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ON COMMUNITY DEVELOPMENT

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

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2005 MAY -3 PM 3:55

(25)

April 26, 2005

Pennsylvania Public Utility Commission
Attention: Secretary
2nd Floor
400 North Street
Harrisburg, PA 17120

RE: 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)
Docket No. L-00040169

To the Commission:

Pursuant to the announcement of proposed rulemaking in the February 26, 2005 Pennsylvania Bulletin (35 Pa.B. 9), the Allegheny Conference on Community Development hereby submits its comments to the Pennsylvania Public Utility Commission ("Commission") regarding the Commission's proposed definitions of the obligation of electric distribution companies to serve retail customers at the conclusion of their respective transition periods.

The Allegheny Conference on Community Development and Affiliates is the private sector leadership organization focused on improving economic growth and the quality of life in the 10-county southwestern Pennsylvania region.

The availability, cost, reliability, and predictability of electric service is an important component of a region's business climate for many types of businesses. It is particularly important for many large manufacturing businesses, such as those in the metals, chemicals, and other specialty materials industries, where electricity is a major cost of production. Firms in these industries provide over 40,000 jobs directly in southwestern Pennsylvania, and tens of thousands more jobs in supplier and service firms that are dependent on the continued competitiveness of these businesses.

Due to the recent changes in power rates and terms, the cost of electric power in Allegheny and Beaver Counties has become a competitive disadvantage for large commercial and industrial users, particularly in comparison to neighboring states. Based on national data and reports from individual businesses, industrial customers in Allegheny and Beaver Counties are facing electricity prices that are 50%-100% more than what is obtainable by similar businesses in nearby states such as Kentucky, Ohio, and West Virginia. In addition, the Commission's decision to limit the options available to large customers after June 1, 2007 has had the effect of making electric service in these counties even less competitive. Similar problems are likely to occur in other parts of the state over the next several years as more utilities end their transitional periods. If competitive disadvantages in Pennsylvania cause large commercial and industrial customers to scale back or shut down operations in Pennsylvania, it could cause a dramatic negative impact on all citizens in the Commonwealth, not only in terms of higher costs of electricity (due to lower demand), but loss of jobs and revenues.

The goal of the Electric Competition Act of 1996 was to make Pennsylvania's electric service more competitive for its customers. This is a desirable goal, and one that the Allegheny Conference supports. However, success in implementing the law should not be measured by whether a particular *process for pricing* is in place, but rather whether *service is competitive* for each class of customers in terms of the availability, cost, reliability, and predictability of electric power. Consequently, the Commission should attempt to establish a regulatory structure which maximizes the ability for customers to obtain electricity under terms that are most competitive for them. For example, competitive bidding is a means to an end, not an end in itself, and service providers should have the flexibility to pursue other means of obtaining power on behalf of specific customers if they can demonstrate that these alternative means will result in electric service options that are more desirable for those customers without negatively impacting other customers. Similarly, if fixed price service options are desired by major customers, service providers should not be precluded from offering them by the Commission.

In addition, the Commission must recognize that Pennsylvania's competitiveness is determined not only by the regulatory structure which exists within the Commonwealth, but by the actions of neighboring states and by the federal government. Each year, businesses make decisions as to where to expand or contract their operations or to locate new facilities, and the types of power contracts they can obtain can be an important factor – sometimes a critical factor – in their decision-making. Therefore, the Commission must strive to enable service providers to offer electricity under service and rate packages that are competitive with other states and that are predictable for major business customers. Although the Commission has looked to states to its east (New Jersey and Maryland) as comparisons, it must also look to states to its west, such as Kentucky, Ohio, and West Virginia, as well. In particular, the Commission's refusal to allow default service providers to offer fixed-price, multi-year contracts creates a competitive disadvantage for Pennsylvania relative to other states.

The Commission's regulations guiding the provision of default service need to support a system that provides for the best interest of all customers. In order to do so, we urge that the regulations provide as much flexibility as possible to enable utilities to offer

the most competitive and attractive electric service packages, particularly to large commercial and industrial customers, as long as these packages do not negatively impact the price or reliability of electric service for customers in other rate classes. In particular, we believe that the Commission's regulations should be modified as follows:

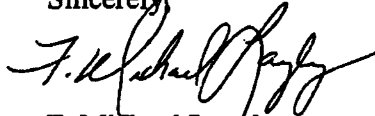
- Section 54.186 (Default Service Supply Procurement) should permit default service providers to use procurement processes other than competitive bidding for specific customers or classes of customers where they can demonstrate that the resultant service is more competitive for the customers.
- Section 54.187(d) (Default Service Rate and the Recovery of Reasonable Costs) should allow default service providers to offer a fixed rate option for large customers.

In addition, we believe that Section 54.185 (Default Service Implementation Plans and Terms of Service) should allow default service providers to provide terms of service greater than 12 months, as has been proposed by the Commission.

We believe that by giving providers the flexibility to offer these service options, Pennsylvania's competitiveness for commercial and industrial customers will be improved, and the risk of negative economic impacts on the state will be reduced or eliminated.

We urge the Commission to give priority consideration to these economic competitiveness issues before finalizing its regulations and in making future decisions about specific service implementation plans. We further urge that the Commission undertake appropriate research on these issues to guide it when making policy decisions of this nature both now and in the future. Please feel free to call on us if we can be of assistance to the Commission in addressing these issues.

Sincerely,



F. Michael Langley
Chief Executive Officer

Original: 2463

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April 25, 2005

RECEIVED
2005 MAY -3 PM 3:53
PA PUBLIC UTILITY COMMISSION

Honorable James J. McNulty
Secretary
Commonwealth of Pennsylvania
Pennsylvania Public Utility Commission
P.O. Box 3265
Harrisburg, Pennsylvania 17105-3265

Re: 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)
Docket No. L-00040169

Dear Secretary McNulty:

In Volume 35, Number 9 of the Pennsylvania Bulletin, the Pennsylvania Public Utility Commission ("Commission") issued for public comment proposed regulations ("Regulations") that define the obligation of electric distribution companies ("EDC") to serve retail customers at the conclusion of their respective transition periods. I enclose an original and 15 copies of Pike County Light & Power Company's ("Pike" or the "Company") comments regarding the Regulations. For the sake of convenience, Pike's comments will address specific provisions of the Regulations in the order in which they are set forth in the Regulations.

Section 54.123 (2)

Section 54.123 (2) provides that an electric generation supplier ("EGS") may initiate transfers through standard electronic data interchange ("EDI") protocols. Pike is a small utility with approximately 4,000 electric customers. Given its size, location in the far northeast corner of Pennsylvania, and affiliation with the New York Independent System Operator ("NYISO") as discussed below, to date EGSs have had little interest in serving Pike's customers. For these reasons, Pike has not invested in the systems required to facilitate electronic data exchange. We do not read the proposed Regulations as requiring utilities to establish EDI protocols. If Pike is required to implement EDI protocols, however, Pike requests that it be allowed to implement the EDI protocols currently utilized by Pike's parent, Orange and Rockland Utilities, Inc. ("Orange and

Rockland"). Orange and Rockland, like Pike, is affiliated with the NYISO. Accordingly, any EGSs wishing to serve Pike's customers would be familiar with Orange and Rockland's EDI protocols. The cost of requiring Pike to develop its own separate EDI protocols would be out of proportion to any possible benefit.

Section 54.185 (a) (e)

As recognized by the Commission in the comments preceding the Regulations, the settlement in Pike's rate cap exception proceeding[1] provides that if the Commission has not issued the final version of the Regulations by June 1, 2005, Pike will file a plan to establish provider of last resort (referred to in the Regulations as "default service") rates, to become effective January 1, 2006. The Commission recognizes that the Regulations will not be finalized by June 1, 2005. Accordingly, by no later than June 1, 2005, Pike will be filing an interim default service plan, covering at a minimum calendar year 2006, with the Commission.

Section 54.185 (d)

This section provides that a default service implementation plan must propose a fair, transparent and nondiscriminatory competitive procurement process consistent with § 54.186 (relating to default service supply procurement) for the acquisition of sufficient electric generation supply, at prevailing market prices, to meet demand of all of the default service provider's retail electric customers for the term of service. Pike is different from the other Pennsylvania default service providers. First, Pike only has approximately 4,000 customers. More important, Pike is the only Pennsylvania default service provider affiliated with the NYISO rather than the PJM Interconnection, LLC ("PJM"). Given its size and non-PJM affiliation, Pike is concerned that it would not be able to attract the interest of a sufficient number of suppliers if it issued a request for proposals for the provision and delivery of the physical supply needed to serve its default service customers. To increase its ability to achieve the goal of default coverage, Pike would propose to utilize commodity swap transactions rather than physical purchases. Pike likely will utilize two separate financial swaps, one pertaining to the forecasted capacity requirement, and the other pertaining to the forecasted energy requirement.[2] These commodity swap transactions would be for a term of up to three years.

Pike's New Jersey affiliate, Rockland Electric Company, has utilized this approach successfully for the default service requirements of its Central and Western Divisions. Like Pike, these two Divisions are affiliated with the NYISO rather than PJM. Accordingly, this section should be amended so as to clarify that a default service provider is allowed to utilize financial instruments when acquiring its electric generation

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[1] Docket No. P –00011872, *Petition of Pike County Light & Power Company for Exception to Rate Cap Limitations Pursuant to 66 Pa. C.S. § 2804(4)(iii)(D), and for Expedited Proceedings Pursuant to 66 Pa. C.S. § 2804(4)(iv),* Opinion and Order (adopted August 8, 2002) (hereinafter referred to as the "Rate Cap Order").

[2] Since there is no active, liquid market for ancillary services, Pike would be unable economically to utilize commodity swap transactions to lock in their price. Rather, Pike would purchase ancillary services, as required, through the NYISO.

supply. Specifically, Pike recommends that Section 54.185(d) be amended to read as follows:

> A default service implementation plan must propose a fair, transparent and nondiscriminatory competitive procurement process consistent with § 54.186 (relating to default service supply procurement) for the acquisition of sufficient electric generation supply, either through contracts for physical supply or by means of financial transactions, at prevailing market prices, to meet the demand of all of the default service provider's retail electric customers for the term of service. The default service plan must identify its method of compliance with the Alternative Energy Portfolio Standards Act (73 P. S. §§ 1647.1--1647.7).

Section 54.186 (f) (2)

Section 54.186 (f) (2) provides that the Commission has a period of not less than three business days to review the results of a default service provider's acquisition of generation supply. A minimum three-day period is a very long time for suppliers to maintain their price offers. Pike would note that the New Jersey Board of Public Utilities reviews and decides on the results of the annual Basic Generation Service Auction in no more than two days. Pike strongly recommends that the Commission adopt a similar standard. Experience in similar solicitations indicates that adoption of a longer review period is likely to cause prospective suppliers to add a risk premium to their prices to protect against market movement during the lengthy review period. Ultimately, this will result in higher prices for Pennsylvania customers.

Therefore, Pike recommends that Section 54.186 (f) (2) be amended to read as follows:

> The review period may not be less than two business days.

Section 54.187 (a) (1)

Section 54.187 (a) (1) states that the generation supply charge would be a nonreconcilable charge. As noted above, Pike intends to utilize commodity swap transactions to lock in the capacity and energy components for the majority of its default service supply. Pike would propose to set, once per calendar year, the generation supply charge based upon the prices reflected in those commodity swap transactions and the Company's best estimate of the cost of the unhedged portion of its energy supply. Pike also would include a forecasted price of ancillary services in such generation supply charge. Inevitably, however, the actual prices of unhedged energy and ancillary services will diverge from the forecasted prices of such services. In addition, revenues collected on a bill cycle basis will differ from costs incurred on a calendar month basis. In order to address this situation, Pike requests that it be allowed to reconcile the generation supply

charge monthly, on a two-month lag.[3] Such a reconciliation process will ensure that customers pay neither more nor less than they should for default service. Such a reconciliation process will ensure that Pike remains indifferent as to whether customers continue as full service customers or choose to take service from an EGS. Finally, such a reconciliation process will ensure full recovery of Pike's costs for acting as default service provider.[4]

Therefore, Pike recommends that Section 54.187(a)(3) be amended to read as follows:

> A default service provider shall use an automatic energy adjustment clause, consistent with 66 Pa.C.S. § 1307 (relating to sliding scale of rates; adjustments) to reconcile differences between revenues received through the generation supply charge and generation supply costs and to recover reasonable costs incurred through compliance with the Alternative Energy Portfolio Standards Act (73 P. S. §§ 1647.1--1647.7).

Section 54.187 (a) (2)

Section 54.187 provides that the costs for providing default service shall be recovered through several separate charges. These include a nonreconcilable generation supply charge, as well as a non-reconcilable customer charge. Such a customer charge, according to Section 54.187 (a) (2), is supposed to collect the "default related costs for customer billing, collections, customer service, meter reading and uncollectible debt." Since Pike has not performed the sort of cost of service study necessary to unbundle these charges, Pike is not able to identify these specific costs. More important, this sort of unbundling exercise should occur in the context of a base rate case. This makes sense especially for a very small-sized utility like Pike. Accordingly, the Regulation should be amended to provide that a utility may choose to develop these separate charges in the context of its next base rate proceeding.

Therefore, Pike recommends that Section 54.187(a)(2) be amended to read as follows:

> The customer charge is a nonreconcilable, fixed charge, set on a per customer class basis, that includes all identifiable, reasonable costs associated with providing default service to an average member of that class, exclusive of generation supply costs and costs recovered through paragraph (3). The associated costs with this charge include:
>
> (i) Default service related costs for customer billing, collections, customer service, meter reading and uncollectible debt;

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[3] For example, an over or undercollection for the month of April would be computed during the month of May and credited or charged to customers in June.

[4] Section 54.181 states "The EDC shall fully recover all reasonable costs for acting as a default service provider of electricity to all retail customers in its certificated distribution territory."

(ii) A reasonable return or risk component for the default service provider;

(iii) Applicable taxes; and

(iv) Other reasonable and identifiable administrative or regulatory expenses.

An EDC may choose to establish the customer charge, consistent with Section 54.187 (a) (2), in its next base rate case.

Section 54.187 (b)

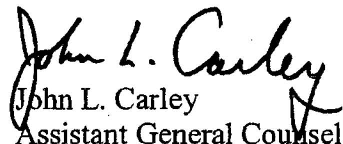
Section 54.187 (b) provides that a default service plan "must include a fixed rate option for all residential customers." Pike would propose that the methodology described above, in the discussion regarding Sections 54.185 (d) and 54.187 (a) (1), be deemed to qualify as such a fixed rate option plan. Given the size of Pike's customer population, Pike should not be required to offer another fixed rate option for residential customers.

Section 54.187 (d)

Section 54.187 (d) provides that the default service provider "shall include an hourly rate in its implementation plan for all default service customers whose load test indicates a registered peak demand of greater than 500 kilowatts." Pike currently has only one such customer. In order to implement such an hourly rate, Pike would need to implement both billing and metering modifications. Such expenditures are not justified given Pike's current circumstances. Section 54.187 (d) does go on to provide, however, that the default service provider may propose a fixed rate for these customers in its default service implementation plan. Accordingly, Pike requests that the Commission clarify that the rate offering, described in the discussion above regarding Sections 54.185 (d) and 54.187 (a) (1), would qualify as such a fixed rate.

If you have any questions regarding the issues discussed above or require any additional information, please contact me at the telephone number or address listed above.

Very truly yours,



John L. Carley
Assistant General Counsel

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April 7, 2006

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

VIA EXPRESS MAIL

James J. McNulty, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17120

Re: Implementation of the Alternative Energy Portfolio Standards Act of 2004, Docket No. M-00051865

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), Docket No. L-00040169

Dear Secretary McNulty:

Enclosed for filing please find an and original and fifteen copies of the reply comments of UGI Utilities, Inc. – Electric Division. A copy of these comments has also been sent electronically to Carrie Beale at cbeale@state.pa.us.

Should you have any questions concerning this filing, please feel free to contact me.

Very truly yours,

Mark C. Morrow

Counsel for UGI Utilities, Inc. – Electric Division

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2006 APR 13
INDEPENDENT REGULATORY REVIEW COMMISSION

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Implementation of the Alternative Energy Portfolio Standards Act of 2004	:	Docket No. M-00051865
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)	:	Docket No. L-00040169

REPLY
COMMENTS OF UGI UTILITIES, INC. - ELECTRIC DIVISION

UGI Utilities, Inc. – Electric Division ("UGI") appreciates this opportunity to submit this reply to the comments filed in the above-captioned proceeding.

THE COMMISSION SHOULD NOT HEED CALLS TO ADOPT DEFAULT SERVICE REGULATIONS IN AN EXPEDITIED FASHION OR, ALTERNATIVELY, SHOULD DEFER THE EFFECTIVE DATE OF ANY REGULATIONS UNTIL 2011

Some of the parties submitting comments at this docket have argued for the rapid adoption of default service regulations to provide guidance in interim POLR proceedings, to provide comfort to investors in electric distribution companies or to provide time to prepare for post-statutory rate cap default service obligations. UGI believes, however, these objectives would either not be advanced by the immediate adoption of default service regulations, or are outweighed by the compelling reasons for deferring immediate action. Accordingly, UGI urges the Commission to defer the adoption of final default service regulations until shortly before 2010 or 2011, when the vast majority of electric

consumers in the Pennsylvania will no longer be subject to statutory rate caps, or to defer the effective date of default regulations until 2010 or 2011.

UGI has consistently argued in both the Commission's Roundtable proceeding and at this docket that the Commission should defer the adoption of default service rules until near the end of the period when most statutory rate caps expire to consider the effects of further developments in wholesale markets, changes in regulatory policies and the outcomes of retail choice programs both in Pennsylvania and other jurisdictions. Based on its long experience in procuring both electric power and gas in wholesale energy markets, UGI has also urged the Commission to not precipitously adopt an auction model for the procurement of wholesale power, and the Commission has wisely left room for differing competitive procurement approaches in its current draft regulations.

Evolving events and conditions during the course of the Commission's evaluation of default service rules have confirmed the wisdom of deferring final action on default service rules and of maintaining the flexibility to adapt to changing conditions and events.

For example, issues associated with the adoption and implementation of the Alternative Energy Portfolio Standards Act have resulted in the reopening of this docket for further public comments, and could lead to changes in the default service regulations that would have been more difficult to implement if the proposed default service regulations had been finalized.

The Commission's investigation of the results of the Pike County Light & Power Company competitive procurement process[1], its consideration of the retail aggregation proposal submitted by Direct Energy, and the recent lack of bidders in the most recent competitive solicitation of the Duquesne Light Company, also show that there may still be much to be learned about how best to procure default service supplies in evolving wholesale power markets, and that flexible and creative approaches may need to be taken to meet local conditions and needs.

Also, the results of the recent competitive procurement processes in Maryland and Delaware have triggered further reviews of competitive procurement policies, and the New Jersey Board of Public Utilities has announced a further review of its auction process for procuring default service supplies.[2] By deferring immediate action, the Commission can have the benefit of reviewing the developing experiences and policies of other jurisdictions in crafting final rules.

UGI believes that the lack of final regulations will not impede the crafting of any further interim default service plans for the few electric distribution companies that are currently out from under the statutory rate cap, and that these interim default service proceedings can provide the Commission with valuable lessons that can be considered in adopting final default service rules and regulatory policies. For example, UGI has been able to operate under interim default service plans using a portfolio and risk management approach that is market-based (UGI procures all of its power in the wholesale markets

[1] In this investigation a coalition of industrial customers filed comments asserting that the locational marginal pricing model used within certain RTOs, including the PJM Interconnection LLC, may not producing appropriate results.

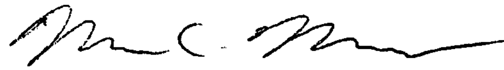
[2] http://www.pcs.state.md.us/pcs/aboutus/Press/MitigationPlanBGE03062006.pdf; http://www.state.de.us/governor/publications/Governors_Energy_Report.pdf; http://bpu.state.nj.us/wwwroot/energy/BGSProceednotice.pdf.

from unaffiliated suppliers), but has produced rates that are significantly below those established through auction processes. UGI has also been able to offer multiple year price protection plans guaranteeing rates over an extended period that have selected by approximately one third of the load and one third of the customers in each customer class that has both provided considerable savings and price certainty. Important experience and lessons have also undoubtedly resulted from the experience gained under other interim default service plans. Moreover, the Commission's proposed default service regulations wisely provide for flexibility in approach, and the immediate adoption of such regulations would not definitively resolve all default service procurement issues as some commenters apparently assume.

UGI would also urge the Commission to cast a skeptical eye on assertions that the immediate adoption of default service regulations is required to assure investors or would facilitate advance preparation. The rapid adoption of default service regulations well in advance of the date such regulations would have applicability to the vast majority of Pennsylvania electric consumers would not mean that the regulations could not be further revised to reflect new regulatory or market developments and, as noted above, the proposed regulations wisely do not prescribe rigid default service procurement rules, but instead permit a variety of competitive procurement policies to be proposed. If an individual electric distribution company needs some regulatory guidance in advance of the date statutory rate caps expire to make necessary preparations, it can always make a filing at the Commission to receive such guidance even if default service regulations are not yet effective. There is also no evidence that investors are clamoring for the adoption of final regulations.

Accordingly, UGI would strongly urge the Commission to defer the adoption of default service regulations until sometime shortly before 2010 or 2011 so that it can evaluate and consider the implications of the still evolving wholesale and retail electric markets, and the results of interim default service plans and approaches within Pennsylvania, and the results of retail choice programs and regulatory approaches in other jurisdictions. Alternatively, should the Commission decide to proceed with the rapid adoption of default service regulations, it should defer the effective date of such regulations until 2010 or 2011 so that it will have the flexibility to make necessary corrections if future events suggest that revisions are necessary to protect the public interest or meet evolving regulatory requirements.

Respectfully submitted,



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Counsel for UGI Utilities, Inc. –
Electric Division

Dated: April 7, 2006

Original: 2463

COPY

(17)

BEFORE
THE PUBLIC UTILITIES COMMISSION OF PENNSYLVANIA

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)	)	**Docket No. L-00040169**
Provider of Last Resort Roundtable	)	**Docket No. M-00041792**

2005 MAY -3 PM 3:53

COMMENTS OF THE
NATIONAL ENERGY MARKETERS ASSOCIATION

Pursuant to the Public Utilities Commission of Pennsylvania's ("Commission") Proposed Rulemaking Order, dated December 16, 2004, and published in 35 Pa.B. 1421, the National Energy Marketers Association ("NEM")[1] hereby submits comments on the proposed regulations governing the obligation of electric distribution companies ("EDCs") to serve retail customers at the conclusion of each EDC's transition period.

The National Energy Marketers Association and its members are pleased to submit NEM's recommendations for an orderly, reliable, competitive, value-driven and consumer-focused electricity market for the Commonwealth of Pennsylvania. NEM has

[1] NEM is a national, non-profit trade association representing wholesale and retail marketers of natural gas, electricity, as well as energy and financial related products, services, information and advanced technologies throughout the United States, Canada and the European Union. NEM's membership includes independent power producers, suppliers of distributed generation, energy brokers, power traders, electronic trading exchanges and price reporting services, advanced metering, demand side management and load management firms, billing, back office, customer service and related information technology providers. NEM members are global leaders in the development of enterprise solution software for energy, advanced metering, telecom, information services, finance, risk management and the trading of commodities and financial instruments. NEM members also include Multiple Service Organizations (MSOs), inventors, patent holders, systems integrators, and developers of advanced Broadband over Power Line (BPL), Power Line Communications (PLC) technologies, and Hybrid-PLC as well. NEM and its members are committed to helping federal and state lawmakers and regulators to implement a consumer-focused, value-driven transition to a reliable, price and technology competitive retail marketplace for energy, telecom and financial related products, services, information and technologies.

developed these recommendations for their equity, efficiency, competitive neutrality, cost to consumers, and related benefits to the Commonwealth of Pennsylvania. Finally, NEM believes that these recommendations. if implemented, should assist Pennsylvania in achieving a competitive transition and post-transition market, while also serving the public interest.

I. <u>The Proposed Default Service Regulations Should Move Pennsylvania Towards a More Competitive Retail Market.</u>

NEM applauds the Commission's policy decisions that recognize: (i) that competitive markets are superior to utility regulation, protection, compliance and enforcement and estimations in utility rate cases for determining "market based" prices for the cost of electric generation; (ii) that the prevailing market price in a competitive market is analogous to just and reasonable utility rates; and (iii) a preference for customer choice, as evidenced by a decision not to restrict the ability of customers to move from Default Service to competitive service.

NEM recommends, consistent with the Commission's statutory authority, that the Commission set a date certain by which the EDCs must exit the merchant function. Furthermore, NEM recommends that the Commission focus its initial efforts in developing the competitive electric market by requiring the utilities to file fully allocated embedded cost-based rates. Proper rate unbundling is a prerequisite to sending proper price signals to educate consumption decisions and permit suppliers to invest risk capital to make competitive product and service offerings available to Pennsylvania consumers. Subsequent to the utilities implementation of embedded cost-based unbundled rates, a competitively neutral migration process may be appropriate to serve customers that have not yet migrated.

II. The Commission Should Establish A Date Certain for EDCs to No Longer Provide Default Commodity Service.

NEM also recommends that the Commission should establish a date certain by which EDCs no longer provider Default Service. As the Electricity Generation Customer Choice and Competition Act (the "Act") recognizes, the Commission has the express authority to require the EDCs to exit the merchant function and to approve an alternative supplier as the entity to acquire "electric energy at prevailing market prices" and to provide Default Service. (66 Pa. C.S. § 2807(e)). By requiring the EDCs to exit the merchant function by a date certain, the Commission will be implementing one of the Act's key policy declarations, *i.e.*, markets are superior to economic regulation in determining the cost of electric generation, as well as the Commission's goal to develop a regulatory framework for Default Service that will "serve the public interest by fostering a robust retail market for electricity." (Rulemaking at 5). NEM agrees wholeheartedly with the Commission's sentiment and urges the Commission to implement this important policy by unequivocally stating an official end date for each EDC to no longer provide Default Service.

By establishing transitional rules that allow EDCs to continue to provide Default Service for an open-ended duration of time, the Commission imposes a significant regulatory risk of continuing, commercial negotiations and/or regulatory filings with no end in sight. The public interest is not properly served by mandating ratepayers to underwrite the high costs, high risks and potential losses associated with commodity trading, hedging and the related functions of the merchant energy business. This is particularly true when private capital is both willing and able to underwrite these costs and risks and to accept losses that are currently borne by captive ratepayers. True

"market solutions" for the formation of a competitive marketplace can be implemented with the Commission approving market participants, not the monopoly EDC, to serve as the Default Service provider.

The Commission already has recognized that regulatory risks can increase the cost of capital significantly when it found that allowing for a longer term of service "may allow a default service provider to attract needed capital investment necessary for the reliable provision of service." (Rulemaking Order at 11). Indeed, some regulatory risks can make a competitive rate of return on invested capital impossible to achieve. Establishing a date certain for EDCs to exit the merchant function is imperative in order to permit market participants an opportunity to manage regulatory risks. The capital and commodity markets need as much regulatory certainty as possible to efficiently price capital. The Commission establishing and sticking to a date certain by which EDCs no longer use their capital and credit to engage in risky commodity purchasing is a very low cost way to lower the cost of capital for both regulated and unregulated investments.

Thus, NEM urges the Commission to permit all stakeholders to rely without concern on the fact that by the end of a clearly defined period for each EDC, Pennsylvania EDCs will no longer be in the commodity supply business. The next step in Pennsylvania's transition to robust retail markets should be the adoption of Default Service regulations that, among other things, encourage, and mandate, if necessary, each EDC to fully exit the merchant function by a date certain.

III. The EDCs' Obligation to Serve Should be an Obligation to Deliver.

NEM encourages the Commission to adopt a long-term vision in which EDC services are defined as those services that only a monopoly can perform and in which

EDCs exit or outsource competitive functions. In particular, reliable EDC delivery services should be separated from competitive commodity supply services. It is no longer in the public interest to continue the EDCs' obligation to serve related to the electricity commodity. However, it is in the critical public interest that the EDCs continue to have an obligation to deliver electricity in a timely, efficient and reliable manner. By removing the obligation to serve a competitive commodity, the EDCs will be able to focus their resources on reliable, cost effective and efficient delivery that the Pennsylvania public both expects and requires.

By separating the obligation to serve into EDC delivery services and competitive supplier commodity services, the Commission potentially will enhance the reliability of electricity supply as well as delivery. NEM submits that the Commission may capture important restructuring dividends for the Commonwealth and its consumers in the form of both competitively-priced electricity and enhanced reliability quality.[2] The public interest would be better served if the EDCs focused on reliability and the competitive suppliers bear the risk of buying and selling volatile commodities. The EDCs should be permitted and encouraged to redeploy capital and credit into reliability-related infrastructure investments, while the competitive marketplace is permitted and encouraged to underwrite the costs and risks of the energy supply/merchant function.

IV. EDCs Must Be Required to Disclose Their Fully Allocated, Embedded Costs to Serve Each Class of Customers.

NEM strongly supports the Commission's decision that "all reasonable, identifiable costs associated with providing default service should be fully allocated to default service rates." (Rulemaking Order at 15). It is imperative that proper embedded

[2] EDC resources historically related to performing competitive functions can be freed up to be reinvested in infrastructure.

cost based unbundled rates be developed to provide consumers proper price signals about default service. In that regard, each EDC must be required to conduct embedded cost of service studies as part of EDC-specific distribution and transmission rate cases.

To assist the Commission in the future "additional on the record" cost of service proceedings (Rulemaking Order at 16)., NEM has attached to these comments a list of electricity functions identified by the New York Public Service Commission in its proceeding on embedded cost based rate unbundling.[3] Functions related to electricity include but are not limited to billing, meter reading, collections, uncollectible debt, customer service, etc. *See* Attachment A. As the Commission has recognized, each EDC must be subject to an embedded cost of service study that determines the "proper allocation of costs to the appropriate rates" for each cost to serve each class of customer in the EDC's service territory. (Rulemaking Order at 16). By properly assigning costs and unbundling competitive services from monopoly services, the Commission will encourage true competition on the basis of pricing, quality of service, and provision of value-added services.

V. Proposed Modifications to the Competitive Procurement Process

Notwithstanding NEM's recommendations to implement embedded cost based rate unbundling at the beginning of the transition, NEM offers the following observations about the proposed default service competitive procurement process.

A. Fixed Price Products are Competitive Offerings that Should be Provided by the Marketplace

NEM is concerned that the proposed rules would permit default service prices to be fixed for extended periods. Even if fixed prices differ seasonally there is a strong

[3] New York Public Service Commission Case 00-M-0504, Order Directing Filing of Embedded Cost Studies, issued November 9, 2001, attachment A.

likelihood that fixed prices will not be reflective of market conditions thereby sending inaccurate pricing signals to consumers. Consumers interested in obtaining fixed price options should be required to obtain such services from the marketplace. Conversely, Default Service should be no-notice, 365 day/7 days a week/24 hours a day commodity service for any customer that is in need of emergency last resort service. Such a service should be a short-term option and priced to reflect all of the risks associated with full, no-notice emergency service. It is anticompetitive to set the Default Service rates at a fixed price for the entire term of the Default Service implementation plan, particularly when the minimum term is one year.

The pricing of commodity to large commercial and industrial customers who can be billed hourly should be based on an hourly, time of use rate. On one hand, the Commission has recognized the importance of accurate pricing for large customers by requiring hourly pricing, but the Commission then overrides the appropriate price signals of hourly pricing by permitting EDCs also to offer fixed priced options for these customers. EDCs should not be permitted to offer fixed pricing for large commercial and industrial consumers. For commodity services to small commercial and residential customers, the commodity component of the Default Service should start with a monthly adjusted, market-based rate to which should be added the fully allocated, embedded costs associated with providing all of the other commodity-related products, services, information and technologies. In addition to the wholesale price of commodity, the costs of providing retail electricity supply includes transmission charges, scheduling and control area services, losses and pool operating expenses, risk management premiums, load shape costs, commodity acquisition and portfolio management, working capital,

taxes, administrative and general expenses, metering, billing, collections, bad debt, information exchange, compliance with consumer protection regulations and laws, and customer care.

B. The Proposed Definition of "Prevailing Market Price" and Default Service Rate Charges Should Be Modified to Represent a Retail Default Service Price

NEM supports the Commission determination that, "in a competitive market the prevailing market price is analogous, though not identical, to the "just and reasonable" standard for utility rates." (Rulemaking at 7). In fact, NEM submits that utility regulation plus the costs associated with estimating via rate cases a "just and reasonable" price are costly proxies for the willingness of privately funded risk capital to compete for customers thereby creating market prices as a by-product.

The source of NEM's concern is the Commission's definition of "prevailing market price" and the charges comprising default service rates that focus on the wholesale market as determinative of default service price without inclusion of the full retail costs of providing this no notice, last resort service. As set forth in proposed Section 54.182 "prevailing market price" is defined as the, "price of electric generation supply for a term of service realized through a default service provider's implementation of and compliance with a Commission approved default service plan." This definition is further explained as the, "price of electric generation supply in the RTO or ISO administered energy markets in whose control area default service is being provided, acquired pursuant to the conditions specified in §§ 54.186(g), 54.187(i) or 54.188(e)." Reading these two parts of the definition together leads to the conclusion that the price of

default commodity service will be a function of wholesale markets only and not reflective of the full retail costs of serving 24 hour/7 days last resort service.

Furthermore, proposed Section 54.187 defines the "generation supply charge" as being comprised of: "(i) The prevailing market price of energy, (ii) The prevailing market price of RTO or ISO capacity or any similar obligation, (iii) FERC approved ancillary services and transmission charges, (iv) Required RTO or ISO charge, (v) Applicable taxes, (vi) Other reasonable, identifiable generation supply acquisition costs." Again, the components of the generation supply charge reference only the wholesale market and do not include the fully allocated embedded retail costs associated with providing retail electric default service as discussed above.

C. Default Service Rate Charges Should Be Unbundled on an Embedded Cost Basis

NEM notes that the Commission has proposed a "customer charge" as part of the default service rate that would include: "Default service related costs for customer billing, collections, customer service, meter reading, and uncollectible debt, (ii) A reasonable return or risk component for the default service provider, (iii) Applicable taxes, (iv) Other reasonable and identifiable administrative or regulatory expenses." NEM submits that structuring the charge in this fashion will not permit migrating customers to receive accurate price signals and will cause migrating customers to pay twice for these services. If a migrating customer is paying to receive these services (such as billing, customer care, etc.) from a competitive supplier, it should not have to continue to pay the utility for these same services. Accordingly, in order to provide consumers with clear and accurate price signals, NEM recommends that the customer charge should be unbundled, on an embedded cost basis.

VI. Qualified Entities Should be Allowed to Provide Default Service.

As the Commission has recognized by proposing regulations that allow an EDC to voluntarily exit the merchant function as well as regulations that allow the Commission on its own motion to require an EDC to exit the Default Service function, an EDC supplying delivery is not inherently more reliable than a contractual obligation to serve by a qualified supplier, unless there are anti-competitive remnants that remain in law or practice. Many competitive suppliers have the scale, capital and scope necessary to act as Default Service providers. In addition, competitive suppliers have risk management assets that historically have not been part of an EDC's business model since the Commission normally has acted as the EDC's risk manager.

While NEM recognizes that the Commission must adopt regulations governing the competitive Default Service provider, the proposed Default Service regulations do not include sufficient detail regarding the operational and fitness requirements for a competitive Default Service provider, nor do they clearly state which certificate of public convenience requirements will be applied to competitive suppliers providing Default Service.

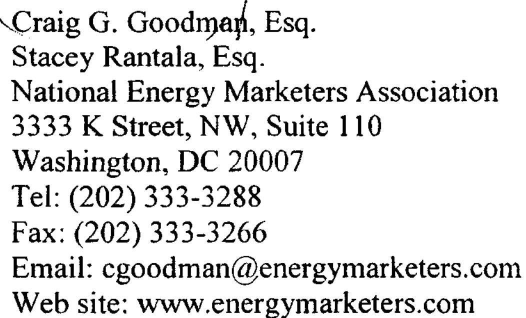
In order not to create artificial barriers to competition, unreasonable requirements must not be adopted for competitive Default Service providers. For example, companies with certain S&P or Moody ratings should be deemed to meet any creditworthiness standards, with other companies able to satisfy such standards through the posting of a reasonable bond. The regulations governing a competitive Default Service provider should be tailored to address the contractual obligations of a qualified supplier to serve

voluntarily, while recognizing that a voluntary contract to serve is a binding obligation to serve.

VII. Conclusion

NEM appreciates this opportunity to offer comments on the Commission's proposed rulemaking for Default Service. NEM suggests that consumers, EDCs and competitive suppliers will be best served by a Default Service regime that is provided by a competitive supplier by a date certain. In the transition prior to that time, utilities should be required to unbundle their rates on an embedded cost basis.

Respectfully submitted,



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Dated: April 25, 2005

Attachment A
Electricity Functions

Supply
- Procurement – including risk management

Non-bypassable Supply
(e.g., NUG contracts, other items that may be EDC specific)

Delivery
- Transmission (including Capital, Operation, Maintenance)
- Distribution (including Capital, Operation, Maintenance)
- System Reliability
- Customer Choice including Supplier Care
- Revenue Protection/Theft
- Metering
- Customer Information Systems
- Energy Services

Metering Services
(e.g., installation, maintenance, testing and removal)

Meter Data Services
(e.g., meter reading, meter data translation, customer association, validation, editing and estimation)

Meter Ownership
(e.g., physical meters)

Billing and Payment Processing
(e.g., printing and mailing bills, receiving and recording payments)

Energy Services

Uncollectibles
- Uncollectibles – supply
- Uncollectibles – non-supply

Customer Care
(e.g., call centers, service centers, complaint handling, emergency call handling, customer accounting, non-routine field activities, customer education and outreach, credit and collections, including special needs programs)
- Customer Care – EDC full/default service and T&D related
- Customer Care – EDC Customer Choice, including Supplier care
- Customer Care – Metering, Billing and Payment Processing

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April 7, 2006

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

VIA OVERNIGHT MAIL

James J. McNulty, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building, 2nd Floor
400 North Street
Harrisburg, PA 17120

Re: Docket No. M-00051865
Implementation of the Alternative Energy
Portfolio Standards Act of 2004

Docket No. L-00040169
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)

Dear Secretary McNulty:

Enclosed please find for filing an original and fifteen (15) copies of Reply Comments of Strategic Energy in the above-referenced cases. A copy this day has been sent by electronic mail to Carrie Beale of your office. Thank you for your assistance in this matter.

Sincerely,

Joseph Kubacki, Jr.
Strategic Energy LLC
jkubacki@sel.com

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Implementation of the Alternative Energy Portfolio Standards Act of 2005	:	**Docket No. M-00051865**
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)	:	**Docket No. L-00040169**

Reply Comments of Strategic Energy

The Reply Comments of Strategic Energy, LLC (Strategic) will focus on the appropriateness of having electric distribution companies (EDCs) or other default service providers (DSPs) enter into long-term contracts for the supply of alternative energy resources and the affect of the alternative energy cost passthroughs by the EDCs.

Long-term supply contracts by EDCs or DSPs, whether for alternative energy or other generation supplies, will create an unlevel playing field for competitive EGSs that could destroy retail competition and would be contrary to the intent of the Competition Act.

Various parties have commented that the Commission should permit electric distribution companies (EDCs) and default service providers (DSPs --- collectively referred to as EDC/DSPs) to enter into long-term contracts to purchase alternative energy resources provided that the price is consistent with market conditions[1] or to ensure price stability[2]. Some parties indicate that long-term contracts are necessary for the development of alternative energy resources or other types of new generation.[3]

1. **Long-term supply contracts involving EDC/DSPs will impede the fluid operation of a competitive retail supply market in Pennsylvania**

If EDC/DSPs are permitted to enter into long-term wholesale supply contracts, default rates will begin to diverge from current market prices. This will cause the competitive retail supply market to destabilize.

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[1] Comments of United States Steel Corporation at page 3.
[2] Comments of the Office of Consumer Council at page 2.
[3] Comments of PennFuture at page 3.

If default rates that are based on long-term supply contracts are lower than short-term market prices, then customers will migrate away from the competitive market to the default supply. This could destroy effective retail competition, as many competitive EGSs may not be able to compete with default rates that are below short-term market prices.

If the converse is true, i.e., that default rates based on long-term supply contracts are greater than short-term market prices, customers will migrate to competitive retail suppliers. Then a problem would arise as to who pays for the high-priced default supply if a substantial amount of default customers move to competitive suppliers (see comments on new PURPA-style contracts below). As customers leave the default supplier, an ever-smaller base of default customers are left to absorb default rates that are above the current short-term supply market prices. This is an untenable result that would likely lead to new customer surcharges. Here the EDC/DSP likely gets a bailout, whereas in the above example of low-priced long-term default supply contracts many EGSs could be forced out of the competitive retail supply market without any recourse.

Squeezing EGSs out of the market in this manner could not be the intent of the Electric Generation Customer Choice and Competition Act (Competition Act). The Competition Act found that (a) it was in the "public interest to permit retail customers to obtain direct access to a competitive generation market"[4]; (b) "competitive market forces are more effective than economic regulation in controlling the cost of generating electricity"[5]; and (c) the procedures established under this chapter were to transition to "a structure under which retail customers will have direct access to a competitive market for the generation and sale or purchase of electricity."[6]

2. Long-term supply contracts by EDC/DSPs could result in a new wave of "PURPA-type" high-priced default generation supply contracts.

During the 1980s the Commission approved a wave of long-term PURPA[7] contracts that included pricing that was well above prevailing short-term market prices for that time. Arguably the Commission did not have much choice in approving those contracts due to the mandates of PURPA. Other states such as California also went down the path of approving many high-priced PURPA contracts. These contracts later became part of the basis for competitive transition charges as we moved into the era of retail electric competition.[8] Now that we are almost clear of those competition transition costs, we should not revert back into the realm of long-term utility-controlled generation contracts. This would impede the fluidity of the competitive retail market, and is not consistent with Competition Act's intent to facilitate retail electric supply competition.

[4] 66 Pa.C.S. Section 2802 (3).
[5] 66 Pa.C.S. Section 2802 (5).
[6] 66 Pa.C.S. Section 2802 (13).
[7] Public Utility Regulatory Policies Act of 1978.
[8] Duquesne Light has also recognized the uneconomic results of the PURPA contracts. See Comments of Duquesne Light Company at page 11.

3. EDC/DSPs could corner the market for renewable generation sources.

As discussed further in the next section, EDC/DSPs would not be corporately responsible for the credit risk associated with purchase of long-term generation supply. This risk would be passed onto customers, presumably default customers. This could likely result in EDC/DSPs being the preferred counter-party for alternative energy suppliers. EGSs could be left to scramble to pick-up short-term supplies at a higher price or being forced to pay the statutory "alternative compliance payment" for alternative energy sources, resulting in an unlevel playing field for EGSs.

4. The significant default/credit risk of long-term alternative energy supply contracts by EDC/DSPs could result in detrimental cost passthroughs to default customers. With cost passthroughs, credit/delivery risks are not likely to be priced into the initial supply prices accepted by EDC/DSPs .

Strategic believes that EDC/DSPs should not enter into long-term contracts for alternative energy resources. An EDC or DSP can pass through to default customers all costs associated with long-term supply contracts. With a long-term supply contract, the purchase risks would be assumed by the default customers and not the EDC or DSP. One such risk is the risk of non-delivery, which can be substantial.[9] The longer the contract, the more risk is involved, the more unfair is the situation that allows the EDC/DSP to pass these costs onto future default customers. While at the same time EGS are left on their own to cover such risk, as it should be for all generation suppliers.

Competitive EGSs would be at a disadvantage in bidding for alternative energy supply contracts as they will be required to price delivery risk into their bid. This would cause competitive suppliers to offer a lower bid price to absorb any delivery or credit risks, potentially losing long-term alternative energy supply contracts to an EDC or DSP that could offer a higher initial supply price and pass these risks (should they materialize) on to default customers at a later time.[10] This results in an unlevel playing field for EGSs.

5. EDC/DSPs should not be able to create non-bypassable surcharges if long-term contracts turn out to be uneconomic.

As discussed above, long-term generation supply contracts with EDC/DSPs have the potential to be uneconomic compared to future shorter-term market prices. If such a result comes to fruition, customers that are not on default service (i.e., competitive supply customers)

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[9] See, for example, Building a "Margin of Safety" Into Renewable Energy Procurements: A Review of Experience with Contract Failure (January 2006). Prepared by KEMA, Inc. for the California Energy Commission. The Abstract on page 2 states that "the data suggests that a **minimum** overall contract failure rate of 20 to 30 percent should generally be expected for large solicitations conducted over multiple years. (Emphasis in original.)

[10] If such a default occurs the EDC/DSP would just pass through to default customers any premiums associated with cover supplier, without any recovery risk to the EDC/DSP. Specifically, 66 Pa.C.S. Section 2807(e)(3) provides that in this situation the EDC/DSP "shall recover fully all reasonable costs."

should never be saddled with the obligation of paying surcharges on high-priced EDC/DSP supply contracts that they did not intend to use. Some EDCs believe that costs associated with long-term alternative energy supply contracts should be recoverable through a non-bypassable cost recovery mechanism.[11]

It is likely that competitive supply customers would not want the EDC/DSPs to enter into long-term contracts on their behalf. To saddle competitive retail supply customers with non-bypassable costs associated with EDC/DSP alternative energy contracts intended for default service would be patently unfair. Competitive supply customers wishing to rely on service from competitive EGS will not benefit from long-term supply contracts of EDC/DSPs. Therefore such competitive supply customers should not have to be concerned with being forced to pay for uneconomic long-term EDC/DSP supply contracts that they did not intend to use. A good example would be a customer that enters into a long-term multiple-year supply contract with an EGS. Such a customer should not be expected to pay a subsequent surcharge due to an uneconomic long-term supply contract entered into by an EDC/DSP. This dilemma can be avoided by simply not allowing EDC/DSPs to enter into long-term supply contracts.

6. Under no circumstances should an affiliate of an EDC or DSP be allowed to enter into supply contracts with their affiliated EDC or DSP.

The potential for self-dealing is evident and certainly the appearance of a potential self-dealing situation should be avoided. This type of protocol would enhance real competition in the state's generation and supply sector and would preserve consumer confidence in the integrity of the competitive supply system. Affiliates that should not contract with the EDC/DSPs should be broadly defined and include competitive supply affiliates, wholesale supply affiliates, or affiliated generation companies.[12]

7. The Commission should wait to assess the impact of federal renewable tax credits, which will likely result in a surge of alternative energy resources.

The federal Energy Policy Act of 2005 included substantial incentives for the development of renewable resources, including the extension of Section 45 tax credits for certain renewable energy projects that will be built and in service before December 31, 2007. It is our understanding that a significant number of renewable project developers are earnestly working to complete renewable projects before this deadline to take advantage of these tax credits.

[11] Duquesne Light in their comments suggests that "default service providers could enter into long-term alternative energy contracts, and recover costs using a separate non-bypassable cost recovery mechanism." Comments of Duquesne Light Company at page 11.

[12] For example, Duquesne Light Company's affiliates include Duquesne Light Energy and Montauk Energy Capital including its subsidiaries Waste Energy Technology and GSF Energy. Among other things, Montauk and its subsidiaries own and operate landfill gas facilities and have experience in using landfill gas to generate electricity.

8. **Other states have met their renewables mandates without resorting to long-term alternative energy supply contracts by EDC/DSPs.**

Texas[13] and Massachusetts[14] have significant renewable energy goals that are currently in effect. These states have not experienced the need to approve any long-term renewable supply contracts by EDC/DSPs. In Texas, renewables have developed without long-term EDC/DSP supply contracts. To the contrary, Texas' renewables goals were revised upward by the state as progress on the initial goals has exceeded expectations.[15] Massachusetts has various incentive programs in place to foster renewables development, including the use of renewables floor prices to spur development.[16]

The Commission should take a "wait and see" approach to evaluate the progress of development of alternative energy resources. In the event that further incentives are needed, the Commission should consider a Massachusetts-style approach that provides incentives to alternative energy supply developers from proceeds of the alternative compliance payments or if necessary some other type of incentive that applies to all qualified renewables facilities or to all generation suppliers. The Commission should not create programs that apply just to EDC/DSPs but not to EGSs, e.g., long-term supply contracts with the ability to pass through risks of default only applicable to EDC/DSPs. Any such distinction could serve to impede the development of a fluid competitive retail electric supply market in Pennsylvania.

9. **Customers wishing to obtain price stability can and should lock-in long-term prices through a competitive EGS. This is consistent with the intent of the Competition Act.**

One of the primary benefits of a competitive retail electric supply system is to provide customers with potentially unlimited choices. The Commission should not favor long-term supply contracts by EDC/DSPs just because a current market cycle has experienced a price upturn. This is the nature of any competitive marketplace. More recently market prices have trended down from the highs experienced in the fall of 2005. Such price fluctuations define and create efficiency in the marketplace.

Customers that want price certainty can contract with EGSs. The Competition Act was passed to allow for and encourage just such a choice. The Competition Act found that

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[13] 25 PURA Section 25.173(h)(1) requires certain defined renewable capacity in the amount of: 2280 MW by 1/1/07, 3272 MW by 1/1/09, 4264 MW by 1/1/11, 5256 MW by 1/1/13, and 5880 MW by 1/1/15.

[14] The Massachusetts Electric Utility Restructuring Act (Chapter 164, Acts of 1997) requires certain defined renewables in the amount of 2.0% by 1/1/05, 2.5% by 1/1/06, 3.0% by 1/1/07, 3.5% by 1/1/08, 4.0% by 1/1/09 and increases of 1% per year thereafter until ended by the Massachusetts Division of Energy Resources.

[15] 2005 Report to the 79th Legislature, Scope of Competition in the Electric Markets in Texas, Public Utility Commission of Texas, January 2005.

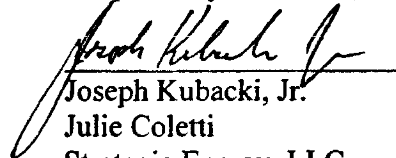
[16] This floor price program is run by the Massachusetts Technology Collaborative (MTC). The MTC establishes periodic auctions as asks the renewables developers bid projects to be built based on receiving a certain floor prices from MTC. If the project is accepted, the project can use the floor price at any time or instead sell the output to the market if prevailing prices or higher. This floor price or price option is funded from proceeds derived from alternative compliance payments.

"competitive market forces are more effective than economic regulation in controlling the cost of generating electricity."[17] If the Commission begins to allow long-term supply contracts for EDC/DSPs, they will increasing become the primary electricity supply providers, potentially driving out competition, limiting choices for customers, and generally reverting back to the old way of the utility-dominated supply business. For the reasons expressed above, long-term contracts by EDC/DSPs can have the potential to destroy the competitive retail market structure that currently exists and does not further the intent of the legislature under the Competition Act to enhance a competitive retail market structure.

10. The meaning of "prevailing market prices" should be interpreted in a manner consistent with the legislative intent of the Competition Act to create and maintain a competitive retail market structure.

Pa.C.S. Section 2807(e)(3) provides that if a customer does not choose an alternative electric generation supplier, an EDC or DSP shall acquire electric energy at "prevailing market prices" to serve that customer and shall recover fully all reasonable costs. If EDC/DSPs enter into long-term supply contracts, EDC/DSPs will create a market disparity that is contrary to the efficient operation of a competitive supply market and the intent of the Competition Act. Therefore, to be consistent with the legislative intent to create a competitive retail supply market, EDC/DSPs should rely on prevailing market prices in the short-term supply market.

Respectfully submitted,



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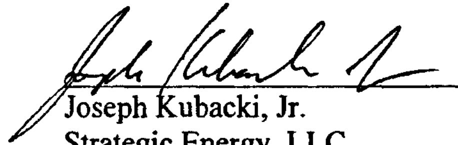
Date: April 7, 2006

[17] 66 Pa.C.S. Section 2802(5).

CERTIFICATE OF SERVICE

I hereby certify that I have served a copy of this document upon each person designated on the official service list compiled by the Secretary in this proceeding by hard copy mailing or electronic mailing, where appropriate.

Dated at Pittsburgh, PA this 7th day of April, 2006.



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COMMONWEALTH OF PENNSYLVANIA

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April 7, 2006

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Re: Implementation of the Alternative Energy Portfolio Standards Act of 2004
Docket No. M-00051865

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)
Docket No. L-00040169

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Dear Secretary McNulty:

I am delivering for filing today the original plus fifteen copies of the Reply Comments on behalf of the Office of Small Business Advocate in the above-captioned matter. In accordance with your Secretarial Letter dated February 8, 2006, I have also e-mailed the Comments to Carrie Beale.

If you have any questions, please contact me.

Sincerely,

William R. Lloyd, Jr.
Small Business Advocate

Enclosures

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Implementation of the Alternative Energy Portfolio Standards Act of 2004	:	Docket No. M-00051865
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)	:	Docket No. L-00040169

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**REPLY COMMENTS OF THE
OFFICE OF SMALL BUSINESS ADVOCATE
IN THE REOPENED PUBLIC COMMENT PERIOD**

I. INTRODUCTION

The Electricity Generation Customer Choice and Competition Act ("Competition Act"), 66 Pa.C.S. Ch. 28, provides that, after the recovery of stranded costs, generation rates are to be determined through market forces rather than through traditional rate base/rate of return/energy clause regulation. To that end, each Electric Distribution Company ("EDC"), or an approved alternative default service provider, is to acquire electric energy "at prevailing market prices" to serve those customers who do not choose an Electric Generation Supplier ("EGS") or whose EGS fails to deliver. *See* 66 Pa.C.S. § 2807(e)(3).

Section 2807(e)(2) requires the Pennsylvania Public Utility Commission ("Commission") to promulgate regulations to define the EDC's obligation under Section 2807(e)(3). To assist in the rulemaking process, the Commission convened the Provider of Last Resort ("POLR") Roundtable at Docket No. M-00041792 and sought written and oral comments from interested

parties. The Office of Small Business Advocate ("OSBA") provided written comments and reply comments and made an oral presentation as part of the POLR Roundtable.

By Order entered December 16, 2004, the Commission closed the docket at M-00041792 and initiated a proposed rulemaking at Docket No. L-00040169. The proposed rulemaking was published on February 26, 2005, in the *Pennsylvania Bulletin*, at 35 Pa.B. 1421. On April 27, 2005, the OSBA filed initial comments. On June 27, 2005, the OSBA filed reply comments.

By Order entered November 18, 2005, the Commission reopened the public comment period. By Secretarial Letter dated February 8, 2006, the Commission requested interested parties to provide written comments on a specific list of questions and issues as well as on any other issues related to cost recovery under the act of November 30, 2004 (P.L. 1672, No. 213), known as the Alternative Energy Portfolio Standards Act ("Act 213"), 73 P.S. §§ 1648.1-1648.8.

On March 8, 2006, the OSBA submitted its Initial Comments in the Reopened Public Comment Period.

By the aforementioned Secretarial Letter dated February 8, 2006, the Commission also invited interested parties to reply to the Initial Comments of other parties. The OSBA rests on its Initial Comments as its response to the specific questions posed by the Commission.[1] However, the OSBA submits the following in response to Initial Comments by other parties which addressed issues beyond the Commission's specific questions.

[1] The OSBA notes that it previously addressed some of those questions in its comments and reply comments in the first public comment period at Docket No. L-00040169. Those previous comments and reply comments are incorporated herein by reference.

II. REPLIES TO THE COMMENTS OF OTHER PARTIES

A. Procurement Method

1. Position of the Parties

Beginning with the POLR Roundtable, parties have offered differing proposals on how default service electricity should be acquired. In that regard, the OSBA has recommended the use of a statewide procurement process after all generation rate caps have expired.[2] Under the OSBA's proposal, the statewide process would be used to acquire default service electricity for 2011 and thereafter.

In their Initial Comments, numerous parties renewed the debate about overall default service procurement as part of their discussion of the role, if any, which should be played by long-term contracts for electricity from alternative energy sources.

For example, Duquesne Light Company ("Duquesne") pointed to the high prices in the most recent competitive solicitations in New Jersey, Delaware, and Pike County Light & Power Company ("Pike") as evidence that the competitive procurement model is flawed, that the wholesale market may not be fully functional, and that some alternative to an RFP or an auction should be permitted. As possible alternatives, Duquesne suggested setting an EDC's default service rates on the basis of other electricity prices in the region, on the basis of a market price formula, or through other means (such as long-term contracts for the procurement of electricity from alternative and non-alternative energy sources).[3]

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[2] The statewide procurement process could be either an auction or a Request for Proposals ("RFP").

[3] Duquesne's Initial Comments, pp. 2-4, 7, and 10.

Similarly, the Office of Consumer Advocate ("OCA") pointed to rate shock in Pike, New Jersey, Delaware, and Maryland as support for requiring an EDC to meet its default service obligation by assembling a portfolio of resources, including long-term contracts.[4]

Furthermore, PPL Electric Utilities Corporation ("PPL") argued that an EDC should have the option to use a default service procurement process other than a standard RFP or auction and should be allowed to rely on long-term contracts as part of the mix.[5]

2. Mitigating Rate Shock

The OSBA shares the stated intent of Duquesne, the OCA, and PPL to achieve the most reasonable default service rates possible. However, the OSBA questions whether any of the procurement models suggested by those parties would have avoided the rate shock experienced in New Jersey, Delaware, and Maryland—or the rate shock Pike would have experienced even if it had not been conducting an auction immediately following Hurricanes Katrina and Rita. The simple fact is that the market price of electricity rose substantially in late 2005. Although prices have declined since the hurricanes, they are still considerably higher than they were in 2004 when the Commission approved the current default service plans for Duquesne and for UGI Utilities-Electric Division.[6] Therefore, rate shock is a distinct possibility when existing generation rate caps expire, regardless of what method is used to satisfy the statutory requirement to acquire default service electricity at prevailing market prices. Moreover, the requirements of Act 213 are likely to exacerbate that rate shock.

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[4] OCA's Initial Comments, pp. 2-4, 9-10, and A-1.

[5] PPL's Initial Comments, pp. 4-6.

[6] *See Petition 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); and *Pennsylvania Public Utility Commission v. UGI Utilities Inc.-Electric Division, Petition of Office of Small Business Advocate*, Docket No. R-00017033 (Order entered May 28, 2004).

In an effort to mitigate rate shock, the Commission should promulgate final form regulations which make the wholesale market as attractive as possible to potential suppliers.

First, the Commission should require that an EDC's rates for each customer class, and for each customer within each class, be as close as practicable to prevailing market prices. Such an alignment could be achieved by bidding by rate class, modernizing the EDC's generation cost allocation methodology, or making the rate design in EDC tariffs more consistent with competitive market price patterns. In addition to helping eliminate inter-class and intra-class subsidies, setting prices for each customer reasonably close to market would reduce the risk faced by potential wholesale suppliers that customers will opt out of default service and shop. Therefore, if rates were aligned with market prices, wholesale suppliers should be able to eschew part of the risk premium they otherwise would include in their bids.[7]

Second, the Commission should require EDCs to bid a variety of different portions of their load at different times and for different supply durations. As vividly demonstrated in Pike, a single-day procurement of an EDC's entire load for two full years provides virtually no diversification to either suppliers or customers. Under the Pike approach, the winning wholesale supplier faces a huge risk that the actual market prices at some time during the two-year period will be well below market prices, thereby resulting in shopping (and stranded costs for the

---

[7] The OSBA has consistently supported designing default service rates for small commercial and industrial customers in a way that represents a reasonable balance between precisely matching short-term prevailing market prices and offering a product with a fixed price. The OSBA observes that small business customers tend to be uncomfortable with electric rates that vary frequently with market cycles and are more comfortable with prices that are fixed for some reasonable duration. Offering "ugly" default service to small business customers would simply increase the risk that they will opt out of default supply for competitive alternatives, if those alternatives develop. Wholesale suppliers would necessarily reflect that higher risk in their bids.

supplier). Likewise, default service customers face the risk that little retail competition will develop and they will be exposed to huge rate increases with no alternatives.[8]

Although spreading out the purchase of an EDC's load could result in using some long-term supply options, the OSBA recommends against undue reliance on long-term supplies. The OSBA is skeptical about the ability of EDCs to outguess the market when they acquire the various components of their portfolio. Therefore, the OSBA believes that default service rates set solely on the basis of long-term contracts are as likely to be above market as they are to be at or below market.

Furthermore, even if each individual EDC were to use a competitive process to acquire its portfolio (including long-term contracts), the market for the individual components of that portfolio could be very thin, particularly for some of the smaller EDCs in Pennsylvania. For example, an effort to acquire default service for the District of Columbia through contracts of longer than three years' duration drew no acceptable bids. If there were only limited competition by generators to provide default service electricity under long-term contracts, it would be difficult for the Commission to evaluate the reasonableness of such contracts.

3. Statewide Procurement Process

In the OSBA's view, a statewide procurement process continues to offer the best opportunity to get reasonable prices and to mitigate volatility. Such a process could take one of two basic forms: 1) an auction or RFP in which wholesale suppliers bid on a percentage of the statewide load without regard to individual EDCs, or 2) an auction or RFP in which each EDC seeks bids on its own load but does so under the same general rules as the other EDCs.

[8] The OSBA suggests that the Pike approach, were it used by a natural gas distribution company, would likely be deemed imprudent.

Under the first approach, the prospect of selling no electricity to any of the major Pennsylvania EDCs should assure greater participation by wholesale suppliers than a process limited to a single EDC, particularly in the case of the smaller EDCs. In addition, the ability to seek bids on many more tranches than needed by a single EDC should facilitate bidding by rate class, thereby enabling the Commission to avoid the need to develop a cost allocation methodology for translating systemwide wholesale bids into class retail rates. Furthermore, because of the size of the statewide load, EDCs could purchase a significant quantity of electricity for 2011 in each quarter (or even each month) of 2010, thereby reducing the risk of a price spike caused by the weather or an international event. Such diversification would provide risk reduction benefits to both default service customers and wholesale suppliers.

Under the second approach, congestion costs could be matched to the service territory in which congestion is a significant problem rather than spread across the state on an average basis. However, even with bidding on the basis of individual EDCs, the Commission should standardize the procurement approach and, to the extent possible, the specific terms of the procurement for each EDC. Giving each EDC the leeway to specify its own peculiar terms and conditions in the supply agreement would add complexity and cost to the procurement process.

The Commission should also coordinate the timing of the procurements. Bidder interest in a single EDC should be greater if all or most of the EDCs are procuring some specific portion of their load on the same day. [9] Such coordination of timing should also make it easier to bundle the loads of several EDCs together for bidding purposes. Moreover, acquiring electricity for all EDCs at the same time would reduce the differences in default service rates throughout the Commonwealth.

[9] The OSBA understands that the New Jersey statewide procurements follow this approach.

Finally, the Commission should encourage multiple EDCs to combine their loads for bidding purposes, thereby likely increasing participation by wholesale suppliers and making it easier to bid by rate class and to acquire portions of the load at different times and for different durations. Such a bundling could be especially valuable to small EDCs which might not attract a significant number of bidders on their own.

B. <u>Recovery under Section 1307</u>

In addressing the Commission's questions about blending the costs of electricity from alternative energy sources with the costs of electricity from non-alternative energy sources, several parties renewed the debate over the extent, if any, to which default service rates should be reconcilable.

Section 3(a)(3) of Act 213 provides that costs incurred by an EDC for the purchase of electricity from alternative energy sources and costs for the purchase of alternative energy credits shall be recovered "pursuant to an automatic energy adjustment clause under 66 Pa.C.S. § 1307 as a cost of generation supply under 66 Pa.C.S. § 2807."

In its Initial Comments (as well as in its previous comments at Docket No.L-00040169), the OSBA proposed that the Commission allow an EDC to waive recovery of its alternative energy costs through a Section 1307 surcharge if that EDC is acquiring electricity from alternative and non-alternative energy sources on a combined basis through a single RFP or auction and if that EDC is recovering the costs of that electricity through "blended" rates.

In contrast, numerous other parties argued in their Initial Comments that because an EDC is entitled to use a Section 1307 surcharge to recover alternative energy costs, EDCs should use a

Section 1307 surcharge to recover the costs of *all* electricity acquired for default service customers.[10]

The OSBA recognizes that Section 1307 has been used in the past for the recovery of fuel costs and purchased power costs, but the General Assembly neither stated nor implied in the Competition Act that *any* default service costs may be recovered through such a surcharge. Furthermore, the legislature explicitly provided in Act 213 for recovery of *alternative energy costs* under a Section 1307 surcharge. If the legislature had thought that either Section 1307 or the Competition Act already permitted recovery of default service costs through a surcharge, it would have been unnecessary to include explicit language in Act 213 authorizing a Section 1307 surcharge to recover the alternative energy portion.

The Commonwealth Court has rejected the Commission's attempt to authorize wastewater utilities to collect certain investments in collection systems through a Section 1307 surcharge. Critical to the Court's holding was the fact that the General Assembly explicitly authorized the use of a surcharge for the collection of water distribution system improvements but did not do so with regard to wastewater collection system improvements. *See Pennsylvania Public Utility Commission v. Popowsky*, 869 A.2d 1144 (Pa. Cmwlth. 2005), appeal denied ___ A.2d ___ (Pa. 2006). In view of that holding, the OSBA does not believe that the Commission has the legal authority to permit recovery of non-alternative energy costs through a Section 1307 surcharge.

The OCA also argued in its Initial Comments that a single Section 1307 surcharge should be used for alternative and non-alternative energy costs because having two separate generation

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[10] OCA's Initial Comments, pp. 11-12 and A-6; PPL's Initial Comments, p. 11; Initial Comments of the Exelon Companies ("Exelon"), pp. 5 and 10; and Initial Comments of Citizens' Electric Company and Wellsboro Electric Company ("Citizens'/Wellsboro"), p. 3.

cost lines on a customer's bill would complicate shopping.[11] However, it should be possible to show only one generation cost line on a customer's bill, which line equals the sum of the non-alternative energy rate and the alternative energy rate. Furthermore, if the goal is to facilitate shopping, then reconciliation should be minimized, in that the EGSs contend that reconciliation is a barrier to shopping.[12]

C. Hourly Pricing

In their Initial Comments, the Industrial Energy Consumers of Pennsylvania, *et al.*, ("IECPA"), suggested that electricity acquired for industrial customers on the basis of hourly pricing will not include electricity generated from alternative energy sources.[13]

Assuming that IECPA is correct, an EDC will have to meet its Act 213 obligation entirely from the electricity it acquires for default service customers who are not on hourly pricing. An EDC's Act 213 obligation is calculated on the basis of the quantity of electricity it sells to *all* default service customers, regardless of whether those customers are on hourly pricing or are not on hourly pricing. Therefore, both hourly-priced and non-hourly-priced customers should share in paying for the cost of complying with Act 213. In the case of hourly-priced service customers, the EDC could forecast the cost of complying with Act 213 for a subsequent calendar year. This cost estimate could then be added to hourly prices on a per kWh basis for that future year. Finally, at the conclusion of the future year, the EDC could "true-up" its compliance cost forecast with its actual compliance costs and adjust hourly prices, as appropriate, for the next future year.

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[11] OCA's Initial Comments, A-6.

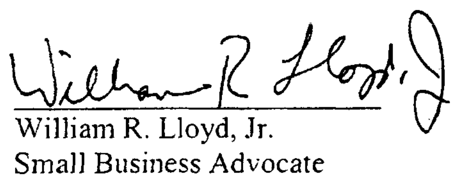
[12] Initial Comments of Strategic Energy, LLC ("Strategic"), p. 3; Initial Comments of Dominion Retail Inc. ("Dominion"), pp. 2-3.

[13] IECPA's Initial Comments, pp. 18-19.

III. CONCLUSION

The OSBA respectfully requests that, in promulgating default service regulations and any additional regulations needed to implement Act 213, the Commission consider the aforementioned reply comments.

Respectfully submitted,



William R. Lloyd, Jr.
Small Business Advocate

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Dated: April 7, 2006

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April 7, 2006

Carrie Beale
PA Public Utility Commission
Bureau of Conservation, Economics & Energy Planning
cbeale@state.pa.us

VIA E-MAIL

Docket No. M-00051865 — Implementation of the Alternative Energy Portfolio Standards Act of 2004

Docket No. L-000410169 — Rulemaking RE Electric Distribution Companies' Obligations to Serve Retail Customers at the Conclusion of the Transition Period Pursuant to *66 PA. C.S. § 2807(e)(2)*

Dear Ms Beale:

To follow, please find the reply comments of PPM Energy regarding the Implementation of the Alternative Energy Portfolio Standards Act of 2004.

Respectfully submitted,

Roby J. Roberts
Director
Policy and Regulatory Affairs

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PENNSYLVANIA PUBLIC UTILITIES COMMISSION

Docket No. M-00051865	Implementation of the Alternative Energy Portfolio Standards Act of 2004
Docket No. L-000410169	Rulemaking RE Electric Distribution Companies' Obligations to Serve Retail Customers at the Conclusion of the Transition Period Pursuant to *66 PA. C.S. § 2807(e)(2)*

REPLY COMMENTS OF PPM ENERGY

PPM Energy, a developer and owner of wind power facilities, previously commented in response to the Secretarial Letter of February 8, 2008 seeking comments regarding Implementation of the Alternative Energy Portfolio Standards Act of 2004 (AEPS) and the 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). PPM Energy would like to take this opportunity to submit reply comments in this matter.

PPM Energy wishes to offer comments on two topics: (1) long-term contracts and pricing and (2) *force majeure*.

Long-Term contracts

Many of those who commented on this issue supported the option of long-term contracts for alternative-energy resources, as does PPM Energy, and we strongly urge the Commission to give full weight to those comments. We particularly commend to the Commission's attention the discussion of this issue by the Office of the Consumer Advocate (OCA), which rightly argues that long-term contracts for alternative energy resources will provide the consumers of the Commonwealth an important benefit: "reasonable and stable prices." As the OCA notes, long-term contracts for alternative energy resources can provide a "hedge against price volatility." The cost of fuel to operate a wind farm is *zero*. The Commission should recognize this signal virtue of wind and encourage long-term contracts for alternative resources to ensure that electricity consumers can take advantage of the price stability that this vast, local resource can provide.

In addition, PPM urges the Commission to accept the arguments of the OCA regarding the definition of "prevailing market price." As the OCA wrote in its "Supplementary Comments" in response to the Commission's Secretarial Letter of February 8, 2006 :

> *The OCA has consistently maintained that the phrase [prevailing market price] includes a range of generation products of varying lengths and is not synonymous solely with spot prices or prices in the short-term energy markets. As long as a generation product is competitively procured, the price that is arrived at will constitute the "prevailing market price" for that product at the time it is procured . . . .*

When using the phrase "long-term contracts," PPM Energy would define that to mean a minimum of ten (10) years, although fifteen (15) years would be preferable. Contracts of 10-15 years will be most effective in providing consumers with protection against price volatility and ensuring that project developers can arrange the financing necessary to bring new alternative energy generation on-line.

<u>Force Majeure</u>

In its comments, the Office of the Small Business Advocate (OSBA) has argued that the Commission should be able to declare a condition of *force majeure* to exist if prices for alternative energy were to be "unreasonable." OSBA goes on to suggest that the Commission establish a percentage limit above commodity electricity prices as the "reasonable" price for alternative-energy sources.

OSBA is creating a proposition out of whole cloth, and it should be rejected. Nothing in the Alternative Energy Portfolio Standards Act of 2004 provides for invoking *force majeure* based on prices. The Act specifically refers to ". . . alternative energy resources [being] reasonably available in the marketplace in <u>sufficient quantities</u> .. ." (emphasis added). The Act allows for the recovery of costs of alternative resources, indicating that the Legislature fully understood that alternative resources could cost more than undifferentiated commodity electricity, but the Act does not explicitly set a ceiling on the price of the required resources.

The alternative compliance payment of $45 is likely to work as effective price ceiling on alternative resources, and there is no reason or basis in the law for the Commission administratively to set a price cap on alternative resources. Robust competition among alternative energy resources will discipline

prices, and the Commission should concentrate on establishing the conditions necessary to foster the development of eligible resources.

Force majeure is by definition a surprising and unexpected event. PPM Energy respectfully argues that the Commission must communicate clearly to all Electricity Suppliers that the AEPS obligation is an obligation that is every bit as essential as the obligation to provide customers with a reliable supply of electrons. The goal should not be to devise ways to short-circuit the AEPS requirement but to ensure that it is met fully. There are profoundly important reasons to advance the development of alternative-energy resources, which the Legislature recognized by enacting the AEPS. As the majority of those commenting in this docket have stated, the Commission should move decisively to put rules in place to ensure that the contracting and development of new resources will occur in a timely manner. Electricity Suppliers should be required to begin their planning and procurement of alternative energy resources now, so they will be able to meet their AEPS obligations fully when the time comes.

By moving decisively and establishing the right expectations, the Commission can make certain that *force majeure* will, in fact, be unlikely ever to occur.

Thank you for your consideration of these views.

KLETT ROONEY LIEBER & SCHORLING

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April 7, 2006

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INDEPENDENT REGULATORY REVIEW COMMISSION

VIA HAND DELIVERY

James J. McNulty, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17120

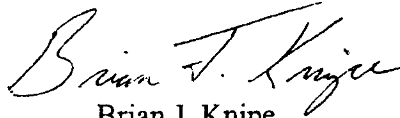
Re: Implementation of the Alternative Energy Portfolio Standards Act of 2004, Docket No. M-00051865

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), Docket No. L-00040169

Dear Secretary McNulty:

I have enclosed for filing an original and fifteen copies of Reply Comments of Reliant Energy, Inc. on Proposed Default Service Rulemaking. Please call me if you have any questions.

Very truly yours,



Brian J. Knipe
For KLETT ROONEY LIEBER & SCHORLING
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BJK/eh

Enclosures

cc: Carrie Beale (via e-mail at cbeale@state.pa.us, w/encl.)

PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17105-3265

Implementation of the Alternative Energy Portfolio Standards Act of 2004 — **Docket No. M-0051865**

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) — **Docket No. L-00040169**

INDEX TO REPLY COMMENTS OF RELIANT ENERGY, INC. ON PROPOSED DEFAULT SERVICE RULEMAKING

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PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17105-3265

Implementation of the Alternative Energy Portfolio Standards Act of 2004	**Docket No. M-0051865**
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)	**Docket No. L-00040169**

REPLY COMMENTS OF RELIANT ENERGY, INC. ON PROPOSED RULEMAKING ORDER

Reliant Energy, Inc., ("Reliant") is pleased to offer reply comments in the Pennsylvania Public Utility Commission's ("Commission") proposed rulemaking ("Rule") for default service in the Commonwealth. Reliant will be responding to various parties on the following issues:

1) Long-term contracting for alternative energy resources;
2) Long-term contacting for default service supply;
3) Reconciliation of Alternative Energy Portfolio Standards ("AEPS") costs; and
4) Reconciliation of default service costs.

Introduction

BP Solar, the Pennsylvania Department of Environmental Protection, and DTE Energy Company among others support long-term contracting for renewable resources. As explained in Initial Comments,

Reliant does not support the use of regulatory-mandated long-term contracting for alternative energy resources or extraordinary reconciliation of AEPS costs.[1] Reliant, like other Electric Generation Suppliers ("EGS"), and as a wholesale generator, believes that regulatory-mandated contracting and ex-post reconciliations[2] for renewable resources will have detrimental effects on the development of a competitive retail market.[3] Further, establishing default service prices through long-term contracts allows the default prices to become out- of-market for sustained periods, which creates a barrier to entry for competitive providers or force customers to bear the costs through regulatory-based long-term contracts.[4] Furthermore, allowing default service prices to be reconciled ex-post can cause unintended results that will ultimately harm a competitive market.

Reply Comments

1) Long-term contracting for alternative energy resources

In its Initial Comments on the Commission's Issue List filed on March 3, 2006, Reliant stated that mandatory long-term contracting is not

[1] Cost recovery for alternative energy resources is provided for in Reliant's Market Responsive Pricing ("MRPM") Proposal through the market adjustment mechanism that the default service provider would use to adjust the default service price for changing market conditions.
[2] Under Reliant's MRPM, the default service provider can make a financial integrity filing if needed.
[3] Constellation Energy and Direct Energy Services commented on the impact of long-term contracting for renewables on a competitive market. Dominion Retail, and Strategic Energy also commented on the impacts of renewable cost reconciliation.
[4] Recent developments regarding Pike County show that locking customers into long-term contracts may not be a desired result.

necessary for the development of alternative energy resources. Act 213 established the level of alternative compliance payments. Thus, other than the rules to comply with the statutory requirement and the means to account for compliance, regulating the terms and conditions of contractual arrangements in the competitive marketplace is unnecessary. In fact, there is market evidence that renewable contracting can occur without regulated procurement.[5]

With rules that clearly state the annual AEPS requirements for both EDCs and EGSs, these companies will procure in the manner that best fits their own procurement strategy. If the default service provider wants to pursue long-term contracts with alternative energy resources to meet their Act 213 obligations, they can. However, they should do so with the risk being borne by their shareholders, not ratepaers.

2) Long-term contracting for default service supplies

Several EDCs[6], along with the Office of Consumer Advocate ("OCA") filed comments that supported the ability of the EDCs to pursue long-term contracts for default service supply at their discretion. These

[5] As part of its restructuring legislation passed in 1999, Texas did not require default service providers to procure any resources through long-term contracts, including renewable energy. Texas initially called for 2000 MWs by 2009, with the level raised to 5000 MWs by 2015 during a 2005 legislative session. Even without a requirement that default service providers procure resources through long-term contracts, Texas has met its annual renewable resource requirements. Since 1999, an influx of 2055 MWs of renewable resource capacity has been installed in Texas. https://www.texasrenewables.com/publicReports/rpt5.asp

[6] Citizens and Wellsboro Electric Company, FirstEnergy. Exelon Companies, and PPL Electric Utilities Corporation

EDCs are attempting to craft a default service rule that allows them as much latitude as they desire to procure supply and price default service, but at the same time minimizing their risk by shifting it to customers. While such a format is understandable in a regulatory paradigm, if crafted incorrectly, default service structured in such a manner will not allow a competitive market to develop.

In its Initial Comments in the POLR Rulemaking filed April 27, 2005, Reliant supported the default service provider being able to procure supply in any manner it chooses, so long as the default service provider was a competitive affiliate of the utility.[7] In this scenario, the default service provider is free to pursue long-term contracts if it desires, but it also assumes the risk of those contracts becoming out-of-market, not its default service customers.

The problem with the utility pursuing long-term contracts is the regulated structure under which it recovers expenditures from customers. The utility simply passes on supply costs to customers, with presumed Commission approval, and recovers the cost regardless of the effectiveness of such a procurement process. That is just one anti-competitive reason to prevent such events from occurring. Pennsylvania ratepayers went through one round of stranded cost recovery already, and do not need to have a

[7] Reliant noted in its Initial Comments that its MRPM proposal could also work if the EDC remained in the role of default provider.

system that would require another round of stranded cost recovery. Competitive suppliers on the other hand may not be able to pass on long-term contract costs to customers and still be able to compete with the default price. Clearly, the playing field is not level in this situation.

3) Reconciliation of Alternative Energy Portfolio Standards ("AEPS") costs

Several parties, including First Energy, Exelon Companies, and PPL Electric Utilities support the reconciliation of AEPS costs. As stated in its Initial Comments filed on March 8, 2006, Reliant believes that reconciliation of AEPS costs is not necessary because mandated, long-term contracting for alternative energy resources is not needed. Reliant's proposed Market Responsive Pricing Model ("MRPM") does not entail administratively-determined procurement processes for default supply or renewable energy. Under the MRPM, an initial retail price is established that would cover the costs of the default service provider's Act 213 obligations. This is not to say that providers of default service would not be allowed to recover increased AEPS expenses. However, going forward into a competitive market, any changes associated with Act 213 should be made at the time that the default service provider came in for one of its allowed adjustments per a known index.

4) Reconciliation of default service costs

As noted above, Reliant's does not believe that the default service costs should be reconcilable because ex-post reconciliations are a regulated construct, not a competitive market construct. Imposing regulated constructs into the competitive market can cause unintended results that ultimately harm market participants. Consider the example given in Reliant's Reply Comments filed on June 27, 2005. Assume a retail market that allows customers to freely switch providers. The reconcilable charges can allow regulatory based arbitrage to occur because customers can switch to an alternative EGS when fuel surcharges go up to get out of paying their fair share of electricity costs. Conversely, they can then switch back to the default provider when the prices charged by the default provider falls below prevailing market prices due to reconciliation rebates. While one may argue that a fix to such an arbitrage is to have minimum stay provisions on default service, those making that argument are exposing their objections to competition and their preference for regulated markets, rather than allowing for competitive markets. Thus, the Commission should avoid imposing regulated constructs, such as reconcilable default prices, on the competitive retail market to avoid market destructive outcomes that serve to introduce significant barriers to market entry. The Commission's Rule correctly recognizes that the default service price should not be reconcilable, and the

parties'[8] attempts to suggest once again that the default price should be reconcilable should be rejected.

Summary

Reliant appreciates the opportunity to offer reply comments in this Rulemaking regarding default service in the Commonwealth. It is imperative that the Commission not impede the goals of the Choice Act in order to implement Act 213 cost recovery. Both pieces of legislation are intended to bring important benefits to the citizens of Pennsylvania, but one cannot be given precedence over the other, nor do they need to as both can be achieved hand-in-hand. The Commission should avoid implementing the provisions of Act 213 in a manner that will thwart the development of a robust, sustainable competitive retail market. Reliant urges the Commission to find that mandated long-term contracting and cost reconciliation by EDCs will be detrimental to a competitive market.

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[8] Citizens and Wellsboro Electric Company, FirstEnergy, Exelon Companies, and PPL Electric Utilities Corporation.

ORIGINAL: 2463

BEFORE THE
PENNSYLVANIUA PUBLIC UTILITY COMMISSION

Reply Comments Of
Citizens for Pennsylvania's Future
(PennFuture)

Regarding

Docket No. M-00051865
Implementation of the Alternative
Energy Portfolio Standards Act of 2004

And

Docket No. L-00040169
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)

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Submitted by:
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April 7, 2006

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Introduction

Citizens for Pennsylvania's Future (PennFuture) hereby submits Reply Comments pursuant to the Commission's Order reopening the comment period for its default service rulemaking in consideration of the Alternative Energy Portfolio Standards Act of 2004 (Act 213) as entered on November 18, 2005. These Reply Comments respond to a number of issues raised in comments previously submitted by other interested parties in relation to the Commission's February 8, 2006 request for comments.

Force Majeure

The Office of Small Business Advocate (OSBA) advises the Commission to evaluate a force majeure claim on the basis of whether electricity from alternative energy sources is "physically unavailable *or* if electricity from such sources is available only at exorbitant prices". The OSBA goes on to define "exorbitant" as any price higher than that of a traditional energy supply mix in the following paragraph:

> "One alternative for determining whether a force majeure exists would be for an EDC to seek separate bids for a quantity of default service electricity, one which includes the designated percentages from alternative energy sources and one which does not. If the low bid including alternative energy exceeds the low bid without alternative energy by a percentage approved as part of the default service plan, a force majeure would be deemed to exist."

The above description of how to evaluate a claim of force majeure goes against the original legislative intent of Act 213 and will basically render the Act useless. A similar proposal for a "cost trigger" approach to evaluating force majeure was considered in the initial stages of drafting Act 213 and was rejected. In fact, the General Assembly passed Act 213 with full knowledge that while new markets are developed, alternative energy will be more expensive than traditional fossil fuel based sources. If prices were on par or less, as they will be at some future date, the Act would be unnecessary. For these reasons the General Assembly adopted a cost-recovery provision in the Act to address this issue and mitigate the concerns of EDCs and EGSs.

There is nothing in Act 213 that indicates a "cost" or "economic rational" threshold should be used in determining claims of force majeure. Only in extraordinary situations that are beyond the control of those who must comply with the Act, and only after those who must comply with the Act have shown that the Act could not be complied with, should the Commission consider a force majeure claim. If the Commission were to allow for force majeure because the requirements of complying with Act 213 were more expensive than business as usual, the requirements of the Act would never be met.

When reviewing a force majeure claim, the Commission should take into account both the price per kilowatt-hour and the number of kilowatt-hours needed to comply. For example, Act 213 requires that in the first four years the total percentage sold from solar photovoltaic technologies

equal 0.0013 percent, which translates to roughly 1 megawatt per year of installed capacity. However, this 1 megawatt will be distributed across each of the Commonwealth's utilities and will only equal approximately 150 to 200 kilowatts for each of the first four years per utility. At a capital cost of $7.30 per watt installed, the cost for utilities should be minimal at only $1.5 million per utility territory and cannot create a basis for force majeure.

We understand the OSBA is concerned that the costs of complying with Act 213 will be passed down to consumers. However, if costs are passed down at all they will be minimal. The Act requires that Tier I qualifying resources supply eight percent of total electricity demand by 2020, with 1.5 percent of electricity demand two years after the effective date of the Act from Tier I resources. This translates into an annual construction requirement of about 300 megawatts of new Tier I supply, although that number could vary slightly depending on capacity factors and demand growth over the next 15 years. This is not an excessively large number when viewed in comparison to the total electric generating capacity in Pennsylvania, which is currently 46,495 megawatts. The three largest Pennsylvania utilities (FirstEnergy, Exelon, and PPL) will each need to buy the output from roughly 75 to 125 megawatts of new Tier I supply every year. Also the current supply of electricity that meets the Tier II alternative energy source definition exceeds Pennsylvania's Tier II demand, and consequently the payment cost will be very low.

The Commission needs to assure that the criteria for determining force majeure will be stringent and anything less than utilities taking an active role in developing an alternative energy resource market will not be permitted. The Commission should require that utilities submit Request for Qualifications (RFQ) well in advance of the end of their cost recovery period. Utilities should then hold a bidders meeting where they will discuss: the amount of electricity needed, procurement process, and all terms and conditions. Passive compliance attempts should not trigger force majeure. If utilities wait to send out RFQs or Request for Proposals (RFP) until the end of their cost recovery period, they will not be able to meet the requirements of Act 213, and they should not be excused from those requirements, given such inaction or tardy action.

Long-term Contracts

PennFuture and others including: PPL Electric Utilities Corporation, BP Solar, the Industrial Energy Consumers of Pennsylvania, PV Now and US Wind Force agree that long-term contracts are critical to the development of alternative energy resources as required by Act 213.

Constellation Energy and UGI Utilities, however, argue against long-term contracts. Constellation Energy in particular argues that Tier I and most Tier II resources don't necessitate long-term contracts. This is in direct opposition to current industry trends not only for alternative energy resources but for traditional fossil fuel power plants as well. As we stated in our original comments, a long-term contract needs to be in place for the construction of any power plant whether it is gas-fired, nuclear, coal or wind.

This becomes increasingly important for alternative energy projects that need minimum contract lengths of 15 to 20 years as they are still developing in the marketplace. Investors are not willing

to finance a project, unless there are credit worthy institutions committed to long-term off take agreements.

The need for long-term contracts is clearly shown in the marketplace today. In March of 2006, FirstEnergy announced that they entered into a 20-year power purchase agreement with US Wind Force, LLC for two wind projects with a combined output of 250 megawatts in West Virginia. In addition to market signals, governments are beginning to take regulatory action to allow for long-term contracts. The Ontario Power Authority recently announced an Advanced Renewable Tariff for standard offer that allows for homeowners, landowners, farmers, municipalities and others with projects up to 10 megawatts to sell their power to the grid at a fixed price for 20 years.

Constellation also goes on to say that long-term contracts would undermine the benefits of a competitive procurement process and make the playing field uneven. We disagree with this statement as long-term contracts are in fact needed to level the playing field between alternative energy sources and traditional energy sources given the fact that the alternative energy market is still developing.

Without allowing for long-term contracts, alternative energy projects will not be constructed and utilities will not be able to procure the necessary resources to comply with Act 213. Pennsylvania would then not receive any of the environmental and economic benefits that come with the Act including reduced pollution, reduced greenhouse gases and increased jobs and economic input.

Solar Share

Several parties including the Office of Small Business Advocate (OSBA) and the Office of Consumer Advocate (OCA) indicate in their comments that there is no need to treat the solar photovoltaic requirement differently from other alternative energy resources in terms of procurement and cost recovery, while others indicate it is too soon to tell.

PennFuture disagrees with that stance and concurs with the comments made by the solar industry and the Pennsylvania Department of Environmental Protection (DEP) that since the General Assembly decided the solar photovoltaic market was important enough to receive a set aside requirement under Tier I, it should be treated distinctly in terms of procurement and cost recovery.

In particular we support the DEP's request to allow for separate banking provisions for the solar share. As the DEP points out, the solar share requirement increases in a different manner than other Tier I resources with a four-stage ramp-up, increasing sharply in years five, ten and fifteen. Since each of the four requirement stages lasts for five years, it is appropriate to allow utilities to bank solar credits for a minimum of five years as opposed to the two year allowance for Tier I and Tier II resources. This will enable utilities to prepare for the next percentage increase in year five. Allowing for a minimum five year banking period will assure that utilities will be able to meet the requirements of the solar share and is crucial to the success of Act 213 in moving the solar industry forward.

The current installed solar capacity in Pennsylvania is just under 1 megawatt, the majority of which is located in the PECO territory where there was a limited rebate program before funds were expended. This can soon change, however, as solar photovoltaics are the fastest growing energy generating technology in the world. The industry is growing at a rate of 25-35% per year, from a current installed capacity of 1500 megawatts to a projected capacity of 3200 megawatts by 2010. In addition, venture capital funding is pouring into the industry to fuel its growth (three of the last ten Initial Public Offerings were solar companies).

New Jersey, California, Japan and Germany all have seen dramatic growth in solar capacity and the resultant growth in industry due to strong rebate and incentive programs. Pennsylvania does not currently have a statewide rebate or incentive program and therefore must rely on developing its solar renewable energy credits (SRECs) market and complying with the solar set aside within Act 213 in order to duplicate the success of other states and countries. With effective execution of solar rules, Pennsylvania with our strong solar set aside will be able to join the likes of New Jersey and California.

Given the current market structure in Pennsylvania, solar project developers and customers depend on the sale and purchase of SRECs to make projects economically viable. SRECs that are created and traded on a short-term, spot market basis provide little assurance to lenders that SREC revenues will be available in future years or what their value will be. Due to the current structure and reliance on SRECs, it becomes increasingly important to allow for long-term contracts (a minimum of 15 years) for the solar set aside. It will become increasingly difficult to meet the solar share requirements of Act 213 if spot market uncertainty becomes a disincentive to developers. However, if the Commission's regulations are created in a manner that properly develops the SREC market, Pennsylvania will also experience a thriving solar industry.

Additionally, please be alert to the difference between the solar share and other Tier I resources in regards to Alternative Compliance Payments (ACP) as mentioned in comments submitted by BP Solar and MESA Environmental. It is important to account for the fact that solar project owners in New Jersey or other states may receive both an up-front capital rebate, as well as revenue from the sale of SRECs. In Pennsylvania, solar project owners do not receive an up-front capital rebate and, therefore, must finance their solar projects solely on the basis of the sale of SRECs from the project. Therefore, the "average value" used in calculating ACPs should include not only the SREC value received by solar project owners but also the levelized value of capital rebates received by the solar project owners. For example, in New Jersey an SREC trading for 20 cents/kWh actually has an average value of two-times that amount or 40 cents/kWh because of the subsidy that was provided.

ORIGINAL: 2463

COMMONWEALTH OF PENNSYLVANIA

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April 7, 2006

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RECEIVED

Re: 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)
Docket No. L-00040169

Implementation of the Alternative Energy Portfolio Standards Act of 2004
Docket No. M-00051865

Dear Secretary McNulty:

Enclosed for filing are an original and fifteen (15) copies of the Reply Comments of the Office of Consumer Advocate in Response to the Commission Secretarial Letter of February 8, 2006, in the above-referenced proceeding.

Copies have been served as required on the parties of record as indicated on the enclosed Certificate of Service.

Sincerely,

Tanya J. McCloskey
Senior Assistant Consumer Advocate

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INDEPENDENT REGULATORY REVIEW COMMISSION

Enclosure
cc: Chairman Wendell F. Holland
Vice Chairman James H. Cawley
Commissioner Kim Pizzingrilli
Commissioner Bill Shane
Commissioner Terrance J. Fitzpatrick

00088278.DOC

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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)	Docket No. L-00040169
Implementation of the Alternative Energy Portfolio Standards Act of 2004	Docket No. M-00051865

REPLY COMMENTS OF THE OFFICE OF CONSUMER ADVOCATE IN RESPONSE TO THE COMMISSION SECRETARIAL LETTER OF FEBRUARY 8, 2006

Tanya J. McCloskey
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2006 APR -7 PM 4:06

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Dated: April 7, 2006

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I. INTRODUCTION

On March 8, 2006, Comments were filed by numerous parties in response to the Commission's Secretarial Letter of February 8, 2006 and its Order of November 18, 2005. In its Order and Secretarial Letter, the Commission sought comments on three general areas: (1) the interplay between the requirements of the Alternative Energy Portfolio Standards Act (AEPS) and default service; (2) the timing of the completion of the default service rulemaking; and (3) the impact of the Energy Policy Act of 2005 (EPAct 2005) on the default service rulemaking. As to the interplay of the Alternative Energy Portfolio Standards and default service, the Commission raised specific questions as to the use of long term contracts to support alternative energy resource development and the proper interpretation of the phrase "prevailing market prices" if such long term contracts are employed. At least 27 parties filed Comments in response to the Commission's request. In general, the parties filing comments included the electric distribution utilities (EDCs), the customer representatives and statutory parties, the electric generation suppliers (EGSs), and developers (and those working with developers) of alternative energy resources.

While the list of those filing comments may seem broad and diverse, there was significant agreement on some key issues. Of particular note to the questions presented by the Commission regarding AEPS, there was agreement among all but the EGS parties that long term contracts to support alternative energy resources were permitted under the Electric Choice Act and should be allowed. See, *e.g.*, PPL Comments at 4; Duquesne Comments at 10; IECPA Comments at 12; US Steel Comments at 3; OSBA Comments at 3; PennFuture Comments at 2-4; and DEP

Comments at 2. In addition, there was also substantial agreement that long term contracts would be needed to develop the alternative resources called for by the AEPS Act. See, *e.g.*, PPM Energy Comments at 3; PV Now Comments at 2; US Windforce Comments at 1-2; BP Solar Comments at 2; DTE Energy Comments at 2; PennFuture Comments at 3; and DEP Comments at 2. As the developer of the projects commented, long term contracts are needed to provide the certainty for financing and to ensure the lowest cost for the alternative resources. See, *e.g.*, PPM Energy Comments at 3; PV Now Comments at 2; US Windforce Comments at 1-2; BP Solar Comments at 2; and DTE Energy Comments at 2.

The recognition that long-term contracts will be needed for a portion of default supply dovetails well with another key point the OCA has made consistently throughout the Commission's POLR proceeding, *i.e.,* that the best approach for acquiring default supply is for default service providers to competitively procure a portfolio of resources, consisting of resources purchased under contracts of varying lengths, a diversity of fuel types, and including both supply-side and demand-side resources. Numerous commenters also addressed the need for a balanced portfolio of procurements and purchases, including the contracts and purchases needed for AEPS. See, e.g., DTE Energy Comments at 4; Conservation Services Group Comments at 2; IECPA, *et al.* Comments at 13; and PPL Comments at 4-5. Conservation Services Group (CSG) identified the key benefits of this approach as follows:

> CSG urges the PUC to give Default Service Providers the tools to adopt a comprehensive portfolio management strategy including an appropriate balance of long term contracts, short term contracts and current year contracts. Combining the security of long term contracts with the competitive price advantage of short term and current year

> contracts results in a comprehensive portfolio that provides the following: hedging value to protect consumers; due diligence of price discovery; and access to markets that increases generator confidence.

Conservation Services Group Comments at 2. The OCA submits that a portfolio approach can best provide reliable service at reasonable and relatively stable rates.

Finally, there was substantial agreement among the commenters that final regulations should be issued without further delay. See, OSBA Comments at 9-10; PennFuture Comments at 10; US Steel Comments at 4; IECPA Comments at 2; PPL Comments at 13; Exelon Comments at 11; FirstEnergy Comments at 5-6. As the OCA discussed in its Supplemental Comments of March 8, 2006, EDCs need to begin planning and taking actions now to acquire a reasonable portfolio of resources, even if their obligation does not begin until 2010 or 2011. EDCs should be taking advantage of market opportunities that are presented as early as possible. PPL echoed this point when it stated:

> Promulgating final regulations well before compliance is required may encourage development of the competitive market and enable EDCs to begin developing comprehensive and cost-effective compliance strategies.

PPL Comments at 13. The need to begin planning and acquiring contracts now for alternative energy resources may be especially acute as many alternative resources have long development schedules. Additionally, alternative energy projects may face development hurdles as new technology can delay projects. PennFuture Comments at 4-5. An earlier start to the process will benefit developers, EDCs and ratepayers.

The OCA strongly urges the Commission to complete this rulemaking as expeditiously as possible. The Comments have made clear that compliance with the Alternative Energy Portfolio Standards Act can be integrated into the default service framework through the use of a portfolio of resources of varying contract lengths, fuel types, and product types. The Comments have also made clear that the use of long term contracts for a component of these purchases is consistent with the Electric Choice Act and will allow for the development of the alternative resources needed to meet the requirements of the Act. In the end, the OCA submits that establishing a framework that requires the provision of reliable service at reasonable, affordable and stable prices to consumers is of critical importance to the Commonwealth. Default service regulations that allow for the development of resources needed to provide reliable service as well as resources needed to comply with the Alternative Energy Portfolio Standards Act at reasonable prices should be implemented.

II. REPLY COMMENTS

A. The Use Of Long Term Contracts By Default Service Providers

1. Long Term Contracts May Be Necessary To Meet The Requirements Of AEPS.

Of the numerous questions raised by the Commission in the February 8 Secretarial Letter, one which the OCA regards as key is, "Do prevailing market conditions require long-term contracts to initiate development of alternative energy resources?"[3] The OCA has consistently been of the view that if alternative energy projects are to receive adequate financing, it will require that they be able to enter long-term contracts for the sale of their energy and credits. On the basis of the comments received by the Commission in response to this question, this view is shared by many commenters. See, *e.g.*, PPM Energy Comments at 3; PV NOW Comments at 2; US Windforce Comments at 1-2; PennFuture Comments at 3; DTE Energy Comments at 2; PPL Comments at 4; Duquesne Comments at 5; IECPA et al. Comments at 12; and DEP Comments at 2.

The developers of alternative projects, in particular, spoke to the need for long term contracts to provide certainty for financing projects and to ensure the lowest cost for alternative energy resources. See, *e.g.*, PPM Energy Comments at 3; PV NOW Comments at 2; US Windforce Comments at 1-2; and DTE Energy Comments at 2. The Comments of US Windforce captured the essence of these points as follows:

> [C]urrent market conditions do require utilities to be able to enter into long-term contracts in order to initiate the development of alternative energy projects, and more specifically in our case, wind power generation projects. Without long-term commitments for the power offtake, the necessary capital for project development simply isn't

> available, or at least isn't affordable, because the risks to the equity investor are significantly higher. Investors usually are not willing to make the necessary capital investment on a merchant project, meaning building a project where prices received for the energy and green attributes are realized through the spot or short term market.
>
> * * *
>
> If an EGS or EDC is only able to procure the energy/attributes under short term contracts, the equity investors will have to be willing to invest in merchant projects or other credit worthy wholesale marketers will have to take the merchant risk (be willing to step up to offer a project owner long-term contracts), or else the projects will not get built. If the projects are not built, the project development capital will wither. If this occurs, there is a reasonable probability the mandated AEPS requirements will outstrip available supply of alternative energy and significantly drive up the price of energy and attributes available to the end user. This will serve to both defeat the purpose of the AEPS and lead to price volatility for energy and attributes.

US Windforce Comments at 1-2.

The use of long term contracts for alternative energy resources by a default service provider as part of a portfolio of resources to meet its load obligations will spur the development of alternative energy resources allowing for cost-effective compliance with the AEPS Act. The OCA submits that the Commission should allow for long term contracts as one of the purchases a default service provider may make to meet its obligations under the AEPS Act as well as its obligations under the Electric Choice Act.

2. The Use Of Long Term Contracting Is Consistent With The Electric Choice Act.

Some EGSs have suggested that the use of long term contracts would be inconsistent with the "prevailing market prices" standard contained in the Electric Choice Act. See, *e.g.*, Constellation Comments at 6-7. The OCA strongly disagrees. As the OCA has stated, the term "prevailing market prices" as used in the Electric Choice Act in Section 2807(e)(3) clearly contemplates the acquisition of a variety of products and services by the default service provider. Prevailing market prices are the prices for the products that are acquired from the market to meet the default service obligation. PPL explained in its Comments the variety of products available:

> PPL Electric believes that "prevailing market price" does not necessarily equate to a short-term or spot-market price. The electricity market is actually made up of various markets and products; each characterized by the nature of the service provided (i.e. firm load, load following, customer segment, etc.), the term of service (i.e., daily, monthly, annual, multi-year, etc.), the pricing of the service (i.e., spot-market, day-ahead market, indexed price, fixed price, etc.), and other attributes (i.e., with or without associated alternative energy credits, with or without capacity, with or without ancillary services, etc.).

PPL Comments at 5.

PennFuture, in recognizing the need for long term contracts, also recognized that the "prevailing market prices" will reflect all of these resources. PennFuture explained as follows in its comments:

> To build a power plant of any sort in the current period, a long-term power purchase agreement must be in place. The term "prevailing market prices" in the electricity competition and customer choice Act speaks to the time of the price and not the length of the contract or type of product. A prevailing market price is a price that is

available now for the purchase of a product. A prevailing market price could be for a spot purchase now, or it could be for a 6-month purchase made now, or a 2-year purchase made now, or a much longer purchase such as a 10 to 20 year purchase made now.

PennFuture Comments at 2. See also, Duquesne Light Comments at 4 (The statutory provision of "prevailing market prices" should not be interpreted to limit default service prices to short-term prices established by auctions).

The OCA submits that the statutory term "prevailing market prices" does not preclude the use of long term contracts by a default service provider. In fact, the use of the plural term of "prices" clearly contemplates the acquisition of a variety of products. Long term contracts should be considered as one of those products.

3. Conclusion

The OCA submits that the Commission's default service regulations should call for a default service implementation plan that includes a portfolio of resources, including long term resources that are needed to meet the default service obligation. The blended price of these resource acquisitions will represent the default service price for customers. Through this approach, the development of alternative resources will be stimulated so that the requirements of the AEPS Act can be met in the least costly manner, and reasonable, stable default service rates can be developed. The Commission should timely issue regulations allowing for a portfolio of purchases that can include long term contracts.

B. The Use Of Long Term Contracts Does Not Require Irrevocable Orders Or Other Extraordinary Ratemaking Measures.

With the recognition that long-term contracts may be needed to support alternative energy projects and, in turn, to comply with the AEPS, has come the

suggestion by some EDCs that recovery of alternative energy purchase costs should occur through a cost recovery mechanism, supported by irrevocable Commission orders, similar to the Qualified Rate Orders authorized under Section 2812 of the Public Utility Code, 66 Pa.C.S. § 2812. UGI-Electric Comments at 3; EAP Comments at 4. The EDCs also urge that the Commission avoid any "after-the fact" prudence review. FirstEnergy Comments at 3; EAP Comments at 4; Duquesne Comments at 11. The concern expressed is that, if at some point in the future the amounts paid under the contract are found to be "above-market," recovery of the above-market portion will be disallowed and become a "stranded" cost to the EDC.

The OCA understands the EDCs' concern and agrees that we must avoid creating stranded cost when entering into long term contracts. The OCA submits, however, that the EDCs' concern may be misplaced given the statutory standards of the AEPS, the use of competitive procurement processes, the review of the default service implementation plan, and the fact that long term contracts will only be one component of a comprehensive portfolio of resources.

As an initial matter, the call for the use of irrevocable orders such as a Qualified Rate Order, cannot be adopted in the absence of explicit legislative authority. The extraordinary measure of allowing the Commission to issue an irrevocable order was added to the Public Utility Code at Section 2812 only as a means of providing for stranded cost recovery through specific types of transition bonds. 66 Pa.C.S. § 2812. The OCA submits that the Commission can only issue such irrevocable orders pursuant to a direct and specific grant of statutory authority as was given in the case of the Qualified Rate Orders authorized under Section 2812 of the Code. Inasmuch as there is

no statutory grant of power to issue irrevocable orders under AEPS, the OCA submits that any use of such orders in the implementation of the AEPS Act would be unlawful. Use of such orders, however, should not be necessary.

In the OCA's view, the combination of the Commission's review and monitoring of an EDC's default service implementation plan, the procurement of resources through a competitive process, and the language on cost recovery that is already contained in Section 1648.3(a)(3) of the AEPS, is sufficient assurance of cost recovery for the component of the portfolio of resources that will be under long term contracts. 73 P.S. §1648.3(a)(3). As the Commission and EDCs are aware, in the past, prudence reviews have resulted in adjustments primarily where there has been no "up-front" Commission involvement in a course of action taken by a utility. The situations where prudence was raised also did not involve acquisitions of electricity through a competitive procurement process. Here, the Commission's proposed default service regulations require EDCs to submit for approval their implementation plans for acquiring default supply and to use competitive processes for procuring those resources. In addition, the proposed regulations provide for Commission verification of compliance with the plan after acquisition of resources is made. Since the default service rates reflect the blended price of all the competitive acquisitions made in furtherance of the plan over an extended period of time, the Commission should not look to individual contract price comparisons at different points in time in assessing the resource plan.

Further, the language of Section 1648.3(a)(3) of the AEPS makes it clear that the costs of alternative energy or alternative energy credit purchases are to be recovered "on a full and current basis." 73 P.S. § 1648.3(a)(3)(Emphasis added). This

cost recovery provision, together with the up-front approvals by the Commission and the competitive process, should mitigate concerns about after-the fact prudence reviews and adjustments by the Commission.

C. Both EDCs and EGSs Should Satisfy The Requirements Of The Act.

Strategic and Dominion propose that the electric distribution company (EDC) be required to purchase alternative energy credits for the load of all EDC customers, both shopping and non-shopping, rather than having the electric generation suppliers (EGSs) comply with the requirements of AEPS for customers who buy their power from an EGS. Strategic Comments at 3; Dominion Comments at 3. Strategic and Dominion then propose that the cost of this compliance be recovered from all customers through a separate, non-bypassable line item charge. Strategic Comments at 3; Dominion Comments at 3. The OCA submits, however, that such a proposal does not follow the plain language of the statute.

Compliance with the AEPS is required of all electric distribution companies and all electric generation suppliers. 73 P.S. § 1648.3(a)(1). Section 1648.3(a)(1) provides:

> From the effective date of this act through and including the 15th year after enactment of this act and each calendar year thereafter, the electric energy sold by an electric distribution company or electric generation supplier to retail electric generation customers in this Commonwealth shall be comprised of electricity generated from alternative energy sources and in the percentage amounts as described under subsections (b) and (c).

73 P.S. §1648.3(a)(1). Section 1648.3(a)(2) then states:

> Electric distribution companies and electric generation suppliers shall satisfy both requirements set forth in subsections (b) and (c), provided, however, that an electric

> distribution company or electric generation supplier shall be excused from its obligations under this section to the extent that the commission determines that a force majeure exists.

73 P.S. §1648.3(a)(2). It is clear from the language of the AEPS Act that the electric generation suppliers are to satisfy the requirements of the Act for their load.

The OCA would also note that under the proposal of Strategic and Dominion, an EDC could only use separately traded credits, *i.e.*, credit purchases separate from the energy, to satisfy the Act's requirements for the EGS load since the EGS is already meeting the energy requirements of the load. Since the market for separately traded credits has not yet been established, it is difficult to assess the impact of this structure. It is possible that limiting the compliance methodology to a purchase of separate credits could increase the cost of compliance.

The proposal to have the EDC purchase credits for all customers and then pass through the costs as a separate, non-bypassable line item does not appear to be consistent with the structure of the Act. The OCA submits that this approach should not be pursued at this time.

D. Direct Energy's Arguments In Support Of Its Monthly Pricing Proposal Are Flawed.

Direct Energy focused its comments on its proposed default service structure of monthly pricing for residential customers. Direct Energy did not address the requirements of AEPS. The OCA has responded to Direct Energy's arguments in its Reply Comments of June 27, 2005. OCA Reply Comments of June 27, 2005 at 3-5; 8-11. As set forth therein, it is the OCA's position that volatile pricing for residential

customers is not an appropriate default service design. Default service should provide residential customers with reasonable, stable and affordable rates.

Direct Energy makes two arguments in its Comments in support of its monthly pricing proposal that require a response. First, Direct Energy argues that POLR rates that are changed monthly to reflect indexed prices will produce savings as compared to longer term contracts for POLR service. Second, Direct Energy points to the increases in gasoline prices for support of its proposition that residential customers can tolerate variable prices and respond to them. Both arguments are flawed.

Direct Energy bases its assertion that monthly pricing will produce savings, in part, on a study performed by Direct Energy of the monthly spot market prices in PECO Electric Company's service territory compared to the POLR rate in effect from 2000 through 2004. Direct Energy Comments at 9-10. From this comparison, Direct Energy asserts that PECO residential customers would have realized savings of as much as $171.6 million over a 4-year period if they had been subject to monthly average pricing. Direct Energy Comments at 9-10. The OCA submits that Direct Energy's study is seriously flawed.

The Direct Energy study does not present a comparison of monthly pricing to a competitively procured portfolio of default service resources. In its study, Direct Energy compared the monthly costs of energy at PJM's spot market prices to PECO's administratively established POLR rate. The PECO POLR rate during this time period, however, was not a "market" rate as Direct Energy implies. The PECO POLR rate being compared to PJM monthly prices in the Direct Energy study was administratively set by taking PECO's embedded costs, and subtracting out costs related to distribution,

transmission, and stranded cost recovery, as determined during the PECO restructuring proceeding. The POLR rates established at the time of restructuring were intentionally set at a level that was expected to be well above wholesale market prices in order to permit "headroom" for competitive marketers. Application of PECO Energy Co. for Approval of its Restructuring Plan Under Section 2806 of the Public Utility Code, et al., Docket No. R-00973953, 1998 Pa. PUC LEXIS 116 at *10, 29 (1998). Comparing a "market price" with an administrative rate intentionally set high to allow competition is no comparison at all.

Even if stable POLR rates do not provide absolute dollar savings in the long run over the cumulative cost of paying volatile spot market prices, residential customers require stable rates for budgeting and affordability purposes. Most residential customers do not pay their monthly electric bills "in the long run." Rather, they need to pay their bill in full each month. The monthly income for middle and lower income families does not change based on the short term wholesale market price of energy. The usage of households also cannot be easily shifted from month to month based on energy prices since most of it is non-discretionary, essential usage. The OCA submits that volatile, monthly pricing for residential customers is not a reasonable default service approach.

Direct Energy also tries to use an example of increasing gasoline prices to demonstrate that residential customers can modify their behavior in response to volatile prices. Direct Energy argues that in the fall of 2005, consumers responded to increased gasoline prices by altering their driving behavior, resulting in dramatic decreases in prices. Direct Energy Comments at 8-9. The OCA submits that Direct Energy's

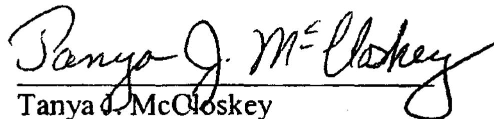
argument is flawed in two respects. First, electric service is an essential service. Doing without electricity, even for a short term, can raise serious health and safety concerns. You can take a bus to work, but you still need to turn the lights on when you get home. Second, the current price of gasoline belies this argument. Gasoline prices have continued to increase despite Direct Energy's assertion of a customer response to the high prices.

The OCA submits that residential customers should not be placed on volatile rates, with only the vague hope that stable service will be offered by retail competitors, as Direct Energy asserts. Electric service is an essential service, necessary for the health and safety of the public. Reasonable, stable and affordable rates should be the goal of the design of any default service plan.

III. CONCLUSION

The structure of default service and the process to procure supply are critical issues for all Pennsylvania consumers. The Commission should move forward with this rulemaking in an expeditious manner and in a manner that will integrate the requirements of the Alternative Energy Portfolio Standards Act and will provide reasonable, stable and affordable default service rates for consumers.

Respectfully Submitted,



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DATED: April 7, 2006
88200

CERTIFICATE OF SERVICE

Re:	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)	:	Docket No.	L-00040169
	Implementation of the Alternative Energy Portfolio Standards Act of 2004	:		M-00051865

I hereby certify that I have this day served a true copy of document, Reply Comments of the Office of Consumer Advocate in Response to the Commission Secretarial Letter of February 8, 2006, upon parties of record in this proceeding in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a participant), in the manner and upon the persons listed below:

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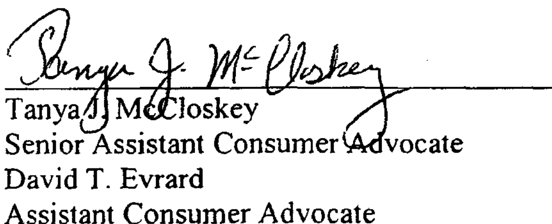

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