%
40	5.5%	400	\$37.68	\$65.35	\$27.67	73.4%
50	6.8%	500	\$40.33	\$65.85	\$25.52	63.3%
60	8.2%	600	\$42.90	\$66.35	\$23.45	54.7%
70	9.6%	700	\$45.38	\$66.85	\$21.46	47.3%
80	11.0%	800	\$47.86	\$67.34	\$19.48	40.7%
90	12.3%	900	\$50.35	\$67.84	\$17.50	34.8%
100	13.7%	1,000	\$52.83	\$68.34	\$15.51	29.4%
200	27.4%	2,000	\$64.97	\$73.34	\$8.37	12.9%
300	41.1%	3,000	\$71.68	\$78.33	\$6.65	9.3%
400	54.8%	4,000	\$78.38	\$83.32	\$4.94	6.3%
500	68.5%	5,000	\$85.09	\$88.32	\$3.23	3.8%
600	82.2%	6,000	\$91.79	\$93.31	\$1.52	1.7%
700	95.9%	7,000	\$98.50	\$98.30	(\$0.20)	-0.2%
730	100.0%	7,300	\$100.51	\$99.80	(\$0.71)	-0.7%

**Duquesne Light Company  
Monthly Distribution Charges  
Rate Schedule GSGM  
Basis: Wal-Mart Proposed Rate Design**

**Average Demand of 25 kW**

A	B	C	D	E	F=E-D	G=F/D
Hours Use	Load Factor	KWH	Monthly Bill Current Distribution	Monthly Bill Proposed Distribution	Distribution Increase Only	% Difference Distribution Only
0	0.0%	0	\$80.76	\$163.40	\$82.64	102.3%
10	1.4%	250	\$87.39	\$164.65	\$77.26	88.4%
20	2.7%	500	\$94.03	\$165.90	\$71.87	76.4%
30	4.1%	750	\$100.32	\$167.14	\$66.83	66.6%
40	5.5%	1,000	\$106.53	\$168.39	\$61.87	58.1%
50	6.8%	1,250	\$112.73	\$169.64	\$56.91	50.5%
60	8.2%	1,500	\$115.32	\$170.89	\$55.57	48.2%
70	9.6%	1,750	\$116.99	\$172.14	\$55.15	47.1%
80	11.0%	2,000	\$118.67	\$173.39	\$54.72	46.1%
90	12.3%	2,250	\$120.34	\$174.63	\$54.29	45.1%
100	13.7%	2,500	\$122.02	\$175.88	\$53.86	44.1%
200	27.4%	5,000	\$138.78	\$188.37	\$49.58	35.7%
300	41.1%	7,500	\$155.55	\$200.85	\$45.30	29.1%
400	54.8%	10,000	\$172.31	\$213.33	\$41.02	23.8%
500	68.5%	12,500	\$189.07	\$225.81	\$36.74	19.4%
600	82.2%	15,000	\$205.84	\$238.30	\$32.46	15.8%
700	95.9%	17,500	\$222.60	\$250.78	\$28.18	12.7%
730	100.0%	18,250	\$227.63	\$254.52	\$26.89	11.8%

**Duquesne Light Company  
Monthly Distribution Charges  
Rate Schedule GSGM  
Basis: Wal-Mart Proposed Rate Design**

**Average Demand of 50 kW**

A	B	C	D	E	F=E-D	G=F/D
Hours Use	Load Factor	KWH	Monthly Bill Current Distribution	Monthly Bill Proposed Distribution	Distribution Increase Only	% Difference Distribution Only
0	0.0%	0	\$170	\$330	\$160	93.9%
10	1.4%	500	\$184	\$333	\$149	81.3%
20	2.7%	1,000	\$196	\$335	\$139	71.0%
30	4.1%	1,500	\$205	\$338	\$133	64.9%
40	5.5%	2,000	\$208	\$340	\$132	63.4%
50	6.8%	2,500	\$212	\$343	\$131	62.0%
60	8.2%	3,000	\$215	\$345	\$130	60.6%
70	9.6%	3,500	\$218	\$348	\$129	59.3%
80	11.0%	4,000	\$222	\$350	\$129	58.0%
90	12.3%	4,500	\$225	\$353	\$128	56.8%
100	13.7%	5,000	\$228	\$355	\$127	55.6%
200	27.4%	10,000	\$262	\$380	\$118	45.2%
300	41.1%	15,000	\$295	\$405	\$110	37.1%
400	54.8%	20,000	\$329	\$430	\$101	30.8%
500	68.5%	25,000	\$362	\$455	\$93	25.6%
600	82.2%	30,000	\$396	\$480	\$84	21.2%
700	95.9%	35,000	\$429	\$505	\$75	17.6%
730	100.0%	36,500	\$439	\$512	\$73	16.6%

**Duquesne Light Company  
Monthly Distribution Charges  
Rate Schedule GSGM  
Basis: Wal-Mart Proposed Rate Design**

**Average Demand of 100 kW**

A	B	C	D	E	F=E-D	G=F/D
Hours Use	Load Factor	KWH	Monthly Bill Current Distribution	Monthly Bill Proposed Distribution	Distribution Increase Only	% Difference Distribution Only
0	0.0%	0	\$349	\$664	\$314	90.0%
10	1.4%	1,000	\$375	\$669	\$294	78.3%
20	2.7%	2,000	\$387	\$674	\$286	74.0%
30	4.1%	3,000	\$394	\$679	\$285	72.3%
40	5.5%	4,000	\$401	\$684	\$283	70.7%
50	6.8%	5,000	\$407	\$689	\$281	69.1%
60	8.2%	6,000	\$414	\$694	\$280	67.5%
70	9.6%	7,000	\$421	\$699	\$278	66.1%
80	11.0%	8,000	\$427	\$704	\$276	64.6%
90	12.3%	9,000	\$434	\$709	\$274	63.2%
100	13.7%	10,000	\$441	\$714	\$273	61.9%
200	27.4%	20,000	\$508	\$764	\$256	50.3%
300	41.1%	30,000	\$575	\$813	\$239	41.5%
400	54.8%	40,000	\$642	\$863	\$221	34.5%
500	68.5%	50,000	\$709	\$913	\$204	28.8%
600	82.2%	60,000	\$776	\$963	\$187	24.1%
700	95.9%	70,000	\$843	\$1,013	\$170	20.2%
730	100.0%	73,000	\$863	\$1,028	\$165	19.1%