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PUBLIC UTILITY ECONOMIST

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April 26, 2005

Pennsylvania Public Utility Commission
Attn: Secretary
P.O.B. 3265
Philadelphia, PA 171035-3265

Re: Proposed Rulemaking – L-00040169
Dear Mr. McNulty:

Attached are an original and fifteen copies of my comments that I am submitting on my own behalf regarding the above referenced rulemaking.

Respectfully,



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PENNSYLVANIA
PUBLIC UTILITY COMMISSION

**Comments on the Pennsylvania Public Utility Commission's Proposed 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 Numbers L-00040169 and M-00041792**

**Submitted by David Magnus Boonin, TBG Consulting
April 26, 2005**

Introduction – Allow Default Service Providers to Use True Market-Based Pricing

The Pennsylvania Public Utility Commission's Proposed Rulemaking dealing with default service is generally sound in developing a process for default service providers to seek resources through a solicitation for forward contracts but unnecessarily omits the critical option of the provider meeting all or part of its resource requirements for at least smaller customers through spot purchases from its RTO or ISO. This seems to have done to protect these smaller customers from price volatility sometimes associated with the spot market. In the Commission's quest to ensure that smaller users have the opportunity to purchase electricity at a known price, it has almost certainly imposed a large price premium on these default customers, estimated to be 10 to 15% higher than needed as compared to spot-based approach with volatility protection described in these comments.

The proposed regulations require that the default provider submit a fixed-price (time-of-year and time-of-day variations allowed) for these customers for at least twelve months based mainly on bids accepted from an auction process. This is the purchase of a future contract. The economic literature is replete with evidence that the PJM forward market for electricity has a significant upward price bias or risk premium, as much as 100% during summer months as compared to the spot market. This bias or risk premium could be eliminated if the default provider met customers' requirements with purchases from PJM on a spot basis, allowing the consumer all of the benefits of one of the world's largest and most liquid electricity markets.

The main purpose of these comments is to propose an additional default supply protocol other than an auction-based model that should more accurately charge default customers a rate based upon the prevailing market price and reduce the cost of default service while offering protection from price volatility. The Commission has indicated that absent the concern about price volatility that the PJM spot market is the fundamental prevailing market rate (e.g., see the proposed regulations at §54.187(i) and §54.188(e)). This proposed default service protocol is called, herein, Spot Market-Based Pricing (SMBP). The Commission should through its final rulemaking allow utility default providers to:

- Purchase its customers' needs on the PJM spot market. Rates charged for this service must be fixed for at least one year for smaller customers and be pre-approved by the Commission.

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- Establish a mechanism such as a Volatility Protection Fund discussed below that protects customers and the supplier from spot-market price volatility by allowing the default service provider to charge customers a pre-determined and Commission approved fixed rate.

The use of SMBP could be voluntary and could be used in lieu or in combination with the auction-program. The auction-based program would still be allowed as described in the rulemaking. Given the huge price premium of meeting customer's needs through forward contracts, a provider that uses these forward-purchased resources to meet its default customers' needs should be required to show why these purchases are in the public interest and possibly be required to run pilot programs on Spot Market-Based Pricing and/or perform ongoing analysis on the risk premium associated with forward contracts implicit in the auction approach.

Energy obtained to meet the Commonwealth's Alternative Energy Portfolio standards should be obtained under different protocols that recognize the need for longer-term commitments to ensure the cost-effective development of these resources and to not limit the cost-recovery mechanisms granted to the Commission in Alternative Energy Portfolio Standards Act.

Why Spot Market-Based Pricing is Superior to Auction/Bid-Based Default Service

As summarized above, default service delivered under Spot Market-Based Pricing should:

- Produce lower prices to default service customers than auction based prices.
- Produce prices that are closer to the prevailing or spot market price than a futures auction.
- Provide customers with prices that are predictable and free of the volatility that usually is associated with market-based electricity prices when coupled with the Volatility Protection Fund discussed herein.

Lower Prices: The economic and financial analysis (see below for a partial list of research that has been considered) of PJM forward contracts and options consistently state that forward contracts for electricity:

- Include huge risk premiums;
- Are biased, inefficient and tend to overreact to perceived market trends;
- Are unduly influenced by changes in current load; and
- Cannot mitigate risk in traditional ways because the commodity cannot be economically stored.

What these experts are saying is that unlike with most commodities or markets, the futures price of electricity contains a substantial risk premium that makes it significantly higher than the expected spot price. The risk premium is highest during periods of high

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demand or high demand volatility such as the summer and disappears during periods of low and stable demand.

Below are listed some indicative findings that quantify what the research categorized as huge risk or price premiums.

- The average summer risk premium of a futures contract price was 54% more than buying the same power on the spot market through 2001
- The risk premium in the summer of 2000 for forward purchases was 100% greater than spot prices.
- Updated analysis using data through 2002 confirmed these findings although the risk premium was slightly less than in the earlier analysis.

These are indicative samples of the research results. The attached charts (See Appendix B) are extracted from the December 2003 research of Pirrong and Jermakyan cited below and are also indicative of the findings found in all the research cited. Please note that these huge price premiums are not for single anomalous hours, but are indicative of the average price increase over all hours during the periods mentioned, e.g., the entire summer. Some of the research notes that it is the volatility of the spot market for electricity that contributes to these risk premiums. Spot market volatility should, therefore, not be confused with higher prices when compared to forward market contracts. In short, there is a large price premium that consumers pay for electricity price insurance when purchased through forward contracts.

These huge price premiums associated with forward contracts may be underestimated by the assessments performed in the research. In the research, the quantities of resources being bought are always known. An additional risk associated with forward-contract default service auctions is that the resource needs is not known. This is an additional risk that must be hedged by anyone responsibly offering to provide service through the bid process. It can be eliminated by breaking the bids into pieces, but the last piece will always be fraught with the uncertainty of consumer demand, whether driven by price, the number and mix of default customers, business cycles, demographics or weather. This risk is on top of the risk premiums discussed above and are also avoided by using the spot market approach. The proposed regulations allow for spot purchases from the ISO if the supply is insufficient with these potentially volatile costs, being recovered from customers.

Market risks that cannot be traditionally managed typically with physical hedges, lead to customers paying an enormous premium for price certainty by buying forward contracts and options. Default service auctions only add to this risk and the related price premium as the supplier needs not only to meet a known demand during periods of uncertainty as with most forward contracts but an unknown demand of the default service customers during periods of price uncertainty. Not only is this the findings of this rigorous research,

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it is also my personal observations as someone who once headed a competitive energy company and needed to price competitive services in the PJM marketplace.

It is possible to conservatively conclude that if the futures price is only 50% higher than the spot price during the summer months and not affected at any other time of year (even though empirical evidence shows similar but smaller trends in the winter), then the year-round price premium that consumers are asked to bear for the volatility protection provided by forward purchases is in the neighborhood of 15%, weighting for peak months' usage. At 5 cents/kWh this would be a 0.75 cent increase on every kWh used throughout the year. This is more than what was gained through some of the rate reductions and rate freezes achieved the market was restructured. Unfortunately, the current market structure has not yielded any way to abate this risk premium other than effective demand-side management, which is still being developed and has yet to be implemented.

Prevailing Market Price: When people in the industry talk about prevailing market prices for electricity in this region, they generally mean the PJM spot price. As stated above, the proposed regulations echo this sentiment. It is only when the issue of price volatility is introduced that there is deviation from the concept that prevailing market price and the PJM spot price are synonymous. As demonstrated above, auctions, although an accurate barometer of future prices including huge risk premiums, are not closely tied to the PJM spot price, especially during periods of peak demand.

The Spot Market-Based Pricing methodology is based on the spot price because the real-time spot market price is the prevailing market price. As discussed below, there is a cost for a volatility hedge of real-time prices, but that cost should be much less than the 15% conservatively estimated as the huge annual premium of the auction-approach as compared to the expected spot price.

Protection From Price Volatility: The Spot Market-Based Pricing solution need not end at this point. The Commission is proposing that smaller consumers should be provided protection from market volatility. As discussed above, when electricity futures are at the core of price stability programs, customers are likely to be charged an enormous risk premium.

A cheaper solution would be to create a customer supported volatility-smoothing fund – herein referred to as a Volatility Protection Fund (VPF). The VPF could be set looking at the maximum and the average impact volatility has had on the expected spot price over several years, future and historic. Assuming that the default rates were set reasonably accurately the cost of this fund to consumers would only be the cost of capital to support the fund. As with the auction-approach, the VPF could be required to be offered or provided to smaller customers and optional for larger customers.

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If the VPF were established as an off-balance sheet asset, it should be possible to keep the cost of capital at the cost of low-risk debt, funding it with special purpose bonds serviced by dedicated revenues. An off-balance sheet approach may be preferable so as not to upset the utility's capital structure while simultaneously isolating the capital costs that would be needed to be recovered to support the VPF.

This fund could operate by first establishing a Commission-approved amount for the fund. When prices exceed the amount charged in rates, the utility default provider could withdraw dollars from the fund. When rates exceed prices, deposits would be made to the fund. Although not the objective of this approach, over time, with conservative rate setting, the bonds associated with fund could possibly be retired and replaced by internally generated funds. These internally generated funds could be a zero-cost customer contribution, given the off-balance sheet, dedicated funding approach being proposed, herein. The use of a volatility self-insurance fund should be possible at a cost significantly below that incurred by buying volatility insurance in the form of a forward contract resulting from an auction.

Following through on the research results summarized above, the annual cost premium associated with a futures contract was in excess of 15%. If a volatility fund equal to 1/3 of the entire forecasted energy purchase for the year were needed, a very conservative initial estimate, and the cost of capital were as high as 7.5% - again a conservative assumption in today's market given for the potential of AAA ratings - the annual premium on the spot price of electricity would only be 2.5%, before any net offsets for interest earned by the VPF. This is one-sixth of the forward contract price premium and more typical of what an unbiased and efficient future commodity price costs relative to spot prices for other commodities or financial services. This example demonstrates that even if in the early years of the program the VPF were set conservatively high, it should still provide lower cost volatility protection than forward contracts.

If programs such as demand-side response evolve to a point where volatility and the risk premiums associated with them were greatly reduced or disappeared, the VPF could be reduced or eliminated. The spot price or the average of the projected spot price could be used without the need for a volatility safety net. Unfortunately, this is not the case today.

What fine points should be included or excluded in any SMBP proposal?

The design of specific SMBP programs should be left to the utilities and subject to approval by the Commission. All SMBPs, however, should include:

- Fixed rates for at least twelve months and in twelve-month increments thereafter, consistent with the Commission's proposed rulemaking.
- Justification for establishing these proposed rates. There are many models currently in use that project the spot market prices. Default providers would need to submit the assumptions and results of their analyses. The Commission, over time, could potentially select a particular universal model.

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- The utility should have the option of submitting zoned rates base upon forecasted locational marginal pricing or a single set of rates for the utility's service territory. LMP is not, however, a necessary component of this program, and may not be appropriate especially for smaller customers.
- These rates would be approved by the Commission.
- The use of time-of-day and time-of-year rates to more closely reflect prevailing market prices. This is consistent with these proposed rulemaking.
- A volatility priced protection plan. This may include the establishment of a VPF and the recovery of associated costs including interest and fund management costs, again subject to commission approval. The estimated and levelized rate would constantly be compared to the actual spot price, with dollars placed in and out of the fund as appropriate. Interest earned by the VPF should be used as an offset against the VPF's expenses.
- Reconciliation should only be allowed in extraordinary situations per the proposed rulemaking. Adjustments to the VPF that do not have an immediate impact on rates and should rather be reviewed annually, should not be governed by this provision. These adjustments should be minor and often be in the customers' favor.
- As in the proposed rulemaking, multi-utility proposals should be permitted and even required by the Commission.

Power purchased to comply with the Commonwealth's renewable resource standards will generally need to be purchased through a mechanism other than PJM spot market, such as auctions or bilateral contracts. As envisioned by the Alternative Energy Portfolio Standards Act, long-term contracts, endorsed by the Commission, should be encouraged so that the cost of capital needed to support these projects is reduced and the cost of meeting these standards is reduced to consumers of electricity in Pennsylvania.

Utilities may have other electric supply resources under their control. Unless customers have a vested interest in these resources, the resources should be excluded from use by a utility in developing its SMBP program. Rather, these resources should be made available to the market or sold-off through bilateral contracts, thereby ensuring adherence to the prevailing market price principle.

Why is SMBP good for Default Customers?

SMBP is good for default customers because empirical research indicates that it better reflects prevailing market rates than an auction, is cheaper than futures contracts that contain huge risk premiums and can still provide price stability.

Why is SMBP good for Default Service Providers?

As proposed, TMBP is good for default service providers because it eliminates the risk associated with providing this service and allows the recovery of costs associated with volatility protection. With the utility as the default provider, lower prices within the service territory without an adverse impact on earnings are also good for the utility.

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Why is SMBP good for the Commonwealth?

Lower electricity prices are good for the Commonwealth's economy. Eliminating huge risk premiums without any detriment to anyone other than market speculators keeps more money in the state for more useful purposes.

Why is SMBP a good fit for competitive markets?

SMBP should have no negative impact on an efficient energy market. The demand for default service would be served through PJM's efficient spot market. Competitive suppliers could still provide supply customers through bilateral contracts that would be compared to true market prices with a small volatility protection charge rather than a huge forward market risk premium.

Additionally, a spot market-based program should produce greater opportunities and potential incentives to consumers to participate in demand side resource initiatives than prices established months or years in advance by an inflexible contract.

Why is SMBP a good fit with the cost recovery of the costs associated with Pennsylvania's Alternative Energy Portfolio's standards?

Not only is SMBP a good fit with the cost recovery associated with Alternative Energy Portfolio standards, it is a better fit than the bid methodology currently included in these proposed regulations. Note that these comments suggest that default service provider be allowed to recover the costs associated with meeting its portfolio standards through long-term contracts. The Alternative Energy Portfolio Standards Act states that the costs of procuring this energy in excess of the RTO's real-time locational marginal price shall be treated as a regulatory asset and recovered through sliding scale of rates. The SMBP is based upon RTO's real-time marginal price and can thus be tied directly and seamlessly to this requirement and calculation.

Should SMBP be mandatory?

Based upon all of the above, one could easily argue that SMBP should be Commission's preferred approach for providing default service. Lower prices, a closer match to prevailing market prices, less expensive price volatility protection and an easier link to demand-side resources make SMBP extremely appealing.

Conversely, SMBP is a late addition to the Commission's policy discussion on default service provision. Because of this, it is recommended that the Commission's rulemaking order only allow but not require utilities to submit programs based in whole or in part upon the principals of SMBP. Given the strong evidence of its potential, any utility that does not utilize SMBP or uses the forward market auction-based approach to meet its resource needs should be required to: explain why it feels forward contracts are a desirable component of its resource portfolio, initiate a pilot SMBP program and/or be required to present the Commission with reports annually of how its future purchases compared to actually occurring PJM spot prices for electricity.

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Specific Language

Specific language needed to integrate the SMBP into the Commission's rulemaking is provided as Appendix A. Proposed edits are in bold and larger type. The approach has been to expand the definition of the competitive procurement process to allow spot purchases supplemented by a VPF with the exiting bid-solicitation process and the alternative energy portfolio resources already allowed in the proposed rulemaking.

Background Information

These comments were prepared by David Magnus Boonin, President of TBG Consulting. He is also a default service customer of a Pennsylvania jurisdictional utility. Mr. Boonin has held several relevant positions, including but not limited, to Chief Economist of the Pennsylvania Public Utility Commission and President of New Energy – Mid-Atlantic. Among other work, he has conducted analysis on the valuation of merchant power plants and the pricing of electricity in competitive markets. Mr. Boonin has extensive experience in finding lower cost solutions to pressing challenges faced by regulated utilities and their regulators. One of Mr. Boonin's current clients is an investment bank.

In addition to his own experience, Mr. Boonin relied, in part, on input from finance professors at the Wharton School and Auburn University and the research papers listed below. Mr. Boonin would like to thank Nomura Securities for supporting the development of these comments. The positions are, however, solely those of Mr. Boonin.

- The Price of Power: The Valuation of Power and Weather Derivatives, Craig Pirrong and Martin Jermakynen, October 12, 2001 and December 4, 2003
- Pricing Power Derivatives: A two-Factor Jump-Diffusion Approach, Pablo Villaplana, September 2003
- Valuation of Electricity Forward Contracts: The Role of Demand and Capacity, Pablo Villaplana, Work in Progress
- Equilibrium Pricing and Optimal Hedging in Electricity Forward Markets, Hendrik Bessembinder and Michael L. Lemmon, Journal of Finance 2002
- Electricity Forward Prices: A High Frequency Empirical Analysis, Francis A. Longstaff and Ashley W. Lang, 2003.

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Submitted by:


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APPENDIX A

Proposed Edits to Proposed Regulations

ANNEX A
TITLE 52. PUBLIC UTILITIES
PART I. PUBLIC UTILITY COMMISSION
Subpart C. FIXED SERVICE UTILITIES
CHAPTER 54. ELECTRICITY GENERATION
CUSTOMER CHOICE
Subchapter A. CUSTOMER INFORMATION

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§54.4. Bill format for residential and small business customers.

* * * * *

(b) The following requirements apply only to the extent to which an entity has responsibility for billing customers, to the extent that the charges are applicable. The [provider of last resort] default service provider will be considered to be an EGS for the purposes of this section. Duplication of billing for the same or identical charges by both the EDC and EGS is not permitted.

* * * * *

§ 54.5. Disclosure statement for residential and small business customers

* * * * *

(b) The EGS shall provide the customer written disclosure of the terms of service at no charge whenever:

* * * * *

(3) Service commences from a [provider of last resort] default service provider.

(c) The contract's terms of service shall be disclosed, including the following terms and conditions, if applicable:

* * * * *

(9) The name and telephone number of the [provider of last resort] default service provider.

* * * * *

(h) If the [provider of last resort] default service provider changes, the new [provider of last resort] default service provider shall notify customers of that change, and shall provide customers with their name, address, telephone number and Internet address, if available.

§54.6. Request for information about generation supply.

(a) EGSs shall respond to reasonable requests made by consumers for information concerning generation energy sources.

* * * * *

(2) The [provider of last resort] default service provider shall file at the Commission the annual licensing report as required by the Commission's licensing regulations in this chapter and shall otherwise comply with paragraph (1).

Subchapter B. ELECTRIC GENERATION SUPPLIER LICENSING

§54.31. Definitions.

* * * * *

[Provider of last resort] Default service provider – [A supplier approved by the Commission under section 2807(e)(3) of the code (relating to duties of electric distribution companies) to provide generation service to customers who contracted for electricity that was not delivered, or who did not select an alternative electric generation supplier, or who are not eligible to obtain competitive energy supply, or who return to the provider of last resort after having obtained competitive energy supply] The incumbent EDC within a certificated service territory or a Commission approved alternative default service provider.

* * * * *

§54.32. Application process.

* * * * *

(h) An EDC acting within its certificated service territory as a [provider of last resort] default service provider is not required to obtain a license.

* * * * *

§54.41. Transfer or abandonment of license.

* * * * *

(b) A licensee may not abandon service without providing 90 days prior written notice to the Commission, the licensee's customers, the affected distribution utilities and [providers of last resort] default service

providers prior to the abandonment of service. The licensee shall provide individual notice to its customers with each billing, in each of the three billing cycles preceding the effective date of the abandonment.

* * * * *

Subchapter E. COMPETITIVE SAFEGUARDS

* * * * *

§54.123. Transfer of customers to default service.

The following standards shall apply to the transfer of a retail customer's electric generation service from an EGS to a default service provider within the meaning of §54.182:

(a) An EGS shall not transfer a retail customer from its electric generation service to the default service provider without the consent of the default service provider, except in the following situations:

(1) Upon Commission approval of the abandonment, suspension or revocation of an EGS license, consistent with §§54.41 and 54.42 (relating to transfer or abandonment of license and license suspension; license revocation).

(2) Upon nonpayment by a retail customer for services rendered by the EGS.

(3) To correct an unauthorized or inadvertent switch of a retail customer's account from default service to an alternative EGS's service.

(4) Upon the normal expiration of contracts that are not structured in a way to exploit seasonal variations in market prices for electric generation service

(b) An EGS may initiate transfers in the above situations through standard electronic data interchange protocols.

(c) An EGS may not initiate or encourage transfers of service to a default service provider from the EGS to exploit seasonal variations in market prices for electric generation service.

(d) The Commission may impose a penalty for every retail customer transferred to default service in violation of §54.123, consistent with 66 Pa. C.S. §§3301-3316 (relating to violations and penalties).

Subchapter G. DEFAULT SERVICE

§54.181. Purpose.

This subchapter implements §2807(e) of the Electricity Generation Customer Choice and Competition Act, 66 Pa. C.S. §§2801-2812, pertaining to an EDC's obligation to serve retail customers at the conclusion of the restructuring transition period. These regulations ensure that all retail customers who do not choose an alternative EGS, or who contract for electric energy that is not delivered, have access to generation supply at prevailing market prices. 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.

§54.182. Definitions.

The following words and terms, when used in this subchapter, have the following meanings, unless the context clearly indicates otherwise:

Alternative energy portfolio standards – A requirement that a certain percentage of electric energy sold to retail customers in the Commonwealth of Pennsylvania be derived from alternative energy sources, as defined in the Alternative Energy Portfolio Standards Act, No. 213 of 2004.

Bid Solicitation Process – The procurement of electricity by a default services provider through forward purchases obtained via competitive bids.

Commission – The Pennsylvania Public Utility Commission.

Competitive procurement process – A fair, transparent, and non-discriminatory process by which a default service provider acquires electric generation supply to serve its default service customers **through a bid solicitation process.**

Default service –

(i) Electric generation service provided by a default service provider to a retail electric customer who does not choose an alternative EGS or who contracts for electric energy and it is not delivered.

(ii) Electric generation service provided pursuant to a Commission approved default service plan.

Default service implementation plan – A filing submitted by a default service provider to the Commission that identifies the means for procuring generation supply for default service customers at prevailing market rates, the reasonable costs associated with default service, and all other necessary terms and conditions of service.

Default service provider – The incumbent EDC within a certificated service territory or a Commission approved alternative default service provider.

EDC – Electric Distribution Company – This term shall have the same meaning as defined in 66 Pa. C.S. §2803.

EGS – Electric Generation Supplier – This term shall have the same meaning as defined in 66 Pa. C.S. §2803.

FERC – The Federal Energy Regulatory Commission.

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Fixed rate option – A default service price that is set in advance for the entire term of the default service implementation plan that may include seasonal, **time-of-day and/or on/off peak** differences.

Hourly priced service – A default service price where the energy component of the generation supply charge is based on the RTO or ISO's LMP for energy, or other similar, mechanism.

ISO – A FERC approved independent transmission system operator.

LMP – Locational marginal pricing – A pricing mechanism used by some RTOs and ISOs, as defined in their FERC approved tariffs.

Prevailing market price –

(i) 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 implementation plan, **whether through spot purchases and a volatility protection plan and/or a bid solicitation process.**

(ii) 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).

Replacement procurement process – A Commission approved process, submitted as part of the default service implementation plan, which provides for the acquisition of generation supply in the event that a supplier fails to deliver generation contracted for under the terms of a competitive procurement process.

Retail customer or retail electric customer – These terms shall have the same meaning as defined in 66 Pa. C.S. §2803.

RTO - A FERC approved regional transmission organization.

Spot Purchases – Purchases by the default service provider from its RTO or ISO on a real time basis.

Volatility Protection Fund - A fund raised by the default service provider for the purpose of stabilizing rates charged to default service customers when spot purchases from the provider's RTO or ISO are part of the provider's resource portfolio.

§54.183. Default service provider.

(a) The default service provider shall be the incumbent EDC in each certificated service territory, except as provided for pursuant to §54.183(b).

(b) An EDC may petition the Commission to be relieved from the default service obligation. In the alternative, the Commission may propose through its own motion that an EDC be relieved from the default service obligation. The Commission may approve such a request if it is in the public interest. In such circumstances, the Commission will announce through an order a competitive process to determine the alternative default service provider, which may be either an EDC or a licensed EGS.

(c) When the Commission finds that an EDC should be relieved of the default service obligation, the competitive process for the replacement of the default service provider shall be as follows:

1. Any EDC or EGS that wishes to be considered for the role of the alternative default service provider shall apply for a certificate of public convenience, consistent with 66 Pa. C.S. §§1101-1103 (relating to certificates of public convenience).

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2. Applicants shall demonstrate their operational and financial fitness to serve and their ability to comply with all Commission regulations, orders and applicable laws pertaining to public utility service.

3. If no applicant can meet this standard, the incumbent EDC shall be required to continue the provision of default service

4. If one or more applicants meet the standard provided in §54.183(c)(2), the Commission shall grant a certificate of public convenience to act as a default service provider to the applicant best able to fulfill the obligation

5. An EGS that is granted a certificate of public convenience to act as an alternative default service provider shall be considered a public utility within the meaning of 66 Pa. C.S. §102.

§54.184. Default service provider obligations.

(a) A default service provider shall be responsible for the reliable provision of default service to all retail customers who are not receiving generation services from an alternative EGS within the certificated territory of the EDC that it serves.

(b) A default service provider shall comply with all applicable Commission regulations and orders to the extent that such obligations are not modified by this subchapter.

(c) A default service provider shall continue the universal service program in effect in the EDC's certificated service territory or implement, subject to Commission approval, a similar customer assistance program consistent with the provisions of the Electricity Generation Customer Choice and Competition Act, 66 Pa. C.S. §§2801-2812.

§54.185. Default service implementation plans and terms of service.

(a) A default service provider shall file a default service implementation plan with the Commission's Secretary's Bureau no later than fifteen months prior to the conclusion of the currently effective default service plan or Commission approved generation rate cap for that particular EDC service territory, unless the Commission authorizes another filing date.

(b) Default service implementation plans shall comply with all Commission regulations pertaining to documentary filings, except when modified by this subchapter. The default service provider shall serve copies of the default service implementation plan on the Pennsylvania Office of Consumer Advocate, Pennsylvania Office of Small Business Advocate, the Commission's Office of Trial Staff, and the RTO or ISO in whose control area the default service provider is operating.

(c) A default service implementation plan shall propose a minimum term of service of at least twelve months, or multiple twelve month periods, or for a period necessary to comply with §54.185(f).

(d) A default service implementation plan shall propose a fair, transparent and non-discriminatory competitive procurement process consistent with §54.186 for the acquisition of sufficient electric generation supply, 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 shall identify its method of compliance with the Alternative Energy Portfolio Standards Act, No. 213 of 2004.

(e) The Commission may direct that some or all default service providers file joint default service implementation plans that propose a competitive procurement process to procure electric generation supply for all of their default service customers. In the absence of such a directive, some or all

default service providers may jointly file default service plans that propose a competitive procurement process to procure electric generation for all of their default service customers. A multi-service territory competitive procurement process shall comply with §54.186.

(f) A default service provider shall document that its proposal is consistent with the legal and technical requirements pertaining to the generation, sale and transmission of electricity of the RTO or ISO in whose control area it is providing service. The default service plan's term of service and generation supply acquisition processes shall align with the planning period of that RTO or ISO.

(g) The default service implementation plan shall include a schedule of rates, rules and conditions of default service in the form of proposed revisions to its tariff. The default service provider may use the already effective retail customer classes in the EDC's service territory, or may propose a reclassification of retail customers.

(h) The default service implementation plan shall identify the costs, consistent with §54.187, that will be recovered through a schedule of rates for the provision of default service.

(i) The default service implementation plan shall include reasonable credit requirements, or other reasonable assurances of any supplier of electric generation services' ability to perform, as approved by the Commission.

(j) The default service implementation plan shall identify the load size and end date of all existing long-term generation contracts that are in effect between the EDC and a retail customer within its service territory. **This list shall distinguish between qualifying Alternative Energy Portfolio resources from other resources.**

(k) The default service implementation plan should include copies of any proposed confidentiality agreements for the protection of proprietary information of the default service provider and generation suppliers. The Commission will approve reasonable confidentiality agreements, including expiration provisions, that will be binding on the default service provider, generation suppliers and any third party involved in the administration, review or monitoring of a default service supply procurement process.

(l) The default service provider shall include in its implementation plan a replacement procurement process to ensure the reliable provision of default service in the event a supplier fails to deliver electric generation supply it has agreed to provide pursuant to the terms of a Commission approved competitive procurement process.

(m) The Commission may issue orders further specifying the form and content of default service implementation plans when necessary to enforce or carry out the provisions of the Electricity Generation Customer Choice and Competition Act, 66 Pa. C.S. §§2801-2812, and other applicable law.

§54.186. Default service supply procurement.

(a) A default service provider shall procure the electricity needed to provide default service ~~only~~ through ~~a competitive procurement bid solicitation~~ process ~~or including a~~ replacement procurement process approved by the Commission, **spot purchases from its ISO or RTO including a volatility protection plan;** and/or purchases or development of resources necessary to meet the standards of its **Alternative Energy Portfolio, subject to the following restrictions.** ~~with the following exceptions:~~

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Re: PA PUC's Rulemaking on Default Service
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(1) Hourly priced service provided pursuant to §54.187(e).

(2) Supply procured through RTO or ISO administered energy markets consistent with §§54.186(g), 54.187(i) or 54.188(e).

(b) A default service provider's competitive bid solicitation procurement process shall adhere to the following standards:

(1) A default service provider's supplier affiliate may participate in any competitive procurement bid solicitation process. The default service provider shall propose and implement protocols to ensure that its supplier affiliate does not receive an advantage in either the solicitation and evaluation of competitive bids, or any other aspect of the competitive procurement bid solicitation process. The process shall comply with the codes of conduct promulgated by the Commission at §54.122 (relating to code of conduct).

(2) A default service provider's proposed competitive procurement bid solicitation process shall include:

- (i) A bidding schedule.
- (ii) A definition and description of the power supply products on which potential suppliers shall bid.
- (iii) Bid price formats.
- (iv) The time period during which the power will need to be supplied for each power supply product.
- (v) Bid submission instructions and format.
- (vi) Bid evaluation criteria.

(vii) Relevant load data, including the following:

(A) Aggregated customer hourly usage data for all retail customers.

(B) Number of retail customers.

(C) Capacity peak load contribution figures by rate schedule.

(D) Historical monthly retention figures by rate schedule.

(E) Estimated loss factors by rate schedule.

(F) Customer size distribution by rate schedule.

(c) ——— A default service provider may obtain all or part of its resources needed to provide its default customers through purchases of spot resources on a real time-of-day basis from its ISO or RTO subject to the following conditions.

(1) All costs associated with these supplies may be recovered including but not limited to energy charges, capacity charges and ancillary charges.

(2) Whenever this approach is used to provide customers with loads of less than 500 kW, the default service shall submit to the Commission for its approval:

- 1. Fixed rates for a period of not less than one year. This may include rates for different classes of customers and may include on and off peak differentials. The Default Service Provider shall submit all underlying assumptions it used to reach these rates, the basis for these assumptions and a description of the model or methodology used to determine the estimates of spot prices needed to determine these rates.**
- 2. A Volatility Protection Plan. This plan may operate by the default service provider establishing or having established a Volatility Protection Fund (VPF). The initial size and cost of the fund must be approved by the Commission. The default service provider must submit detailed explanation of why the VPF is being set at its proposed size. The cost of maintaining this fund, including but**

not limited to interest and the costs of managing the Fund shall be full recoverable through default service rates.

a. Whenever rates charged are in excess of costs incurred to provide the service, this excess shall be deposited into the VPF by the default service provider. If this situation is persistent, the Commission may order a reduction in the VPF.

b. Whenever rates charged are less than the costs incurred, the deficiency shall be withdrawn from the VPF by the default service provider. If this condition is persistent the Commission may order the default service provider to increase the VPF.

c. Changes in the size of the VPF may result in the cost associated with maintaining the Fund.

d. Any interest earned by the VPF shall be used to offset the costs of maintaining the Fund.

e. The VPF may be audited periodically as the Commission finds appropriate.

(3) Larger default customers served by spot market purchases may be either charged the spot rate or allowed to participate in the Volatility Protection Plan in accordance with the approved terms and conditions of the Plan.

(c) A default service provider may employ a third-party to design and implement the competitive procurement process including the development of its base prices and Volatility Protection Plan.

(d) The competitive procurement process may be subject to direct oversight by the Commission or an independent third party. Any third party shall report to the Commission. Commission staff and any third party involved in oversight of the procurement process shall have full access to all information pertaining to the competitive procurement process, and may monitor the process

either remotely or where the process is administered. Any third party retained for purposes of monitoring the competitive procurement process shall be subject to confidentiality agreements identified in §54.185(k). **Whenever the resource mix includes resources from a bid solicitation process, the default service provider must demonstrate why these resources are preferable to spot purchases made from its ISO or RTO. Whenever the resource mix excludes direct purchases from the RTO or ISO the default service provider must demonstrate why this resource was not considered to be an appropriate supply resource.**

(e) **When using a bid solicitation process,** the default service provider shall evaluate and select winning bids in a non-discriminatory manner based on bid evaluation criteria set forth consistent with §54.186(b)(2)(vi).

(f) The Commission shall review the acquisition of generation supply and verify compliance with the approved competitive procurement process as follows:

(1) The Commission's review shall occur within a time period as specified in the approved competitive procurement process.

(2) The review period may not be less than 3 business days.

(3) The Commission's verification of compliance with an approved competitive procurement process shall constitute its certification of the default service provider's compliance with the approved default service implementation plan.

(g) If the implementation of a competitive procurement process under this section does not result in sufficient electric supply to meet the default service

provider's full load requirements, the default service provider shall repeat the competitive procurement process. The default service provider may petition for necessary changes to the previously approved competitive procurement process to ensure the acquisition of sufficient supply. When necessary to procure electric generation supply before the completion of another competitive procurement process, a default service provider shall acquire supply at prevailing market prices and shall fully recover all reasonable costs associated with this activity. In this circumstance, the prevailing market price shall be the price of electricity in the RTO or ISO's administered energy markets in whose control area that service is being provided. The default service provider shall follow acquisition strategies that reflect the incurrence of reasonable costs, consistent with 66 Pa. C.S. §2807(e)(3), when selecting from the various options available in these energy markets.

(h) The bids submitted by a supplier under the competitive procurement process shall be treated as confidential through the expiration date identified in the confidentiality agreement approved by Commission pursuant to §54.185(k). The default service provider, the Commission, and any third party involved in the administration, review or monitoring of the procurement process, shall be subject to this confidentiality provision.

§54.187. Default service rates and the recovery of reasonable costs.

(a) The costs incurred for providing default service shall be recovered through the following mechanisms or charges:

(1) Generation supply charge – the generation supply charge is a non-reconcilable charge that includes all reasonable costs associated with the acquisition of generation supply through §54.186, exclusive of the costs of generation supply recovered through §54.187(a)(3), to meet default service

demand. **Non-reconcilable shall not apply to ongoing adjustments associated with the VPF that may affect the actual annual net interest expense of the VPF.** The associated costs with this charge include:

(i) The prevailing market price of energy.

(ii) _____ ~~(ii)~~ The prevailing market price of RTO or ISO capacity or any similar obligation.

(iii) The costs associated with the VPF including but limited to the fund management cost and the estimated net interest expense adjusted for prior periods.

(iviii) FERC approved ancillary services and transmission charges.

(viv) Required RTO or ISO charges.

vi(v) Applicable taxes.

(viivi) Other reasonable, identifiable generation supply acquisition costs.

(2) Customer charge – The customer charge is a non-reconcilable, 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 §54.187(a)(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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(ii) A reasonable return or risk component for the default service provider, excluding any interest expenses associated with the VPF.

(iii) Applicable taxes.

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

(3) A default service provider shall use an automatic energy adjustment clause, consistent with 66 Pa. C.S. §1307 to recover reasonable costs incurred through compliance with the Alternative Energy Portfolio Standards Act, No. 213 of 2004. **The amounts recoverable shall be considered regulatory assets.**

(4) The costs recovered through the preceding charges and mechanisms shall not be recovered by an EDC acting as a default service provider through its Commission approved distribution rates.

(b) A default service plan shall include a fixed rate option for all residential customers.

(c) A default service implementation plan shall include a fixed rate option for non-residential default service customers whose load test indicates a registered peak demand of 500 or less kilowatts.

(d) 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. The default service provider may propose a fixed rate for these customers in its default service implementation plan.

(e) The rate for hourly priced service shall include:

(1) The RTO's or ISO's LMP or the equivalent pricing mechanism.

- (2) The prevailing market price of RTO or ISO capacity or any similar obligation.
- (3) FERC approved ancillary services and transmission charges.
- (4) Required RTO or ISO charges.
- (5) Applicable taxes.
- (6) Other FERC approved or reasonable, identifiable RTO or ISO charges and costs directly related to the hourly priced service.
- (7) Other reasonable and identifiable administrative or regulatory expenses.

(f) The default service implementation plan shall include rates that correspond to demand side response and demand side management programs available to retail customers in that EDC service territory.

(g) The default service implementation plan may include mechanisms that allow default service providers to adjust their prices during the term of service to recover reasonable, incremental costs of significant changes in the number of default service customers or reasonable, incremental costs of other events that would materially prejudice the reliable provision of default service and the full recovery of reasonable costs.

(h) The default service provider's projected and actual incurred costs for providing service may not be subject to Commission review and reconciliation except in extraordinary circumstances, or as provided in §54.187(a)(3).

(i) When a generation supplier fails to deliver generation supply to a default service provider, the default service provider shall be responsible for acquiring replacement generation supply consistent with its Commission approved replacement procurement process. When necessary to procure electric generation supply before the completion of the replacement procurement process, a default service provider shall acquire supply at prevailing market prices and shall fully

recover all reasonable costs associated with this activity. In this circumstance, the prevailing market price will be the price of electricity in the RTO or ISO's administered energy markets in whose control area the default service is being provided. The default service provider shall follow acquisition strategies that reflect the incurrence of reasonable costs, consistent with 66 Pa. C.S. §2807(e)(3), when selecting from the various options available in these energy markets.

§54.188. Commission review of default service implementation plans.

(a) A default service implementation plan shall initially be referred to the Office of Administrative Law Judge for further proceedings as may be required.

(b) The Commission will issue an order within six months of a plan's filing with the Commission on whether the default service implementation plan demonstrates compliance with this subchapter and the provisions of the Electricity Generation Customer Choice and Competition Act, 66 Pa. C.S. §§2801-2812. The Commission may order modification of the terms of the proposed plan to ensure that a default service plan is compliant.

(c) The Commission will evaluate the default service implementation plan to ensure that it includes a fair, transparent and non-discriminatory competitive procurement process for all potential suppliers provided under §54.186.

(d) Upon entry of the Commission's final order, the default service provider shall acquire generation supply for the term of service in a manner consistent with the terms of the approved competitive procurement process provided under §54.186, and report the bids submitted by EGSs in writing to the Commission.

(e) The Commission will certify the results of a competitive procurement process in their entirety or reject them due to non-compliance with the approved procurement process. If the Commission rejects the results due to non-compliance, the default service provider shall repeat the approved competitive procurement process. When necessary to procure electric generation supply before the completion of the subsequent competitive procurement process, a default service provider shall acquire supply at prevailing market prices and shall fully recover all reasonable costs associated with this activity. In this circumstance, the prevailing market price will be the price of electricity in the RTO or ISO's administered energy markets in whose control area that service is being provided. The default service provider shall follow acquisition strategies that reflect the incurrence of reasonable costs, consistent with 66 Pa. C.S. §2807(e)(3), when selecting from the various options available in these energy markets.

(f) Upon completion of the competitive procurement process, the default service provider shall provide written notice to all default service customers and the named parties identified in §54.185(b) of the Commission certified default service prices and terms and conditions of service no later than 60 days before their effective date, unless another time period is approved by the Commission. The default service provider shall also provide written notice to the named parties identified in §54.185(b) containing an explanation of the methodology used to calculate the price for electric service.

(g) A default service provider may petition for a waiver of any part of these regulations, in a manner consistent with 52 Pa. Code §5.43 (relating to petitions for issuance, amendment or waiver of regulations). The Commission may grant waivers of these regulations to ensure the reliable provision of default service and to enforce and carry out the provisions of the Electricity Generation

Customer Choice and Competition Act, 66 Pa. C.S. §§2801-2812 and any other applicable laws.

§54.189. Default service customers.

(a) At the conclusion of an EDC's Commission approved generation rate cap, all retail customers who are not receiving generation service from an EGS shall be assigned to the Commission approved default service implementation plan.

(b) A default service provider shall accept all applications for default service from new retail customers and retail customers who switch from an EGS, if the customers comply with all Commission regulations pertaining to applications for service.

(c) A default service provider shall treat a customer who leaves an EGS and applies for default service as it would a new applicant for default service.

(d) A default service customer may choose to receive its generation service from an EGS at any time, if the customer complies with all Commission regulations pertaining to changing generation service providers.

(e) A default service provider may not charge a fee to a retail customer that changes its generation service provider in a manner consistent with Commission regulations.

**CHAPTER 57. ELECTRIC SERVICE
Subchapter M: STANDARDS FOR CHANGING A CUSTOMER'S
ELECTRIC GENERATION SUPPLIER**

* * * * *

§57.178. [Provider of Last Resort] Default service provider.

This subchapter does not apply when the customer's service is discontinued by the EGS and subsequently provided by the [provider of last resort] default

*Comments submitted by David Magnus Boonin
Re: PA PUC's Rulemaking on Default Service
Docket Numbers L-00040169 and M-00041792*

service provider because no other EGS is willing to provide service to the customer.

APPENDIX B

Extracted from:

The Price of Power: The Valuation of Power and Weather Derivatives

Craig Pirrong and Martin Jermakyn

December 4, 2003

***Comments submitted by David Magnus Boonin
Re: PA PUC's Rulemaking on Default Service
Docket Numbers L-00040169 and M-00041792***

Page 36

Figure 4 PJM Expected Spot and Fitted Forwards

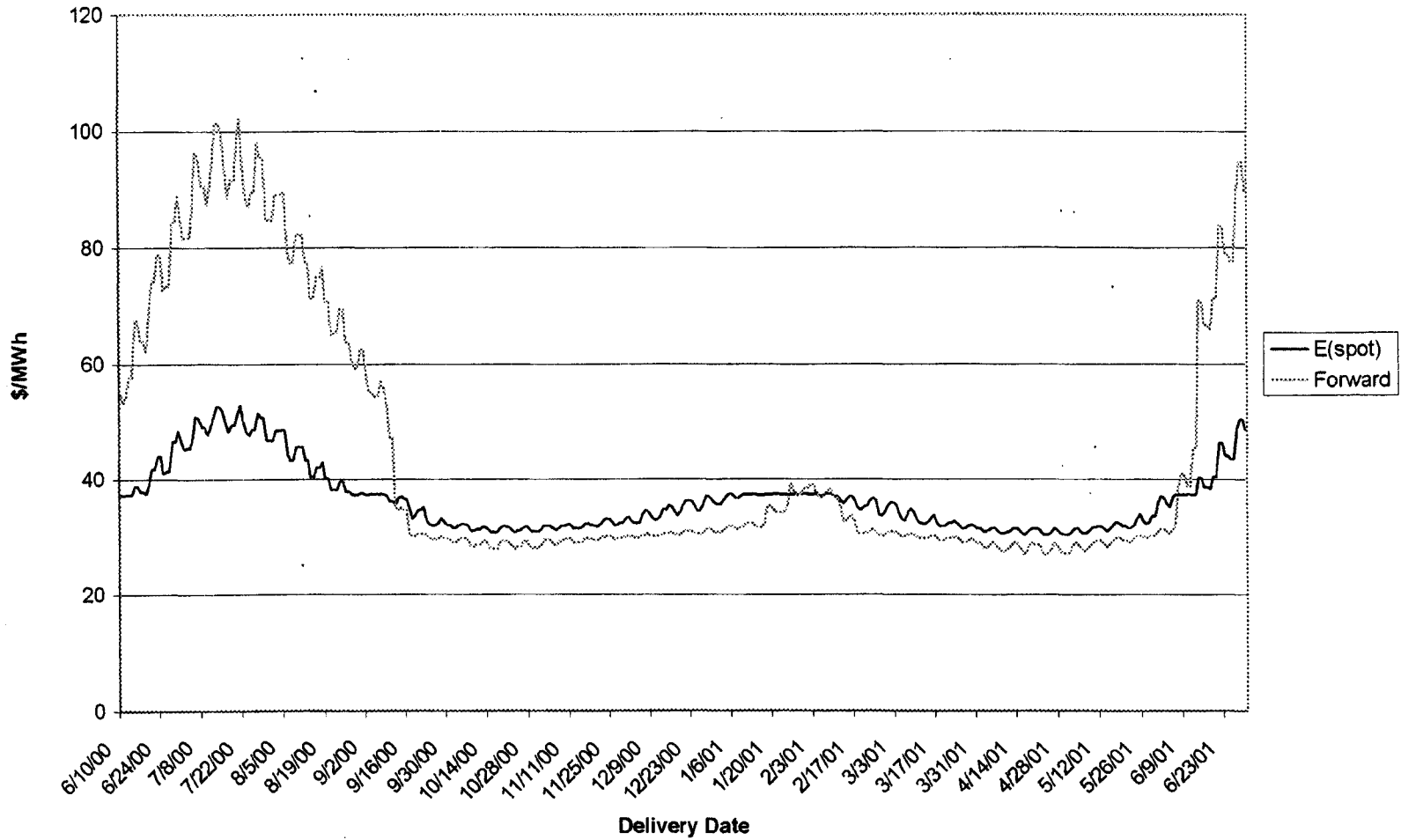


Figure 5
PJM July Forward and Expected Spot Prices

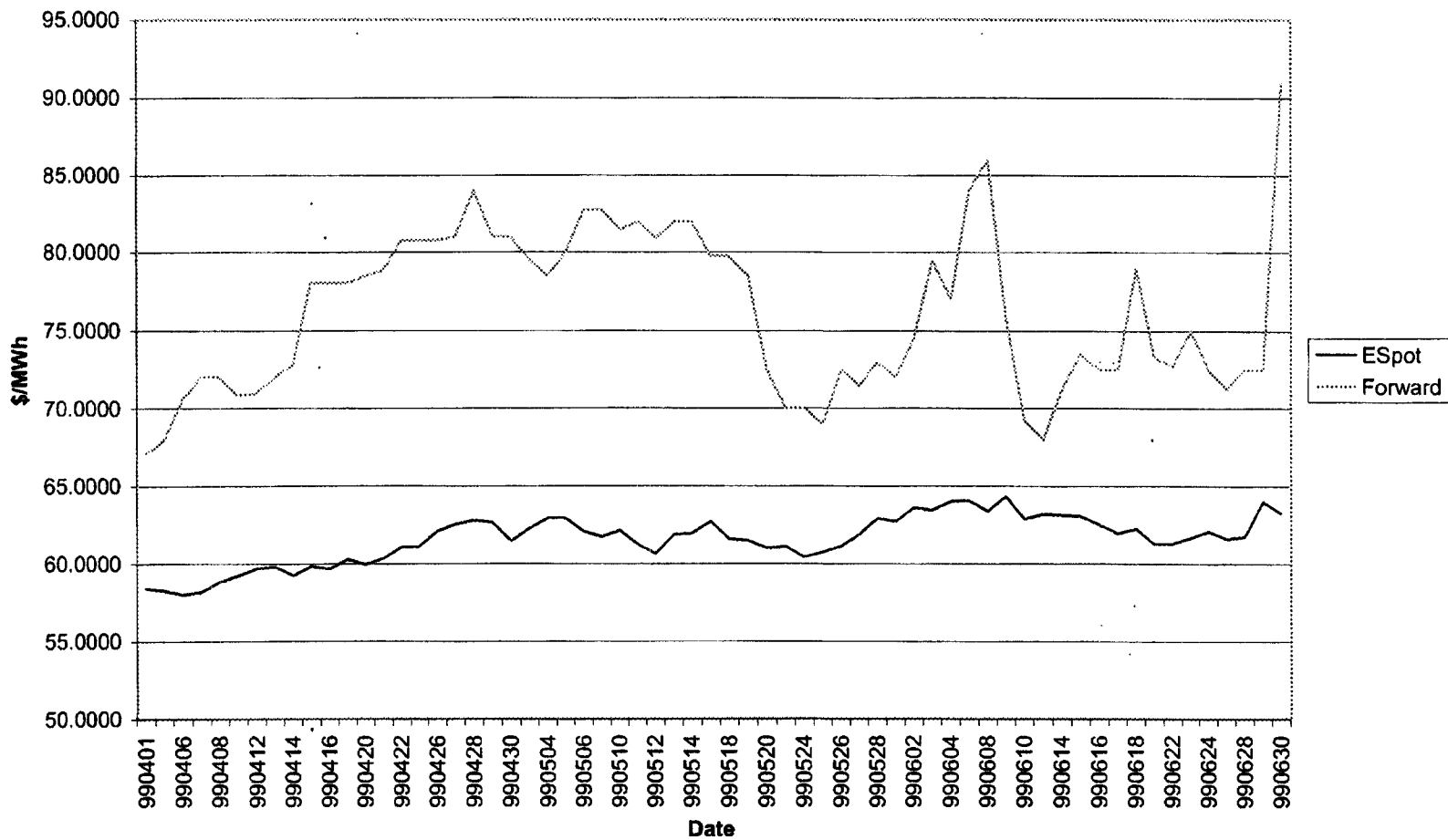
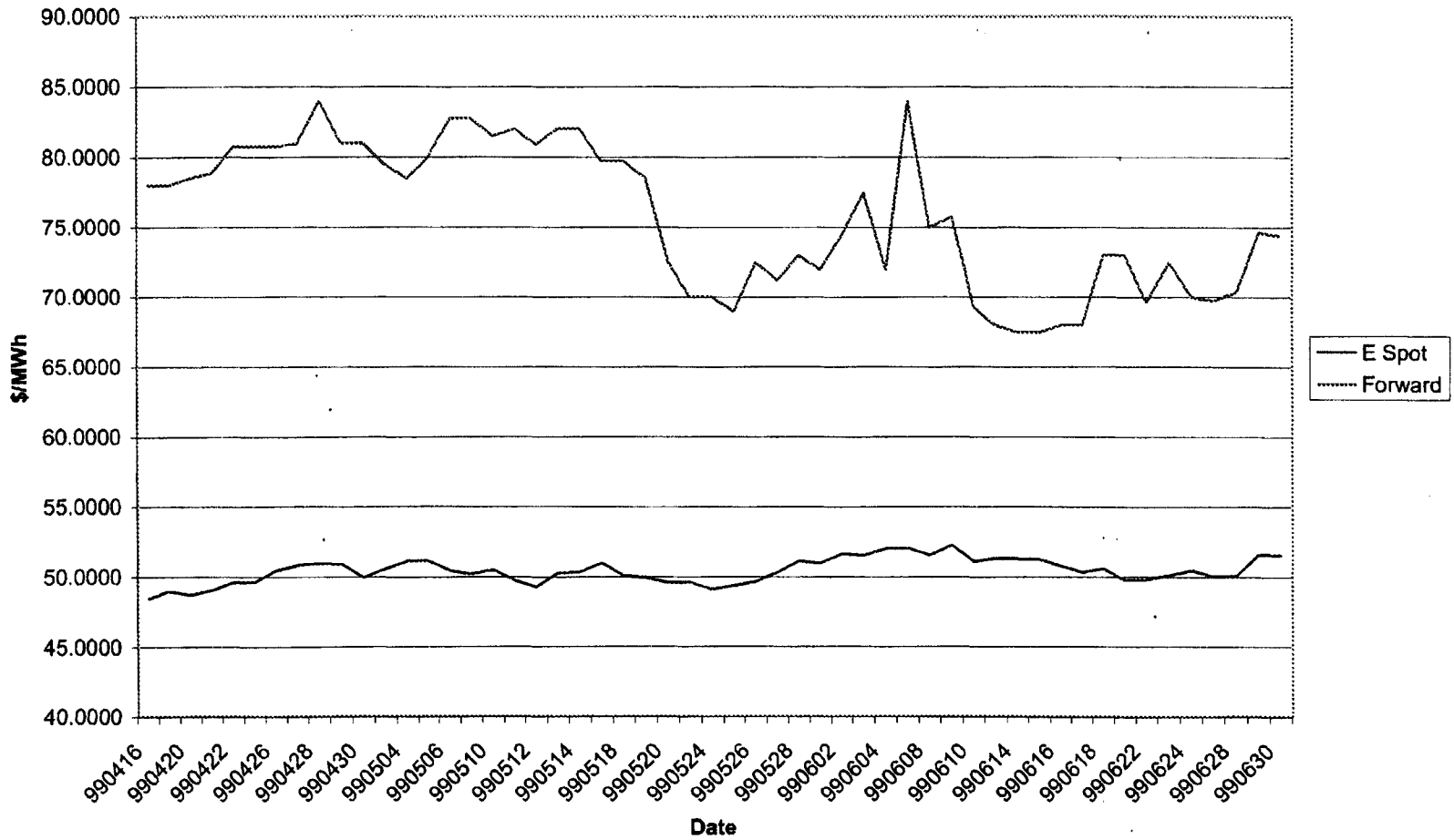


Figure 6
PJM August Forward and Expected Spot Prices



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April 27, 2005

VIA FEDERAL EXPRESS

James McNulty, Secretary
PA Public Utility Commission
Commonwealth Keystone Bldg.
2nd Fl., 400 North Street
P.O. Box 3265
Harrisburg, PA 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. Section
2807(e)(2); Docket No. L-00040169

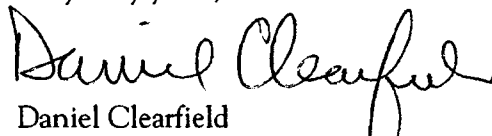
RECEIVED
2005 MAY -3 PM 3:51
PUBLIC UTILITY COMMISSION

Dear Secretary McNulty:

Enclosed are the original and fifteen (15) copies of Direct Energy LLC's Comments in the above-referenced matter. As requested, we are also sending an email version of the Comments to Shane Rooney and Cyndi Page.

If you have any questions regarding this filing, please contact me at your convenience.

Very truly yours,



Daniel Clearfield
For WOLF, BLOCK, SCHORR and SOLIS-COHEN LLP

DC/jls
Enclosures

cc: Shane Rooney w/enc (e-mail)
Cyndi Page w/enc (e-mail)

HAR:58750.1/DIR023-216494

Boston, MA ■ Cherry Hill, NJ ■ Harrisburg, PA ■ New York, NY ■ Norristown, PA ■ Philadelphia, PA ■ Roseland, NJ ■ Wilmington, DE

WolfBlock Government Relations - Harrisburg, PA ■ WolfBlock Public Strategies - Boston, MA and Washington, DC

Wolf, Block, Schorr and Solis-Cohen LLP, a Pennsylvania Limited Liability Partnership

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

RECEIVED
2007 MAY -3 PM 3:51

Rulemaking Re :
Electric Distribution Companies' :
Obligation to Serve Retail Customers at the : Docket No. L-00040169
Conclusion of the Transition Period :
Pursuant To 66 Pa. C.S. §2807(e)(2) :

PENNSYLVANIA
PUBLIC UTILITY COMMISSION

COMMENTS OF DIRECT ENERGY SERVICES, LLC

Direct Energy Services, LLC ("Direct Energy") submits these comments to demonstrate that a full Retail Default Service bid out model – rather than the structure initially proposed by the Commission – provides the greatest opportunity for competitive market forces to deliver the best value to consumers in the post-transition period as envisioned by the Electric Choice Act. If the Commission nonetheless decides to not adopt Direct Energy's model, Direct Energy suggests modifications to the structure initially proposed by the Commission so that market distortions will be minimized and so that consumers can fully realize the benefits of a competitive electricity market, including product options, innovation, service improvement and downward pressure on electricity prices.

I. Introduction and Summary

Direct Energy, a licensed electric generation supplier ("EGS"), is a subsidiary of Centrica, a leading provider of energy and other energy-related services to over 18 million households worldwide, with annual revenues of \$31 billion and \$17 billion in market capitalization, and over 38,000 employees. Direct Energy has over 3.5 million gas and electricity customers in North America. Direct Energy serves about 25,000 residential and small commercial natural gas customers in Western Pennsylvania. In serving electricity customers in

the U.S., Direct Energy provides an "all in" service, including billing and customer care service, and acts as the single point of contact for electricity service, including acquiring and paying for the utility's distribution service. Direct Energy offers retail customers a variety of product options, including multi-year price protection programs that allow customers to mitigate their specific concerns about energy prices.

Direct Energy's position on the issues concerning post-transition Default Service is informed by Centrica's experiences in the United Kingdom, Texas and Canada. In Texas and Canada, Direct Energy provides default and equivalent service in place of the utilities. In the UK, competitive electricity and gas markets have resulted in switching by almost one-half of all customers, and customers have experienced substantial savings as well as service improvements and innovation – demonstrating conclusively that competitive markets can and do work.

The General Assembly has determined that competition is the law of the land for Pennsylvania. In the order initiating this rulemaking, the Commission correctly determined that Default Service "should primarily serve as a backstop to the competitive retail market" and that an appropriately crafted framework for Default Service serves the public interest "by fostering a robust retail market for electricity."¹ The Commission has thus recognized the wisdom of the General Assembly's determination that competition provides the right tools to deliver the best service to retail electric consumers. Therefore, every decision the Commission makes concerning the post-transition period should be in favor of more competition, not less. This is especially true for the design of post-transition Default Service, which the Commission agrees "is the most important task remaining for the Commission in the implementation of the Act."²

¹ December 16, 2004 Order at 5.

² *Id.*

The Commission's proposal to have the incumbent utilities provide Default Service through a wholesale supply bid out is simply the wrong approach. On the other hand, Direct Energy's proposal to bid out the entire Retail Default Service function to qualified EGSs will permit competitive market forces to deliver the best value and service to consumers. Simply put, under the Retail Default Service model, the EGS winning the bid will provide retail electric service to the end user, and will be responsible for billing, collecting and customer care. Many EGSs have the resources and wherewithal to provide Retail Default Service. Having companies other than the incumbent utilities provide default and equivalent service has worked in other territories. In fact, Direct Energy is the provider of "Price to Beat Service" to approximately 700,000 electricity customers in Texas, and finalized an agreement last year to become the provider of "Default Service" to 980,000 gas and electric customers in Alberta, Canada.

The Commission has acknowledged that it has the authority to require a Retail Default Service model.³ However, the Commission has declined to propose a Retail Default Service model for the post-transition period because "the competitive retail market is still in transition." Direct Energy suggests that this rationale does not fully recognize that the rules established in this proceeding will not become effective for the majority of retail customers until January 1, 2011.⁴ Also, this rationale is not consistent with the Commission's determinations that Default Service is both to backstop and foster the competitive retail electric market, and must avoid distortions to the operation of the market.⁵

³ *Id.* at 8.

⁴ Stranded cost recovery periods and rate caps expire December 31, 2010 for the following utilities: West Penn Power Company, Pennsylvania Electric Company, Metropolitan Edison Company and PECO Energy Company.

⁵ December 16, 2004 Order at 5.

Direct Energy submits that, rather than counseling *against* adoption of a Retail Default Service model for the post-transition period, the current market environment demonstrates why the Commission must implement a Retail Default Service bid out for the post-transition period. Otherwise it is likely that competitive market forces will not be able to deliver all of the benefits of competition to customers. The high levels of shopping during the phase-in of electric choice have not been sustained through the transition period primarily because stranded cost charges and rate caps have distorted the normal relationship between wholesale and retail electric markets and prices.⁶ The completion of the utilities' stranded cost collections and the expiration of administratively determined capped rates provide the Commission with the opportunity to do what the General Assembly envisioned in enacting the Electric Choice Act – rely upon full competition to deliver value to customers.

II. A Retail Default Service Bid Out Will Provide the Benefits of Full Competition to Default Service Customers in the Post-Transition Period as Envisioned by the Electric Choice Act.

The purpose of the Electric Choice Act is to "create direct access by retail customers to the competitive market for the generation of electricity."⁷ The reason for this innovation is the General Assembly's declaration that markets are superior to economic regulation in determining the costs of generating electricity.⁸ The Commission's order initiating this rulemaking correctly determines that this is "one of the key policy declarations of the Act."⁹ This key policy

⁶ Former Chairman Fitzpatrick recognized this market distortion in his Concurring Statement to the Commission's decision addressing requests for reconsideration in Duquesne's POLR III case, and in the list of reports and quotations attached to his statement as Appendix A.

⁷ 66 Pa. C.S. § 2802(12).

⁸ 66 Pa. C.S. § 2802(5).

⁹ December 16, 2004 Order at 4. Other key policy declarations identified by the Commission are: "POLR service should be reliable, available on reasonable terms and conditions, associated with high-quality customer service, and provided consistent with the level of protections currently afforded to low-income customers. 66 Pa. C.S. §§2802(9), (10), (11)." *Id.* The Commission also

declaration is the basis for the General Assembly's pricing standard for Default Service in the post-transition period: prevailing market prices and full recovery of all reasonable costs.¹⁰

The Commission has correctly determined that "to foster a competitive market, any POLR service model must be carefully designed to avoid distortions in the market" because the primary function of POLR service is to backstop the competitive retail market.¹¹ Direct Energy believes that the Commission's proposal will distort the retail market and therefore is not supportive of the broader goals of the Act. Moreover, even in the best light, the Commission's proposal can only capture a portion of the benefits the competitive market can provide to customers after the transition period market ends. The Commission must go further and permit competitive market forces to work in the post-transition period as envisioned by the General Assembly by bidding out the entire Retail Default Service function.

There is no dispute that the scope of the post-transition Default Service function is set forth in Section 2807(e)(3) of the Electric Choice Act:

If a customer contracts for electric energy and it is not delivered or if a customer does not choose an alternative electric generation supplier, the electric distribution company or **commission-approved alternative supplier** shall acquire electric energy at prevailing market prices to serve that customer and shall recover fully all reasonable costs.¹²

Thus, the General Assembly has declared that after the transition period, the market is to determine the price for Default Service and, as the Commission acknowledges, the Act envisions that post-transition Default Service can be provided by an EGS alternative provider through a

previously recognized that the means to accomplish these goals is through the competitive market and not through regulation. *Petition of Duquesne Light Company*, Docket No. P-00032071, Order entered August 19, 2004, at 7.

¹⁰ 66 Pa. C.S. § 2807(e)(3).

¹¹ December 16, 2004 Order at 5.

¹² 66 Pa. C.S. § 2807(e)(3) (emphasis added).

competitive retail bid out process.¹³ Section 2802(16) of the Act also declares that "[e]lectric distribution companies should continue to be the provider of last resort *in order to ensure the availability of universal electric service* in this Commonwealth unless another provider of last resort is approved by the Commission."¹⁴ Contrary to the Commission's statement,¹⁵ Direct Energy submits that this provision does not express a preference for utilities to continue the role of Default Service Provider in the post-transition period as a general matter, but rather *only* for the purpose of ensuring the availability of universal electric service. There is no reason why a Retail Default Service bid out could not ensure the availability of universal service from a non-utility Default Service Provider. Bidding out the full Retail Default Service function, with a commitment that the bidder agree to provide service according to all PUC rules, regulations and guidelines, will ensure that competitive market forces deliver the best value to customers for these services in a manner that meets all the key policy declarations of the Electric Choice Act.¹⁶

The Commission should adopt Direct Energy's Retail Default Service proposal to auction off the full retail obligation to default service customers.¹⁷ Under Direct Energy's alternative model, the **entire** Retail Default Service function would be bid out to qualified EGSs who would provide not just the generation service to customers but the retail functions needed to provide the

¹³ *Id.* at 8.

¹⁴ 66 Pa. C.S. § 2802(16) (emphasis added).

¹⁵ Having the EDC act as the default service provider "is consistent with the General Assembly's declaration of policy that incumbent EDCs should continue to act as the default service provider unless the Commission approves an alternative provider. 66 Pa. C.S. §2802(16)." *Id.* at 8-9.

¹⁶ As stated above, the key policy declarations identified by the Commission are that market forces are superior to economic regulation in determining the cost of electric generation, and that POLR service should be reliable, available on reasonable terms and conditions, associated with high-quality customer service, and provided consistent with the level of protections currently afforded to low-income customers. *Id.* at 4.

¹⁷ Proposed regulations to implement Direct Energy's Retail Default Service proposal are attached as Appendix A.

retail service (billing, customer care, etc.) as well. The EDC would continue to meter the service and be responsible for physically terminating a customer's service, as well as retail back-up service for short-term energy replacement. The EDC would not receive an "adder" but could be compensated by a small one-time fee to pay for transferring customers. Other key features of Direct Energy's alternative model, as it is presently being proposed, are:

- Several companies could provide full Retail Default Service (no EDC affiliate could provide service to more than 1/3 of the customers in its affiliated EDC's service territory, and each EDC service territory would have at least three Retail Default Service Providers).
- Companies affiliated with EDCs could bid (so PECO could bid to serve customer in West Penn's service territory – or vice versa) provided the EDC-affiliate is structurally separated from the EDC; statewide, EDC-affiliates would be limited to 2 million customers.
- Retail customers would have an "opt out" option, in which case the customers would take the EDC's monthly priced "default" service.
- Retail Default Service Providers would post security against business failure (other Retail Default Service Providers would be required to step in if needed).
- Retail Default Service Providers would provide service according to all Commission rules, regulations and guidelines, including universal service.

Advantages of Direct Energy's Retail Default Service proposal include:

- **The Retail Default Service Model Brings Greater Value to Consumers** – The right to be the Retail Default Service Provider is valuable. The Retail Default Service bid process will unlock that value and force the winning bidder to share it with customers.
 - Bids would be for two year period, providing stable transition to full competitive market-based prices (without a retail "default" supplier).
- **The Retail Default Service Model Promotes Reliability** – Several companies in each service territory will be set up to serve large numbers of customers.
 - Financial security will compensate any company that takes over for a Retail Default Service Provider/winning bidder that subsequently abandons the market.
- **The Retail Default Service Model will Promote Greater Retail Competition** – The ability of all customers to select from a range of competitors and variety of

products is one of the most important outcomes of any further reform for the electricity market .

- The retail competitive market in Pennsylvania has been shown to offer great benefits to customers when customers are exposed to market-based default prices.¹⁸
- Allowing a variety of companies to provide Retail Default Service will give them a stake in the Pennsylvania competitive market – and a base from which they can compete to serve other consumers in Pennsylvania.
- **The Retail Default Model Can Promote Greater Energy Diversity and Economic Development.**
 - As a condition of the bid, the bidder could propose any increase or expansion in the otherwise applicable AEPS standards for that service territory. Additionally, the bidder would be required to make a contribution to an economic development fund.

Direct Energy's proposal squarely responds to the Commission's view that "the framework associated with implementing a retail POLR model requires further review and consideration."¹⁹ Direct Energy's Retail Default Service Model will provide immediate, real benefits to retail customers by taking the economic profits embedded in EDCs' monopoly on providing default service and forcing this value of incumbency to end users. At the same time it provides these benefits from competitive market forces, Direct Energy's proposal satisfies the post-transition standard of Section 2807(e)(3) that Default Service reflect prevailing market prices and provide for full recovery of all reasonable costs. The Retail Default Service bid out will produce market-based prices that reflect the market-based costs of the Retail Default Service provider (generation procurement expenses, customer migration risks/costs, administrative & operational costs, customer care costs, and reasonable profits), and will permit default prices to reflect the different risks and costs of serving Default Service customers.

¹⁸ The increased competition among large business customers versus the lack of competition among residential and small business customers in Duquesne's service territory demonstrates this most clearly.

¹⁹ December 16, 2004 Order at 9.

However, Direct Energy's proposal alters the Commission's proposed process for appointing an alternative Default Service Provider ("DSP").²⁰ By requiring an alternative DSP to obtain a certificate of public convenience, the Commission's proposed process treats an alternative DSP as a full-fledged "public utility" under the Public Utility Code. The Electric Choice Act envisions just the opposite. Section 2807(e)(3) states that "*the electric distribution company or commission-approved alternative supplier shall acquire electric energy at prevailing market prices to serve*" default service customers. This language shows the General Assembly's intent that an alternative Default Service Provider is not to be an EDC-type public utility. An alternative DSP will provide service through contract only to a segment of customers and will not be providing EDC "public utility" service. A blanket requirement for an EGS to become a "full-fledged" public utility if it is to serve as an alternative DSP is also contrary to requirement of Section 2809(e) of the Act. This section requires the Commission to show that the imposition of additional Public Utility Code provisions applicable to EDCs is necessary to maintain quality of service, protect the public or ensure safety and reliability of electric service.²¹ Such a blanket requirement is also not good policy and is unnecessary. The Commission need only impose financial security requirements on an alternative DSP to guarantee performance which, in effect, will treat the alternative DSP the same as an EGS rather than a utility.

III. Commission's Proposal

The Commission has proposed that Default Service should be provided through a wholesale auction with the incumbent EDC continuing the customer relationship. Direct Energy does not support wholesale auctions to provide default service for the following reasons:

²⁰ December 16, 2004 Order at 9; Annex A, proposed Section 54.183(b),(c).

²¹ 66 Pa. C.S. § 2809(e); see *PPL Energyplus v. Com.*, 800 A.2d 360, 362 (Pa.Cmwlth. 2002); 814 A.2d 861, 864-65 (Pa.Cmwlth. 2002), *reversed on other grounds, Delmarva Power & Light Co. v. Commonwealth & Pa. PUC*, 2005 Pa. LEXIS 632 (Pa., March 31, 2005).

- Wholesale auctions, especially when structured as long-term price hedge arrangements, do not provide customers with proper price signals,
- Wholesale auctions do not provide generators with proper price signals to make incremental investments in power stations,
- Wholesale auctions do not allow consumers the opportunity to effectively manage their energy usage in response to price signals,
- Wholesale auctions do not encourage customers to become educated shoppers of retail electricity prices,
- Wholesale auctions do not enable consumers to see and make decisions based on reducing the environmental impact of their energy usage, and
- Wholesale auctions fail to recognize the critical non-price benefits of retail competition, especially product innovation and service improvements.

The Commission has suggested that customers be provided with default pricing with a proposed term of service of at least one year, and an initial term of 17 months²². Providing default fixed pricing for periods of 12, 17 or more months will not create a workable retail market, as demonstrated by the lack of competitors and product options in New Jersey. Moreover, a wholesale auction model will give consumers little incentive to consider the environmental impact of their energy usage, as customers will be provided with a fixed price regardless of their usage pattern. Consumers will not be empowered or even encouraged to respond to, let alone see, the prevailing market price. As the Commission's proposed model will result in a disconnect between the price consumers pay and the prevailing market price, demand response will not be considered. In order to be able to effectively promote demand side response consumers should have the opportunity to effectively manage their energy usage in response to

²² December 16, 2004 Order at 11.

price signals. Also, as can be seen from the experience in New Jersey, wholesale auctions do not promote the development of a competitive market. In February 2005, New Jersey had 1,481 residential customers being served by alternate suppliers out of a market with well over 3 million residential customers, resulting in a participation rate of less than 0.05%.²³ Forcing consumers onto extended default fixed prices provided through a wholesale auction is ultimately bad for the environment, does not empower consumers to be able to make their own decisions and will stifle the creation of a competitive market. Providing consumers with prevailing market prices through monthly pricing will allow them to make rational decisions, use energy more efficiently and will provide consumers with options for their energy supply through the competitive market.

IV. Modifications To The Commission's Proposal

If Direct Energy's Retail Default Service model is not adopted as the post-transition Default Service model, the Commission's proposal should be modified according to the six points outlined below.

1. The Commission should include Direct Energy's model as a pilot program for each EDC territory to be implemented according to a definite timetable, or upon petition from a qualified entity. The New York Public Service Commission recently approved a settlement in a Consolidated Edison rate case that includes on-going consideration of the implementation of such a retail auction pilot.²⁴ The Commission should embrace this opportunity to continue to be at the forefront of exploring ways to increase development of the competitive retail market. The Commission could direct that 20% of residential and small commercial customers be subject to a

²³ New Jersey Board of Public Utilities Electric Switching data for February, 2005, available at <http://www.bpu.state.nj.us/energy/elecSwitchData.shtml>.

²⁴ Case # 04E0572. See ORDER ADOPTING THREE-YEAR RATE PLAN, issued by the New York Public Service Commission March 24, 2005 available at: [http://www3.dps.state.ny.us/pscweb/WebFileRoom.nsf/ArticlesByCategory/BFCF5488B5C3620A85256FCD005A5F0F/\\$File/04e0572.ord.03.24.05.pdf?OpenElement](http://www3.dps.state.ny.us/pscweb/WebFileRoom.nsf/ArticlesByCategory/BFCF5488B5C3620A85256FCD005A5F0F/$File/04e0572.ord.03.24.05.pdf?OpenElement).

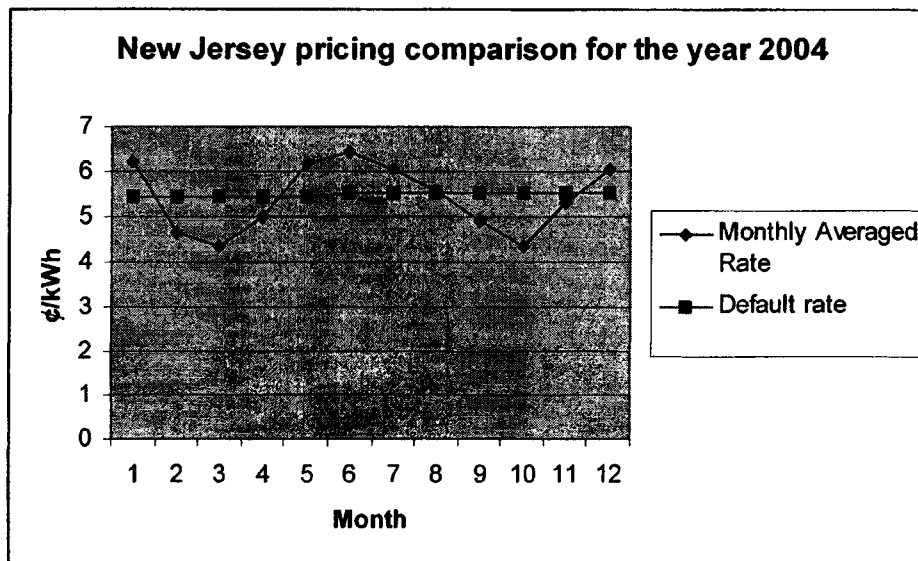
full retail POLR model bid out. The results of the pilot could then be monitored to allow the Commission to judge the success of the program in light of real-world conditions.

2. With respect to the details of Commission's proposed wholesale supply model, the Commission should require a uniform statewide competitive procurement process rather than permitting each EDC to implement a different procurement process for its service territory. Requiring Competitive Suppliers to deal with many different procurement rules and practices imposes anticompetitive burdens on suppliers that are unnecessary and not outweighed by any purported benefits to individual EDCs. Additionally, having differing rules on default supply is confusing for Pennsylvania consumers that move between EDC territories or that have meters in more than one EDC territory. Providing uniformity in rules and practices across the state promotes customers understanding of and ability to participate in the market.

3. Default prices for residential customers and small business customers should be set at a monthly average price and, as the Commission has suggested, not be subject to reconciliation. By setting monthly average prices the Commission will allow customers to see the "prevailing market prices", will eliminate the need for reconciliations or true-ups, which are inherently difficult for consumers to understand, and will reduce the opportunity and risk of "gaming".

Monthly average prices can result in savings for default consumers when compared to fixed default prices gained through a wholesale auction and will not result in extreme monthly volatility in prices. Internal analysis of New Jersey's market by Direct Energy shows just this result. Comparing pricing under the New Jersey wholesale auction model and what monthly prices in 2004 could have been demonstrates that electricity consumers would have benefited to a tune of \$6 million had New Jersey used the structure advanced by Direct Energy. Moreover, while there would have been seasonal price variations, consumers would not have seen dramatic

price volatility. Monthly prices would have ranged from a low of 4.33¢/kWh in March to a high of only 6.45¢/kWh in June. Clearly this approach gives consumers a fair arrangement, minimizes the migration risk issues, provides better price signals to consumers to understand their usage and environmental impact, and allows for real retail competition.



Graph compiled from Direct Energy analysis

Opponents of monthly pricing claim that it would expose consumers to the volatility of the spot market prices. However, these views fail to recognize that consumers pay the average price over an entire month, whereas perceptions of price volatility are generally based on hour-to-hour spot market price changes.

4. The threshold between small and large business customers should be reduced from 500 kW annual peak demand as proposed to 25 kW annual peak demand, consistent with the Commission's regulations concerning customer information²⁵ with all large business customers (≥ 25 kW annual peak demand) receiving hourly pricing as their default option. The Commission should rely upon the competitive market to deliver fixed price options to these customers, as customers have been able to in Duquesne's service territory. Information on the

²⁵ 61 Pa. Code § 54.2.

Pennsylvania Consumer Advocate's website shows that as of April 1, 2005, over 43% of industrial customers in Duquesne's service territory are being supplied by alternative suppliers.²⁶ Any large business customers that do not have the appropriate technology to allow hourly pricing at the end of their EDCs transition period should be provided with hourly profiles to allow them to receive pricing which properly reflects their usage. If the Commission sets the threshold between large and small business customers above 25kW annual peak demand it should establish a schedule to reduce the threshold to 25kW over a set time period or establish a mechanism to allow the threshold to be reduced in the future. Setting the threshold at 500kW, which is higher than the threshold already set in the Duquesne service territory, without a means to revise this downward would reduce options available to customers and stifle the competitive market.

5. The Commission should require the deployment of advanced metering technology and the provision of EGS competitive metering to all customers prior to the end of each EDC's transition period to enable smaller commercial customers, and ultimately residential and small business customers, to obtain benefits of real-time pricing and demand response programs.

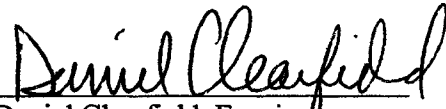
6. Finally, the proposed switching rules should be changed to state that the Default Service Provider must accept the return of shopping customers as the general rule, with exceptions only to prevent actual "gaming." The Commission's proposal treats the utility's acceptance of these customers as the exception rather than the rule. The Commission's proposal complies with Section 2807(e)(4) of the Act *only* if the utility can refuse to accept a returning customer for the same reasons it could refuse service to a new applicant, that is, bad credit concern. This concern is further minimized if the Commission adopts monthly pricing as the default price mechanism.

²⁶ <http://www.oca.state.pa.us/cinfo/instat.htm>, April 1, 2005 statistics.

V. Conclusion

The Commission has the opportunity to set the framework for a successful competitive electric market that will benefit all Pennsylvania consumers while ensuring that these customers will have access to reliable service. Direct Energy believes that the ultimate framework should foster a robust retail market and, wherever possible, should foster more competition. Direct Energy's primary and alternative proposals for the Commission's post-transition default service rules will accomplish these goals and should be incorporated into the final product.

Respectfully submitted,



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APPENDIX A

PENNSYLVANIA PUBLIC UTILITY COMMISSION

**DIRECT ENERGY'S PROPOSED REGULATIONS
Provision of Retail Default Service in Post-Transition Period**

1. Definitions.

“Act” – The act of December 3, 1996, known as the “Electricity Generation Customer Choice and Competition Act,” (P.L.802, No.138), as amended.

"Competitive Transition Charge" (CTC) - as defined in 52 Pa. Code § 54.2.

"Retail Back-Up Default Service" - Retail back-up service available to a customer in the event that: (i) the applicable Retail Default Service Provider or EGS was unable to provide service to that customer; (ii) the term of Retail Default Service has been completed; (iii) the customer is unable to receive Retail Default Service or EGS Retail Services for whatever reason; or (iv) the customer opts out of Retail Default Service. Default Service does not include service from a Replacement RDSP or a Designated RDSP.

“Designated Retail Default Service Provider” – A Retail Default Service Provider appointed by the Commission in accordance with section 5.

"Distribution" - the delivery of electricity over lines which operate at a voltage level typically equal to or greater than 110 volts and less than 69,000 volts to an end-use customer within the Commonwealth.

"Distribution Service" - the delivery of electricity to a retail customer by the electric distribution company, on behalf of the customer's EGS or Retail Default Service Provider, from points on the transmission system or from a generating plant, but shall in no case include any component of Retail Services as defined herein.

"Electric Distribution Company" (EDC) - An electric distribution company as defined in section 2803 (relating to definitions) of the Act, including any provider of Distribution Service in accordance with orders or regulations of the Commission.

"Electric Generation Supplier" (EGS) – an electric generation supplier as defined in Section 2803 of the Act, including any provider of Generation Service and/or Retail Services in accordance with orders or regulations of the Commission.

"Generation Service" - the provision of electric energy and capacity to a retail customer.

"Intangible Transition Charge" (ITC) - as defined in 52 Pa. Code § 54.2.

"Large Non-Residential Customer" - a non-residential electric service customer with a maximum registered peak load exceeding 50kW in the last 12 months.

"Non-Generation Retail Services" - those aspects of Retail Services other than procuring and providing Generation Service.

"POLR Service" - "Retail Default Service" or "Retail Back-Up Default Service"

"Replacement Retail Default Service Provider" – A Retail Default Service Provider appointed by the Commission in accordance with Section 10.

"Residential Customer" - a customer who receives or would receive Distribution Service in accordance with the EDC's residential service tariff.

"Retail Services" - the provision to one or more retail customers of services other than Distribution Service. As of January 1, 2010, Retail Services shall include, but need not be limited to, procuring and providing Generation Service, initiating and procuring Distribution Service, retail billing, customer care services, call center facilities for customer inquiries; and other information services as determined by the Commission.

"Retail Default Service" - The provision of Retail Services to customers: (i) who have not chosen an EGS to provide Retail Services; (ii) who have previously chosen an EGS but have elected to return to Retail Default Service; or (iii) who have returned to Retail Default Service when their EGS has defaulted, exited the market or otherwise ceased serving the customer. Retail Default Service does not include Retail Back-Up Default Service.

“Retail Default Service Provider (RDSP) - Any company appointed by the Commission through auction or otherwise to provide Retail Default Service.

“Small Non-Residential Customer” - a non-residential customer with a maximum registered peak load no greater than 50kW in the last 12 months.

POLR Service for Residential and Small Non-Residential Customers.

The Commission shall appoint through auction a Retail Default Service Provider for a 2-year period at the end of the Transition Period.

2. Retail Default Service.

(a) Upon the completion of the collection of competitive transition charges and intangible transition charges by an EDC, Retail Default Service in the EDC's service territory for Residential Customers and Small Non-Residential Customers shall be provided by one or more RDSPs selected as a result of a Retail Default Service Auction, as described in section 3. Retail Default Service shall be provided for a period of two (2) years after which such service shall no longer be available.

(b) The Commission shall designate Retail Default Service Providers to provide Retail Default Services to all Residential Customers and Small Non-Residential Customers in each EDC's service territory, provided, however, that any such customer who has already chosen an EGS to provide service effective on or before the effective date of the initiation of Retail Default Service shall continue to receive service from the customer's chosen EGS.

Process for Retail Default Service Auction.

3. Retail Default Service Auction.

(a) General. The Commission shall appoint the providers of Retail Default Service no later than 120 days prior to the initiation date for the provision of Retail Default Service. Selection by the Commission of such providers, and the price at which Retail Default Service will be provided, shall be determined through a competitive

bidding process. The design of the competitive bidding process shall be determined by the Commission through an on-the-record proceeding, and shall include, at a minimum, the following characteristics: (i) the bidding process shall be in the form of a retail auction designed to arrive at two-year fixed prices retail price for all Retail Default Service customers in each EDC service territory and shall be conducted in an efficient manner that minimizes the administrative costs involved in conducting the auction; (ii) the Commission shall structure the auction so that each customer type (e.g., Residential Small Non-Residential) is auctioned separately and shall create reasonable size customer tranches that promote an efficient auction; (iii) should any EDC have fewer than 100,000 customers eligible for the auction, the Commission shall determine the appropriate treatment of such customers so that they will not be placed at a disadvantage with respect to customers in other EDC service territories; (iv) the auction shall be conducted in all EDC service territories by a neutral third party that is not an affiliate of either any EDC for purposes of Chapter 21 of the Public Utility Code or any EGS that will be participating in the auction; (v) no EDC-affiliated EGS may be awarded a number of customers greater than one third of the customers eligible for the auction in the service territory of the EDC of which such EGS is an affiliate, or more than 2,000,000 customers in total through the auction process; (vi) no non-EDC-affiliated EGS may be awarded more than 3,000,000 customers in total through the auction process; and (vii) each EDC service territory shall have a minimum of three (3) Retail Default Service Providers providing Retail Default Service.

(b) All bids shall include:

(i) A commitment that the bidder will meet the retail requirements it serves as a Retail Default Service Provider by using a renewable energy and conservation portfolio representing no less than ___% of total energy consumed.

(ii) A commitment that the bidder will agree to contribute \$5 per customer assigned through the auction process to a state-administered economic development fund designated by the Commonwealth in an amount to be pre-defined by the Commission;

(iii) A commitment that the bidder will agree to provide service according to all rules, regulations and guidelines of the Commission, including universal service;

(iv) A commitment that the bidder pay to the EDC as a Retail Default Service coordination fee (which will not be considered as distribution revenues for the EDC) an amount equal to \$20 per customer assigned through the auction process within 10 days of receiving results of the auction process; and

(v) A commitment that the bidder will maintain sufficient collateral with the Commission approved credit agency to meet the obligations of its Retail Default Service customers.

4. To participate in the auction, an EGS must first qualify by establishing that:

(a) it meets the qualifications for or has already been granted an EGS license pursuant to PUC rules;

(b) it meets appropriate standards for financial strength and security, to be determined by the Commission, which shall take into account the total number of customers for which the EGS proposes to bid; and

(c) it meets all other appropriate standards determined by the Commission.

5. Designated RDSP. In the event that no company bids to provide such service for all or any portion of Retail Default Service in the service territory of an EDC, the Commission shall require that one or more EDC-affiliated or non-EDC-affiliated Retail Default Service Providers serve as the provider therefor as a condition of maintaining license certification. In the event that the Commission must utilize this section, the limitations imposed in section 3(a) above are no longer binding. The Commission and the designated EGS(s) shall arrive at mutually acceptable prices, terms and conditions pursuant to which the EGS(s) shall serve as Designated RPSPs. If terms cannot be arrived at through negotiation, the Commission shall issue an order, after an on-the-record proceeding, setting forth the prices, terms and conditions of the Retail Default Service to be provided by the Designated RDSP(s).

Customers may opt-out of Retail Default Service and go directly to Retail Back-Up Default Service. Customers already taking competitive supply are not included in the auction.

6. Any customer otherwise eligible for Retail Default Service may choose to opt out of this service at least 30 days prior to initiation of Retail Default Service and take service

from the Retail Back-Up Default Service provider or a licensed EGS. In order to opt out of Retail Default Service in this manner, a customer must express an affirmative choice to do so in a manner consistent with the Commission's Standards for Changing Customer's Electricity Generation Supplier (52 Pa. Code § 57.171-.176). Customers selecting the Retail Back-Up Default Service provider shall not be allowed to take Retail Default Service, but may depart Retail Back-Up Default Service at any time in order to take a competitive service offering from an EGS.

RDSPs may market alternative products and services to Retail Default Service customers.

7. Nothing in this section shall preclude a designated Retail Default Service Provider from offering its Retail Default Service customers products and services, other than the aforementioned Retail Default Service package, at prices, terms and conditions that are not be subject to review by the Commission.

Customers who migrate from Retail Default Service cannot return.

8. Customers being provided Retail Default Service may choose at any time to leave Retail Default Service in order to be served by an EGS (including the non-Retail Default Service product being offered by the EGS providing Retail Default Service). Customers choosing to obtain service other than Retail Default Service pursuant to this subsection shall no longer be eligible for Retail Default Service.

Process at end of 2-year Retail Default Service term.

9. Retail Default Service shall be provided for a term of two (2) years. No later than three months prior to the end of the two-year term, Retail Default Service Providers shall offer to their current Retail Default Service customers a choice of no fewer than two Retail Service offerings for service effective the first day after the end of the two-year term. At least one such Retail Services offering shall be a one-year fixed price product, and the Commission shall not impose any other material contract limitations on such product. Retail Default Service customers may choose one of these Retail Services offerings or any other EGS competitive service offering. Retail Default Service customers who make no choice will receive the one-year fixed price product.

Failure of Retail Default Service Provider - Replacement RDPS.

10. In the event a Retail Default Service Provider is unable to continue serving its customers as a result of bankruptcy, involuntary dissolution or otherwise, the Commission shall arrange for a Replacement Retail Default Service Provider for the duration of the two-year term through means the Commission determines appropriate. Any Retail Default Service Provider(s) serving customers on such an emergency basis shall provide Generation Service at rates determined by the Commission. The Commission shall make every effort to maintain the Generation Service rate(s) at the level(s) determined in the Retail Default Service Auction, recognizing that a Replacement Retail Default Service Provider should be allowed an opportunity to recover its reasonable costs. Any security deposit or other form of financial assurance made available by the Retail Default Service Provider that will be discontinuing service shall be applied to mitigate the cost impacts, if any, to the Replacement Retail Default Service Provider(s) that continue serving customers affected by the discontinuance of service.

The EDC shall be allowed to participate as a Retail Default Service Provider if the Commission approves the EDC's proposal for structural separation.

11. EDC Participation as an RDSP.

(a) An EDC that desires to participate in the Retail Default Service auctions of other Pennsylvania EDCs pursuant to section 8 may do so only if it voluntarily agrees to participate in the Retail Default Service auction in its service territory, as well as the auctions for the other EDCs' service territories, through an affiliated EGS that shall be structurally separate from the EDC as provided in this section. Nine months before the scheduled completion of the EDC's collection of CTC or ITC charges, each such EDC shall file with the Commission a detailed plan for restructuring its operations such that all Retail Services currently provided by the EDC, as well as all rights, liabilities, and costs related to the provision of such Retail Services, shall be transferred to an EGS formed by and affiliated with the EDC. As an element of its filing, each such EDC shall propose new tariffed rates for Distribution Service consistent with the provisions of section 14 of this regulation and section 1301 of the Public Utility Code, and shall also show that it has created a system of cost-accounting and records, consistent with the requirements of the Federal Energy Regulatory Commission, to ensure that the costs associated with the provision of Distribution Service and the provision of Retail Services are accurately and separately identified. Each such EDC's proposal shall also propose tariffed rates for the

provision of Non-Generation Retail Services on a wholesale basis to EGSs and RPSPs, consistent with the provisions of section 12 of this regulation, and shall describe the manner in which the EDC and its affiliated EGS will exchange safety and reliability-related customer information. Each such EDC's proposal shall also describe the manner in which its affiliated EGS will provide Non-Generation Retail Services to non-affiliated RPSPs.

(b) The Commission shall review each plan filed pursuant to this section and shall make an express finding as to whether such plan complies with the provisions of this chapter. All EGSs in the Commonwealth shall have standing to participate in such proceedings. Each plan shall be designed to implement such restructuring of the EDC's operations sufficiently prior to the point that the Retail Default Service auction will be conducted and shall include all information and materials required by the Commission as it so designates, for the participation of the EDC's affiliated EGS in the auction. The Commission shall review a proposal filed by a EDC pursuant to this section and shall issue an order accepting, modifying, or rejecting such plan within three (3) months of its being filed. If the Commission rejects the plan, it shall state the specific reasons for rejection and direct the EDC to file an alternative plan addressing the objections within thirty (30) days of the Commission's order rejecting the plan. The Commission shall review this alternative plan and issue a final order regarding its compliance with this chapter within thirty (30) days of the filing thereof.

(c) No EDC or affiliate of an EDC, as defined by Chapter 21 of the Public Utility Code, that elects not to structurally separate as provided in subsection (a) may participate in any Retail Default Service auction other than the auction for the EDC with which it is affiliated. The EDC participating in the Retail Default Service auction in its own territory shall do so through a division or portion of the company that complies with a code of conduct which assures that the operations of the division or portion of the company are not subsidized by distribution operations and receive no preference or advantage in providing Retail Default Service in comparison to non-affiliated Retail Default Service Providers. Such an EDC shall file a restructuring plan demonstrating compliance with these requirements.

Provision of Non-Generation Retail Services.

12. Non-Generation Retail Services and Rates.

(a) As part of the Commission's order accepting or modifying an EDC's Default Service restructuring plan, the Commission shall approve new tariffed rates and terms and conditions for the provision of Non-Generation Retail Services by the EDC's affiliated Retail Default Service Provider to non-affiliated Retail Default Service Providers. Any EDC-affiliated Retail Default Service Provider electing to participate in the Retail Default Service Auctions of EDCs other than the EDC with which it is affiliated, must offer such Non-Generation Retail Services to non-EDC-affiliated Retail Default Service Providers for two (2) years from the date of the initiation of Retail Default Service. All non-EDC-affiliated Retail Default Service Providers must procure Non-Generation Retail Services from the EDC-affiliated Retail Default Service Provider at the tariffed wholesale rates approved by the Commission for resale to their customers for the first year in which Retail Default Service is provided. Thereafter, non-EDC-affiliated Retail Default Service Providers may, but are not required to, procure Non-Generation Retail Services from the EDC-affiliated Retail Default Service Provider at the tariffed wholesale rates approved by the Commission pursuant to this subsection. Where a non-EDC-affiliated Retail Default Service Provider procures Non-Generation Retail Services from the EDC-affiliated Retail Default Service Provider, billing shall be on a consolidated basis only; provided, however, that the Commission shall issue guidelines requiring EDC-affiliated Retail Default Service Providers to design, produce and distribute customer bills as directed by the applicable Retail Default Service Provider. The guidelines shall also require EDC-affiliated Retail Default Service Providers to purchase the accounts receivable of non-EDC-affiliated Retail Default Service Providers at a discount to be determined by the Commission which shall reflect the affiliated EDC's or the EDC-affiliated Retail Default Service Provider's actual uncollectible accounts experience or bad debt expense for the prior two (2) years.

(b) The Commission shall determine an appropriate method for the exchange of safety and reliability-related customer information between an EDC and a non-affiliated Retail Default Service Provider that chooses to provide Non-Generation Retail Default Services on a competitive basis in such EDC's service territory.

Retail Back-Up Default Service for Residential and Small Non-Residential Customers.

13. Retail Back-Up Default Service Provider.

(a) There shall be established rates, terms and conditions for Retail Back-Up Default Service for customers who opt out of Retail Default Service. The Retail Back-Up Default Service provider shall make available to customers a retail service package consisting of firm Generation Service and Non-Generation Retail Services with prices that vary on a monthly basis. The Retail Back-Up Default Service provider shall recover all reasonable costs in the period incurred and shall not be authorized to recover any costs through true-up or other retroactive recovery mechanism. Such Retail Back-Up Default Service provider costs shall include all reasonable costs of providing service, including but not limited to all administrative costs and bad debt expense.

(b) The Commission shall appoint the EDC as the Retail Back-Up Default Service provider for its service territory for the first 5 years after the EDC's completion of the collection of CTC and ITC. After the initial period, the Commission shall designate a Retail Back-Up Default Service provider pursuant to a competitive bid process. The Commission may relieve a Retail Back-Up Default Service provider from its obligations for good cause shown.

(c) The Retail Back-Up Default Service provider may not require that a customer contract for a minimum term as a condition of service. A customer may leave Retail Back-Up Default Service at any time in order to take a competitive service offering from an EGS.

(d) A customer who has opted out of Retail Default Service or who has chosen service from an EGS or a Retail Default Service Provider but who is not able to procure service from such company, either temporarily or permanently, due to said company's failure to provide contracted service shall be eligible for Retail Back-Up Default Service provided pursuant to these rules.

(d) A new Residential or Small Non-Residential Customer who was not taking service from an EGS or a Retail Default Service Provider subject to this chapter prior to the beginning of the Retail Default Service term, and who wishes to obtain electric service, may do so by affirmatively choosing an EGS. In the absence of such affirmative choice, such customers shall be assigned to the Retail Back-Up Default Service provider.

Distribution Service will be provided to Retail Default Service Providers by EDCs.

14. Distribution Service.

(a) The Commission shall approve rates, terms and conditions for Distribution Service, which rates shall exclude all rights, liabilities, and costs related to the provision of Retail Default Service and Retail Back-Up Default Service. Distribution Service shall continue to be provided by the EDC to its affiliated or non-affiliated Retail Default Service Providers and to all EGSs on a tariffed, non-discriminatory basis in accordance with rules, regulations and guidelines to be developed by the Commission.

(b) An EDC shall provide advanced metering services to all Residential and Small Non-Residential Customers in its service territory. Such advanced metering services shall include the capacity to take interval metering measurements and transmit data to and from the meter in real-time. In addition, such advanced metering shall provide for access to customer data and access to meter data by EGSs and RPSPs as necessary, in accordance with rules and regulations to be developed by the Commission.

EDCs no longer provide Retail Services but remain responsible for safe and reliable Distribution Service. Customer calls related to Distribution Service shall be forwarded to the EDCs or information provided electronically.

15. All responsibility for the safe and reliable operation of the distribution system shall remain with the EDCs. EDC-affiliated Retail Default Service Providers shall exchange safety and reliability-related customer information with EDCs in the manner prescribed by the Commission. Non-EDC-affiliated Retail Default Service Providers shall exchange safety and reliability-related customer information with EDCs in the manner prescribed by the Commission.

POLR Service for Large Non-Residential Customers.

1. The Commission shall appoint the EDC as the Retail Back-Up Default Service provider to Large Non-Residential Customers after the EDC has completed collection of its CTC and ITC.

2. The Retail Back-Up Default Service product for Large Non-Residential Customers shall reflect the hourly price of energy and passthrough of all other costs, including but not limited to costs for capacity and administrative costs plus the tariffed rates for Non-Generation Retail Services.

(a) If the Commission determines, after a formal on-the-record proceedings, that the market in the service territory of an EDC is not sufficiently developed such that the Commission cannot reasonably conclude that at least two (2) non-EDC-affiliated EGSs shall offer fixed price products of at least one year in duration, the Commission shall order that the EDC conduct a wholesale auction to provide fixed price service with a price applicable for 12 months. The Commission through an on-the-record proceeding shall determine the design of the competitive bidding process. The Commission shall determine in the proceeding the amount that each EDC will be compensated (in the form of mils per kWh) in return for sponsoring and administering the auction. At the end of the fixed price service period, the Commission shall review the market and determine if the market has sufficiently developed to dispense with any further wholesale auctions. Once the Commission has determined that the market in a particular EDC's service territory is sufficiently developed, the Commission shall not have the authority to implement this subsection with respect to that EDC.

3. The Retail Back-Up Default Service provider for Large Non-Residential Customers may not require that a customer contract for a minimum term as a condition of service or require any other restriction or cost recovery for leaving Default Service. A customer may leave Retail Back-Up Default Service at any time without any restriction in order to take a competitive service offering from an EGS.

Original : 2463

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Pennsylvania Department of Environmental Protection

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April 27, 2005

Office of Energy and
Technology Development

717-783-0540

HAND DELIVERED

Commonwealth of Pennsylvania
Secretary's Bureau
Pennsylvania Public Utility Commission
P.O. Box 3265
Harrisburg, PA 17105-3265

Re: 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 fifteen (15) copies of the Department of Environmental Protection's comments on the Rulemaking Re Electric Distribution Companies Obligation to Serve Retail Customers at the Conclusion of the Transition Period.

Respectfully Submitted,

Daniel J. Desmond
Deputy Secretary
Office of Energy and Technology Development

Enclosures

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Introduction

Pursuant to Act 18 of 1995 the Pennsylvania Department of Environmental Protection (DEP) assumed the primary duties of the former Pennsylvania Energy Office. Recognizing the importance of these responsibilities Governor Rendell created the Office of Energy and Technology Development within DEP to serve as the primary entity responsible for energy programs and policy for agencies under the Governor's jurisdiction.

Governor Rendell has advocated an Alternative Energy Portfolio Standard, statewide net-metering and interconnection standards, and reliable and affordable electricity for Pennsylvania's consumers. As such, the final form of "Rulemaking Re Electric Distribution Companies' Obligation to Serve Retail Customers at the Conclusion of the Transition Period" (hereafter referred to as default service rules) will be an important component of achieving the Governor's energy goals.

The following comments reflect the Governor's and DEP's concerns that electricity be provided consistent with the administration's environmental and economic goals to ensure the delivery of clean, reliable and affordable electricity to all electricity customer classes. As a result we raise several considerations for the Commission's consideration relative to the default service rules set forth in the draft order.

Length of Service

DEP is concerned that the one-year minimum term of service for default generation contracts may not provide enough protection from market fluctuations. The Department recommends that the PUC consider requiring a staggered bid-process under which default providers would secure up to one-third of their load every year for three years. We believe this will mitigate abnormally high prevailing market prices impacting customers in any given year.

The proposed rules do allow default service providers to propose implementation plans for multiple twelve month periods. The option for default providers to secure long-term contracts for generation is important for the maintenance of price stability. Additionally, long-term contracts are critical to the deployment of alternative energy resources in the Commonwealth. The provisions of the default service rulemaking should allow for long-term contracting by default providers to ensure price stability and to promote the deployment of alternative energy resources.

We are specifically concerned that default providers have an opportunity to address price volatility relative to peaking fuels such as natural gas. Shorter contract terms and a potential reliance on spot prices to meet peak energy needs will make it more difficult to avoid price spikes associated with peaking fuel volatility.

Alternative Energy Portfolio Standard

The Department agrees that default service plans should identify a default provider's method of compliance with the Alternative Energy Portfolio Standards Act, No. 213 of 2004.

Failed Procurement Process and Replacement Generation

The default service provisions require the default provider to acquire electricity at the prevailing market price from the RTO or ISO in whose control area the default service is provided in cases in which the procurement process does not result in sufficient electric supply or when a generation supplier fails to deliver generation supply to a default service provider. Presumably the RTO or ISO prevailing market price in this instance would be the RTO or ISO spot price. The default provider would acquire electricity to service its load on the spot market until another competitive procurement process is completed or until a replacement procurement process is approved and implemented. Such circumstances would expose consumers to potentially higher prices or price variations that would not have occurred had the default provider secured reliable generation.

The Commission should take steps to ensure that the impacts to consumers of a default provider needing to purchase electricity on the RTO or ISO spot market are limited. Staggered procurement processes and long-term contracts are potential remedies.

Hourly Pricing

The administration strongly endorses The Electricity Generation Customer Choice and Competition Act's (Act 138) advocacy for market forces. Act 138's policy declarations recognize competition as a preferable means to control costs but clearly underscore that the purpose of competition is to achieve cost and reliability benefits for all electricity customers. We believe that markets are a means to achieve these ends as was recognized by Act 138. However, we do not believe in competition for competition's sake when provisions designed to spur enhanced competition might actually lead to negative impacts for electricity consumers counter to the price and reliability objectives of Act 138.

Specifically we are concerned that the provisions requiring non-residential customers with a load of over 500 kilowatts to submit to hourly pricing based on the RTO's or ISO's locational marginal price will create undue economic hardship on these customers. We recognize that the Commission's objective in advancing these provisions is to encourage further competition by encouraging customers seeking long-term contracts to shop. In order to ensure undue economic hardship does not befall these customers we encourage the Commission to take the following steps:

- Survey the market for competitive suppliers to ensure that a reasonable number of competitive suppliers exist to meet potential consumer demand and provide that information to consumers.
- Develop provisions that allow default providers to provide long-term price options to consumers should the competitive supplier market fail to develop sufficiently to meet consumer demand.

We are also curious as to why the Commission chose the 500 kilowatt level for non-residential customers to receive hourly pricing for default service. The commentary associated with the default service provisions references New Jersey as a model for the hourly pricing option and

notes that New Jersey's hourly pricing requirement takes effect for non-residential customers over 1500 kilowatts. We recommend that the Commission provide some commentary on why it chose the 500 kilowatt level.

A final issue of concern is how hourly pricing relates to Alternative Energy Portfolio Standards. In our view the spot market for alternative energy credit acquisition will be quite limited with prices higher relative to longer-term contracts. We envision most alternative energy credits being contracted for bilaterally between generators and suppliers. We are concerned that the hourly pricing requirement for non-residential customers over 500 kilowatts will limit default providers flexibility in meeting the requirements of the Alternative Energy Portfolio Standard.