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## 2463

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July 16, 2007

### VIA HAND DELIVERY

Hon. Arthur Coccodrilli, Chairman  
Independent Regulatory Review Commission  
14th Floor, Harrisstown 2  
333 Market Street  
Harrisburg, PA 17101

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INDEPENDENT REGULATORY  
REVIEW COMMISSION

RE: Pennsylvania Public Utility Commission Regulation #57-237 (IRRC #2463)  
Provisions of Default Service

Dear Chairman Coccodrilli:

On behalf of the Retail Energy Supply Association ("RESA")<sup>1</sup> we are submitting comments to the Pennsylvania Public Utility Commission's ("PUC" or "Public Utility Commission") Final Regulations concerning electricity Default Service in the post-transition period. While RESA does not agree with each and every provision contained in the Final Regulations, on the whole RESA supports the regulations because they conform to the directives of the General Assembly in the Electricity Generation Customer Choice and Competition Act (66 Pa. C.S. §§ 2801-2812 ("Electric Choice Act" or "Act")) and provide the

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<sup>1</sup> RESA is a nonprofit organization and trade association that represents the interests of a broad and diverse group of retail energy suppliers who share the common vision that competitive retail energy markets deliver a more efficient, customer-oriented outcome than the regulated utility structure. RESA is devoted to working with all stakeholders to promote vibrant and sustainable competitive retail energy markets for all consumers. RESA members currently serve residential, commercial and industrial ("C&I") and institutional customers in Pennsylvania and throughout jurisdictions in North America that have enacted retail choice. RESA's members include Consolidated Edison Solutions, Inc; Direct Energy Services, LLC; Hess Corporation; Liberty Power Corp.; Reliant Energy Retail Services, LLC; Sempra Energy Solutions, LLC; Strategic Energy, LLC; SUEZ Energy Resources NA, Inc. and US Energy Savings Corp. The comments expressed in this filing represent the position of RESA as an organization but may not represent the views of any particular member of RESA.

HAR:74270.1/MID051-158776

framework for the development of competitive retail electric markets **and** assure reasonable and reliable service for customers. Therefore, they should be approved by IRRC .

Default Service is electric service to retail customers who do not shop for electricity from alternative competitive retail suppliers (electric generation suppliers, or "EGSs") or whose chosen supplier does not deliver the contracted energy. The PUC Final Regulations direct that the incumbent utilities (electric distribution companies, or "EDCs") shall acquire power to provide Default Service either through a competitive procurement process or spot market purchases, or a combination of both, to comply with the "prevailing market prices" standard in Section 2807(e)(3) of the Electric Choice Act. 66 Pa. C.S. § 2807(e)(3). Consistent with IRRC's recommendation that retail rates must have some variability to reflect market prices in order to be consistent with this requirement, the PUC concluded that retail prices for default service must adjust at least quarterly for residential and small business customers (maximum registered peak load up to 500 kW), and at least monthly for large business customers (maximum registered peak equal to or greater than 500 kW). The Default Service Provider ("DSP") can propose more frequent retail price changes.<sup>2</sup> The regulations permit, but do not require, EDCs to employ a reconciliation mechanism to ensure full recovery of both energy costs and associated administrative, regulatory and other operating costs. Accompanying the Final Regulations is a Policy Statement which sets forth guidelines as to how the PUC envisions its Final Regulations should be interpreted and implemented by EDCs in formulating and filing Default Service Programs. The PUC indicated that the "policy statement, coupled with the default service regulations, and the order on electricity price mitigation, represents a comprehensive strategy for addressing retail rates in the context of expiring rate caps and still developing retail and wholesale energy markets."<sup>3</sup>

As IRRC is well aware, in reviewing an agency's regulations, it "shall, first and foremost, determine whether the agency has the statutory authority to promulgate the regulation and whether the regulation conforms to the intention of the General Assembly in the enactment of the statute upon which the regulation is based." 71 P.S. §745.5b(a).

There is no question about the PUC's statutory authority to promulgate the regulations because Section 2807(e)(2) of the Electric Choice Act directs the PUC to do so: "At the end of the transition period, the commission shall promulgate regulations to define the electric

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<sup>2</sup> *Rulemaking Re Electric Distribution Companies Obligation to Serve Retail Customers at the Conclusion of the Transition Period Pursuant To 66 Pa.C.S. § 2807(e)(2), Notice Of Final Rulemaking Order, Docket No. L-00040169, Order entered May 10, 2007 ("Final Default Service Rulemaking") at 31.*

<sup>3</sup> *Default Service and Retail Electric Markets; Final Policy Statement, Docket No. M-00072009, Order entered May 10, 2007 ("Final Default Service Policy Statement") at 2-3.*

distribution company's obligation to connect and deliver and acquire electricity under paragraph (3) that will exist at the end of the phase-in period." 66 Pa. C.S. § 2807(e)(2).<sup>4</sup>

Additionally, the PUC's Final Regulations plainly "conform...to the intention of the General Assembly in the enactment of the statute upon which the regulation is based." The intent of the General Assembly in enacting the Electric Choice Act is clear – to provide all retail electricity customers with direct access to a competitive retail electricity market. The General Assembly stated explicitly that the purpose of the Electric Choice Act "is to modify existing legislation and regulations and to establish standards and procedures in order to **create direct access by retail customers to the competitive market for the generation of electricity** while maintaining the safety and reliability of the electric system for all parties." 66 Pa. C.S. § 2802(12) (emphasis added).

The General Assembly's clear intent is expressed in other findings and declarations of the General Assembly:

- "It is now in the public interest to permit retail customers to obtain direct access to a competitive generation market . . . ." 66 Pa. C.S. § 2802(3).
- "Competitive market forces are more effective than economic regulation in controlling the cost of generating electricity." 66 Pa. C.S. § 2802(5).
- "This Commonwealth must begin the transition from regulation to greater competition in the electricity generation market to benefit all classes of customers and to protect this Commonwealth's ability to compete in the national and international marketplace for industry and jobs." 66 Pa. C.S. § 2802(7).

Most importantly, and as noted above, Section 2807(e)(3) of the Electric Choice Act requires a DSP to acquire Default Service supply in the post-rate cap period at prevailing market prices, and to recover in retail prices all reasonable costs.<sup>5</sup>

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<sup>4</sup> The reference to "paragraph (3)" is to Section 2807(3) of the Electric Choice Act. The "phase-in period" is set forth in Section 2807(b) of the Act and refers to the time during which all retail customers gradually obtain the opportunity for direct access to the competitive generation market. The transition period is set forth in Section 2804 of the Act and refers to the time during which the retail rates of EDCs are capped per Section 2804(4) and the EDCs are recovering their approved stranded costs in accordance with Sections 2803 and 2808. The phase-in and transition periods for nearly all of the major EDCs have been established through restructuring settlements approved by the PUC consistent with these sections.

<sup>5</sup> The PUC described the General Assembly's finding – that competition is more effective than economic regulation in controlling electric generation costs – as a "bedrock principle." *Petition*

The Final Regulations conclude that the optimal method of implementing these directives is through direct exposure to market forces through competitive bid solicitations and spot market purchases.<sup>6</sup> The Public Utility Commission has indicated that DSPs "should consider a portfolio of energy supply products," including a mix of fixed-term and spot market energy purchases of varying terms.<sup>7</sup> In Section 7 of its comments, IRRC stated that the issue of Default Service supply contracts extending more than 12 months "is important because it will directly affect the procurement strategies of the DSPs and will influence how closely rates for default service will reflect prevailing market prices." The PUC agreed with IRRC's comments concerning "excessive reliance" on energy contracts longer than 12 months and encouraged DSPs "to gradually increase their utilization of spot market purchases and short fixed term contracts." The Public Utility Commission concluded that "[t]his procurement approach is consistent with [the] Competition Act standard that energy be acquired at prevailing market prices."<sup>8</sup> RESA remains concerned that the Final Regulations may result in default service programs that rely too heavily on long-term supply procurement. However, RESA recognizes that the gradual phase out of long-term supply purchases, as the Public Utility Commission in its Policy Statement has suggested may be appropriate, should, over time, serve to mitigate the impacts to the competitive market of over-reliance on long-term procurement.

This approach will produce reasonable results for default service customers because it assures that default service prices will not be set on the basis of wholesale prices at a single point or a few points in time. This will make sure that the kind of dramatic, triple digit price increases that some default service customers have experienced upon the removal of rate caps will not occur. At the same time, it will make it more likely that customers will have competitive alternatives available potentially offering a variety of competitively priced products and other new and innovative services.

With respect to reconciliation, the Public Utility Commission concluded that the reconciliation of default service costs "is more desirable" to enable DSPs to fully recover all reasonable costs so that the price to the retail customer "reflects market prices" as required by Section 2807(e)(3),<sup>9</sup> and provided guidelines in the Final Default Service Policy Statement for

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*of Duquesne Light Company for Approval of Plan for Post-Transition Period Provider of Last Resort Service, Docket No. P-00032071, Order entered August 23, 2004, at 44.*

<sup>6</sup> *Final Default Service Rulemaking* at 20-21.

<sup>7</sup> *Final Default Service Rulemaking* at 5.

<sup>8</sup> *Final Default Service Rulemaking* at 16, 24-25.

<sup>9</sup> *Final Default Service Rulemaking* at 29.

a cost reconciliation mechanism. In the Policy Statement, the Public Utility Commission recognized that under its revised approach requiring regular price adjustments and permitting reconciliation, Default Service rates will change during the term of a Default Service Program for two reasons: (1) adjustments to reflect changes in incurred costs due to the use of a portfolio of multiple procurements including laddered contracts or spot market energy purchases because, "[a]s the term covered by the laddered contract or spot market energy purchases expire, new contracts, most likely at different prices, will take effect."; and (2) the rates must be refined to reconcile default service costs and revenues because "[t]here will almost certainly be some variation between revenues received and costs incurred on a month to month basis."<sup>10</sup>

However, in response to IRRC's comment that the PUC should retain the prohibition against reconciliation "to keep the EDCs on a more equal competitive footing with EGSs," the Public Utility Commission concluded that "that parity between EDCs and EGSs can be maintained through the regular adjustment of rates, the gradual increase in spot market products, and the limitation on the use of long-term contracts, and several other measures. With these elements, the default service rate will more closely track the market prices offered by EGSs."<sup>11</sup> While RESA has opposed the use of a reconciliation mechanism for over- or under-recoveries of wholesale energy costs as unnecessary and inconsistent with the "prevailing market prices standard," the remainder of the regulations are plainly consistent with that standard as well as the requirement that the EDC be permitted to recover all of its associated, reasonable costs of providing Default Service.

Finally, whether or not reconciliation is used, as stated above the Final Regulations require frequent retail price adjustments "to ensure the recovery of costs reasonably incurred in acquiring electricity at prevailing market prices and to reflect the seasonal cost of electricity."<sup>12</sup> Again, this provision plainly is in line with the statutory requirements that default service rates reflect prevailing market prices,<sup>13</sup> and should ensure that Default Service rates are market-reflective and market-responsive. This is also reasonable for customers because it will make it more likely that they will have a variety of competitive alternatives from which to choose, and will permit decreases in wholesale prices to be reflected in retail prices in a timely manner.

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<sup>10</sup> *Final Default Service Policy Statement* at 10.

<sup>11</sup> *Final Default Service Rulemaking* at 16.

<sup>12</sup> *Final Regulations*, §§ 54.187(h), (i) and (j).

<sup>13</sup> 52 Pa Code § 54.184(a), implementing, 66 Pa C.S. § 2807(e)(3).

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Accordingly, the PUC's Final Regulations satisfy IRRC's lodestar review criteria – consistency with the General Assembly's intentions in the enabling legislation – and must be approved.

Sincerely,



Daniel Clearfield

For WOLF, BLOCK, SCHORR and SOLIS-COHEN LLP

DC/jls

cc: Kim Kaufman, Exec. Dir.  
Scott Schalles, IRRC  
Bohdan R. Pankiw, Esq., Chief Counsel, PaPUC  
Richard Hudson