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UGI UTILITIES, INC.

June 27, 2005

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

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

Dear Secretary McNulty:

Enclosed for filing, please find an original and fifteen copies of the Reply Comments of UGI Utilities, Inc. – Electric Division ("UGI"). Copies of these comments have also been e-mailed to Shane Rooney and Cyndi Page at srooney@state.pa.us and cypage@state.pa.us.

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

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Very truly yours,

Mark C. Morrow

Counsel for UGI Utilities, Inc. – Electric Division

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

REPLY COMMENTS OF UGI UTILITIES, INC. - ELECTRIC DIVISION

UGI Utilities, Inc. – Electric Division ("UGI") appreciates this opportunity to submit Reply Comments in this important rulemaking docket. These Reply Comments are meant to supplement the Reply Comments filed by the Energy Association of Pennsylvania ("EAP") at this docket.

I. THE COMMISSION SHOULD RESIST CALLS TO ESTABLISH DETAILED DEFAULT SERVICE PROCUREMENT RULES OUTSIDE OF A DEFAULT SERVICE PROCUREMENT PLAN PROCEEDING

In its comments, the Morgan Stanley Capital Group, Inc. ("MSCG") argues that the Commission should ensure "fair, transparent and non-discriminatory procurement" by mandating a statewide simultaneous auction process modeled on New Jersey's approach with a "full service agreement" specifying bilateral credit, alternative guarantee and termination payment notional quantity terms determined through a regulatory

process[1].MSCG Comments, p. 1-2. In the joint comments of PPL Electric Utilities Corporation and PPL Energy Plus, LLC (the "PPL Entities"), the Commission is urged to "establish a tightly structured competitive procurement process" that would have "standard products" and "standard terms", presumably determined through a regulatory process, and where price would be the only permissible criteria used to evaluate bids (as opposed to such considerations of risk of default or the spreading of risks through the use of a diversified portfolio of suppliers). In its comments Reliant Energy, Inc. ("Reliant") criticizes the results of the New Jersey auction process, and offers a number of specific alternative proposals that would limit the ability of the default service provider or, in some instances, its affiliate, to offer fixed price default service rates. In its comments, Strategic Energy, LLC ("Strategic") offers detailed default service proposals involving a competitive RFP process with special rules governing affiliate bids and would, once again, limit the ability of the default service provider to offer fixed price default service rates. Amerada Hess Corporation ("Hess") argues for uniform statewide default service terms and would limit the ability of a default service provider to offer fixed price default service rates to Commercial and Industrial ("C&I"). Strategic Energy LLC proposes a detailed RFP process for small customers, and rules limiting the ability of a default service provider to offer fixed price default service rates to C&I customers. The OSBA supports a statewide competitive procurement process beginning in 2011, with interim default service plans comporting with the proposed regulations as closely as possible.

UGI believes the Commission appropriately decided "that each default service provider should have the option of proposing a default service implementation plan best

[1] Even MSCG concedes, however, that an alternative to the New Jersey style auction process, such as an RFP process, may be appropriate for smaller utilities like UGI. MSCG Comments, p. 2.

suited to its service territory." Proposed Rulemaking Order, p. 10. The Commission should have the most complete understanding possible of the practical effects of a default service procurement plan before it makes a decision on that plan. Since the pertinent facts and circumstances of each Electric Distribution Company ("EDC") will vary, and these circumstances will change over time, such filings will present the proper opportunity for the development of an appropriate record. In such a proceeding, the practical effects of the default service procurement plan proposed by the EDC, as well any alternative plans of the sort advanced in the comments outlined above, can be considered, relevant facts investigated and developed, and a decision made in the context of a well developed record.

In general, UGI believes the Commission should retain a healthy skepticism about calls to adopt particular concepts or procurement program details now under the guise of promoting competition or providing certainty, or of proposals to substitute administrative decisions for market outcomes.

For example, MSCG calls for the wholesale adoption of the state-wide New Jersey auction process in Pennsylvania under the guise of providing "fair, transparent and non-discriminatory procurement". In is conceivable, however, that the practical effect of such a process, given transmission constraints and other factors, might be a situation where undue temporal or regional market power might be created, leading to higher prices. Stated another way, the practical effect of MSCG's suggestion, when applied to a particular set of facts and circumstances, might be the creation of an "ugly" default service price thereby promoting the transfer of customers to alternate suppliers or the payment of excessively high default service rates.

Similarly, while the PPL Entities and others call from the creation of a structured procurement process with defined "standard products", such as on-peak energy, to promote certainty and establish market prices, it is possible that this process, if performed in the abstract, could be a barrier to placing the risks of customer migration or other supply risks with potential bidders on the grounds that these risks are not part of a "standard product".

Calls by the PPL Entities and others for judging bids submitted by potential suppliers on price alone, or by MSCG and others for the development of standardized supply contracts with bilateral credit terms developed through an administrative process, may also, upon closer examination, not be all that they seem. Counterparty performance and credit risks are real costs. In the existing wholesale electric market, standard contracts, such as the Edison Electric Institute Agreement ("EEI Agreement"), are used and contain a laundry list of potential performance assurance and default provisions that can be tailored to the individual circumstances of the parties, such as credit ratings and financial characteristics. Risks are managed through both the use of performance assurance measures and the construction of diversified supply portfolios that, to some extent, can reduce the required levels of performance assurance. The adoption of administrative rules requiring bids in a structured procurement process to be judged by price alone, or rules requiring of adoption of standardized contracts and credit terms through an administrative process could, rather than promoting competition, be means of inappropriately placing undue risks on default service providers or customers, and a potential attempt to substitute administrative outcomes for market outcomes.

The calls by marketers for restrictions on the ability of default service providers to offer fixed price service offering to C&I customers with even modest levels of consumption could also be viewed as an inappropriate attempt to substitute administrative, for market, outcomes. As the marketers realize, hourly service offerings are not a viable option for most C&I customers. By requiring default service providers to only provide hourly default service (with all of the attendant system implementation costs), while prohibiting them from offering the fixed price products most C&I customers need, marketers are attempting to limit competition by administrative fiat, and to force C&I customers to their fixed price offerings. While UGI recognized that the Commission has proposed a threshold above which fixed price default service could not be offered to C&I customers, UGI has argued in its comments, and reiterates here, that the Commission should retain the discretion to adjust or remove any such threshold based on the facts and circumstances, including system costs and customer desires, applicable in each service territory.

In response to the many detailed, often conflicting and possible self-serving default service proposals contained in the comments submitted by marketers, the Commission should stick to its decision to permit the submission of default service implementation plans tailored to the circumstances of individual default service providers, should defer consideration of submitted or alternate default service procurement plans until such plans are submitted. The Commission should also reserve the right to evaluate the practical effects of proffered plans before rendering final decisions. The Commission should also seriously consider, as UGI emphasized in its

initial comments, removing its proposed unilateral right to short circuit this process by ordering, on its own motion, the submission of multi service territory procurement plans.

UGI believes that, based on its experience in providing default service over a number of years, the interests of its default service customers would not be best served through the rigid and restrictive auction or RFP processes and restrictions on default service product offerings advocated in the marketer comments. Instead, default service providers should have the flexibility to build a portfolio of supplies in a disciplined manner that permits reactions to market trends and opportunities and a full consideration of credit and supplier risks. The results of this approach can be enhanced by the adoption of sensible switching rules and restrictions that moderate supply risks, and by providing the default service provider the opportunity to offer longer term fixed price service options to customers willing to contractually commit to default service for an extended period of time in return for a guaranteed price. UGI's confidence in this approach is bolstered by (1) the fact that there is no evidence that the MSCG or other marketers choose to procure their supplies through the rigid and restrictive procurement practices they propose and (2) UGI's long experience in using the portfolio approach to procure supplies in wholesale gas markets to meet the needs of its purchased gas cost customers. In its comments, the OCA has also endorsed the portfolio approach, perhaps reflecting its experience in reviewing supply procurement plans in annual Section 1307(f) proceedings. UGI or others should not be precluded from proposing such an approach, or other approaches, in the future by the adoption of overly prescriptive default service regulations.

II. THE COMMISSION SHOULD RETAIN THE FLEXIBILITY TO APPROVE DIFFERING DEFAULT SERVICE RATE APPROACHES, INCLUDING RECONCILABLE RATES

In its comments the OCA suggests that because of the passage of the Alternative Energy Portfolio Standards Act ("AEPSA"), default service rates should now be reconcilable in their entirety since certain costs incurred to comply with the AEPSA are recoverable pursuant to a reconcilable rate mechanism and "it would be extremely difficult to implement" two cost recovery mechanisms. The OCA also suggests that default service plans and rates would be subject to "periodic" review to make sure that purchases are made pursuant to a previously reviewed procurement plan. Marketers, such as Reliant and Strategic, argue that default service rates should be subject to periodic adjustment to reflect current market conditions and not unduly impede competition. Many comments noted that the General Assembly indicated in the Electricity Generation Choice and Competition Act that market forces are better than economic regulation in controlling the costs of electric generation. The National Energy Marketers Association ("NEMA") argues that EDCs should be transitioned out of the merchant function, and many marketers argue that the role of the default service provider should be limited and customers encouraged to switch to EGSs by various mechanisms.

Under 66 Pa.C.S. §2807(e), the only functional differences between a default service provider and a licensed electric generation supplier ("EGS") is that the default service provider is (a) required to provide service to all customers who do not shop or who shop but do not receive the electric generation service they contract for, (b) required to acquire electric energy at prevailing market prices to provide this service and (c) has

the right to fully recover all reasonable costs. The General Assembly did not express the intent to have administrative actions taken to force customers to be served by EGSs against their will or to place undue burdens on default service providers to discourage the use of their service offerings.

If the General Assembly's intent to have market forces, rather than economic regulation, control the costs of electric is to be honored, the Commission should be aware that a rigid auction process, whether conducted statewide or otherwise, is not the only available policy option, and may not, for the reasons discussed above, produce the best result for default service customers.

Specifically, another obvious solution would be to permit the default service provider to procure energy, assess supply and other risks and to set its own price for default service outside of any administrative process. To the extent that price established would be too high for retail market conditions, it could be undercut by competing EGSs and customers would switch to competing EGSs. To ensure that the default service provider is able to compete on a comparable basis, it would be able to establish reasonable contractual commitments from customers in the same manner that EGSs do in their contracts with customers. The default service provider would retain any profits made and would absorb any losses incurred for the risks it shoulders in providing a non-reconcilable rate.

As part of an interim settlement UGI negotiated an agreement that would have permitted it to set its own default service rates commencing January 1, 2005, but eventually was not permitted to implement this portion of the agreement since public parties were not comfortable with completely relinquishing at least some degree of

administrative oversight of default service rates. To accommodate a perceived or actual need of public parties to exercise some administrative oversight over default service rates, at least for an interim period, another viable option is for the default service provider to provide advance notice of the proposed rates or range of rates of it would be willing to offer in light of the supply risks and other factors it would face. If a mutual agreement can be reached between public parties and the default service provider, then the default service rates, reflecting prevailing market prices, could be implemented without the need for after-the-fact administrative review or reconciliation. Such negotiated rates would not be the equivalent of the lengthy rate caps associated with the implementation of the Electricity Choice and Competition Act criticized by many marketers, since default service providers would not be willing to voluntarily agree to negotiated limits that are below prevailing market rates, and such agreements would be periodically reestablished. UGI essential operates under this regime today, and it has worked well for UGI's customers.

If agreement between public parties and the Commission cannot be reached, a default service provider should not be required to assume supply risks it is unwilling to accept, and a reasonable fallback mechanism to ensure that the cost recovery right under 66 Pa.C.S. §2807(e)(3) is realized, would be to recover the costs incurred in acquiring power through an approved supply strategy by way of reconcilable rates. Any after-the-fact review, if required, would be to ensure that supplies were acquired in accordance with the supply strategy and to confirm that reconciliations were calculated properly.

UGI does not agree with the OCA's suggestion that the provisions of the AEPSA require all default service rates to be reconcilable. The costs incurred in fulfilling

obligations under the AEPSA will be identifiable and can be recovered through a surcharge mechanism in the same manner that state taxes, gas transition costs, customer education expense costs and other costs are recovered through surcharges. The surcharge would be an assigned rate, and recovery could be easily determined by applying the assigned rate to actual volumes sold. This would not create a need to reconcile the remaining portion of default service rates. It is also possible that the right to recover such costs through a reconcilable mechanism could be waived where circumstances warrant.

Since there are many ways of achieving the objective of setting default service rates, many potentially interrelated factors to consider, and many circumstances that the Commission may not be able to foresee at the present time, the Commission should not prematurely limit its discretion to consider potential default service pricing proposals, including methodologies that would employ reconcilable rates.

III. THE COMMISSION SHOULD HEED THE COMMENTS OPPOSING THE RATE STRUCTURE CHANGES PROPOSED IN SECTIONS 54.187(a) AND (b) OF THE PROPOSED REGULATIONS

In Section VI of its Comments, UGI identified many legal and practical problems with the dramatic rate structure changes proposed in Section 54.187(a) and (b) of the default service regulations. UGI would note that OCA and IECPA, as well as the EAP and other EDCs, have also expressed many concerns about these proposed changes. See, e. g., OCA Comments, pp. 16-18; IECPA Comments, pp. 18-21; PPL Companies, pp. 18-21.

UGI wishes to reemphasize that the rate structure changes proposed in the default service regulations would be impossible to implement fairly, would inevitably distort

default service rates by including distribution costs in generation rates, would prevent customers from effectively comparing costs and are at odds with the provisions of the Electricity Generation Customer Choice and Competition Act which provided for the unbundling of EDC rates in restructuring proceedings that have been completed, and made no provision for a second round of rate restructuring upon the implementation of default service. An attempt to implement the proposed provisions would almost certainly lead to the creation of "ugly" and confusing default service rates, and thus would have the effect of indirectly substituting administrative, for market, outcomes by artificially forcing customers to more rationally priced service offerings from marketers.

IV. CALLS FOR STRICTER STANDARDS OF CONDUCT ARE MISPLACED

On pages 30-36 of its Comments, Strategic suggests that the Commission's standards of conduct need to be strengthened and proposes new detailed standards, apparently based on standards of conduct adopted in New Jersey, while at the same time acknowledging that EDC marketing affiliates are already subject to strict FERC codes of conduct.

As noted above, the Commission should be very skeptical of the various proposals that have been advanced by the marketers and their proponents at this docket. While these comments purport to be in favor of promoting competition, the many proposals advanced provide a remarkable array of proposals to substitute administrative for market outcomes, by either limiting the ability of default service providers to offer products customers want or by burdening default service providers with procurement processes that the marketers themselves would not use to procure their own wholesale supplies.

Strategic's call for new Standards of Conduct is part of a long history of calls by marketers, including Enron, for harsh rules based on exaggerated concerns about affiliate abuse. The undeniable fact is, however, that Pennsylvania has now operated under the Commission's Standards of Conduct for many years without incident. Moreover, many Pennsylvania EDC's, including UGI, do not even have licensed EGS providing retail service offerings in their service territory, thereby completely undermining any implication that marketers are not able to compete for customer loads because of affiliate abuse.

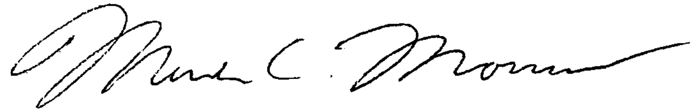
Moreover, the Commission recently investigated whether its interim standards of conduct should be made permanent, and concluded that they should after convening a group of all stakeholders, including marketer representatives. See Permanent Standards of Conduct Pursuant to 66 Pa. C.S. §2209(b), Docket No. L-00030162 (Order Entered September 23, 2003). As the Commission noted in its Order:

> . . . we reconvened the working group that assisted us in drafting the interim Standards of Conduct. The working group convened on April 28, 2003, and consisted of representatives from natural gas distribution companies, natural gas suppliers, the Office of Consumer Advocate, other interested parties and our staff. The working group indicated that the interim Standards of Conduct are working well and that they are now invested in the current regulatory framework.

Order, p. 2. When the Commission's proposed rule has published for comment, there is no evidence that marketers, including Strategic, called for any modification of the Commission's Standards of Conduct.

UGI submits that Strategic's call for new standards of conduct is completely unsupported and unnecessary, and should be summarily rejected.

Respectfully submitted,



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Dated: June 27, 2005

Original: 2463

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June 27, 2005

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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

Dear Secretary McNulty:

Enclosed are the original and fifteen (15) copies of Direct Energy LLC's Reply Comments in the above-referenced matter. As requested, we are also sending an email version of the Reply 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:59749.1/DIR023-216494

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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)	:	

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REPLY COMMENTS OF DIRECT ENERGY SERVICES, LLC

Direct Energy Services, LLC ("Direct Energy") submits these Reply Comments to the comments of several parties suggesting that the Commission remove the suggested option for the appointment of an alternative Default Service Provider ("DSP") or that the concept needs to be extensively investigated before including it in the rules. Such opposing comments are grounded in the traditional regulatory construct and the current state of the competitive retail market, and fail to acknowledge that a full Retail Default Service bid out model provides the greatest opportunity for competitive market forces to deliver the benefits of a competitive electricity market, including product options, innovation, service improvement and downward pressure on electricity prices. The Commission should reject these comments and adopt, in whole or in part, Direct Energy's Retail Default Service model as set forth below.

I. Retail Default Service Bid Out

In its initial comments, Direct Energy explained why the Commission's proposal to have the incumbent utilities provide post-transition Default Service through a wholesale supply bid out is the wrong approach, noting the deficiencies of wholesale auctions[1] – and why a bid out of

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[1] Direct Energy Comments at 9-11. Direct Energy explained that the Commission's wholesale supply bid out proposal is not supportive of the broader goals of the Electric Choice Act because it will distort the retail market and, even in the best light, can only capture a portion of the

the entire Retail Default Service function to qualified EGSs is the correct approach to permit competitive market forces to deliver the best value and service to consumers as envisioned by the Electric Choice Act.[2] Direct Energy pointed out that allowing companies other than the incumbent utilities to provide default and equivalent service has worked in other areas, such as Texas and Canada.

Despite the Commission's clear authority to require a Retail Default Service model,[3] some commentators recommend that the Commission should not provide for the appointment of an alternative DSP,[4] which is the basis for a retail bid out model. Other commentators acknowledge the Commission's authority to appoint an alternative DSP, but raise a myriad of issues they believe must be examined and resolved before the Commission can consider doing so.[5] These comments do not provide support for rejecting outright, in whole or in part, Direct Energy's Retail Default Service Bid Out model.

1. The Commission should reject requests not to exercise its authority to provide for the appointment of an alternative DSP.

The OCA argues that the provisions for the appointment of an alternative DSP should be removed from the regulations because doing so would be "unworkable" and "the EDC will always be the 'last resort' since it must connect and deliver supply."[6] Although Direct Energy's

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benefits the competitive market can provide to customers after the transition period market ends. *Id.* at 3-4.

2 *Id.* at 1-9. Bidding out the full Retail Default Service function based upon 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. *Id.* at 6.

3 December 16, 2004 Rulemaking Order at 8.

4 OCA Comments at 13-14, 31; OSBA Comments at 7-8.

5 Industrial customer groups' Comments at 7-10; Exelon Comments at 8-9; PPL Comments at 4.

6 OCA Comments at 13-14. The OCA also argues that there is no efficiency, clear purpose or need to consider authorizing an alternative DSP. *Id.* at 14.

Retail Default Service Bid Out proposal envisions the EDC providing retail back-up service for short-term energy replacement,[7] that approach is not absolutely necessary. In the United Kingdom, other retailers act as the retail back-up providers under the direction of the regulators, rather than the incumbent "wires" utilities. In Georgia, the incumbent utility Atlanta Gas Light ("AGL") provides only a pure "wires equivalent" delivery service, and marketers are responsible for arranging customer connections,[8] billing, customer care and retail back-up service. Contrary to the OCA's argument that the EDCs "must" connect and deliver supply in the post-transition period,[9] Sections 2807(e)(2) and (3) of the Electric Choice Act provide the Commission with the authority to permit an alternative DSP to perform some, or all, of the EDCs' "obligation to connect and deliver and acquire electricity" for Default Service customers in the post-transition period.[10]

The OCA also argues that "the obligation to provide universal service programs must remain with the EDC as a non-bypassable distribution function and cost" and not transferred to an alternative DSP.[11] Similarly, Duquesne Light Company ("DLC") argues that funding for universal service programs is currently recovered through distribution rates, and that this should continue even if an alternative DSP is appointed.[12] Although Direct Energy argued in its initial

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7 Direct Energy Comments at 7.

8 AGL makes the connections.

9 OCA Comments at 14.

10 Section 2807(e)(2) provides that after the transition period ends, the Commission must promulgate regulations to define the EDC's obligation to connect and deliver and require electricity under Section 2807(e)(3), and Section 2807(e)(3) specifically authorizes the Commission to direct that these obligations be performed by a "commission-approved alternative supplier." 66 Pa. C.S. § 2807(e)(2),(3).

11 OCA Comments at 32.

12 DLC Comments at 34.

comments that an alternative DSP could provide universal service programs,[13] Direct Energy does not oppose this position.

The OSBA appears to accept the idea of an alternative DSP, but argues that it is "questionable" whether permitting an alternative DSP would result in lower rates or better service for small business customers.[14] The OSBA also argues that even if an alternative DSP obtained a certificate of public convenience, as contemplated in the proposed regulations,[15] the Commission would have "more leverage" over an EDC's *supply* performance by reason of the Commission's authority over the return on the EDC's *distribution* service.[16] This argument is questionable to say the least,[17] and, at most, a red herring and should be ignored. The Commission has ample powers to ensure that an alternative DSP abides by the Commission's rules for Default Service to the same extent as an EDC, without requiring the alternative DSP to obtain a certificate of public convenience. The OSBA's comments, in essence, amount to a rejection of the concept of an alternative DSP for the foreseeable future, similar to the reasons relied upon by the Commission in not adopting a retail default service bid out model in the

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13 Direct Energy Comments at 6.

14 OSBA Comments at 7.

15 A certificate of public convenience is not required for the Commission to protect customers against an alternative DSP's abandonment of service without Commission approval. Direct Energy Comments at 9.

16 *Id.* at 8. In its initial comments, Direct Energy explained why the proposed requirement that an alternative DSP obtain a public utility certificate of public convenience is contrary to the Electric Choice Act and not good policy – and unnecessary. Direct Energy Comments at 9.

17 It is not clear that the Commission would be able to take any legally supportable action against an EDC's separate distribution service if the EDC failed to adequately live up to its separate DSP supply obligation.

proposed regulations.[18] The OSBA's position should be rejected for the reasons explained in Direct Energy's initial comments.[19]

2. There is no need to "reinvent the wheel" concerning the appointment of an alternative DSP.

Although some EDCs acknowledged the Commission's authority to appoint an alternate DSP, they argue that there are a host of issues that must be examined and resolved before the Commission can even consider appointing an alternative DSP.[20] The Industrial customer groups argue that issues concerning separation of customer care functions (no "double-dipping" by the DSP and EDC) must be addressed, adding that Section 2807(d) suggests that EDCs will continue to perform all customer care functions in the post-transition period even if an alternative DSP is appointed.[21] This argument fails to recognize that Section 2807(d) provides that EDCs shall continue to provide customer care functions "consistent with the regulations of the commission." Clearly, the Commission could provide for alternative DSPs to provide customer care functions in the regulations established in this rulemaking.

PPL argues that "the administrative burdens associated with approving another entity as the default service provider are enormous,"[22] while the OCA argues that "there are insufficient

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18 The Commission rejected the retail bid out model because "the competitive market is still in transition." December 16, 2004 Rulemaking Order at 9.

19 The Commission's rationale for not adopting a retail bid out model is inconsistent with the Electric Choice Act and the Commission's other determinations concerning the purpose of post-transition Default Service, and the state of the current shopping market actually supports adoption of a retail bid out model. Direct Energy Comments at 3-4.

20 Industrial customer groups' Comments at 7-10; Exelon Companies' Comments at 8-9; PPL Comments at 4; OCA Comments at 31.

21 Industrial Customer Groups' Comments at 8-9. Their comments that "the PUC must ensure that the rates charged by the DSP do not go above any rate caps that are in place" should be ignored because these regulations are to apply in the post-transition period when there are no rate caps.

22 PPL Comments at 4.

procedural steps, standards, and restrictions" for a retail POLR approach.[23] Direct Energy believes that its comprehensive Retail Default Service Bid Out proposal submitted with its initial comments adequately addressed the relevant issues raised by these commentators. However, to the extent some implementation questions remain unanswered, Direct Energy submits that the experience with Competitive Default Service plans included in some EDCs' restructuring plans[24] demonstrate that these comments exaggerate the implementation issues, and that such implementation details can be examined and resolved with much less controversy than implied by these comments.

However, Direct Energy agrees with the Industrial customer groups' recommendation that an alternative DSP be required to meet the credit requirements in PJM's Tariff, which all EGSs operating as Load Serving Entities ("LSEs") in PJM must do.

3. At a minimum, the Commission should provide for a Retail Default Service Bid Out to ensure a minimum level of shopping in the Post-Transition Period.

In its initial comments, Direct Energy proposed a Retail Default Service pilot in each EDC territory for about 20% of residential and small commercial customers, as an alternative to a bid out of the entire Retail Default Service function.[25] In its initial comments, Dominion Retail suggested that the Commission should "specifically link the EDC's privileged and incumbent position as the default service provider to the degree of customer switching."[26] Dominion Retail recommended that the Commission do so either by: (1) giving competitive suppliers first priority

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[23] OCA Comments at 31. The Exelon Companies argue that the implications of an alternative DSP's "public utility" status in obtaining a certificate of public convenience must be "carefully explored." Exelon Companies' Comments at 9.

[24] *E.g.*, PECO, MetEd and Penelec.

[25] Direct Energy Comments at 11-12.

[26] Dominion Retail Comments at 9.

to serve small customers if at least 20% of small customers are not shopping at the end of the EDC's transition period; or (2) setting forth in the regulation the conditions under which the Commission would mandate a Retail Default Service bid out, such as where "small customer shopping is non-existent or sluggish (i.e., less than 10%)."[27] Direct Energy wholeheartedly agrees with this approach as reasonable first steps for the Commission to take if it is not inclined to adopt Direct Energy's proposals.

Direct Energy also agrees with the comments of the National Energy Marketers Association ("NEM") that the Commission should require EDCs to exit the merchant function.[28] However, in light of the Commission's views expressed in its Rulemaking Order, Direct Energy believes that adoption of its Retail Default Service Bid Out model, either in whole or in part or in conjunction with Dominion Retail's proposals, would be alternatives to NEM's proposal that would be more acceptable to the Commission at this time and provide more benefits and nurture the development of the retail market more than a wholesale bid out model.

II. Modifications to the Commission's Wholesale Bid Out Proposal

Direct Energy supports the Reply Comments of the Retail Energy Supply Association ("RESA") concerning modifications to the Commission's wholesale bid out proposal recommended by other commentators, with the exception of the 200 kW threshold for large customers subject to hourly pricing. As explained in Direct Energy's initial comments, the threshold should be 25 kW.[29]

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27 *Id.* at 9-10.

28 NEM Comments at 2-4.

29 Direct Energy Comments at 13-14.

III. Conclusion

Direct Energy emphasizes once again that 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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Date: June 27, 2005

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June 27, 2005

James J. McNulty, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
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. §2807(e)(2) Docket No. L-00040169 Comments of Strategic Energy, LLC

Dear Secretary McNulty:

Enclosed for filing with the Commission are the original and fifteen (15) copies of Strategic Energy LLC's Reply Comments in the above-captioned matter. If you have any questions concerning the submittal, please direct them to the undersigned.

Very truly yours,

Julie Coletti
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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

REPLY COMMENTS OF STRATEGIC ENERGY, LLC

To aid in the consideration of the Pennsylvania Public Utility Commission's ("Commission") Proposed Rulemaking Order on Dec. 16, 2004 requesting comments and reply comments on the proposed regulations for implementation of Default Service at the conclusion of the utilities' transition periods, Strategic Energy, LLC ("Strategic") respectfully submits these reply comments to comments submitted on April 27, 2005 by the Exelon Companies ("Exelon"), PPL Electric Utilities Corporation and PPL EnergyPlus LLC ("PPL"), Allegheny Power ("Allegheny"), Duquesne Light Company ("Duquesne"), UGI Utilities, Inc. ("UGI") and The Energy Association of Pennsylvania ("EAPA").

I. Background

Strategic's initial comments addressed eight topics: (I) competitive procurement model, (II) customer switching and new customers, (III) prevailing market price, (IV) retail service cost recovery charge, (V) uniform standards, (VI) access to customer

information, (VII) Alternative Energy Portfolio Standards and (VIII) Affiliate Code of Conduct. Strategic also offered revisions to the proposed regulations in a separate Annex. In general, Strategic's initial comments focused on promoting retail competition through strengthening the affiliate code of conduct; requiring market-responsive pricing; the elimination of switching restrictions (including exit fees, or minimum stay requirements); and uniformity of rules across all of Pennsylvania Electric Distribution Company ("EDC") territories.

The initial comments submitted by Exelon, PPL, Allegheny, Duquesne, UGI and the EAPA could be organized into discrete categories. A number of the comments addressed the basic structure of default service with recommendations that the incumbent EDC remain the default service provider following the end of the transition periods; switching rules; the threshold for C&I customers on hourly priced service; the Commission's proposal to establish fixed rate default service for all residential customers and non-residential customers with a demand of 500 KW or less; among other issues.

Strategic, in these reply comments, would specifically like to address the comments that focus on the incumbent EDC remaining the default service provider following the end of the transition periods; switching rules; the threshold for C&I customers on hourly priced service; and the proposed establishment of fixed rate default service to all residential customers and non-residential customers.

II. Comments that the incumbent EDC should remain the default service provider following the end of transition periods

In this section, Strategic addresses comments on the issue of whether the EDC should remain the default servicc provider following the conclusion of the transition periods. As set forth more fully below, the Commission's default service regulations must reflect the Choice Act's statutory mandate that at the end of the transition period, the default service provider will be either the EDC or the Commission-approved alternative supplier. In addition to leaving this statutory mandate in place, it is imperative that the Commission implements a more rigorous code of conduct and other protections from abuses if the incumbent EDC is to remain as the default service provider.

The Commission's default service regulations must reflect the Choice Act's statutory mandate that at the end of the transition period, the default service provider will be either the EDC or the Commission-approved alternative supplier. Various parties submitted comments on this issue, which recognize this. For example, in comments filed by Exelon, Exelon states "The Exelon Companies agree that the incumbent EDC should be the default service provider in its certificated service territory in the first instance and that incumbent EDCs, should they so choose, should be allowed to petition the Commission to be relieved of that obligation." Exelon comments at 8. PPL states in its comments, "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 ... [and] PPL believes this obligation should remain with the incumbent EDC." PPL comments at 3-4. Comments from Allegheny state, "AP supports the role of default

service provider being reserved to the incumbent EDC within each service territory." Allegheny comments at 3-4. While several comments support the EDC as default service provider, there is no reason to deviate from the Choice Act's statutory mandate that either the EDC or another Commission-approved supplier can fill the role.

If the EDC acts as the default service provider, it is imperative that the Commission put in place appropriate rules to protect the development of competitive markets and the consumers in Pennsylvania. As most utilities in Pennsylvania either own generation or have a merchant affiliate (or both), and since most may be bidding on "tranches" if a wholesale auction is mandated, Strategic believes that the Commission should do a careful analysis of existing regulations to address "ring-fencing" and rules should be initiated before embarking on default service regulations. Activities of unregulated affiliates should not expose anyone to potential harms from failed ventures of those unregulated affiliates. In fact, on February 18, 2005, the Maryland Public Service Commission ("Maryland PSC") staff put out a report titled "COMMISSION STAFF ANALYSIS OF RING-FENCING MEASURES FOR INVESTOR-OWNED ELECTRIC AND GAS UTILITIES". As noted in this report, "Ring-fencing is defined as the legal walling off of certain assets or liabilities within a corporation, as in a company forming a new subsidiary to protect (ring-fence) specific assets from creditors[1]." Additionally, as Dr. Fred Grygiel and John Garvey[2] explain in an article on the subject:

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[1] Fetter, Steve. *Don't Fence Me Out*, Public Utilities Fortnightly, October 2004, pages 20-22.

[2] At the time of the article, Fred Grygiel was chief economist and John Garvey was an economic analyst with the New Jersey Board of Public Utilities.

"In recent years a persistent battle has developed between state public utility commissions (PUCs) and holding companies over the negative financial and operational impacts on regulated utilities of failed diversification investments. Ratepayers expect to compensate companies for the costs of providing utility service—not those costs associated with the unregulated activities of affiliated companies." [3]

At the federal level, provisions in the 1935 Public Utility Holding Companies Act ("PUHCA") prevents cross-subsidization of unregulated businesses by utilities. In addition, FERC policies address affiliates cross-subsidization issues. With the on-going debate of the repeal of PUHCA, it is increasingly important that the Commission enact regulations for the supervision of holding companies and affiliates.

As part of the Maryland PSC staff report noted above, (Appendix D of that report), ten suggested items were included as contents for an annual ring-fencing report to be filed by each utility with the Maryland PSC. The ten suggested items are listed below.

1. Provide a complete, detailed organizational chart that identifies the regulated company and each affiliate. Please state the business purpose of each business unit of the organization.

2. Provide a complete description of all ring-fencing measures in effect between the regulated company and its affiliates and statement as to how each measure operates.

3. Provide a list of shared corporate officers and other key personnel between the regulated company and any affiliate, along with a description of each person's duties and responsibilities to each entity.

4. Provide a corporate risk assessment profile indicating the financial exposure that each unregulated affiliate poses to the regulated company based on routine and extraordinary business activities.

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[3] *http://www.state.nj.us/bpu/tmp/BusinessMoney.pdf*

5. Provide a description of the regulated company's and each affiliated company's capital structure. Describe specific steps or measures taken to maintain an investment quality capital structure by the public service company.

6. What limitations, if any, are placed on non-utility asset investments by the regulated company?

7. Provide a summary of financing secured by the assets of, or guaranteed by, the regulated company on behalf of a non-regulated entity.

8. Identify all assets shared by the regulated company and any of its affiliates.

9. Indicate whether any affiliate of the regulated company has experienced a default of a material obligation or a default that triggers a cross default, or has filed for bankruptcy.

10. Describe any specific protections that exist between the regulated company and nonregulated affiliated companies that mitigate exposure of the regulated company in the event of bankruptcy proceedings by any affiliate.

Strategic suggests, at a minimum, the Commission immediately adopt a similar mechanism of annual reporting and include regulations that enhance affiliate code of conduct issues within the Commonwealth. Additionally, as indicated in Strategic's initial filing in this proceeding, Strategic believes the Commission should re-examine all affiliate code of conduct issues. The Commission needs to ensure a level playing field with non-discrimination policies and where no cross-subsidization of costs occur.

III. Comments that suggest restrictions on customers switching

In this section, Strategic addresses comments on the issue of customer switching restrictions. As set forth more fully below, the Commission's default service regulations must allow customers to move freely between competitive supply and default service without restrictions such as minimum stay provisions and/or exit fees. Strategic believes

that market based price signals, in the form of hourly-priced default service for large customers and market adjustable prices for small commercial and residential customers will achieve this goal.

Many of the comments continue to address the issue of "gaming", and some of the comments suggest remedies for gaming such as minimum stays, switching fees or Generation Rate Adjustments ("GRAs"). Exelon recommends that default service providers be allowed to either (1) require fixed rate service customers to remain on that service for at least 12 months or (2) implement another appropriate mechanism to prevent gaming. Exelon comments at 19. However, Exelon never suggests what "another appropriate mechanism to prevent gaming" might be. PPL, in its comments, referenced switching fees, seasonal pricing, minimum stay provisions and GRAs to prevent seasonal gaming. PPL comments at 17. Duquesne referenced mechanisms such as minimum stay provisions and GRAs under certain circumstances. Duquesne comments at 20-24. Duquesne also stated that customer shopping increased in the Duquesne territory after the minimum stay and GRA rules were adopted during POLR II. However, Duquesne presented no evidence stating that the increase in shopping and the imposition of a minimum stay and GRAs had a one to one correlation. Duquesne failed to recognize that other factors could have influenced shopping during that time, such as the 300 kW threshold for default hourly priced service. UGI suggests that the Commission should not prohibit the consideration of reasonable customer switching rules such as those currently available on UGI's system (such as minimum stays). UGI comments at 14-15.

While a minimum stay provision may appear simple to implement, it is not. Moreover, it places undue and unnecessary burdens on customers, as it requires them to keep track of the date when they last received default or competitive service, and it also requires the default supplier to keep a record of such dates. In addition to imposing confusing burdens on customers (especially smaller customers), such restrictions impose administrative burdens and costs on the EDC or Default Service Provider ("DSP") customer care centers. Strategic believes the imposition of a minimum stay term would be unreasonably burdensome to customers and would have a stifling effect on the competitive market. Strategic also believes that default service should be designed to encourage minimum stays, and that requiring a minimum term would negate that principle. Strategic also observes that the purpose of default service is to be a "safety net" for customers whose EGS defaults or for customers that are not offered competitive service. A safety net is transitional by nature and placing minimum term requirements on the "safety net" would not be logical.

When a GRA or "exit fee" is added into the mix, customers must first understand the mechanism's concepts, remember their return dates and anniversary dates for each of their accounts, understand the GRAs method of calculation, and determine how to internally account for any payments for the GRA upon exiting default service. Most GRAs involve onerous equations that are not easily understood by customers. Thus, consumers are asked to make their switching decisions without having a full understanding of the exit fee mechanism that the default supplier would impose on them. For example, in reviewing the equations involved in calculating the GRAs for

Metropolitan Edison Company and Pennsylvania Electric Company in Docket Nos. R-00016219, R-00016219C001, R-00016220, R-00016220C001, there are four GRAs that only serve to confuse all the parties. Some of the complex options included: (i) a Standard Pricing Adjustment" ("SPA"), which will allow customers to shop for Generation Supply before the end of their standard 12-month supply contract if they are willing to pay a "pricing adjustment" that may increase their otherwise applicable tariff rate to reflect any higher market price for Generation Supply when they were taking POLR service; (ii) a Monthly Pricing Option ("MPO") where customers will be billed their applicable C&I retail tariff rates for the period October to May. For the months of June through September, MPO customers will pay the higher of (a) their applicable C&I retail tariff pricing for Generation Supply or (b) the MPO pricing, which is a forecast price for Generation Supply published by the Company on the previous May 1st and which shall be applicable for the four month period June through September. MPO customers may shop for electric service from an EGS at any time without regard to the remaining time on their supply contract and without paying the SPA or other compensation to the Company; (iii) an Alternative Monthly Pricing Option ("AMPO") that would allow C&I customers to shop for generation supply at any time without paying the SPA if they pay an after-the-fact market price for such supply during the months of June through September; and (iv) Standard Pricing – Market ("SPM") which will allow C&I customers to shop for generation supply at any time without paying the SPA (which includes an administration fee) in return for paying prevailing market prices upon their later return to POLR service. There have been numerous filings and litigation on these mechanisms and Strategic believes onerous devices such as these will prevent consumers

from shopping, increase utility costs (which may be embedded in distribution rates or may be part of the "customer charge"), increase customer costs and instill confusion and fear into the entire default service process.

The Commission in the provision for Default Service Proposed Rulemaking Order did address Default Service Customers and the Standards for Transferring Customer Accounts to Default Service Providers. Specifically, Section 54.189 identifies the standards governing customer choice in the context of default service. The Commission in its Proposed Rulemaking Order opined:

> These regulations do not provide for restrictions on the ability of customers to move from default to competitive service, and vice versa. Given the Act's clear policy preference for customer choice, and the express language of Section 2807(e)(4) regarding the treatment of customers, we decline to endorse restrictions such as minimum stay provisions or switching fees at this time. We conclude that these proposed regulations give default service providers the flexibility to effectively manage the risks associated with customer migration without restricting choice. In an effort to limit potential abuse of default service by the competitive marketplace, we do include restrictions on the transfer of retail customers' accounts to default service by electric generation suppliers. We are addressing this issue through an amendment to the competitive safeguards found at 52 Pa. Code §54.122-123. The new section provides that the transfer of customer accounts to default service may not be initiated without the consent of the default service provider, except for the non-payment by a retail customer for services rendered by an EGS, to remedy unauthorized or inadvertent transfers of a customer's account away from the default service provider, upon the normal expiration of a contract not designed to exploit seasonal price variations, and when the Commission has approved the abandonment, cancellation or suspension of an EGS license.

Additionally, pursuant to the Commission's Order entered August 23, 2004 in the Petition of Duquesne Light Company for Approval of Plan for Post-Transition Period Provider of Last Resort Service at docket number P-00032071, as a threshold matter, the

Commission found that the POLR II switching restrictions "improperly discriminate between new and returning customers" in violation of Section 2807(e)(4) of the Electricity Generation Customer Choice and Competition Act ("Electric Choice Act"). 66 PA. C.S. 2807(e)(4). Section 2807(e)(4) requires the local distribution company to treat a customer who is returning to the local distribution company for generation service exactly the same as it would any new applicant for energy service. Order at 26. The Commission noted that competitive generation markets can only develop and mature if consumers have free and direct access to the competitive market as contemplated by section 2802(3) of the Electric Choice Act. Order at 27. In addition, the Commission found that "the record before us establishes that there are seasonal contracting risks faced by the POLR provider, commonly referred to as the "beach phenomenon – i.e., EGSs switch customers back to POLR service in the summer when market prices are high then switch them back to competitive service when market prices are low." Order at 26. To address this concern, the Commission directed Duquesne to alter the POLR III Plan to provide that only customers can initiate a switch back to POLR service. Order at 28. Duquesne also has the ability to seek relief from the Commission in the event it believes that an EGS is exploiting the seasonal variations of the market. Order at 28. In the Commission's Order on reconsideration the Commission noted that the Rule is designed to address the behavior of the EGS not the customer and that remedies for seasonal gaming have as little impact on the customer as possible. Order on Reconsideration at 14.

Strategic believes that minimum stay-out provisions and/or GRAs or exit fees violate Sections 2807(e)(4) and 2804(6) of the Electric Choice Act in two ways. First,

the switching restrictions violate the Electric Choice Act by failing to treat shopping customers returning to default service the same as new customers. 66 Pa. C.S. § 2807(e)(4). Second, the restrictions violate the requirement that EDCs provide comparable access to their transmission and distribution systems. 66 Pa. C.S. § 2804(6). Strategic believes if any protection is necessary, it should take the form of seasonal rates for residential and small commercial customers and hourly priced service for other non-residential customers, and should not restrict a customer's access to the competitive market. Strategic has acknowledged the need for switching rules that promote competition while providing reasonable protection for default suppliers from potentially increased default service costs due to seasonal switching activity. Strategic acknowledges that the absence of switching restrictions may impose higher costs on a default supplier, but believes that those costs are legitimate and should be factored into the auction bid during the procurement process for the provision of default supply. Strategic fully believes that the risk of market fluctuations should be built into the bid, if wholesale auctions are the standard, and once this risk is built into the bid, the "gaming" problem is solved. The bidder should strive to reflect in the rate the risk that a customer can leave default service at any time. Market-pricing flexibility such as the use of seasonal prices, which the proposed rule allows, will encourage bidders because they will be able to match their pricing more closely to the risks inherent with default service. If migration does take place and the risk is built into the bid, the winning bidder should immediately be relieved of that obligation and be allowed to sell that energy elsewhere. Customers must be free to choose between default service and competitive retail service. Switching restrictions that limit a customer's ability to choose freely between default and

competitive service should be eliminated in favor of seasonal rates, hourly rates or other customer migration risk mitigation methodologies like Maryland's volumetric risk mechanism for Standard Offer Service ("SOS") that does not deter competition.

IV. Comments that promote raising the threshold for hourly priced default service

In this section, Strategic addresses comments that request the Commission to raise the threshold for hourly priced default service. The Commission, in this proposed rulemaking, suggested an hourly priced threshold of peak annual demand of 500 kW. In response, the EDCs requested that this threshold be raised because of the need for the their metering and billing systems to be updated to accommodate a minimum 500 kW hourly priced default service threshold. As set forth more fully below, and contrary to many of the EDC comments on this issue, Strategic believes there is credible evidence to support even a lower threshold of 300 kW. A lower threshold will allow more customers to enjoy the benefits that competitive EGSs provide and allow substantial levels of competition. Strategic also believes the EDC's should be required to update billing and metering systems to accommodate lower threshold levels.

Exelon, in its initial comments, suggests that the breakpoint between fixed price and hourly priced default service should be set at no lower than 750 kW. Exelon comments at 17. Exelon reasons that a threshold set at 750 kW would allow them to avoid the need to change out its meters and upgrade its automatic meter reading system. Allegheny suggests a fixed rate option be available to all non-residential customers with a demand of 1,000 kW or less. Allegheny suggests customers of 1,000 kW or less do not

necessarily have the level of sophistication or resources available to effectively manage an hourly priced default service. Allegheny comments at 10. UGI suggests a one-megawatt threshold because the costs of modifying their automated billing systems to accommodate hourly rates would not be justified by customer demands and such bills would need to be calculated manually. UGI comments at 15-16. EAPA suggests a one-megawatt threshold because the sophistication and existing metering capabilities do not support a 500 kW level. EAPA comments at 9.

Strategic envisions a market place where hourly priced default customers will receive multiple offers from EGSs, offers that will allow those customers to select an energy product and service that best meets their needs and risk profile, unlike the homogenous default service product. A typical 500 kW customer in Pennsylvania has an annual retail electric bill of $150,000 or more. These are supermarkets, anchor department stores and smaller versions of private colleges and secondary schools, hospitals, corporate headquarters, manufacturing facilities, and government complexes. Clearly, these customers have the business acumen and bottom-line incentives to select the electricity products and services that best suit their needs. They have the size, flexibility and expertise to use hourly pricing to their full advantage. Moreover, even though many of these customers may not have previously chosen a competitive electricity supplier, these customers have long been in the competitive energy market, choosing among natural gas suppliers since 1999. Strategic proposes that the Commission provide customer education and outreach for hourly priced default service customers well in advance of implementation date of default service plans. Additional time for customer

education and outreach will serve several purposes. The additional time will allow customers to learn about the products and services available in the competitive market. Equally important, the additional time will give EGSs a greater opportunity to meet with new customers, develop a deeper understanding of their energy needs, and thus, create new products that are responsive to those needs. As the competitive market in Pennsylvania grows, more and more EGSs will enter the State, investing in the business functions that are necessary to serve Pennsylvania customers. Revising the hourly priced default service class upwards, however, as the current EDCs have advocated, would have lasting negative consequences for the competitive energy market and its customers. This would force EGSs to decide whether to remain active in the Pennsylvania retail electric market. If suppliers exit the market, customers who have relied on choice will have fewer alternatives. Rather than create an uncertain future, Strategic asks the Commission instead to set a clear course, bringing some predictability and certainty to the competitive market.

Several of the comments suggest that their metering and billing systems will need to be updated to accommodate a minimum 500 kW hourly priced default service. However, just because something is "difficult" or time consuming should not necessarily preclude one from doing it. As Strategic proposed in its initial comments, interval metering should be available to all customers and mandated for customers with a minimum PJM capacity peak load contribution ("PLC") of 500 kW. If the EDC is made responsible for the installation and maintenance of metering, the EDC should recover all costs through distribution rates. Strategic also requests that the customer (or the

customer's agent) be allowed to have read-only access to the metering equipment and EGSs should also be granted access to the interval meters that are approved for service so that they would have the opportunity to create and more effectively provide services such as load management products. EDCs would benefit because the end result would be a more-informed customer and reduced meter-reading expenses with remotely read meters. C&I customers would benefit since they could be more proactive in managing their energy consumption, identifying areas for efficiency improvements and controlling costs. Also, with PJM making numerous enhancements to current demand response programs, and the implementation of AEPS, benefits will accrue to customers with interval meters in the form of revenue streams as well as the grid will benefit with enhanced reliability and less costly generation additions.

The evidence to date provides ample and credible evidence to support a minimum 500 kW threshold. Maryland, for example utilizes a 600 kW threshold for C&I customers and has experienced a great deal of customer switching. Additionally, beginning January 1, 2005 all customers in the Duquesne Light service territory where demand is not less than 300 kW default to hourly priced service. Of course other factors may have played a role, but statistics provided by the Pennsylvania Office of Consumer Advocate on April 8, 2005, shows that 20.1 % of commercial customers and 43.5 % of industrial customers have chosen an alternate supplier in the Duquesne Light service territory, by and large the most significant amount of shopping in Pennsylvania.[4]

[4] http://www.oca.state.pa.us/cinfo/Stats0405.pdf

Strategic believes, as evidenced above, the 300 kW threshold the Commission set in Duquesne's POLR III case, and the dynamic competition that has resulted, provides credible evidence for even lowering the threshold below 500 kW (to 300 kW) at the onset of default service provisions. Competitive service C&I customers in Pennsylvania have reliable power sources, are dealing with financially stable suppliers, are reducing their generation costs and are receiving energy management services. The Commission's signaling of their support for a minimum 500 kW threshold (and even a 300 kW threshold) will maintain a sustainable and robust competitive marketplace and attract even more retail marketers to serve Pennsylvania's C&I customers. Strategic, in its initial comments suggest the Commission incrementally, each year, adjust the level of fixed-price-service downward as the benefits of demand response become more evident and metering technology more fully develops. Strategic also suggested the Commission undertake a metering study sometime around January 1, 2007, and if the results indicate that metering the technology has advanced and is cost effective, the Commission mandate that all or a portion of customers under 500 kW (or 300 kW as proposed by Strategic) including all customers with peak load of at least 25 kW move to default hourly pricing beginning January 1, 2009 (or upon the conclusion of stranded costs, whichever is longer).

V. <u>Comments on the establishment of a fixed rate default service for all non-residential customers</u>

In this section, Strategic addresses comments that request the Commission to a fixed rate "option" for all non-residential customers. Many of the EDCs request that a fixed rate option be put in place for all non-residential customers due to the lack of

sophistication by customers and the need to avoid the complexities and negative impacts of hourly priced service. As set forth more fully below, Strategic believes that customers at or below 500 kW have the business acumen, bottom-line incentives and expertise to use hourly pricing to their full advantage. In addition, allowing the DSP to offer more than one service to customers would, in effect, become a competitive service offering. The EGS should be the one extending the fixed price competitive offering, not the DSP. By not allowing the DSP to compete directly with the EGS, customers would receive what is in effect truly "Default Service". Customers would pay actual market prices and those who wish a fixed price could obtain one from an EGS.

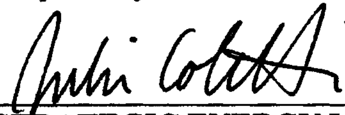
PPL states that it supports the Commission's proposal to establish fixed rate default service to all residential customers and non-residential customers with a demand of 500 KW or less and hourly rate default service to all other customers. PPL further states "at this time, hourly pricing is not an appropriate 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." PPL comments at 11-12. Allegheny suggests that "due to the complexities associated with hourly priced service, and the potential negative impact to those customers, AP suggests a fixed rate option be made available to all non-residential customers with a demand of 1,000 kW or less." Allegheny comments at 9-10.

As noted in Strategic's initial comments, we believe that utilities should not be given regulatory tools that hinder competition and the structure proposed by the Commission in which the price of energy for non-residential customers over 500 kW can be fixed for a term, even say one-year, leaves little incentive for an EGS to enter or remain in the market. Additionally, allowing the DSP to offer more than one service to customers would, in effect, become a competitive service offering. The EGS should be the one extending the fixed price competitive offering, not the DSP. Strategic further believes non-residential customers (especially those with peak loads over 300 kW, as evidenced in the Duquesne territory) have both the sophistication and the bottom-line incentive necessary to respond to hourly price signals. If a DSP is provided with a tool that competes directly with an EGS, in effect that creates a dominant regulatory practice, which produces thoroughly perverse incentives. The result is lost opportunities to reduce energy costs and improve reliability and diminished innovative EGS offerings. Among the casualties are effective resources such as energy efficiency, demand-side management, and distributed generation, which can effectively avoid many costly capacity additions and greatly enhance grid reliability. This antiquated design must be eliminated such that there is a reward for consumers making more economically and environmentally efficient decisions based on a transparent, real-time market. One of the premises of hourly rates is that customers will act rationally in response to more precise price signals such that customers will shift load from high price periods to low price periods or otherwise reduce load whenever it makes economic sense to do so. Such actions by hourly customers will benefit all customers by making the market place more efficient and will improve reliability.

VI. Conclusion

In conclusion, Strategic urges the Commission to adopt regulations regarding "ring-fencing", to eliminate any switching restrictions, to maintain or even lower the threshold for hourly priced service to 300 kW, to eliminate the fixed-price option for non-residential customers, and to reject the modifications advanced by Exelon, PPL, Allegheny, Duquesne, UGI and the EAPA, respectively, on switching restrictions, the threshold for hourly priced service and the fixed-price option. Strategic believes that adhering to these key policies will result in a robust, competitive retail marketplace in Pennsylvania.

Respectfully submitted



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Dated: June 27, 2005

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June 27, 2005

VIA HAND DELIVERY

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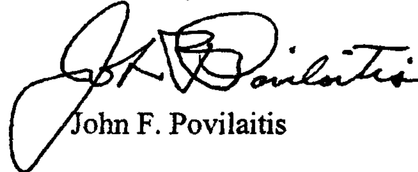
Re: Rulemaking Re Electric Distribution Companies' Obligation to Server Retail Customers at the Conclusion of the Transition Period Pursuant to 66 Pa. C.S. §2807(e)(2), Docket No. L-00040169

Dear Secretary McNulty:

Enclosed please find an original and fifteen (15) copies of the Reply Comments of Metropolitan Edison Company, Pennsylvania Electric Company and Pennsylvania Power Company in the above-captioned proceeding. Copies of the Reply Comments have also been sent by email to Shane Rooney, Esquire and Cyndi Page, as requested. Please contact me if you have any questions.

Very truly yours,



John F. Povilaitis

Enclosures

JFP/ck

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

REPLY COMMENTS OF METROPOLITAN EDISON COMPANY, PENNSYLVANIA ELECTRIC COMPANY AND PENNSYLVANIA POWER COMPANY ON PROPOSED DEFAULT SERVICE REGULATIONS

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

REPLY COMMENTS OF METROPOLITAN EDISON COMPANY, PENNSYLVANIA ELECTRIC COMPANY AND PENNSYLVANIA POWER COMPANY ON PROPOSED DEFAULT SERVICE REGULATIONS

I. INTRODUCTION

Metropolitan Edison Company, Pennsylvania Electric Company and Pennsylvania Power Company submit the following Reply Comments to the April 27, 2005 comments filed in this proceeding. The importance of this rulemaking is confirmed by the voluminous comments submitted by a wide array of interested parties on the issues addressed by the Pennsylvania Public Utility Commission's ("Commission") proposed default service regulations. The Companies continue to support the basic framework for establishing post-transition period default service laid out in the proposed regulations and urge the Commission to stay the course on the core elements of its proposals.[1] The following are the Companies' specific replies to a number of the commentators' proposals.

[1] The Companies' Reply Comments focus on proposals that operate within the framework of the proposed regulations. A number of commenting parties have filed proposals that conflict with the Commission's core concepts for default service or stray into extraneous issues such as competitive safeguards, access of competitive suppliers to customer information or development of retail POLR models. *See* Comments of Amerada Hess Corporation, Direct Energy Services LLC, Mid-Atlantic Power Supply Association, Reliant Energy, Inc. and Strategic Energy, LLC. To the extent these commentators submit recommendations fundamentally inconsistent with the Commission's proposed regulations, as modified by the Companies' initial comments, these recommendations are opposed.

A. Term of Service and the Portfolio of Resources Procurement Concept

The Companies will address a number of implementation plan-related proposals in subsection B. of these Reply Comments. However, two recommendations related to implementation plans advocated by the Office of Consumer Advocate ("OCA") must be addressed at the outset due to their significance and their conflict with the fundamental premise of default service. OCA advocates a *minimum* term of service for implementation plans of five years and a portfolio of resources procurement as the model for an appropriate implementation plan. Neither of these concepts should be adopted by the Commission.

It is clear from OCA's comments that it seeks a continuation of the electric distribution Company's ("EDC") pre-Electricity Generation Customer Choice and Competition Act ("Competition Act") obligations as its model for the default service provider. Citing the "small" or "absent" level of retail competition available to residential customers in the current rate cap era, OCA states "...default service must be viewed as the primary vehicle for delivery of the promises of the 1996 Act."[2] To obtain the benefits of the Competition Act for residential customers, OCA advocates an EDC purchasing strategy "designed over the long term" utilizing "[a] variety of products, resources, contracts, and financial instruments" that should "mitigate the various risks of the service and result, long term, in reasonable costs for the type of service being provided."[3]

OCA's view of the default service provider's generation service obligation is indistinguishable from the pre-Competition Act role of the EDC. However, it is the clear

[2] OCA Comments, p. 2.
[3] OCA Comments, p. 3.

intent of the Competition Act that the EDC's obligation to serve be modified once the transition period is over:

> (e) **Obligation to serve.** An electric distribution company's obligation to provide electric service following implementation of restructuring and the choice of alternative generation by a customer is revised as follows:
> (1) While an electric distribution company collects either a competitive transition charge or an intangible transition charge or until 100% of its customers have choice, whichever is longer, the electric distribution company shall continue to have the full obligation to serve, including the connection of customers, the delivery of electric energy and the production or acquisition of electric energy for customers.
> (2) At the end of the transition period, the commission shall promulgate regulations to define the electric distribution company's obligation to connect and deliver and acquire electricity under paragraph (3) that will exist at the end of the phase-in period.
> (3) 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.[4]

(Emphasis added). The Commission's regulations must make it clear that the EDC's obligation to serve is being modified at the end of transition to conform with a competitive regime wherein the EDC has a short-term duty to acquire electric energy at prevailing market prices. A specific suppliers' failure to deliver and a customers' failure to choose an alternative supplier are not events that can be assumed to continue on a long-term basis. Obligating the EDC to assemble a portfolio of resources, as described by OCA, to ensure long-term "reasonable" rates for customers is inconsistent with a default service that is available when expected service by an EGS is not delivered or a customer fails to choose an alternative electric generation supplier – the statutory

[4] 66 Pa.C.S. § 2807(e)(1)-(3).

definition of default service.[5] OCA's position bets against competition and the customers' freedom to shop as a restraint on prices and is in fundamental conflict with the Competition Act which states "[c]ompetitive market forces are more effective than economic regulation in controlling the cost of generating electricity."[6]

Five year minimum terms of service and Commission evaluation of what constitutes the correct portfolio of resources, as OCA suggests, assumes that default service is in long-term competition with service provided by EGSs and further assumes the default service provider should plan for the long-term electricity needs of customers. This is an erroneous perception of the role of the default service provider. The Commission should clarify that default service implementation plan filings are not intended to be litigations of long-term procurement policies. Instead implementation plans should be evaluated for whether they will achieve what is needed – the procurement of sufficient quantities of electricity at prevailing market prices for customers who need the safety net of default service. OCA's view of the planning horizon for a default service provider is more akin to the OCA/Duquesne six year stipulation period that was rejected by the Commission in Duquesne Light's POLR proceeding.[7]

The Commission should reject OCA's length term of service and portfolio of resources proposals as inconsistent with the Competition Act and clarify that the EDCs' obligation to serve is being modified to that of a default service provider.

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[5] Section 2807(e)(3) of the Public Utility Code defines default service in this manner. 66 Pa. C.S. § 2807(e)(3).
[6] 66 Pa. C.S. § 2802(5).
[7] *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).

B. Implementation Plan Issues

Various commentators submitted recommendations relating to the implementation plans and review by the Commission as outlined in Sections 54.185 – 54.188 of the proposed regulations. The Companies' Reply Comments address the following implementation plan issues: the time for Commission review of implementation plans, the length of those plans relative to the effective date of regulations, the number of customer rate classes, seasonal rates and the appropriate designation of what constitutes a large customer.

1. Time for Commission Review

The proposed regulations provide for the assignment of implementation plans to the Office of Administrative Law Judge for a six month review process. A nine month review period was urged by OCA and OSBA.[8] Enlargement of the review period can only be achieved by shortening the EDC's time to implement the approved plan or forcing the EDC to file a proposed plan more than 17 months in advance of its effective date. Either option is unnecessary and ill-advised. The implementation plan filings will be made pursuant to the Commission's detailed regulations which should expedite the evaluation process. In addition, if the Commission adopts the Companies' recommendations regarding simplification of the default service rate (i.e., adoption of a fully reconcilable generation supply rate and elimination of the supply customer charge), a six month review period should be adequate. The Commission should retain its proposed six month review period for implementation plans.

[8] OCA Comments, p. 22; OSBA Comments, p. 15.

2. Length of Implementation Plans Adopted Prior to Final Regulations

Constellation Energy Commodities Group, Inc. and Constellation NewEnergy, Inc. ("Constellation") recommends that the effective length of implementation plans for EDCs emerging from transition prior to the effective date of the default service regulations should be curtailed to the shortest possible time period to ensure consistency with the regulations.[9] This recommendation assumes there will be conflict between an approved implementation plan and the regulations. Conflict between approved implementation plans and the final regulations is unlikely since the decision makers for both matters are the same. Rather than require an implementation plan to have an unduly short time frame, the Commission should leave resolution of any actual conflict between an approved plan and the requirements of the final regulations to the time when it is clear such a conflict exists. Approved implementation plans should not have shortened life spans due to potential conflicts with the final approved regulations.

3. Number of Customer Rate Classes

Constellation recommends that the regulations provide for the Commission reserving the authority to reclassify or subdivide existing customer rate classes as part of the implementation plan.[10] This proposal appears more related to enhancing the marketing efforts of EGSs than the effective provision of default service, which will likely follow traditional customer tariff classifications. Explicit reservation of Commission authority in the regulations on this point is therefore unnecessary.

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[9] Constellation Comments, p. 3.
[10] Constellation Comments, p. 5.

4. Seasonal Rates

OCA recommends that default service providers be barred from proposing seasonal rates as the only rate option for residential customers, but concedes that optional seasonal rates could be proposed subject to the implementation plan review process.[11] EDCs should not be barred from proposing seasonal rates for residential customers as their sole default service option. This is particularly true if the Commission continues to preclude switching rules. The reasonableness of a seasonal rate proposal can be evaluated in the implementation plan review process. EDCs should not be barred from proposing seasonal rates for customers as their sole default service rate option.

5. Designation of Large Customers

There is no consensus as to what demand level should be the threshold for a large customer.[12] This diversity of opinion reinforces the appropriateness of deciding what is a "large" customer in the course of the EDC's implementation plan proceeding. The characteristics of each company's customer base can then be taken into account as part of the determination of what constitutes a large customer.

Classification of customers as "large" should occur in each implementation plan proceeding.

C. Rate Issues

Numerous comments addressed elements of the Commission's default service rate proposals. The primary subjects of rate comments were the generation-related Customer

[11] OCA Comments, pp. 22-24.
[12] PPL has proposed 500 kw, PECO 750 kw, Allegheny 1,000 kw and UGI proposes 1 mw except where the default service provider establishes another standard.

Charge, reconciliation of rates, the large customer hourly rate requirement and the proposed inclusion of transmission costs in the generation supply charge.

1. Customer Charge

In addition to the Companies, other parties have supported elimination of the proposed generation–related Customer Charge.[13] As stated in the Companies' initial comments, the Commission should refrain from requiring separate costs of service studies and the breakout of a new customer charge for default service billing, collections, customer service, meter reading and uncollectible debt. These functions are not easily allocated between supply services and transmission and distribution services. Given the EDC's role in distribution service, it is implausible to assume that these functions would ever completely leave the EDC.

Besides the fact that development of a new cost-of-service-study-based customer charge will significantly add to the cost and complexity of the implementation plan proceedings, parties such as OCA aptly noted that a separately stated generation related customer charge (that may not be on a cents per kwh basis) will greatly increase the difficulty customers will have discerning their price to compare, chilling their interest in seeking a competitive supplier. A separate customer charge for generation supply should not be mandated.

2. Reconciliation of Rates

The comments relating to reconciliation of rates raise primarily two issues: whether the generation supply charge should be fixed or adjustable, and how the charge

[13] OCA Comments, p. 18.

should relate to the Act 213 alternative energy charge which is required by the law to be an adjustable Section 1307-type rate.

OCA, for example, supports the use of a reconcilable rate for default service generation supply in view of Act 213's requirement that alternative power costs be recovered on an adjustable rate basis.[14] OSBA appears to support a blended procurement process, where alternative (Act 213) and non-alternative energy is obtained in a single procurement process, as the most efficient method of obtaining power for default service customers.[15] The Companies support Commission adoption of a single reconcilable generation supply retail charge developed from the results of a combined alternative and non-alternative supply procurement. This approach to the generation supply rate will not only fully comply with the Act 213 and Competition Act requirements that these costs be fully recovered, but in addition will produce a readily understandable price to compare for customers.

If the Commission adopted a fully reconcilable generation supply rate for default service, the Companies would accept the elimination of any risk adder component as part of the default service rate. The Commission should adopt a fully reconcilable generation supply charge as the product of a combined procurement that obtains alternative and non-alternative power

3. Rate Options for Large Customers

IECPA et al. proposes a fixed rate for large customer default service.[16] The proposed regulations require default service providers to offer hourly service to large

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[14] OCA Comments, pp. 19-21.
[15] OSBA Comments, p. 13-14.
[16] IECPA et al. Comments, pp. 22-26.

customers but make fixed price rates optional for the EDC.[17] The Companies note the arguments made by IECPA et al. and recommend that the regulations provide flexibility on the issue of default service rates for large customers. The issue of hourly rates versus fixed rates will be influenced by the type of large customers operating in each EDC's service territory as well as the point in time that this decision is being made.

Consistent with the flexibility provided by the proposed regulations on other issues, the question of whether hourly rates, fixed rates or some alternative is appropriate for large customers should be resolved in each EDC's implementation plan at the time that plan is being reviewed.

It may still be appropriate for an EDC to have a single default service rate per customer class, however that determination should be part of the implementation plan process.

4. Transmission Costs

The regulations propose including transmission costs in the generation supply rate and the hourly rates of large customers.[18] This proposal has drawn the opposition of IECPA et al.[19]

The inclusion of FERC-approved transmission rate costs in the default service rate and the proper allocation of those costs to customers is an issue that would significantly complicate the matters that must be addressed in implementation plans. The issue of recovering these costs should be dealt with outside of the process that sets default service rates. The Companies recommend that transmission costs not be considered part

[17] Small customers must be offered a fixed rate under the proposed regulations.
[18] Sections 54.187(a)(1) and 54.187(e)(3).
[19] IECPA et al. Comments, pp. 11-18.

of the default service supplier bids, but rather continue to be a service supplied through the EDC, with appropriate cost recovery by the EDC outside of the default service rate setting process.

D. Competitive Procurement

The Companies have supported the concept of a single procurement process to acquire alternative and non-alternative power, as part of the recommendation for a single reconcilable generation supply charge addressed in section C.2. above. In addition to this issue, the comments have raised other issues relating to the actual competitive procurement including: the mandate of a state-wide bidding process, scope of procurement issues, third party review, scope of the Commission's role in evaluating a procurement, the length of the Commission's review period and procurement in the context of a supplier default.

1. State-Wide Bidding Process

OSBA supports a state-wide bidding process commencing in 2011 when all the EDCs are expected to have emerged from their transition periods.[20] The Companies agree with this recommendation for companies in the same power pool and urge the Commission to identify state-wide procurement as a goal for Pennsylvania.

Coordination of the state-wide competitive procurement will require careful direction from the Commission which should be provided as the EDCs and other interested parties approach 2011 when a state-wide procurement is possible. Implementation of a state-wide procurement will require the Commission to address the

[20] OSBA Comments, pp. 6-7.

technical issues associated with companies transitioning from their separate implementation plans established prior to 2011. The Commission should establish the goal of a state-wide competitive procurement in 2011 and focus carefully on the details of transitioning to this approach which could vary for different EDCs.

2. Scope of Issues Resolved in the Procurement

The Companies agree with Constellation's recommendation that the non-price issues relating to the competitive procurement should be resolved in advance of the actual procurement so that the focus of the procurement is strictly price.[21] Narrowing of the issues to price assures bidders they are operating on a level playing field. If issues other than price are outstanding during the procurement compliance review period, the rapid evaluation process envisioned by the Commission and numerous commenting parties will not be practical. Procurement should focus on price.

3. Third Party Review

Several comments have raised the issue of selecting a third party to review the results of the competitive procurement process and the authority of the third party. Constellation recommends that use of a third party evaluator should be made mandatory and the third party should be selected by the Commission.[22] IECPA et al. seeks additional details in the regulations on the procedure for selecting a third party and specification of the scope of authority for the third party.[23]

The Companies oppose mandatory selection of the third party evaluator of the procurement by the Commission and a precise specification of their authority in the

[21] Constellation Comments, pp. 7-8.
[22] Constellation Comments, p. 7.
[23] IECPA et al. Comments. pp. 10-11.

regulations. This is the type of issue that benefits from the flexibility the Commission has built into the proposed regulations. Proposed Section 54.186(d) provides that the procurement may be subject to oversight by a third party that reports to the Commission and maintains adherence to confidentiality agreements. This is an appropriate amount of direction on the subject of third party evaluations.

There is no need to compel the use of a third party evaluator or detail their precise authority in the regulations. These issues are easily addressed in the implementation plan proceeding, including the threshold issue of whether the EDC's form of procurement would benefit from the involvement of a third party. The nature of the procurement should dictate the details of third party participation and that will become clear only at the time the implementation plan is filed. The Commission's regulations should not compel the use of a third party evaluator and specify their precise role at this time.

4. Scope of the Commission's Role in Evaluating Procurement

The proposed regulations properly describe the Commission's role relative to the results of the procurement process as one of verifying that the procurement occurred consistent with the implementation plan previously approved by the Commission. OCA recommends a broader role for the Commission, starting with its evaluation of the implementation plan and continuing through the Commission's evaluation of the results of the procurement. [24] Specifically, OCA believes the Commission should review an implementation plan "to determine if it is properly designed to produce the lowest priced, reliable electric supply and only includes reasonable costs for recovery."[25] OCA also suggests that the regulations impose on the Commission the obligation to determine, as

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[24] OCA Comments, pp. 52-54.

[25] OCA Comments, p. 52.

part of the procurement evaluation process, whether the process produced "non-competitive" results.[26]

The Commission should reject these recommendations that arise from OCA's incorrect view of the role of the default service provider. Essentially OCA seeks to convert the implementation plan process into a prudency review of procurement plans, followed up by a Commission obligation to reject the results of that process, even if it is followed to the letter, on the vague ground that the results were "non-competitive". OCA's proposed standards fit with a model where the default service provider is competing with EGSs for customers, rather than the true role of default service as a safety net. The enhanced regulatory burden OCA proposes being placed on the Commission is inconsistent with the principles of the Competition Act to rely on market forces rather than regulation.

The Companies are confident that EDCs, as part of their implementation plans, will reserve the right to reject procurement results that are aberrant due to world events or events of another nature that drastically skew competitive procurement results. OCA's proposed standards for approval of implementations plans and evaluating the procurement result of those plans should be rejected. The Commission's proper role in evaluating procurement results is to determine consistency with the implementation plan.

5. Compliance Verification Period

Constellation seeks to shorten the time for Commission evaluation of procurements to two days.[27] The Companies support a three day maximum evaluation period which is a reasonable compromise period that should be adopted. The

[26] OCA Comments, p. 53.
[27] Constellation Comments, p. 8.

Commission's procurement evaluation period should be no more than three business days.

6. Reliance on the RTO/ISO to Obtain Supplies

The Companies support the regulations' references to obtaining power quickly through the RTO/ISO in the event of a supplier default or problems in completing a procurement. OCA recommends that these references be stricken from the regulations.[28] The proposed regulations prudently recognize that reliance on the RTO/ISO to cope with these types of supply inadequacies is appropriate. OCA's opposition to the Commission's endorsement of this remedy stems from their core view that default service should be a competitive offering and the EDC should plan for long term service to a significant number of customers. The Commission's references to reliance on the RTO/ISO in supply failure circumstances is true to the proper role of default service as a safety net and should be retained.

The regulations should reference the RTO/ISO as the means to resolve procurement difficulties and default situations.

E. Miscellaneous Recommendations

Two other comments that do not fit within the foregoing general categories of topics warrant a reply by the Companies.

1. Flow Through of DSM "Savings"

PJM posits a scenario where a default service provider resells default service power made available from customer demand side management efforts at higher market

[28] OCA Comments, pp. 39, 48-49.

prices. As the Companies understand PJM's proposal, the profits from such resales would then be flowed back to the customers who made the sale of excess power possible.[29]

The Companies challenge the basic premise of PJM's recommendation, which is that default service providers will purchase more power than is needed by default customers. Moreover, PJM's proposal does not take into account the equity of routing the benefit of all such hypothetical transactions to customers, when EDC expenditures supported demand side management programs. PJM's DSM "savings" proposal should be rejected.

2. Compulsory Retail POLR Model

Dominion Retail, Inc. recommends a retail POLR pilot program that would force customers to take third party supply. Such forced shopping programs are inadvisable as a state-wide mandate. The Companies recommend that the Commission not devote resources to development of such programs. The Commission should not direct initiation of state-wide retail POLR programs that force customers to take third party supply.

II. CONCLUSION AND SUMMARY

The Companies reply comments are summarized as follows:

- The Commission should reject OCA's length term of service and portfolio of resources proposals as inconsistent with the Competition Act and clarify that the EDCs obligation to serve is being modified to that of a default service provider that provides service at prevailing market prices.

- The Commission should maintain its proposed six month review period for implementation plans.

[29] PJM Comments, pp. 6-7.

- Previously approved default service plans should not terminate when the default service regulations are made final.

- It is unnecessary for the Commission to reserve authority to create additional customer rate classes as part of its implementation plan review

- EDCs should not be barred from proposing seasonal rates for customers as their sole default service rate option.

- Classification of customers as "large" customers should occur in implementation plan proceedings.

- A separate customer charge related to generation supply should not be mandated.

- The Commission should adopt a fully reconcilable generation supply charge as the product of a combined procurement that obtains alternative (Act 213) and non-alternative power.

- The issue of appropriate rate design for large customer default service should be determined in each EDC's implementation plan and take into account the characteristics of each EDC's service territory.

- FERC-approved transmission charges should be recovered by EDCs outside of the default service cost recovery process; it is not necessary to make transmission costs part of the default service procurement program.

- The Commission should establish the goal of a state-wide competitive procurement in 2011 with careful attention to the issues relevant to each EDC.

- Procurement should focus primarily on price.

- The regulations should not compel the use of a third party evaluator and specify its precise role at this time.

- The Commission's proper role in evaluating the result of a procurement is to determine consistency of the procurement with the implementation plan.

- The Commission's procurement evaluation period should be no more than three business days.

- The regulations should reference the RTO/ISO as the means to resolve procurement difficulties and default situations.

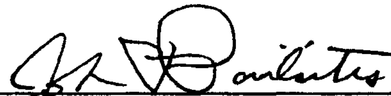
- PJM's DSM "savings" proposal should be rejected.

- The Commission should not direct initiation of state-wide retail POLR programs.

The Companies look forward to the Commission's issuance of default service regulations and their progress through the regulatory review process.

Date: June 27, 2005

Respectfully submitted,



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FILE NO. 6710.63

June 27, 2005

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

COPY

VIA HAND DELIVERY
James J. McNulty, Secretary
Pennsylvania Public Utility Commission
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Dear Secretary McNulty:

Enclosed for filing in the above-captioned proceeding are an original and sixteen (16) copies of the Reply Comments of Amerada Hess Corporation. Please time-stamp one copy and return.

I have served a copy of this document on all parties to this proceeding by U. S. Mail.

Very truly yours,

RHOADS & SINON LLP

By: David W. Francis

Enclosures

cc: Attached Service List

560728.1

SERVICE LIST

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STATE OF PENNSYLVANIA
PUBLIC UTILITY COMMISSION

Rulemaking Re Electric Distribution Companies' Obligation To Serve Retail Customers at the Conclusion of the Transition Period Pursuant To 66 P.A. C.S. §2807(e)(2)
Docket Number L-00040169

Reply Comments of Amerada Hess Corporation

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June 27, 2005

INTRODUCTION

Amerada Hess Corporation ("Hess") submits these reply comments for consideration in this proceeding to examine the Pennsylvania Public Utility Commission's proposed default service rulemaking order ("*Rulemaking Order*").[1] The initial comments filed in this proceeding have provided a comprehensive discussion of the Commission's proposed default service regulations and, not surprisingly, have revealed a number of divergent positions on several key issues.

As stated in Hess' initial comments, in order to foster the robust, fair and transparent competitive retail electric markets envisioned by the Pennsylvania Electricity Generation Customer Choice and Competition Act ("Act"), the Commission must provide for default service that promotes customer choice by enabling consumers to respond swiftly to accurate, real-time market price signals. In addition, default service must be what its name implies -- a market-price-based last resort service -- and not a competitive service that enables a Pennsylvania electric distribution company ("EDC") to compete directly on an uneven playing field against the product offerings of the competitive marketers.

Several commenting parties argue for implementation of default service rules that prohibit hourly priced default service for commercial and industrial ("C&I") customers, allow for fixed-price default service, and erect other barriers to competitive retail electric markets such as minimum stay provisions and switching fees. Collectively, these proposals, if adopted, will continue to hinder the

[1] *See Rulemaking Re Electric Distribution Companies' Obligation to Serve Retail Customers at the Conclusion of the Transition Period Pursuant to 66 Pa. C.S. §2807(e)(2)*, Docket No. L-00040169; *Provider of Last Resort Roundtable*, Docket No. M-00041792 (Proposed Rulemaking Order entered December 16, 2004).

development of robust competitive markets during the remainder of Pennsylvania's transition and will sound the death knell for retail electric competition in Pennsylvania in the post-transition period, when the burden of stranded costs and the existing generation caps expire.

With these observations, Hess replies to several issues raised by the other commenting parties.

REPLY COMMENTS

I. DEFAULT SERVICE PRICING

A. Hourly Priced Default Service Threshold

Several commenting parties -- most notably the Pennsylvania EDCs -- propose hourly priced default service thresholds ranging from 750 kW to 1 megawatt ("MW"). These proposals contradict the Act's tenets of promoting competitive retail electric markets through customer choice and customer empowerment to respond swiftly to accurate real-time market price signals. They also ignore the current conditions and development of Pennsylvania markets that warrant a much lower threshold.

As discussed in Hess' initial comments, the Pennsylvania EDCs will not implement default service models based on the Commission's proposed regulations until the end of their respective transition periods, which for some EDCs do not end until as late as 2010 and 2011. It is entirely conceivable, given the Commission's push for the expansion of interval meters to customers with peak loads as low as 200 kW, that most customers with a peak load share above 200 kW will have interval metering technology available to them by the time the EDC default service plans take

effect as late as 2010 and 2011. These customers, who already are sophisticated buyers of goods and services, both inside and outside the energy procurement context, will have at their disposal the interval metering equipment necessary to make swift and informed decisions in response to accurate, real-time price signals. Therefore, the application of hourly priced default service for customers with a peak load share of 200 kW and higher is an entirely reasonable threshold and one that most appropriately adheres to the Act's policy preferences.

The Pennsylvania EDCs' arguments for higher 750 kW and 1 MW thresholds not only lack any reasonable justification but are also undermined by the Commission's implementation of a 300 kW hourly priced default service threshold in the Duquesne Light Company's ("Duquesne") service territory in 2005. Since adoption of this 300 kW threshold, Duquesne has acknowledged that shopping in its service territory as of March 2005 accounts for 46% of the retail load (more than four times the level of shopping in the Pennsylvania EDC territory with the next highest level of shopping) and is double the level of shopping in 2002.[2] Given this development, it makes little sense to implement a 300 kW threshold for hourly priced default service in the Duquesne service territory in 2005 and 750 kW to 1 MW thresholds in other EDC territories as late a 2011. That is, unless the goal is to balkanize Pennsylvania's markets so as to perpetuate barriers to market entry well into Pennsylvania's post-transition period. This is exactly what will happen if the Commission implements the Pennsylvania EDCs' recommendations.

[2] *See Duquesne Initial Comments* at 4.

The application of a lower hourly priced default service threshold in the Duquesne service territory should serve as a model for the rest of Pennsylvania. The setting of a reasonably low threshold is squarely consistent with the Act's clear policy preferences for promoting customer choice in all EDC territories through promulgation of accurate market price signals. On the other hand, to permit adoption of 750 kW to 1 MW thresholds in other EDC territories as late as 2010 and 2011 will impose additional costs on marketers by preventing them from benefiting from economies of scale. Erection of such a barrier will result in serious disparities in the level of competitiveness across the Pennsylvania EDC territories, as the current disparity between the level of competitiveness in the Duquesne territory and the other EDC territories demonstrates. In other words, the Pennsylvania EDCs' proposed balkanization of hourly priced default service will produce a result that is squarely inconsistent with the Act's policy declarations -- no competitive marketers from which to seek service, no competitive pressures to drive market efficiencies, and no benefits produced by robust and sustainable retail electric competition.[3]

Given the length of time before the completion of the Pennsylvania EDC transitions in 2010 and 2011 and the Commission's continuation to push for expansion of interval metering technology, all EDC territories, including Duquesne, should be ready to implement an hourly priced default service threshold of 200 kW within the next five to six years. The Commission's default service regulations should reflect these considerations.

[3] In addition, the Office of Consumer Advocate's ("OCA") argument that hourly priced default service cannot accommodate compliance with the Alternative Energy Portfolio Standards Act ("AEPS Act") is nothing more than a red herring. This argument has been rejected in New Jersey (which has both renewable portfolio standards and hourly pricing for large C&I customers) and ignores the fact that PJM's Generation Attributes Tracking System ("GATS") will provide the necessary renewable energy attribute information on an hourly basis.

B. Fixed Price Default Service For C&I Customers

In its initial comments, Hess argued that by allowing Pennsylvania EDCs to provide a fixed-price default service to C&I customers, the Commission would transform default service into something not envisioned by the Act -- a competitive service. For customers who remain with the Pennsylvania EDCs upon the expiration of the transition period, a fixed price default service product would offer no incentive for customers to switch to a marketer, which in and of itself is an impediment to retail competition. It is for this reason that the Commission should not permit Pennsylvania EDCs to offer a menu or choice between an hourly price and a fixed price for default service.

Several parties, however, recommend that fixed price default service be retained as an option for even large C&I customers. Most prominent among these parties are the Pennsylvania EDCs, who would obviously benefit from the retention of fixed price default service at the expense of competition. Allowance of a fixed price default service will enable the EDCs to compete directly with the marketers while maintaining their competitive advantage in their ability to recover any related costs. This result, which would add yet another barrier to marketer entry, is antithetical to developing the robust competitive electric markets mandated in the Act's policy declarations.

In addition, both the OCA and the Office of the Small Business Advocate ("OSBA") attack hourly priced default service as antithetical to the primary goal of the Act. In its place, the OSBA and OCA recommend that the Commission utilize the Pennsylvania EDC fixed price default service as the primary vehicle for delivering

lower prices to consumers as opposed to competitive offerings. The OSBA's and OCA's arguments are squarely in contravention of the Act's policy declarations. The implementation of market-responsive pricing for "plain vanilla" default service that provides for the full recovery of all costs of providing the retail service is exactly what the Act requires.

Finally, the Industrial Energy Consumers of Pennsylvania and its coalition of joint commenting Pennsylvania large energy users groups ("the IECPA Coalition") argue against implementation of hourly priced default service and claim that implementation of such a mechanism will "force" consumers into the competitive market in order to obtain a fixed price option.[4] Because, according to the IECPA Coalition, marketers will be cognizant of this fact, marketers will therefore have the opportunity to raise their competitive offerings artificially above the market price because the customer will be without options.[5]

Hess, which is a major supplier of natural gas and electricity to C&I customers throughout the Mid-Atlantic and Northeast regions, takes the concerns expressed by the IECPA Coalition very seriously. However, Hess respectfully disagrees with IECPA Coalition's assertions because, as has been demonstrated in Duquesne's service territory, the expansion of hourly priced default service will result in robust competitive retail electric markets that will provide customers with an ample choice of competitively priced product offerings. In this environment, it is Hess' experience that if, as the IECPA Coalition argues, a marketer were to raise the price of its competitive offerings to take advantage of the lack of a fixed price default service, there would be

[4] *See IECPA Coalition Comments* at 24.

[5] *Id.* at 24-25.

another marketer waiting in the wings to offer a more competitively priced service to that customer. The marketer best positioned to offer a product that, in terms of both price and quality, is best tailored for the customer will prevail. The marketer who prices competitive service simply to game the lack of a fixed price default service will fail. This is what robust competitive retail electric markets are all about and these are precisely the type of markets that the expansion of hourly priced default service will produce.

On the other hand, the establishment of a fixed price default service that enables EDCs to compete directly with the marketers' competitive offerings will erect substantial barriers to market entry, making the development of robust competitive retail electric markets impossible. It is under this scenario -- where little to no competition will exist in the Pennsylvania EDC service territories -- that the IECPA Coalition's doomsday prophecy of being "forced" into an above-market fixed price product for electric supply will become reality.

II. UNIFORMITY OF DEFAULT SERVICE

As stated in its initial comments, it is Hess' position that default service *terms and conditions* should be uniform across Pennsylvania while default service *prices* should reflect the market conditions in each EDC's service territory. This position arises from Hess' concern that the balkanization of different default service terms and conditions for the different Pennsylvania EDC territories will create barriers to entry by preventing marketers from benefiting from economies of scale and imposing additional costs on marketers.

Throughout their initial comments, the Pennsylvania EDCs repeatedly advocate for the need for "flexibility" in every aspect of the Commission's proposed regulations. This includes more flexibility in developing their implementation plans, procurement processes, cost recovery mechanisms and ability to impose various customer switching restrictions. Hess is concerned that the "flexibility" sought by the Pennsylvania EDCs is a slippery pathway toward balkanization of Pennsylvania's retail electric markets. Adoption of these recommendations will enable the Pennsylvania EDCs to perpetuate old barriers to competition as well as erect new barriers to competitions and market distortions that have grounded development of Pennsylvania's competitive retail electric markets to a halt during the stranded cost/generation rate cap transition period.

While Hess acknowledges that valid reasons may exist for providing different default service rules for large and small Pennsylvania EDCs, the Commission should not permit the large Pennsylvania EDCs to balkanize Pennsylvania's retail electric markets through adoption of different default service terms and conditions.

III. SWITCHING RESTRICTIONS

The Pennsylvania EDCs, arguing the need for flexibility to manage customer migration risks, request the perpetuation of switching restrictions, minimum stay provisions and exit fees to manage these risks. As Hess pointed out in its initial comments, switching restrictions, minimum stay provisions and exit fees are inherently anticompetitive because they strip consumers of the choice to switch from default service to competitive service and vice versa. For this reason alone, these restrictions have no place in the Commission's proposed default service regulations.

In addition, the Commission should not, nor does it need to, utilize the artificial obstructions of switching restrictions, minimum stay provisions and switching fees in order to allow the Pennsylvania EDCs to manage their customer migration risk. First, if the Pennsylvania EDCs want to be the fixed price default supplier, then it is only appropriate that they assume the risk for taking on this role. Second, the Pennsylvania EDCs implemented these restrictions to prevent the gaming of fixed price rates that were flat year-round. If the Commission is to adopt, as Hess is advocating, hourly priced default service for most C&I customers, then the impetus and rationale for establishing these restrictions dissipates, as does any reasonable justification for perpetuation of these artificial barriers. Third, the post-transition period pricing standard requires default service prices to cover the reasonable cost of providing the service, and this clearly includes the cost of implementing customer migration risk strategies. If default service is priced to cover the full cost of implementing these customer migration strategies, then the incentive for customers to switch to exploit seasonal price variations will be eliminated.

For these reasons, there is no basis for the Commission to allow for switching restrictions, minimum stay provisions and exit fees in its proposed default service regulations.

IV. TERM OF DEFAULT SERVICE

In its initial comments, Hess argued for a maximum 3-month term of default service for non-energy cost components (i.e., capacity and ancillary charge cost components) in order to ensure that default service rates do not diverge from the prevailing market price, thereby causing distortions of the correct market price signal.

In addition, Hess opposed the adoption of an initial default service term of 17 months to conform the start date of the proposed default service term (January 1) with the start date of the PJM planning year (July 1).

In its initial comments, PJM endorses alignment of the default service term with the PJM planning year because, according to PJM, such an alignment will enable suppliers to meet their capacity obligations in PJM. In addition, the alignment of default service terms with the PJM capacity planning year start date, according to PJM, allows suppliers to enter into financial transmission rights ("FTR") auctions.

It is Hess' position that the benefits of establishing an initial 17-month default service term solely to align the start dates of the default service term and the PJM planning year do not outweigh the costs of moving away from the provision of accurate market price signaling. On the contrary, a 3-month term of default service that more closely tracks real-time markets does not preclude suppliers from participating in PJM capacity year planning or FTR auctions. As stated in Hess' initial comments, PJM currently employs multiple interval periods during the calendar year, including one that begins on January 1, the same start date as the term of default service. PJM has failed to provide a compelling reason, other than that of convenience, for establishing a term of default service that grossly distorts correct market price signaling for consumers.

To the extent, however, that a genuine concern remains with respect to aligning the start dates of the term of default service and the PJM planning year, Hess proposes an alternative. The Commission should establish an initial default service term of 6 months (January 1 to July 1) to align the start date of the term with

the start date of the PJM planning year. The Commission should then establish a 3-month term of default service following the initial term to ensure that default service rates reflect the prevailing market price and do not distort correct market price signaling for Pennsylvania's consumers.

V. RECOVERY OF DEFAULT SERVICE RELATED COSTS

In its initial comments, Hess argued that in order to develop a robust competitive environment in the post-transition period, default service prices had to provide for the recovery of all costs associated with providing the default service. This meant that the Commission's default service regulations had to allocate all reasonable and identifiable costs associated with providing default service from distribution rates to default service rates. Specifically, this meant that the proposed regulations had to prohibit the Pennsylvania EDCs from recovering default service costs in distribution rates in order to prevent double-recovery of costs and subsidization of default service from customers who choose a competitive electric supplier.

The Pennsylvania EDCs request the Commission to allow them to reconcile *historic* default service costs and revenues through retroactive adjustments or "true ups" and specifically cite to the automatic adjustment clause in the AEPS Act as a potential vehicle for such recovery. This suggested approach should be rejected because retroactive adjustments to account for variations in historic costs and revenues distort current prevailing market prices and, therefore, inhibit the ability for Pennsylvania's consumers to receive correct market price signaling. Hess believes that the Act does not grant authority to recover post-transition default service costs

through automatic adjustment clauses, but to the extent it does default service prices should be adjusted to the *prevailing market price* in order to minimize price signal distortions for consumers.

Finally, the Pennsylvania EDCs, arguing that unbundling and allocating customer care costs is unworkable, unnecessary and too complicated, request that customer care costs associated with the provision of default service remain in distribution rates. The Commission should reject the Pennsylvania EDCs' request. First, the request is squarely contrary to the Act's clear policy preference of transitioning to competition whereby customers will be able to make an informed choice as to its electric supplier through the provision of accurate market price signaling. Such accurate signaling cannot occur if the Commission permits the Pennsylvania EDCs to continue to distort correct price signaling through the misallocation of customer care costs in distribution rates.

Second, while Hess certainly would not object to cost-of-service study proceedings to ensure proper allocation of these costs, some Pennsylvania EDCs -- most notably Exelon and Pennsylvania Power and Light -- have demonstrated that there are reasonable ways to address the unbundling and allocation of costs short of a cost of service study proceeding. The Commission should explore these avenues to ensure that all default service costs are unbundled and allocated to ensure accurate market price signaling. The one thing the Commission should not permit is for the Pennsylvania EDCs to misallocate customer care costs in distribution rates simply because to unbundle and allocate them into default service rates is "too complicated."

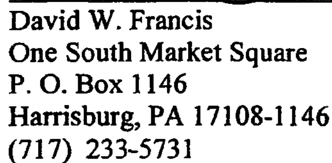
CONCLUSION

Hess appreciates the opportunity to comment on the Commission's proposed default service regulations. As both a licensed natural gas and electricity marketer in Pennsylvania, Hess supports the development of the Pennsylvania Electricity Generation Customer Choice and Competition Act's core vision of fair, transparent, open and robust competitive retail electric markets throughout Pennsylvania. Hess cannot overemphasize enough the importance of establishing default service regulations that enable marketers to compete on a level playing field in robust market structures throughout all Pennsylvania service territories.

For these reasons, Hess respectfully requests that the Commission adopt the recommendations set forth in Hess' initial comments and reject the recommendations of other commenting parties as outlined in these reply comments. Hess looks forward to working with the Commission to ensure that the benefits of robust competitive retail markets envisioned in the Pennsylvania Electricity Generation Customer Choice and Competition Act are realized for Pennsylvania and its citizens.

Respectfully submitted,

RHOADS & SINON LLP

By: 

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CERTIFICATE OF SERVICE

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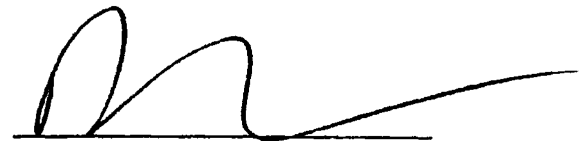
By: 

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