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June 1, 2010

VIA ELECTRONIC FILING AND OVERNIGHT MAIL

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building, 2nd Floor
400 North Street
Harrisburg, PA 17120

Re: Implementation of Act 129 of October 15, 2008; Default Service
Docket No: L-2009-2095604

Dear Secretary Chiavetta:

Enclosed for filing please find one (1) original of Duquesne Light Company's Comments in response to the Commission's January 14, 2010 Rulemaking Order regarding Implementation of Act 129 of October 15, 2008; Default Service. These comments are being electronically filed on the Commission's E-Filing website, with a paper copy and confirmation of electronic filing being sent via overnight mail.

Per the Commission's Order, this is also being electronically mailed to Elizabeth Barnes, Assistant Counsel. If you have any questions, please contact me.

Sincerely yours,

Erin H. Creahan
Senior Attorney

Enclosures

cc: Elizabeth Barnes, Assistant Counsel (via electronic mail)

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Re: Implementation of Act 129	:	**Docket No. L-2009-2095604**
Of October 15, 2008;	:	
Default Service	:	

COMMENTS OF
DUQUESNE LIGHT COMPANY

I. Introduction

The Pennsylvania Public Utility Commission entered a Rulemaking Order on January 19, 2010, which was subsequently published in the Pennsylvania Bulletin on May 1, 2010, with respect to Implementation of Act 129 of October 15, 2008, Default Service. Pursuant to this Order, the Commission opened a proceeding seeking comments on potential amendments to the default service regulations as required by the enactment of Act 129, such that the regulations shall be consistent with the Act. More specifically, the Commission is seeking comments on proposed amendments to the regulations, as well as general comments on how Act 129 should be interpreted, via a list of 16 questions.

Duquesne Light is also filing separate comments in Docket No. M-2009-2140580, Proposed Policy Statement Regarding Default Service and Retail Electric Markets, which is closely related to this proceeding.

II. Comments

Duquesne Light supports the Commission's attempt to update its Default Service Regulations in light of Act 129. Duquesne Light will respond to each of the proposed

revisions to the Default Service Regulations individually below in Section A. In Section B, Duquesne Light will provide its responses to the sixteen questions posed by the Commission.

A. Duquesne Light's Comments to the Proposed Revisions

1. 52 Pa. Code § 54.182 (Definitions)

Duquesne Light supports the proposed amendment to the term "Default Service Provider," as well as the addition of the definition for "Bilateral contract." However, the amendments are currently drafted so that both definitions simply reference the "meaning as defined in 66 Pa.C.S. § 2803." Duquesne Light believes that for thoroughness and clarity, the actual substance of the definitions for "Default Service Provider" and "bilateral contract" as provided in 66 Pa.C.S. § 2803 should also be recited in 52 Pa. Code § 54.182. Further, in light of this revision to the definition of "Default Service Provider," the Commission may want to consider revising 52 Pa. Code 54.183(a) to correspond with the new definition of "Default Service Provider."

2. 52 Pa. Code § 54.186 (Default Service Procurement and Implementation Plans)

Duquesne Light supports the Commission's proposed amendments to 52 Pa. Code § 54.186. However, Duquesne Light believes that one important additional amendment is necessary. The Commission states in its January 19, 2010 Order that "[w]e propose deleting the old standard and replacing it with the "prudent mix" standard as outlined in Act 129." Order, p. 9. However, there are several locations in the proposed amendments to Section 54.186 where the Commission failed to replace the "prevailing market prices" standard with the new standard of "adequate and reliable service at the least cost to

customers over time," as set forth in Act 129. More specifically, the "prevailing market prices" standard should be removed from Section 54.186(a) and (d).

Duquesne Light would further like to point out an issue with respect to statements made in the January 19, 2010 Rulemaking Order. The Order states that "Act 129 provides that the DSP may petition for modifications to the approved procurement and implementation plans when material changes in wholesale energy markets occur to ensure the acquisition of sufficient supply at prevailing market prices. 66 Pa.C.S. § 2807(e)(6)" (emphasis supplied). Order, p. 10. This statement is not entirely correct and does not adequately represent Section 2807(e)(6); Section 2807(e)(6) provides that a default service provider may propose amendments to its plan, but there is no longer a requirement to ensure sufficient supply at "prevailing market prices." Further, the Order states that "the DSP is obligated to monitor changes in wholesale energy markets to ensure that its procurement plan continues to reflect the incurrence of reasonable costs, consistent with 66 Pa.C.S. § 2807(e)(3.4) (relating to the prudent mix)." Duquesne Light has no objection to this statement, but it should be understood that the threshold for incurrence of reasonable costs is in light of the time that the plan was approved – there should not be a look backward. Order, p. 10. Act 129 does not place such a burden upon default service providers. The Commission may wish to clarify these issues in its next Order on this topic.

3. 52 Pa. Code § 54.187 (Default Service Rate Design and the Recovery of Reasonable Costs)

Duquesne Light supports the proposed changes to 52 Pa. Code § 54.187. However, Duquesne Light also recommends that the Commission replace the "prevailing market prices" standard which remains in new subsections i, j, k, and l with the new

standard of "adequate and reliable service at the least cost to customers over time," as set forth in Act 129.

4. 52 Pa. Code § 54.184 (Default Service Provider Obligations), 52 Pa. Code § 54.185 (Default Service Programs and Periods of Service), and 52 Pa. Code § 54.188 (Commission review of default service program and rates).

Duquesne Light supports the Commission's proposed amendments to 52 Pa. Code §§ 54.184, 54.185, and 54.188.

5. 52 Pa. Code § 54.189 (Default Service Customers)

Duquesne Light supports the Commission's decision to leave 52 Pa. Code § 54.189 unchanged.

B. Duquesne Light's Answers to Questions Posed by the Commission

The Commission has also sought comments on how Act 129 should be interpreted in order to ensure adequate and reliable service at the least cost to customers over time. Duquesne Light provides the following information in response to the 16 questions posed by the Commission:

1. What is meant by "least cost to customers over time?"

Answer: Act 129 requires the use of "competitive procurement processes" to obtain a "prudent mix" of contracts that is designed to ensure "adequate and reliable service" at the "least cost to customers over time." 66 Pa.C.S. § 2807(e)(3.1)-(3.2) & (3.4). In approving a default service provider's plan, the Commission is required to make specific findings that "the default service provider's plan includes prudent steps necessary to negotiate favorable generation supply contracts...[and] includes prudent steps necessary to obtain least cost generation supply contracts on a long-term, short-term and spot

market basis." 66 Pa.C.S. § 2807(e)(3.7). Act 129 itself does not define the terms "prudent mix" or "least cost over time" but it is clear that the General Assembly when adopting Act 129 recognized that consideration of "least cost" should "[take] into account any benefits of price stability." 66 Pa.C.S. § 2807(e)(3.1). Furthermore, as amended by Act 129, Section 2807(e)(3.6) makes clear that "[c]osts incurred through an approved competitive procurement plan shall be deemed to be the least cost over time as required under paragraph (3.4) (II)." That is, once the plan is approved by the Commission, the generation supply subsequently procured in accordance with that plan will be deemed to be procured at the least cost over time. Act 129 clearly envisions ex-ante (prior) consideration of the least cost standard in evaluating procurement plans and not ex-post (after) review. An ex-ante review is appropriate especially since supply products that provide rate stability are often designed to protect customers from risks that could increase rate levels. These price stability benefits are not captured in an after-the-fact analysis, to the degree that such an analysis focuses on the actual market outcome instead of all of the market scenarios that could have occurred. Also see response to question 15.

Act 129's explicit requirement that electric supply be procured through a "prudent mix" of contracts indicates that the risks to customers associated with a proposed procurement plan must be considered, taking into account the unique characteristics of the customer class and the benefits of price stability. "Least cost" is ensured when products are procured through some type of competitive procurement process, whether it is an auction, RPF or competitively negotiated bilateral agreements, which is required by Act 129.

2. What time frame should the Commission use when evaluating whether a DSP's procurement plan produces least cost to customers over time?

Answer: The Commission should evaluate the least cost to customers over time for the duration of the proposed Default Service Plan. The Commission has recommended that plans generally last for two to three years. However, Duquesne Light believes that this evaluation period should not preclude the use of long-term contracts or laddered multi-year contracts that may begin delivery during a procurement plan and extend beyond the term of that plan. Rather, the Commission should consider the impact that such procurements in the current plan could have on prices in future default service plans when such contracts are filed as part of a procurement plan.

3. In order to comply with the requirement that the Commission ensure that default service is adequate and reliable, should the Commission's default service regulations incorporate provisions to ensure the construction of needed generation capacity in Pennsylvania?

Answer: No. While added generation capacity in Pennsylvania may be beneficial, it will not necessarily serve to ensure adequacy and reliability; such functions are ensured via power supply through PJM and through contractual provisions with suppliers. Thus, while Duquesne Light is obviously not opposed to added generation capacity in Pennsylvania, it does not believe that this should be required as part of the Commission's default service regulations. It is PJM's responsibility to ensure adequacy and reliability and such a requirement in the default service regulations is unnecessary. Also, requiring construction of generation capacity in Pennsylvania could actually hinder an EDC's ability to procure power at least cost over time. Competitive electric markets should be allowed to determine the location of future generation and customers should not be

forced to bear the costs and risks associated with building generation. Act 129 does not include any requirement that a portion of default service supply be obtained from Pennsylvania generating facilities. Furthermore, Duquesne Light does not believe that new regulations are required to allow it to own generation (e.g., renewable resources) in order to serve default service customers. For all these reasons, Duquesne Light does not believe the Commission should adopt a provision to require default service suppliers to construct generation capacity in Pennsylvania.

4. If the Commission should adopt a provision to ensure the construction of needed generation capacity, how should the default service regulations be revised?

Answer: N/A (See response to question 3 above).

5. Which approach to supply procurement – a managed portfolio approach or a full requirements approach – is more likely to produce the least cost to customers over time?

Answer: A "managed portfolio approach" and "full requirements approach" can vary considerably from one jurisdiction to another, and the answer to this question depends on the unique characteristics and situation of the customer class for which the DSP is procuring. Ultimately, supply procurement should be left up to the discretion of the DSP – a single mix of default service supply resources is not likely to be appropriate for all service areas in Pennsylvania, or all customer classes within a DSP territory. Therefore, the Commission's regulations should remain flexible and consider the appropriate procurement approach on a case-by-case basis taking into account the benefits of price stability and the proper allocation of risks to customers and suppliers.

Furthermore, while several different approaches are currently being implemented in Pennsylvania, an ex-post review or hindsight analysis of which approach resulted in

the least cost to customers over time can be misleading. As stated in our response to questions 1 and 15, the price stability benefits are not captured in an after-the-fact analysis, to the degree that such an analysis focuses on the actual market outcome instead of all of the market scenarios that could have occurred.

6. What is a "prudent mix" of spot, long-term, and short-term contracts?

Answer: A "prudent mix" of contracts is not specifically defined in Act 129. Act 129 also does not specify the percentage share of each type of product to be included in the portfolio,[1] nor does it mandate the types of contracts to be entered into (e.g., full requirements, block, and/or option products) or the specific durations of the contracts.[2] Instead, Act 129 provides discretion to default service providers to propose, and the Commission to consider, different mixes of products on a case-by-case basis given the circumstances at the time of approval. Duquesne Light believes that the "prudent mix" requirement of Act 129 is satisfied so long as a DSP's portfolio ensures adequate and reliable service at the least cost to customers over time, and takes into account the benefits of price stability and risks to customers. It would not be prudent to set a numerical requirement on how much of each type of contract should be included in a DSP's portfolio. That said, while Duquesne Light supports leaving this as an open issue to be determined on a case-by-case basis, Duquesne Light has determined that a "prudent mix" for its customer base includes between 25% to 40% of the portfolio made up of

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1 Act 129 does limit the percentage of long-term contracts to not more than 25% of the default service provider's projected default service load unless the Commission, after a hearing, determines for good cause that a greater portion of load is necessary to achieve least cost procurement.

2 Act 129 does state that "long-term" contracts are those of more than four and not more than twenty years.

bilateral purchases for multi-year periods, 15% to 30% of seasonal and monthly purchases, and 5% to 15% of spot market purchases. These ranges may not be appropriate for all EDCs, but this is what Duquesne Light has deemed appropriate at this time, and it was approved as part of Duquesne Light's most recent default service proceeding.

It is important to recognize that the "prudent mix" of contracts may differ for each customer class. What is considered prudent for residential customers might not be considered prudent for large C&I customers, given the different circumstances of each customer group.

Therefore, the Commission should continue to allow flexibility in how "prudent mix" is defined and should not attempt to put restrictions on DSPs regarding a specific mix of supply.

7. Does a "prudent mix" mean that the contracts are diversified and accumulated over time?

Answer: It is not necessarily true that a prudent mix of contracts are diversified. For example, a fixed price full requirements contract could be less risky for customers and produce lower and more stable rates for customers at times than a mix of diverse block, spot, and options contracts. Having more contracts does not imply "less risk" or "more prudence." With regard to contracts that are accumulated over time, again the answer is not clear. In general, the Commission has supported laddering of contracts in order to promote rate stability and to avoid purchasing all of one's supply at a given point in time in the future at uncertain prices. On the other hand, staggering purchases may not always be warranted. For instance, there may be times when it may be considered

prudent to "lock-in" lower supply costs at a particular point in time. Also see response to question 6.

8. Should there be qualified parameters on the prudent mix? For instance, should the regulations preclude a DSP from entering into all of its long-term contracts in one year?

Answer: No, there should be no qualified parameters. While there is an argument to be made to preclude a DSP from entering into all long-term contracts in one year, to protect customers, this is more likely to work to the detriment of customers; it may preclude a DSP from locking in a retail rate decrease or lower supply costs at a particular point in time. In general, the Commission should avoid restrictive or other qualified parameters that attempt to dictate when a DSP must buy.

9. Should the DSP be restricted to entering into a certain percentage of contracts per year?

Answer: No, see responses to questions 6, 7 and 8.

10. Should there be a requirement that on a total-DSP basis, the "prudent mix" means that some quantity of the total-DSP default service load must be served through spot market purchases, some quantity must be served through short-term contracts, and some quantity must be served through long-term contracts?

Answer: No, no specific requirements or percentages should be established on a total-DSP basis for spot, short-term contracts, and long-term contracts. Duquesne Light believes that this would harm the DSP's ability to purchase supply at least cost over time. What may make sense today may not look attractive tomorrow. The Commission should preserve this flexibility in the regulations. See responses to questions 6-9.

11. Should there be a requirement that some quantity of each rate class procurement group's load be served by spot market purchases, some quantity through short-term contracts, and some quantity through long-term contracts? In contrast, should a DSP be permitted to rely on only one or two of those product categories with the choice depending on what would be the prudent mix and would yield the least cost to customers over time for that specific DSP?

Answer: No, the "prudent mix" standard should be interpreted according to the DSP's load as a whole, not based upon individual rate classes. A DSP should not be required to source a class with all of these products, as it is not necessarily in that classes' best interest. The characteristics of each class differ, and what is considered prudent for residential customers might not be considered prudent for large C&I customers.

12. Should the DSP be required to hedge its positions with futures including natural gas futures because of the link between prices of natural gas and the prices of electricity?

Answer: No, this should not be required. However, this is certainly permissible if the DSP believes that it is a prudent course of action.

13. Is the "prudent mix" standard a different standard for each different customer class?

Answer: How the prudent mix standard is applied varies given the unique characteristics of each customer class. For example, each customer class may have different competitive opportunities to access competitive markets and different needs for rate stability. These and other factors should be considered in the prudent mix of products. Duquesne Light, for instance, has found that it is prudent to rely more heavily on shorter-term products for larger customers than for smaller customers, but recognizes

that the prudent mix of contracts may vary in future procurement plans as wholesale and retail markets evolve and technologies change.

14. What will be the effects of bankruptcies of wholesale suppliers to default service suppliers on the short and long term contracts?

Answer: In general, everything else being equal, the effects of bankruptcies on long term contracts is likely to be larger than bankruptcies on short term contracts. Under a long term contract, the load obligation by definition lasts longer and the financial harm associated with bankruptcy is larger. A long term contract also increases the market uncertainty as conditions change over time and may affect both the likelihood of bankruptcy and the financial impact of bankruptcy. Both short and long term contracts require credit and collateral provisions in supply agreements between a DSP and its suppliers. These provisions should require the supplier to post an amount of collateral to cover the amount of supply to be provided under the contract. Supply contracts also should contain protections to ensure adequacy and reliability in the event of a bankruptcy or supplier default. Typically, if a supplier does default, the DSP can either seek to replace the contract or purchase supply in the PJM spot market, which results in a financial consequence as opposed to a physical supply shortage. Therefore, the credit and collateral provisions of these supply contracts are very important.

15. Does Act 129 allow for an after-the-fact-review of the "cost reasonableness standard" in those cases where the approved default service plan gives the EDC substantial discretion regarding when to make purchases and how much electricity to buy in each purchase?

Answer: No. Act 129 provides only for review of procurement plan costs in two specific circumstances: 1) when the party seeking recovery of the costs of a procurement plan is, after hearing, found to be at fault for not complying with the Commission-approved procurement plan; or 2) has committed fraud, collusion or market manipulation with regard to default service contracts. 66 Pa. C.S. § 2807(e)(3.9).

The Commission's determination regarding whether the least cost standard has been met must be made, for the most part, on an ex-ante basis and should not be subject to an ex-post review. For clarification, "ex-ante" refers to a time before the Commission approves a plan, and "ex-post" refers to a later time. Once a plan is approved by the Commission, the costs incurred pursuant to such a plan are deemed to be the least cost over time. A forward looking review is appropriate especially since supply products that provide rate stability are often designed to protect customers from risks that could increase rate levels. These price stability benefits are not captured in an after-the-fact analysis, to the degree that such an analysis focuses on the actual market outcome instead of all of the market scenarios that could have occurred. If an abnormally hot summer had occurred and wholesale prices had spiked, then customers being provided default service supply with some degree of rate stability would have been provided some protection against the associated electricity price volatility. The fact that wholesale prices did not spike in a particular year does not mean that it was not valuable to have protection in place against that risk. For example, if we do not get sick in a particular year, we do not look back and say "I should not have bought health insurance last year; that was a bad decision."

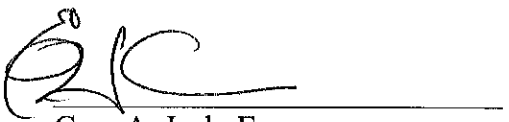
16. **How should the requirement that "this section shall apply" to the purchase of AECs be implemented. Section 2807(e)(3.5) states that "...the provisions of this section shall apply to any type of energy purchased by a default service provider to provide electric generation supply service, including energy or alternative energy portfolio standards credits required to be purchased, etc."**

Answer: Alternative Energy Credits should be treated no differently than any other component of the total power supply. There is no single correct way to procure AECs – such credits can be purchased through bilateral agreements, auctions, RFPs, or produced by the Company, or a combination of these procurement methods.

III. Conclusion

Duquesne Light supports the Commission's efforts to revise the Default Service Regulations and appreciates the opportunity to comment on this matter.

Respectfully Submitted,



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