

BEFORE THE INDEPENDENT REGULATORY REVIEW COMMISSION 9: 37

 INDEPENDENT REGULATORY
 REVIEW COMMISSION
 COMMENTS OF THE COMMONWEALTH OF PENNSYLVANIA,
 DEPARTMENT OF ENVIRONMENTAL PROTECTION ON
 REGULATION No. 57-237, PROVISIONS OF DEFAULT SERVICE

The regulations under review will affect one of the central energy policy questions facing the Commonwealth; that is, how electricity is purchased by utility companies for their customers, and at what price. For this reason, careful scrutiny of this regulation is appropriate.

The Pennsylvania Department of Environmental Protection ("Department") requests that the Independent Regulatory Review Commission ("Review Commission") disapprove and remand the final form Default Service Regulations (#57-237) under Public Utility Commission ("PUC" or "Commission") Docket No. L-00040169 to the Commission to provide an opportunity for further consideration. Such action would provide the PUC the opportunity to revise the regulations to address the issues described below and to take into account recent and coming legislative action on the matters in question.

The Review Commission has authority to do so under Section 5.2 of the Regulatory Review Act. 71 P.S. § 745.5b. The Regulatory Review Act, in relevant part, directs the Review Commission to consider whether a proposed regulation conforms with the intent of the General Assembly, consider the economic impacts of the regulation -- including the adverse effects on prices, productivity or competition -- and whether the regulation represents a policy decision of such a substantial nature that it requires legislative review. 71 P.S. § 745.5b.

1. Price Stability and Legislative Intent.

The purpose of the Electricity Generation Customer Choice and Competition Act ("Act"), 66 Pa.C.S. §§ 2801 *et seq.*, is to provide safe, reliable electric service at the lowest cost to consumers 66 Pa.C.S. § 2802(12). The need to provide reasonably priced service was considered essential for consumer welfare and economic development. 66 Pa.C.S. § 2802(9). As a means of achieving that goal, the Act sought to ensure that consumers had access to a competitive generation market. The Act also provided that service should be available to all customers on reasonable terms and conditions. 66 Pa.C.S. § 2802(9). To achieve these purposes the Department in its comments to the PUC supported a "portfolio" approach for a default service provider to provide safe reliable service at the lowest reasonable rates over time. Such a portfolio would include an array of contract lengths and products, including long-term contracts, short term contracts, spot market purchases, demand side resources and resources needed to comply with the Alternative Energy Portfolio Standards Act. The use of a diverse array of products and contracts is most likely to result in reasonable and stable rates for consumers over the long term.

Although the policy statement accompanying the regulations mentions a portfolio approach as an acceptable method for utilities to use in procuring electricity, it is not made a requirement in the regulation. This structure creates uncertainty with regard to how the Commission will apply the regulations. As currently determined by the Commission, the regulations may result in decisions that stress the value of competition in electric service generation over least cost pricing for consumers and price stability to a degree that it is inconsistent with the Act.

There is some sentiment on the Commission regarding the overriding importance of the competition provisions of the Act. As Commissioner Fitzpatrick put it during the recent June 5 Senate hearing, default service is "backup service."¹ Indeed, default service has been traditionally called "Provider of Last Resort" service. This concept tends to establish the Electric Distribution Company ("EDC") as the last place consumers would go to purchase electricity.

Creating a "Provider of Last Resort" atmosphere for consumers fits with § 69.1802 of the PUC's Policy Statement (which must be read in conjunction with the proposed regulations).² The Statement provides: "The goal of default service regulations is to bring competitive market discipline to historically regulated markets. This can be accomplished by structuring default service in a way that encourages the entry of new retail and wholesale suppliers." A strict adherence to this principle above others enshrined in the Act could lead to implementation of the Act that is inconsistent with its other provisions.

For example, the mandated frequent opportunities for price fluctuations and the resulting possibility of unstable rates could prevent customers, particularly low income customers, from planning for affordable basic electric service and this is inconsistent with the intent of the Act. 66 Pa.C.S. § 2802(9)(10). In addition, the interpretation of the term "prevailing market prices" by the Commission to date has called into question whether certain procurement strategies designed to provide the lowest reasonable stable rate for reliable electric service will be allowed. The Department believes that a proper reading of the Act is one that gives deference to the effects on consumer cost, price stability and reliability.

The plain language of the Competition Act shows that EDC's are not intended to simply be a backup service. See, 66 Pa C.S. 2807(e). The legislature contemplated that customers could choose to keep the EDC as their electricity provider or that a customer would terminate its relationship with an Electric Generation Supplier ("EGS") and return to the EDC. In fact, rather than establish a preference for one electricity supplier over another, the law merely imposes an additional burden on EDCs to be prepared to provide service if the EGS cannot.

A. Long-term Contracts Can Provide Electricity at Prevailing Market Prices.

¹ See testimony of Commissioner Fitzpatrick at <http://senatormjwhite.com/environmental/060507/fitpatrick.pdf> Page 4.

² See page 6 of the Commission's Final Rulemaking Order. "[W]e do not attempt to dictate the exact manner by which every DSP will acquire electricity. Adjust rates, and recover their costs. The Commission is issuing a separate policy statement that contains guidelines for DSPs in the areas of procurement, rate design, and cost-recovery. Reserving some aspects of our regulation of default service to a policy statement will allow the Commission, DSPs, retail customers, and other market participants to consider these policies in the context of individual default service plans and to more effectively respond to changes in retail and wholesale markets."

In reading the text of the PUC's regulations and policy statement, it is difficult to predict what kind of purchasing strategies the Commission will approve. This lack of certainty or "flexible" approach is the Commission's stated intent. However, a reading of the commentary to the regulations and policy statement calls into question as to how or whether long-term contracts with generators will be allowed as part of a portfolio approach. This comes about as a result of varying interpretations of the meaning of the words "prevailing market prices".

Section 2807(e)(3) of the Competition Act requires EDCs to acquire electric energy at "prevailing market prices." 66 Pa.C.S.A. 2807(e)(3). Clearly, what constitutes the prevailing price is dependant on the "market" in question. For example, interest rates for home mortgages vary significantly depending on the term of years, points, size of the loan, and whether the term is fixed, adjustable or balloons. Similarly, prevailing prices for electricity are dependent on the market in question. Factors to consider in determining the "market price" are the location of the generating facility, type of generation resource, length of contract term, and if a short term contract – the time of year.

Although there are several variables to consider, electricity prices from similarly situated facilities should be the same. If one facility's offer is higher than others, that facility is not selling electricity at prevailing market prices and the Commission should not approve a contract with that facility. This is the protection provided to the consumer by requiring EDCs to purchase electricity at phrase "prevailing market prices". However, it is unclear from the regulations how long-term contracts or other arrangement not specifically approved by the regulations can fit into this the Commission's narrowly constructed definition of a "prevailing market prices."³

Of course, the Commission's policy statement allows for a "prudent" amount of long-term contracts "initially". See § 69.1805. Also, long-term contracts may be used if "necessary" for compliance with the Alternative Energy Portfolio Standards Act. *Id.* However, this seems to be at odds with the definition used for prevailing market prices and the contention that short-term contracts will save customers money.⁴ Thus, it is possible that long-term contracts may never be deemed prudent or necessary.

House Bill 1201 is currently pending before the General Assembly and would, in part, delete the phrase "prevailing market prices". As set forth below, this proposal is a major part of an energy legislative package that the General Assembly will consider in September in a Special Legislative Session. Accordingly, these regulations "represent a policy decision of such a substantial nature that it requires legislative review. 71 P.S. § 745.5b(b)(4). The Review Commission should disapprove these regulations to give the General Assembly time to review and address this critical public policy issue.

B. Long-term Contracts Are Essential For Alternative Energy Resources.

³ Prevailing market price is defined as "The price that is available in the wholesale market at particular points in time for electric generation supply."

⁴ See comment to § 54.186, page 25.

EDCs are the most significant wholesale buyers and retail sellers of electricity in the Commonwealth. Alternative energy sources are important new generators of electricity and long-term contracts are often essential to their viability and continued development. If the Competition Act is intended to promote competition among generators, the best way to achieve this goal is to develop policies that encourage the construction of new generation resources.

The Department has been an ardent supporter of the development of alternative energy resources. These resources provide a clear path to energy security, clean air and water, long-term health benefits to Pennsylvania citizens, and dynamic new businesses with good paying jobs. Unlike existing power plants that are guaranteed to recover their construction costs through ratepayers via the competitive transition charge, alternative energy sources have no guaranteed source of revenue. These facilities often need long-term power purchase agreements to secure financing for development. The lack of clear regulatory indication that long term contract for these facilities will be allowed will deter construction of new alternative energy sources.

2. Ambiguity.

The Commission has chosen to reserve a number of substantive issues for disposition in its Policy Statement.⁵ Regulations should serve as a guide for action by regulated entities and make the rules of the game clear to all stakeholders. This proposal, while appropriately detailed in terms of process, leaves much in doubt in terms of the goals and substance of default service purchasing. For example, the proposed regulations are unclear as to which sorts of electricity products may be used to satisfy the default service purchasing requirement. The Default Service Implementation Plan defined in section 54.182, indicate that only competitive bid solicitations and spot market purchases that occur on a pre-scheduled basis are permitted. The definition of prevailing market price is similarly unhelpful, stating that this is a price "available in the wholesale market" without enumerating the products that fall within this market. Unfortunately, the Commission clarifies the definition of market only obliquely.⁶

Leaving the core of the issues in question unresolved in the regulations denies clear guidance to electric distribution companies and commission approved alternative service providers. This may also ultimately affect ratepayer access to reasonable rates. The Commission has addressed many administrative requirements that can assure customers that default service purchases will be done according to reasonable purchasing rules using arms-length transaction. These things are fundamental to protecting consumers against arbitrary or ill-planned purchasing. Regrettably, no one can determine from anything in these regulations whether default service purchasing has the potential for producing reasonable prices.

3. Customer Rates.

⁵ At pages 1 and 2 of the Final Rulemaking Order, the PUC states that "At separate dockets, we are issuing a final policy statement on default service and retail electric markets, and identifying other policies for addressing potential electric price increases." see Proposed Policy Statement on Default Service and Retail Electric Markets; Docket no. L-00070183.

⁶ "We expect that DSPs will gradually increase their reliance on shorter term contracts and spot market energy products over time." Final Rulemaking Order at p.5

As stated previously, the goals of the Commission's proposed Default Service regulations are to define an EDC's obligation to provide electric service to customers who choose to be served by the EDC and to customers whose EGS fails to provide electric service. In doing so, the Commission should strive to ensure that customers receive the lowest reasonable rates on a long-term stable basis. This is stated clearly in the Act's declarations of policy, "The cost of electricity is an important factor in decisions made by businesses concerning locating, expanding and retaining facilities." 66 Pa.C.S. § 2802(6). In addition, the Act expresses the ongoing concern that "... electric service should be available to all customers on reasonable terms and conditions." 66 Pa.C.S. § 2802(9). In the context of the Act, this can only be interpreted to include price because the Commission can only regulate default service, having no authority over most aspects of service offered by electric generation suppliers.

The Act clearly expresses the intent of opening the opportunity, rather than the requirement, for consumers to take service from electric generation suppliers. Specifically, "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).

Instead of ensuring the lowest reasonable rates on a long-term stable basis, the regulation may have the effect of driving customers from the EDC to EGSs, thereby raising and adding volatility to electricity prices offered by the EDC. Low cost, reliable electric service is absolutely essential to Pennsylvania's economy and to the lives and livelihoods of its citizens.

For this reason it is appropriate for these rules to receive further consideration by the Commission pending further policy developments. Indeed, the most critical element of the regulation – the manner in which an EDC may purchase electricity – is at the heart of House Bill 1201. This bill is the centerpiece of the Governor's Energy Independence Strategy and will be the focal point of debate during the General Assembly's special session on September 17, 2007. If enacted, this bill will fundamentally alter the law that underlies these regulations. Accordingly, this Commission should disapprove these regulations.

4. Coming Legislative Action.

Governor Rendell's Energy Independence Strategy (EIS) was actively considered by the General Assembly as part of the recent budget discussions.¹ The major components of the EIS are reflected in four major legislative proposals that are under consideration by the General Assembly. One of the proposals contains amendments to Title 66 including language concerning long-term contracts and prevailing market prices as contained in House Bill 1201. The General Assembly has scheduled a Special Legislative Session beginning on or about September 17, 2007 to again consider the EIS legislative proposals.

The Commission regulations before the Review Commission would be superseded if the pending EIS legislative proposals or similar language becomes law. The coming Special Legislative Session provides a basis to conclude that the issue on the authority of long-term contracts is an issue of such importance that "requires legislative review" later this year during the Special Legislative Session.

In addition, the proposal also fails to take into account House Bill 1530, and there is every indication this bill will already have become law by the time of the Review Commission's action or will do so shortly thereafter. House Bill 1530 authorizes long-term contracts for certain industrial users of electricity and allows certain EDCs to construct or purchase an interest in a generating facility.

Conclusion

The most appropriate course of action for the Review Commission would be to disapprove these regulations and return them to the Commission for further consideration and in anticipation of further legislation on this subject.