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ppl

VIA FEDERAL EXPRESSS

April 27, 2005

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

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

Dear Mr. McNulty:

Enclosed for filing on behalf of PPL Electric Utilities Corporation and PPL EnergyPlus, LLC ("PPL") are an original and fifteen (15) copies of PPL's comments in the above-captioned proceeding.

Pursuant to Shane Rooney's e-mail dated April 25, 2005, PPL is serving copies of these comments upon Shane M. Rooney and Cynthia L. Page.

Pursuant to 52 Pa. Code § 1.11, the enclosed document is to be deemed filed on April 27, 2005, which is the date it was deposited with an overnight express delivery service as shown on the delivery receipt attached to the mailing envelope.

In addition, please date and time-stamp the enclosed extra copy of this letter and return it to me in the envelope provided.

If you have any questions regarding the enclosed comments, please call.

Very truly yours,

Paul E. Russell

Enclosures

cc: Irwin A. Popowsky, Esquire
William R. Lloyd, Esquire
J. Edward Simms, Esquire
Shane M. Rooney, Esquire
Ms. Cynthia L. Page
Mr. Robert Bennett
David M. Kleppinger, Esquire

Rulemaking Re Electric Distribution Companies' Obligation to Serve Retail Customers at the Conclusion of the Transition Period Pursuant to 66 Pa. C.S. §2807(e)(2)
Docket No. L-00040169
Docket No. M-00041792

Comments of
PPL Electric Utilities Corporation and
PPL EnergyPlus, LLC

I. Introduction

On December 16, 2004, the Pennsylvania Public Utility Commission ("PUC" or the "Commission") issued a proposed rulemaking order regarding Provider of Last Resort ("POLR") obligations following the conclusion of the Transition Period pursuant to Section 2807(e)(2) of the Electricity Generation Customer Choice and Competition Act ("Customer Choice Act"). 66 Pa. C.S. 2807(e)(2). The proposed rulemaking was published in the Pennsylvania Bulletin on February 26, 2005, with a 60-day comment period for all interested parties. PPL Electric Utilities Corporation and PPL EnergyPlus, LLC ("PPL") jointly submit these comments to the proposed rulemaking. PPL has actively participated in the Commission's various proceedings regarding default service, most recently submitting written comments and testimonies in the POLR Roundtable proceedings.

PPL appreciates this opportunity to provide comments on the proposed rulemaking order. Resolution of the issues related to default service[1] in Pennsylvania is critical to maintaining high quality electric utility service to customers throughout the Commonwealth and facilitating continued development of competitive retail electric markets.

PPL believes that development of specific default service regulations should be guided by the following four fundamental principles. First, default service should be considered a "back stop" to the competitive retail market, not an alternative or option to that market. Second, the

[1] In its proposed rulemaking order, the Commission identified POLR service as "default service." PPL will use that term throughout its comments.

incumbent Electric Distribution Company ("EDC") should be the only entity to provide default service unless it is unable to fulfill that obligation. Third, the default service provider should recover, on a full and current basis, all costs it incurs to provide that service. Fourth, and finally, the Commission's default service regulations should enhance and facilitate continued development of competitive retail electricity markets.

At the outset, it is important to note that PPL agrees with the vast majority of the Commission's proposals in this rulemaking proceeding. In developing proposed default service regulations, the Commission has successfully struck an appropriate balance among all stakeholder interests. The Commission has allowed the incumbent EDC to continue its relationship with customers by proposing that the EDC take on the responsibilities of default service provider following the end of the Transition Period. In addition, the Commission has recognized that the EDC must recover all of the costs that it incurs to provide default service. Finally, the Commission has promoted the development of competitive retail markets by proposing that large non-residential customers take default service at hourly market prices.

The Commission has proposed a state-wide framework for default service, but has incorporated into that framework significant flexibility in procuring default service supply and in the ability for customers to switch between default service and competitive service. However, PPL believes the Commission should develop a structured state-wide bidding process to increase the level of consistency for obtaining default service supply. A consistent approach to obtaining default service supply can facilitate development of the competitive market without requiring the default service provider to establish a wholesale trading infrastructure or actively participate in wholesale markets.

One overriding theme in the Company's comments is the need to coordinate the Commission's default service regulations with the recently enacted legislation establishing Alternative Energy Portfolio Standards ("AEPS Act"). The obligation to comply with the AEPS Act will begin on January 1, 2010, and default service obligations begin at that time (for PPL Electric) or within several years. In that time frame, EDCs in Pennsylvania must begin to obtain generation supply to meet both obligations. And, at that time, EDCs will begin to recover the cost of that supply

from retail customers. Accordingly, PPL believes many elements of the AEPS Act can be used to guide the development of regulations for default service. For example, a single adjustment clause can be used to recover the cost of obtaining both default service supply and AEPS Act supply. In addition, the reporting period for the AEPS Act is June 1 through May 31, and this period can also be used for the default service procurement schedule and default service price changes.

II. Comments

A. Definitions

PPL accepts all of the definitions set forth in the Commission's draft default service regulations. However, a key element of the following four definitions is the manner in which they are implemented or applied:

- Default service provider
- Ratemaking policies for default service
- Prevailing market price
- Procurement process

In its comments, PPL addresses the implementation aspects of these four defined terms.

B. Default Service Provider

PPL recommends the incumbent EDC should remain the default service provider following the end of the Transition Period.

At the end of the Transition Period, the Customer Choice Act provides that the default service provider will be either the EDC or Commission-approved alternative supplier. Similarly, the Commission's draft default service regulations track this provision. For the reasons set forth below, PPL believes this obligation should remain with the incumbent EDC. The Commission should not approve an alternative default service provider unless the incumbent EDC is unable to fulfill that obligation.

The incumbent EDC should be retained as the default service provider after the end of the Transition Period for the following four reasons. First, this approach would minimize customer confusion and disruption. The incumbent EDC was the customers' utility before restructuring and has been the customers' default service provider throughout the Transition Period. Customers know the identity of the default service provider and are comfortable dealing with it. Under the Customer Choice Act, customers can choose to purchase supply from an Electric Generation Supplier ("EGS") rather than the default service provider at any time. However, customers who have elected to remain with their incumbent EDC for default service provider should not be arbitrarily assigned to another entity.

Second, as a practical matter, the incumbent EDC will remain the "last resort" default service provider. If another entity is identified as the default service provider and that entity fails to meet its responsibilities, the incumbent EDC will be required to step into the role of default service provider to protect the affected customers. In fact, this series of events already has occurred in the context of Competitive Discount Supplier ("CDS") service in the PECO Energy service territory. Given this reality, it makes sense to retain the incumbent EDC as the default service provider and approve an alternative supplier only if the EDC cannot meet its obligations as default supplier.

Third, the administrative burdens associated with approving another entity as the default service provider are enormous. A quick review of the issues identified by the Commission in this area reveals the scope of such an undertaking. What requirements must the entity meet? How would the non-EDC default service provider be selected? How would competing proposals be evaluated? How would customers be assigned to the default service provider? What happens if the non-EDC default service provider defaults? Retaining the incumbent EDC as the default service provider eliminates all of these issues and ensures that the regulated entity with decades of experience in this area will provide default service to all of the customers in its service area.

Fourth, approving a non-EDC as the default service provider risks "stranding" the EDC's investment and personnel in the metering, billing and customer care functions. If the non-

EDC default service provider assumes these functions, there is no need for the EDC to retain those facilities and personnel. Conversely if, as discussed above, the EDC is likely to become the "last resort" default service provider, then it must retain facilities and personnel needed to perform those functions in the future, even if they are not being used currently. Identification of the incumbent EDC as the default service provider avoids this problem.

C. Default Service Provider Obligations

Important functions of a default service provider include: retail market support, customer care, and compliance with the AEPS Act. These functions currently are being performed by the EDCs and PPL believes the EDC should continue providing these important functions as the default service provider following the end of the Transition Period.

- **Retail Market Support Functions: EDCs currently perform a number of critical activities to support the functioning of competitive markets and these activities should continue with the EDC acting as default service provider. These activities include:**

1. Maintaining EDI platforms and billing protocols for the purpose of facilitating customer switches, transmitting usage, billing options, and remittance to EGSs. These functions are integral to billing functions that are the duty of the EDC under the Commission's regulations and, accordingly, PPL believes they should remain the responsibility of the EDC. Under appropriate circumstances, these functions could be obtained by the EDC from other providers (for example, some EDCs currently contract for EDI), but the EDC should continue to be responsible for how these functions are carried out.

2. Maintaining information (such as load profiles) and systems necessary for the scheduling and reconciliation of energy supplies. These functions currently are performed by EDCs (or contracted for by EDCs) and should remain the responsibility of EDCs in their role as default service provider.

3. Other administrative duties as determined by regulation or order – including maintaining customer lists and disclosure elections, providing Price to Compare information, and providing customer education materials – should remain the responsibility of the EDC as the default service provider. PPL believes that one of the benefits of having the EDC perform the default service provider function is that such an approach avoids the consumer confusion and administrative complexity that is likely to arise from the sharing of these functions.

- **Customer Care Functions: All retail customer care obligations currently are assigned to EDCs, including those found in Chapter 14 of the Public Utility Code and Chapter 56 of the regulations.** Currently all customer care functions, especially those functions defined under Chapter 14 of the Public Utility Code and Chapter 56 of the Commission's regulations, are the responsibility of EDCs and PPL believes those functions should remain the responsibility of the EDCs in their role as default service provider.

- **Under the AEPs Act, all EDCs and EGSs (serving retail load) must ensure that a certain percentage of supply is obtained from renewable resources.** The AEPS Act requires EDCs to comply with the alternative energy requirements after the Transition Period. To minimize administrative burdens and possible market disruptions, the EDC also should be the default service provider.

D. Ratemaking Policies for Default Service

PPL recommends ratemaking policies for default service that strive to balance the interests of customers, suppliers, and the default service providers.

PPL believes that two fundamental principles should guide the development of retail rates for default service. First, the default service provider must recover all of the costs it incurs to provide that service. This result is required by the Customer Choice Act which specifically provides that the provider of default service "shall recover fully all reasonable costs" of obtaining supply to meet that obligation. 66 Pa. C.S. Section 2807(e)(3). The default service

provider should not be exposed to the risk of any under recoveries. Similarly, the default service provider should not have the opportunity to over recover. To satisfy this requirement, all costs of default service must be identified and reflected in the cost recovery mechanism, including any infrastructure enhancements necessary to provide hourly metering and billing services. In addition, full cost recovery is possible only if interest on under recoveries is calculated and treated exactly that same as interest on over recoveries.

Finally, full cost recovery requires that the cost recovery mechanism for fixed price default service be reconciled on an annual basis. Reconciliation of costs for hourly price default service is a much less critical issue because presumably the EDC would obtain supply on an hourly basis and simply pass through those costs to the default service customers. However, without reconciliation of fixed price default service rates, both under recovery and over recovery are distinct possibilities, depending upon the circumstances in a given year.

Moreover, failure to provide for reconciliation has a number of other consequences for customers, suppliers, and default service providers. A major exposure in supplying default service is forecast error, which is the difference between the forecast load and the actual load. If reconciliation is not permitted, the default service provider will be exposed to this risk which it will attempt to shift to the default supplier. In turn, the supplier will charge a premium for absorbing this risk, which will result in a higher price for default service. With reconciliation, risk of forecast error and under recovery of default service costs is eliminated, thereby eliminating a need for a risk premium and reducing the price for default service. However, to the extent that the default service provider is forced to bear any risk of under recovery of costs, it should be permitted to recover a compensating return on that portion of its service. For all of these reasons, PPL believes that reconciliation is an appropriate mechanism to balance the interests of customers, suppliers, and default service providers.

The second principle of developing rates for default service is consistency with the ratemaking provisions of the AEPS Act. Under that act, EDCs are required to obtain qualifying generation supply and all costs of acquiring that supply "shall be recovered on a full and current basis pursuant to an automatic adjustment clause under 66 Pa. C.S.

Section 1307." At the same time, the EDCs must obtain generation supply to meet their default service obligations. PPL believes that each of the standard supply products discussed below will include a renewable generation component sufficient to meet the default supplier's AEPS Act compliance obligation. For that reason, it will difficult to split the costs and resulting retail rates between default service and AEPS Act compliance. Accordingly, PPL believes that the Commission should permit default service providers to use the proposed AEPS Act automatic adjustment clause as the mechanism for recovering costs that they incur to provide default service.

However, as currently drafted, the proposed rulemaking provides for the recovery of default service costs through two fixed charges and one automatic adjustment charge. Following is a discussion of each of the charges proposed in the Commission's draft default service regulations.

- **Generation Supply Charge**

  The first proposed charge, the "Generation Supply Charge," would be used to recover the costs associated with the acquisition of generation supply and related charges. The proposed charge would recover the costs of energy, capacity, ancillary services and transmission charges approved by the Federal Energy Regulatory Commission ("FERC"), RTO and ISO charges, taxes, and other reasonable and identifiable costs.

  For the reasons discussed above, PPL recommends that the Commission combine the Generation Supply Charge with the AEPS Act automatic adjustment clause. However, if the Commission does not accept that recommendation, PPL proposes the following two changes to the charge. First, the charge should be reconciled on an annual basis. Otherwise, the default service provider may not fully recover its costs as required by the Competition Act. Second, as applied to PPL Electric, the Generation Supply Charge should not include FERC-approved ancillary service and transmission charges and RTO and ISO charges. On January 1, 2005, PPL Electric implemented a Commission-approved Transmission Service Charge ("TSC") that recovers from retail customers the FERC-approved services and transmission service charges imposed by PJM under the

provisions of its Open Access Transmission Tariff ("OATT"). The TSC is reconciled annually to reflect the actual and transmission service charges from PJM to PPL Electric.

PPL Electric should be permitted to continue collecting transmission service charges through the TSC, with annual reconciliation, beyond the end of the Transition Period. This approach will allow PPL Electric to fully recover the cost of ancillary services and transmission it will incur as the default service provider.

- **Customer Charge**

  The second charge proposed in the rulemaking order is a "Customer Charge," to recover the non-generation supply costs associated with providing default service. This charge would recover the costs incurred by the default service provider for functions such as billing, meter reading, collections, uncollectible debt, customer service, a return component, taxes, and other reasonable identifiable costs. The proposed rulemaking order indicates that these costs may be more appropriately recovered through default service rates than distribution rates.

  For the reasons discussed above, PPL recommends that the Commission eliminate the Customer Charge. Elimination of this charge also is supported by fundamental ratemaking considerations. Specifically, the Customer Charge is inappropriate because it includes costs that should be recovered through distribution rates, not default service rates. Currently, the costs identified for this charge are recovered from customers through distribution rates and, therefore, are recovered from all customers – both default service and shopping customers. To properly determine a Customer Charge, as proposed, would entail allocating all of these costs between default service customers and shopping customers. This allocation could be problematic because the number and mix of shopping customers is constantly changing. As a result, the EDC could under recover or over recover these costs from year-to-year. Moreover, because the default service provider must accommodate the return of shopping customers to default service, it is more appropriate to allocate these costs to all customers instead of splitting the costs

between default service customers and shopping customers. Accordingly, PPL recommends that the Commission withdraw its proposal to create a Customer Charge.

Finally, if the Customer Charge is adopted, it should be reconciled on an annual basis. As discussed above, all charges for default service should be fully reconcilable to ensure that the EDC does not under recover or over recover the costs of providing that service.

- **Automatic Adjustment Clause**

  Finally, the rulemaking proposes the creation of an automatic adjustment clause for recovery of costs incurred to comply with the AEPS Act. That act specifically provides for recovery of all reasonable costs associated with the obligations of the AEPS Act through an automatic adjustment clause. The clause proposed in the rulemaking is consistent with that requirement.

  However, for the reasons discussed above, PPL recommends that the Commission permit default service providers to use this automatic adjustment clause to recover all costs of default service, including generation costs. Generation costs can vary significantly due to dramatic changes in fuel costs, environmental requirements, or changes due to legislative actions, all of which can directly affect costs incurred by the default service supplier. Moreover, if a supplier cannot deliver electricity, the default service provider is required to obtain supply from the wholesale markets until arrangements can be provided with a new supplier. These costs must be recovered from the default service customers and an automatic adjustment clause is the appropriate mechanism. Transmission costs are another cost that can change significantly and are outside the control of the default service provider. PJM can institute new charges that may increase or decrease charges to the default service provider, which should be passed on to the default service customers. As discussed above, PPL Electric proposes to continue using its existing Commission-approved TSC to recover transmission service charges imposed by PJM.

In conclusion, PPL proposes that the default service provider be permitted to recover all costs of providing default service and complying with the AEPS Act through a single

reconcilable automatic adjustment clause, with the exception that PPL Electric should be permitted to continue to recover its transmission service charges through the TSC.

E. Pricing Default Service

PPL supports the Commission's proposal to establish fixed rate default service to all residential customers and non-residential customers with a demand of 500 KW or less and hourly rate default service to all other customers.

PPL believes that the pricing of default service to retail customers should reflect three practical considerations. First, the pricing should facilitate and encourage continued development of competitive retail electricity markets. Second, pricing should be as simple and straight forward as possible.

Third, and finally, the pricing for default service should be closely coordinated with the acquisition of supply for that service. For example, if supply is priced on an annual basis, the default service should be acquired on an annual basis. Any other approach would place the recovery of costs on a different basis than the incurrence of those costs. The result could be an over recovery or under recovery of actual costs to the extent that rates for default service (e.g., set on an hourly basis) differ from the costs of supply (e.g., incurred on an annual basis). If the cost recovery mechanism for default service is not reconciled, the EDC may not fully recover its costs of providing the default service. That result would be inconsistent with the requirements of the Customer Choice Act. On the other hand, if the cost recovery mechanism is reconciled, costs of supply would be shifted among customers on a random and unpredictable basis.

The proposed rulemaking establishes fixed rate default service for all residential customers and all non-residential customers whose peak registered demand is 500 kilowatts or less. The fixed price option allows for seasonal pricing that may vary as frequently as monthly. In addition, the proposed rulemaking establishes hourly rate default service for all non-residential customers whose peak registered demand is greater than 500 kilowatts. The Commission does not endorse any particular mechanism, and will allow the default service

provider to propose reasonable methods of pricing default service. PPL supports the Commission's proposed approach for pricing default service.

The Commission's approach reflects a careful balancing of public interest considerations. Hourly pricing of default service is appropriate because it supports the development of a competitive retail market. Under such an approach, customers are aware of the hourly market price and, based on that knowledge, can make informed decisions regarding their use of electricity. Competitive suppliers will have an opportunity to attract these customers with alternative pricing and service options. Hourly priced default service also will encourage customers to understand and explore demand side options which will help to limit wholesale market price volatility. But, at this time, hourly pricing is not an appropriate option for residential customers or small commercial customers. Many of these customers are relatively unsophisticated regarding the competitive electricity market. Many do not have the resources to manage their electricity use or shop for electricity. For these customers, a fixed rate option for default service is preferable at this time. In its proposed regulations, the Commission recognizes and balances both of these considerations. However, a different balance may evolve over time. As all customers become more knowledgeable about energy issues, the hourly rate option may become appropriate only for some residential and small commercial customers.

Although PPL supports the Commission's proposed approach regarding hourly price default service, that approach will entail some significant implementation issues. PPL Electric analyzed the 2004 billing records of all retail customers (shopping and non-shopping) to determine the customers, load, and sales levels associated with the 500 kilowatt threshold for hourly price default service. Based on 2004 billing data, more than 1,600 non-residential customers had peak registered demands greater than 500 kilowatts. The peak-metered load of these customers exceeded 3,200 megawatts and the total annual metered sales exceeded 13 million mwh. For PPL Electric, almost one-third of the total retail electric sales would take default service at hourly rates. The types of customers that exceeded the 500 kilowatt peak demand include groups such as schools, hospitals, churches, prisons, government facilities, housing facilities, retail stores, and many commercial and industrial businesses. A successful

transition to hourly pricing for these customers in 2010 will require comprehensive customer education programs and outreach efforts.

One other implementation detail that will require substantial attention is the proper design of rates for default service. In PPL's opinion, the rate design effort should be driven by two concepts discussed above. First, default service providers should be permitted to recover the costs of providing that service through reconcilable automatic adjustment clauses. In PPL's case, the Company proposes that it be permitted to recover generation costs through the clause established for recovery of AEPS Act implementation costs. It proposes that it be permitted to recover transmission costs through the existing TSC. Second, pricing of default service should be coordinated with procurement of supply for that service. PPL believes that supply for hourly price default service will be obtained from the market on an hourly basis. Supply for fixed price default service will be acquired through a standard procurement process on an annual (or longer term) basis. Because supply will be obtained and priced separately, discrete generation cost and transmission cost clauses will have to be established for each type of service. For its system, PPL Electric envisions a generation clause and TSC for fixed price default service and a generation clause and a TSC for hourly default service. Each clause would be calculated and reconciled independently (on an annual basis).

At the end of the Transition Period, it is likely that EDCs will offer new rates, such as Demand Side Response ("DSR") programs that give customers more control in managing their energy costs. The Commission's Demand Side Working Group is preparing a policy statement that will likely require EDCs to offer DSR programs to all eligible customers at the end of the Transition Period. It is also likely that traditional blocked rates will be revised to better correlate to the mechanism by which the energy and capacity are procured. As new programs are being offered, EDCs also will evaluate existing programs to determine if any programs are no longer appropriate after the end of the rate cap.

The transition from the rate cap period is likely to be a dramatic change for customers as they begin to pay market prices for electric service, new rate programs are introduced, and some

existing programs are eliminated. PPL believes that this transition can be successful but, as noted above, will require significant customer education and outreach efforts.

F. Prevailing Market Price

To meet the requirements of default service, the Commission is proposing that generation supply must be acquired: (1) "prevailing market prices," (2) through a "competitive procurement process," and (3) for at least a one-year term. The "prevailing market price" standard is established by the Customer Choice Act . 66 Pa. C.S. Section 2807(e)(3). The Commission indicates that the "competitive procurement process" must track the generation procurement processes adopted by FERC in its decision in Boston Edison Company Re. Edgar Electric Energy Company. The minimum term of at least one year was selected by the Commission reduce the frequency of the default service provider undertaking the "competitive procurement process." The Commission recognizes that allowing terms of supply longer than one year may allow generators serving default service loads to attract capital investment necessary for the reliable provision of service. The Commission also acknowledges that a longer term could lead to lower default service prices from suppliers, who may be attracted by the opportunity of securing long-term customers. However, the Commission believes a longer term may lead to a divergence from the "prevailing market price," which is the legal standard that controls default service prices.

PPL believes if generation supply for default service is procured through a competitive process, then that supply will be acquired at "prevailing market prices." PPL agrees with the Commission that terms of supply longer than one year will attract the needed capital investment to ensure reliable generation supplies are developed. However, PPL does not agree that longer terms may lead to a divergence from the "prevailing market price" standard. If the price for default service is tied to the term of supply, and that supply is obtained through a competitive process, then a divergence from the "prevailing market prices" will not occur. Accordingly, default service providers should be permitted to select, and obtain through a competitive procurement process, the portfolio of supply options that best meet the needs of its system.

G. Procurement Process

PPL recommends the Commission establish a tightly structured competitive procurement process that facilitates the development of the competitive market and ensures that supply for default service customers is obtained at prevailing market prices.

- **Competitive Procurement**

  The proposed rulemaking requires the default service provider to use a "competitive procurement process" to obtain the generation supply for default service. PPL agrees with this general requirement and further believes that only a tightly defined and structured state-wide process will ensure the most competitive procurement for default service customers. Other jurisdictions, such as New Jersey and Maryland, have adopted either state-wide auctions or uniform Request for Proposals (RFP) for each default service provider. At this time PPL is not endorsing either procurement method, rather PPL is recommending that certain key elements of the process should be identified and applied consistently across all default service providers. Several key elements PPL believes the Commission should incorporate in a structured state-wide procurement process are:

  - **Standard Products** – PPL recommends any procurement method use products that are easily priced and can be traded in the wholesale markets. For example, standard products in the wholesale markets are on-peak energy and off-peak energy. These products are traded every day in markets across the country.

  - **Standard Terms** – PPL recommends standard products should be procured in the market under standard terms. For example, on-peak energy is traded on daily, monthly, seasonal, and annual terms. By using standard terms, the products become commodities that can be traded, thereby enhancing the liquidity of the market.

- **Price** – PPL believes price should be the only criteria used to evaluate competitive bids to provide the generation products for default service. If criteria other than price are used to determine the supply, the products are no longer standard and are not easily traded in the market. An example of a non-price criterion could be a product for energy from a specific type of generation, such as nuclear.

PPL believes that the structured procurement mechanism discussed above will provide at least three important benefits. First, it will ensure that supply for default service is obtained at "prevailing market price." Second, such a mechanism, if developed before the end of the Transition Period and reflected in the Commission's regulations, will provide certainty and predictability to all market participants and create products that are liquid and easily traded. Third, it will eliminate the inefficiencies that could arise if the EDCs were forced to establish a wholesale market trading infrastructure and actively participate in the wholesale markets.

The foregoing discussion of a structured procurement mechanism based upon standard products and standard terms applies primarily to supply for fixed price default service. PPL believes that supply for hourly default service should be obtained in the relevant "spot" markets, e.g., real-time or day ahead. To provide hourly service, the default service provider must obtain energy, capacity, transmission, ancillary service and AEPS Act compliance supply. Obtaining these products in the "spot" market will enable the default service provider to properly match the costs of procuring supply with the hourly rates it will charge large non-residential retail customers for default service.

- **AEPS Act Requirements**

  PPL recommends that requirements of the AEPS Act should be included in the competitive procurement process. The AEPS requirements can be included as part of the standard products and terms for default service, which is the approach followed in New Jersey for most renewable products. PPL envisions that standard products for AEPS Act

requirements will develop over time in PJM and other markets in the region resulting in a very liquid and tradable commodity.

- **Seasonal Gaming**

  PPL believes the Commission should take the lead in developing rules that prohibit seasonal gaming by customers switching between default service and competitive service. This problem was addressed very early in deregulation and could occur after the Transition Period if appropriate rules are not established. The rules for customers switching between default service and competitive service should balance the interests of the customer, the default service provider, and the EGS. Some possible rules to prevent seasonal gaming include switching fees, seasonal pricing, and minimum stay requirements. Another example is the Generation Rate Adjustment currently included in PPL Electric's Commission-approved retail tariff. Absent such rules, seasonal gaming could occur and could result in higher prices for default service due to the greater uncertainty of the default service load. Consistent with PPL's recommendation of standard products and standard terms, PPL recommends that the Commission establish state-wide rules to prohibit seasonal gaming.

- **Independent Review**

  The proposed regulations indicate that the competitive procurement process may be subject to independent monitoring by the Commission or a third party. Any third party involved in oversight of the process must be independent from the default service provider and the participating bidders. As a practical matter PPL believes it is unnecessary for third party review of the procurement process because the Commission has the final review of that process. Inserting review by a third party simply adds administrative burden, delay and expense. Commission review of the competitive procurement process is much more efficient and will provide more than adequate protection against abuse or misuse of the process.

- **Review Period**

  The proposed regulations indicate that the Commission will expedite review of the competitive procurement results to minimize regulatory uncertainty or risk associated with review. The Commission's review must occur within a time period specified, but this period may not be less than three business days. PPL commends the Commission for recognizing the need for timely review of the procurement process. However, the Company recommends that a maximum time period for review be established in the regulations, e.g., three business days. Without having a certain time period for review, bidders probably will submit higher prices for generation supply to compensate for the risk of the wholesale market changing during the review period.

III. Conclusion

PPL Electric Utilities Corporation and PPL EnergyPlus, LLC respectfully request that the Public Utility Commission develop its final regulations for default service consistent with the fundamental principles and comments set forth above. Specifically, the PPL Companies make five principal recommendations. First, the incumbent EDC should be the default service provider unless it is unable to fulfill that obligation. Second, all functions regarding retail market support, customer care and compliance with the AEPS Act should remain with the EDC. Third, the default service provider should recover all costs of providing that service through a reconcilable automatic adjustment clause. Fourth, all residential customers and non-residential customers with demands of 500 KW or less should receive fixed price default service; all other customers should receive hourly price default service. Fifth, the Commission should establish a tightly structured process for procurement of default service supply.

PPL appreciates this opportunity to submit comments to the Commission on its proposed default service regulations and looks forward to working with the Commission and all stakeholders to develop final regulations addressing this critical element of electric restructuring in Pennsylvania.

Original :2463

(8)

COMMONWEALTH OF PENNSYLVANIA

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Small Business Advocate

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April 27, 2005

HAND DELIVERED

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

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

Dear Secretary McNulty:

I am delivering for filing the original plus fifteen copies of the Comments on behalf of the Office of Small Business Advocate on the Proposed Rulemaking.

Copies of the comments have been served on Shane Rooney and Cyndi Page via electronic mail. If you have any questions, please contact me.

Sincerely,

William R. Lloyd, Jr.
Small Business Advocate

RECEIVED
2005 APR 27 PM 3:23
SECRETARY'S BUREAU

Enclosures
cc: Shane Rooney, Esquire
Law Bureau

Robert Bennett, FUS

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

COMMENTS ON BEHALF OF THE OFFICE OF SMALL BUSINESS ADVOCATE ON THE PROPOSED RULEMAKING

I. BACKGROUND

The enactment of 66 Pa.C.S. Ch. 28, known as the Electricity Generation Customer Choice and Competition Act ("Competition Act"), fundamentally changes the way the rates are to be set for the generation portion of electric service.

Prior to the Competition Act, the Pennsylvania Public Utility Commission ("Commission") set electricity rates on a bundled basis (Generation + Transmission + Distribution) in base rate cases pursuant to 66 Pa.C.S. §1308. The Commission also approved the recovery of certain fuel and purchased power costs through a surcharge pursuant to 66 Pa.C.S. §1307.

In contrast, the Competition Act provides that generation rates are to be determined through market forces rather than through traditional rate base/rate of return/energy clause regulation. At the end of the transition period, each Electric Distribution Company ("EDC"), or a Commission-approved alternative default service provider, is to acquire electric energy "at prevailing market prices" to serve those customers who do not choose an Electric Generation Supplier ("EGS") or whose EGS fails to deliver. See 66 Pa.C.S. §2807(e)(3).

Section 2807(e)(2) requires the Commission to promulgate regulations to define the EDC's obligation under Section 2807(e)(3). To assist in the rulemaking process, the Commission convened the Provider of Last Resort ("POLR") Roundtable at Docket No. M-00041792 and sought written and oral comments from interested parties. The Office of Small Business Advocate ("OSBA") provided written comments and reply comments and made an oral presentation as part of the POLR Roundtable.

By Order entered December 16, 2004, the Commission closed the docket at M-00041792 and initiated a proposed rulemaking at Docket No. L-00040169. By Ordering Paragraph 5, the Commission invited comments on the proposed rulemaking within 60 days of publication in the Pennsylvania Bulletin. The proposed rulemaking was published on February 26, 2005, at Pennsylvania Bulletin, 35 Pa.B. 1421. Consequently, the deadline for comments is April 27, 2005.

Set forth below are the OSBA's comments.

II. COMMENTS ON COMMISSION'S DISCUSSION

In an effort to simplify these comments, the OSBA will respond first to the portion of the proposed rulemaking labeled "Discussion," wherein the Commission provides the rationale for its major policy decisions. In the succeeding section, the OSBA will offer amendments to the proposed regulations, as those regulations are set forth in Annex A to the Commission's Order.

Preamble

In the preamble of the Discussion section of the proposed rulemaking, the Commission appears to endorse the view of some presenters in the POLR Roundtable that the principal objective of the proposed regulations is "fostering a robust retail market

for electricity." (emphasis added) Any such endorsement by the final form regulations would be inconsistent with the legislative history of the Competition Act and would give insufficient weight to the priority of reducing rates.

A review of the floor debate in the House and Senate will verify that legislative supporters and opponents of the Competition Act started with the same stated goal: to reduce rates. No participant in that debate suggested that the Commission should require or permit artificially high POLR rates in order to stimulate retail competition.

Pressed by irate constituents, the General Assembly sought in the 1980s to mitigate rate shock caused primarily by the construction of nuclear power plants at a time when the demand for electricity was falling far short of projections. For example, legislators severely limited rate relief for construction work in progress, authorized the Commission to cancel the construction of unnecessary power plants, and provided for at least a partial denial of rate requests in cases involving excess capacity or construction cost overruns.

Unfortunately, the Commission responded by making only modest excess capacity and cost overrun adjustments, choosing not to halt the construction of the Limerick II nuclear power plant, and approving rates for the Philadelphia Electric Company ("PECO") and the Duquesne Light Company ("Duquesne") which were among the country's highest. Faced with that track record, legislators were open to the argument that competition would do a better job of restraining electric rates in the future than would traditional regulation. However, competition was the means to an end (i.e., lower electric rates) and not the end itself. In short, the General Assembly approved the Competition Act to benefit consumers—not to benefit EGSs.

The Commonwealth Court has already held that "[t]he purpose of the Competition Act is clear: to relinquish the local utilities' monopoly control over the generation of electricity and to invite competition in an effort to lower electric generation rates for the citizens of this Commonwealth." (emphasis added) Indianapolis Power & Light Company v. Pennsylvania Public Utility Commission, 711 A.2d 1071, 1077 (Pa. Cmwlth. 1998), appeal denied 556 Pa. 698, 727 A.2d 1124, certiorari denied 119 S. Ct. 1143, 143 L. Ed.2d 210. Nowhere in its opinion did the Court suggest that retail competition is a higher priority under the Competition Act than is wholesale competition. Nowhere did the Court endorse the view of some POLR Roundtable presenters that POLR rates should be artificially inflated—i.e., be made "as ugly as possible"—in order to give customers an incentive to shop.

The General Assembly approved the Competition Act because "[r]ates for electricity in this Commonwealth are on average higher than the national average, and significant differences exist among the rates of Pennsylvania electric utilities" and because "[t]he cost of electricity is an important factor in decisions made by businesses concerning locating, expanding and retaining facilities in this Commonwealth." See 66 Pa.C.S. §2802(4) and (6), respectively.

The legislature opted to allow competition in the belief that "[c]ompetitive market forces are more effective than economic regulation in controlling the cost of generating electricity." (emphasis added) See 66 Pa.C.S. §2802(5).

Consistent with its goal of restraining the cost of generation, the General Assembly mandated that the POLR supplier "acquire electric energy at prevailing market prices" (emphasis added) in order to serve POLR customers. See 66 Pa.C.S. §2807(e)(3).

Therefore, the proposed regulations must assure that the EDC acquires energy at prevailing market prices, regardless of what effect that may have on how many customers shop.

The Competition Act does expressly state that "all customers of electric distribution companies ... shall have the opportunity to purchase electricity from their choice of electric generation suppliers." (emphasis added) However, the Competition Act makes clear that "[t]he ultimate choice of the electric generation supplier is to rest with the consumer." (emphasis added) See 66 Pa.C.S. §2806(a). Nowhere does the Competition Act explicitly or implicitly empower the Commission to influence that choice by making POLR rates "as ugly as possible." Instead, the Competition Act requires that electric service be "available to all customers on reasonable terms and conditions." (emphasis added) See 66 Pa.C.S. §2802(9).

A. Purpose

The OSBA agrees with the Commission's decision to utilize "default service" rather than "POLR service" to describe the service governed by the proposed regulations. The OSBA also agrees with the Commission's decision to designate the EDC as the "default service provider." Consistent with the Commission's own discussion of the issue, the OSBA will address the designation of the default service provider in more detail at a later point in these comments.

B. Definitions

- The OSBA agrees with the Commission that the proposed regulations should avoid overly prescriptive language at this time. Most of the major EDCs will not be providing default service pursuant to these regulations until 2009, 2010, or 2011.

Intervening changes in federal or state law may require amendments to the regulations. In addition, Duquesne's experience (under its current POLR plan and under a plan to be proposed for the period beginning January 1, 2008) and the experience of other states may identify the need for specific amendments. Similarly, the anticipated increase in the number of states acquiring energy through competitive procurement may cause timing-related market distortions which the Commission will need to address before the regulations become applicable to all Pennsylvania EDCs.

- The OSBA agrees with the Commission that the default service provider should acquire energy through an open competitive auction or Request for Proposals ("RFP").

- Although the Commission states that "different procurement mechanisms may be appropriate in different territories or terms of service," the Commission has not articulated what those differences are. In addition, in a later section ["E. Default Service Implementation Plans and Terms of Service"], the Commission acknowledges that a statewide procurement process may be appropriate in the future. Furthermore, the requirement to acquire energy through an open competitive procurement process will apply both under a uniform statewide plan and under plans designed by individual EDCs. Therefore, the OSBA questions the need to allow each EDC to propose its own default service plan. At a minimum, that approach will assure litigation of each plan. Allowing each EDC to follow its own model may also increase the transaction costs for potential wholesale suppliers and may make it more difficult to achieve the Competition Act's goal of eliminating territorial differences in generation rates. New Jersey and Maryland EDCs are acquiring electric energy pursuant to a uniform statewide procurement process. The

OSBA believes that Pennsylvania's EDCs can, and should, do the same for 2011 and subsequent years (when no EDC will be subject to transition rate caps).

- The OSBA agrees with the Commission that a fixed rate or fixed price option should be available to small commercial and industrial customers.

C. Default Service Provider

The General Assembly designated the EDC as the default service provider unless the Commission selects some other entity to perform that function. See 66 Pa.C.S. §§2802(16) and 2807(e)(3). The OSBA agrees with the Commission's decision to maintain the EDC as the default service provider at the present time and to set forth a procedure for evaluating potential changes in the future.

For numerous reasons, the OSBA believes that the EDC should be the default service provider for the foreseeable future.

First, the requirement to acquire energy at prevailing market prices through an open competitive procurement process will be the same, whether the default service provider is the EDC or an alternative supplier designated by the Commission. Therefore, it is questionable whether selecting an EGS as the default service provider would result in lower rates or better service.

Second, the bulk of the potential savings accruing to small business customers because of the Competition Act will result from competition at the wholesale level. Therefore, it is questionable whether designating an EGS as the default service provider would have significant benefit for small business customers, especially when compared to the potential cost to those customers if an EDC must pick up the pieces after an EGS's default.

Third, consumers, the Commission, and elected officials would look to the EDC to keep the lights on if an EGS were designated as the default service provider but were then to fail to perform.

Fourth, EDCs are more likely to respond to the Commission's directives than are EGSs. An EGS has the option of leaving Pennsylvania or closing its doors entirely. In contrast, because an EDC is required to obtain a certificate of public convenience, an EDC is not permitted to abandon service without Commission approval, even if the EDC declares bankruptcy. See 66 Pa.C.S. §1102(a)(2). Therefore, the OSBA agrees with the Commission that, in order to become the alternative default service provider, an EGS must first obtain a certificate of public convenience. However, even if the EGS were made subject to that requirement, the Commission would continue to have more leverage over an EDC's performance than over an EGS', because the return an EDC is authorized to earn on its "wires" business depends upon Commission decisions.

D. Default Service Provider Obligations

The OSBA agrees with the Commission that default service providers are required to continue universal service programs but may propose modifications in those programs, subject to Commission approval.

E. Default Service Implementation Plans and Terms of Service

The OSBA agrees with the Commission's decision to permit existing POLR plans to continue through their respective scheduled expiration dates. Although the default service regulations may not be finalized by the time each of these EDCs must propose its next plan, the OSBA believes that such interim plans should comply with the proposed regulations as closely as possible. At a minimum, each EDC which proposes an interim

plan should be required to acquire electric energy through a process which is both competitive and transparent.

The OSBA also agrees with the Commission's proposed one-year minimum term for each default service plan. However, the OSBA is concerned that the failure to set a maximum term length will lead to a waste of resources. For example, Duquesne expended resources to design a six-year POLR III Plan. Duquesne and the various intervenors subsequently expended resources to litigate the case, with much of the dispute focused on the permissible length of the plan. Thereafter, the Commission approved only the first three years of the six-year plan. See Petition of Duquesne Light Company for Approval of Plan for Post-Transition Period Provider of Last Resort Service, Docket No. P-00032071 (Order entered August 23, 2004). To avoid a repeat of that case, the OSBA believes that the Commission should, at least, provide a "safe harbor" for three-year plans. Furthermore, the OSBA notes that the Commission could avoid dealing with the length-of-term issue on an EDC by EDC basis by providing for a statewide plan to govern procurement by all EDCs for 2011 and beyond.

F. Default Service Supply Procurement

The OSBA agrees with the Commission that the competitive procurement process should be transparent and should be open to all qualified bidders.

To get the lowest prices for consumers, a generating entity affiliated with one EDC should be permitted to bid to supply energy to any or all EDCs, including its own affiliate. To minimize risk to the EDC, each winning bidder should deliver energy to the default service provider under a load-following contract and without reconciliation.

The OSBA recognizes that the Commission needs a reasonable period of time to review the results of the competitive procurement process. However, the OSBA believes that extending that review process beyond three business days will lead bidders to build an additional premium into their bids, thereby resulting in higher rates for consumers. Furthermore, the OSBA points out that another benefit of a statewide procurement process would likely be the need for a shorter review period than needed under the "one EDC/one plan" approach allowed by the proposed regulations.

G. Default Service Rates and the Recovery of Reasonable Costs

- At the time of restructuring, small business customers generally were paying rates in excess of the cost of supplying energy to them. The restructuring process did not correct that inequity because the Competition Act prohibits interclass shifting of stranded costs during the transition period. See 66 Pa.C. S. §2808(a). However, perpetuation of this cost misallocation beyond the transition period would be inconsistent with basing default service rates on market prices.

The OSBA appreciates the Commission's intention to require EDCs to conduct cost-of-service studies as part of their first post-transition distribution and transmission rate cases. Unless and until interclass subsidies have been eliminated, any generation-related customer care costs which are embedded in current distribution and transmission rates should not be shifted to generation. However, the Commission's goal of shifting those embedded customer care costs to generation when generation rate caps have expired should not be used as justification for failing to move each class toward cost-based distribution and transmission rates during the remainder of each EDC's transition period. Delaying the elimination of embedded subsidies until the end of the transition

period would be inconsistent with 66 Pa.C.S. §1304 and would increase the risk of rate shock when generation-related customer care costs are ultimately shifted to generation.

- As the Commission has implicitly recognized, some embedded customer care costs are related both to generation service and to distribution and transmission service. In view of the General Assembly's intent that the Competition Act reduce rates, the OSBA opposes any shifting of customer care costs to generation rates without a dollar-for-dollar reduction in distribution and transmission rates. To assure revenue neutrality, the Commission should permit the shifting of only those customer care costs which the EDC actually would avoid if it were not the default service provider.

- Because of the embedded interclass subsidies in current rates, default service retail rates should not be calculated by allocating a systemwide wholesale generation bid price among the rate classes on the basis of the EDC's last approved "bundled" cost-of-service study or on the basis of an across-the-board adjustment to existing class generation rates. Instead, the EDC should be required to eliminate generation-related embedded subsidies by acquiring energy through separate bids for residential customers, small commercial and industrial customers, and large commercial and industrial customers. Therefore, the OSBA supports the Commission's decision to require competitive procurement on a rate class by rate class basis and believes that that requirement should preclude the need for any system-wide generation cost allocations.

- The OSBA supports the Commission's decision to guarantee a fixed rate option for small business customers with a load of 500 kW or less. As the Commission has recognized, many small business customers can not readily shave their electricity use to respond to hourly fluctuations in market prices. Instead, they must consume energy to

accommodate their own customers. That is especially true for restaurants and retail businesses.

Small businesses also need to be able to predict their costs in order to set the prices they charge for their own goods and services. A UGI witness at the POLR Roundtable provided empirical evidence to support that proposition. Specifically, he observed that, instead of taking their chances with year-to-year market fluctuations, one-third of UGI's business customers chose a three-year plan with a known rate increase each year. Therefore, the default service provider should offer prices to small businesses which are fixed for no less than one year.

- The OSBA does not believe that the risks to the default service provider are as great as the Commission appears to be assuming.

For example, unanticipated seasonal migration can be a serious risk for EDCs when they are under capped generation rates. However, in the post-transition period, the winning bidders in the competitive procurement process presumably will be obligated to provide electric energy on a load-following basis. Therefore, the risk of seasonal migration will be borne by the winning bidders and not by the EDCs. Because bidders will build the risk of seasonal migration into their bids, there should be no need for the Commission to authorize risk premiums or new procedures for EDCs to recover costs associated with changes in market conditions, sales, and switching.

Similarly, the proposed regulations guarantee that an EDC will recover all of its reasonable costs, including the cost of energy, if a wholesale supplier fails to deliver. Therefore, there should be no need for customers to pay a risk premium to the EDC for risks the EDC will <u>not</u> incur.

- Section 3(a)(3) of the act of November 30, 2004 (P. L. ___, No. 213), known as the Alternative Energy Portfolio Standards Act ("Alternative Energy Act") provides that costs incurred by an EDC for the purchase of electricity from alternative energy sources and costs for the purchase of credits shall be recovered "pursuant to an automatic energy adjustment clause under 66 Pa.C.S. §1307 as a cost of generation supply under 66 Pa.C.S. §2807."

Under Section 2807(e)(3), an EDC "shall acquire electric energy at prevailing market prices . . . and shall recover fully all reasonable costs." (emphasis added) Under Section 1307(a), surcharges are intended to provide a public utility with a "just and reasonable return" on its rate base and may be revoked if rates are "unjust or unreasonable." Therefore, by linking purchases under the Alternative Energy Act to Sections 2807 and 1307, the General Assembly set parameters for the charges to ratepayers. To fit within those parameters, the OSBA recommends that EDCs be required to utilize a competitive procurement process for acquiring electricity, or associated credits, from alternative energy sources.

Electric energy generated from alternative energy sources has the potential to offset volatility in the market price of electricity. Ideally, an EDC would seek bids for a specified quantity of electricity, with a bid requirement that the statutorily-designated percentage of that electricity be provided from alternative energy sources. Potential wholesale suppliers responding to such a solicitation might then be in a position to lower their bid prices to reflect the benefits of using alternative energy sources as a hedge.

Unfortunately, because the Alternative Energy Act provides for the recovery of alternative energy costs through a surcharge, the Commission may not be empowered to

order each EDC to conduct a competitive procurement process which results in a "blended" price for the required combination of electricity from non-alternative sources and electricity from alternative sources. However, the OSBA recommends that each EDC be given the option to waive recovery of its alternative energy costs through a surcharge and, instead, to collect those costs as part of a "blended" price which results from an open and transparent competitive procurement process.

- The proposed regulations authorize EDCs to recover the cost of Demand Side Response ("DSR") programs on a separate basis. The OSBA believes that this portion of the proposed regulations is inconsistent with the Alternative Energy Act.

Specifically, Section 2 of the Alternative Energy Act lists "demand side management" as an alternative energy source. Section 2 defines "demand side management" to include DSR. Section 3 requires that EDCs include a designated percentage of alternative energy in the electricity they sell in Pennsylvania. As long as an EDC meets the overall percentages designated by Section 3, the EDC is in compliance with the Alternative Energy Act even if it decides not to include any DSR in its alternative energy portfolio. Therefore, the Commission should not use the proposed default service provider regulations to mandate that each EDC make DSR available.

H. Commission Review of Default Service Implementation Plans

As stated above, the OSBA believes that all EDCs should acquire energy for 2011 and beyond through a statewide competitive procurement process. If the Commission were to adopt that approach, there would be no need for periodic and lengthy reviews of individual EDC plans. However, the OSBA offers the following comments in recognition that the Commission may decide not to mandate a statewide procurement

process and in recognition that the Commission will need to review interim plans for some EDCs even if it does order a statewide process for 2011 and beyond.

- The OSBA is concerned that extending the period for Commission review of the results of the competitive procurement process beyond three business days will cause bidders to build an additional premium into their bids, thereby resulting in higher rates for consumers.

- A six-month period for Commission review of an EDC's competitive procurement plan is inadequate. Generation costs are a bigger share of a customer's bill than are distribution costs. Distribution rate cases typically involve a nine-month review period. Although it may be reasonable to have a shorter review period for an EDC's second plan, there should be a review period of at least nine months for the first plan. A longer review period is necessary (at least for the initial plan) because the Commission is proposing to give EDCs flexibility to design competitive procurement plans which may differ from each other in significant and unpredictable ways.

The OSBA assumes that requiring 60 days' notice of the rates, terms, and conditions of default service is intended to facilitate shopping. However, the OSBA would support shortening that notice period to 30 days if that were the only way to provide adequate time for review of the EDC's plan. In that regard, the Commission's proposal to allow virtually unlimited switching would make a 30-day notice period less problematic.

Similarly, the OSBA believes that the seven-month implementation period could be shortened in order to assure adequate time for review of the plan. Furthermore, the

OSBA questions whether an EDC will need a seven-month implementation period when it is implementing its second or other succeeding plans.

I. Default Service Customers and the Standards for Transferring Customer Accounts to Default Service Providers

- The Commission's decision not to endorse minimum stay and switching restrictions at this time will result in higher rates for those customers who do not shop. Wholesale suppliers will build switching risk into their bid prices or seek to mitigate such risk by requesting authorization for periodic rate adjustments. Experience to date has been that shopping is much more extensive among large commercial and industrial customers than among small business customers. Therefore, higher bid prices because of switching risk will be especially problematic for the smallest commercial customers, who are unlikely to create switching costs because they are unlikely to shop. However, the Commission's decision to require the competitive acquisition of energy by rate class should help mitigate the burden on non-shopping small business customers because costs associated with switching risk will be recovered on a class basis.

- The OSBA agrees, in general, with the Commission's proposed restrictions on an EGS's ability to return customers to default service. However, the OSBA questions whether the proposal is adequate to prevent an EGS from timing its contract termination date to exploit seasonal price variations. Therefore, the Commission should consider prohibiting an EGS from entering contracts which terminate within one month of the beginning of the EDC's peak season.

- Seasonal usage is only one factor to be considered in the design of rates. In no event should seasonal rates be implemented in isolation, simply to facilitate the

elimination of switching rules, or be implemented in a punitive fashion, simply to make default service rates "as ugly as possible."

Although seasonal rates can be revenue neutral on a class basis, they are unlikely to be revenue neutral on an individual customer basis. Many small business customers can not respond to seasonal price signals and, therefore, can not mitigate the bill impacts associated with such signals. For example, restaurants and stores could lose customers and offices could lose worker productivity if air conditioning use were curtailed significantly. Similarly, small manufacturers must meet customer demand, regardless of the season.

Furthermore, because there has been minimal shopping by small business customers, the small commercial and industrial rate classes have generally not been involved in the switching abuses which seasonal rates are intended to deter.

- The OSBA believes that there would be less need to consider strengthening competitive safeguards if the Commission were to require a statewide procurement process for energy acquired for 2011 and beyond. The Commission's proposal to allow each EDC to design its own plan will unnecessarily increase the danger that an EDC will try to discourage shopping in order to preserve customers for the EDC's generation affiliate.

III. COMMENTS ON COMMISSION'S REGULATORY LANGUAGE

The following are specific amendments to the proposed regulations to implement the OSBA's recommendations which are set forth under "II. COMMENTS ON COMMISSION'S DISCUSSION":

§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:

* * *

(4) Upon the normal expiration of contracts that are not structured in a way to exploit seasonal variation in market prices for electric generation service and that do not expire less than one month prior to the beginning of the default service provider's peak seasonal period.

* * *

(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. An EGS may not enter a contract to provide electric generation service to a non-residential customer with a load of 500 kW or less unless the expiration date of that contract is at least one month prior to the beginning of the default service provider's peak seasonal period.

§54.182. Definitions.

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

Fixed rate option—A default service price that is set in advance for one or more successive twelve-month periods or for the entire term of the default service implementation plan. The default service price [that] may include seasonal differences.

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

* * *

(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). A default service implementation plan may propose a maximum term of service of up to 36 months, provided that the Commission, for good cause shown, may approve a maximum term of service of greater than 36 months.

(d) * * * The default service plan shall identify a fair, transparent and non-discriminatory competitive procurement process as its method of compliance with the Alternative Energy Portfolio Standards Act, No. 213 of 2004. An EDC serving as the default service provider may, at its option, include such method of compliance with the Alternative Energy Portfolio Standards Act as part of its default service supply procurement under §54.186 and may recover the costs of complying with the Alternative Energy Portfolio Standards Act as part of the price for default service supply procurement determined under §54.186.

(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. All default service providers shall file a joint, statewide default service implementation plan that proposes a statewide competitive procurement process for the acquisition of electric generation supply for all default service customers for periods beginning on or after January 1, 2011.

§54.186. Default service supply procurement.

(a) A default service provider shall procure the electricity needed to provide default service, and to comply with the Alternative Energy Portfolio Standards Act, No. 213 of 2004, only through a competitive procurement process or replacement procurement process approved by the Commission, with the following exceptions:

* * *

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

* * *

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

* * *

(ii) A definition and description of the power supply products on which potential suppliers shall bid. Such products shall be bid by each already effective retail customer class in the EDC's service territory or by such reclassification of retail customers proposed in accordance with §54.185(g) and approved by the Commission.

* * *

(vii) Relevant load data, including the following:

* * *

(C) Capacity peak load contribution figures, including capacity obligations, by rate schedule.

* * *

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

* * *

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

* * *

§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:

* * *

(2) Customer charge—* * * The associated costs with this charge include:

* * *

[(ii) A reasonable return or risk component for the default service provider.]

* * *

(3) A default service provider [shall] may 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.

* * *

[(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] for acquiring replacement generation supply when a generation supplier fails to deliver generation supply to the default service provider.

(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). Nothing herein shall be construed as prohibiting a default service provider from seeking extraordinary rate relief under 66 Pa.C.S. §1308(e).

* * *

§54.188. Commission review of default service implementation plans.

* * *

(b) The Commission will issue an order within [six] nine 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. * * *

* * *

(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] 30 days before their effective date, unless another time period is approved by the Commission. * * *

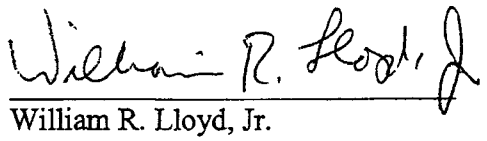
* * *

IV. CONCLUSION

According to the shopping statistics compiled by the Office of Consumer Advocate, the number of shopping customers is relatively modest statewide (and virtually non-existent in some service territories). Furthermore, if the wholesale competitive procurement process works properly, it would be surprising if EGSs were able to beat the default service rates available to most small commercial and industrial customers. However, the proper yardstick for measuring the Competition Act's success, now and after implementation of the regulations, is whether rates are lower than they would have been under traditional regulation.

WHEREFORE, the OSBA respectfully requests that the Commission revise the proposed regulations in accordance with the foregoing comments prior to submission of the regulations in final form to the Independent Regulatory Review Commission and the standing committees of the General Assembly.

Respectfully submitted,



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Dated: April 27, 2005